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Morning Briefing

Materials, Earnings & Nvidia's AI

Check out the accompanying [chart collection](#).

Executive Summary: Looking at the S&P 500's ytd performance by sector can be deceptive. You'd never guess that one underperforming sector, Materials, is home to three industries among the S&P 500's top performing. Also not apparent is the breadth of industry participation in this year's market strength. Only four of the S&P 500's 20 top performing industries are tech related. Jackie examines why the ytd winners have been doing so well. ... Also: She looks at the projected earnings growth of various sectors and industries this year and next. ... And: What Nvidia execs had to say last week about the AI wave they're riding—which appears to be far from over.

Materials: Geography Matters. A top-down look at the S&P 500's ytd performance by sector might suggest that only tech-related industries have been soaring, given that the techy Communication Services sector (up 11.7% ytd through Friday's close) and Information Technologies sector (9.6%) have far outperformed the S&P 500 and its other sectors so far this year: Health Care (8.2%), Financials (6.8), S&P 500 (6.7), Industrials (5.3), Consumer Staples (4.0), Consumer Discretionary (3.0), Energy (1.9), Materials (1.3), Utilities (-2.6) and Real Estate (-3.4).

And, yes, four of the top 10 performing industries two months into 2024 hail from tech-related sectors: Semiconductors (28.2% ytd), boosted by the inclusion of Nvidia; Movies & Entertainment (16.4%), helped by Netflix; Semiconductor Materials & Equipment (16.2%), up thanks to voracious demand from China; and Interactive Media & Services (14.4%), land of Alphabet and Meta Platforms.

But that still leaves 16 industries among the top 20 performers that reside in a wide variety of S&P 500 sectors. Here are the other 16 top-performing industries ytd through Friday's close grouped by sector:

- *Consumer Discretionary:* Broadline Retail (14.8%), Other Specialty Retail (12.1), and Home Furnishings (11.1)

- *Consumer Staples*: Food Distributors (10.5) and Consumer Staples Merchandise Retail (10.3)
- *Energy*: Oil & Gas Refining & Marketing (11.4)
- *Financials*: Multi-Sector Holdings (17.0), Property & Casualty Insurance (16.1), and Consumer Finance (10.2)
- *Health Care*: Health Care Facilities (15.2), Pharmaceuticals (14.3), and Health Care Distributors (11.3)
- *Industrials*: Trading Companies and Distributors (14.0), Environmental & Facilities Services (11.9), and Construction & Transportation Equipment (10.3)
- *Materials*: Construction Materials (11.6)

Given that the Materials sector's stock price index has risen only slightly ytd, 1.3%, it's surprising that three of its industries have outperformed the broader market. They are Construction Materials—with its 11.6% gain placing it among the top 20 industries mentioned above—and two that just missed the top-20 cutoff: Metal, Glass, & Plastic Containers (9.3) and Steel (8.7).

Here's a look at what has boosted the winning industries in the S&P 500 Materials sector so far this year:

(1) *Staying home helps*. Companies in the Construction Material and Steel industries have benefitted from their focus on selling products in the USofA, where the economy has been stronger than those in Europe and Asia. Materials industries that sell global commodities internationally haven't fared as well.

Here's how the other Materials sector industries have performed ytd through Friday's close: Fertilizers & Agricultural Chemicals (3.5%), Commodity Chemicals (3.4), Industrial Gasses (3.4), Paper & Plastic Packaging Products (2.5), Specialty Chemicals (0.1), Copper (-8.5), and Gold (-24.4). Gold's drop in fact makes it the very worst performing industry in the S&P 500 ytd through Friday's close.

The stock price index of the S&P 500 Construction Materials industry, which includes Martin Marietta Materials and Vulcan Materials, defied expectations over the past year, climbing to new 52-week highs despite rising interest rates ([Fig. 1](#)). The two companies mine for crushed stone, sand, gravel, and other natural resources in the US. New home sales stayed unexpectedly strong last year, and government funding helped non-home construction spending climb as well.

The Construction Materials industry's hearty earnings growth last year of 49.1% won't be matched this year, but analysts' consensus revenue estimate targets growth of 2.9% this

year and 7.2% in 2025, while earnings are forecast to jump a respectable 14.4% this year and 13.1% in 2025 ([Fig. 2](#) and [Fig. 3](#)). The industry's above-market P/E of 28.0 is toward the upper end of its range over the past decade, and that range is higher than it was from 2000-08 ([Fig. 4](#)).

Vulcan's Q4 earnings per share beat analysts' forecasts, and the company was able to hike both volumes and prices last quarter. Management forecasts a 2024 profit of \$1.07 billion to \$1.19 billion, implying that the company should be able to top the \$1.08 billion that analysts had been forecasting, a February 16 MarketWatch [article](#) reported.

This year, Martin Marietta expects strength in infrastructure and large-scale non-residential projects will largely offset softness in the residential and light nonresidential sectors, which include data centers and warehouses. Construction spending on US manufacturing projects continues to trend positively, with the December seasonally adjusted annual rate of spending for 2023 at \$214 billion, a 61% increase y/y, said CEO Ward Nye on the company's February 14 earnings [conference call](#).

"Manufacturing projects continue to be supported by [healthy] demand from the ongoing reshoring of critical product supply chains, including semiconductors and electric vehicle battery manufacturing," Nye said on the call. If interest rates fall, activity in the home construction market could pick up given the pent-up demand for housing. Altogether, he's expecting flat aggregate shipments and double-digit pricing growth.

(2) *Steel in the USA*. The S&P 500 Steel industry is also focused on the domestic market with its two constituents, Nucor and Steel Dynamics, selling steel products in North America. The industry's stock price index is at an all-time high, but analysts don't seem to be as confident about the future as investors ([Fig. 5](#)). Analysts are calling for revenue and earnings to decline both this year and next. Revenue is expected to fall 4.3% this year and decline 3.3% in 2025, while earnings are projected to drop 25.8% this year and 7.1% next year ([Fig. 6](#) and [Fig. 7](#)).

The recent decline in the price of steel certainly doesn't engender confidence. The price of US Midwest domestic hot-rolled coil steel rose from a low of \$686.00 per ton in 2023 to a recent peak of \$1,149.00 per ton by December 28. Since then, the price has dropped to \$922.00 ([Fig. 8](#)).

Nucor's January 29 earnings [press release](#) said that management expects its Q1 earnings to increase q/q. Analysts are calling for the same, with a consensus Q1 estimate of \$4.02 a

share, higher than Q4's \$3.16 a share. But those results would represent a y/y drop from Q1-2023's \$4.45 a share.

Steel Dynamics' earnings also are expected to drop y/y in Q1, to \$3.43 a share from \$4.01 a year earlier, though that would be an improvement from Q4's \$2.61 results.

Instead of focusing on earnings, optimistic investors may be looking at Nippon Steel's recent offer to buy US Steel. The offer represented a 142% premium to US Steel's share price in August, before its first suitor, Cleveland-Cliffs, made a failed bid, a December 18 Reuters [article](#) reported.

In sum, domestic demand for steel may not be strong enough to offset lower demand for the metal internationally. Until steel prices show signs of making a U-turn, this industry may not live up to investors' optimism.

Strategy: Looking to 2025. The Materials sector might not be expected to grow earnings much this year, but 2025 is a different story. The sector's earnings growth is expected to be almost as fast as its techie counterparts' growth. Here's the performance derby for the S&P 500 and its sectors' earnings for this year and next as of Friday's close: Information Technology (15.2% in 2024 and 17.9% in 2025), Consumer Discretionary (12.2, 15.7), Materials (-0.8, 14.7), Communications Services (17.4, 13.8), Industrials (9.1, 13.8), S&P 500 (9.6, 13.5), Health Care (15.5, 12.6), Energy (-6.8, 11.9), Financials (6.0, 11.3), Real Estate (-3.7, 10.2), Consumer Staples (4.5, 8.5), and Utilities (6.7, 7.4).

Semiconductors, Semiconductor Materials & Equipment, Movies and Entertainment, and Wireless Telecommunication Services (T-Mobile) each are expected to continue their rapid earnings growth into 2025 (30.9%, 21.9%, 26.8%, and 25.3% respectively).

A number of Materials industries are expected to have market-leading earnings growth next year, including: Copper (3.5% earnings growth in 2024, 34.0% in 2025), Commodity Chemicals (12.4, 30.0), Paper & Plastic Packaging Products (-3.8, 21.1), Specialty Chemicals (-4.2, 18.6), and Gold (38.4, 16.5).

Some industries in the S&P 500 Real Estate sector also should enjoy sharp earnings gains in 2025 if analysts' forecasts are on target. REITs would benefit if the Federal Reserve decides to cut interest rates, as the financial markets expect will happen twice this year. The industry with the fastest earnings growth in the S&P 500 next year is Health Care REITs (21.1% in 2024, 56.1% in 2025). Strong 2025 earnings growth is also expected from Timber

REITs (6.9, 21.9), Industrial REITS (-22.2, 21.1), and Data Center REITs (-23.9, 17.5).

That said, not all REITs are equal when it comes to earnings prospects. Five of the 10 industries with the slowest earnings growth in 2025 are REIT industries. Office REITs are expected to have the fourth slowest earnings growth compared to other S&P 500 industries in 2025 (1.3%), followed by Telecom Tower REITs (2.6), Other Specialized REITs (2.9), and Retail REITs (3.3).

Disruptive Technologies: Three Nvidia Takeaways. Despite the shareholder handwringing prior to Nvidia's earnings announcement last week, Nvidia delivered better-than-expected Q4 earnings growth, and its shares jumped to new highs, bringing their one-year gain to almost 240%. The company's February 21 earnings [conference call](#) made it clear that its executives believe the AI era is still just beginning.

Three things jumped out at us from the call. First, all the technology we've been writing about for years appears to have laid the groundwork to make AI possible. Second, data centers and computers are going to need upgrades. Third, it's clear from all the name-dropping on the call that companies from all different industries are experimenting with AI.

Here's what Nvidia CEO Jensen Huang and CFO Colette Kress told analysts last week:

(1) *AI: A tech whose time has come.* AI is benefiting from the maturation and convergence of many powerful technologies. For years, we've been writing about the rollout of 5G and how much faster information can be transmitted over the new system. We've also watched as companies collected data on customers—often in the cloud—wondering what could be done with the reams of information. And then we tracked Nvidia's success with its GPU chips in the gaming industry. They managed to crunch information far faster than CPU chips.

AI takes advantage of all these technological wonders. The technological advancements of the past decade may have finally found their killer app.

(2) *AI kickstarts an upgrade cycle.* In this new world of AI, data centers are undergoing a facelift, and it looks like laptops will be next. "[T]he \$1 trillion installed base of data center infrastructure is rapidly transitioning from general purpose to accelerated computing," said Kress. They're moving from using mostly CPU chips to depending on GPU chips to crunch data faster. And of course, Nvidia has the chips, switches, and security systems to move this transition along.

Up next: computer upgrades. “Enterprises are refreshing their workstations to support generative AI-related workloads, such as data preparation, (large language model) fine-tuning, and retrieval augmented generation,” said Kress.

(3) *Everyone’s in the pool.* Companies in “virtually every industry” are building and deploying AI solutions, said Kress.

“Companies from search to e-commerce, social media, news and video services, and entertainment are using AI for deep-learning-based recommendation systems. These AI investments are generating a strong return by improving customer engagement, ad conversion and click-through rates,” Kress said. Meta said more accurate predictions and improved advertiser performance “contributed” to the significant acceleration in its Q4 revenue. (See last Thursday’s [Morning Briefing](#) discussion of how WPP is using AI to help its marketing and advertising clients.)

Enterprise software companies—such as ServiceNow, Adobe, SAP, and Snowflake—are using AI to boost customers’ productivity. Kress noted that AI is being adopted by large companies in the automotive, healthcare, and financial services industries to help develop autonomous driving programs, discover new drugs, and detect fraud. Nvidia products are also being used by companies developing robots for use in warehouses and in surgeries, as well as humanoid robots.

The company has developed a platform aimed at each of the industry verticals, which includes both chips and software. For example, the NVIDIA Clara healthcare platform and the NVIDIA BioNeMo generative AI service help companies develop, customize, and deploy AI models for computer-aided drug discovery. In financial services, American Express has increased its fraud detection accuracy by 6% using NVIDIA AI.

The company is also encouraging developers to use computers with Nvidia chips and Nvidia tools and services to create the next wave of AI applications. All the software and services surrounding its chips have made Nvidia the company to beat.

Calendars

US: Thurs: Personal Income & Spending 0.4%/0.2%; Headline & Core PCE 0.3%
0.3%
m/m/2.4%/y/y & 0.4%
m/m/2.8%/y/y; Initial Claims 209k; Kansas City Manufacturing Index; Chicago PMI 47.9; Pending Home Sales; Williams; Bostic; Goolsbee; Mester. **Fri:**

ISM M-PMI & Price Index 49.5/54.6; University of Michigan Consumer Sentiment, Current Conditions, and Expectations 79.6/81.5/78.4; University of Michigan One-Year & Five Year Inflation Expectations 3.0%/2.9%; Construction Spending 0.2%; Baker-Hughes Oil Rig Count; Daly; Bostic; Waller. (FXStreet estimates)

Global: Thurs: Germany Employment Change 7k; Germany Unemployment Rate 5.8%; Germany Retail Sales 0.5%; Germany CPI 0.7%*m/m* 2.8%*y/y*; France Consumer Spending -0.1%; France CPI 0.7%*m/m*/0.7%*y/y*; France PPI; Italy Industrial Sales; Spain 2.8%*y/y*; Japan Unemployment Rate 2.4%; Caixin M-PMI 50.7; Nagel. **Fri:** Eurozone Headline & Core CPI 2.5% & 2.9% *y/y*; Eurozone Unemployment Rate 6.4%; Eurozone, Germany, France, Italy, and Spain M-PMIs 46.1/42.3/46.8/49.0/49.7; Italy Unemployment Rate 20%; UK M-PMI 47.1; UK Nationwide HPI 0.2%; Japan Household Confidence 38.4; Pill. (FXStreet estimates)

Strategy Indicators

Stock Market Sentiment Indicators ([link](#)): The *Bull-Bear Ratio* slipped to 3.45 this week, after climbing the prior two weeks from 3.18 to 3.54 (the highest since August 2021). *Bullish* sentiment edged up to 57.6% this week from 57.3% last week. Two weeks ago it was at 58.8%—which was the most bulls since summer 2021. Meanwhile, *bearish* sentiment ticked up to 16.7% this week from 16.2% last week—which was the lowest since summer 2021. The *correction count* slipped to 25.7% this week from 26.5% last week. Turning to the *AAll Sentiment Survey* (as of February 22), optimism advanced during the week, while both neutral sentiment and pessimism decreased. The *percentage expecting stock prices to rise over the next six months* climbed 2.1ppts to 44.3%, remaining above its historical average of 37.5% for the 16th straight week. The *percentage expecting stocks to fall over the next six months* fell marginally by 0.6ppts to 26.2%, remaining below its historical average of 31.0% for the 16th straight week. The *percentage expecting stock prices will stay essentially unchanged over the next six months* slipped 1.5ppts to 29.5%, below its historical average of 31.5% for the 10th time in 12 weeks.

S&P 500 Earnings, Revenues, Valuation & Margins ([link](#)): The S&P 500's forward profit margin remained steady w/w at a five-month high of 12.8% during the February 22 week. That's up from a 24-month low of 12.3% during the March 30, 2023 week, but is down 0.6pt from its record high of 13.4% achieved intermittently in 2022 from March to June. It's now 2.5pts above its seven-year low of 10.3% during April 2020. Forward revenues rose less than 0.1% w/w to a record high. Forward earnings gained 0.2% w/w to new record high too.

It had hit that mark during the September 21 week for the first time since the June 16, 2022 week. Revenues and earnings 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 was steady w/w at 4.8%. It's now 0.3pt below its 15-month high of 5.1% in early January, but has gained 2.5pts from its 33-month low of 2.3% during the February 23, 2023 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 0.1pt w/w to 10.7%. That's down from a 26-month high of 11.5% in early January and is now 7.2pts 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 4.4% in 2024 (unchanged w/w) and 5.8% in 2025 (down 0.1pt w/w) compared to a revenues gain of 2.4% in 2023. They expect an earnings gain of 9.7% in 2024 (up 0.1pt w/w) and a 13.7% rise in 2025 (up 0.2pt w/w) compared to an earnings gain of 2.3% in 2023. Analysts expect the profit margin to rise 0.6ppt y/y to 12.6% in 2024 (unchanged w/w), compared to 12.0% in 2023, and to rise 0.9ppt y/y to 13.5% in 2025 (unchanged w/w). The S&P 500's weekly reading of its forward P/E fell 0.2pt w/w to 20.4 from a 24-month high of 20.4. That 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 ticked down 0.01pt w/w to 2.59 from a 24-month high of 2.60. That's up from a six-month low of 2.22 during the October 26 week and compares to a 31-month low of 1.98 in October 2022. That 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 during the February 22 week, just four had their forward revenues rise w/w, and only three had forward earnings move higher. The forward profit margin moved higher w/w for three sectors. None of the sectors have forward revenues at post-pandemic or record highs this week. A week earlier, Health Care and Industrials were in that club. Among the remaining nine sectors, only three have forward revenues more than 5.0% below their post-pandemic highs: Energy, Financials, and Materials. Communication Services and Information Technology were the only sectors with forward earnings at a record high this week. Two other sectors, Consumer Discretionary and Consumer Staples, were in that camp several weeks earlier. Among the remaining seven sectors, only Energy and Materials have forward earnings down more than 10.0% from their post-pandemic highs, while Financials and Real Estate exited that club in late 2023. 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. Communication Services, Consumer Discretionary, and Information Technology are the only sectors with their forward profit margin at a record high this week. Industrials' forward profit margin remains close to their post-pandemic high. Energy's remains near its 21-month low in late January, while those of Consumer Staples and Health Care remain at or close to their record lows. The annual profit margin is expected to fall y/y in 2024 for Energy, Materials, and Real Estate and improve for the other eight sectors. 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 (26.4%, a new record high this week), Financials (18.5, down from its 19.8 record high in August 2021), Real Estate (16.3, down from its 19.2 record high in 2016), Communication Services (17.0, matching its prior record high in October 2021), Utilities (13.7, down from its 14.8 record high in April 2021), S&P 500 (12.8, down from its record high of 13.4 achieved intermittently in 2022 from March to June), Energy (10.5, down from its 12.8 record high in November 2022), Materials (10.6, down from its 13.6 record high in June 2022), Industrials (10.6, down from its record high 10.8 in September 2023), Health Care (8.8, a record low this week and down from its 11.5 record high in February 2022), Consumer Discretionary (8.7, a record high this week), and Consumer Staples (6.8, down from its 7.7 record high in June 2020).

US Economic Indicators

GDP ([link](#)): Real GDP was little changed from Q4's advance estimate of 3.3%, with the second estimate revised down slightly to 3.2%, a slowing from Q3's 4.9% expansion. Revisions show movements within the different components that are worth noting. Real consumer spending during Q4 rose 3.0% (saar), up from the advance estimate of 2.8%; services (2.8% from 2.4%, saar) consumption was slightly stronger than first reported, while goods (to 3.2 from 3.8) consumption was weaker—with a downward revision to durable goods (3.2% from 4.6%) spending. Growth in real gross private domestic investment (to 0.9% from 2.1%, saar) was weaker than initial estimates, with inventory investment (\$66.3 billion from \$82.7 billion) revised lower and nonresidential investment (2.4 from 1.9) revised higher—led by spending on structures (7.5 from 3.2) and intellectual property products (3.3 from 2.1). Revisions show equipment spending (-1.7 from 1.0) declined rather than increased. Meanwhile, real residential investment (2.9% from 1.1%) was stronger than first reported. Real government spending (to 4.2% from 3.3%, saar) was stronger than the initial estimate, led by a sizable revision to state & local government (5.4 from 3.7) spending, while federal spending (2.3 from 2.5) was slightly weaker than first reported. Meanwhile,

within trade, imports—which are a subtraction in the calculation of GDP—increased 2.7% (saar) from the initial estimate of 1.9%, while real exports (6.4 from 6.3) were virtually unchanged from the initial report.

Global Economic Indicators

Eurozone Economic Sentiment Indicators ([link](#)): The Economic Sentiment Indexes (ESIs) for the both the EU and Eurozone weakened unexpectedly in February, with the EU's measure ticking down 0.4 points to 95.4, while the Eurozone's slipped 0.7 points also to 95.4. There was widespread weakness in ESIs among the six largest EU economies this month, with only the Netherlands (+1.7 points to 98.5) posting an increase. ESIs in Italy (-1.6 to 99.2), Germany (-0.6 to 89.0), and Poland (-0.5 to 101.5) recorded the largest declines, while ESIs were broadly stable in France (-0.3 to 97.6) and Spain (-0.2 to 102.4), according to the report. By sector, within the Eurozone, sentiment remains on steep downtrends in retail trade (-1.1 to -6.7), construction (-0.8 to -5.4), and industrial (-0.2 to -9.5). Meanwhile, consumer (+0.6 to -15.5) sentiment has rebounded from recent lows but moved sideways the past few months, while sentiment in the service sector (-2.4 to 6.0) remains in a volatile flat trend around recent lows. While Eurozone economy continues to struggle, the survey shows inflation relief continues, with selling price expectations moving down again this month.

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