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Morning Briefing

Transports, Insurance & More AI

Check out the accompanying chart collection.

Executive Summary: The S&P 500 Transportation Composite has been on the move this year, Jackie reports, especially its Airlines and Railroad components. Airline traffic is up to pre-pandemic highs for the big players, and so are their earnings and stock prices. Budget airlines aren't faring as well. Rail loadings are up, though the S&P 500 Rail Transportation index isn't yet reflecting the strength analysts see in revenues and earnings this year and next. … Also: Insurers exposed to the California wildfires are fuming over the state's market interventions, but the share prices of two rose after managements' Q4 earnings calls. … And: Is DeepSeek a mouthpiece for the Chinese Communist Party?

Industrials: Transports Chug Along. After a tough 2024, the S&P 500 Transportation Composite is having a strong start to the year, with traffic gains in multiple modes of transportation leading to strong earnings and rising stock prices. The Transports' stock price index has risen 7.2% ytd through Tuesday's close, bolstered by several of its component industries: S&P 500 Passenger Ground (12.8%), Passenger Airlines (7.2), Rail Transportation (6.9), Cargo Ground Transportation (5.8), and Air Freight & Logistics (4.1) (*Fig. 1*). The index still hasn't topped its March 29, 2022 peak, but it has been moving steadily higher after hitting bottom on September 30, 2022.

Let's take a look at two of the strongest industries in the Transportation sector: Airlines and Railroads:

(1) *Flying high.* Anyone who's been in an airport recently knows the airline business is booming. Demand remains robust from consumers traveling far and wide and business travelers back in the skies, returning air traffic to levels last seen before the pandemic (*Fig. 2*). The S&P 500 Passenger Airlines stock price index has risen 65.4% over the past year, on the wings of United Airlines Holdings (149.9%), Alaska Air Group (94.2), Delta Air Lines (70.7), and Southwest Airlines (5.9) (*Fig. 3*).

Alaska Air's shares have risen on strong earnings and growing expectations that its pending merger with Hawaiian Airlines will be completed now that the Justice Department has decided against challenging the deal. It still needs approval from the US Department of Transportation, which is more likely with President Trump in office.

United Airlines shares keep flying higher as the airline's earnings have bested analysts' estimates. The airline reported Q4 adjusted earnings per share of $3.26, topping the $3.00 analysts expected and far above the $2.00 earned a year earlier, a January 21 CNBC *article* reported. UAL told analysts to expect adjusted earnings per share of $11.50-$13.50 in 2025, in line with analysts' target of $12.82 and above 2024's adjusted EPS of $10.61. For the full year 2024, United *reported* that it operated the most flights and carried the most customers in its history, and so far this year, demand has continued to accelerate.

(2) *Smaller carriers hit turbulence.* Unlike some of the large carriers, budget airlines have been having a tougher time of it. JetBlue Airways shares are up only 9.3% over the past year through Tuesday's close, after they sold off sharply on Tuesday. The company, which has been restructuring its operations, reported Q1 revenue guidance that disappointed analysts and investors.

"The company's costs are rising faster than its revenue, and its turnaround efforts are being stymied by changing consumer preferences and issues with aircraft," a January 28 *WSJ* *article* reported. Labor and maintenance costs have been rising faster than revenues. The company also blamed the late timing of Easter this year.

With Southwest still on tap to report Q4 results, the y/y earnings growth rate so far for S&P 500 Passenger Airline industry is 42.8%, and analysts see clear skies ahead. The industry's revenues are forecast to grow 6.8% this year and 5.8% in 2026, leading to prospective earnings growth of 35.9% this year and 15.1% next year (*Fig. 4* and *Fig. 5*). Meanwhile, at 9.6, the industry's forward P/E is on par with its historical average (*Fig. 6*).

(3) *Chugging along nicely.* Union Pacific shares are leading the way in the railroad industry. Its shares have climbed 9.3% ytd, followed by Norfolk Southern (7.5%) and CSX (1.3). Railcar loadings are up 6.9% since the recent bottom in July to 498,000 units in January, using a 26-weekly average (*Fig. 7*). Rail activity has been boosted by an uptick in trade, with the number of containers entering and leaving the West Coast ports increasing to 10.7 million TEUs as of December on a 12-month-sum basis (*Fig. 8*). Companies may have been importing goods proactively late last year in order to avoid the tariffs President Trump is expected to announce. That could be a headwind this year.

At Union Pacific, a drop in fuel surcharge revenue depressed the railroad company's Q4 revenues, down slightly y/y at $6.12 billion. Excluding the fuel surcharge, revenue grew 4%. UNP net income rose 6.7% y/y to $1.76 billion as fuel expense dropped sharply and operating expenses declined by 4%. Freight volume rose 5% y/y in the quarter, including a 16% gain in intermodal shipments.

International volumes were up 26% in the quarter due to imports from the West Coast, which means this year's comparisons will be difficult. Also dragging on the business is reduced demand for coal and curtailed production by car makers to better manage high inventories.

Conversely, the railroad expects a pickup in its industrial chemicals and plastics business due to plant expansions in its territory. "[W]e currently have over 200 track construction projects in progress with a potential revenue of $1.5 billion, and our business development pipeline is just as strong as it was this time last year," said Kenny Rocker, UNP's head of marketing and sales, in the railroad's earnings *conference call*.

While the railroad's business could be hurt if President Trump follows through with tariffs, it could benefit if the President lowers regulations and taxes. UNP continues to boost efficiency with 75 productivity initiatives. It's automating its terminals, inspections, maintenance tasks, and distribution of materials, said CEO Jim Vena. In addition, it is thinking about automating some of its vans. Add it all up, and this year UNP executives anticipate high-single-digit to low-double-digit earnings growth.

The S&P 500 Rail Transportation stock price index has been in the same sideways channel since roughly 2021 (*Fig. 9*). Likewise, its forward revenues per share and forward operating earnings per share have plateaued over the same time period (*Fig. 10* and *Fig. 11*). But analysts are optimistic that results will improve this year, with revenue expected to increase 3.4% this year and 4.8% in 2026 and earnings forecast to rise 8.6% this year and 12.6% next year (*Fig. 12* and *Fig. 13*). Some of that optimism is priced into the stocks, trading at a forward P/E of 19.1 (*Fig. 14*).

Financials: California Insurance Update. Travelers and Chubb, two insurers with modest exposure to California's wildfires, reported earnings in recent days. Both companies posted strong results, with pricing and earnings rising. Chubb gave some color on the impact the wildfires would have on its Q1 results. Travelers took a pass. Here's a look at what they had to say:

(1) *Wildfires to hit Q1.* Chubb reported that its current estimate of the California wildfires cost is $1.5 billion net pre-tax, and it will impact the company's Q1 results. The estimate is based on what their adjusters on the ground have determined after evaluating each property, said CEO Evan Greenberg in the company's Q4 earnings *conference call*. The estimate includes Chubb's projection of what the assessment will be from the California's state-run Fair Access to Insurance Requirements (FAIR) plan.

Prior to the fires, Chubb had more than halved its exposure to the ravaged area. "We're not going to write insurance where we cannot achieve a reasonable risk-adjusted return for taking the risk," said Greenberg.

He took the state to task for not allowing insurers to charge a fair price or to tailor coverage in California to improve availability and affordability. By offering more affordable insurance through the FAIR plan, California is distorting the insurance market, leading consumers and businesses to take on more risk in deciding where to live or work, he said. The underpriced insurance also encourages less risk management and loss mitigation activity by federal, state, and local governments. One way or another, Greenberg contends, the citizens of the state pay the price for insurance coverage.

Travelers did not produce an estimate of the California wildfire claims' cost. But CFO Dan Frey said in the earnings *conference call* that the fires were a "material event for the industry" that would "have a material impact on our first quarter earnings." The company had been shrinking its exposure to California prior to the event, he noted, but didn't provide any additional specifics.

(2) *A look at their numbers.* Chubb reported Q4 adjusted earnings of $6.02 a share, meeting analysts' consensus estimate and rising above last year's adjusted earnings of $5.54. Results benefited from a 6.7% increase in property and casualty net premiums written, excluding agriculture. The company also reported a 13.7% increase in net investment income to $1.69 billion.

"We are confident in our ability to continue growing operating earnings and EPS at a double-digit rate, driven by our three major sources: P&C underwriting, investment income, and life income," said Greenberg in the company's earnings *press release*. Chubb shares rose 3.4% this week through Wednesday.

Travelers reported Q4 earnings per share of $9.15, up from $7.01 a year earlier, beating the analysts' consensus forecast of $6.63 a share. Net written premiums increased 7% to $10.7

billion; net investment income increased 23% pretax y/y, and total revenues increased 10% to $12.0 billion. Travelers' shares likewise added 3.2% this week through Wednesday.

Disruptive Technology: Digging into DeepSeek. The global competition for the best AI model is heating up. Focus on China's DeepSeek and its AI model managed—momentarily—to grab the spotlight away from President Donald Trump. Developers behind the model claim that DeepSeek is able to crunch data and process information far faster than OpenAI using far less infrastructure, like Nvidia's chips. Not to be outdone, Alibaba Group Holding stated on Wednesday that its new Owen2.5-Max AI model outperformed DeepSeek-V3, OpenAI GPT-4, and Meta Platforms' Llama3.1-405B in certain benchmark tests, a January 29 *SCMP* *article* reported.

In last Thursday's *Morning Briefing*, we highlighted DeepSeek as one of several technology companies in China that aim to dominate the artificial intelligence (AI) business. Below are more aspects of the DeepSeek story that have caught our attention:

(1) *DeepSeek tows the party line.* If the US government opposed TikTok due to the potential influence the Chinese government could exert through the app to users, the US government should most definitely oppose the use of DeepSeek. So far, only the US Navy has prohibited DeepSeek's use by Navy members due "security and ethical concerns associated with the model's origin and usage," a January 28 CNBC *article* reported.

The app reportedly gives answers that parrot the Chinese Communist Party. In a January 27 *article*, *The Epoch Times* reported that when DeepSeek was asked whether the Chinese regime has backed intellectual property thefts from the United States, DeepSeek replied that such allegations "are unfounded and not in line with the facts" and that the Chinese regime "has always been a staunch defender of intellectual property rights and has made significant progress in establishing a comprehensive legal framework for IP protection."

When asked "Who is the president of Taiwan?," the app replies that the question is beyond its "current scope." DeepSeek also wouldn't answer "What do Chinese people think of Xi Jinping?," "What's the Falun Gong Protection Act?," and "What's the White Paper movement?" And when asked what occurred on June 4, 1989, the app wouldn't say that the massacre of protestors on Tiananmen Square occurred on that date. Given that DeepSeek was more popular on the Apple store than OpenAI this week, we might have expected the US government to have acted. It might at least have made Apple put a warning on the app's listing noting its biases.

(2) *DeepSeek's a hometown hero.* Judging by some headlines in the *South China Morning Post*, DeepSeek has become a national hero in China. "*DeepSeek's tech breakthrough hailed in China as answer to win AI war*," read one article on Tuesday. Chinese tech leaders claim that the company changed China's "national fate" in its tech war with the US and has "upended the world."

(3) *A bit surprised.* Given China's desire to win the tech war with the US, it's a bit surprising that DeepSeek was allowed to open source its product. As a result, tech gurus across the world can follow DeepSeek's mechanics and replicate them to make their AI programs faster and more efficient.

Calendars

US: Thurs: GDP & Price Index 2.8%, 2.5%; Initial Claims 220k; Pending Home Sales. **Fri:** Personal Income & Consumption 0.4%, 0.5%; Headline & Core PCED 0.3%m/m, 2.6%y/y & 0.2%m/m, 2.8%y/y; Employment Cost Index 0.9%q/q; Bowman. (FXStreet estimates)

Global: Thurs: Eurozone GDP 0.1%q/q, 1.0%y/y; Eurozone Economic Sentiment 94.1; Eurozone CPI 0.0%m/m, 2.6%y/y; Eurozone Import Price Index 0.3%m/m, 1.9%y/y; Eurozone Unemployment Rate 6.3%; Eurozone Rate on Deposit Facility 2.75%; Italy GDP 0.1%q/q, 0.6%y/y. **Fri:** Eurozone Retail Sales 0.2%m/m, 2.5%y/y; Eurozone Unemployment Rate 6.2%; Germany CPI 0.1%m/m, 2.6%y/y; France CPI 0.0%m/m, 1.9%y/y; Canada GDP -0.1%m/m. (FXStreet estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The *Bull-Bear Ratio* rose for the second week to 1.61 this week after dropping to 1.32 two weeks ago, which was the lowest in a year. *Bullish sentiment* climbed for the second week to 47.5% week after falling from 62.9% (the most bulls since late July 2024) to 42.4% the previous five weeks. *Bearish sentiment* also slipped for the second week, to 29.5% this week after climbing from 16.1% to 32.2% the prior five weeks, while the correction count fell for the third week to 23.0% after increasing three of the prior four weeks from 21.0% to 27.9%. In the *AAII Sentiment Survey* (as of January 23), bullish sentiment about the short-term outlook for stocks rose, while bearish and neutral sentiment fell. *Bullish sentiment* soared 18.0pts to 43.4%, moving above its historical average of 37.5% for the first time in four weeks. Meanwhile, *bearish sentiment* sank 11.1ppts to 29.4%, below its historical average of 31.0% for the second time in 10 weeks, while neutral sentiment fell 6.9ppts to 27.1%—below its historical average of 31.5% for the 27th time in 29 weeks.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward revenues ticked down again during the January 23 week to 0.1% below its record high several weeks earlier, but forward earnings rose to a new record high. As a result, the forward profit margin remained steady w/w at a record high of 13.6%. It is now 3.3ppts above its seven-year low of 10.3% during April 2020. The consensus expectations for forward revenues growth was unchanged w/w at 5.7%, and is just 0.1ppt below its 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 14.1%, just 0.2ppt below its 38-month high of 14.3% during the December 12 week. It's now 10.8ppts 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 boosted by the recovery from the pandemic to its highest reading since June 2010 and up substantially from its record low of -5.6% at the end of April 2020. Analysts expect revenues to rise 5.5% in 2025 (unchanged w/w) and 6.4% in 2026 (unchanged w/w), an acceleration from 2024's forecasted 4.6% (down 0.1ppt w/w). They expect an earnings gain of 14.0% in 2025 (unchanged w/w) and a 13.9% rise in 2025 (up 0.1ppt w/w) compared to 2024's forecasted earnings gain of 10.2% (umchanged w/w). Analysts expect the profit margin to rise 1.0ppt y/y to 13.4% in 2025 (unchanged w/w) and another 1.0ppt y/y in 2026 to 14.4% (unchanged w/w), compared to 2024's forecasted 12.4% (unchanged w/w). The S&P 500's weekly reading of its forward P/E rose 0.5pt w/w to a 4-week high of 22.2, and is now just 0.2pt below its 43-month high of 22.4 during the December 12 week. It's up 2.5pts from a 14-week low of 19.7 during the August 8 week and 6.9pts 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 rose 0.07pt w/w to 3.01 and is now just 0.01pt below its December 12 record high. 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 January 23 week, forward revenues rose for two of the 11 S&P 500 sectors and forward earnings rose for three. This led to rising forward profit margins for three of the 11 sectors too. These two sectors posted record-high forward revenues this week: Financials and Health Care. These six sectors are just a hair below their record-high forward revenues of recent weeks: Communication Services, Consumer Discretionary, Consumer Staples, Information Technology, Real Estate, and Utilities. Industrials' forward revenues remains 3.0% below its early September record. Improvement for Materials and Energy has stalled again, and they remain the biggest laggards at 6.0% and 16.3% below, respectively. These three sectors had record-high forward earnings this week: Communication Services, Financials, and Utilities. These six sectors are close behind at less than 1.9% below their recent record-high forward earnings: Consumer Discretionary, Consumer Staples, Health Care, Industrials, Information Technology, and Real Estate. Among the remaining two sectors, forward earnings remains depressed for Energy and Materials, which are heading lower again in recent weeks at 34.1% and 23.1% below their respective post-pandemic highs. Looking at the record-high forward profit margin club, Financials' rose another 0.1ppt this week to 20.0%, after entering the club several weeks earlier. Also at a record high this week is Communication Services. In recent weeks, the Consumer Discretionary, Industrials, and Information Technology sectors were in that club. Among the laggards, Energy's forward margin fell 0.1ppt w/w to 9.4%, just 0.1pt from its 34-month low of 9.3% in late December and down 1.5ppts since its six-month high of 10.9% in mid-June; Consumer Staples' 6.8% is just 0.1ppt above its seven-year low in March 2023; Health Care's 8.7% is only 0.2ppt above its record low in April; and Real Estate's dropped 0.2ppt w/w to 17.0%, but that's up from a low of 12.4% in December 2020. 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 (26.9%, down from its 27.6% record high in September prior to low-margin Dell's index addition, which lowered the margin 1.3ppts then to 26.3%), Financials (20.0, up 0.1ppt w/w to another record high, its first since August 2021), Communication Services (18.6, a record high this week), Real Estate (17.0, down 0.2ppt w/w and from its 19.2 record high in 2016), Utilities (14.4, down from its 14.8 record high in April 2021), S&P 500 (13.6, a record high this week and in 20 of the past 21 weeks), Materials (11.0, down 0.1ppt w/w and from a 20-month high of 11.6 in July 2023 and a 13.6 record high in June 2022), Energy (9.5, down 0.1ppt w/w to just 0.2ppt above its 34-month low of 9.3 in late December and down from its 12.8 record high in November 2022), Industrials (11.2, down 0.1ppt w/w from its 11.3 record high a week earlier), Consumer Discretionary (9.4, matches its record high in early December), Health Care (8.7, 0.2ppt above its 8.5 record low at the end of April and down from its 11.5 record high in February 2022), and Consumer Staples (6.8, down from its 7.7 record high in June 2020).

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