Yardeni Research

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Morning Briefing

China, Tech & Solar Panels

Check out the accompanying chart collection.

Executive Summary: Collateral damage from China's ailing real estate sector has hit its consumer sector. US companies with exposure to China's consumers have felt the blow of depressed consumer sentiment and spending. Jackie shares her takeaways from some of the victims' June-quarter earnings reports. … Is the MegaCap-8 stocks' recent selloff a canary in a coal mine, warning that AI won't live up to its hype? Nope, suggests a look at their valuations together with their earnings growth prospects. … Also: Our Disruptive Technologies segment focuses on prospects for solar panel manufacturers and some innovations they're developing.

China: Consumers' Woes Hit US Shores. The long, slow implosion of China's real estate market is having lasting effects on consumer confidence and spending. US companies with exposure to the Chinese markets haven't escaped. Chinese consumers have been less willing to buy everything from Big Macs to Mercedes Benzes.

The Chinese government has taken numerous steps to boost its economy, including lowering interest rates, starting its own version of "Cash for Clunkers," lowering home buying costs, and allowing local governments to purchase unsold apartments—so far to no avail. On Tuesday, Bloomberg *reported* that Chinese leaders acknowledged the consumer spending problem but failed to detail how they planned to fix it, simply saying, "The focus of economic policies needs to shift toward benefiting people's livelihood and promoting spending."

Here's an update on the state of Chinese consumption and a look at what companies have said about China's markets in recent earnings reports:

(1) *China's depressed consumers.* The decline of the Chinese real estate market has lasted a painful three years and counting (*Fig. 1*). New home prices in China fell 4.5% y/y and 0.7% m/m in June to their lowest levels since June 2015, a July 15 Reuters' *article* reported.

Prices continue to decline even though the yield on the 10-year Chinese government bond has fallen to a 20-year low of 2.14% (*Fig. 2*).

Were that not enough, the rally in Chinese stocks earlier this year has petered out. After rising 31.7% from January 22 to a nine-month high on May 20, the China MSCI stock price index fell by 14.5% through Tuesday's close, leaving it down 0.9% ytd (*Fig. 3*).

No wonder Chinese consumers are in no mood to spend. Consumer confidence dropped in China again in June to 86.2, near its all-time low of 85.5 in November 2022. It was at an all-time high of 127.0 in February 2021 (*Fig. 4*). Chinese real retail sales in June rose only 1.8% y/y, the slowest yearly pace since January 2023 (*Fig. 5*).

(2) *Chinese pass on Starbucks.* China is Starbucks' second largest market, and the company's same-stores sales there fell 14% y/y in the June quarter as both the average ticket size and the number of transactions fell. Management blamed price cutting by local coffee shops in China. It hopes to accelerate growth in the market via strategic partnerships, according to a July 30 CNBC *article*.

(3) *Chinese pass on McDonald's.* McDonald's global comparable-store sales declined 1.0% y/y in Q2, with US sales down 0.7%, sales in international markets where McDonald's operates the restaurants down 1.1%, and sales in international markets where licensees operate the restaurants down 1.3%. Each category was lapping strong results in the year-ago quarter, up 10.5, 11.9%, and 14.0% y/y, respectively.

Licensed restaurants in China had negative comparable-store sales in the quarter. McDonald's CEO Chris Kempczinski described the Chinese market as competitive and highly promotional on the company's earnings *conference call*. He said that "less confident" Chinese consumers are willing to switch brands based on whomever is offering the best deal. That said, McDonald's market share has remained steady, and new store openings are still generating acceptable returns. So the company remains committed to its goal of opening 1,000 restaurants per year in China.

(4) *Chinese pass on iPhones.* For the first time in five years, Apple's iPhone is no longer one of the top five selling smartphone brands in China. Local companies Vivo, Huawei, Oppo, Honor, and Xiaomi each have larger Q2 market shares, ranging from Vivo's 18.5% to Xiaomi's 14.0%, a July 25 *FT* *article* reported.

Apple's Q2 market share dropped to 13.6% after its iPhone sales declined 3.1% y/y even though shipments of China's smartphones as a whole grew 8.9% y/y, the article noted, citing International Data Corp. data. iPhone sales flagged as Huawei introduced a 5G smartphone and employees of the Chinese government and of Chinese state-owned enterprises were instructed to stop using iPhones, presumably owing to security concerns.

The latest data follow a 10.8% y/y decline in Apple's Chinese sales during the six months ended March 30. Perhaps the introduction of its AI-enhanced software will energize iPhone sales.

(5) *Chinese pass on luxury bags.* Luxury brands from LVMH to Cartier recently reported declining sales in China. Cartier's owner, Richemont, said its June-quarter sales fell 27% y/y in China, Hong Kong, and Macau. LVMH said that its sales in Asia fell 14% in the June quarter following a 6% decline in the March quarter.

But the situation may not be as bleak as the numbers imply. Chinese customers are still buying luxury brands but when they visit Japan, said LVHM CFO Jean-Jacques Guiony on the company's earnings *conference call*. The Japanese yen is at a 34-year low against the euro, making Japan the most attractive shopping destination for Asian customers—including those from China. The drop in the yen creates the equivalent of a deflationary situation in China.

Strategy: Microsoft & the MegaCap-8. Alphabet's and Microsoft's earnings both disappointed investors who have grown to expect a lot from these tech titans. But fortunately, neither company reported anything that would indicate that artificial intelligence (AI) won't be as big as advertised. In fact, their capital spending plans—higher than expected—signal that they are moving ahead full steam to build out their infrastructure to support AI. If that's the case, much of the selloff may be in the rearview mirror.

Here's a look at the MegaCap-8 stocks' recent selloff, earnings forecasts, and multiples:

(1) *Selloffs happen.* Many of the MegaCap-8 stocks peaked on July 5. Here's how they've performed from July 5 through Tuesday's close: Apple (-1.2%), Amazon (-8.0), Microsoft (-8.2), Alphabet (-8.3), Netflix (-8.8), Meta (-9.2), Tesla (-9.7), and Nvidia (-19.4).

While selloffs are never fun, the MegaCap-8 stocks (except for Tesla) are still having a banner year: Nvidia (109.5% ytd through Tuesday's close), Meta (30.9), Netflix (27.9), Alphabet (21.9), Amazon (19.6), Apple (13.6), Microsoft (12.5), and Tesla (-10.4) (*Fig. 6*).

(2) *A mixed bag.* While are all grouped together as the MegaCap-8, the individual members' forward multiples and earnings growth rates are very different. For example, Nvidia's forward P/E of 32.1 looks extremely cheap relative to its expected forward earnings growth of 60.9%. Likewise, Meta and Netflix get little credit for their strong earnings growth, which almost equals their respective forward P/Es.

Conversely, some forward multiples are harder to justify, like Tesla's forward P/E of almost 80 with forward earnings growth of less than 6%. Investors are placing a lot of faith in the company's ability to roll out autonomous cars and an electric semi-trailer truck. Apple and Microsoft's forward multiples look a touch stretched. A lot is riding on Apple's ability to roll out its AI offering, Apple Intelligence, and Microsoft must expect the billions it's spending quarterly to build out its AI infrastructure to pay off.

Here's the performance derby for the MegaCap-8 stocks' multiples and their forward earnings growth: Tesla (79.0 forward P/E, 5.8% forward earnings growth), Amazon (34.2, 36.9), Nvidia (32.1, 60.9), Microsoft (31.4, 13.0), Apple (30.3, 10.4), Netflix (29.1, 32.4), Meta (21.1, 22.0), and Alphabet (20.6, 20.1) (*Fig. 7* and *Fig. 8*).

Disruptive Technologies: Solar Shining. The world is gleaming with solar panels as the US and China both strive to dominate an industry that may be fundamental to electricity production in the future. Next year, the world is expected to have 2.13 GWdc of solar capacity, most of that—1.71 GWdc—from China. That's more than three times what the world needs, according to Rystad Energy data in a July 22 *Financial Times* article.

The bright side of excess capacity is that it's driving down prices and making solar more affordable. The dark side is that it's pushing companies to close factories in locations where building solar panels is no longer economically feasible, like Europe. The US government has both protected US solar companies with tariffs on Chinese goods and provided ample funding through the Inflation Reduction Act (IRA). One of the prime beneficiaries has been First Solar, which reported strong Q2 earnings earlier this week.

Let's take a look at First Solar's results as well as some of the new advancements in the industry:

(1) *First Solar beats.* First Solar shares have risen 22.4% ytd through Tuesday's close. And for good reason: It's one of the few US manufacturers that survived the industry's shakeout. First Solar's Q2 revenue jumped 24.6% y/y to $1.01 billion, its net income soared 104.8% y/y to $349.3 million, and management left its full-year guidance unchanged.

First Solar has used Biden Bucks from the IRA to dramatically expand its manufacturing capabilities, having committed more than $2.8 billion in US capital investments since the IRA was signed into law.

The political waters might get more treacherous if former President Trump returns to the White House or if Republicans gain control of the Congress and unwind some or all of the IRA. That said, Republicans might also slap even more restrictive tariffs on imports that originate in China.

CEO Mark Widmar noted on the earnings *conference call* that the company began seeing the impact in Q2:“We have observed increasing constraints on access to capital … Our financing parties wait to make investment decisions until they have a clear view of the policy picture.” The political uncertainty is also impacting developers.

While longer-term projects might be delayed while the dust settles, projects slated for 2025 might be pulled forward so they are funded or completed before the potential administration change. Widmar also called out the industry’s “irrational oversupply driven almost exclusively by China’s well-documented ambitions to dominate solar supply chains.” The company’s shares rose 2.4% on Wednesday.

(2) *Introducing perovskite.* First Solar and others are working to develop the use of perovskite in solar cells. The material is vastly more efficient than the silicon currently used, but it’s unstable; it can decompose in the presence of moisture, oxygen, light, heat, or applied voltage—which is problematic, to say the least.

Researchers at Hong Kong University of Science and Technology, however, have developed a more resilient perovskite film after discovering “concavities” in perovskite that make it unstable, a July 29 *Popular Mechanics* *article* reported.

Late last year, First Solar acquired Evolar AB, a European company focused on developing manufacturing equipment for commercializing a tandem solar technology using perovskite thin films. First Solar paid $38 million for Evolar, and will pay up to an additional $42 million if future development milestones are hit, a May 12, 2023 *article* in *Renewable Energy World* reported. First Solar is also exploring the development of multi-junction solar cells, which theoretically would absorb more sunlight and increase the efficiency of solar panels to north of 80% from about 33% today.

(3) *Robots lend a hand.* AES has developed a robot, dubbed “Maximo,” that can help build

solar farms. The robot allows AES to install solar panels in half the usual time and at half the cost, the company noted in a *press release*. Maximo has already installed 10 MW of solar and is projected to install 100 MW by 2025.

(4) *An out-of-this-world idea.* Researchers at startup Virtus Solis are developing solar panel-covered satellites that would collect the sun's rays and beam the energy back down to Earth. The energy could be sent into the electrical grid or directly to a facility that needs it. The system would be always on and solve Earth-bound solar panels' intermittency problem.

Calendars

US: Thurs: Productivity & Unit Labor Costs 1.5%/1.6%; Initial Claims 239k; ISM M-PMI & Price Index 49.0/52.5; Atlanta Fed GDPNow 2.8%; Construction Spending 0.2%; Total Vehicle Sales. **Fri:** Total & Private Payroll Employment 177k/155k; Average Hourly Earnings 0.3%; Average Weekly Hours; Unemployment Rate 4.1%; Factory Orders 0.5%; Total Vehicle Sales; Baker Hughes Rig Count. (FXStreet estimates)

Global: Thurs: Eurozone, Germany, France, Italy, and Spain M-PMIs 45.6/42.6/44.1/46.2/51.9; Eurozone Unemployment Rate 6.4%; ECB Economic Bulletin; UK M-PMI 51.8; BoE Interest Rate Decision 5.00%; Bailey; Pill. **Fri:** France Industrial Production 0.9%; Italy Industrial Production -0.2%; Italy Retail Sales 0.2%; Pill. (FXStreet estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The *Bull-Bear Ratio* fell to 3.81 this week after climbing the prior two weeks from 3.50 to a 16-week high of 4.31. It was at 4.43 17 weeks ago—which was the highest reading since February 5, 2018. *Bullish sentiment* retreated to 59.4% after climbing the prior two weeks from 62.7% to 64.2%, which exceeded the end of March's peak rate of 62.5% for the most bulls since late 2020. Meanwhile, *bearish sentiment* rose to 15.6% after falling the prior two weeks, from 17.9% to 14.9%, which again was the fewest bears since just 14.1% in late March 2024 (which also saw the last high for the bulls, which was just exceeded). The *correction count* rose for the third week from 19.4% to 25.0%—the highest count since early May—ending the seven consecutive readings near 20%. In the *AAII Sentiment Survey* (as of July 25), bullish sentiment among individual investors about the short-term outlook for stocks decreased during the latest week, while both neutral sentiment and pessimism increased. *Bullish sentiment* sank 9.6ppts to 43.2%—remaining above its historical average of 37.5% for the 37th time in 38 weeks. Meanwhile, *bearish sentiment* jumped 8.3ppts to 31.7%—moving above its historical average of 31.0% for the first time in seven weeks. Neutral sentiment rose 1.3ppts to 25.1%, below its historical average of 31.5% for the 12th time in 19 weeks.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin remained steady w/w at a 25-month high of 13.3% during the July 25 week. That's up from a 24-month low of 12.3% during the March 30, 2023 week and just 0.1pt below its record high of 13.4% achieved intermittently in 2022 from March to June. It's now 3.0pts above its seven-year low of 10.3% during April 2020. Forward revenues rose 0.2% w/w to its first record high since the July 4 week. Forward earnings rose 0.1% w/w to a new record high. It had hit that mark during the September 21, 2023 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 a 22-month high of 5.8%. It has gained 3.5pts 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 was unchanged w/w at a 33-month high of 13.2%. It's now 9.9pts 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 4.9% in 2024 (up 0.2pt 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 10.3% in 2024 (unchanged w/w) and a 14.9% rise in 2025 (unchanged w/w) compared to an earnings gain of 2.5% 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 1.0ppt y/y to 13.6% in 2025 (unchanged w/w). The S&P 500's weekly reading of its forward P/E fell 0.6pts w/w to a seven-week low of 20.8 and is down from a 31-month high of 21.6 during the July 11 week. 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 fell 0.09pts w/w to a seven-week low of 2.84 and is down from a 31-month high of 2.86 during the July 11 week. That's up from a six-month low of 2.22 during the October 26, 2023 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 July 25 week, forward revenues rose for seven sectors and forward earnings rose for five. This led to rising forward profit margins w/w for five of the 11 sectors. These three sectors had forward revenues at a record or post-pandemic high this week: Communication Services, Health Care, and Information Technology. Financials' forward revenues would be at a record high too when adjusted for the incoming transfer of five former Tech sector firms in March 2023. Five sectors remain less than 1.1% below their recent post-pandemic highs: Consumer Discretionary, Consumer Staples, Industrials, Real Estate, and Utilities. The two remaining sectors have forward revenues more than 5.0% below their post-pandemic highs: Energy and Materials. Two sectors have record-high forward earnings this week: Communication Services and Information Technology. Just two sectors still have forward earnings down more than 22.0% from their post-pandemic highs: Energy and Materials. Six sectors are less than 1.4% from their recent record highs in forward earnings: Consumer Discretionary, Consumer Staples, Financials, Industrials, Real Estate, and Utilities. Health Care's forward earnings is 6.7% below its high and has stalled since late 2022. Looking at the forward profit margin, nearly all of the sectors are showing signs of recovering from their early 2023 forward profit margin lows. Communications 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 not much above 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 (27.3%, record high), Financials (19.2, down from its 19.8 record high in August 2021), Communication Services (17.9, up 0.1pt w/w to a record high), Real Estate (17.5, up 0.3pts to a 21-month high and down from its 19.2 record high in 2016), Utilities (14.0, down from its 14.8 record high in April 2021), S&P 500 (13.3, a 25-month high and just 0.1pt below its record high of 13.4 achieved intermittently in 2022 from March to June), Materials (11.1, down 0.5pt w/w from a 20-month high and down from its 13.6 record high in June 2022), Energy (10.5, down 0.1pt w/w and from its recent six-month high of 10.9 and down from its 12.8 record high in November 2022), Industrials (10.7, down 0.1pt from its 10.8 record high), Consumer Discretionary (9.1, a record high this week), 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

ADP Employment (*link*): Employment gains missed expectations in July—adding the fewest number of jobs since the start of this year—while wage gains slowed. *Private payrolls* increased a smaller-than-expected 122,000 (vs 150,000 expected) in July, following an upwardly revised 155,000 increase in June, first reported up 150,000. Service-providing jobs climbed 85,000 last month, while goods-producing jobs advanced 37,000. Within *service-providing* industries, trade, transportation & utilities (61,000) once again posted the largest gain, followed by leisure & hospitality (24,000), educations & health services (22,000), other services (19,000), and financial activities (14,000), while employees in the professional & business services (-37,000) and information services (-18,000) industries saw job cuts. Within *goods-producing* industries, construction (39,000) jobs continued to lead the pack, with natural resources/mining (2,000) showing a slight uptick. The decline in manufacturing (-4,000) jobs was roughly one-fifth of June's cut. By *company size*, medium companies (70,000) recorded the largest gain in July, followed by large companies (62,000), with small companies (-7,000) in the red. *Turning to wages*: "With wage growth abating, the labor market is playing along with the Federal Reserve's effort to slow inflation," noted Nela Richardson, chief economist of ADP. "If inflation goes back up, it won't be because of labor." The yearly rate for *job-changers* slowed from 7.7% to 7.2% in July, while the yearly rate in pay for job-stayers slowed to 4.8%—the slowest pace in three years.

Employment Cost Index (*link*): The Employment Cost Index (ECI)—which is the broadest measure of labor costs and the Fed's preferred measure—is showing a dramatic slowing in labor costs recently. The overall *ECI for private industry workers* increased 0.9% during the three months ending June, slowing from 1.1% during the three months through March, with *wages & salaries* (to 0.8% from 1.1%) and *benefits* (0.8 from 1.0) both showing an easing in cost increases over the period. On a yearly percent change basis, *overall labor costs* for the private sector slowed for the eighth consecutive quarter since peaking at a recent high of 5.5% during Q2-2022, slowing to a three-year low of 3.9% Q2-2024, with the rates for *wages and salaries* (from 5.6% to 4.0%) and *benefits* (5.3 to 3.5) both easing over the comparable periods.

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