Yardeni Research

MORNING BRIEFING
September 17, 2020

Transports Cruising Along

Check out the accompanying chart collection.

(1) Transports benefit from pandemic-fueled online shopping. (2) Industry rebounds on business restocking and resumption of global trade too. (3) Railroads and truckers doing great, airlines not so much. (4) FedEx posts banner earnings, plans for holiday and vaccine onslaught. (5) Cruising the ocean blue using green energy. (6) Ammonia fuel cells propel a ship in Norway. (7) Ferries among first adopters of hydrogen fuel cells. (8) ExxonMobil making biofuels to propel ships. (9) Capturing ships' carbon—possible alternative to changing fuels?

Transports: Restocking the Shelves. Most transportation industries are on a roll thanks to the Covid-inspired surge in e-commerce and the more recent need for retailers to restock their shelves. The S&P 500 Transportation stock price index hit a new record high on Wednesday and is up 11.1% ytd through Tuesday's close, almost twice the S&P 500's 5.3% ytd return. But even that strong result vastly understates the recovery that most transport industries have enjoyed, as the S&P 500 Transportation index is being dragged down by the 42.1% ytd decline in the S&P 500 Airlines stock price index.

Other transportation industries have more than compensated for the nosedive in airlines. The S&P 500 Air Freight & Logistics stock price index has led the way, rising 40.7% ytd. Not far behind is the S&P 500 Trucking stock price index, up 37.0% ytd, and the S&P 500 Railroads stock price index, up 12.8% ytd. All three indexes are at or near record-high levels (*Fig. 1*).

Americans once again are proving that shopping is their favorite sport—and, thanks to e-commerce, closed malls won't stop them. Let's take a look at some of the broader economic data, then home in on Tuesday's fiscal Q1 earnings report from FedEx, which beat consensus estimates by a longshot:

(1) *Trading again.* The transportation industry benefits when countries are playing nicely and international trade flourishes. The US/China trade spat followed by the Covid-induced shutdown of the global economy sank trade flows, and they've only started to recover in recent

months. Real merchandise exports jumped 25.1% in July from their May bottom, while real merchandise imports jumped 16.1% over the same period (*Fig. 2* and *Fig. 3*).

(2) *Hitting the rails and the roads.* The recent surge in trade and the revival of the US economy have boosted both rail and truck traffic. Total railcar loadings excluding coal and oil are up 14.8% from the June 13 week through the week of September 12, using the 12-week moving average (*Fig. 4*). And the ATA Truck Tonnage Index has bounced 7.4% from its May low, though it did dip slightly in July (*Fig. 5*).

Activity in the West Coast ports is so strong that news reports have characterized it with hyperbolic language like "bursting at the seams." A September 10 *WSJ* article stated: "The Global Port Tracker report released Wednesday by the National Retail Federation and Hackett Associates said the preliminary estimate for August showed 2.06 million loaded containers, measured in 20-foot-equivalent units, hit U.S. shores last month, which would be the most in any month since the report was first published in 2002."

The tight markets are forcing customers to pay up if they want their merchandise delivered inland. Trucking payrolls were up by 10,000 in August, the best monthly gain since August 2018, and wages were up 3.4% y/y in July (*Fig. 6* and *Fig. 7*). Companies seem confident enough about the future to add capacity. Medium- and heavy-weight truck sales were up 30% in August from May's low (*Fig. 8*).

(3) *FedEx provides the latest datapoint.* FedEx's earnings for its quarter ending August 31 confirmed the heightened demand for domestic and international shipping. A crush of online deliveries as shoppers avoided physical stores during the Covid outbreak more than made up for any drop in business deliveries. FedEx's revenue jumped 13.5% y/y, and adjusted operating income climbed 56.2%, in the quarter.

Spending that normally would have been on services has shifted toward spending on goods, said Brie Carere, FedEx's chief marketing and communications officer on its September 16 conference call. And those goods were being purchased online and shipped, expanding the domestic market more quickly than FedEx had forecast. The company now expects a milestone to be reached three years faster than expected before Covid: 100 million packages shipped per day in the US by 2023.

Demand was strong enough that the company was able to pass on pricing increases, including peak surcharges. Operating margins expanded 2.4ppts to 8.5%. This earnings report proves wrong those who doubted the company's ability to rebound after dropping Amazon as a customer in 2019.

Looking forward, the company is planning ahead for the holiday shipping season, which FedEx President Raj Subramaniam expects will "be a peak like none other." The company is hiring 70,000 additional employees, opening up new facilities, and continues to offer Sunday delivery in an effort to handle peak deliveries. In addition, FedEx is preparing to distribute vaccines, a challenge given that they need to be transported at extremely low temperatures.

(4) *Analyst forecasts.* FedEx is a member of the S&P 500 Air Freight & Logistics industry, which is expected to see revenue grow by 6.1% this year and 4.8% in 2021 (*Fig. 9*). Its earnings, which are forecast to fall slightly this year, by -0.5%, are expected to grow by 14.8% in 2021 (*Fig. 10*). The industry's forward P/E, at 20.7, is elevated relative to historical levels, but it should fall as earnings improve (*Fig. 11*).

The S&P 500 Railroads industry saw its earnings fall this year, but analysts are expecting a recovery in 2021. This year, the industry's revenue is forecast to fall 11.9%, and earnings are thought to drop 11.0%. But next year, revenue is forecast to grow by 8.3% and earnings by 19.5% (*Fig. 12* and *Fig. 13*). Much of this good news appears to be priced into the industry's stock price index already, however, as its forward P/E is 21.1, a high for the past 25 years (*Fig. 14*).

The S&P 500 Trucking industry also trades at an elevated forward P/E valuation of 29.3, the highest in the past decade (*Fig. 15*). Analysts are expecting the S&P 500 Trucking industry's financial results to rebound in 2021. Declines are expected for revenue growth (-1.2%) and earnings growth (-4.0%) this year, followed by leaps of 8.9% and 23.0% next year (*Fig. 16* and *Fig. 17*).

Net earnings revisions for each of these three S&P 500 industries (Air Freight & Logistics, Railroads, and Trucking) turned positive in August for the first time in more than a year (*Fig. 18*, *Fig. 19*, and *Fig. 20*). But as we said earlier, much or all of the earnings optimism appears to be priced into these industry indexes' forward P/Es, all at or near all-time highs.

Disruptive Technologies: Going Green To Explore the Seas. The shipping industry, which contributes up to 3% of the world's greenhouse gases, is trying to go green. The International Maritime Organization (IMO) aims to cut greenhouse gas emissions by at least 50% from 2008 levels by 2050. Scientists and companies are experimenting with hydrogen, ammonia, and biofuels to propel ships. With assets that live for as long as ships do, the ability to change fuels quickly is important if IMO is to meet its goals.

Marine vessels will consume about 4% of global oil in 2020, or about 4.4 million barrels per day (mbd), according to a 2019 International Energy Agency report. The type of oil being consumed by ships is changing dramatically thanks to new IMO rules banning high-sulfur fuel oil this year. Shippers will either switch to low-sulfur oil alternatives or install scrubbers that take the sulfur out of emissions. If shippers stopped using oil to propel their ships, it would have an environmental impact but a small one compared to the impact that cars' switching to electric batteries from gasoline would have. Cars consume about a quarter of oil used worldwide.

Here are some of the industry players' efforts to wean ships away from crude oil:

(1) *Ammonia: Zero emissions, but volatile.* Norwegian shipping company Eidesvik and state-backed oil and gas company Equinor built the Viking Energy, a ship that runs on ammonia fuel cells, a March 29 *FT* article reported. When ammonia is burnt properly, it creates water and nitrogen. It has a high-energy density, almost twice as much as liquid hydrogen and nine times as much as lithium ion batteries.

There are undeniable downsides, however. Ammonia is toxic, so spills would hurt the environment, and improper burning can produce nitrous oxide. Also, producing ammonia takes a lot of fossil fuel, defeating the purpose of going green.

(2) *Hydrogen fuel cells gaining adoption.* Ferries are among the largest early adopters of hydrogen fuel cells. In Europe, the move toward this propulsion method is gaining steam so that ships can meet the Norwegian government's regulatory requirements for a zero-emissions vessel area within the country's fjords starting in 2026.

"There are 50 ferries [using hydrogen fuel cells] on order or under construction and [the number could] well be 100 in the next few years," said an ABB executive quoted in a

November 5, 2019 Riviera article. Within five years, these ships will make up “a significant” segment of the coastal fleet.

Separately, Norwegian Electrical Systems is developing a 3.2MW hydrogen fuel cell for a large vessel being designed for shipowner Havila, a February 3 article in Recharge reported. It would be the largest fuel cell ever put on a major ship, and batteries would store additional energy, making the system emissions-free.

“The liquid hydrogen will be supplied from a bunkering vessel or truck, and then stored on board of the cruise ship in a liquid hydrogen tank. To be used in the fuel cell, the liquid hydrogen will be converted into gas again,” the article stated. Linde and PowerCell are also involved with the project.

The International Council on Clean Transportation conducted a study in March 2020 that examined whether shipping containers could use hydrogen fuel cells to travel between China to the US. It concluded that 43% of the voyages could be made without changing the ship’s space allotted for fuel or the ship’s route. Another 56% of the voyages could be made using hydrogen fuel cells if an additional 5% of cargo space were allotted to holding additional hydrogen fuel and adding one refueling stop.

Barriers to using hydrogen fuel cells include the lack of fueling infrastructure (though all new fuel sources face that barrier), the higher costs involved compared to existing fossil fuels, and the fact that it takes energy to make hydrogen.

(3) *Giving biomass a chance.* ExxonMobil announced earlier this week a successful trial of its first marine biofuel oil with shipping company Stena Bulk. The fuel, which has very low sulfur content, can reduce CO2 emissions by up to 40% compared to conventional marine fuel, Exxon states.

The fuel was used in the ship’s existing engines, without any modifications or additional equipment, during normal commercial operations. Initially available in Rotterdam later this year, the fuel ultimately will be available across ExxonMobil’s port network.

Biofuels are typically created using waste produced by industries such as agriculture or farming, or by dedicated biofuel crops. Their broad adoption has been stymied by their higher

costs to produce than traditional fuels. The fuel would need to be widely available to become a viable alternative.

"Concerns revolve around developing countries where using land for bio crops rather than edible food can aggravate existing food insecurity. Felling forests or turning grasslands into agricultural land can also undo the positive effects of biofuels by increasing greenhouse gas emissions," an October 1, 2018 article in Ship Technology explained. ExxonMobil's press release didn't give the biofuel's cost or describe how it was produced.

(4) *Ships capturing carbon.* Instead of finding a carbon-free fuel, Japanese operator Kawasaki Kisen Kaisha (K-Line) is exploring how it can capture the carbon its ships emit. It's partnering with Mitsubishi Shipbuilding and ClassNK to develop a small-scale plant to capture CO_2 on K-Line's thermal coal carrier, Corona Utility. If the carbon can effectively and safely be captured and stored on the ships, the captured CO_2 would be used in "enhanced oil recovery processes or as raw material in synthetic fuel through methanation," a September 15 Riviera article reported.

(5) *Time for a crazy idea.* Much of shipping involves sending raw goods from Country A, where they come from, to Country B, where they are made into products, to Country C, where they're consumed. So producing more of the world's goods closer to their consumption point in Country C could significantly shorten the last leg of the journey, saving a lot of energy and reducing emissions.

CALENDARS

US: **Thurs:** Housing Starts & Building Permits 1.478mu/1.523mu, Initial & Continuous Claims 850k/13.0m, Philadelphia Fed Manufacturing Index 15, EIA Natural Gas Storage.
Fri: Consumer Sentiment Index Total, Present Conditions, and Expectations 75.0/83.9/67.8, Current Account -$157.9b, Baker-Hughes Rig Count. (DailyFX estimates)

Global: **Thurs:** Europe New Car Registrations, Eurozone Headline & Core CPI -0.2%/0.4% y/y, Japan CPI -0.4% y/y, BOE Rate Decision 0.1%, Guindos. **Fri:** UK Retail Sales Total & Excluding Fuel 3.0%/4.2% y/y, Canada Retail Sales 0.5%, Guindos, Schnabel. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) this week dipped below 3.00 for the first time in 11 weeks. The BBB posted its second decline in as many weeks, slipping to 2.99 this week after climbing 20 of the previous 23 week from 0.72 (lowest since March 2018) during the March 24 week to 3.75 (highest since January 2018) two weeks ago. Bullish sentiment has dropped 6.7ppts the past two weeks, to 54.8%, after rising 31.4ppts (to 61.5% from 30.1%) from the March 24 week through week of September 1. Bearish sentiment climbed to 18.3% this week (the highest since the July 7 week), after fluctuating in a flat trend between 16.2% and 16.5% the prior five weeks; it was at 41.7% during the March 24 week. The correction camp has climbed 4.8ppts (to 26.9% from 22.1%) the past two weeks, moving out of its flat trend prevalent since June to its highest percentage since the May 19 week. The AAII Ratio declined for the second week to 32.9% last week after advancing the previous four weeks from 29.4% to 44.7%. Bullish sentiment fell for the second week to 23.7% after rising from 20.2% to 32.1% the prior four weeks, while bearish sentiment rose for the second week to 48.5% after falling from that same level, 48.5%, to 39.6% over 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 0.1% w/w to its highest level since early April and is now 4.2% below its record high in mid-February. Forward earnings was steady w/w at its highest level since early April and is now 12.7% below its record high in early March. Forward revenues growth rose 0.1ppt w/w to 5.2% as forward earnings growth remained steady at 13.7%. Forward revenues growth is 1.1ppts 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 remained steady w/w at 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 dropped 1.1pt to 22.0 from 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 slipped 0.13pt w/w to 2.40 from 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 rise w/w for eight of the 11 S&P 500 sectors and forward earnings for five. Consumer Staples, Health Care, Materials, and Tech had both measures rise, while Financials 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 lower for Energy and Financials. 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 (14.3, 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 (2.2, 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 4.2%, forward earnings has gained 10.9%, and the forward profit margin has risen 0.6pt to 10.9%. The S&P 500 and ten of its 11 sectors posted new highs during the last two weeks in either their forward revenues, earnings, or 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 again in the latest week. 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 34.5%), Information Technology (5.1, 7.2), Financials (4.9, 11.3), Industrials (4.7, 15.6), Communication Services (4.6, 6.8), S&P 500 (4.2, 10.9), Materials (4.1, 13.8), Health Care (3.4, 8.7), Energy (2.3, 292.0), Consumer Staples (2.1, 4.2), Real Estate (0.4, -5.2), and Utilities (-2.0, 0.2).

US ECONOMIC INDICATORS

Retail Sales (*link*): Retail sales continued to set new highs in August, though the rate of growth has slowed since May and June's double-digit gains. Sales advanced 0.6% last month after a downwardly revised 0.9% (vs 1.2% preliminary) increase in July—with sales up 30.2% during the four months through August. Core retail sales—which excludes autos, gasoline, building materials, and food services—ticked down 0.1% in August after soaring 18.2% the prior three months to a new record high. Adjusted for inflation, we estimate headline sales was little changed in August, though sales accelerated a record 57.1% (saar) during the three months through August, based on the three-month average, and core retail sales accelerated 30.2% over the comparable period—indicating a record-breaking rebound in Q3 real consumer spending in the GDP accounts, following Q2's record shortfall. Last month, eight of the 13 nominal retail sales categories were in the plus column, four were negative, while sales of nonstore retailer was unchanged. Here's a snapshot of each categories' performance since their April lows and where they stand relative to their pre-COVID levels: i) clothing & accessory stores (488.6% & -19.9%); ii) furniture stores (153.7 & 1.0); iii) electronics & appliance stores (110.1 & -2.0); iv) sporting goods & hobby stores (102.6 & 10.7); v) auto dealers (60.4 & 4.4); vi) food services & drinking places (82.0 & -16.4); vii) miscellaneous store retailers (50.2 & -4.0); viii) gasoline service stations (35.1 & -14.8); ix) health & personal care stores (16.4 & 4.6); x) building materials & gardening equipment (13.5 & 11.8); xi) general merchandise stores (7.5 & 0.8); xii) nonstore retailers (5.1 & 20.6); and xiii) food & beverage stores (-0.1 & 10.4).

Business Sales & Inventories (*link*): Nominal and current (reported with a lag) business sales continued to recover from Covid-19-related declines in July and June, respectively, after dropping sharply from February through April. Nominal sales expanded 3.2% in July and 21.6% during the three months ending July, after a two-month plunge of 18.9%. These sales are within 1.3% of their pre-pandemic level. Real business sales rebounded 15.3% during the two months through June after sliding 14.5% during the two months ending April; these sales are only 1.5% below pre-Covid levels. Real retail sales soared 23.5% during the two months

through June to a new record high, while real wholesale and manufacturing sales posted increases of 11.5% and 10.9%, respectively, over the same two-month period, leaving them 4.6% and 5.3% below February levels. July's nominal inventories-to-sales ratio sank to 1.33 after shooting up from 1.38 in February to 1.67 in April; the real inventories-to-sales ratio for June dropped to 1.41 after soaring to a record high of 1.66 in April from 1.43 in February.

Contact us by email or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-497-5306
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-775-6823

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