MORNING BRIEFING
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Retail, Earnings & Fintech

Check out the accompanying chart collection.

Executive Summary: Three major retailers recently reported Q1 results that provide a glimpse into consumers' shifting spending trends. Notably, consumers seem to be putting off discretionary purchases. … Also: Perusing YRI's forward earnings growth charts for S&P 500 industries is an eye-opening exercise: For four unrelated industries, analysts have set extremely high sights. Jackie explores. … And our Disruptive Technologies focus: Walmart's self-reinvention as a financial services provider to the masses.

Consumer Discretionary: A Win, a Loss & a Tie. Three major retailers reported Q1 earnings this week, each with different outcomes. Home Depot's sales declined 4.2% y/y, Target's sales rose a flattish 0.6%, while TJX's top line increased 3.3%. Considering that consumer price inflation rose 0.8% from February through April, none of these results were heroic.

Let's take a look at the consumer's health and what some of the retailers had to say about it this quarter:

(1) *Extra SNAP benefits expire, but gas prices fall.* In addition to inflation, some consumers faced the reduction of government benefits doled out during the pandemic. In March, the extra SNAP (food stamp) benefits first granted in March 2020 ended. They had amounted to an extra $90 a month per beneficiary, the Center on Budget and Policy Priorities estimates.

The sting was somewhat offset by the 12.5% cost-of-living increase in SNAP benefits in October. For a single person, the maximum benefit rose to $281 per month from $250. Personal income excluding government social benefits and adjusted for inflation is up 2.0% y/y in March and up 0.3% q/q (Fig. 1).

Conversely, consumers have benefitted over the past year from the drop in the price of gasoline. Its current average price nationwide is $3.65 per gallon, down from $5.11 at its peak in mid-June 2022 (Fig. 2). The lower price has notably reduced what households have had to spend on the fuel over the past year (Fig. 3).

(2) *Target talk.* Target's management emphasized the pressure on discretionary purchases from inflation and rising interest rates. Apparel, home, and hard lines all experienced y/y declines in sales growth from the mid-single digits to low double digits as guests continued to pull back on discretionary purchases, said Chief Growth Officer Christina Hennington on the company's earnings *conference call* Wednesday. She noted that shoppers are waiting until the last minute to buy discretionary items like new decor or clothes, often in response to upcoming holidays or events.

Conversely, sales of consumer staples fared better. Target's beauty category enjoyed y/y comparable-store sales growth in the mid-teens, with the category benefiting from Ulta Beauty stores within Target stores. Food and beverage sales grew at rates in the high single digits, while household essentials delivered low-single-digit growth, with notable strength in the health and pet care categories.

Of some concern is Hennington's observation that total sales were strongest in February, began decelerating in March, and softened further near the end of April. Target could pick up market share this summer as college students shop to fill their dorm rooms because that had been a strong niche for the now-bankrupt Bed Bath & Beyond.

Target seems to have resolved its inventory problem from earlier this year. Inventory ended Q1 16% below year-ago levels. The drop was even more dramatic in consumer discretionary inventories, which fell more than 25% y/y.

Lastly, management noted that theft at stores could shrink the company's bottom line by $500 million this year compared to 2022. It's a growing problem for every player in the industry.

(3) *More warnings about discretionary spending.* Home Depot executives also warned that consumers continue to pull back on discretionary purchases. "After a couple of years of unprecedented demand in the home improvement market, we continue to see softness in big-ticket discretionary categories like patios, grills, and appliances," said Billy Bastek, Home Depot's executive vice president of merchandising, on Tuesday's earnings *conference call*.

Bastek also noted softness in Home Depot's flooring, kitchen, and bath divisions and attributed it to consumers moving away from larger projects. As we noted in last Thursday's *Morning Briefing*, Home Depot might also be facing increasing competition from Floor & Décor, a growing big-box retailer with a vast offering of flooring, decorative tiles, and other home improvement products. The competitor wasn't mentioned on Home Depot's call.

Officials did note that they saw strength in purchases of items that were part of smaller-ticket outdoor projects. The company has also been affected by lower commodity prices, including lower lumber prices. Framing lumber averaged about $420 per 1,000 board feet during the quarter compared to $1,170 in Q1-2022, a 64% decrease.

Home Depot's comp-store sales growth followed a different pattern than Target's, falling 2.8% y/y in February, declining 7.5% y/y in March, and improving to a 3.7% y/y drop in April. The company now expects 2023 sales to decline 2%-5% and earnings per share to drop 7%-13%.

CEO Ted Decker said that while consumers are still relatively strong, as evidenced by continued increases in personal consumption, Home Depot's average customer is even stronger, tending to have "good jobs, increasing wages, and [they] own their homes." But the company grew at a faster-than-average clip during the pandemic, and now its growth trend is normalizing.

(4) *TJX pounces on deals.* The strongest results were turned in by TJX, a retailer that has built its reputation on buying up inventories when other retailers are looking to sell. Over the past quarter or two, retailers have been reducing bloated inventories, creating an opportune environment for the off-price retailer. Same-store sales at the company's retailing operation, Marmaxx, grew 5% y/y as customer traffic in the stores increased at a rate in the mid-single digits.

"Our [corporate] buyers took advantage of amazing deals in the marketplace, and the organization flowed product to the right stores at the right time and did a great job of merchandising the product, delivering on customer satisfaction and marketing. We are happy with our good start to the second quarter and are in a great position to take advantage of the phenomenal buying environment and ship fresh selections to our stores and online," said CEO Ernie Herrman on the earnings *conference call*. "Going forward, we are excited about the opportunities we see to gain market share in the U.S. and internationally and continue to improve the profitability of TJX."

The retailer wasn't invincible. Its HomeGoods Q1 same-store sales decreased 7% y/y. Like Home Depot, HomeGoods saw unusually large sales increases during the pandemic, and sales are now normalizing. In Q1-2022, its same-store sales rose 40% y/y.

That said, results should improve going forward, and the retailer seems to be targeting the Bed Bath & Beyond market share that's up for grabs: "We continue to see a terrific opportunity to capture additional share of the U.S. home market. In the first quarter, we opened our 900th HomeGoods store and continue to see excellent opportunities to grow both our HomeGoods and Home Sense banners," said CFO John Klinger.

Strategy: Charts Heading to the Moon. They say a picture is worth a thousand words. We like to think so, with hundreds of charts on the Yardeni Research website. One of our favorite *chart collections* depicts the S&P 500 industries' forward earnings estimates indexed to zero as of March 5, 2009, the start of the post-2008 financial crisis bull market. With just a quick glance, it's clear which industries are expected to have brisk earnings growth and which aren't so lucky.

Four charts that show eye-popping forward earnings growth come from four very different industries in four very different S&P 500 sectors: Managed Health Care (Health Care sector); Construction Machinery & Heavy Trucks (Industrials); Hotels, Resorts & Cruise Lines (Consumer Discretionary); and Electric Utilities (Utilities). (FYI: "Forward" earnings is the time-weighted average of analysts' consensus operating earnings-per-share estimates for this year and the following year.)

Let's give these exceptional charts a second look:

(1) *One healthy chart.* Since 2010, the S&P 500 Managed Health Care Industry's forward earnings has been on an upward trajectory (*Fig. 4*). Analysts have forecast double-digit earnings growth for the industry's companies collectively every year since 2015, including this year and next: Earnings are expected to climb 12.6% in 2023 and 11.8% in 2024 (*Fig. 5*).

After rising along with earnings for many years, the industry's stock price index has plateaued for much of the past two years, and it's down 9.9% ytd through Tuesday's close (*Fig. 6*). As a result, the industry's forward P/E has fallen to 16.6 down from a recent high of 21.4 in April 2022 (*Fig. 7*).

(2) *Trucking upwards.* Higher interest rates have failed to curtail construction, particularly when it comes to building factories for companies that are reshoring their manufacturing operations back to US shores. The industrial construction boom has helped bolster demand for construction machinery and heavy transportation equipment. The S&P 500 Construction Machinery & Heavy Transportation Equipment industry's earnings forecasts have been on a

sharp upward trajectory since early 2020, but that ends soon (*Fig. 8*).

At year-end 2020, analysts had expected the industry's earnings to grow by 43.1% in 2021 and by 29.4% in 2022. This year, they expect 28.1% earnings growth. But that's where the positive trend ends: In 2024, analysts are forecasting that earnings will drop by 3.0% (*Fig. 9*).

Investors clearly worry that this industry's cycle is about to turn as well, because its stock price index has fallen 9.1% ytd through Tuesday's close, and its forward P/E has fallen to 11.6, down from its 2021 high of 21.9 (*Fig. 10*).

(3) *Cruising higher.* The Covid pandemic brought travel to a halt, and the earnings growth that hotels and cruise lines enjoyed in 2019 quickly turned into double-digit losses by 2020. Since the start of 2021, the industry's expected losses over the next 12 months have gotten incrementally smaller, and by the end of that year the industry once again was expected to generate forward earnings growth (*Fig. 11*).

Analysts are optimistic about next year, collectively projecting that earnings will grow 31.9% in 2024, and net earnings revisions just turned positive in March for the first time in eight months (*Fig. 12*). Investors have been feeling optimistic as well, sending the industry's shares up 23.9% ytd through Tuesday's close.

(4) *Utilities: Not so boring.* The S&P 500 Electric Utilities forward earnings chart is electrifying. Except for a few short-lived downward blips, the industry's forward earnings has been on an upward trajectory since 2014 (*Fig. 13*). Earnings growth has accelerated from low-to-mid-single-digit to high-single-digit percentages. Analysts' consensus estimates collectively imply earnings growth for the industry of 9.0% this year and 9.2% in 2024 (*Fig. 14*).

Despite the positive earnings projections, the industry's stock price index has fallen 5.9% ytd through Tuesday's close, and it has moved sideways for much of the past two years (*Fig. 15*). As a result, the industry's forward P/E has fallen to 18.1, down from 21.9 last year (*Fig. 16*). Higher interest rates may have hurt the debt-laden industry, which pays dividends that compete with interest-paying bonds. But if the Federal Reserve is close to ending its hiking cycle, utilities stocks once again could electrify investors' portfolios.

Disruptive Technologies: Walmart Grows Banking. The retail banking business isn't easy. Just ask Goldman Sachs, which has been peddling back its attempt to break into the area.

Walmart, however, has continued making inroads into retail banking. It started by offering its customers financial services provided by other companies, like Capital One Financial and Affirm. Then in 2021, Walmart launched a fintech company in which it owns a controlling stake. Last year, that company acquired two other fintech companies that offer banking services directly to customers. Now Walmart's fintech company reportedly plans to offer banking services to the retailer's clients, likely displacing some of Walmart's current corporate partners to do so.

Here's a look at how the retail giant is laying the groundwork to become a financial giant as well:

(1) *Growth through acquisitions.* In January 2021, Walmart launched a fintech startup together with Ribbit Capital, one of the firms backing Robinhood. Two months later, Walmart hired Omer Ismail from Goldman Sachs, where he had headed Marcus, the investment bank's online consumer banking business. Our March 11, 2021 *Morning Briefing* discussed possible implications of his arrival.

Our May 19, 2022 *Morning Briefing* noted that the Walmart majority-owned fintech purchased Even Responsible Finance and ONE Finance. Even allows companies to offer employees their paychecks early, and ONE's offerings include debit cards and savings accounts through its relationship with Coastal Community Bank. Since the acquisition, the companies have adopted the ONE brand.

"The strategy is to build a financial services super app, a single place for consumers to manage their money," Ismail told the *WSJ* in a January 26, 2022 *article*.

(2) *Credit card crisis.* Walmart offers a number of banking products through other companies. It offers credit cards through Capital One Financial, buy-now-pay-later loans through Affirm, and savings accounts and debit cards through Green Dot Bank. But recent moves seem to indicate that Walmart is moving toward replacing those vendors with the ONE fintech.

Walmart is suing Capital One, seeking to exit their credit card partnership. The lawsuit claims that the credit card company didn't provide Walmart customers with the customer service it was obligated to offer, an April 7 *WSJ* *article* reported. Capital One reportedly failed to replace lost cards promptly and didn't promptly post some transactions and payments to clients' accounts.

A Capital One spokesman told the *WSJ*: "These immaterial servicing issues were cured by Capital One pursuant to the terms of the agreement, without harm to customers, the program, or Walmart." They speculated that the suit was an attempt to renegotiate the terms of the contract or end it before its 2026 termination date. More recently, Capital One has claimed that Walmart "failed to meet its marketing obligations because it was unhappy with the economic terms of the partnership. In a new court filing, Capital One also accuses Walmart of trying to abandon a long-term deal … because the retail chain wants to move its credit card business" to ONE, a May 9 *American Banker* *article* reported.

Walmart presumably would benefit more from offering a credit card through its fintech joint venture to customers instead of issuing cards through Capital One.

(3) *More banking services on the way?* ONE reportedly is launching a buy-now-pay-later service that will be offered to Walmart customers online and in the stores, according to a December 8 *article* in *The Information*. ONE is also expected to offer checking accounts to Walmart employees and select customers in a beta test, according to a September 14 Reuters *article*.

The new ONE services could potentially replace similar ones Walmart currently offers (buy-now-pay-later via Affirm and MoneyCard savings accounts, debit cards, direct deposits, and online banking via Green Dot Bank).

Calendars

US: Thurs: Leading Indicators -0.6%; Philadelphia Fed Manufacturing Index & Prices Paid Index -19.8/8.10; Existing Home Sales 4.30m; Initial & Continuous Jobless Claims 254,000/1.818m; Fed's Balance Sheet; Natural Gas Storage; Barr; Jefferson; Logan. **Fri:** Baker-Hughes Rig Count; Powell; Williams; Bowman. (Bloomberg estimates)

Global: Thurs: UK Gfk Consumer Confidence -27; BoE Quarterly Bulletin; BoE MPC Treasury Committee Hearings; BoC Financial System Review; Lagarde; De Guindos; Pill; Macklem. **Fri:** Germany PPI -0.5%m/m/4.0%y/y; Canada Headline & Core Retail Sales -1.4%/-0.8%; ECB Economic Bulletin; Lagarde; Schnabel; Haskel. (Bloomberg estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The *Bull-Bear Ratio* slipped for the second week this week, to 1.83, from 1.94 in each of the prior two weeks; it was at 2.11 four weeks ago—which was the highest reading since the January 4 week last year. *Bullish* sentiment rose to 45.2% this week after falling the prior three weeks from 50.7% (the highest since November 2021) to 44.6% last week. Bulls outnumbered bears for the 26th consecutive week. *Bearish* sentiment edged up for the second week to 24.7% this week, after edging down from 25.0% to 23.6% two weeks ago—which was the fewest bears since early January 2022. The *correction count* moved down to 30.1% this week after moving up the prior three weeks from 25.3% to 31.3%—remaining well below its late September 2022 peak of 40.3%. Turning to the *AAII Sentiment Survey* (as of May 11), pessimism was above average for the 12th consecutive week, while optimism rose and neutral sentiment fell during the week. The *percentage expecting stock prices to rise* over the next six months rose to 29.4% after falling the prior two weeks from 27.2% to 24.1%. While optimism continues to be at a low level, it is no longer unusually low, though it's still below its historical average of 37.5% for the 75th time in the past 77 weeks. The *percentage expecting stocks to fall* over the next six months fell to 41.2% after climbing the prior three weeks by 10.4ppts (to 44.9% from 34.5%). Pessimism remained above its historical average of 31.0% during 72 of the past 77 weeks—and was unusually high for the second straight week. The *percentage expecting stock prices will stay essentially unchanged* over the next six months moved lower for the fourth week, from 39.5% to 29.4%; this keeps neutral sentiment below its historical average of 31.5% for just the third time in 19 weeks.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin remained steady w/w at 12.4% during the May 11 week, up from a 24-month low of 12.3% during the April 27 week. That's down 1.0pt from its record high of 13.4% achieved intermittently in 2022 from March to June. It's now 2.1pts above its seven-year low of 10.3% during April 2020. Forward revenues edged down 0.1% w/w from a record high. Forward earnings fell 0.2% w/w to 4.3% below its record high during the June 16, 2022 week. Both had been steadily making new highs from the beginning of March 2021 to mid-June; prior to that, they peaked just before Covid-19 in February 2020. The consensus expectations for forward revenues growth fell 0.1pt w/w to 3.1%, which is 0.8pt above its 33-month low of 2.3% during the February 23 week. That's down from a record high of 9.6% growth at the end of May 2021 and compares to 0.2% forward revenues growth during April 2020, which was the lowest reading since June 2009. Forward earnings growth dropped 0.1pt w/w to 5.7% and is now 2.2pts above its 31-month low of 3.5% in mid-February. That's down from its 23.9% reading at the end of April 2021, which was its highest since June 2010 and up substantially from its record low of -5.6% at the end of April 2020. Analysts expect revenues to rise 1.9% in 2023 (up 0.1pt w/w) and 4.6% in 2024 (down 0.1pt w/w) compared to a revenues gain of 12.2% in 2022. They expect flat earnings in 2023 (down 0.1pt w/w) and an 11.2% rise in 2024 (unchanged w/w) compared to an earnings gain of 7.2% in 2022. Analysts expect the profit margin to drop 0.2ppt y/y to 12.0% in 2023 (unchanged w/w), compared to 12.2% in 2022, and to rise 0.8ppt y/y to 12.8% in 2024 (up 0.1pt w/w). The S&P 500's weekly reading of its forward P/E rose 0.2pt w/w to 18.2, which is 0.3pt below its 43-week high of 18.5 during the February 16 week. That's up from a 30-month low of 15.3 in mid-October. It also compares to 23.1 in early September 2020, which was the highest level since July 2000 and up from a 77-month low of 14.0 in March 2020. The S&P 500 weekly price-to-sales ratio rose 0.02pt w/w to 2.24, and is now down 0.05pt from a 24-week high of 2.29 during the February 16 week. That's up from a 31-month low of 1.98 in mid-October and down from a four-month high of 2.38 in mid-August; it also compares to a record high of 2.88 at the end of 2021 and a 49-month low of 1.65 in March 2020.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins (*link*): Looking at the 11 S&P 500 sectors, the April 27 week saw consensus forward revenues and forward earnings rise for four sectors. The forward profit margin rose w/w for four sectors and fell for seven. Health Care and Utilities are the only sectors with forward revenues at a record high this week. Among the remaining nine sectors, just two have forward revenues more than 5.0% below their post-pandemic highs: Energy and Financials. None of the sectors have forward earnings at a record high, but Consumer Staples, Industrials, and Utilities remain closest to their recent records. Among the remaining eight sectors, just three have forward earnings down more than 10.0% from their post-pandemic highs: Energy, Financials, and Materials. Since mid-August, all but the Industrials sector have seen forward profit margins retreat from their record highs, but half of them are showing early signs of recovering from their lows in early 2023. Industrials' forward profit margin is at a record high this week, and those of Consumer Discretionary, Financials, Real Estate, and Tech remain close to their post-pandemic highs. Energy and Industrials were the only two sectors to have their profit margins improve y/y for full-year 2022, and these five sectors are expected to see them improve y/y in 2023: Communication Services, Consumer Discretionary, Financials, Industrials, and Utilities. Here's how the sectors rank based on their current forward profit margin forecasts along with their record highs: Information Technology (23.6%, down from its 25.4% record high in June 2022), Financials (18.5, down from its 19.8 record high in August 2021), Real Estate (17.0, down from its 19.2 record high in 2016), Communication Services (15.2, down from its 17.0 record high in October 2021), Utilities (12.9, down from its 14.8 record high in April 2021), S&P 500 (12.4, down from its record high of 13.4

achieved intermittently in 2022 from March to June 2022), Energy (11.3, down from its 12.8 record high in November), Materials (11.0, down from its 13.6 record high in June), Industrials (10.5, new record high this week), Health Care (9.5, new record low this week), Consumer Discretionary (7.6, down from its 8.3 record high in 2018), and Consumer Staples (6.7, down from its 7.7 record high in June 2020).

US Economic Indicators

Housing Starts & Building Permits (*link*): Home construction is showing signs of stabilizing. *Housing starts* in April increased for the second time in three months, climbing 2.2% m/m and 4.6% over the period to 1.401mu (saar), with *single-family* units rising 1.6% and 2.8% over the comparable periods to 846,000 units (saar). Single-family starts were in a freefall from last March through November, plunging 33.6% over the period, but they've recovered 5.2% since November's bottom. Meanwhile, *multi-family* starts increased for the third time in four months, by 3.2% m/m and 18.1% ytd, to 555,000 units (saar). *Building permits* fell three of the first four months of 2023, dropping 1.5% in April to 1.416mu (saar), though did eke out a 0.5% gain ytd. *Single-family* permits haven't recorded a decline this year, advancing 3.1% in April and 14.3% ytd, to 855,000 units (saar). Meanwhile, *multi-family* permits remain in a slump, falling 7.7% in April and 15.1% ytd to 561,000 units (saar)—the lowest level since July 2021. Homebuilders' confidence for May, reported on Tuesday, was encouraging once again. All *three components* of homebuilders' confidence have climbed steadily the first five months of this year, with future sales (+22pts to 57) showing the biggest gain, followed by current sales (+20 to 56) and traffic (+13 to 33). They were at record highs of 89, 96, and 77, respectively, during November 2020.

Global Economic Indicators

Eurozone CPI (*link*): The CPI rate for April ticked up to 7.0% y/y after slowing steadily from a record-high 10.6% last October to 6.9% this March. Looking at the main components, *energy* returned to positive territory, accelerating 2.4% y/y after falling 0.9% in March, following double-digit yearly gains from April 2021 through February of this year; it peaked at a record high of 44.3% last March. The rate for *food, alcohol & tobacco* slowed to 13.5% y/y after accelerating steadily from June 2021's 0.5% to a record high of 15.5% this March. The rate for *non-energy* industrial goods eased for the second month to 6.2% y/y from February's record-high 6.8%. The *services* rate accelerated for the third month, to 5.2% y/y in April—which was the highest since May 1993. Of the *top four Eurozone economies*, rates in both Italy (8.7% y/y) and Germany (7.6) are above the Eurozone's rate of 7.0%, while France's (6.9) rate is just a tick below; Spain's (3.8) is roughly half the Eurozone's headline rate. Here are the record-high inflation rates and dates they were achieved for the four countries: Italy (12.6%, October & November 2022), Germany (11.6%, October 2022), France (7.3%, February 2023), and Spain (10.7%, July 2022).

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