Yardeni Research

MORNING BRIEFING
December 3, 2020

Delivering Vaccines During the Holidays

Check out the accompanying chart collection.

(1) More holiday shopping moves online as consumers avoid stores and Covid-19. (2) Freight & Logistics and Trucking industries having a banner year. (3) Opportunities and challenges in the holiday online shopping surge for FedEx and UPS. (4) Both companies aim to deliver vaccines at Warp Speed. (5) Truckers still hiring drivers and expanding capacity. (6) Rails helped by trade and autos, hurt by coal and oil. (7) Airlines having a year to forget. (8) Much optimism priced into Transports' earnings multiples, except for Airlines'. (9) AI seeping into everything. (10) CRM companies harness AI in battle for market share. (11) Look Mom, no driver.

Transports: Santa's Helpers. With Covid-19 putting a damper on our willingness to visit stores, online shopping is soaring this holiday season. Cyber Monday spending rose 15.1% y/y, according to Adobe Analytics, which forecasts that online sales for the entire holiday season will jump 30% y/y. That's good news for the transportation companies involved with getting that special package from the manufacturer, to the retailer, and into its designated stocking.

The S&P 500 Transportation Composite has risen 19.0% ytd through Tuesday's close, trouncing the S&P 500 and all the index's sectors except those heavily weighted with technology companies (*Fig. 1*). Here's the performance derby for the S&P 500's sectors ytd through Tuesday's close: Information Technology (36.5%), Consumer Discretionary (30.2), Communication Services (20.9), Materials (16.6), S&P 500 (13.4), Health Care (8.3), Industrials (7.6), Consumer Staples (7.0), Utilities (-2.5), Real Estate (-4.8), Financials (-8.2), and Energy (-39.6) (*Fig. 2*).

Let's take a look at what's been driving the S&P 500 Transport stocks higher so far this year:

(1) *Profits in the last mile.* Propelling the S&P Transportation index are the S&P 500 Air Freight & Logistics stock price index, up 51.1% ytd, and the S&P 500 Trucking index, up 44.1%. They

are sharply outperforming the solid ytd performance of Railroads (17.9%) and the horrible year the Airlines industry is suffering through (-31.7). Excluding the Airlines, the S&P 500 Transportation index would be up almost 30.0% ytd.

While all the members of the Air Freight & Logistics industry have beaten the S&P 500's performance, FedEx, up 90.3% ytd, and UPS, up 43.5%, are the standouts. FedEx hit a new all-time high last week, while UPS hit its high in October and has fallen only 4.8% since then. FedEx received its most recent endorsement Tuesday from Barclays analyst Brandon Oglenski, who upgraded his (presumably 12-month) stock price target to $360 from $240 due to the company's growth opportunities and the surge of e-commerce, a Street.com article reported Tuesday.

The challenge for the delivery companies this holiday season will be delivering the deluge of packages both profitably and on time given that their systems are already busy with the Covid-19 induced surge of shopping for everyday items. UPS "imposed shipping restrictions on some large retailers such as Gap Inc. and Nike Inc. this week," a *WSJ* article reported yesterday. The temporary restrictions, which hadn't been used in the past, will be lifted once more capacity in the company's system becomes available, presumably in the next week. The shippers have been urging retailers to space out their promotions and start them earlier in October and November. Abercrombie & Fitch is telling customers to place orders by December 4 if they want them to arrive by Christmas using standard shipping.

In addition to watching how both companies perform during the holidays, the companies' ability to deliver Covid-19 vaccines over the next year will come under a microscope. Delivery of Pfizer's vaccine will be particularly tricky because it must be kept at temperatures of minus 70 to minus 80 Celsius. FedEx said it is working with the US Department of Health and Human Services, the US Department of Defense, and its healthcare customers on vaccine distribution plans as part of Operation Warp Speed. In a statement to Fox13 Memphis, FedEx noted its history of delivering flu vaccines each year and its various refrigeration facilities.

UPS, which is also working with Operation Warp Speed, put out a November 25 press release announcing that it has increased its US production of dry ice to 1,200 pounds per hour, which will increase the company's supply-chain agility and reliability. "We have a great opportunity, and frankly a great responsibility to serve the world when a COVID-19 vaccine becomes available. When that time comes, our global network, cold chain solutions and our people will be ready," said UPS CEO Carol Tomé on the October 28 Q3 earnings conference call.

The S&P 500 Air Freight & Logistics industry surprised industry analysts, who as recently as this summer expected 2020 to be a year of declining earnings. However, expectations reversed sharply in recent months, and now the industry is expected to see revenue growth of 10.5% and earnings growth of 18.9% this year (*Fig. 3* and *Fig. 4*). Growth is expected to slow but remain strong in 2021, with revenue growth of 4.4% and earnings growth of 9.5% targeted. The industry's valuation is a bit stretched, with a forward P/E of 19.3, which is near the highs of the past decade (*Fig. 5*).

(2) *Santa needs truckers too.* As noted above, the S&P 500 Trucking index, up 44.1% ytd, is also having a banner year, despite the October ATA Truck Tonnage Index reading. The seasonally adjusted index fell to 106.8 in October, down from 114.0 in September (*Fig. 6*). While the economy might be losing some momentum, ATA Chief Economist Bob Costello blamed the negative reading on atypical seasonality this year. Not seasonally adjusted, the index rose to 114.4 in October, up from the not seasonally adjusted September level of 111.4.

The trucking industry's strength is backed by a number of other data points. For example, medium and heavy truck sales are 38.5% above their May low, even after dipping in November (*Fig. 7*). Also, trucking companies continued adding employees and average hourly earnings increased (*Fig. 8* and *Fig. 9*). And prices for truck transportation of freight continued to improve in October's producer price index (*Fig. 10*).

Old Dominion Freight Line's CEO Greg Gantt seemed optimistic about the rest of 2020 and next year on the company's October 27 Q3 conference call. "We believe the domestic economy and customer demand will continue to improve," he said, noting that the company plans to invest in equipment and additional service center capacity and hire additional drivers and platform employees.

Old Dominion has performed better than the other S&P 500 Trucking industry member, J.B. Hunt. For the overall S&P 500 Trucking index, revenue this year is expected to rise only 1.0%, and earnings are forecast to drop slightly, by 0.6% (*Fig. 11* and *Fig. 12*). Next year, results are expected to improve, with revenue growing a projected 10.4% and earnings expected to jump 24.7%. The industry's main problem is the optimism priced into its forward P/E of 27.2, which is near recent all-time highs (*Fig. 13*).

(3) *Rails rebound.* Railcar loadings, based on a 26-week average, have jumped 10.4% from their lows this June, but they remain down 4.4% y/y (*Fig. 14*). The improvement is impressive given the sharp drop in oil and coal shipments (*Fig. 15* and *Fig. 16*). Traffic was helped by a jump in auto transportation and continued improvement in trade. West Coast ports container traffic continued to edge higher in October after bottoming in June (*Fig. 17*).

Even so, analysts are expecting the S&P 500 Railroads industry's revenue to drop 11.4% and earnings to drop 8.4% this year (*Fig. 18* and *Fig. 19*). Investors, however, appear to have flipped the calendar to next year, when revenue is expected to increase 8.5% and earnings to jump 19.8%. The S&P 500 Railroad stock price index hit a new high on November 24, and its forward P/E, at 21.9, is near a 25-year high (*Fig. 20*).

(4) *Airlines have room to improve*. The one area in Transports that hasn't priced in a full recovery is the S&P 500 Airlines index. It's down 31.7% ytd but up 100.5% from its May 15 low (*Fig. 21*). After cratering through April, the number of passengers going through TSA checkpoints rose into the summer, but gains halted as Covid-19 cases surged in the western states. More than 1 million passengers flew during the Thanksgiving week, but that's just half of the weekly passenger traffic seen at the start of 2020 (*Fig. 22*).

Analysts expect the S&P 500 Airlines industry's revenue to fall 62.6% this year, resulting in losses (*Fig. 23* and *Fig. 24*). Encouraged by the recent good news about vaccine developments, they've grown optimistic, projecting that revenue will surge 62.4% in 2021, but another loss is expected.

Disruptive Technologies: AI Becoming More Embedded. Melissa McCarthy's movie "Super Intelligence" is sweet, has some chuckles, and takes you back to a time before masks. It also brings up the threat that artificial intelligence (AI) will break free of human control and threaten our existence. During the movie, an AI threatens McCarthy's character by communicating with her through her cloud-connected appliances, her TV, and her Tesla—which the AI drives, of course.

AI is rapidly being imbedded in just about everything, including retailers' chat boxes, CRM software, drug development programs, and autonomous vehicles. So far, humans appear to be retaining the upper hand. Or maybe that's just what the AI wants us to think?!

I asked Jackie to take a look at some of the latest advancements in AI. Here's what she found:

(1) *CRM software gets smarter.* Customer relationship software (CRM) has historically tracked sales leads and customers to help improve employees' productivity. Add some AI capability, and that CRM software can now forecast customer demand, predict which customers will leave, and analyze e-mail messages before they're sent to gauge the likelihood that they'll be opened or otherwise acted upon. "IDC said AI CRM application revenue will reach $48.3 billion in 2024, up from $24.6 billion in 2020," an informative November 20 *WSJ* article reported.

C3.ai hopes to tap into the excitement surrounding CRM AI, with expected IPO pricing that values the company north of $3 billion. The company also is selling an additional $100 million of stock at the IPO price to Spring Creek Capital and another $50 million to Microsoft, a November 30 TechCrunch article reported. Besides providing CRM AI, the company's AI software has applications for predictive maintenance, fraud detection, sensor network health, supply network optimization, energy management, and anti-money laundering.

C3.ai was founded by Tom Siebel, who also founded Siebel Systems, the CRM software company that he sold to Oracle in 2005 for $6 billion. C3.ai is partnering with Microsoft and Adobe. They will compete with CRM industry leader Salesforce.com, which purchased Tableau last year for $15.7 billion to enhance its AI data analytics offerings.

(2) *AI helping doctors.* Eko Devices has developed a stethoscope that allows doctors to hear heart sounds, digitize them, and listen to a patient's recordings over time to evaluate how they change, a November 9 *WSJ* article stated. The company claims to identify heart murmurs with 87% accuracy, compared to the 43% accuracy of using a traditional stethoscope. The private company has another product that combines a digital stethoscope with an electrocardiogram to detect atrial fibrillation and yet another that patients can use at home to monitor themselves and have a virtual meeting with the doctor.

(3) *AI navigating the streets of San Fran.* A number of autonomous vehicles got a major vote of confidence when given the ability to test cars on San Francisco's roads without a safety driver. Cruise, the self-driving arm of GM, said it is allowed to test five vehicles on roads with speed limits of no more than 30 miles per hour and cannot drive on days with heavy rain or heavy fog. Waymo, AutoX, Nuro, and Zoox also have driverless permits. But Cruise says it will be the first to use the permit and put driverless cars on the street by the end of this year.

Waymo's driverless cars have been tested in the Phoenix area since 2018 with preestablished riders of its ride-hailing service. In October, the company said its cars could pick up anyone looking for a ride. A remote team of Waymo employees watches real-time feeds of the vehicles' eight cameras and can help if the software glitches.

(4) *AI designing proteins.* Alphabet's DeepMind has a deep learning system, AlphaFold, that accurately predicts the structure of proteins. It matched the accuracy of other existing methods of mapping out a protein's structure, but the DeepMind program did the job inexpensively and in a few days, not a few years. The problem is tougher than it sounds because proteins are made from amino acids that fold up with many twists and turns. The structure determines the function of the protein. And there are tens of thousands of different proteins in humans and billions of proteins in all living things.

"The breakthrough could help researchers design new drugs and understand diseases. In the longer term, predicting protein structure will also help design synthetic proteins, such as enzymes that digest waste or produce biofuels. Researchers are also exploring ways to introduce synthetic proteins that will increase crop yields and make plants more nutritious," a November 30 article in *MIT Technology Review* reported. Next, DeepMind will study leishmaniasis, sleeping sickness, and malaria, because they all are linked to unknown protein structures.

CALENDARS

US: Thurs: Initial & Continuous Jobless Claims 775k/5.92m, ISM NM-PMI 60.9, IHS Markit C-PMI & NM-PMI 57.9/57.7, EIA Natural Gas Storage. **Fri:** Nonfarm Payrolls Total, Private, and Manufacturing 500k/598k/40k, Unemployment Rate 6.8%, Average Hourly Earnings 0.1%m/m/4.3%y/y, Average Workweek 34.8hrs, Factory Orders 0.8% Balance of Trade -$64.8b, Baker-Hughes Rig Count, Bowman, Evans. (DailyFX estimates)

Global: Thurs: Eurozone Retail Sales 0.8%m/m/2.7%y/y, Eurozone, Germany, and France C-PMIs 45.152.0/39.9, Eurozone, Germany, and France NM-PMIs 41.3/46.2/38.0, UK C-PI & NM-PMI 4. **Fri:** Germany Factory Orders 1.5%, Canada Employment Change & Unemployment Rate 20k/8.9%. (DailyFX estimates)

STRATEGY INDICATORS

Stock Market Sentiment Indicators (*link*): The Bull/Bear Ratio (BBR) moved higher for the fourth week this week, to 3.87 (highest since January 2018), after falling from 3.00 to 2.60 during the first week of November—as bullish sentiment moved further above 60.0%. Bullish sentiment jumped 11.1ppts (to 64.7% from 53.6%) over the four-week span—the most bulls since January 2018—after sliding 7.0pts (53.6 from 60.6) during the first week of November. Bearish sentiment fell for the fourth week by a total of 3.9ppts (to 20.6% to 16.7%), back near early September's 2.5-year low; it had been fluctuating in a range from 19.4% to 23.2% the prior two months. The correction count increased to 18.6% this week after sliding 7.6ppts the prior three weeks from 25.8% to 18.2%—which was the lowest since December 2006. The AAII Ratio rose to 63.2% last week after falling from 69.2% to 62.7% the previous week, as bullish sentiment rose from 44.4% to 47.3% and bearish sentiment climbed from 26.4% to 27.5%.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The rapid pace of Covid-19 estimate cuts has turned into a V-shaped recovery as analysts continue to play catch-up from their lowball estimates prior to the better-than-expected Q2 and Q3 earnings seasons. Consensus S&P 500 forecasts previously had been falling at rates paralleling the declines during the 2008-09 financial crisis. Forward revenues is at its highest level since mid-March and is now just 2.4% below its record high in mid-February. Forward earnings is at its highest level since late March and is now 7.7% below its record high in early March. Forward revenues growth of 6.9% rose 0.1ppts w/w and is up from 0.2% in April, which was the lowest reading since June 2009. Forward earnings growth of 18.5% was also up 0.1ppts w/w and has risen 24.1ppts from its record low of -5.6% at the end of April. Analysts expect revenues to decline 3.1% y/y in 2020 and rise 7.7% in 2021 compared to the 4.3% reported in 2019. Analysts expect an earnings decline of 15.4% y/y in 2020 and a 21.9% gain in 2021 compared to a 1.5% rise in 2019. The forward profit margin of 11.3% was steady w/w at its highest reading since early April. That's up a full point from 10.3% during April and May, which was the lowest level since August 2013. It's still down 1.1ppt from a record high of 12.4% in September 2018. Analysts expect the profit margin to fall 1.4ppt y/y in 2020 to 10.1%—from 11.5% in 2019—and to improve 1.3ppt y/y to 11.4% in 2021. Valuations dropped for a second straight week from six-week highs in mid-October. The S&P 500's weekly forward P/E rose 0.4pts w/w to a 12-week high of 22.2 and is up from a six-month low of 20.6 at the end of October. That compares to 23.1 in early September, 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 0.04pt w/w to 2.51. That's below its record high of 2.53 at the beginning of September and up from the 49-month low of 1.65 in mid-March.

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 rose for all but Utilities. 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 expected to have an improved profit margin 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, Real Estate's forward profit margin continued to edge up from its lowest level since March 2012. Industrials' margin improved too and is now up 1.2ppts from its 10-year low in May. Here's how the sectors rank based on their current forward profit margin forecasts versus their highs during 2018: Information Technology (22.3%, down from 23.0%), Financials (15.2, down from 19.2), Utilities (14.3, record high), Communication Services (14.0, down from 15.4), Real Estate (13.1, down from 17.0), S&P 500 (11.3, down from 12.4), Health Care (10.7, down from 11.2), Materials (10.5, down from 11.6), Industrials (8.5, down from its record high of 10.5% in mid-December), Consumer Staples (7.5, down from 7.7), Consumer Discretionary (6.5, down from 8.3), and Energy (2.5, 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 6.1%, forward earnings has gained 17.2%, and the forward profit margin has risen 1.0pt to 11.3%. Among the 11 sectors, all but Real Estate posted new post-Covid-19 highs last week in either their forward revenues, earnings, or profit margin. The major laggards since then: Energy's revenues and earnings, and Real Estate's earnings and profit margin. Energy's forward revenues continues to fall from its post-Covid-19 high in July and is near a 15-year low. Real Estate's forward earnings remains near a six-year low, but its profit margin has improved slightly from an eight-year low in early November. Here's how the 11 sectors rank by their changes in forward revenues and forward earnings since May 28: Consumer Discretionary (forward revenues up 10.1%, forward earnings up 52.9%), Information Technology (8.1, 11.1), Materials (7.1, 27.5), Industrials (7.0, 23.5), Communication Services (8.2, 13.4), Financials (7.0, 20.7), S&P 500 (6.1, 17.2), Health Care (5.1, 12.6), Consumer Staples (2.9, 7.5), Real Estate (0.3, -7.9), Energy (-0.6, 342.3), and Utilities (-1.9, 1.4).

US ECONOMIC INDICATORS

ADP Employment (*link*): "While November saw employment gains, the pace continues to slow," said Ahu Yildirmaz, vice president and co-head of the ADP Research Institute. November employment climbed a smaller-than-expected 307,000 (vs 440,000 expected) though there were upward revisions to October (to 404,000 from 365,000) and September (754,000 from 753,000) payrolls, for a net gain of 40,000. While employment is up 10.0 million from its April low through November, it's still a sizeable 9.7 million below February's record high. Service-providing industries are up 8.4 million since April, but are 8.9 million below February levels, while goods-producing are up 1.6 million and down 824,000 over the comparable periods. Here's a tally of industry performances from strongest to weakest during the seven months through November, and where they stand relative to February's levels: leisure & hospitality (+3.7 million & -3.9 million), trade transportation & utilities (+1.6 million & -1.5 million), health care & social assistance (+1.2 million & -846,000), construction (+824,000 & -174,000), other services (+777,000 & -503,000), manufacturing (+757,000 & -574,000), administrative & support services (+651,000 & -915,000), professional & technical services (+193,000 & -346,000), education (+151,000 & -309,000), financial activities (+ 116,000 & -145,000), management of companies & enterprises (-17,000 & -100,000), natural resources & mining (-22,000 & -76,000), information services (-29,000 & -290,000). Here's the same exercise by company size: Large (+4.0 million & -5.3 million), small (+3.6 million & -1.8 million), and medium (+2.4 million & -2.6 million) businesses.

Auto Sales (*link*): Motor vehicle sales in November slipped for the second month since rebounding to a seven-month high in September. Sales fell to 15.9mu (saar) last month after climbing steadily from a pandemic-depressed record low of 8.7mu in April to 16.5mu by September. Domestic light truck sales remained high in November, at 9.2mu (saar), though was down from September's 9.9mu—which was only a tick below its peak rate of 10.0mu at the start of the year; the level sank to a cyclical low of 5.3mu in April. Meanwhile, domestic car sales remains in a rut, holding at 2.8mu (saar) in November—only 1.3mu above April's record low of 1.5mu. Sales of imports has recovered virtually all of its Covid-related declines, climbing to 3.8mu (saar) last month—not far from February's 3.9mu; the level fell to just 2.0mu in April.

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