Yardeni Research

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Morning Briefing

Housing, Drug Stores & IPOs

Check out the accompanying chart collection.

Executive Summary: If the market for existing homes revs up as mortgage rates drop, will homebuilders be able to clear their excess inventories? Investors don't seem worried, Jackie notes. … Also: The sole constituent of the S&P 500 Drug Retail industry, Walgreen Boots Alliance, has been through the wringer: booted from the DJIA, abandoned by its former CEO, and stripped of its investment-grade debt rating. But with a forward P/E battered to just 6, might all the misfortune be priced into the stock? ... And: With the IPO market moribund, private equity firms—and their investors—are caught in a logjam of immobile assets.

Consumer Discretionary: Home Selling Season Starts. Spring has arrived in New York along with daffodils and the home selling season. Real estate agents who suffered through the bust of 2023 could find that they are busier this year.

Buyers and sellers have had a year to adjust to higher mortgage rates, and pent-up demand—to buy and to sell—has had a year to build. It still looks like a sellers' market, but mortgage rates have fallen by one percentage point from last year's highs, and that may give both buyers and sellers of existing homes enough wiggle room to make transactions happen. If so, homebuilders—which have elevated inventories of homes—could find that the bonanza of 2023 does not repeat.

Here's a deeper look at the current status of the housing market and how it may impact companies in the S&P 500 Homebuilding industry, which resides in the S&P 500 Consumer Discretionary sector:

(1) *Mortgage rates fall.* Gyrating mortgage interest rates have given the housing market whiplash over the past four years. Existing home sales boomed during the Covid pandemic as mortgage rates fell to historically low levels and consumers opted to move out of cities and into suburban homes with offices. Then existing home sales slumped last year as inflation and mortgage rates jumped.

As this year's home selling season kicks off, the interest rate on a 30-year mortgage has fallen to 6.87%, down from last year's peak of 7.79% but still far above the 2.65% interest rate home buyers paid in January 2021 when yields hit their recent low (*Fig. 1*). If the Federal Reserve lowers interest rates this year, as the market expects, mortgages will become even more affordable.

(2) *Stuck at home.* High mortgage rates kept homeowners with old 3% mortgages from selling their homes last year because it's tough to justify buying a new home with a 6% mortgage. The number of existing homes for sale cratered to a low of 85 million in 2022, and they've only ticked up slightly since then, hitting 107.0 million in February (*Fig. 2*).

As a few more homes have come on the market, existing home sales have increased slightly, off very low levels. Sales of single-family homes hit a recent low of 3.4 million units during October 2023, and the number of sales picked up slightly, to 4.0 million in February (*Fig. 3*).

With supply still tight, the price of existing homes has continued to rise, most recently by 5.6% in February (*Fig. 4*). And of course, everyone has a story of just how tight the market is. From the Long Island market: Jackie's friend listed her home last month and within a week had 10 offers, including one funded with all cash.

(3) *A homebuilder bonanza.* Homebuilders have made hay over the past year, taking advantage of the low inventories of existing homes for sale. While new homes aren't selling at the red-hot pace they were during the pandemic, they remain strong, with 662,000 units sold in February (*Fig. 5*).

One potential area of concern is the growing inventory of new homes available for sale. It has increased to 463,000 in February, up from 457,000 units in January and far greater than the 281,000 new homes on the market in October 2020 (*Fig. 6*).

February's inventory levels would take 8.4 months to sell using the pace of new homes sold in February (*Fig. 7*). That's historically been considered a lot of inventory, with four or five months typically representing a "well supplied" market. If new home sales slow, that figure will quickly jump even higher. New homes are still being started at a rapid clip, especially in the South, the region with the most single-family housing starts by far (*Fig. 8*).

High inventory levels may be giving new home buyers more leverage. The median new home price fell 7.6% y/y in February, bringing the price of new homes down to their lowest level since May 2022 (*Fig. 9*). Conversely, the price of existing homes has continued to climb.

So far, investors in the S&P 500 Homebuilding stock price index don't appear concerned. The index has jumped 66.4% over the past year and is at an all-time high (*Fig. 10*). The industry's revenue is expected to climb 4.0% this year and 6.7% in 2025, while its earnings are forecast to grow 3.6% this year and 9.3% next year (*Fig. 11* and *Fig. 12*). And at a recent 11.2, the industry's forward P/E is neither cheap nor expensive (*Fig. 13*).

(FYI: "Forward P/E" is the multiple using forward earnings, i.e., the time-weighted average of industry analysts' consensus operating earnings-per-share estimates for the current and following years; forward revenues are the same but calculated from the analysts' revenue estimates.)

(4) *Watching agent fees.* The way home buyers and sellers pay for real estate agents' fees is changing in July due to the settlement of antitrust litigation against real estate agents. Historically, sellers have paid for the fees charged by the seller's and the buyer's agents, which could total 5%-6% of the home's sale price.

Under the settlement, buyers will negotiate the selling fee directly with their agent. It is possible that buyers will try to buy a home before the rule changes, and sellers might want to wait to sell their home until after the rule changes. But both buyers and sellers know that families want to be in contract before July so that they can close and have their kids in their new schools by September. While negotiations about real estate agent fees may be a little more convoluted, we suspect that it won't change the pace of sales.

Consumer Staples: Has Drug Retail Hit Bottom? The S&P 500 Drug Retail industry has had a no-good, very bad year—and it's only March. The stock price of Walgreens Boots Alliance, the industry's sole constituent, has fallen 21.5% ytd through Tuesday's close compared to the S&P 500's 9.1% gain. And over a one-year period, Walgreens' shares have dropped 37.3% compared to the S&P 500's 31.0% gain (*Fig. 14*).

Walgreens Boots Alliance competes against CVS Health, which purchased Aetna in 2018 and resides in the S&P 500 Health Care Services industry, and against Rite Aid, which was dropped from the S&P 500 after its market capitalization declined. It subsequently filed for bankruptcy protection last year.

What could have caused such devastation in the S&P 500 Drug Retail Industry? Let's take a look:

(1) *Dividend cut and Dow expulsion.* In January, Walgreens slashed its dividend to 25 cents a share from 48 cents. The move will save about $800 million annually, giving the company the flexibility to reduce debt among other things, but the shares fell on the news anyway.

In February, the drug retailer was booted from the Dow Jones Industrial Average and replaced by Amazon, which—in an ironic twist—is trying to break into the pharmacy business. Amazon announced earlier this week that it is expanding same-day pharmacy delivery to New York and Los Angeles and plans to be in more than a dozen cities by the end of the year, a March 26 *WSJ* *article* reported. The company already offers same-day pharmacy delivery in Indianapolis, Miami, Phoenix, Seattle, and Austin.

(2) *Debt downgrade and CEO resignation.* In December, Walgreens' debt was cut from investment grade to the junk rating of Baa2 by Moody's Investors Service. The shares fell once again. And in August, the company's CEO Roz Brewer resigned after just a two-year stint.

This is the company that Tim Wentworth inherited when he was tapped to become CEO in October. Wentworth was previously CEO of pharmacy benefits manager Express Scripts, which was sold to Cigna. And he'll be presiding over his second earnings conference call on Thursday.

(3) *Lots of bad news priced in.* While the company's forward revenues has continued to climb to new highs, its forward earnings just recently halted a five-year decline and began moving sideways at an 11-year low (*Fig. 15* and *Fig. 16*). While earnings declined by 21.0% last year and is expected to fall again this year, by 18.3%, analysts are hopeful that earnings will climb in 2025 by 8.6%.

Shareholders, however, are far from convinced that the operation will turn around. The company's forward P/E has sunk to 6.0, near record-low levels (*Fig. 17*). Even the slightest morsel of good news could give the stock a shot in the arm.

Disruptive Technologies: Private Equity Logjam. Comparing Cisco circa 2000 and Nvidia today in the *March 14* and *March 20* *Morning Briefings* made us realize just how different the capital markets for small companies are today compared to 2000. The lackluster initial public offering (IPO) market over the past two years has left private equity funds holding their investments for longer periods. In 2000, the IPO market was robust and had been for the prior eight years.

Let's take a closer look:

(1) *Comparing IPO markets.* Leading up to the stock market bubble of 2000, the IPO market was on fire. In all but one year from 1992 through 2000, more than 380 companies went public EACH year. Today's investment bankers can only dream of such bounty. The one exception was 1998, when only 283 deals came to market, according to *data* from Jay Ritter, a professor at the University of Florida. The deals raised between $17.1 billion (1994) and $64.8 billion (in 2000) each year.

(Ritter excluded from his data IPOs with an offer price under $5.00, ADRs, unit offers, closed-end funds REITs, natural resource limited partnerships, small best efforts offers, banks and S&Ls, and stocks not listed on the major exchanges.)

Over the past decade, the number of deals coming to market annually has been almost one quarter of the number that came to market in the 1990s. The best year we've had recently was in 2021, when 311 IPOs raised $119.4 billion. In more typical years, 100-200 deals came to market. That is, until the IPO drought of the past two years: In 2023, only 54 deals came to market, raising $11.9 billion; in 2022, a scant 38 deals raised $7.0 billion.

(2) *Private equity problem.* Tapping the IPO market is one of the ways private equity companies sell their investments and log profits. With the IPO market largely closed over the past two years, private equity players have been forced to either hold onto their investments for longer periods or sell them to another investor or company.

Private equity firms are sitting on a record $3.2 trillion of unsold investments in 28,000 companies, according to a March 11 *article* in *Private Equity News*. The average holding period for buyouts among US and Canadian private equity funds hit 7.1 years in November 2023, the longest holding period since 2000, according to a November 22 S&P Global *report*. That period is up from an average of 5.8 years from 2014 to 2023 and 4.9 years over the prior decade.

This clogged pipeline has ripple effects. If private equity investors can't monetize their investments, they don't have funds to distribute to their institutional investors. Institutional investors "have received just a trickle of money over the past five years, even as they committed enormous sums to fund the new buyout deals," a January 2 *FT* *article* reported. If institutional investors don't receive their distributions, they have less to invest in new private equity funds.

It may take the Federal Reserve and lower interest rates to unstick this merry-go-round.

Calendars

US: Thurs: Real GDP & Price Index 3.2%/1.7%; Real Consumer Spending 3.0%; Headline & Core PCED 1.8%/2.1%; University of Michigan Consumer Sentiment, Current Conditions, and Expectations 76.5/79.4/74.6; Initial Claims 214k; Kansas City Manufacturing Index; Chicago PMI 45.9; Pending Home Sales; Natural Gas Storage; Baker-Hughes Rig Count; Fed's Balance Sheet. **Fri:** Headline & Core PCED 0.4%m/m/2.4%y/y & 0.3%m/m/2.8%y/y; Personal Income & Spending 0.4%/0.5%; Wholesale Inventories 0.2%; Powell; Daily. (FXStreet estimates)

Global: Thurs: Germany Retail Sales 0.4%m/m/-0.9%y/y; Germany Unemployment Rate 5.9%; Italy Business Consumer & Business Sentiment 97.3/87.6; UK GDP -0.3%q/q/-0.2%y/y; Japan Unemployment Rate 2.4%; Japan Industrial Production 1.2%; Japan Retail Sales 2.8%y/y. **Fri:** France CPI 0.7%m/m/2.8%y/y; Italy CPI 00%m/m/1.4%y/y. (FXStreet estimates)

Strategy Indicators

Stock Market Sentiment Indicators (***link***): The *Bull-Bear Ratio* dipped a little this week to 3.99, from 4.10 last week and 4.20 two weeks ago—which was the highest since February 5, 2018. *Bullish* sentiment ticked up to 60.6% this week, after slipping to 60.3% last week from 60.9%—which was the most bulls since summer 2021. The bulls last exceeded 60.0% in April and July 2021, at 63.7% and 61.2%, respectively. Meanwhile, *bearish* sentiment ticked up for the second week to 15.2% from 14.5%—which was the lowest count since March 2018. The *correction count* ticked down to 24.2% after ticking up last week from 24.6% to 25.0%. Turning to the *AAII Sentiment Survey* (as of March 21), pessimism among individual investors increased sharply during the latest week, while both optimism and neutral sentiment fell. The *percentage expecting stocks to fall over the next six months* jumped 5.3ppts to 27.2%, remaining below its historical average of 31.0% for the 20th straight week. The *percentage expecting stock prices to rise over the next six months* dropped 2.7ppts to 43.2%, remaining above its historical average of 37.5% for the 20th straight week. The *percentage expecting stock prices will stay essentially unchanged over the next six months* sank 2.6pts to 29.6%, below its historical average of 31.5% for the sixth time in eight weeks.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin ticked down 0.1pt w/w to 12.8% during the March 21 week from a 16-month high of 12.9% a week earlier. That's up from a 24-month low of 12.3% during the March 30, 2023 week, but is down 0.5pt from its record high of 13.4% achieved intermittently in 2022 from March to June. It's now 2.6pts 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 dropped 0.2% 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 was unchanged w/w at a 17-month high of 5.2%. It has gained 2.9pts 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 a nine-week high of 11.3%. That's down from a 26-month high of 11.5% in early January and is now 8.0pts above its 31-month low of 3.3% during the February 16, 2023 week. 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 4.8% in 2024 (up 0.1pt w/w) and 5.9% in 2025 (unchanged w/w) compared to a revenues gain of 2.2% in 2023. They expect an earnings gain of 10.0% in 2024 (up 0.1pt w/w) and a 13.7% rise in 2025 (up 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 12.5% in 2024 (down 0.1pt w/w), compared to 11.9% in 2023, and to rise 1.0ppt y/y to 13.5% in 2025 (unchanged w/w). The S&P 500's weekly reading of its forward P/E rose 0.3pt w/w to a 26-month high of 21.0. That's 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 0.03pt to a 25-month high of 2.70. 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 March 21 week, nine had their forward revenues rise w/w, and four had forward earnings move higher. The forward profit margin moved higher w/w for only one sector. Five sectors have forward revenues at post-pandemic or record highs this week: Communication Services, Consumer Staples, Health Care, Industrials, and Information Technology. Among the remaining six sectors, only three have forward revenues more than 5.0% below their post-pandemic highs: Energy, Financials, and Materials. Two sectors had record-high forward earnings this week: Communication Services and Information Technology. Consumer Discretionary, Consumer Staples, Real Estate, and Utilities were in that camp in very recent weeks, and Industrials isn't too far off. Among the remaining four sectors, only Energy and Materials have forward earnings down more than 10.0% from their post-pandemic highs, with Health Care and Real Estate nearly in that club. 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. None of the sectors have their forward profit margin at a record high this week. A week earlier, three sectors were in that club: Communication Services, Consumer Discretionary, and Information Technology. The forward profit margin for Industrials also remains close to its record high. Energy's is edging up now from February's 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%, down from its 26.6 record high a week earlier), 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 (16.9, down from its 17.0 record high a week earlier), Utilities (13.5, 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 (10.7, 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, down from its 8.8 record high a week earlier), and Consumer Staples (6.9, down from its 7.7 record high in June 2020).

Global Economic Indicators

Eurozone Economic Sentiment Indicators (*link*): The Economic Sentiment Indexes (ESIs) for the both the EU and Eurozone picked up in March, with the *EU's measure* increasing 0.7 point to 96.2 and the Eurozone's also climbing, by 0.8 point to 96.3. There was more strength than weakness in ESIs among the *six largest EU economies* this month, with France (+2.6 points to 100.7) and Italy (+1.5 to 100.9) posting the biggest gains, followed by Germany (+0.9 to 89.8) and to a lesser extent Poland (+0.3 to 101.8); ESIs in the Netherlands (-0.7 to 97.8) and Spain (-0.4 to 102.0) deteriorated. By sector, within the Eurozone, *retail trade* (+0.7 points to -5.7) and consumer (+0.6 to -14.9) sentiment posted the biggest gains in March, followed by services (+0.4 to 6.3) and *industrial* (+0.3 to -8.8) confidence; construction sentiment remained stable at -5.6. Most sectors remain on downtrends, with the exception of consumer sentiment, which is on an improving trend, and services sentiment, which remains in a volatile flat trend, posting the highest reading of the group.

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