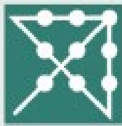
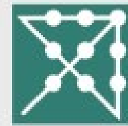
 Yardeni Research 

October 24, 2024

Morning Briefing

Industrials, Housing & Smart Robots

Check out the accompanying chart collection.

Executive Summary: The S&P 500 Industrials sector has performed well this year to date, even though it's been dragged down by the Aerospace & Defense industry, home to the deeply underperforming Boeing. Today, Jackie takes a look at what Boeing management and two other industry stalwarts had to say when reporting September-quarter earnings. … Also: The S&P 500 Homebuilding stock price index is down from its recent high, reflecting the climb in interest and mortgage rates and weak home prices in many large metro areas. … And our Disruptive Technologies segment focuses on the next evolution of humanoid robots, which are learning to expect to the unexpected.

Industrials: Tough to Beat Lofty Expectations. The stock price index of the S&P 500 Industrials sector may not be soaring as high as those of the Information Technology or Communication Services sectors, but it's still having one heck of a year, up 20.2% ytd through Tuesday's close.

Here's how the Industrials' performance stacks up against the S&P 500 and its other sectors ytd: Information Technology (34.7%), Communication Services (28.7), Utilities (28.3), Financials (25.2), S&P 500 (22.7), Industrials (20.2), Consumer Staples (15.7), Materials (12.4), Consumer Discretionary (11.5), Health Care (10.7), Real Estate (9.4), and Energy (8.6) (*Fig. 1*).

Some of the industries within the Industrials sector have had even more impressive ytd performances than the sector, including: Industrial Conglomerates (34.5%), Passenger Airlines (31.9), Construction Machinery & Heavy Trucks (28.9), and Electrical Components & Equipment (21.0) (*Fig. 2*).

The sector's ytd performance would have been higher had it not been dragged down by the likes of Boeing (-38.7% ytd), which weighed on the Aerospace & Defense industry index (18.6%). Also hurting the Industrials sector were Industrial Machinery (14.5%) and some

transportation-related industries, such as Rail Transportation (0.5%), Cargo Ground Transportation (-3.7%), and Air Freight & Logistics (-6.7%) (*Fig. 3*).

This week, GE Aerospace, Lockheed Martin, RTX, and Boeing reported September-quarter earnings. Let's take a look at what they had to say.

(1) *High expectations.* Many Industrials stocks sold off after reporting Q3 earnings, but they remain up sharply for the year. GE Aerospace shares fell 9.1% after reporting earnings on Tuesday, reducing the stock's ytd gains to a still impressive 73.6%. Lockheed Martin shares dropped 6.1% on Tuesday, but its ytd gain remains a healthy 27.3%. 3M shares dipped 2.3% and RTX shares declined 0.29% on Tuesday, but both stocks remain up more than 40% ytd. The S&P 500 was essentially flat on Tuesday, down 0.05%.

Boeing, however, is a different story. Its shares fell roughly 1.5% after reporting earnings on Wednesday, bringing its ytd decline to almost 40%. The company has made an offer to union workers that it hopes ends their strike. It also faces operational issues that have led to two plane crashes, plane malfunctions, and the delayed rollout of new planes. The company reported a $6.2 billion Q3 loss.

Ironically, Boeing's woes have benefited GE Aerospace. Older planes in the air need more repairs, and that's good for GE's aftermarket parts business. GE makes better margins on replacement parts than it does on the sale of engines that go into new planes.

GE Aerospace's Q3 revenue of $9.8 billion rose 5.8% y/y and topped Wall Street's estimate of $9.3 billion. Adjusted EPS of $1.15 topped analysts' consensus estimate of $1.13. The company also upped its full-year EPS forecast to $4.35 from $4.20.

(2) *Wars boosts defense spending.* Lockheed Martin and RTX both benefitted from increased defense spending by countries around the world. Lockheed has had some difficulties updating its F-35 fighter jet, but investors seem to be hoping the issue will be resolved soon and are focusing instead the orders backlog for all Lockheed products, which has grown to $165 billion. The defense contractor also manufactures missiles, which are in high demand, with sales in that segment up 8% y/y.

Lockheed's Q3 sales rose only 1.3% y/y, and adjusted EPS came in at $6.84, above the consensus of $6.50 and up from $6.77 a year ago. The company increased its 2024 earnings forecast to $26.65 a share, above the previous range of $26.10-$26.60.

RTX reported adjusted Q3 sales excluding divestitures of $20.1 billion, up 8% y/y, and adjusted EPS of $1.45, a 16% increase. The contractor also has a large backlog of $221 billion. Like its competitors, RTX benefitted from a strong aftermarket airplane parts market and solid spending on missiles and missile defense systems, among other defense products. It too boosted its 2024 forecast, with adjusted EPS now expected to come in at $5.50- $5.58 instead of $5.35-$5.45 previously.

(3) *Multiples flying high.* Despite being weighed down by the shares of Boeing, the S&P 500 Aerospace & Defense industry's stock price index has risen 18.6% ytd through Tuesday's close (*Fig. 4*). Analysts presumably are optimistic that Boeing will get its act together next year or at least benefit from the easier y/y comparisons it faces, because the overall industry's sales are expected to flip from declining 4.5% this year to rising 9.5% in 2025 (*Fig. 5*). Likewise, the industry's earnings, which declined slightly this year, by 0.6%, is expected to surge 52.0% next year (*Fig. 6*).

The only thing not to like about the S&P 500 Aerospace & Defense industry is its lofty forward P/E of 26.4 (*Fig. 7*). That's well above even the highest valuations of the past three decades. Boeing's return to profitability and the continuation of wars around the world may allow the industry to grow into its multiple, but it's certainly something for investors to watch.

Housing: Higher Rates Spook Homebuilders. The S&P 500 Homebuilding stock price index is up 22.8% ytd through Tuesday's close but has fallen 7.6% from its high on Friday as interest rates backed up over the past week (*Fig. 8*). The 10-year Treasury yield has popped back up to 4.20% from its recent September 16 low of 3.63% and mortgage rates followed suit, inching up to 6.44% from their recent low of 6.08% during the final week of September (*Fig. 9*).

That said, home mortgage rates remain almost a percentage point below where they stood a year ago. The unadjusted mortgage purchase index decreased 5% w/w, but rose 3% y/y for the survey week ended October 18, the Mortgage Bankers Association *reported* on Wednesday.

We've been keeping an eye on the inventory of new and existing homes for sale. The number of existing homes for sale has been creeping up but remains near record-low levels. Existing home sales in September fell 3.5% y/y and 1.0% m/m, and the inventory of unsold existing homes rose 1.5% m/m and 23.0% y/y, the National Association of Realtors *reported* yesterday.

The number of new homes for sale has jumped more sharply and bears watching. The inventory of new homes on the market rose to 467,000 units (saar) in August, up from a recent low of 426,000 units in May 2023 (*Fig. 10*).

Most home prices are up y/y, with the median existing-home sales price up 3.0%y/y in September. There are a handful of exceptions, however, including small percentage declines in the once-hot markets of Austin, Dallas, and San Antonio, Texas as well as Tampa and Jacksonville, Florida, an October 21 *Fast Company* *article* reported.

More surprising are the price declines in 20 of the 50 largest metro areas since the 2022 peak in housing prices. Some drops were modest, in the low single-digit percentages. But other price declines were nothing to sneeze at, such as in Austin (-20.4%), Phoenix (-8.0), San Antonio (-6.8), Denver (-6.4), and Salt Lake City (-5.7). While it's hard to imagine a broad-based housing decline during a time of low unemployment, inventory levels and prices deserve watching.

Disruptive Technologies: Spatially Intelligent Robots. Robots traditionally have been used for repetitive tasks, like welding or painting a particular object on an assembly line. But the most advanced humanoid robots can react to unexpected events thanks to artificial intelligence (AI). They can be trained to respond appropriately to events they've never encountered by watching videos or human trainers. They possess "spatial intelligence."

"The next generation of robotics will be able to sense, see, make decisions, and take action based on their objectives and surroundings," explained an excellent Business Insider *article*. And companies creating these futuristic, intelligent robots are out raising oodles of money. Let's take a look at how these robots are being trained and who's attracting some of the big bucks:

(1) *Training robots.* Large language models are trained by "reading" everything available on the web. But there isn't as much video available to train robots. So folks like Fei-Fei Li, the "Godmother of AI," are working to digitize the 3D world so that robots can be trained to implement what they learn in the real world under circumstances they recognize.

Li began down this road by identifying and labeling objects in pictures for computers. Her company ImageNet was launched in 2007, and two years later it had labeled 15 million images in 22,000 categories using everyday English words. Li gave a sense of the project's massive size in a 2015 *TedTalk*. She explained the project labeled the pictures of 62,000 cats in all kinds of poses and species so that the computer would be able to recognize a

kitten poking out from behind a chair as well as a large cat laying on its back. And then it did the same for dogs and cows, etc.

Once pictures were labeled, computers could use a neural network to recognize pictures and then computers were "taught" to apply language to the visual picture so that they could describe it. That was the start of giving "sight" to the machines.

Now Li and other researchers have formed World Labs, a spatial intelligence AI company, which plans to build large world models to perceive, generate, and interact with the 3D world. The company plans to release products next year for applications in robotics, gaming, and other areas.

Li envisions a future where humans digitize the world into 3D environments and create a wide variety of simulations with which to train robots, she explained in a April *TedTalk*. Beyond just identifying an object, trained robots will be able to react appropriately in "real world" situations. They'll not only know that an object is a glass of milk; they'll know when to support it to prevent a spill (and won't cry if they're not fast enough!).

(2) *Companies raising lots of cash.* Companies involved with AI and robots are out pounding the pavement raising cash, while investors are extremely enthusiastic about this intersection of AI and robotics.

Figure, which is building general use robots, raised $675 million this spring from investors that include Microsoft, Nvidia, Jeff Bezos, OpenAI Startup Fund, Amazon Industrial Innovation Fund, Parkway Venture Capital, Intel Capital, Align Ventures, and ARK Invest. The deal placed a $2.6 billion valuation on the company, a February 29 Reuters *article* reported. The company will use the funds to train its robots, build manufacturing facilities, and hire more people.

Physical Intelligence raised $70 million in seed funding to help it "develop foundation models and learning algorithms that can power a wide range of robots and physically-actuated devices," a March 12 *article* in Maginative reported. More simply, the company aims to bring AI to the physical world and allow robots to operate in any environment. Investors included Thrive Capital, Khosla Vetures, Lux Capital, OpenAI, and Sequoia Capital.

Skild AI aims to build a "scalable AI foundation model for robotics," which would basically lead to a generalist robot that isn't pretrained on any one task. The company raised $300

million, which values the company at $1.5 billion. Funding was led by Lightspeed Venture Partners, Coatue, SoftBank Group, and Jeff Bezos.

And Carbon Robotics raised an undisclosed amount of new funding in May to further its efforts to create a robot that uses AI and lasers to kill weeds on farms. “Carbon Robotics said the LaserWeeder processes 4.7 million high-resolution images per hour and can eradicate 5,000 weeds per minute with sub-millimeter precision. The company also said its agricultural image dataset consists of 25 million labeled plants and more than 30,000 crop and weed models,” a May 7 *article* in The Robot Report reported. The LaserWeeder should reduce the amount of herbicide farmers need to apply either preventatively or after the weeds appear.

Calendars

US: Thurs: Initial Claims 243k; M-PMI & NM-PMI Flash Estimates 47.5/55.0; New Home Sales 717k; KC Fed Manufacturing Index. **Fri:** University of Michigan Consumer Sentiment Index, Current Conditions, and Expectations 68.9/62.7/72.9; University of Michigan One-Year & Five-Year Inflation Expectations 2.9%/3.0%; Headline & Core Durable Goods Orders -1.1%/-0.1%; Atlanta Fed GDPNow 3.4%; Baker Hughes Rig Count; IMF Meetings. (Trading Economics estimates)

Global: Thurs: Eurozone C-PMI Flash Estimate 49.7; Eurozone, Germany, and France M-PMI Flash Estimates 45.1/40.7/45.1; Eurozone, Germany, and France NM-PMI Flash Estimates 51.5/50.6/49.9l; UK M-PMI & NM-PMI Flash Estimates 51.5/52.3; UK Gfk Consumer Confidence -20; Lane; Woods; Bailey; McCaul. **Fri:** Germany Ifo Business Climate Index, Current Assessment, and Expectations 85.6/84.1/86.6; France Consumer Confidence 94; Spain Unemployment Rate 11.4%; Canada Headline & Core Retail Sales 0.5%/0.3%; Japan Leading & Coincident Indicators -2.6%/-3,7%; McCaul. (Trading Economics estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The *Bull-Bear Ratio* climbed for the second week to 2.67 this week after falling to 2.35 two weeks ago from 2.62 the week before. *Bullish sentiment* climbed for the second week by 5.1ppts (to 58.3% from 53.2%), indicating

the most bulls since late July (when the report noted seven consecutive weeks with bulls over 60%, ending at 64.2%). Bullish sentiment was at 43.5% six weeks ago—which was the lowest percentage since last August. Meanwhile, *bearish sentiment* edged down from 22.0% last week to 21.7% this week. Both are still far above the mid-July percentage of just 14.9%. The *correction count* edged down for the second week, from 24.2% to 20.0%. Recent readings are down from 33.9% at the start of September and now nearing the low levels during early summer. In the *AAII Sentiment Survey* (as of October 17), both bullish and neutral sentiment among individual investors about the short-term outlook for stocks fell during the latest week, while bearish sentiment rose. *Bullish sentiment* fell 3.6ppts to 45.5%, above its historical average of 37.5% for the 49th time in 50 weeks. *Neutral sentiment* was little changed, edging up 1.3ppts to 29.2%, below its historical average of 31.5% for the 15th straight week. *Bearish sentiment* increased 4.8ppts to 25.4%—below its historical average of 31.0% for the ninth time in 10 weeks.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin was unchanged w/w at a record high of 13.4% during the October 17 week. It is now 3.1ppts above its seven-year low of 10.3% during April 2020. Forward revenues and earnings were both at record highs during the October 3 week, but each ticked down 0.1% w/w to 0.2% and 0.3% below their respective highs. Prior to that, revenues and earnings had been steadily making new record highs for just over 12 months. 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 fell 0.1ppt w/w to 5.6%, but remains close to its 23-month high of 5.8% during the August 1 week. It has gained 3.3ppts 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 36-month high of 14.2%. It's now 10.9ppts 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 5.6% in 2025 (down 0.1ppt w/w) compared to a revenues gain of 2.1% in 2023. They expect an earnings gain of 9.3% in 2024 (down 0.2ppt w/w) and a 15.0% rise in 2025 (up 0.1ppt w/w) compared to an earnings gain of 2.4% in 2023. Analysts expect the profit margin to rise 0.5ppt y/y to 12.4% in 2024 (unchanged w/w), compared to 11.9% in 2023, and to rise 1.1ppts y/y to 13.5% in 2025 (unchanged w/w). The S&P 500's weekly reading of its forward P/E rose 0.2pt w/w to a 42-month high of 21.9, and is up 2.2pts from a 14-week low of 19.7 during the August 8 week and 6.6pts 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 0.02pt w/w to a new record high of 2.93. That's up from a six-month low of 2.22 during the October 26, 2023 week and compares to 49-month low of 1.65 in March 2020.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins (*link*): During the October 17 week, forward revenues rose for four of the 11 S&P 500 sectors and forward earnings rose for three sectors. This led to rising forward profit margins w/w for four sectors. Three sectors posted record-high forward revenues this week: Communication Services, Financials, and Information Technology. These six sectors are not far from their record-high forward revenues recently during the past few weeks: Consumer Discretionary, Consumer Staples, Health Care, Industrials, Real Estate, and Utilities. Energy and Materials are the biggest laggards at 5.2% and 13.1% below, respectively. These three sectors had record-high forward earnings this week: Communication Services, Financials, and Information Technology. These seven sectors are less than 2.8% below their recent records: Consumer Discretionary, Consumer Staples, Health Care, Industrials, Real Estate, and Utilities. Forward earnings remains depressed for Energy and Materials; both are more than 21.0% below their post-pandemic highs. Looking at the forward profit margin, most of the sectors have recovered from their early 2023 forward profit margin lows to near-record high readings again. In recent weeks, the Consumer Discretionary, Financials, Industrials, and Information Technology sectors were in that club. Among the laggards, Energy's forward margin has cratered 1.2pts to a 31-month low of 9.7% from its six-month high of 10.9% in mid-June; Consumer Staples' 6.9% is 0.2ppt above its seven-year low in March 2023; and Health Care's 8.8% is up 0.3ppt since its 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 (26.5%, up 0.1ppt w/w and down from its 27.6% record high in September), Financials (19.4, up 0.1ppt w/w and down from its 19.8 record high in August 2021), Communication Services (18.0, down from its 18.1 record high during the August 8 week), Real Estate (17.2, down from its 19.2 record high in 2016), Utilities (14.2, down from its 14.8 record high in April 2021), S&P 500 (13.4, a record high in six of the past seven weeks), Materials (11.2, down from a 20-month high of 11.6 in July and from its 13.6 record high in June 2022), Energy (9.7, a 31-month low and down from its 12.8 record high in November 2022), Industrials (11.1, down 0.1ppt w/w from its 11.2 record high a week earlier), Consumer Discretionary (9.2, a record high this week), Health Care (8.8, up 0.3ppt 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

Existing Home Sales (*link*): Existing home sales sank to a 14-year low in September, as consumers remain cautious ahead of the November elections. *Existing home* sales in September fell 1.0% to 3.84mu (saar) and were 3.5% below a year ago, led by *condominium and co-op* sales, which fell 5.1% m/m and 14.0% y/y to 370,000 units. *Single-family* sales edged down 0.6% to 3.47mu (saar), down 2.3% versus a year ago. “Home sales have been essentially stuck around a four-million-unit pace for the past 12 months, but factors usually associated with higher home sales are developing,” notes NAR chief economist Lawrence Yun. “There are more inventory choices for consumers, lower mortgage rates than a year ago and continued job additions to the economy. Perhaps, some consumers are hesitating about moving forward with a major expenditure like purchasing a home before the upcoming election.” *Regionally*, existing home sales, both on a monthly and yearly basis, fell in three of the four regions, while sales out West were in the plus column: West (+4.1% m/m & +5.6 y/y), South (-1.7 & -5.5), Midwest (-2.2 & -5.3), and Northeast (-4.2 & -6.1). Total *housing inventory* at the end of September was 1.39 million units, up 1.5% from August and 23.0% from last September—with unsold inventory at 4.3 months’ supply at the current sales pace, up from 4.2 months in August and 3.4 months’ last September. Yun noted, “More inventory is certainly good news for home buyers as it gives consumers more properties to view before making a decision.” He added, however, that inventory of distressed properties remains very low, accounting for only 2% of all transactions last month, as the mortgage delinquency rate remains very low. The *median price* of an existing home for all housing types in September was $404,500—up 3.0% y/y (from $392,700), the 15th consecutive y/y gain, with all four regions once again posting price gains in September.

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