November 14, 2024

Morning Briefing

Consumers, China & COP29

Check out the accompanying chart collection.

Executive Summary: Consumers look ready to deck the halls with abandon this holiday season, Jackie reports. Their incomes are up, gas prices are down, and Home Depot says consumers are spending freely when they can do so without using credit. … Also: China's long ailing real estate market appears to have perked up in October after the government's injections of targeted stimulus programs. … And: Funding for green technologies has dropped off precipitously this year, with money gravitating toward all things AI related. But some promising new technologies to help the environment are in the works.

Consumer Discretionary: The Holidays Are Looking Jolly. Our Thanksgiving turkey hasn't even been bought, and already the neighbors have their outdoor Christmas lights shining. They're not alone in jumping the gun. Stores' shelves have been piled high with holiday goods even before kids polished off their trick-or-treating candy.

That said, most of the ingredients are in place for consumers to drive relatively strong holiday spending. Wages are up, and gas prices are down. Interest rates are surprisingly high and may put a damper on large purchases that rely on debt financing, as they did in Home Depot's Q3. But otherwise, sales of toys, sweaters, and the like should be solid.

The season is starting off on the right foot. October's core retail sales, which exclude restaurants, car dealerships, and gas stations, rose 0.83% m/m and 4.6% y/y, according to a National Retail Federation (NRF) *report*. That's an improvement over the 0.28% m/m decrease in September. The NRF's survey is based on credit- and debit-card purchase data compiled by Affinity Solutions.

Bank of America Institute's *Holiday Survey* suggests that consumers plan to spend $2,100 in addition to what they typically spend on obligations and necessities this holiday season, up 7% y/y. A National Retail Federation *report* projects holiday spending will climb between 2.5%-3.5% y/y. And the folks at Visa *expect* holiday sales to rise 4.0% y/y this season.

Here are some more details about consumers' health this holiday season and a look at Home Depot's earnings:

(1) *Incomes are up.* Consumers have a little more cash in their pockets this year with the unemployment rate remaining low at 4.1% and wages rising faster than inflation. YRI's real Earned Income Proxy (EIP) rose 0.3% in September to $6.9 trillion (*Fig. 1*). (The EIP is calculated by multiplying nonfarm payrolls times average weekly hours times average hourly earnings in total private industries times 52.)

(2) *Gas prices are down.* The cost to fill up a car's tank has fallen from elevated levels in 2022, freeing consumers to spend more on discretionary items. The retail price of a gallon of gasoline has headed south since spiking up to $4.98 in 2022. For the week ended November 11, the average retail price of gas nationwide was $3.18 a gallon (*Fig. 2*).

Consumers also appear to be benefiting from more fuel-efficient vehicles because the number of miles driven is at a record high while the amount of gasoline used remains well below peak levels (*Fig. 3*).

(3) *High interest rates hurt.* Home Depot's earnings report presented a picture of relatively healthy consumers who are ready to spend when they don't have to borrow to do so. Excluding the impact from hurricanes, Home Depot's Q3 performance "exceeded" management's expectations. "As weather normalized, we saw better engagement across seasonal goods in certain outdoor projects. But … we continue to see pressure on larger remodeling projects driven by the higher interest-rate environment and continued macroeconomic uncertainty," said CEO Ted Decker in the company's earnings *conference call*.

Q3 sales rose 6.6% y/y thanks to an acquisition and hurricane sales, while US same-store sales declined 1.2%. Power, outdoor garden, building materials, indoor garden, and paint departments posted positive same-store sales. Conversely, big-ticket same-store sales (i.e., purchases over $1,000) fell 6.8% y/y. "We continue to see softer engagement in larger discretionary projects where customers typically use financing to fund the project, such as kitchen and bath remodels," explained Billy Bastek, Home Depot's executive vice president merchandising, on the call.

The Federal Reserve's two recent rate cuts totaling 0.75ppt have yet to result in lower mortgage rates. Instead, mortgage rates are up about 0.60ppt since the first cut in

September, and housing turnover, at about 3%, is at a 40-year low. "[B]ut this is a market after all, and markets return to equilibrium and remodeling will as well. We just don't think we're quite there yet," said Decker. Remodeling will resume either because interest rates drop or because consumers get used to the current interest-rate environment and stop postponing projects.

China: Glimmers of Hope. The Chinese government has announced several financing programs to bolster the country's ailing real estate market. While lower interest rates and smaller down payments can't fix the country's serious demographics problem, the government's actions may be enough to put a floor under the housing market. Home sales appear to have stopped falling in some of the country's largest markets, and that may beget improved consumer confidence and retail sales down the road.

Let's take a deeper look:

(1) *October sales improve.* Some of China's largest developers reported strong October sales, albeit off of depressed September sales. China Vanke reported a 23% m/m jump in October's contracted sales to $3.0 billion; Longfor Group's sales jumped 37% m/m; and China Jinmao saw a 66% m/m increase, a November 9 *South China Morning Post* (*SCMP*) *article* reported.

Keep in mind that one banner month can't offset the sales declines that developers have experienced for much of the past four years. In fact, sales are still deeply negative ytd through October versus the same period last year, with Vanke's down 35.2%, Longfor's down 44.2%, and Jinmao's down 38.5%.

The high-end property market in China's major cities has been strong as well. It took only three hours for Sunac China Holdings to sell all of the units offered in its latest Shanghai luxury project. Sunac's contracted sales jumped fourfold m/m in October. But even in the luxury markets, ytd sales through October are miserable compared with a year earlier—Sunac's ytd sales fell 42.2% y/y.

(2) *More help expected.* China's government has launched many different plans to get its economy chugging along again. The most recent program, announced last week, allows local governments to swap $1.4 trillion of special purpose debt for their off-the-books—or "hidden"—debt over the course of the next five years, a November 8 *WSJ* *article* reported. The new debt could carry lower interest rates and longer maturities than the debt being replaced, increasing local governments' financial liquidity but not reducing their debt loads.

Like other programs, the debt swap program disappointed investors who were hoping for fiscal stimulus aimed directly at boosting consumer spending. The government announced in October plans to provide credit to renovate one million apartments in urban shantytowns. Another $550 billion in loans is being provided to complete unfinished apartments and ensure delivery of homes. An earlier program allowed local governments to buy up housing inventory.

The government also is allowing Chinese homeowners to refinance their mortgages and take advantage of lower interest rates. Since the beginning of 2022, China's central bank has cut the rate off of which mortgages are priced—its five-year loan prime rate—by 0.8ppt. Regulators also cut the minimum down payment on a second home to 15% from 25%.

The Chinese government plans to boost fiscal stimulus again next year and unveil tax policies that support "healthy development" of the real estate market, a November 8 *SCMP* *article* stated. But investors' hopes for the fiscal support believed necessary remain higher than what the government has been willing to provide so far.

(3) *Mixed results.* Chinese stocks took off in anticipation of government stimulus, but they have given back a portion of those gains because the latest government support again failed to target consumer demand.

The Shanghai Shenzhen CSI 300 stock price index soared 34.7% from its five-year low on September 13 to an 80-month high on October 8, before retracing some of that advance and closing at 4110.89 as of Tuesday's close (*Fig. 4*). The Shenzhen Real Estate Stock price index followed a similar path, and both indexes remain far off their record highs.

On a positive note, the manufacturing component of China's official purchasing managers index edged up to 50.1 in October, marking the first time in six months that it entered expansion territory (*Fig. 5*). Conversely, in an ominous sign, China's M1 fell 6.1% last month and imports declined by 3.7% (*Fig. 6* and *Fig. 7*). While consumer prices edged higher in October, by 0.3% y/y, producer prices remained negative, falling 2.9% y/y (*Fig. 8*).

China needs its exports to continue to find homes in the world's markets (*Fig. 9*). Regarding US markets, that prospect is dimmed by incoming President Trump's threats to impose 60% tariffs on imports of Chinese goods. The yuan has continued to fall against the dollar, and China's 10-year government bond yield remains near record lows at 2.1% (*Fig. 10* and *Fig. 11*). Investors may have to wait until the government's next major meeting in March before learning whether greater fiscal support is in the offing.

Disruptive Technologies: More on Climate Tech. The United Nations' annual conference on climate change, COP29, opened on Monday in Azerbaijan, a country where, ironically, half of all exports are oil and gas.

The conference is having a rocky start. The presidents of the US and China are skipping the event. So is European Commission President Ursula von der Leyen. French President Emmanuel Macron, who has been critical of Azerbaijan's military offensive against Armenian separatists, is opting out. And German Chancellor Olaf Scholz is staying home to deal with the collapse of his ruling coalition government.

That said, more than 50,000 government delegates, lobbyists, academics, and media representatives are flying in to attend—yet another irony.

Despite rising temperatures and the alarming lack of rain in the northeastern US this fall, financing for climate technology has declined as investors opt instead to fund the latest, shiny new thing: artificial intelligence technology. Globally, new funding for climate technology fell 51.5% during the first three quarters of 2024 compared to the same period last year, according to a Bloomberg *report*. Conversely, capital for AI has climbed 49.4% over the same period.

Nonetheless, here are some interesting new technologies being developed to help the environment:

(1) *Scrubbing the air.* Norwegian company SINTEF (a.k.a. *Stiftelsen for industriell og teknisk forskning*) has developed a continuous swing adsorption reactor (CSAR), which "uses a heat pump and a vacuum pump to efficiently capture CO2," a November 12 *article* in *Popular Mechanics* reported. It uses electricity to operate its pumps, making it easier to install in existing plants compared to other CO2 capture systems that require heat to be generated.

The system was successfully tested in a Norwegian plant that burns household waste to generate electricity. The CSAR captured roughly 100 kilograms of CO2 per day and will next be permanently installed at a Spanish cement factory.

(2) *Greener fertilizer.* RTI International is developing green ammonia technology "produced using renewable energy to split water into hydrogen and oxygen. The hydrogen then combines with nitrogen from the air to create ammonia," a November 11 WRAL *article*

reported. This process throws off far less emissions than traditional methods, which use fossil fuels to produce ammonia. Green ammonia could be used as fuel to propel ships, power machinery, or produce electricity or it could be turned into fertilizer.

(3) *Flying cleaner.* LanzaJet is turning corn, sugar cane, and other inputs into alcohol and then turning the alcohol into jet fuel, explains an October 1 *MIT Technology Review* article. The company opened its first commercial jet fuel factory in Georgia in January and has buyers lined up for all the fuel produced in that factory through 2034, including British Airways, one of its investors.

Burning LanzaJet's fuel will still produce CO2 and other greenhouse gasses when burned, but some of that is offset when the corn or sugarcane is grown. The company estimates its fuels could cut the climate impact from burning traditional fuel in half. LanzaJet still needs to prove it can scale its operations and bring down the cost of its fuel. In general, alternative jet fuels cost 2.8 times more than traditional jet fuel.

Calendars

US: Thurs: Headline & Core PPI 0.2%m/m/2.3%y/y & 0.3%m/m/2.9%y/y; Initial Claims 222k; Crude Oil Inventories & Gasoline Production; IEA Monthly Report; Powell; William; Barkin. **Fri:** Headline & Core Retail Sales 0.3%/0.2%; NY Empire State Manufacturing Index 3.60; Industrial Production -0.2%; Capacity Utilization 77.4%; Business Inventories 0.2%; Import Price Index -0.1%; Atlanta Fed GDPNow 2.5%; Baker Hughes Rig Count. (FXStreet estimates)

Global: Thurs: Eurozone GDP 0.4%q/q/0.9%y/y; Eurozone Industrial Production -1.2%m/m/-1.6%y/y; Eurozone Employment Change 0.2%; Spain CPI 0.6%m/m/1.8%y/y; Japan GDP & Price Index 0.2% & 2.9%; Japan Industrial Production 1.4%; China Retail Sales 3.8%y/y; China Industrial Production 5.5%y/y; China Unemployment Rate 5.1%; ECB Publishes Account of Monetary Policy Meeting; Schnabel; Baily; De Guindos; Mauderer. **Fri:** Germany WPI 0.1%; France CPI 0.2%m/m/1.2%y/y; Italy CPI 0.3%m/m/1.0%y/y; European Union Economic Forecasts; Eurogroup Meetings; UK GDP 0.2%q/q/0.1%y/y; UK Headline & Manufacturing Industrial Production 0.2%m/m/-1.2%y/y & 0.0%m/m/0.1%y/y; McCaul; Lane. (FXStreet estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The *Bull-Bear Ratio* rose to 2.91 this week, the highest since early August, after easing the prior two weeks from 2.69 to 2.61. *Bullish sentiment* climbed from 56.7% to 60.3% this week—the most bulls since late July (when the report noted seven consecutive weeks with bulls over 60%, ending at 64.2%). The reading remains in the "the high risk danger zone above 55.0% for the fifth straight week," according to the report. Meanwhile, *bearish sentiment* slipped for the second straight week by 1.3ppts (to 20.7% from 22.0%), the fewest bears since early August, though remaining in a tight range. Recent percentages are still far above the mid-July percentage of just 14.9%. The *correction count* fell to 19.0% this week after rising the prior two weeks from 20.0% to 21.6%. Recent readings are down from 33.9% in early September and just below the early July count of 19.3%. In the AAII Sentiment Survey (as of November 7), both bullish and neutral sentiment among individual investors about the short-term outlook for stocks increased during the latest week, while bearish sentiment fell. *Bullish sentiment* climbed 2.1ppts to 41.5%, remaining above its historical average of 37.5% for the 52nd time in 53 weeks, while *neutral sentiment* rose 1.3ppts to 30.9%, below its historical average of 31.5% for the 17th time in 18 weeks. *Bearish sentiment* fell 3.3ppts to 27.6%—below its historical average of 31.0% for the 12th time in 13 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 November 7 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 for the first time since the October 3 week. 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 ticked down 0.1ppt w/w to 5.5%, and is down 0.3ppt from its 23-month high of 5.8% during the August 1 week. It has gained 3.2ppts 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 13.8% from a nine-week low of 13.7% and is down 0.4ppt from a 36-month high of 14.2% during the October 17 week. It's now 10.5ppts 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 (up 0.2ppt w/w) and 5.5% in 2025 (down 0.1ppt w/w) compared to a revenues gain of 2.1% in 2023. They expect an earnings gain of 9.9% in 2024 (up 0.2ppt w/w) and a 14.1% rise in 2025 (down 0.4ppt 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 43-month high of 22.1. It's up 2.4pts from a 14-week low of 19.7 during the August 8 week and 6.8pts 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 0.04pt w/w to a record high of 2.96. That's up from a six-month low of 2.22 during the October 26, 2023 week and compares to a 49-month low of 1.65 in March 2020.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins (*link*): During the November 7 week, forward revenues rose for nine of the 11 S&P 500 sectors and forward earnings rose for 10 sectors. This led to rising forward profit margins w/w for three sectors. Seven sectors posted record-high forward revenues this week: Communication Services, Consumer Discretionary, Financials, Health Care, Information Technology, Real Estate, and Utilities. Industrials' forward revenues is 3.4% below its early September record due to Boeing's strike. Energy and Materials are the biggest laggards at 5.9% and 13.6% below, respectively. These five sectors had record-high forward earnings this week: Communication Services, Consumer Discretionary, Financials, Information Technology, and Utilities. These four sectors are less than 2.4% below their recent records: Consumer Staples, Health Care, Industrials, and Real Estate. Forward earnings remains depressed for Energy and Materials, which are 31.8% and 21.9% below their respective post-pandemic highs. Looking at the forward profit margin, these three sectors had record- or post-pandemic highs this week: Communication Services, Consumer Discretionary, and Financials. In recent weeks, the Industrials and Information Technology sectors were in that club. Among the laggards, Energy's forward margin has cratered 1.4pts to a 33-month low of 9.5% from its six-month high of 10.9% in mid-June; Consumer Staples' 6.9% is just 0.2ppt above its seven-year low in March 2023; and Health Care's 8.7% is only 0.2ppt above its record low in April. 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 (26.6%, up 0.2ppt w/w and down from its 27.6% record high in September), Financials (19.5, up 0.1ppt w/w to a post-pandemic high), Communication Services (18.4, up 0.2ppt w/w to a record high this week), Real Estate (17.4, up 0.1ppt w/w and 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 nine of the past 10 weeks), Materials (11.2, down from a 20-month high of 11.6 in July and a 13.6 record high in June 2022), Energy (9.5, down 0.1ppt w/w to a 32-month low and down from its 12.8 record high in November 2022), Industrials (11.1, down from its 11.2 record high in early October), Consumer Discretionary (9.3, up 0.2ppt w/w to a record high this week), Health Care (8.7, up 0.2ppt from its 8.5 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

Consumer Price Index (*link*): Both the headline and core CPIs matched expectations in October, both on a monthly and yearly basis. *Headline* CPI rose 0.2% for the fourth consecutive month, while the *core* CPI increased 0.3% for the third straight month. On a *year-over-year basis,* the *headline* rate climbed to 2.6% from 2.4% in September—which was the lowest rate since February 2021; it peaked at 9.1% in June 2022. Meanwhile, the core rate remained at 3.3% in October, after slowing from September 2022's 6.6% to 3.2% in both July and August of this year—which were three-year lows. *Goods inflation* fell 1.0% y/y in October, with durable goods prices dropping 2.5% y/y, down from the 18.7% peak in February 2022, while the rate for nondurable goods (-0.5% y/y) remained just below zero, down from 16.2% in June 2022. *Services excluding energy services* is drifting lower, though remains relatively high at 4.8%, 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 (-3.4% y/y), furniture & bedding (-2.7), major appliances (-2.3), and new vehicles (-1.3), though most are up from recent lows, while motor vehicle parts & equipment (2.3) moved back above zero this August for the first time since last August. Here's a snapshot of yearly rates for some key *nondurable goods* prices from highest to lowest: recreational commodities (8.2), food (2.1), medical care commodities (1.0), apparel (0.3), and housekeeping supplies (-0.1). Energy prices (-4.9% y/y) fell back below zero in August, and fell deeper into negative territory in September after five months above, though was slightly less negative in October. It posted a recent peak of 3.7% in May. 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 (to 4.6% from 8.8%) and owners' equivalent rent (5.2 from 8.1). Turning to *non-housing-related services*, the yearly rate of transportation service (8.2) remains high, though is down from recent highs, while the rate for recreation services (2.8) is up from September's 2.2%—which was the lowest since mid-2021. Meanwhile, the yearly rate for education & communication services is hovering around 2.0%, while the medical services (3.8) rate has been on an accelerating trend, up from its recent bottom of -2.6% in September 2023. The rate for other personal services (4.1) remained at September's rate after moving up to 5.1% in July from 4.0% in May—which was the lowest rate since October 2021.

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