MORNING BRIEFING
September 10, 2020

Survival of the Fittest in Retailing

Check out the accompanying chart collection.

(1) Market bounces after correction in go-go tech industries. (2) Economically sensitive industries outperformed during the correction. (3) Pace of retail bankruptcies picks up this year. (4) As more stores shut lights permanently, will the survivors benefit? (5) Technology aims to save the world from global warming. (6) Electric construction trucks replace diesel. (7) Generators switch from diesel to hydrogen. (8) Waiting for the unveiling of long-lasting aqueous air batteries.

Strategy: Fast and Furious. Could that be it? Could the market selloff be over after just three days? The S&P 500 surged by 67 points on Wednesday after losing 249 points over the prior three trading sessions (*Fig. 1*). The selloff certainly looked like a valuation correction, with some of the best-performing tech stocks ytd hit hardest and the economically sensitive laggards outperforming. Let's take a closer look at how the S&P 500 industries and sectors performed from last Wednesday's close through Tuesday's close, during which time the S&P 500 dropped by 7.0%:

(1) *Not all defensive.* Usually big market selloffs send investors running to defensive areas that have steady earnings during good times and bad. While the S&P 500 Utilities sector was the top performer over the recent three-day selloff, other cyclical sectors also turned in surprisingly strong performances. While all sectors fell, the Industrials, Financials, and Materials sectors were among the top performers.

Here's the performance derby for the S&P 500 sectors during the three-day selloff: Utilities (-2.4%), Real Estate (-3.4), Financials (-3.4), Consumer Staples (-4.1), Industrials (-4.5), Materials (-4.7), Energy (-4.7), Health Care (-5.1), Consumer Discretionary (-6.9), S&P 500 (-7.0), Communication Services (-7.5), and Information Technology (-11.4) (*Table*).

(2) *Consumer industries' top performers.* Along the same lines, the top-performing industries during the correction give little indication that the economy is in trouble. Many consumer-related industries posted positive returns over the three-day swoon, though you'd never guess

it by looking at the S&P Consumer Discretionary sector. The sector fell -6.9% over the three days, dragged down by Amazon. Without the Internet retailer, the Consumer Discretionary sector would have dropped just 2.0%.

Here are the 10 top-performing S&P 500 industries during the market selloff: Department Stores (5.6%), Specialized Consumer Services (4.3), Airlines (3.3), Automobile Manufacturers (3.2), Hotels, Resorts & Cruise Lines (2.3), Hotels & Resort REITs (1.9), Apparel, Accessories & Luxury Goods (1.7), Broadcasting (1.2), Retail REITs (1.2), and Housewares & Specialties (0.9). Not far behind are Home Furnishings (-1.9), Diversified Banks (-1.9), Casinos & Gaming (-2.1), and Construction Machinery & Heavy Trucks (-2.3).

(3) *Tech rotates to the back of the line.* And as you'd expect, the technology-related industries that had led the market for most of the year got hit the hardest during the selloff. Over the three-day period, the S&P 500 Information Technology sector's forward P/E fell to a six-week low of 25.1 from 28.7.

Here are the S&P 500 industries that sold off hardest during the correction and how they've performed ytd through Tuesday's close: Semiconductor Equipment (-16.3%, -3.2%), Technology Hardware, Storage & Peripherals (-13.8, 47.3), Application Software (-12.5, 36.1), Systems Software (-12.0, 27.6), Internet Services & Infrastructure (-11.6, 9.8), Electronic Equipment & Instruments (-11.1, -11.0), Interactive Media Services (-10.9, 21.0), Semiconductors (-10.8, 17.4), Internet Direct Marketing Retail (-10.3, 60.8), and Interactive Home Entertainment (-9.6, 23.8).

Consumer Discretionary: Who's Left in Retailing? As you can tell by walking through nearly any mall in America, retailers are filing for bankruptcy protection at an unprecedented pace, hurt by recent COVID-19-related shutdowns and continued depressed demand for clothing given social distancing by most and the financial struggles of many. Catching our eye are the growing number of outright retail liquidations and store closures. After years of being overstored, could enough capacity and capital finally be exiting the retail industry that the remaining players have a fighting chance at survival? Macy's CEO Jeff Gennette said on the company's Q2 earnings conference call: "With many competitors closing or struggling, we see the potential to bring new customers into our brands and gain market share."

Look closely at retail sales charted in Fig.2: In-store and online sales in department stores and all others have rebounded sharply this year while online-only sales have yet to rebound (*Fig.*

2). After years of online sales taking market share, some of the brick-and-mortar retailers may be holding their own, helped by the push to offer online purchases that can be delivered to doorsteps or picked up in stores (*Fig. 3*). Let's take a look at some of the recent industry news:

(1) *Bankruptcies abound.* Retail bankruptcies are nothing new. They often happen during recessions, and many retailers have gone through the process more than once, in what bankruptcy pros jokingly call "Chapter 22" (Chapter 11 twice). But the volume of bankruptcies is up sharply. Twenty-four retailers have filed for bankruptcy from the start of the year through July 16. That's more than the 20 retailers that filed during all of 2019, a July 22 *WSJ* article reported.

Retailers reorganizing under bankruptcy protection and those just trying to stay alive outside of the bankruptcy courts are closing underperforming stores at a shocking pace. "Retailers will likely decide to close as many as 25,000 U.S. stores in 2020, which would be a record, and more than double the 9,832 stores that closed last year, according to global market-research firm Coresight Research. So far this year, major U.S. chains have announced more than 5,400 permanent closures," the *July* WSJ article stated.

Here are some of the retailers that have filed for bankruptcy protection and are closing hundreds of storefronts: Ascena—owner of Ann Taylor, Lane Bryant, and other brands—plans to close up to 1,600 of its 2,800 stores, including all of its 264 Catherines stores and all or the majority of its Justice stores. Tailored Brands—owner of Men's Wearhouse and Jos. A. Bank—plans to close as many as 500 of its 1,450 stores. New York & Co.'s parent, RTW Retailwinds, plans to close most, if not all, of its 378 retail and outlet stores; and Tuesday Morning will close about 230 of its 700 stores.

Closures might have been even more aggressive if the large mall operators hadn't stepped in and bought some of bankrupt retailers. Yesterday, a *WSJ* article reported that Simon Property Group and Brookfield Property Partners agreed to buy 490 J.C. Penney stores out of bankruptcy while the store's lenders will own its remaining 160 locations. Brooks Brothers was sold earlier this summer to Simon Property Group and Authentic Brands Group, which agreed to keep operating at least 125 of the company's 424 global stores. Simon, Brookfield Property Partners, and Authentic Brands also bought Forever21 out of bankruptcy earlier this year.

(2) *Survivors trimming too.* Even the retailers who aren't filing for bankruptcy protection are trimming their store counts, sometimes sharply. Gap is shutting about 230 locations, and L

Brands is cutting 250 Victoria's Secret stores, or about a quarter of them. Chico's is shuttering 250 locations, and Macy's has closed more than 125 stores this year. G-III Apparel Group is closing its 110 Wilsons Leather and 89 G.H. Bass stores. And there are only 60 Sears and 35 Kmart stores left, down from a collective total of more than 3,500 at one time.

(3) *For some the end has arrived.* And then there are the bankrupt companies, unable to find a buyer, that are turning off their lights for good. Among those who have liquidated or plan to do so are home goods retailer Pier 1, Modell's Sporting Goods, Lord & Taylor (38 department stores), Stein Mart (279 stores), and Stage Stores (738 stores across six brands including Stage department stores).

(4) *Dismal data.* While some retailers' stocks have boomed during COVID-19 (think: the S&P 500 Home Improvement Retail stock price index, up 24.7% ytd through Tuesday's close, or Internet & Direct Marketing Retail, up 60.8%), the pure clothing retailers have had a horrible year. The S&P 500 Department Stores stock price index—which now has only one constituent, Kohl's—has fallen 55.6% ytd, and the S&P 500 Apparel, Accessories & Luxury Goods stock price index has dropped 34.7% (*Fig. 4* and *Fig. 5*). In fact, these two industries have fallen by 81% and 50% from their 2014-15 peaks.

Revenue for the S&P 500 Department Stores industry is expected to tumble 19.4% this year while its earnings dive to a steep loss (*Fig. 6*). Likewise, revenue for the S&P 500 Apparel, Accessories & Luxury Goods industry is expected to drop 20.3% this year while its earnings fall 79.0% (*Fig. 7* and *Fig. 8*). With its 2020 and forward expected earnings now at a deep loss, the forward P/E for the Department Stores industry is no longer calculable, and the forward P/E for the Apparel, Accessories & Luxury Goods industry has risen to 13.8 from a thread below 10 in mid-March (*Fig. 9*).

Disruptive Technologies: Tech Tackles Global Warming. With fires raging on the West Coast and tropical storms pounding the East, it's hard not to worry that global warming is gaining the upper hand on Mother Nature. However, we remain hopeful that humans will save the planet because there are a bevy of new, green technologies being developed. Some we've discussed in the past, including solar, wind power, electric cars, lithium ion batteries, and drones planting trees. But that's just scratching the surface. We'll keep updating you on the latest tech tools being developed to reduce the CO2 emissions and fight global warming. Today's installment includes Jackie's report on electric construction equipment, a hydrogen powered generator, and a new battery purported to last for 150 hours:

(1) *Construction trucks going green.* Construction vehicles are normally very large, very loud, and very smelly. They spew large volumes of CO2-containing exhaust. But now manufacturers are starting to introduce electric trucks, particularly for smaller construction vehicles. By 2023, there will be 19 all-electric or hydrogen-fuel-cell-powered heavy duty trucks in production in North America, up from five today, a July 13 article in Greentech Media reported.

European companies seem to be leading this trend, with electric excavators, loaders, and dumpers available from manufacturers including Hitachi, Komatsu, and Volvo. “Oslo launched the world's first zero-emission construction site last year, and Norway's capital city has mandated that by 2025 all public construction sites will operate only zero-emission construction machinery,” the Greentech Media article stated.

Volvo Group’s construction equipment subsidiary has stopped developing diesel engine compact wheel loaders and compact excavators and has introduced electric versions of those trucks instead. The company officially announced that it would begin accepting preorders for those electric powered vehicles in the US in early August. Fifteen states and the District of Columbia have agreed that 100% of all new medium- and heavy-duty truck sales will be emissions free by 2050.

Both Volvo trucks use lithium ion batteries. The mini excavator and the compact wheel loader each can run for eight hours when used for their most common applications. Both can be fully charged overnight or charged to 80% in an hour or two with a fast charger. Faresin Industries, an Italian construction equipment manufacturer, offers an electric telehandler with six hours of battery life that can be recharged in 13 hours, or 2.5 using a fast charger.

(2) *Hydrogen fuel cell replaces diesel generator.* Siemens Energy has introduced a hydrogen fuel cell system that will be used to generate electricity, heat, and hot water for a construction site in England for at least six to eight months, eliminating the need for diesel generators, a September 3 CNBC article reported.

In general, a hydrogen fuel cell allows hydrogen atoms to enter at the fuel cell’s anode. The atoms are stripped of their electrons, and the positively charged protons pass through a membrane to the cathode. The negatively charged electrons are forced through a circuit, generating electricity. Afterwards, they combine with the protons and oxygen from the air to generate water and heat, explains this primer. Fuel cells are efficient and scalable.

The problem is that hydrogen needs to be made. Often, it's made by using electrolysis to split water into its components: hydrogen and water. Electrolysis requires energy, and unless that energy is produced using solar or wind power, you're back to burning natural gas or coal and throwing off carbon dioxide. Some scientists are studying how to use sunlight to fuel electrolysis, and others are trying to harness algae, which naturally produces hydrogen.

(3) *Aqueous air batteries on the way.* Form Energy, a startup that has raised more than $50 million from investors including Bill Gates' incubator Breakthrough Energy Ventures and MIT's The Engine, claims to have developed a new aqueous air battery that lasts 150 hours. The problem: No one knows what an aqueous air battery is, and the company isn't saying. But if it lasts 150 hours on a single charge as claimed, it would be a huge advance that could make solar and wind power a viable alternative to traditional energy sources.

Form Energy recently received a lot of attention after announcing it's working with Great River Energy, a Minnesota-based wholesale electric power co-op, to set up its aqueous air battery system for the first time commercially. Form Energy has said that its goal was to use metals or other elements that are lower cost and easier to obtain than the lithium, nickel, cobalt, and other metals used in today's lithium ion batteries. A May 8 article in CleanTechnica speculated that the aqueous air battery could use sulfur.

CALENDARS

US: **Thurs:** Initial & Continuous Jobless Claims 846k/12.9m, Headline PPI 0.2%m/m/-0.3%y/y, Core PPI 0.2%m/m/0.3%y/y, Wholesales Inventories -0.1%, EIA Natural Gas Storage. **Fri:** Headline & Core CPI 1.2%/1.6% y/y, Monthly Budget Statement -$245b, Baker-Hughes Rig Count. (DailyFX estimates)

Global: **Thurs:** France Industrial Production 5.0%, Italy Industrial Production 3.5%m/m/-9.7%y/y, ECB Interest Rate Decision & Deposit Facility Rate 0.0%/-0.5%, Lagarde, Machlem. **Fri:** Germany Headline & Core CPI -0.1%/0.0% y/y, UK GDP 6.7%m/m-7.5%3m/3m/-11.3%y/y, UK Headline & Manufacturing Industrial Production -8.9%/-10.5% y/y, UK Trade Balance -£6.9b, China New Yuan Loans & Social Financing ¥1.22t/¥2.73t, China M2 10.7% y/y, Eurogroup Meeting, Weidmann, Lane, Schnabel. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) this week slipped to 3.64 after climbing 20 of the prior 23 weeks from 0.72 (lowest since March 2018) during the March 24 week to 3.75 (highest since January 2018) last week. The correction camp saw all the action this week, rising 2.7ppts to 24.8%, as both bullish and bearish sentiment fell. It did however remain within its 22.5% to 26.5% flat trend prevalent since June. Bullish sentiment dipped to 59.0% this week after rising 31.4ppts (to 61.5% from 30.1%) from the March 24 week through last week. Bearish sentiment fell from 16.4% to 16.2% this week—fluctuating in a flat trend between 16.2% and 16.5% the past five weeks; it was at 41.7% during the March 24 week. The AAII Ratio declined to 42.4% last week after advancing the previous four weeks from 29.4% to 44.7%. Bullish sentiment sank to 41.8% after rising from 20.2% to 32.1% the prior four weeks, while bearish sentiment rose to 41.8% after falling from 48.5% to 39.6% the previous four weeks.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The rapid pace of COVID-19 estimate cuts has morphed into gains as analysts play catch-up from their lowball estimates prior to the better-than-expected Q2 earnings season. Consensus S&P 500 forecasts previously had been falling at rates paralleling the declines during the 2008-09 financial crisis. Forward revenues rose 0.6% w/w to its highest level since early April and is now 4.3% below its record high in mid-February. Forward earnings surged 1.9% w/w to its highest level since early April and is now 12.7% below its record high in early March. Forward revenues growth jumped 1.0ppt w/w to 5.1% as forward earnings growth soared 4.1% to 13.7%. Forward revenues growth is 1.2ppts below its seven-year high of 6.3% in February 2018, but is up from 0.2% in April, which was the lowest reading since June 2009. Forward earnings growth remains 3.2ppts below its six-year high of 16.9% in February 2018 but is up 19.3ppts from its record low of -5.6% at the end of April. Analysts expect revenues to decline 4.3% y/y in 2020 compared to the 4.3% reported in 2019. That's unchanged w/w and down 9.5ppts since the start of the year. Analysts expect an earnings decline of 19.4% y/y in 2020 compared to a 1.4% rise in 2019. Their 2020 growth rate was also unchanged w/w and is down 28.4ppts since the beginning of the year. The forward profit margin rose 0.1ppt w/w to 10.9%. That's up 0.6ppt from 10.3% during April and May, which was the lowest level since August 2013. It's still down 156ppt from a record high of 12.4% in September 2018. Analysts expect the profit margin to fall 1.9ppt y/y in 2020 to 9.6%—from 11.5% in 2019—and to improve 1.7ppt y/y to 11.3% in 2021. The S&P 500's weekly forward P/E rose 0.3pt to 23.1, which was the highest level since July 2000 and up from a 77-month low of 14.0 in mid-March. The S&P 500 price-to-sales ratio gained 0.06pt w/w to a record high of 2.53. That's up from the 49-month low of 1.65 in mid-March and compares to the previous record high of 2.29 in mid-February.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins (*link*): Last week saw consensus forward revenues and earnings rise w/w for all 11 S&P 500 sectors. Consumer Staples and Real Estate were the only sectors to post declines in both measures. Due to the sharp decrease in forward earnings this year, forward P/E ratios for nearly all sectors now are back above their recent record or cyclical highs prior to the bear market. Tech and Utilities are the only sectors now expected to have improved profit margins in 2020, whereas back in early March eight sectors were expected to see margins improve y/y. During 2019, just two sectors' margins improved y/y: Financials and Utilities. The forward profit margin rose to record highs during 2018 for 8/11 sectors, all but Energy, Health Care, and Real Estate. Since 2018, it has moved lower for nearly all the sectors. In the latest week, the forward profit margin moved higher for six sectors and fell for Real Estate. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (22.2%, down from 23.0%), Financials (14.4, down from 19.2), Utilities (14.2, record high), Real Estate (13.4, down from 17.0), Communication Services (13.6, down from 15.4), S&P 500 (10.9, down from 12.4), Health Care (10.5, down from 11.2), Materials (9.6, down from 11.6), Industrials (8.1, down from its record high of 10.5% in mid-December), Consumer Staples (7.3, down from 7.7), Consumer Discretionary (5.9, down from 8.3), and Energy (2.3, down from 8.0).

S&P 500 Sectors Forward Revenues and Earnings Recovery from COVID-19 Trough (*link*): The S&P 500's forward revenues and earnings, as well as its implied forward profit margin, bottomed at cyclical lows on May 28 after 14 weeks of COVID-19 declines. Since then, S&P 500 forward revenues has risen 4.1%, forward earnings has gained 10.9%, and the forward profit margin has risen 0.6pt to 10.9%. The S&P 500 and eight of its 11 sectors posted new highs in the latest week in their forward revenues, earnings, and profit margin. The exceptions: Energy's revenues; Utilities' revenues and earnings; and Real Estate's revenues, earnings, and profit margin. Real Estate's margin made a new low. Here's how the sectors rank by their changes in forward revenues and forward earnings since May 28: Consumer Discretionary (forward revenues up 7.3%, forward earnings up 34.6%), Information Technology (5.0, 7.0), Financials (4.9, 11.6), Industrials (4.6, 15.8), Communication Services (4.6, 6.9), Materials (3.4, 11.2), S&P 500 (4.1, 10.9), Health Care (3.3, 8.7), Consumer Staples (2.0, 4.0), Energy (1.4, 303.0), Real Estate (0.4, -5.1), and Utilities (-1.9, 0.2).

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