MORNING BRIEFING
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Consumer Spending, China & Robots

Check out the accompanying chart collection.

Executive Summary: Is the consumer spending pendulum swinging back to bingeing on goods from splurging on services? Jackie sees a few nascent signs pointing to that possibility. … Also: The Chinese government has been trying to pull China's economy up by its bootstraps with new infrastructure projects, but critics say the initiatives are too small to make much difference. Property developers remain distressed, and economic activity is likely to remain anemic. … And: In our Disruptive Technologies spotlight are humanoid robots. We look at how they're being deployed today and what they may be used for in the future.

Consumer Discretionary: Pivoting Back to Goods? Remember the spending boom on things that helped us adjust to being trapped at home during the pandemic? Sales of items like home office equipment, outdoor heaters, and bikes surged, then fell sharply as consumers switched to bingeing on services and experiences. Hanging out on the deck wearing a winter coat under a heater was out, and "revenge travel" was in.

But now many people have scratched their travel itch, and buying goods may make a resurgence just in time for the holiday shopping season. The ratio of what consumers spend on goods versus what they spend on services spiked from 0.48 in December 2019, just before the pandemic, to a high of 0.59 in March 2021, one year into it. The ratio fell to 0.53 by November 2022, as consumers increased their spending on services (*Fig. 1*). The ratio has basically moved sideways since then, suggesting that spending on goods has stopped losing wallet share and may again find favor. (Note: the numerator and denominator of the ratio are adjusted for inflation.)

Let's take a look at an optimistic holiday spending survey by Deloitte, slowing sales declines at Logitech International and Taiwan Semiconductor, along with some stats on retail sales and transportation:

(1) *Could it be a jolly holiday?* Many retail analysts are calling for muted spending that sends holiday sales up 3%-4% y/y, which isn't much after taking inflation into consideration. However, the *2023 Deloitte Holiday Survey* caught our eye, as its 4,318 respondents plan to increase spending by 14% y/y on average to $1,652—shelling out 9% more than last year

on gifts, 10% more on experiences & entertainment, and a whopping 25% more on "non-gift purchases," including clothing, home furnishings, and holiday decorations.

Admittedly, the survey was taken from August 30 to September 8, when the 10-year Treasury yield was closer to 4.25% than 5.00% and before war in the Middle East broke out. But if the respondents' expectations translate into actual spending, 2023 will mark the first year that holiday spending surpasses 2019's spending of $2,496.

(2) *Spending more on mice.* The work-from-home trend was one of the biggest to come out of the Covid pandemic. Buying of computer peripherals and gaming equipment from Logitech and others surged before it crashed. But Logitech's fiscal Q2 (ended September 30) earnings report has us thinking that the bust may be close to running its course.

While Logitech's sales last quarter fell y/y, they rose q/q for the second quarter in a row and beat Wall Street's consensus estimate. Here are Logitech's fiscal Q2 sales over the past four years: fiscal Q2-2024 ($1.06 billion), fiscal Q2-2023 ($1.15 billion) fiscal Q2-2022 ($1.31 billion), and fiscal Q2-2021 ($1.26 billion). Since troughing at $960 million in fiscal Q4-2023 (ended March 31), sales now have been up for two quarters in a row. CFO Chuck Boynton said on the company's *conference call* that the y/y rate of decline has improved and is expected to continue doing so in the back half of the year.

The Logitech sales rollercoaster was accompanied by an inventory bubble. Inventory levels have fallen every quarter since peaking in fiscal Q4-2022 at $933 million. The level sank to $533 million in fiscal Q2-2024 but remained north of fiscal Q2-2021's $395 million.

Logitech shares jumped 12.9% on Tuesday after the company increased its full fiscal year (ending March 31) sales forecast to a range of $4.0 billion to $4.2 billion from the previous $3.8 billion to $4.0 billion. Likewise, management's adjusted operating income projection for fiscal 2024 was raised to $525 million to $575 million, up from $400 million to $500 million, provided during the fiscal Q1 (ended June 30) earnings report.

(3) *More optimism from TSMC.* Taiwan Semiconductor Manufacturing Co. (TSMC) recently reported that Q3 sales declined 10.8% y/y, dragged down by the industry's buildup of chip inventories as sales of cell phones and computers slowed after the pandemic ended. But the company's revenue forecast for Q4, while still down roughly 4% y/y, is above analysts' estimates.

"The chipmaker says it has begun to see signs of stabilization in demand for smartphones and personal computers—although C.C. Wei, TSMC's CEO, says it's too early to call it a sharp rebound," an October 19 *WSJ* article reported. The use of artificial intelligence (AI) is also expected to boost demand for chips.

The company's shares have risen 23.0% ytd through Tuesday's close compared with the S&P 500's 10.6% ytd advance.

(4) *Running its course.* Sometimes, time does heal all wounds. In this case, the more time that goes by, the more likely it is that consumers will return to buying goods. Real retail sales & food services, which surged 14.5% from December 2019 through April 2021, flatlined over the ensuing three years (*Fig. 2*).

The flattening of growth in real retail sales has had a huge impact on companies shipping goods. The number of shipping containers entering the West Coast ports fell 24.4% from its peak in August 2021 through last month (*Fig. 3*). Notably, for the first time since the imports' downturn began, the number of containers increased ever so slightly, by 115,000 TEUs (twenty-foot equivalent unit) compared to the August level.

The shipping downturn is also apparent in producer prices for truck transportation of freight, which rose 24.9% y/y in May 2022 and has fallen for most of 2023. Most recently, prices fell by 10.4% in September, but that was a very slight improvement over the level in July, when prices fell 12.8% (*Fig. 4*).

China: More Baby Steps. Faced with below-target economic growth, China took its latest small step to improve the country's lot by announcing funding for new infrastructure projects. The move isn't expected to extricate the country from the weight of excessive debt owed by local municipalities or property developers. Nor will it divert attention from the country's harassment of its private sector. Arresting executives does little to encourage investment. Unless China restructures its debt or starts dropping money out of helicopters, the country's economy may continue to limp along.

Here's a look at some of the initiatives that have made headlines recently:

(1) *New projects lined up.* Earlier this week, China announced a plan to raise 1 trillion yuan ($137 billion) in sovereign debt to fund infrastructure projects in the wake of severe flooding and other natural disasters, an October 24 *WSJ* article reported. The country also raised its budget deficit target, the first time it has done so outside of a regular legislative session in more than a decade.

There is already criticism that the government's actions still fall short. "The 1 trillion yuan of sovereign bonds make up less than 1% of China's gross domestic product. By comparison, the stimulus China launched in the 2008 global financial crisis accounted for more than 12% of its GDP at the time," the *WSJ* article stated. Some are calling for the country to give funds directly to citizens to boost consumer spending.

(2) *Knocking on the central bank's door.* On Tuesday, China's President Xi Jinping visited the People's Bank of China for the first time since he became president a decade ago, an October 24 Bloomberg *article* reported. He was accompanied by Vice Premier He Lifeng and other government officials, who also visited the Administration of Foreign Exchange. Vice Premier He also stopped by the nation's sovereign wealth fund, China Investment Corp. (CIC).

What was discussed at the meetings is unknown. The visits came one day after Central Huijin Investment Limited, a unit of the sovereign wealth fund CIC, bought an "undisclosed amount of exchange-traded funds and vowed to keep increasing its holdings in the latest attempt to boost the country's slumping stock market. Earlier this month, Huijin bought shares in China's largest state banks," Bloomberg reported.

(3) *Real estate woes continue.* The clock is ticking as Evergrande revises its proposed restructuring plan. It will have to move quickly because the company has an October 30 court hearing in Hong Kong regarding a petition to wind up the firm, which could include liquidating its assets, an October 20 Bloomberg *article* reported. Evergrande has about $327 billion of liabilities, and its founder Hui Ka Yan is "under police control," as he's suspected of committing crimes.

Meanwhile, Country Garden Holdings appears headed toward its own restructuring after officially defaulting on a $15.4 million dollar-denominated bond. The price of its dollar-denominated bonds has fallen about 75% this year to only 5 cents on the dollar, an October 25 Bloomberg *article* reported.

Country Garden is even larger than Evergrande. "The company was the country's largest builder by contracted sales for several years before plunging to seventh so far in 2023," the Bloomberg article reported. The company's sales in September fell 81% y/y, as buyers feared the company wouldn't be able to complete the construction of its buildings.

(4) *China behaving badly.* "60 Minutes" had an eye opening *segment* last weekend about China featuring the US FBI Director Christopher Wray and the intelligence directors of

Canada, United Kingdom, Australia, and New Zealand. Together known as “The Five Eyes,” these officials were speaking together for the first time ever to alert executives and officials that “the technology secrets that are about to change the world, in artificial intelligence, biology and computing are falling into the wrong hands—stolen—in a global espionage campaign by China.”

Wray said: “We have seen efforts by the Chinese government, directly or indirectly, trying to steal intellectual property, trade secrets, personal data—all across the country. We’re talking everything from Fortune 100 companies, all to smaller startups. We’re talking about agriculture, biotech, health care, robotics, aviation, academic research. We probably have somewhere in the order of 2,000 active investigations that are just related to the Chinese government’s effort to steal information.”

Australia’s Director-General of Security Mike Burgess said the spying goes well beyond the norm. “This scale of theft is unprecedented in human history. And that’s why we’re calling it out.”

China has been acting with impunity in many areas. In the private sector, it was reported last weekend that Chinese tax authorities were probing Foxconn’s operations in China just as the company’s founder Terry Gou was running for president of Taiwan. Militarily, China has been patrolling the South China Sea as if it owns the neighborhood. A Chinese ship collided with two Filipino boats off contested shoal on Sunday. And of course, recent meetings and trade between Xi and Russian President Vladimir Putin leave no mystery as to whose side Xi is on.

Disruptive Technologies: Humanoid Robots Join the Workforce. Amazon *announced* last week plans to test Digit, a humanoid robot by Agility Robotics. The internet retailer is famous for the massive amount of technology it uses to pick and move products in its warehouses. But the testing of Digit grabbed headlines because the robot moves on two “legs” and looks a lot like a human wrapped in tinfoil.

Perhaps the most famous designer of these human wannabes is Elon Musk, who is building Optimus. The robot uses neural networks and AI to learn by watching millions of examples of what humans have done and applies what it learns to situations it encounters, we noted in the September 28 *Morning Briefing*.

But Digit and Optimus aren’t alone. Scientists at startups are also working on EVE, Figure, and Phoenix. Here’s a look:

(1) *Introducing Digit.* Agility's Digit can pick up and transport the bins used to bring products from shelves to human packers in warehouses like Amazon's. It can also return empty bins to areas where they can be refilled. Up next, Digit will learn to unload trailers, and somewhere down the road, it will learn to make home deliveries, a company *website* explains. Digit runs for 16 hours, longer than most of its humanoid competitors.

A new factory the company is building in Oregon will be able to produce more than 10,000 humanoid robots a year. Digit will be working in the factory, which the company calls "The RoboFab," a company *press release* stated last month. Spun out of Oregon State University's Dynamic Robotics Laboratory in 2015, Agility was one of five companies that received a grant from Amazon's $1 billion Industrial Innovation fund last April.

(2) *Meet EVE.* Norway-based 1X Technologies has created EVE, a humanoid robot that rolls around on wheels, wears a white and black cloth "uniform," and has a face with two large cartoonish eyes that makes it seem friendlier than its fellow humanoids. EVE has an AI "brain" that allows it to observe tasks and then repeat them. It's been designed for use in factories and warehouses and to patrol buildings for safety or to assist humans, according to the company's *website*.

A human can receive feeds of what EVE "sees" and take over control of the robot from a distance. 1X is working with the security firm Everon, which was facing problems with turnover and high costs for human guards. Everon now uses EVE for itself as well as its clients and has invested in 1X. Coming next: NEO, an android that has human-like "legs" and "hands."

(3) *Hello, Figure.* Figure, made by a company of the same name, looks like a robot: metallic, legs, hands, and a screen with no friendly googly eyes on its face. Its management's goal is to build general-purpose humanoid robots that will help alleviate labor shortages, take over unsafe jobs, and boost productivity. Figure CEO Brett Adcock lays out the future in the company's *Master Plan*:

"As automation continues to integrate with human life at scale, we can predict that the labor-based economy as we know it will transform. Robots that can think, learn, reason, and interact with their environments will eventually be capable of performing tasks better than humans. … [T]he cost of labor will decrease until it becomes equivalent to the price of renting a robot, facilitating a long-term, holistic reduction in costs. Over time, humans could leave the loop altogether as robots become capable of building other robots—driving prices down even more. This will change our productivity in exciting ways. Manual labor could become optional and higher production could bring an abundance of affordable goods and services, creating the potential for more wealth for everyone."

The company plans to address areas with labor shortages first—e.g., manufacturing, shipping and logistics, warehousing, and retail—and promises not to use humanoids in military operations.

(4) *Phoenix gets a star.* Phoenix, a humanoid robot created by Sanctuary AI, was voted one of the best inventions of 2023 by *Time* magazine. The Canadian company also uses AI to make its robots smarter and able to tackle a wide range of tasks. A YouTube *video* shows Phoenix doing 60 different tasks, including cutting a cucumber, putting a lid on a paper cup, scanning bar codes, picking fruit, and decorating a Christmas tree.

Prior to co-founding Sanctuary, CEO Gordie Rose founded D-Wave, a quantum computing company, and was CEO of Kindred, a robotics company, founded by Sanctuary co-founder and CTO Suzanne Gildert. Kindred was acquired by Ocado in 2020.

Calendars

US: **Thurs:** GDP & Price Index 4.2%/2.5%; Durable Goods Orders Headline & Nondefense Good Orders Ex Aircraft 1.5%/0.3% Goods Kansas City Fed Manufacturing Index; Trade Balance -$85.5b; Wholesale Inventories 0.1%; Initial & Continuous Jobless Claims 209k/1.72m; Pending Home Sales -1.3%; Natural Gas Storage; Waller. **Fri:** Headline & Core PCED 0.3%m/m/3.4%y/y & 0.3%m/m/3.7%y/y; Personal Income & Spending 0.4%/0.5%; University of Michigan Consumer Sentiment Headline, Current Conditions, and Expectations 63.0/66.7/60.7; University of Michigan One- and Five-year Expected Inflation Rates 3.8%/3.0%; Baker-Hughes Total Rig Count; Barr. (FXStreet estimates)

Global: **Thurs:** ECB Interest Rate Decision & Deposit Facility Rate 4.50%/4.00%; Spain Unemployment Rate 11.5%; UK CBI Distributive Trade Survey -16; EU Leaders Summit; Lagarde; Cunliffe. **Fri:** Eurozone PPI; France Consumer Confidence 83; Spain GDP 0.3%q/q; Italy Business & Consumer Confidence 96.0/104.7; EU Leaders Summit. (FXStreet estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The *Bull-Bear Ratio* moved down this week to 2.06 after rising the prior two weeks from 1.77 to 2.32. *Bullish* sentiment slipped to 50.0 after a two-week climb to 9.1ppts (to 51.4% from 42.3%). It was at 57.1% during the August 1 week—which was the most bulls since November 2021, when the reading reached a danger level of 57.2%. Meanwhile, *bearish* sentiment rose to 24.3% after falling the prior two weeks by 1.7ppts (to 22.2% from 23.9%)—with the 23.9% reading the highest percentage since the end of May. The *correction count* dropped for the third week by 8.1ppts (25.7% from 33.8%); it was 24.3% 12 weeks ago, which was the lowest since mid-January. Turning to the *AAII Sentiment Survey* (as of October 19), optimism decreased in the latest survey, while pessimism fell again, though remains above average. The *percentage expecting stock prices to rise over the next six months* fell 5.9ppts to 34.1% after rising the prior two weeks by 12.2ppts (to 40.0% from 27.8%)—with the 27.8% reading the lowest since May 25. Optimism is below its historical average of 37.5% for the fifth time in six weeks. The *percentage expecting stocks to fall over the next six months* fell for the second week by 7.0ppts (to 34.6 from 41.6). Despite the recent decline, pessimism was above its historical average of 31.0% for the fifth time in seven weeks. The *percentage expecting stock prices will stay essentially unchanged over the next six months* increased 7.8pts to 31.3% after pulling back the prior four weeks by 12.9ppts (to 23.5% from 36.4%). It was below its historical average of 31.5% for the fourth time in seven weeks.

S&P 500 Q3 Earnings Season Monitor (*link*): With the Q3-2023 earnings season now nearly 30% complete, the early indications from the companies that have reported so far suggest a similar earnings surprise compared to Q2-2023 but a weaker revenues surprise. During Q4-2022, the earnings surprise was the lowest since Q4-2008, and the revenue surprise the smallest since Q1-2020. Furthermore, the earnings surprise failed to outpace the revenue surprise in Q4-2022 for the first time since we began tracking that data in Q1-2009. With 146 of the S&P 500 companies finished reporting for Q3-2023, revenues are ahead of the consensus forecast by 0.9% and earnings have exceeded estimates by 7.5%. At the same point during the Q2 season, revenues were 1.5% above forecast and earnings had beaten estimates by 7.1%. Just 59% of the 146 Q3 reporters that have reported so far through mid-day Wednesday has reported a positive revenues surprise, while 80% has reported an earnings beat. That’s on pace for the weakest revenues surprise reading since Q1-2020; but the percentage with positive earnings surprises would be the highest since Q3-2021 if it holds to the end of the season. The early reporters’ aggregate y/y growth rates has ticked down for revenues from their Q2-2023 readings, but improved for earnings: to

4.6% from 6.2% for revenues growth and to 9.5% from 3.6% for earnings growth. Over the past 58 quarters through Q2-2023, y/y earnings growth has trailed y/y revenues growth in only 16 quarters and for six straight quarters, but earnings growth is ultimately likely to outpace revenue growth in Q3-2023 as the Energy sector becomes less of a drag on overall results. Slightly fewer companies have been reporting positive y/y earnings growth in Q3 (59%) than positive y/y revenues growth (64%). With half of the MegaCap-8's results complete, they have been a net positive contributor to the S&P 500's revenue and earnings surprise and the y/y growth rates, and those four measures remains positive without the MegaCap-8 reporters. Looking at the S&P 500 excluding the MegaCap-8 reporters to date, the revenue surprise edges down to 0.8% from 0.9% , the earnings surprise falls to 7.2% from 7.5%, revenue growth drops to 3.9% from 4.6%, and earnings growth falls to 5.4% from 9.5%. These figures will continue to change as more Q3-2023 results are reported in the coming weeks. While we expect y/y revenues growth rates to remain positive yet again in Q3, earnings growth will be positive on a y/y basis for the first time in four quarters.

S&P 500 Sectors & Industries Forward Profit Margin Since March 30 Bottom (*link*): The S&P 500's forward profit margin fell 0.1ppt to 12.6% during the October 19 week, and is 0.2ppt shy of its 11-month high of 12.8% during the September 21 week. It's now up 0.3ppt from a two-year low of 12.3% during the March 30 week. Six of the 11 sectors' margins have improved since then, with the S&P 500's gain paced by four sectors. It's still down 5.9%, or 0.8ppt, from its record-high 13.4% during the June 9, 2022 week, as seven of the 11 sectors' margins are down since then, with the S&P 500's drop paced by three of the 11 sectors. Here's the sector performance since the S&P 500's forward profit margin bottom on March 30: Communication Services (up 12.5% to 16.3%), Consumer Discretionary (up 11.7% to 8.2%), Information Technology (up 7.8% to 25.2%), Industrials (up 4.3% to 10.7%), S&P 500 (up 2.8% to 12.6%), Real Estate (up 2.3% to 17.0%), Consumer Staples (up 1.4% to 6.8%), Materials (unchanged at 11.0%), Utilities (down 1.2% to 13.0%), Financials (down 1.3% to 18.2%), Energy (down 3.1% to 11.4%), and Health Care (down 4.7% to 9.1%). These are the best performing industries since the March 30, 2023 bottom: Casinos & Gaming (up 87.8% to 7.2%), Apparel & Accessories (up 25.6% to 11.0%), Publishing (up 20.6% to 2.9%), Wireless Telecommunication Services (up 19.5% to 13.7%), Personal Care Products (up 18.4% to 10.0%), Interactive Media & Services (up 17.2% to 23.4%), Brewers (up 16.9% to 9.3%), Semiconductors (up 16.7% to 31.1%), Homebuilding (up 16.6% to 12.5%), and Hotels, Resorts, & Cruise Lines (up 15.5% to 13.4%).

US Economic Indicators

New Home Sales (*link*): New home sales (counted at the signing of a contract) soared in September to its fastest pace since February 2022 due to a chronic shortage of existing homes on the market. “Buyers still in the market will seek out new construction, given the strikingly low levels of existing single-family homes on the market,” noted Robert Dietz, chief economist at NAHB. New home sales soared 12.3% to 759,000 units (saar) last month, though mortgage rates nearing 8% could curb demand. Sales rose in all regions in September: Northeast (22.5%), South (14.6), West (7.5), and Midwest (4.7). Of the 759,000 homes sold in September, 293,000 had been completed, 351,000 were under construction, and 115,000 hadn’t been started. Of the 435,000 homes for sale during September, 75,000 had been completed, 255,000 were under construction, and 105,000 hadn’t yet broken ground. The months’ supply at the current sales rate dropped to 6.9 months—the lowest since February 2022. In September, 32% of builders reduced home prices, up from 25% in August, with the average price discount 6%. The median sale price for a new home fell 3.3% in September to $418,800, down from its record high of $496,800 last October.

Global Economic Indicators

Germany Ifo Business Climate Index (*link*): “Germany’s economy can see a silver lining ahead,” according to Clemens Fuest, Ifo president. German business confidence this month posted its first gain in six months, rising to 86.9 from September’s 85.8 reading, which was the lowest since October 2022. It was at 93.2 this April, which was the highest since February 2022. *Current conditions* rose 0.5 points to 89.2 after a six-month slide of 6.8 points (to 88.7 from 95.5) to its lowest level since August 2020. Meanwhile, companies were less pessimistic about coming months, with the *expectations* component rising for the second month by 2.0 points to 84.7, after falling the prior four months by 8.6 points to 82.7. Looking at the different sectors, the *service sector’s* business climate index rose 3.4 points (to -1.5 from -4.9), with the current situation component climbing 4.2 points to 13.5. The expectations component posted a two-month gain of 3.7 points to -15.5, though remains mired in negative territory. Sentiment in *manufacturing* saw a slight uptick for the second month (to -15.9 from -16.5 in August), due to less skepticism in companies’ expectations, which rose 3.1 points (to -26.5 from -29.6) the past two months—though remained deep in contractionary territory. Companies assessed their current situation as worse, falling deeper into contractionary territory to -4.7, the lowest reading since October 2020. Sentiment in the *trade sector* (-27.2 from -25.0) continued to deteriorate, as both the current situation (-16.2

from -13.2) and expectations (-37.6 from -36.1) measures moved lower, driven primarily by the wholesale segment. The *construction* sector saw its business climate index (-31.1 from -31.2) holding around its lowest level since January 2009. Companies assessed their current situation (to -17.2 from -17.0) as marginally worse, while expectations (-43.9 from -44.2) improved slightly though remained pessimistic

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