Yardeni Research

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Morning Briefing

Inventories, China & Norway's EV Roadtrip

Check out the accompanying chart collection.

Executive Summary: If Target's recent quarterly earnings report is indicative, retailers have reached the light at the end of the excessive-inventory tunnel. Jackie shares what Target management had to say about the benefits of appropriate inventory levels now that they've been restored as well as other evidence that retail's inventory correction is probably over. … Also: China is targeting 5% economic growth but has scant hope of achieving it without a massive debt restructuring in its imploded real estate sector. … And in our Disruptive Technologies segment, why Norwegians love their electric vehicles.

Consumer Staples: The Inventory Correction Ends. Target was one of many retailers caught flatfooted after the pandemic ended. Like others, Target experienced a surge of consumer demand for everything from toilet paper to outdoor furniture. But when that surge abruptly ended in 2022, the retailer was caught with too much inventory.

Fast-forward two years: The company recently reported results that show its inventory has been whittled down, enabling it to sell more of its merchandise without resorting to unplanned sales. Sales still aren't as robust as one might hope, but they're moving in the right direction too. All this has positive implications for economic growth, as declining inventories will no longer weigh on GDP.

Here's a look at what Target reported as well as related economic data:

(1) *Inventories on Target.* Target reported inventories at year-end fiscal 2024 (ended February 3) that were sharply lower than the past two years' bloated levels ($11.9 billion versus $13.5 billion a year earlier and $13.9 billion a year before that) but not historically low; they were up from fiscal 2021's $10.7 billion. The trimmer inventory position and fewer markdowns in fiscal Q4 were credited for Target's improved margins. The retailer's operating margin was 5.8%, up about 2ppts from a year earlier. Likewise, the Q4 gross margin was 25.6%, up from 22.7% a year earlier, according to the company's *press release*.

Management seemed happy with current inventory levels. "The benefit of exceptionally well managed inventory just shows up everywhere. We're so much more productive in store and in our [distribution centers] when inventory is well managed," said CFO Michael Middelke in the company's *conference call* on Tuesday. "We "feel great about our inventory position as we step into 2024." He also noted that the company benefitted from lower freight and transportation costs during the quarter.

(2) *Sales still sluggish.* Target's sales improved compared to last year, but growth remains lackluster. Total Q4 revenue rose 1.7% y/y, helped by the quarter's additional week compared to Q4-2023, but same-store sales declined 4.4% y/y. Because of the quarter's extra week and the improved inventory position, adjusted Q4 earnings per share rose sharply y/y, to $2.98 from $1.98 in Q4-2022, beating the analysts' $2.42 consensus expectation.

Target shares jumped 12.0% on the news Tuesday. But they have lots of ground to make up, having risen only 1.5% over the past year compared to the S&P 500's 25.6% gains over the same period.

Target expects only a modest improvement in revenue growth going forward, with same-store sales expected to decline 3%-5% in the current quarter and forecast to finish the full year flat to up 2%. The retailer is expected to produce adjusted earnings per share of $1.70-$2.10 for fiscal Q1 (ending May 31) and between $8.60-$9.60 for the full fiscal year; that compares to the just reported $8.94 for fiscal 2024.

(3) *Retailers better positioned.* Target wasn't the only retailer that found itself with warehouses bursting with inventories. Real retail inventories excluding motor vehicles and parts peaked at $588.7 billion in June 2022, and they've declined ever since, hitting $555.5 billion in December (*Fig. 1*). That said, they remain sharply higher than $465.7 billion, where they stood in December 2019 prior to the pandemic.

But if Target is any indication, retailers have had a year to whittle their inventory positions down to desirable levels. So going forward, inventories might provide a boost to GDP growth (*Fig. 2*).

More evidence that the inventory correction may be over comes from the West Coast ports, where inbound traffic has started to pick up. Containers coming into the West Coast ports fell from a peak of 963.5 million TEUs in 2021 to a low of 579.6 million in March 2023. Imports as measured by containers has subsequently jumped to 805.3 million in January

(*Fig. 3*). There's certainly much more room for improvement, but it's a start.

China: Looking Beyond the Talking Points. China's political elite met this week and announced plans to target 5% annual real GDP growth, the creation of 12 million urban jobs, a 5.5% unemployment rate, and inflation of 3% in 2024. Its economic growth target is being politely described as "ambitious" given the pressures the economy faces. They include the country's aging population, youth unemployment that was extremely high before the country stopped reporting the data, and a real estate sector that's imploding.

So while Premier Li Qiang's saying that the country aims to hit 5% GDP growth is all well and good, we prefer to examine alternative signs to understand the economy's health. Right now, things aren't looking good:

(1) *Watch what they do.* China's plans to sell its off-balance-sheet debt and offer property developers the ability to extend their loans indicate that government officials recognize there's a problem.

Li said China will sell Rmb1 trillion of special treasury bonds, putting the proceeds toward "major national strategies" and building up security capacity in key areas, a March 5 *FT* *article* reported. The last time that the country issued these bonds, which are not included in the government's deficit, was in 2020 during the pandemic.

The country also announced a new "whitelist" financing program. Cities are proposing real estate projects that they believe should receive additional funding from banks. "By the end of January, 170 cities in China's 26 provinces had proposed their first batch of more than 3,000 favored projects to commercial banks, with a total 17.86 billion yuan ($2.48 billion) of loans already earmarked for 83 such projects, state media reported Sunday, citing official sources," a February 4 *WSJ* *article* reported.

However, there were some reports that the banks were merely extending the maturity dates of existing loans instead of providing new, additional funding. Potential home buyers appear unconvinced that this new program will work. China's 100 largest developers sold homes worth $32.8 billion in January, down 34% y/y, the *WSJ* reported.

Separately, Chinese government-related funds have been propping up the stock market. In October, the state-owned Central Huijin Investment, a sovereign wealth fund, increased its ownership of bank shares. "The last time China's sovereign wealth fund intervened in the market was eight years ago. This followed the 2015 equity market crash when the Shanghai

Composite index fell more than 40 per cent," an October 12 *FT* *article* reported.

Purchases continued this year, with the China Securities Regulatory Commission saying last month that market stability would be maintained with an influx of funds, a February 11 Nikkei Asia *article* reported. State-backed institutions have been buying exchange-traded funds. In addition, restrictions on short-selling regulations were tightened in January. The market manipulation has had the desired effect. The China MSCI stock price index has risen 8.4% since its bottom on January 22, but the index remains down 58.3% from its peak on February 17, 2021 (*Fig. 4*).

(2) *US companies' China woes*. Some US companies are starting to report sales troubles in China.

Starbucks reduced its fiscal 2024 (ending September 30) same-store sales growth estimate for China from 4%-6% y/y to percentages in the low single digits. In the company's fiscal Q1-2024 (ended December 31), foot traffic in China stores rose 21% y/y as Covid restrictions eased but check sizes dropped 9%. As a result, same-store sales increased 10% y/y in the quarter, below analysts' 16% call. The company has faced increasing competition from Chinese competitors Luckin Coffee and Cotti Coffee, which have been promotional.

Tesla's February shipments from its Shanghai factory dropped 19% y/y, and the company cut prices yet again, a March 4 Yahoo! Finance *article* reported. Sales may have been depressed by the Chinese Lunar Holiday, which fell in February this year. But Tesla also has faced growing EV competition from China's BYD, which has also been cutting prices. Tesla was offering various incentives to buyers of the Model 3 and Model Y vehicles by the end of March. This follows price cuts in January on the same two models of 5.9% and 2.8%, respectively.

Sales of iPhones during the first six weeks of 2024 fell 24% y/y, while Huawei's smartphone shipments rose 64% over the same period, according to Counterpoint Research data cited in a March 5 CNBC *article*. Apple faced competition from Huawei's new 5G phone.

Conversely, Yum China reported a strong Q4, with sales up 21% y/y and operating profit rising 170% to $110 million, while adjusted earnings per share rose 164%, the company's *press release* stated.

(3) *Global commodities woes.* Some global commodity prices have fallen, potentially

signaling weak demand from China, a voracious user of commodities like copper, iron ore, and oil.

The price of copper, at $3.84 per pound, is 22% off of its $4.93 high and 81% off of its $2.12 low (*Fig. 5*). Despite the war between Israel and Hamas and the Red Sea ship bombings by the Houthis, the price of crude oil remains depressed. Brent crude oil futures, at a recent $82.04, are down from their 2022 peak of $127.98 (*Fig. 6*). Meanwhile, the price of iron ore has fallen to $104.67 per ton from a recent peak in January of $130.49.

(4) *Developers stuck in purgatory.* The Chinese real estate market has made little progress in restructuring its billions of dollars of debt even though it has been in distress since regulators' 2021 real-estate-debt crackdown. China needs to clear the deck and push along massive debt restructurings if it hopes to revive the country's important real estate sector.

The largest developer that's also the furthest along in the restructuring process is China Evergrande, which defaulted in 2021 and has an estimated $300 billion of outstanding debt. In January, a Hong Kong judge ordered the developer to liquidate its assets after 19 months of negotiations between foreign creditors and Evergrande ended without a resolution. However, even this step forward involves half a step backward. It's unclear whether Chinese authorities will allow proceeds from the sale of properties in China to fund the repayment of foreign creditors, a January 29 CNN *article* reported.

Many of the largest restructurings are still at stage one: hiring restructuring advisors. A group of Country Garden's lenders hired Allen & Overy and Deloitte as advisors prior to the property developer's May 17 date in court to face a creditor's liquidation petition, a March 5 Reuters *article* reported. Country Garden, which missed a $15 million coupon payment in October, has $200 billion of liabilities including $11 billion of offshore debt. The developer, which has hired its own advisors, announced that its sales in January and February fell 80% y/y and 217 of its residential projects are available for loans under the country's whitelist program.

Investors are also worried about state-backed real estate developers. Reports that China Vanke was seeking debt extensions from some insurers spooked investors, another March 5 Reuters *article* reported. The developer's bonds trade at 40-50 cents on the dollar, as it reportedly is trying to raise $631 million of debt to cover two bonds maturing in May and June.

Disruptive Technologies: EV Lessons From Norway. Last year, some 80% of new cars sold in Norway were electric vehicles (EVs), far more than the 7% sold in the US. Norwegians seem to have few complaints about their EVs, if our numerous Internet searches to find some are any indication. The country boasts many electric charging stations, and it generates ample hydroelectric power, so electricity prices didn't spike nor did the electric grid collapse.

The most frequent concern we encountered was that the government's financial incentives to buy an EV encouraged a car culture instead of pushing more residents to walk, bike, or take mass transit. The country has rolled back some of those incentives, and it will be interesting to see whether EV popularity continues with less of a financial carrot.

Here's a quick look at Norway's EV market:

(1) *No complaints about the cold.* There was hysteria earlier this winter when EVs stalled on the streets of Chicago as temperatures dropped sharply. Cold temperatures can reduce an EV's range by roughly 20%. In addition, heaters used to warm car cabins can quickly drain EV batteries.

Norwegians have some tricks to keep their EVs running in winter temperatures that average around 19 degrees Fahrenheit and can fall as low as negative 40 degrees. Some EV owners preheat their car while it's still plugged into their home charger, a January 17 *Fast Company* article reported. The warm battery performs better, and jumping into a preheated car allows owners to drive without turning on the car's heater—for a while, anyway. Turning on the steering wheel or seat heating mechanisms for warmth works too, as they draw less electricity than the car's heaters. EV owners also try to keep the car's battery as charged as possible when the temps are cold, the article reported. Parking indoors or using a battery blanket can keep an EV battery warm.

(2) *Still too many cars.* Some of the most frequent complaints questioned the government's financial incentives for EVs. The funds that went toward encouraging EVs could have been used to upgrade mass transit systems or to subsidize e-bikes, reducing congestion in cities and eliminating the dependence on cars, regardless of their fuel source. Others noted that the EV incentives were used by residents who could afford to buy a new car. The incentives unintentionally increased the inequality between upper- and lower-income households.

Norway's incentives are certainly generous. Here's a British writer's witty description of Norway's incentives in a February 26 opinion piece in Hagerty Media: "The dried-cod–loving Nordmenn kicked things off in 1990, when they announced they'd do away with import tax on electric cars, followed six years later by ditching road tax. Then things started to get really interesting. From 1997, *if you drove an EV*, they'd wave the many toll road charges, and from 1999 you could park for free. … Good, huh? It gets better. Next came cuts to company car tax, then VAT was dropped from the purchase price for private buyers. By 2005, those crazy cats did the unthinkable and allowed EVs to drive in bus lanes, then later dropped ferry charges and removed VAT from leasing. In 2017, they legislated for a right to charge, addressing the issue of charging when living in high-rise flats—a concept our politicians still can't get their heads around."

Some of the incentives have been pared back to address some of the inequality. In 2017, EV owners started to pay for parking, road tolls, and ferries but at a discounted rate. And starting last year, only the first $45,000 of an EV's purchase price is tax free, an October 31 Vox *article* reported. Those who buy the largest EVs pay an additional fee that rises with vehicle weight.

Calendars

US: Thurs: Nonfarm Productivity & Unit Labor Costs 3.1%/0.7%; Consumer Credit $10.0b; Jobless Claims 212k; Trade Balance -$63.2b; Powell Testifies; Mester. **Fri:** Total, Private, and Manufacturing Payroll Employment 190k/150k/10k; Average Hourly Earnings 0.2%m/m/4.4%y/y; Average Hourly Earnings 34.4; Unemployment Rate 3.7%; WASDE Report; Baker-Hughes Rig Count; Williams. (FXStreet estimates)

Global: Thurs: ECB Interest Decision & Deposit Facility Rate 4.50%/4.00%; Germany Factory Orders -6.0%; UK Halifax HPI 0.8%; Japan Household Spending 0.4%m/m/-4.1%y/y; Lagarde; Balz. **Fri:** Eurozone GDP 0.0%q/q/0.1%y/y; Eurozone Employment Change 0.3%q/q/1.3%y/y; Germany Industrial Production 0.5%; Germany PPI 0.1%; Canada Employment Change 20k; Canada Unemployment Rate 5.8%; Japan Leading & Coincident Indicators. (FXStreet estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The *Bull-Bear Ratio* climbed to 3.71 this week—the highest since January 8, 2021—after slipping from 3.54 to 3.45 last week. *Bullish* sentiment climbed for the second week to 59.4%—exceeding their recent highs for the most bulls since summer 2021. Meanwhile, *bearish* sentiment ticked down 16.0%—the lowest since summer 2021—from 16.7% last week. The *correction count* slipped for the second week from 26.5% to 24.6%. Turning to the *AAII Sentiment Survey* (as of February 29), both optimism and neutral sentiment improved during the latest reporting week, while pessimism declined. The *percentage expecting stock prices to rise over the next six months* climbed 2.2ppts to 46.5%, remaining above its historical average of 37.5% for the 17th straight week. The *percentage expecting stock prices will stay essentially unchanged over the next six months* rose 2.6pts to 32.2%, above its historical average of 31.5% for the third time in 13 weeks. Meanwhile, the *percentage expecting stocks to fall over the next six months* dropped 4.9ppts to 21.3%, an unusually low percentage—and below its historical average of 31.0% for the 17th straight week.

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 29 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 ticked down a hair from its record high a week earlier. 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 rose 0.2pts w/w to 5.0%. It's now just 0.1pt below its 15-month high of 5.1% in early January, but has gained 2.7pts 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 10.8%. That's down from a 26-month high of 11.5% in early January 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 4.7% in 2024 (up 0.3pt w/w) and 5.8% in 2025 (unchanged w/w) compared to a revenues gain of 2.2% in 2023. They expect an earnings gain of 9.8% in 2024 (up 0.1pt w/w) and a 13.6% rise in 2025 (down 0.1pt w/w) compared to an earnings gain of 2.2% 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 rose 0.2pt w/w to a 25-month high of 20.6. 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 rose 0.04pt w/w to a 25-month high of 2.64. 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, eight had their forward revenues rise w/w, and seven had forward earnings move higher. The forward profit margin moved higher w/w for four sectors. Five sectors have forward revenues at post-pandemic or record highs this week: Communication Services, Consumer Discretionary, Consumer Staples, and Industrials, and Real Estate. Among the remaining six sectors, only three have forward revenues more than 5.0% below their post-pandemic highs: Energy, Financials, and Materials. Consumer Discretionary and Utilities were the only sectors with forward earnings at a record high this week. Three other sectors, Communication Services, Consumer Staples, and Information Technology, were in that camp in very recent weeks. Among the remaining six sectors, only Energy and Materials have forward earnings down more than 10.0% from their post-pandemic highs, while Health Care remains close. 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. Consumer Discretionary and Information Technology are the only sectors with their forward profit margin at a record high this week. The forward profit margins for Communication Services and Industrials remain close to their post-pandemic high or record highs. Energy's is at a 23-month low, 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 (16.4, down from its 19.2 record high in 2016), Communication Services (16.9, down from its 17.0 record high a week earlier), Utilities (13.6, 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 (10.4, 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

ADP Employment (*link*): "Job gains remain solid. Pay gains are trending lower but are still above inflation," noted Nela Richardson, chief economist, ADP. *Private payrolls* increased a smaller-than-expected 140,000 (vs 150,000 expected) in February, following an upwardly revised increase of 111,000 (from 107,000) in January. Service-providing jobs rose 110,000 in February, while goods-producing industries increased 30,000. Within *servicing-providing* industries, leisure & hospitality (41,000) posted the biggest monthly gain, followed by trade, transportation, and utilities (24,000), financial activities (17,000), other services (14,000), education & health services (11,000), while professional & business services (5,000) payrolls were marginally higher, and information services (-2,000) once again showed a slight decline in payrolls. Within *goods-producing* industries, construction (28,000) jobs continue to lead the pack, while manufacturing jobs (6,000) posted a small decline, and natural resources/mining (-4,000) lost jobs during the month. By *company size*, medium (69,000), large (61,000), and small (13,000) all added to payrolls. Turning to ADP's *median annual pay* measures, the yearly rate for *job-stayers* slowed to 5.1% in February, continuing a deceleration that began from last September's 7.8% peak, while the rate for *job-changers* accelerated to 7.6% in February from 7.2% in January—which was the smallest annual gain since May 2021.

JOLTS (*link*): Job openings fell in January to their lowest level since March 2021. *Openings* slipped slightly to 8.86 million from 8.89 million at the end of last year. While there are still lots of job openings, they have declined from the series peak of 12.2 million in March 2022. Prior to the pandemic in early 2020, the highest level of job openings recorded was 7.6 million. Openings reached 10.0 million in June 2021 for the first time in the history of the series going back to 2000. There were 6.1 million people unemployed in January, so there were 1.45 available jobs for each unemployed person. This ratio was at a recent high of 2.0 during March 2022. *By industry*, the biggest increases in job openings during January occurred in accommodation & food services (94,000), nondurable goods manufacturing (82,000), health care & social assistance (71,000), other services (64,000), financial activities (57,000), and professional & business services (54,000). The biggest decreases in job openings occurred in retail trade (-170,000), transportation, warehousing, and utilities (-66,000), durable goods manufacturing (-48,000), private educational services (-41,000), and construction (-21,000). *Separations* include *quits*, which are generally voluntary separations initiated by employees—serving as a measure of workers' willingness or ability to leave jobs. *Total quits* have been in a downtrend since peaking at 4.5 million during April 2022, falling to 3.4 million in January—the lowest level since February 2021. *Hirings* were little changed at 5.7 million at the start of the year.

Global Economic Indicators

Eurozone Retail Sales (*link*): Eurozone retail sales increased in January for the third time in four months, by 0.1% m/m, but was up only 0.2% over the period, depressed by December's 0.6% drop. Sales have been negative on a year-over-year basis for 16 consecutive months. Sales of *automotive fuels* increased for the fifth successive month, by 1.7% in January and 4.2% over the period, while sales of *food, drinks, and tobacco* rebounded 1.0% in January after a three-month slide of 1.6%. Meanwhile, sales of *non-food products excluding fuel* fell 1.1% over the two months through January after climbing 1.3% over the prior two-month period. *Eurozone retail* sales fell 1.0% y/y in January, with sales of *non-food products ex food* (-1.4% y/y) and *food, drinks, and tobacco* (-0.6) in the red, while *automotive fuels* were up 0.8% over the 12-month period. January data are available for only two of the *Eurozone's four largest economies* and show *Germany* (-0.4% m/m & -1.6% y/y) fell on both a monthly and yearly basis, while sales in *France* (1.2 & -1.1) rose in January but fell on a y/y basis.

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