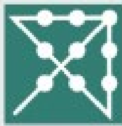
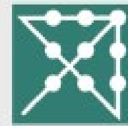
 Yardeni Research 

September 5, 2024

Morning Briefing

Retailers, Markets & AI

Check out the accompanying chart collection.

Executive Summary: Why did the managements of Walmart and Dollar General paint vastly different pictures of low-income consumers in recent Q2 earnings calls? Jackie explores the differences in the two companies' business models and operating landscapes that account for their divergent Q2 results and impressions of consumer spending behavior. … Also: a look at which S&P 500 industries and sectors shifted into and out of market leadership positions during the summer's rebound. … And: Wall Street firms are implementing AI initiatives fast and furiously. The operating efficiencies that result could mean that recent finance grads with sights set on the Street need a Plan B.

Consumer Staples: Mixed Signals. Two retailers positioned for good insight into the health of the low-end consumer segment are Dollar General and Walmart. Yet their earnings reports for last quarter were so different that you might think the two sell their wares on different planets.

Dollar General's results were so disappointing that it lowered its full-year earnings forecast, and the stock fell 32.1% on the day of the report. Conversely, Walmart's results were so strong that it raised its full-year earnings target; its shares have climbed 46.9% ytd. And the managements of the two retailers told Wall Street opposite narratives about low-end consumers on their earning conference calls. Why?

A bit has to do with the two companies' different business models. Walmart is a global and online behemoth, offering high-margin services such as club memberships. Walmart has also been attracting middle- and high-end consumers looking to save a buck or two, particularly on essentials.

Moreover, investors and analysts are concerned that there may be too many dollar stores competing with Dollar General and that the company lacks enough exposure to Internet retailing. On Wednesday morning, another dollar store, Dollar Tree, reinforced this tale of

woe. It cut its full-year earnings targets after reporting Q2 results, and its shares slid more than 20%.

Here's a quick look at the two versions of reality that Dollar General and Walmart served up when they reported earnings in recent weeks:

(1) *Different Q2 results.* Dollar General and Walmart reported similar top-line increases. Dollar General's Q2 sales (August 2) climbed 4.2% to $10.2 billion. Walmart's Q2 sales (July 31) jumped 4.8% to $169.3 billion, within which US revenue climbed 4.1%.

The picture starts to differ when discussing same-store sales. At Dollar General, same-store sales increased 0.5%, thanks to 1.0% growth in customer traffic offset by a decline in the average transaction amount, driven by a lower average unit retail price. At Walmart, US same-store sales rose 4.2%, thanks in part to the sale of the GLP-1 drugs, hardlines, home, and fashion businesses. The number of US transactions jumped 3.6%, and the average ticket rose by 0.6%.

The divergence gets more dramatic further down the income statement. Dollar General's operating income fell 10.6% to $550.0 million. The company's gross margin shrank by 1.12ppts due to markdowns, increased inventory damage, mix of goods sold, and increased shrink. The company's selling, general, and administrative expenses went up as a percentage of revenue due to labor costs, depreciation and amortization, store occupancy costs, and utilities. Conversely, Walmart's adjusted operating income rose 7.2%, which it attributed to higher gross margins, growth in membership income, and reduced ecommerce losses.

(2) *Different forecasts.* In the wake of Q2 results, Dollar General reduced its full-year forecast, and Walmart did the opposite. Dollar General now expects full-year net sales to increase 4.7%-5.3% (down from 6.0%-6.7% previously), same-store sales to inch up 1.0%-1.6% (down from 2.0%-2.7%), and diluted EPS to come in at $5.50-$6.20 (down from $6.80-$7.55).

At Walmart, net sales expected this fiscal year was boosted to an increase of 3.75%-4.76%—up from 3.0%-4.0% earlier. Consolidated adjusted operating income is now expected to increase 6.5%-8.0% (up from 4.0%-6.0%), and adjusted EPS is now pegged at $2.35-$2.43 (up from $2.23-$2.37).

(3) *Different commentary.* Dollar General executives painted a picture of a consumer who is

financially stretched and having a tough time getting from paycheck to paycheck. Walmart executives sounded a much happier tune.

The last week of each month was Dollar General's weakest in Q2, which implies that customers are "less able to stretch their budgets through the end of the month," said CEO Todd Vasos on the company's August 29 earnings *conference call*. He added, "We believe the softer-than-anticipated sales performance in Q2 is at least partially attributable to a core customer that is less confident of their financial position."

Dollar General's core customers, who predominantly come from households earning less than $35,000 annually, "state that they feel worse off financially than they were six months ago as higher prices, softer employment levels, and increased borrowing costs have negatively impacted low-income consumer sentiment."

Due to rising prices on rent, utilities, healthcare, and other items, "cash strapped" consumers are refraining from purchasing basic necessities. More are using credit cards to pay for basic household needs, and 30% of them have at least one maxed-out credit card. A quarter of customers surveyed anticipate missing a bill payment in the next six months. Dollar General executives described consumer spending softening in July and the company ramping up promotional activity in August.

Walmart's CEO Doug McMillon sang a happier tune: "So far, we aren't experiencing a weaker consumer overall." Nonetheless, the company has been lowering prices. "Customers from all income levels are looking for value, and we have it," he said.

"We're also seeing higher engagement across income cohorts, with upper-income households continuing to account for the majority of gains, even while we grow sales and share among middle- and lower-income households," said CFO John David Rainey. Ecommerce sales in Walmart US were up 22% y/y, with weekly active customers up 20%.

Walmart execs also explained how artificial intelligence (AI) is helping their business: AI is being used to describe items in the catalog more accurately, and it would have taken the company 100 times longer to update the catalog had it used humans to do the job. AI is helping employees pick and pack items faster by showing them high-quality images of the items. And an AI-powered search engine is helping customers find the products they want.

(4) *Industry data.* Both Dollar General and Walmart are members of the S&P 500 Merchandise Retail stock price index, which resides within the Consumer Staples sector.

The industry's stock price index—which also includes Costco (up 33.1% ytd through Tuesday's close), Dollar Tree (-42.5), and Target (6.5)—has risen 28.4% ytd (*Fig. 1*). Thanks to the contributions of Walmart and Costco, the index's forward revenues and forward operating EPS have climbed sharply to record highs, and its forward profit margin is 3.3%, a record high (*Fig. 2*, *Fig. 3*, and *Fig. 4*).

The Merchandise Retail industry's revenue is forecast to grow 4.0% this year and 5.1% in 2025; meanwhile, the industry's annual earnings growth is expected to jump 46.6% this year and 43.6% in 2025 (*Fig. 5* and *Fig. 6*). With the largest members of this industry rallying the hardest, it's not surprising that the industry's forward P/E is 30.8, near a four-year high (*Fig. 7*).

Strategy: Some Leadership Changes. The 2.1% decline in the S&P 500 on Tuesday made for a tough start to the always prickly fall trading season. It abruptly ended the strong rebound that the market was enjoying since the last major selloff finished on August 5.

Market selloffs and recoveries often shake up the leadership board, and the sharp summer selloff is no exception. The S&P 500 Financials sector has dethroned all things technology to become the best performing sector from August 5 through September 2, rising 11.7%. Of course, Financials and Technology underperformed during Tuesday's market selloff. But August's market action may provide some insight into what sectors and industries will rebound once the fall selloff concludes. Consider the following:

(1) *Anticipating lower rates.* The growing expectation that the Federal Reserve will lower interest rates at its meeting later this month bolstered many industry indexes in the S&P 500 Financials sector from August 5 through September 2, including Consumer Finance (13.6%), Diversified Banks (13.5), Property & Casualty Insurance (12.3), Transaction & Payment Processing Services (10.2), Reinsurance (10.1), Regional Banks (10.1), Investment Banking & Brokerage (10.0), and Multi-line Insurance (9.8).

Expectations that interest rates will fall have also helped the Consumer Discretionary sector, which is the third best performing sector in the S&P 500, an improvement from its second-to-last ranking in the year prior to August 5. The S&P 500 Consumer Discretionary sector's stock price index jumped 9.5% from August 5 to September 2. Industries that bolstered the sector's performance during that period include Computer & Electronics Retail (25.1%), Footwear (15.9), Consumer Electronics (13.4), Hotels, Resorts & Cruise Lines (10.9), Restaurants (10.8), Broadline Retail (10.8), Apparel, Accessories & Luxury Goods (10.6), and Automobile Manufacturers (9.3).

(2) *Sector performance derbies.* Notably, the Energy sector is an underperformer both in the period since the August 5 selloff and in the year prior to the selloff.

Here's the performance derby for the S&P 500 and its 11 sectors from August 5 through September 2: Financials (11.7%), information Technology (11.0), Consumer Discretionary (9.5), S&P 500 (8.9), Industrials (8.8), Real Estate (7.1), Health Care (7.0), Materials (7.0), Communications Services (5.9), Consumer Staples (5.8), Utilities (5.1), and Energy (4.7) (*Table 1*).

Here's the performance derby for the S&P 500 and its 11 sectors for the year prior to the correction that ended on August 5: Information Technology (27.7%), Communication Services (26.9), Financials (17.2), S&P 500 (15.8), Utilities (13.0), Industrials (11.6), Health Care (10.9), Real Estate (9.6), Consumer Staples (6.6), Materials (5.5), Consumer Discretionary (1.4), and Energy (0.2) (*Table 2*).

(3) *Nvidia weighs.* One of the top performing industries in both time periods is Semiconductors. It's up 16.5% from August 5 through September 2, making it the second-best performing industry during that time period. In the year prior to the August selloff, the Semiconductors industry was the top performer, up 66.2%.

The industry lost ground on Tuesday because of a report that its largest member, Nvidia, has received subpoenas from the US Justice Department, which is looking for evidence that Nvidia violated antitrust laws, a September 3 Bloomberg *article* reported. Nvidia shares fell 11.0% on Tuesday and Wednesday.

Here are the top five performing industries from August 5 through September 2: Computer & Electronics Retail (25.1%), Semiconductors (16.5), Independent Power Producers & Energy Traders (16.2), Footwear (15.9), and Passenger Airlines (15.7). In the doghouse were Drug Retail (-13.7%), Construction Materials (-4.0), Health Care Distributors (-2.2), Timber REITs (-2.1), and Food Retail (-1.3).

Disruptive Technologies: AI on Wall Street. Wall Street titans historically have been early adopters of technology, particularly if it enhances productivity and the bottom line. So it's no surprise that AI has taken Wall Street by storm, with CEOs boasting of all the new AI programs being rolled out to summarize meetings, mine for potential investment banking clients, structure investment portfolios, and write legal documents. It's still early days, but here are some of things the initial adopters have learned:

(1) *Centralization helps.* Firms that centralized their AI operations (instead of letting various business lines implement their own AI plans) have adopted generative AI more quickly. “Centralized steering allows enterprises to focus resources on a handful of use cases, rapidly moving through initial experimentation to tackle the harder challenges of putting use cases into production and scaling them,” a March 22 McKinsey & Co. *report* found.

(2) *Limiting AI’s scope.* Generative AI programs hallucinate, making up answers and leaving users unsure of their credibility. Morgan Stanley has addressed this problem by limiting its AI programs to searching only the firm’s data and content, not that of the Internet at large. Morgan’s AI program is available only to employees, it shows users justifications for each answer, and it provides links to source materials, a July 10, 2023 Investment News *article* reported.

(3) *Talk of slimmer workforces.* With AI making work easier and faster, there’s much speculation about how fast Wall Street firms will start trimming employees, particularly those in entry-level jobs. It turns out that AI is good at summarizing meetings, making PowerPoint presentations, and dumping data into Excel spreadsheets. This may mean that far fewer college finance majors hoping to become Masters of the Universe will be hired by Wall Street in the future, an April 10 *NYT* *article* suggested. For now, however, Wall Street firms are hiring briskly—but it’s technology folks they’re hiring, those able to build and implement AI platforms.

Calendars

US: Thurs: ADP Nonfarm Employment Change 136k; Initial Claims 225k; Nonfarm Productivity & Unit Labor Costs 2.3%/0.9%; ISM NM-PMI 50.9; S&P Global C-PMI & NM-PMI 54.1/55.2; Auto Sales; Fed’s Balance Sheet; Crude Oil Inventories & Gasoline Production. **Fri:** Nonfarm Payroll Employment Total & Private 164k/136k; Average Hourly Earnings 0.3%; Average Weekly Hours 34.3; Unemployment Rate 4.2%; Baker-Hughes Rig Count; Williams; Waller. (FXStreet estimates)

Global: Thurs: Eurozone Retail Sales 0.1%; Germany Factory Orders -1.6%; Japan Household Spending -0.2%m/m/1.2%y/y; Tuominen; Bullock. **Fri:** Eurozone GDP 0.3%q/q/0.6%y/y; Eurozone Employment Change 0.2%q/q/0.8%y/y; Germany Industrial Production -0.4%; France Industrial Production -0.3%; Italy Retail Sales 0.1%; UK Halifax House Price Index 0.2%; Canada Employment Change 25.6k; Canada Unemployment Rate

6.5%; Elderson; Balz. (FXStreet estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The *Bull-Bear Ratio* rose for the third week to 2.42 this week after falling the prior three weeks from a 16-week high of 4.31 to 2.07. It was at 4.43 21 weeks ago—which was the highest reading since February 5, 2018. *Bullish sentiment* slipped to 52.3% after climbing the prior two weeks from 44.6% to 53.2%. It was at 64.2% six 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* edged down to 21.6%, after climbing the prior five weeks by 7.7ppts (to 22.6% from 14.9%), with the 14.9% reading the fewest bears since just 14.1% in late March 2024. The *correction count* increased to 26.1% after falling the prior three weeks from 34.4% to 24.2%. In the *AAII Sentiment Survey* (as of August 29), pessimism among individual investors about the short-term outlook for stocks increased during the latest week, while both bullish and neutral sentiment decreased. *Bullish sentiment* edged down 0.5ppt to 51.2%, remaining unusually high for the second successive week—and above its historical average of 37.5% for the 42nd time in 43 weeks. *Neutral* sentiment fell 2.9ppts to 21.9%, below its historical average of 31.5% for the eighth straight week. Meanwhile, *bearish sentiment* climbed 3.3ppts to 27.0%, below its historical average of 31.0% for the third straight week.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin remained steady w/w at a 26-month high of 13.3% during the August 29 week. That's up from a 24-month low of 12.3% during the March 30, 2023 week and just 0.1ppt below its record high of 13.4% achieved intermittently in 2022 from March to June. It's now 3.0ppts above its seven-year low of 10.3% during April 2020. It was another very light week for revisions as forward revenues edged up a hair to 0.1% below its record high during the August 4 week. Forward earnings rose 0.1% w/w to 0.2% below its record high, also during the August 4 week. Revenues and earnings have been steadily making new record highs for 11 months now. That compares to its prior 16-month string of record highs from 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 steady w/w at 5.7% and is down from a 23-month high of 5.8% during the August 1 week. It has gained 3.4ppts 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 0.1ppt w/w to a 35-month high of 13.7%. It's now 10.4ppts 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 4.7% 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 10.0% in 2024 (up 0.1ppt w/w) and a 15.3% rise in 2025 (up 0.1ppt 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 (unchanged 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 edged down 0.1pt w/w to 21.2 from a four-week high of 21.3 but is up 1.5pts from a 14-week low of 19.7 during the August 8 week. It's now just 0.4pts from its 31-month high of 21.6 during the July 11 week and is up 5.9pts 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 0.01pt w/w to 2.83 from a six-week high of 2.84 but is up 0.20pts from a 14-week low of 2.63 during the August 8 week. It's now just 0.03pts 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 29 week, forward revenues rose for five of the 11 S&P 500 sectors and forward earnings rose for two sectors. This led to rising forward profit margins w/w for four sectors. Information Technology was the only sector with forward revenues at a record high this week. Financials' forward revenues remains near its recent record high when adjusted for the incoming transfer of five former Tech sector firms in March 2023. These eight sectors are less than 0.5% from their post-pandemic or record highs: Communication Services, Consumer Discretionary, Consumer Staples, Health Care, Industrials, Real Estate, and Utilities. Energy and Materials are the biggest laggards at 5.5% and 11.4% below, respectively. While Information Technology and Utilities are the only two sectors with record-high forward earnings this week, these six sectors are less than 1.6% below their recent records: Communication Services, Consumer Discretionary, Consumer Staples, Financials, Industrials, and Real Estate. Health Care's forward earnings is 5.1% below its high and has stalled since late 2022. Forward earnings remains depressed for Energy and Materials; both are more than 22.2% 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. While Financials is the only sector with its forward profit margin at a post-pandemic or record high this week, these four sectors were in that camp

recently: Communications Services, Consumer Discretionary, Industrials, and Information Technology. Among the laggards, Energy's forward margin has fallen 0.4ppts from its six-month high of 10.9% in mid-June to a hair above its 23-month low of 10.4% in February; Consumer Staples' is 0.2ppt above its seven-year low of 6.7% in March 2023; and Health Care is 0.2ppts above its 8.5% record low in April. 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 (27.4%, up 0.1ppt w/w to match record high in early August), Financials (19.3, down from its 19.8 record high in August 2021), Communication Services (17.8, down 0.1ppt w/w and from its 18.1 record high during the August 8 week), Real Estate (17.3, down 0.1ppt w/w and 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 26-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 (10.5, up 0.1ppt w/w and 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 (9.1, down from its 9.2 record high during the August 8 week), Health Care (8.7, up 0.2ppts 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

JOLTS (*link*): *Job openings* in July sank to the lowest level since January 2021, signaling a further cooling in the labor market. Job openings dropped to 7.67 million in July (versus 8.09 million expected), while June's figure was revised down to 7.91 million from 8.18 million. Openings have been falling steadily this year from 8.75 million in January. Openings remain at relatively high levels, but down sharply 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 6.8 million people unemployed in July, so there were 1.1 available jobs for each unemployed person. This ratio was at a recent high of 2.0 during March 2022. *By industry,* the number of job openings fell in health care & social assistance (-187,000), state & local governments, excluding education (-101,000), and transportation, warehousing, and utilities (-88,000). Job openings in the following industries posted the biggest monthly gains: professional & business services (+178,00), other services (+51,000), and durable goods manufacturing (+30,000). *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 3.3 million in July.

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