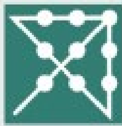
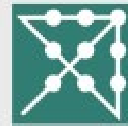
 Yardeni Research 

June 27, 2024

Morning Briefing

Freight, Travel & AI-Trained Cars

Check out the accompanying chart collection.

Executive Summary: Jackie has been mining information from earnings conference calls for insights into industry and economic trends. For example, air freight demand is unexpectedly strong as a result of shippers' Red Sea travails; that and the end of inventory drawdowns could benefit FedEx. … Earnings reports from Pool Corporation and Carnival Cruise Line suggest that consumers aren't sinking money into backyard pools as much anymore, but they're dropping it with abandon on cruise ships and air travel. … And in our Disruptive Technologies segment: how AI will accelerate the adoption of autonomous driving systems.

Industrials: FedEx Delivers. A massive restructuring that involved merging divisions, laying off employees, and cutting costs helped FedEx deliver fiscal Q4 earnings (ended May) that beat Wall Street's expectations. Looking forward, the company faces the expiration of its contract with the US Postal Service this fall. But if the US inventory correction has run its course, a slimmed down FedEx could continue to surprise the naysayers.

Let's take a look at what the company had to say on its earnings *conference call* and some related economic data on inventories and trade:

(1) *Cost cutting saves the day.* FedEx shares jumped more than 15% on Tuesday after the company reported adjusted fiscal Q4 earnings per share of $5.41 compared to $4.94 a year earlier, beating the $5.34 consensus estimate of analysts. The 9.5% y/y earnings gain broke a five-quarter string of declines thanks to cost cutting. However, fiscal Q4 revenue stagnated at $22.1 billion compared to $21.9 billion a year earlier.

FedEx also introduced its fiscal 2025 forecast, which included low-to-mid-single-digit percent revenue y/y growth, permanent cost reductions from its restructuring of $2.2 billion, and adjusted earnings per share of $20.00-$22.00, up from $17.80 in fiscal 2024. The

midpoint of the estimate range would mark an 18.0% y/y increase.

Investors were excited to hear that the FedEx board is examining its options for the FedEx Freight division. The less-than-truckload operator has operating margins above the company's average and might be spun off because it is too large to be purchased by another operator, a June 26 FreightWaves *article* speculated.

(2) *Talking macro.* Looking into fiscal 2025, the company expects demand to "moderately improve" as the year progresses, said Chief Customer Officer Brie Carere. She noted that international air cargo demand from Asia accelerated in early May and is stronger than had been expected: "Shippers are facing tightened capacity both in air and sea freight services. Red Sea disruptions have further exacerbated shipper challenges from Asia to Europe. These conditions should bring strength to the overall air freight yields from Asia."

Growth will be driven by e-commerce and low inventory levels, she added. After climbing sharply in the wake of the pandemic, wholesale inventory levels peaked in November 2022 and have moved sideways since (*Fig. 1*). Retail inventories followed the same pattern (*Fig. 2*). After almost two years of drawdowns, the inventory correction should have run its course or be close to doing so.

(3) *Tariffs loom.* Management dodged a question about the impacts on the company of the upcoming presidential elections and tariff policy. Former President Donald Trump has floated the idea of placing a new 60% tariff on all Chinese imports and a 10% across-the-board tax on imports from anywhere in the world. The Biden administration has enacted its own tariffs targeting Chinese technology, including electric vehicles, semiconductors, and solar panels.

FedEx CEO Raj Subramaniam did note that the company's wide network would adjust to wherever trade flows moved. "There are opportunities as supply-chain patterns change."

Both US real imports and real exports have been flat since Q1-2022 (*Fig. 3*). What has changed are the countries from which the US is importing products. US imports from Mexico have jumped sharply, to $484.7 billion from $322.5 billion in February 2021, while US imports from China are flat over the same period (*Fig. 4*).

Consumer Discretionary: Everyone's Traveling. American consumers may no longer be putting pools in their backyards en masse as during Covid lockdowns, but they certainly are traveling. The latest data confirming Americans' travel bug came from the Transportation

Security Administration (TSA) and Carnival Cruise Line. On Tuesday, the company raised its 2024 net income guidance thanks to strong demand for cruises.

Carnival confirmed what airlines and other travel providers have been saying: The post-pandemic travel itch continues. Here's a look at what Carnival's and Pool Corporation's managements had to say and how consumers are affording their vagabond ways:

(1) *Cruising along.* Carnival's fiscal Q2 (ended May) results beat expectations, and management raised its fiscal Q3 (ending August) forecast. The cruise operator reported adjusted net income of $134 million, up from a year-earlier adjusted loss of $395 million and well above the company's $35 million loss guidance.

The improved results reflect increased cruise bookings, prices paid to sail, and cruisers' onboard spending. The strength has left Carnival with fewer spots to fill on 2024 cruises, so it's hopeful that its pricing power will continue improving. The company boosted its adjusted net income forecast for 2024 to $1.6 billion from $1.3 billion previously.

CEO Josh Weinstein noted on the earnings *conference call* that Carnival's performance doesn't reflect post-pandemic pent-up demand but the growing strength of the company's brands, its yield management techniques that have raised ticket prices, and the financial strength of its consumers. The numbers of repeat and new guests each rose 10% y/y in the quarter.

The stronger demand resulted in improved adjusted free cash flow—$1.3 billion last quarter, up from $625 million a year earlier—which has helped the company pay down some debt. It had $29.3 billion of outstanding debt at the end of the May quarter and aims to regain its investment-grade bond rating. Weinstein said questions about reinstating the company's dividend were "premature," as its priority is strengthening its balance sheet.

Carnival's share price popped almost 9% Tuesday to $17.82. That left the stock down just 3.9% ytd through Tuesday's close, a sharp rebound from down 25.0% ytd in mid-April. The S&P 500 Hotels, Resorts & Cruise Lines stock price index has climbed 10.7% ytd through Tuesday's close (*Fig. 5*).

(2) *Trains, planes, and automobiles.* Carnival isn't the only company benefiting from what's shaping up to be a busy travel season. The number of US air travelers hit a record Sunday, with 2.99 million folks flying (*Fig. 6*). That record could be broken as soon as Friday, when more than 3 million travelers are expected to fly before the July 4 holiday, the TSA *reports*.

“TSA expects to screen more than 32 million individuals from Thursday, June 27 through Monday, July 8, which is a 5.4% increase over 2023 Independence Day holiday travel volumes.”

The S&P 500 Passenger Airlines stock price index has gained 9.1% ytd through Tuesday’s close (*Fig. 7*).

(3) *Home-related items sink.* Consumers’ preference to spend on travel instead of home improvements was highlighted by a stark earnings warning for Q2 and the full year released on Monday by Pool Corporation, a wholesaler of swimming pool and related backyard products: “The most recent pool permit data suggests persistently weak demand for new pool construction […] [W]e now believe that new pool construction activity could be down 15% to 20% for the year with remodel activity down as much as 15%,” a Pool *press release* stated.

Pool Corporation lowered its 2024 earnings-per-share guidance to $11.04-$11.44 from $13.19-$14.19 expected in April.

Shares of home-related stocks fell Tuesday on the news including shares of: Pool Corporation (-8.0%), Mohawk Industries (-5.7), Lowe’s (4.9), Home Depot (-3.6), and Sherwin-Williams (-2.0). Likewise, the S&P 500 Homebuilding industry’s stock price index is roughly flat on the year (-0.1%), and the Home Improvement Retail index has dropped 2.4% (*Fig. 8*).

(4) *Consumers still spending.* While consumers’ spending habits have changed, there’s been no letup in their spending. Consumers are employed, inflation has moderated, and consumers’ debt-service levels relative to income are lower than usual.

The real YRI Earned Income Proxy has been gradually trending up since the pandemic. Most recently, it increased in April to $6.8 trillion (saar), up from $6.6 trillion a year ago. We calculate the proxy by multiplying nonfarm payrolls by average weekly hours by average hourly earnings (*Fig. 9*).

Outstanding consumer credit has been increasing but more slowly than usual during economic expansions. While it hit a record $5.1 trillion in April, consumer credit balances increased only $6.4 billion m/m that month and fell by $1.1 billion in March; increases of more than $10.0 billion a month are typical (*Fig. 10* and *Fig. 11*). Just as importantly, consumers’ debt-service ratio—the ratio of debt-service payments to disposable personal

income—remains low historically, at 9.8 in Q4-2023 (*Fig. 12*).

Disruptive Technologies: AI Meets Autonomous Driving. The tech world is hopeful that artificial intelligence (AI) can help accelerate the development of autonomous driving, which has been disappointingly slow to materialize. So far, only Google's Waymo drives the streets without a human behind the steering wheel. Most robotaxi-wannabes are testing their autonomous systems with humans ready to take control.

Autonomous driving systems were originally trained by having humans drive cars for millions of miles, to allow the systems to experience every driving situation possible. This method is time consuming and may not cover all scenarios. Using AI, cars—theoretically—can be trained faster via intuitive learning and simulations.

Here's a look at what Waabi and Nvidia are doing to steer autonomous driving systems in the right direction:

(1) *AI helps a startup catch up.* Waabi, a startup headed by the former head of Uber's now defunct autonomy project, has developed an "AI system capable of human-like reasoning," a June 18 Axios *article* explained. The system is trained in an advanced virtual simulator. Founded in 2021, the company claims that it has caught up to rivals that started developing autonomous driving systems years earlier. It plans to launch fully driverless trucks next year.

(2) *Nvidia jumps into the driver's seat.* Nvidia earlier this month introduced Omniverse Cloud Sensor RTX, new AI simulation software that it claims will improve safety, reduce costs, and expedite the training of autonomous driving systems.

The software program "combines real-world data from various sensors with synthetic data, supposedly allowing developers to test sensor perception and associated AI software in realistic virtual environments before real-world deployment," a June 19 *article* in PYMNTS reported. The software creates a digital twin of driving environments that allows developers to test and refine their designs.

Foretellix and MathWorks are software developers using the sensor program for autonomous vehicle development. Separately, General Motors' Cruise subsidiary is using Nvidia's self-driving software program.

Calendars

US: Thurs: GDP & Price Index 1.3%/3.1%; Atlanta Fed GDPNow (Q2) 3.0%; Headline & Core Durable Goods Orders -0.1%/0.1%; Kansas City Fed Manufacturing Index; Trade Balance -$96.0b; Jobless Claims 240k; Pending Home Sales; Wholesale Inventories 0.2%; Fed Bank Stress Results. **Fri:** Personal Income & Spending 0.4%/0.3%; Headline & Core PCED 0.0%m/m/2.6%y/y & 0.1%m/m/2.6%y/y; University of Michigan Consumer Sentiment Index, Current Conditions, and Expectations 65.9/62.5/67.6; University of Michigan Inflattioon 1-Yeat & 5-Year Inflation Expectations 3.3%/3.1%; fed Monetary Policy Report; Baker-Hughes Rig Count; Barkin. (FXStreet estimates)

Global: Thurs: Eurozone Business and Consumer Sentiment 96.3; Japan Unemployment Rate 2.6%; Japan Industrial Production 2.0%; BoE Stability Report; Euro Summit; Eurogroup Meetings; Elderson; Bailey. **Fri:** Germany PPI 0.2%; Germany Retail Sales; Germany Unemployment Rate 5.9%; France CPI 0.1%; France Consumer Spending 0.2%; Italy CPI 0.2%; UK GDP 0.6%q/q/0.2%y/y; EU Leaders Summit; Eurogroup Meetings. (FXStreet estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The *Bull-Bear Ratio* edged down for the second week to 3.32 this week from 3.43 two weeks ago. It was at 4.43 12 weeks ago—which was the highest reading since February 5, 2018. *Bullish sentiment* rose for the third week to 61.5% this week—the highest since the end of March's 62.5%—after falling 1.8ppts (to 57.6% from 59.4%) the previous two weeks. Meanwhile, *bearish sentiment* rose for the second week to 18.5%, after falling from 18.2% to 17.6% two weeks ago. It was at 14.1% in early April—which was the fewest bears since 12.6% in late January 2018. The *correction count* fell for the third week to 20.0%, following a two-week increase of 0.8ppts (to 24.2% from 23.4%); it was at 33.3% eight weeks ago—which was the highest since early October 2023. Turning to the *AAII Sentiment Survey* (as of June 20), both optimism and pessimism among individual investors about the short-term outlook for stocks fell during the latest reporting week, while neutral sentiment rose. *Bearish sentiment* sank 3.2ppts to 22.5%—remaining below its historical average of 31.0% for the sixth time in 10 weeks. *Bullish sentiment* ticked down 0.2ppt to 44.4%, remaining above its historical average of 37.5% for the 32nd time in 33 weeks. Neutral sentiment increased 3.4ppts to 33.1%, above its historical average of 31.5% for the sixth time in 14 weeks.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin remained steady w/w at a 23-month high of 13.2% during the June 20 week. That's up from a 24-month low of 12.3% during the March 30, 2023 week and just 0.2pt below its record high of 13.4% achieved intermittently in 2022 from March to June. It's now 2.9pts above its seven-year low of 10.3% during April 2020. Forward revenues was steady w/w at a new record high. Forward earnings rose less than 0.1% w/w to a 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 rose less than 0.1pt w/w to a 20-month high of 5.4%. It has gained 3.1pts 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 less than 0.1pt w/w to a 31-month high of 12.8%. It's now 9.5pts 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 at 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 4.6% in 2024 (unchanged 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 10.6% in 2024 (down 0.1pt w/w) and a 14.5% rise in 2025 (up 0.1pt w/w) compared to an earnings gain of 2.4% in 2023. Analysts expect the profit margin to rise 0.7ppt y/y to 12.6% in 2024 (unchanged w/w), compared to 11.9% in 2023, and to rise 1.1ppt y/y to 13.7% in 2025 (unchanged w/w). The S&P 500's weekly reading of its forward P/E rose 0.3pt w/w to a 30-month high of 21.2. 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 0.03pts w/w to a 30-month high of 2.80. 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 June 20 week, five had forward revenues that rose w/w and three had forward earnings that moved higher. This led to rising forward profit margins w/w for three of the 11 sectors. These three sectors had forward revenues at a record high this week: Consumer Staples, Information Technology, and Real Estate. Five sectors remain less than 0.9% below their recent post-pandemic highs: Communication Services,

Consumer Discretionary, Health Care, Industrials, and Utilities. The three remaining sectors have forward revenues more than 5.0% below their post-pandemic highs: Energy, Financials, and Materials. (When adjusted for the incoming transfer of five former Tech sector firms in March 2023, Financials' forward revenues would be at a record high too.) Two sectors have record-high forward earnings this week: Information Technology and Utilities (Financials would too adjusted for GICS changes in March 2023). Just two sectors still have forward earnings down more than 19.8% from their post-pandemic highs: Energy and Materials. Among the remaining six sectors, these four are less than 0.1% from their recent record highs: Communication Services, Consumer Discretionary, and Industrials. Looking at the forward profit margin, nearly all of the sectors are showing signs of recovering from their early 2023 forward profit margin lows. Communication Services and Information Technology are the only sectors with a forward profit margin at a record high this week. In recent weeks, Consumer Discretionary and Industrials were in that camp as well. Energy's forward margin is improving now from its 23-month low of 10.4% in February, while those of Consumer Staples and Health Care remain at or slightly above their record lows. The annual profit margin is expected to fall y/y in 2024 for Energy, Materials, and Real Estate and to 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 (27.1%, a new record high), Financials (19.1, down from its 19.8 record high in August 2021), Communication Services (17.8, a new record high), Real Estate (16.9, down from its 19.2 record high in 2016), Utilities (13.9, down from its 14.8 record high in April 2021), S&P 500 (13.2, a 23-month high and down from its record high of 13.4 achieved intermittently in 2022 from March to June), Materials (11.1, down o.1pt w/w from an 11-month high and down from its 13.6 record high in June 2022), Energy (10.9, a six-month high and down from its 12.8 record high in November 2022), Industrials (10.7, down from its 10.8 record high in early April), Consumer Discretionary (9.1, a new record high), Health Care (8.7, up 0.2pts from its record low at the end of April and down from its 11.5 record high in February 2022), and Consumer Staples (6.9, down from its 7.7 record high in June 2020).

US Economic Indicators

New Home Sales (***link***): New home sales (counted at the signing of a contract) slumped to a six-month low as higher mortgage rate depressed demand. New home sales sank 11.3% to 619,000 units (saar) in May—the lowest level since November and below the consensus estimate of 640,000 units. Meanwhile, April sales were revised up to 698,000 units from the preliminary estimate of 634,000. May sales are 16.5% below year-ago levels. At May's

sales pace, it would take 9.3 months to clear the *supply of houses* on the market, up from 8.1 months in April. *Regionally*, sales fell in all four regions, with the Northeast (-43.8% to 18,000 units, saar) posting the biggest monthly loss, followed by the South (-12.0 to 368,000), Midwest (-8.6 to 85,000), and the West (-4.5 to 148,000). Of the 619,000 *homes sold* in May, 294,000 were completed, 253,000 were under construction, while 72,000 weren't started. Of the 481,000 *homes for sale* during May, 99,000 had been completed, 278,000 were under construction, and 104,000 hadn't yet broken ground.

Contact us by *email* or call 480-664-1333.

Ed Yardeni, President & Chief Investment Strategist, 516-972-7683
Eric Wallerstein, Chief Markets Strategist, 201-661-3575
Debbie Johnson, Chief Economist, 480-664-1333
Joe Abbott, Chief Quantitative Strategist, 732-241-6502
Melissa Tagg, Director of Research Projects & Operations, 516-782-9967
Mali Quintana, Senior Economist, 480-664-1333
Jackie Doherty, Contributing Editor, 917-328-6848
Valerie de la Rue, Director of Institutional Sales, 516-277-2432
Mary Fanslau, Manager of Client Services, 480-664-1333
Sandy Cohan, Senior Editor, 570-228-9102