Yardeni Research

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# Morning Briefing

## On Consumers & More On AI

*Check out the accompanying chart collection.*

**Executive Summary:** The US consumer's spending hasn't declined, but it has shifted—leaving retailers of out-of-favor items out of luck. Jackie recaps what company managements have revealed about what consumers do and don't want to buy these days and pinpoints multiple reasons for the shifts. … And: AI seems to be advancing by the minute. Our weekly Disruptive Technologies segment looks at the strides two companies have made in producing avatars and robots that seem very human.

**Consumer Discretionary: Spending Thoughtfully.** US consumers are rational creatures. If they are employed and have money to spend, they spend it. Yes, some retailers, including Starbucks and Home Depot, have reported disappointing quarterly results recently. However, their results shouldn't be extrapolated to retailers generally. For every Starbucks, there's a hip new restaurant concept, like Sweetgreen, a purveyor of salads, that's growing rapidly. And while consumers might not be willing to take out high-interest-rate loans to fund home renovations, that doesn't mean they won't spend on travel or clothing.

Retail sales come out on Thursday. Until then, let's take a look at what company managements have been saying the consumer is willing and unwilling to spend on:

(1) *Starbucks vs Sweetgreen.* Despite our latte habit, Starbucks continues to struggle. It reported a 1% y/y drop in net sales and a 3% decline in comparable-store sales in its fiscal Q3 quarter ended June. Declines hit the company's operations both at home and abroad. US same-store sales dropped 2%, and traffic in US stores fell 6%.

Starbucks' newly appointed CEO Brian Niccol may need to look beyond the US consumer to determine what ails the coffee purveyor. We say that because consumers seem more than willing to spend on pricey salads. Sweetgreen reported Q2 same-store sales that jumped 9% y/y, thanks to a 4% increase in traffic and a 5% increase in menu prices (a new steak salad seems to be flying off the counters, which is ironic for a salad joint).

No doubt, with only 225 US-based stores, Sweetgreen is far smaller than Starbucks, which has operations around the world. Nonetheless, its results show that US consumers are still ready, willing, and able to open their wallets to buy pricey food items that they really want.

(2) *Waiting for lower rates.* During the pandemic, when interest rates were low and near-free money abounded, consumers spent lavishly on buying and fixing up their homes (*Fig. 1*). When the pandemic ended and interest rates spiked, the target of their spending shifted to travel and other fun-related services (*Fig. 2*).

The move toward fun out in the world and away from nesting at home has affected Home Depot. The big-box retailer lowered its 2024 earnings forecast when it reported July-quarter earnings on Tuesday. Home Depot now expects same-store sales to decline 3%-4% this year, down from its earlier forecast for a 1% drop. Consumers are making a rational decision not to spend on their homes given that they've recently splurged on home upgrades and that interest rates have spiked but are likely to drop.

Home mortgage rates jumped as high as 7.79% in October 2023, and they've subsequently fallen to a recent average rate of 6.47% (*Fig. 3*). Higher interest rates have hurt the amount spent on home renovation projects, sent existing homes sales tumbling to levels not normally seen during periods of economic expansion, and kept a lid on car purchases, which often involve loans (*Fig. 4*). At 15.8 million units (saar), auto sales have yet to return to pre-pandemic levels of 17 to 18 million units (*Fig. 5*).

Consumers may have put their home renovation plans on hold until the Federal Reserve actually cuts interest rates this fall, as Fed Chair Jerome Powell recently indicated was the plan. "Everyone's expecting rates are going to fall. So, [they're] deferring those projects," said Home Depot CEO Ted Decker on the *earnings call*.

Meanwhile, interest-rate-sensitive stocks are looking forward to better times ahead. The S&P 500 Homebuilding stock price index has risen 17.0% ytd through Tuesday's close, whereas the S&P 500 Home Improvement Retail index has inched up 2.4% ytd.

The S&P 500 Automobile Manufacturing index is down 13.9% ytd, including a 21.9% drop in Tesla shares and a 16.8% decline in Ford Motor shares. GM shares, however, have risen an impressive 20.6% ytd (*Fig. 6*). Meanwhile, fun-related stocks have started to look sluggish, as their heyday may be over. The stock price indexes have declined for the Casinos & Gaming (-19.4%), Hotels, Resorts & Cruise Lines (-1.8), and Restaurants (-2.3) industry (*Fig. 7*).

(3) *Eyes on the consumer.* With 60 million customers, Bank of America has a lot of first-hand information about US consumers. The bank's customers have spent about 3% more in July and August so far compared to a year ago, said CEO Brian Moynihan in a Sunday *interview* on *Face the Nation*. While that's just half of the year earlier's 6% growth rate, it's still in the plus column.

Consumer credit and debit card spending per household fell 0.4% y/y in July and dropped 0.5% in June, according to a Bank of America Institute *report* based on the bank's card data. On a seasonally adjusted basis, July's card spending per household rose 0.3% m/m, following a 0.1% m/m drop in June.

The report notes that the prices of many of the items purchased on credit cards have declined, while many of the things boosting prices in the CPI, like shelter, insurance, childcare and utility payments, are not traditionally paid using credit cards. So "even a fairly flat rate of growth in nominal card spending can translate into positive growth in the volume of spending," the report noted.

B of A customers still have 15% more in their bank accounts today than they did prior to the pandemic on an inflation-adjusted basis. While that's down from peak levels, it likely also understates savings because consumers have moved funds from savings accounts into higher-yielding alternatives like money market funds. Consumers' bank balances also typically drift downward in the summer months when people go on vacation.

That said, Bank of America has noticed that consumers are still going to grocery stores frequently, but they're spending less and buying more items on sale. Spending on services remains strong, with seasonally adjusted spending in restaurants up 0.5% m/m in July and spending on international travel soaring thanks to the Olympics in Paris and Taylor Swift concerts around Europe. B of A saw a 35% y/y increase in spending in the cities hosting the Eras tour. Never underestimate the power of Swifties.

**Disruptive Technologies: Replicating Humans.** The technologies that replicate human conversation and movements are getting very impressive. In last Thursday's *Morning Briefing*, we discussed the humanoid robots being produced by Chinese companies that are giving US competitors a run for their money. Here are two more examples of lifelike technology. One is a scarily life-like avatar and another is a ping-pong-playing robot. It might not be ready for the Olympics, but we certainly wouldn't want to bet against its winning.

Here's a deeper look:

(1) *Human or avatar?* Synthesia lets users create avatars that are extremely realistic. An AI video creation platform, Synthesia has 160 stock avatars that can "read" text aloud while expressing the appropriate associated emotions through their intonation and facial expressions. Last month, the company introduced personal avatars. Users can create an avatar that looks and sounds like themselves.

In a *video* introducing personal avatars, Synthesia's CEO Victor Riparbelli's avatar was so realistic that Jackie thought it was human at first.

A personal avatar can say words that are fed into the system as text and can appear in front of any background the human feeds into the system via a computer's webcam or a smartphone. The avatar can speak 29 languages in the human's voice. It doesn't have to look right into the camera but can be "shot" from the side so that an interview can be realistically imitated.

Synthesia believes that its avatars when used in personalized sales or community outreach videos will result in a massive increase in response rates. The avatar can use a particular company's details to make the videos more personal. Companies can also make avatars of the senior leadership teams and send a video out to employees even when leaders are in different locations.

Social media creators can use avatars to reduce the time it takes to create content. Instead of making several videos of the social media creator, one avatar of the creator can read many different scripts and appear with many different backgrounds.

(2) *The PPP robot.* Earlier this month, the folks at Google DeepMind unveiled their PPP (ping-pong-playing) robot, an August 8 ARS Technica *article* reported. The article's video shows the robot impressively volleying with a human.

"The system combines an industrial robot arm, called the ABB IRB 1100 and custom AI software from DeepMind," the article stated. "While an expert human player can still defeat the bot, the system demonstrates the potential for machines to master complex physical tasks that require split-second decision making and adaptability."

## Calendars

**US: Thurs:** Retail Sales Headline & Core 0.4%/0.1%; Wholesale Sales -0.6%; Industrial Production -0.2%; Capacity Utilization 78.5%; NY Empire State Manufacturing Index -5.9; Philadelphia Fed Manufacturing Index 5.6; Atlanta Fed GDPNow 2.9%; Business Inventories 0.3%; NAHB Housing Market Index 42; Initial Claims 235k; Import Prices -0.1%; Natural Gas Storage; Harke. **Fri:** University of Michigan Consumer Sentiment 66.7; Housing Starts & Building Permits 1.34mu/1.43mu; Baker-Hughes Rig Count. (FXStreet estimates)

**Global: Thurs:** UK GDP 0.1%m/m/0.6%q/q; UK Headline & Manufacturing Industrial Production 0.1%/0.1%; Japan Industrial Production -3.6%; UK Labor Productivity -0.3%. **Fri:** Germany WPI; Italy CPI; UK Retail Sales 0.6%. (FXStreet estimates)

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## Strategy Indicators

**Stock Market Sentiment Indicators** (*link*): The *Bull-Bear Ratio* fell for the third week to 2.07 this week after climbing the prior two weeks from 3.50 to a 16-week high of 4.31. It was at 4.43 19 weeks ago—which was the highest reading since February 5, 2018. *Bullish sentiment* fell for the third week to 44.6% this week from 64.2% three weeks ago—which ended seven straight months of readings above 60%. The 64.2% reading was the most bulls since late 2020. Meanwhile, *bearish sentiment* rose the latest three weeks to 21.5%, after falling the prior two weeks from 17.9% to 14.9%, which was the fewest bears since just 14.1% in late March 2024. The *correction count* fell this week to 33.9% after rising the prior four weeks by 15ppts (to 34.4% from 19.4%). In the *AAII Sentiment Survey* (as of August 8), bearish sentiment among individual investors about the short-term outlook for stocks increased during the latest week, while both optimism and neutral sentiment decreased. *Bearish sentiment* jumped 12.3ppts to 37.5%, above its historical average of 31.0% for the second time in nine months. Meanwhile, *bullish sentiment* decreased 4.3ppts to 40.5%—remaining above its historical average of 37.5% for the 39th time in 40 weeks, while *neutral sentiment* sank 7.9ppts to 22.0%, and is now unusually low and below its historical average of 31.5% for the fifth straight week.

**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 August 8 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 ticked down 0.1% w/w from a record high. Forward earnings also ticked down 0.1% from a record high after soaring 1.2% w/w. It has hit that mark for nearly 11 months now. 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 dropped 0.1pt w/w to 5.7% from a 23-month high of 5.8% a week earlier. It has gained 3.4pts 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 fell 0.1pt w/w to 13.5% from a 34-month high of 13.6% a week earlier. It's now 10.2pts 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 4.8% in 2024 (unchanged w/w) and 5.7% in 2025 (down 0.2pts w/w) compared to a revenues gain of 2.2% in 2023. They expect an earnings gain of 10.3% in 2024 (down 0.2pts w/w) and a 14.9% rise in 2025 (up 0.1pt w/w) compared to an earnings gain of 2.5% 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 1.1ppts y/y to 13.6% in 2025 (unchanged w/w). The S&P 500's weekly reading of its forward P/E tumbled 1.2pts w/w to a 14-week low of 19.7 from 20.9 a week earlier. It's now down 1.9pts from a 31-month high of 21.6 during the July 11 week and is up 4.4pts 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 tumbled 0.16pts w/w to a 14-week low of 2.63 from 2.79 a week earlier. It's now down 0.23pts 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*): During the August 8 week, forward revenues rose for four of the 11 S&P 500 sectors and forward earnings rose for six. This led to rising forward profit margins w/w for six sectors as well. These three sectors had forward revenues at a record or post-pandemic high this week: Health Care, Information Technology, and Real Estate. 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. These five sectors are less than 1.1% from their record highs: Communication Services, Consumer Discretionary, Consumer Staples, Industrials, and Utilities. Energy and Materials are lagging at more than 4.9% below. Six sectors have record-high forward earnings this week: Communication Services, Consumer Discretionary, Consumer Staples, Financials, Industrials, and Utilities. Information Technology is 0.4% below its record high a week earlier, and Real Estate is 1.5% below its August 2022 record high. Health Care's forward earnings is 5.7% below its high and has stalled since late 2022. Forward earnings remains depressed for Energy and Materials; both are more than 21.4% below their post-pandemic highs. Looking at the forward profit margin, all of the sectors are showing signs of recovering from their early 2023 forward profit margin lows. Communications Services and Consumer Discretionary are the only sectors with a forward profit margin at a record high this week. In recent weeks, Industrials and Information Technology were in that camp as well. Energy's forward margin is just 0.2ppt above its 23-month low of 10.4% in February, while those of Consumer Staples and Health Care are slightly above their post-pandemic lows in 2023. 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%, down 0.1pt w/w from a 27.4% record high), Financials (19.3, down from its 19.8 record high in August 2021), Communication Services (18.1, up 0.1pt w/w to a new record high this week), Real Estate (17.4, down 0.2pt w/w from a 21-month high and down from its 19.2 record high in 2016), Utilities (14.1, 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 from a 20-month high of 11.6 in July and from its 13.6 record high in June 2022), Energy (10.6, down from a six-month high of 10.9 in June and its 12.8 record high in November 2022), Industrials (10.8, just a hair below its 10.8 record high in September 2013), Consumer Discretionary (9.2, up 0.1pt w/w to a new 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

**CPI** (*link*): The headline yearly inflation rate fell below 3.0% in July for the first time since spring 2021, with the monthly gain in line with expectations. *Headline* CPI rose 0.2% last month following a 0.1% downtick in June and no change in May, while core prices edged up 0.2% after gains of 0.1% and 0.2% the prior two weeks—slowing from the 0.4% monthly gains earlier this year. On a *year-over-year basis,* the *headline* rate slowed to 2.9%, its lowest rate since March 2021 and down from June 2022's peak rate of 9.1%. Meanwhile, the *core* rate continues to ease, falling to 3.2% in July—the lowest rate since April 2021; it peaked at 6.6% during September 2022. *Goods inflation* fell 0.4% y/y in July, with durable goods prices falling 4.1% y/y, down from the 18.2% peak in January 2022, while the rate for nondurable goods is at 1.3%, down from 14.4% in June 2022. *Services excluding energy services* is drifting lower, though remains relatively high at 4.9%, well above rates a couple of years ago. Looking at *durable goods* prices, there's lots of red in the yearly percent changes: used cars & trucks (-10.9), furniture & bedding (-5.2), major appliances (-3.3), new vehicles (-1.0), and motor vehicle parts & equipment (-0.3%). Here's a snapshot of yearly rates for some key *nondurable goods* prices from highest to lowest: recreational commodities (8.8% y/y), medical care commodities (2.8), food (2.2), apparel (0.2), and housekeeping supplies (0.1). Energy prices showed a yearly gain in March (2.1) for the first time since February 2023 and moved higher through the 12 months through May (3.7), though eased to 1.1% in July. It had bottomed last June at -16.7%. Turning to services inflation, *rent of shelter* remains high, though the yearly rates are easing from their recent highs in April 2023: rent of primary residence (5.1% from 8.8%) and owners' equivalent rent (5.3 from 8.1). Turning to *non-housing-related services*, the yearly rate of transportation service (8.8% y/y) remains high, though is easing recently, as is the rate for recreation services (3.1), which is the lowest since fall 2021. Meanwhile, the yearly rate for education & communication services is hovering around 2.0%, while the medical services (3.3) rate has been on an accelerating trend, though is looking toppy recently. The rate for other personal services moved up to 5.1% in July from 4.0% in May—which was the lowest rate since October 2021.

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## Global Economic Indicators

**Eurozone Industrial Production** (*link*): Eurozone industrial production fell again in June, posting only one gain so far this year. *Headline* production, which excludes construction, edged down 0.1% in June following declines of 0.9% and 0.1% the prior two months; the declines came after a 0.5% rise in March—the only month in the plus column this year. Production is down 2.8% ytd and 3.9% y/y to its lowest level since October 2020. Among the *main industrial groups*, intermediate goods production rose 0.7% in June following a three-month slide of 1.3%, while capital goods output rose 0.9% following May's 2.6% shortfall. Meanwhile, energy output recovered 2.3% during the two months ending June following a three-month slide of 3.4%. Consumer goods output was a mixed bag in June: Consumer durable goods production rebounded 3.8% in June after sliding 2.9% in May, while consumer nondurable goods production slumped 2.5% after jumping 5.4% during the two months through May. *Compared to a year ago*, total production fell 2.9%, led by shortfalls in capital goods (-7.8%), consumer durable goods (-2.1), and intermediate goods

(-1.5), while energy (2.6) output was above year-ago levels; consumer nondurable goods (0.1) output was basically flat. Looking at the *largest Eurozone economies*, production was in the plus column in June for the top four economies: Germany (1.6% m/m & -4.1% y/y), France (0.7 & -1.7), Italy (0.5 & -2.6), and Spain (0.4 & 0.8), with only Spain showing a slight y/y increase.

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