Yardeni Research

MORNING BRIEFING
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Global Growth Fears Hit Industrials & Materials

Check out the accompanying chart collection.

Executive Summary: Low hopes for the global economy have been weighing on the share price indexes of the S&P 500 Industrials and Materials sectors, especially this week. Today, Jackie examines some counterintuitive stock price action among select industries and companies within the two sectors. For example, automating factories should be a promising business these days, but investors have punished two players in this space, Emerson and Rockwell, for disappointing recent quarters. Conversely, the S&P 500 Steel industry's share price index has been performing well despite analysts' low earnings expectations, lifted by a legal win for continued US tariffs on steel imports and the end of the UAW strike.

Industrials: Halloween Arrives Late. China's declining exports and the drop in the price of oil futures spooked many commodity markets on Tuesday. The news amplified fears that the global economy is slowing under the weight of an overleveraged Chinese economy, higher interest rates, and a stronger US dollar. Truth be told, these fears have been festering and nicking away at commodities prices since many of them peaked earlier this year; they've been sliding ever since.

The price of Brent crude futures is $81.61 a barrel, down 11.7% from its recent high on October 19 and down 6.6% over just the past week (*Fig. 1*). The CRB Industrials metals spot price index has declined 12.0% from its 2023 high (*Fig. 2*). Within that index, copper futures have been weak for most of this year, declining 14.0% from its January 26, 2023 high (*Fig. 3*).

Meanwhile, most S&P 500 sectors were amazingly resilient to the global growth scare on Tuesday. Here's the performance derby for the S&P 500 for Tuesday's markets: Consumer Discretionary (1.2%), Information Technology (1.1), Communication Services (0.6), S&P 500 (0.3), Consumer Staples (0.2), Health Care (0.0), Financials (-0.1), Industrials (-0.3), Utilities (-0.7), Real Estate (-0.9), Materials (-1.9), and Energy (-2.2) (*Table 1*).

The S&P 500 Industrials and Materials sectors' poor performances on Tuesday furthered the downward trajectory they've been on since peaking on August 1 and July 31. Industrials have fallen 11.3%, and Materials have dropped 9.3% since the sectors peaked (*Fig. 4*).

Here's a closer look at what's been ailing the Industrials sector's stocks:

(1) *Some winners, some losers.* This should be a great time for companies in the Industrials sector, with new factories sprouting up around the US and internationally as companies look to diversify their operations outside of China and meet the huge demand for defense equipment. But instead, the sector's price index performance is being weighed down by operational issues at Boeing and weakness in the transportation-related industries.

Here are some of the Industrials industries with positive ytd performances through Tuesday's close: Electrical Components & Equipment (9.8%), Industrial Machinery (8.4), Industrial Conglomerates (6.7), and Construction Machinery & Heavy Trucks (3.3).

Conversely, these industries have been weighing down the Industrials sector's ytd performance: Air Freight & Logistics (-3.4%), Rail Transportation (-4.2), Aerospace & Defense (-5.5), and Passenger Airlines (-11.5).

(2) *Emerson disappoints.* Companies catering to the automation of factories should be prospering given all the new factories being built for offshoring, nearshoring, and friend shoring. But the recent quarterly results of Emerson Electric and Rockwell Automation underwhelmed. Emerson shares fell 7.4% on Tuesday to $84.94 due to its fiscal Q4 (ended September 30) earnings report. The shares are down 15.2% from their 2023 high on September 11.

Emerson has been undergoing a transformation, selling slower growing businesses and buying faster growing ones. Adjusted fiscal Q4 earnings per share grew 20.6% to $1.29, but that was below analysts' consensus estimate of $1.31 and failed to offset investors' disappointment about recent quarters' declining orders in the Discrete Automation and Test & Measurement units.

Emerson's fiscal Q4 sales were up in each of its divisions except Discrete Automation, where they fell 7% y/y due to softer-than-expected demand and weakness in Europe and China, *reported* CFO Mike Baughman. Management expects the segment's sales to recover to flat-to-low-single-digit y/y comparisons by H2-2024.

(3) *Rockwell disappoints too.* Rockwell Automation's share price has fallen by one-fourth since its peak on July 18. The company attributed its lower-than-expected earnings forecast for fiscal 2024 (ending September 30) to distributors' inventory destocking and, to a lesser extent, to a slowdown in its business in China. More optimistically, the company confirmed

that US stimulus spending to encourage building factories domestically will keep Rockwell's US business growing for many years.

The company posted strong fiscal Q4 (ended September 30) organic sales growth of 17.7% y/y and adjusted EPS growth of 20% y/y. However, management's guidance for fiscal 2024 adjusted EPS was less than analysts were expecting: $12.00-$13.50 with a midpoint of $12.75, compared to the consensus estimate of $12.94 for next year and adjusted earnings of $12.12 in full-year fiscal 2023. The consensus estimate for next fiscal year has declined from $13.31 three months ago.

Rockwell noted that its distributors' excess inventory led to a decline in orders in fiscal Q4 and that inventory right-sizing may continue through fiscal Q1 (ending December 31).

The company's fiscal 2024 EPS will also be weighed down by $0.25 dilution from last month's acquisition of Clearpath Robotics, which makes autonomous mobile robots. But over the long run, the acquisition should be a homerun because the market for industrial mobile robots in factory floor applications is expected to grow more than 30% for each of the next five years.

Finally, next year's results will be weighed down by weakness in the company's China business, which represents about 6% of its worldwide sales. "While we saw strong sales growth in China in fiscal year '23, we continue to see high order deferrals and cancellations in China," said CEO Blake Moret on the company's earnings *conference call*. As a result of China's weakness, orders from Asia are expected to fall y/y in 2024; order growth is expected to be the highest in the Americas. Projects funded by US government stimulus spending are still in the "early innings," with decisions on what automation equipment to purchase not yet made.

Emerson and Rockwell are members of the S&P 500 Electrical Components & Equipment industry, which was up by 23.9% at its September 1 peak this year but now is up only 9.8% ytd (*Fig. 5*). The industry is coming off strong results in 2021 and 2022, when earnings grew 26.2% and 14.8%, respectively. The industry's earnings growth is expected to be tepid this year, at 6.3%, before strengthening to 12.4% in 2024 (*Fig. 6*). The industry has benefitted from a record forward profit margin of 16.4%, up from around 13% in 2019, and positive net earnings revisions (*Fig. 7*). The industry's forward P/E ratio has fallen to a more reasonable 19.5, down from 26.3 in July 2021 (*Fig. 8*).

Materials: Steel Enjoys a Cushion. Investing in steel has not been for the faint of heart.

The commodity's price rose 64.0% from the start of this year through April 12; it then fell 42% through October 3 and since has risen 30% to $890 per metric ton. On a ytd basis, steel has risen 20%, far outperforming the 4% decline in the copper price (*Fig. 9*).

The share prices of the two companies in the S&P 500 Steel industry, Nucor and Steel Dynamics, are up 14.9% and 12.9% ytd through Tuesday's close. Both stocks have fallen since March, when both were up by more than 35% (*Fig. 10*).

These stocks' appreciation this year is out of step with analysts' expectations that their earnings will fall sharply. The S&P 500 Steel industry's aggregate earnings rose 610.6% in 2021 and 28.1% in 2022. This year, they're expected to fall 36.9%, followed by a 33.8% decline in 2024 (*Fig. 11*).

Nucor CFO Steve Laxton acknowledged that the steel market had softened in the company's Q3 earnings *conference call* on October 24: "We attribute this to uncertainty arising from the United Auto Workers Strike, higher interest rates, credit tightening, elevated geopolitical risk and concern about another potential US government shutdown." As a result, the company expects Q4 results to decline y/y for the second quarter.

The company's utilization rate fell to 77% in Q3, down from 84% in Q2, and Q3 EPS of $4.57 fell from $5.81 in Q2 and $6.50 in Q3-2022. Earnings in Q4 are expected to decline from Q3 levels, primarily due to lower prices. Nucor shares are up 14.9% ytd through Tuesday's close, but they have deflated from gains north of 30% in August.

Let's take a look at what might be keeping steel stocks in positive territory this year:

(1) *Tariffs help.* The industry continues to benefit from tariffs that former President Trump placed on imports of steel, arguing that it was important to the US's national security to have a strong steel industry. At the end of last month, the US Supreme Court declined to hear an American steel importer's case arguing that tariffs on certain steel products should be invalidated, an October 30 Reuters *article* reported. The Biden administration urged the Supreme Court not to take up the appeal.

(2) *Auto production set to rev up after UAW strike.* On October 30, General Motors and the United Auto Workers (UAW) agreed to a tentative deal to end the workers' six-week strike. Their deal followed deals between Ford Motor and Stellantis and the workers. Workers began walking off the job at specific factories on September 15, and by the strike's end, one third of United Auto Workers' 150,000 members were striking, an October 30 Reuters

reported.

With workers back on the job, car manufacturing by the Big Three automakers is no longer imperiled, so US demand for steel should remain strong. US auto sales came in at 15.7mu (saar) in October, down a smidge from their recent high of 16.2mu but well off the lows of 12.7mu in 2022 (*Fig. 12*). US auto inventories remain near historical lows, with the inventory-to-sales ratio of 1.1 months well below the 2.5 norm (*Fig. 13*).

Calendars

US: Thurs: Initial & Continuous Jobless Claims 215,000/1.815m; Natural Gas Storage; Powell. **Fri:** University of Michigan Consumer Sentiment Index 64.0; Federal Budget Balance -$58.5b; Baker-Hughes Rig Count; Logan. (FXStreet estimates)

Global: Thurs: ECB Economic Bulletin; Lagarde; Nagel; Balz; Lane. **Fri:** Italy Industrial Production; UK GDP -0.1%m/m/-0.1%q/q/0.5%y/y; UK Headline & Manufacturing Industrial Production -0.1%m/m/1.1%y/y & 0.3%m/m/3.1%y/y; China m2 10.4%y/y; Lagarde; Nael. (FXStreet estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The *Bull-Bear* Ratio rose to 2.06 this week, after moving down the prior two weeks from 2.32 to 1.67. *Bullish* sentiment rose 6.4 ppts this week to 49.3%, after falling the prior two weeks by 8.5ppts (to 42.9% from 51.4). Bullish sentiment last week was just above the late September count of 42.3%, which was the fewest bulls since late February, when they dipped below 40%. Meanwhile, *bearish* sentiment fell to 23.9% after rising the prior two weeks by 3.5 ppts (to 25.7% from 22.2%). The *correction count* fell to 26.8% this week after rebounding 5.7ppts (to 31.4% from 25.7%) last week. Turning to the *AAII Sentiment Survey* (as of November 2), optimism continued to decline in the latest survey, while pessimism increased. The *percentage expecting stock prices to rise over the next six months* fell for the third week by 15.7ppts to (24.3% from 40.0%). Optimism is below its historical average of 37.5% for the seventh time in eight weeks, remaining unusually low for the second successive week. The *percentage expecting stocks to fall over the next six months* rose for the second week by 15.7ppts (to 50.3 from 34.6), the highest since December 22, 2022’s 52.3%. Pessimism remains at an unusually high level for the second straight week and is above its historical average of 31.0% for the seventh time in nine weeks. The _percentage expecting stock prices will stay essentially unchanged over the next six months_ fell for the second week by 5.9ppts (to 25.4% from 31.3%). It was below its historical average of 31.5% for the sixth time in nine weeks.

S&P 500 Earnings, Revenues, Valuation & Margins (_link_): The S&P 500's forward profit margin rose 0.1pt w/w to 12.7% during the November 2 week, and is now just 0.1pt below its 11-month high of 12.8% during the September 21 week. That's up from a 24-month low of 12.3% during the March 30 week, but is down 0.7pt from its record high of 13.4% achieved intermittently in 2022 from March to June. It's now 2.4pts above its seven-year low of 10.3% during April 2020. Forward revenues rose 0.4% w/w to a new record high. Forward earnings jumped 0.9% w/w to 0.4% below its record high during the September 21 week, which had been its first since the June 16, 2022 week. Both had been steadily making new highs from the beginning of March 2021 to June 2022; prior to that, they peaked just before Covid-19 in February 2020. The consensus expectations for forward revenues growth rose to a 12-month high of 4.7% and is now up 2.4pts from 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. The forward earnings growth forecast rose 0.3pt w/w to a 24-month high of 10.8%, and is now 7.3pts 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 2.2% in 2023 (unchanged w/w) and 4.8% in 2024 (down 0.1pt w/w) compared to a revenues gain of 12.4% in 2022. They expect earnings gains of 0.9% in 2023 (up 0.3pt w/w) and 11.2% in 2024 (down 0.5pt w/w) compared to 7.3% in 2022. Analysts expect the profit margin to fall 0.1ppt y/y to 12.0% in 2023 (up 0.1pt w/w), compared to 12.1% in 2022, and to rise 0.7ppt y/y to 12.7% in 2024 (unchanged w/w). The S&P 500's weekly reading of its forward P/E rose 0.1pt w/w to 17.6 from a seven-month low of 17.5 and is down from a 17-month high of 19.8 during the July 20 week. That's still up from a 30-month low of 15.3 in October of 2022. It also compares to 23.1 in early September 2020, which was the highest level since July 2000, and to a 77-month low of 14.0 in March 2020. The S&P 500 weekly price-to-sales ratio was steady w/w at a six-month low of 2.22 and compares to a 15-month high of 2.46 during the July 27 week. That's up from a 31-month low of 1.98 in October 2022 and 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 S&P

500 sectors, the November 2 week saw consensus forward revenues rise for 10 of the 11 sectors and forward earnings rise for eight sectors. The forward profit margin moved higher for nine sectors. Four sectors have forward revenues at post-pandemic or record highs this week: Communication Services, Health Care, Industrials, and Information Technology. Among the remaining seven sectors, just three have forward revenues more than 5.0% below their post-pandemic highs: Energy, Financials, and Materials. Communication Services is the only sector with forward earnings at a record high this week, as these four sectors have eased from that mark over the past seven weeks: Consumer Discretionary, Industrials, Information Technology, and Utilities. Among the remaining six sectors, only Energy and Materials have forward earnings down more than 10.0% from their post-pandemic highs, while Financials exited that club in early October. Among the 11 sectors, only Industrials has weathered a broad margin retreat from post-pandemic or record highs. Now nearly all of the sectors are showing signs of recovering from their early 2023 lows, though it has stalled recently. None of the sectors had a forward profit margin at a record high this week. That's down from these three sectors in that club in early October: Consumer Discretionary, Industrials, and Information Technology. The forward profit margins of Communication Services, Consumer Discretionary, Industrials, and Information Technology remain close to their post-pandemic highs. Energy is surging higher now off its low in July, but Consumer Staples and Health Care remain at or close to their record lows. Energy and Industrials were the only two sectors to have their profit margins improve y/y for full-year 2022. The forward profit margin is expected to be flat y/y in 2023 for Consumer Staples, but these six sectors are expected to see their margins improve: Communication Services, Consumer Discretionary, Financials, Industrials, Information Technology, and Utilities. Here's how the S&P 500 and its 11 sectors rank based on their current forward profit margin forecasts along with their record highs: Information Technology (25.4%, down from its 25.7 record high in September), Financials (18.3, down from its 19.8 record high in August 2021), Real Estate (16.8, down from its 19.2 record high in 2016), Communication Services (16.6, down from its 17.0 record high in October 2021), Utilities (13.1, down from its 14.8 record high in April 2021), S&P 500 (12.7, down from its record high of 13.4 achieved intermittently in 2022 from March to June), Energy (11.3, down from its 12.8 record high in November), Materials (10.9, down from its 13.6 record high in June 2022), Industrials (10.7, down from its record high 10.8 in September), Health Care (9.1, a record low and down from its 11.5 record high in February 2022), Consumer Discretionary (8.3, down from its 8.4 record high in mid-September), and Consumer Staples (6.8, down from its 7.7 record high in June 2020).

S&P 500 Sectors & Industries Forward Profit Margin Since March 30 Bottom (*link*): The S&P 500's forward profit margin rose 0.1ppt w/w to 12.7% during the November 2 week, and is 0.1ppt shy of its 11-month high of 12.8% during the September 21 week. It's now up 0.4ppt 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 5.5%, or 0.7ppt, from its record-high 13.4% during the June 9, 2022 week, as eight of the 11 sectors' margins are down since then, with the S&P 500's drop paced by five 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 14.6% to 16.6%), Consumer Discretionary (up 13.9% to 8.3%), Information Technology (up 8.9% to 25.4%), Industrials (up 4.1% to 10.7%), S&P 500 (up 3.4% to 12.7%), Consumer Staples (up 1.7% to 6.8%), Real Estate (up 1.4% to 16.8%), Financials (down 0.7% to 18.3%), Utilities (down 0.8% to 13.1%), Materials (down 1.3% to 10.9%), Energy (down 3.6% to 11.3%), and Health Care (down 5.0% to 9.1%). These are the best performing industries since the March 30, 2023 bottom: Casinos & Gaming (up 80.4% to 6.9%), Wireless Telecommunication Services (up 24.0% to 14.2%), Apparel & Accessories (up 23.9% to 10.8%), Publishing (up 23.1% to 3.0%), Hotels, Resorts, & Cruise Lines (up 20.2% to 13.8%), Interactive Media & Services (up 19.6% to 23.8%), Semiconductors (up 19.1% to 31.3%), Brewers (up 17.9% to 9.4%), Homebuilding (up 16.7% to 12.5%), and Construction Materials (up 15.8% to 14.7%).

S&P 500 Q3 Earnings Season Monitor (*link*): With the Q3-2023 earnings season over 87% complete, the indications from the companies that have reported so far suggest a weaker revenue and earnings surprise compared to Q2-2023. 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 439 of the S&P 500 companies finished reporting for Q3-2023, revenues are ahead of the consensus forecast by 0.8% and earnings have exceeded estimates by 7.1%. At the same point during the Q2 season, revenues were 1.8% above forecast and earnings had beaten estimates by 7.7%. Just 60% of the 439 Q3 reporters 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 Q3-2019; but the percentage with positive earnings surprises would be near the highest since Q3-2021 if it holds to the end of the reporting season. The early reporters' aggregate y/y growth rates have ticked up for revenues from their Q2-2023 readings and improved for earnings: to 1.2% from 0.6% for revenues growth and to 2.2% from -7.7% 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 has outpaced revenue growth in Q3-2023 with the Energy sector now exerting less drag on overall results. Slightly fewer companies have been reporting positive y/y earnings growth in Q3 (61%) than positive y/y revenues growth (63%). With seven 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. While the surprise metrics remain positive without the MegaCap-8 reporters, the y/y growth rates are flat or negative without them. Looking at the S&P 500 excluding the MegaCap-8 reporters to date, the revenue surprise edges down to 0.7% from 0.8%, the earnings surprise falls to 5.7% from 7.1%, revenue growth drops to 0.1% from 1.2%, and earnings growth falls to -4.4% from 2.2%. These figures are not expected to change much as the remaining 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.

Global Economic Indicators

Eurozone Retail Sales (***link***): Eurozone retail sales has shown little growth so far this year. *Retail sales* fell 0.3% in September and was down 0.2% ytd. Since reaching a record high in June 2021, sales have dropped 4.5%. Spending on *food, drinks & tobacco* rose 1.4% in September and is up 2.0% ytd. Meanwhile, sales of *non-food products excluding fuel* fell 2.5% during the two months through September, after a four-month gain of 1.2%. Consumption of *automotive fuels* has declined in all but one month so far this year, by 0.9% during September and 8.3% ytd. September data are available for all of *Eurozone's four largest economies*: Spain's retail sales climbed for 13th time in 14 months, by 0.2% m/m and 9.2% over the period, to its highest level since October 2010. Meanwhile, sales in France have been in a volatile flat trend, showing no change ytd. German sales contracted in September for the fourth time, falling 0.8% m/m and 2.6% over the period, while Italy retail sales haven't posted a gain since January, sliding 3.0% during the eight months through September. *Versus a year ago*, sales in Spain (7.5% y/y) were significantly above year-ago levels, while sales in France (-2.7), Germany (-4.3), and Italy (-5.1) were below.

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