Yardeni Research

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Morning Briefing

On Utilities, Inventories & EVs

Check out the accompanying chart collection.

Executive Summary: Utilities long have had notoriously tepid demand, but that may change over the coming decade as more and more planned data centers plug into the grid. Jackie counters the argument that a bubble is brewing in data centers with statistics from a recent report. … Also: Frontrunning the coming Trump 2.0 tariffs is a popular inventory strategy for firms in various industries, but it carries the risks of tying up cash and leaving companies overstocked if sales drop. … And: With a manufacturing compound the size of San Francisco churning out cheaper and faster-charging EVs, China's BYD may leave Tesla in the dust.

Utilities: Going for Growth. Once a sleepy corner of the stock market, the S&P 500 Utilities sector is now a hotbed of debate. Fans believe that growth in data centers, cryptocurrencies, electric vehicles (EVs), the reshoring of manufacturing to the US, and ultimately robots will spark sharp growth of electricity demand. US power demand grew only 1%-2% annually over the past decade, muted by efficiency increases; but over the next 10 years, demand could grow 6%-8% annually according to a December 19 Fidelity *report*.

Naysayers warn that a bubble is brewing in data centers that could leave utility bulls charging at air. On Tuesday, one of those naysayers grabbed headlines: Alibaba Chairman Joe Tsai *warned* that construction of data centers may outstrip demand. Some projects are raising funds before locking in customers, and the building of data centers on spec suggests to him a bubble forming.

The S&P 500 Utility sector shed 1.6% on Tuesday in the wake of these comments, while the S&P 500 gained 0.2%. Still, the sector is in positive territory ytd through Tuesday's close, while the S&P 500 is in negative territory.

Here's the performance derby for the S&P 500 and its 11 sectors ytd through Tuesday's close: Energy (8.9%), Health Care (5.6), Financials (4.3), Materials (2.9), Industrials (2.1),

Real Estate (1.6), Utilities (1.6), Consumer Staples (0.9), Communication Services (-0.1), S&P 500 (-1.8), Information Technology (-7.7), and Consumer Discretionary (-9.5) (*Fig. 1*).

Folks who watch the real estate market appear to disagree with Tsai's assessment. A recent *report* by Jones Lang LaSalle (JLL) noted that as 2024 concluded, existing data centers were full, space in data centers coming online imminently was largely spoken for, and the market for data centers—and therefore demand for electricity—should remain strong for years to come. Here are some of the report's highlights:

(1) *Tight market in 2024.* The US data center vacancy rate fell to a record low of 2.6% by the end of last year. It's even tighter in the more popular markets, like Northern Virginia, where vacancy is only 0.6%. "Tenants looking to lease any sizable amount of data center capacity must wait 24 months on average. Limited availability is constraining sector growth," the report stated. Given the tight market, data center owners were able to boost rents on average by 12% y/y in 2024, and rents have risen by roughly 50% over the past five years.

The market's tightness was apparent yesterday. Microsoft abandoned leases on new data center projects set to use two gigawatts (GW) of electricity in the US and Europe because it decided "not to support additional training workloads from ChatGPT, maker of OpenAI," Reuters *reported*. But don't expect those data centers to remain dark. Alphabet's Google and Meta Platforms are expected to take over the leases.

In 2024, construction was completed on 2.5 GW of colocation capacity, and almost all of it was absorbed at delivery. At the end of last year, 6.6 GW of colocation capacity was under construction, and 72% of that space has already been leased. Demand comes from cloud providers (43%) and the technology (23%) and finance (9%) industries.

Here's the market's concern: Over the next few years, 22.9 GW of planned projects are in the pipeline but not yet under construction. Despite this large wave of potential supply, the bulls have two solid arguments: (1) Artificial intelligence is a growing source of demand. It represented about 15% of data center workloads, and it could grow to 40% by 2030, JLL noted. (2) The road from planning to completing a project is long and fraught with issues surrounding zoning land, accessing equipment, and buying electricity. So the planned projects will take years to complete and won't hit the market all at once.

(2) *Challenges to building.* JLL considers obtaining power the "primary challenge facing the data center industry." The US power grid is operating near full capacity, so building a new data center can require developing new electricity generation capacity. Those utilities that

do have available capacity often don't have enough of it to run a data center, anywhere from 100 megawatts to 1 GW.

Utilities had been inundated with requests from developers that were buying land on spec, hoping to get electricity run to that land with plans of flipping the improved land to make a profit—until, that is, last summer, when utilities began tightening their requirements, the report states.

Utilities want to see project leaders with development experience, signed tenants, and financing that's in place. They're charging application fees of $200,000 or more, checking credit, and requiring a load impact study to be done, which can take 8-12 months. Moreover, once approved, developers are being required to pay for the infrastructure hookup costs and being asked to sign take-or-pay contracts obligating them to pay a minimum amount of their planned power usage, even if that power isn't used.

As a result, developers have found themselves sitting on land they've purchased that isn't generating cash flow for years longer than expected. Proposed data center projects, particularly those in rural areas, often have to wait four years or more for a connection to the grid.

These tougher requirements may make projects more costly or mean they take longer to complete. But they may also mean that only "good" projects come to the fore and a bubble takes longer to develop, if it does at all.

(3) *Supply chain knots.* For would-be data center builders who have land and electricity, acquiring equipment can be the next hurdle. According to JLL, it can take 28 weeks on average for the delivery of data center equipment. While that's improvement from pandemic lead times of 64 weeks, it's still far longer than the 18 weeks it took in 2019. Generators, transformers, and switchgear have an even longer lead time of 11 months. More than 70% of data center equipment is manufactured in Asia. Some of that manufacturing is relocating to the US or North American, which could improve the situation.

(4) *Utility data.* The S&P 500 Utilities sector includes the S&P 500 Electric Utilities industry, populated with companies that generate, transmit, and distribute electricity, and the Multi-Utilities industry, with companies that provide a combination of utility services, including electricity, gas, and/or water. The former industry index is up 3.2% ytd, the latter up 3.3% ytd (*Fig. 2* and *Fig. 3*). Both are expected to have decent revenue and earnings growth. The Electric Utilities industry's companies collectively are forecast to grow revenues by 6.9%

this year and 4.0% in 2026 and to grow earnings by 4.9% this year and 7.7% next year (*Fig. 4* and *Fig. 5*).

The S&P 500 Multi-Utilities industry is expected to grow a touch faster. Analysts forecast revenues growth of 10.2% this year and 4.4% in 2026, while they predict earnings will improve by 7.3% this year and 7.7% in 2026 (*Fig. 6* and *Fig. 7*). Both industries have sported forward P/Es north of 20 at various times in recent years, and now the Electric Utilities' forward P/E stands at 17.1, and the Multi-Utilities' forward P/E is 18.0 (*Fig. 8* and *Fig. 9*).

Strategy: JBT Inventory Management? Inventories and supply chains are back in the headlines as those who import products appear to be stockpiling them in an attempt to jump ahead of tariffs. Just-in-time (JIT) inventory management is out. Just-before-tariffs (JBT) inventory management is in. But pre-tariff stockpiling ties up corporate cash flow and can leave companies exposed to an unexpected downturn in sales.

US trade imports have jumped sharply since October, while exports have remained flat. Imports increased 12% in January y/y to $3.3 trillion (*Fig. 10*). Meanwhile, total business inventories increased 2.3% y/y in January, led by a 5.0% y/y jump in retail inventories, followed by smaller increases in wholesale inventories (1.1%) and manufacturing inventories (1.0%) (*Fig. 11*).

Here are some anecdotes from businesses willing to take on the extra risk of stocking up ahead of tariffs.

(1) *Retailers plan ahead.* Some retailers have rushed to fill their shelves ahead of Trump's tariffs. Costco's inventories were up about 10% compared to the previous year in the three months ended February 16, a March 24 *WSJ* *article* reported. Inventories were also up at Williams-Sonoma, Zumiez, and Target.

(2) *Stocking up on copper, too.* Copper futures prices hit new records on Tuesday, at $5.18 a pound, up 30% ytd (*Fig. 12*). The rally was attributed to buyers' stockpiling the metal ahead of Trump's 25% tariff. We'll be watching to see whether the price falls once the tariff is imposed.

Copper isn't the only metal affected. To avoid tariffs on Canadian imports, Alcoa *told* Reuters in January that it would reroute its Canada-made aluminum to Europe and send its Australian aluminum to the US.

(3) *Ford leasing trucks and warehouses.* Ford builds the engines for its F-150 trucks and Mustangs in Canada, normally on demand. But with the threat of tariffs on Canadian imports looming, Ford has been leasing trucks and warehouses in Michigan and Ohio so that it can fetch and store its Canadian-built engines in the US asap, a March 21 *article* on Motor Biscuit reported. That said, the industry's inventory-to-sales ratio remains unusually low at 1.4 in January (*Fig. 13*).

Disruptive Technology: Tesla vs BYD. Just over a month ago, Tesla's Elon Musk said that 2025 might be the most important year in the carmaker's history. He was referring to the company's plans to introduce unmanned autonomous vehicles in the US and its intention to produce Optimus humanoid robots and semi-trailer trucks (more in the February 6 *Morning Briefing*).

Musk was right that 2025 would be a memorable year for Tesla but for reasons he might prefer to forget. His involvement with the Trump administration has made Tesla vehicles targets of vandalism at home and abroad by protestors of Trump 2.0's policies. Tariffs by the administration Musk is helping stand to hurt Tesla's US profits. And Chinese competitor BYD has introduced a supercharger that is faster than Tesla's by a long shot. Tesla shares have fallen 28.7% ytd through Tuesday's close, while the Nasdaq has lost only 5.4% over the same period.

Let's home in on BYD's plans to flood the world (excluding the US?) with cheap, fast-charging EVs:

(1) *Fastest charger wins.* China's BYD shocked the markets recently with a new charger that juices up an EV as fast as filling a tank of gas. Using BYD's Megawatt Flash Charging for one minute can provide a car battery with the energy it needs to drive 49.7 miles. That compares with 11.2 miles using Tesla's supercharger and also beats the charging times of LI Auto (26.1 miles/minute), Mercedes-Benz (20.5), Volvo (18.6), and Hyundai (14.3), according to a March 25 *article* in Finbold.

That said, US road warriors won't find BYD chargers on their routes anytime soon. BYD plans to build more than 4,000 ultra-fast chargers across China. In the past, BYD EV owners have relied on other car manufacturers' charging stations to power up.

(2) *Excess capacity on the way?* BYD is building out a ginormous EV manufacturing campus in Zhengzhou, the capital of China's Henan province. After an eight-phase growth process, the campus will cover 50 square miles, a March 24 InsideEVs *article* reported.

That's 10 times the size of Tesla's Nevada Gigafactory and roughly the size of San Francisco.

Almost 60,000 of BYD's 90,000 employees currently work at the campus; they can also live on site. The facility will ultimately have the capacity to produce about one million cars per year. That's in addition to BYD's Latin American hub in Brazil, which when completed in 2028 will produce 300,000 cars a year.

BYD's Q4 revenues topped Tesla's for the second quarter in a row, coming in at $28.8 billion versus Tesla's $22.6 billion. Given the capacity BYD is building, that trend is likely to continue. Recognizing the threat to US manufacturers, the Biden administration placed a 100% tariff on Chinese EVs, which Trump is expected to extend. BYD investors haven't flinched. Shares of the Chinese automaker have risen 30.8% ytd through Tuesday's close.

Calendars

US: Thurs: Real GDP & GDP Price Index 2.3% & 2.4%; Real Consumer Spending 4.3%; Corporate Profits; Kansas City Fed Composite Index; Goods Trade Balance -$134.6b; Jobless Claims 225k; Pending Home Sales 1.5%; Wholesale Inventories 0.4%; Fed Balance Sheet; Barkin. **Fri:** Personal Income & Spending 0.4% & 0.5%; Headline & Core PCED 0.3%m/m, 2.5%y/y & 0.3%m/m, 2.7%y/y; University of Michigan Consumer Sentiment Headline, Current Conditions & Expectations 57.9, 63.5 & 54.2; University of Michigan Five-Year Inflation Expectations 3.9%; Bostic; Barr. (FXStreet estimates)

Global: Thurs: Spain Retail Sales 0.5%m/m, 1.0%y/y; ECB General Meeting; Lagarde; Schnabel; Guindos; Buch; Dhringa. **Fri:** Eurozone Economic Sentiment Indicator 97; Eurozone Employment Change & Unemployment Rate 10k & 6.2%; Germany Gfk Consumer Confidence -23; France CPI 2.7%y/y; UK GDP 0.1%q/q, 1.4%y/y; UK Retail Sales -0.3%m/m, 0.5%y/y; De Guindos. (FXStreet estimates)

Strategy Indicators

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward revenues edged down during the March 20 week to less than 0.1% from its record high several weeks ago. Forward earnings ticked down 0.1% w/w, to 0.2% below its record high

several weeks earlier as well. 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 steady w/w at 5.6%, down just 0.2ppt from 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 fell 0.1ppt w/w to 12.2%, and is now only 0.1ppt above its 43-week low of 12.1% during the February 27 week, but remains near its 38-month high of 14.3% during the December 12 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 5.2% in 2025 (unchanged w/w) and 6.3% in 2026 (unchanged w/w), an acceleration from 4.9% in 2024 (unchanged w/w). They expect an earnings gain of 11.4% in 2025 (down 0.1ppt w/w) and a 14.4% rise in 2025 (up 0.1ppt w/w) compared to 2024's earnings gain of 11.3% (unchanged w/w). Analysts expect the profit margin to rise 0.8ppt y/y to 13.3% in 2025 (unchanged w/w) and 1.0ppt y/y in 2026 to 14.3% (unchanged w/w), compared to 2024's 12.5% (unchanged w/w). The S&P 500's weekly reading of its forward P/E rose 0.3pt w/w to 20.5 from a 31-week low of 20.2, and is now down 1.9pts from a four-year high of 22.4 during the February 20 week. It's just 0.8pt above its 14-week low of 19.7 during the August 8 week and 5.2pts 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 2.79 from a 31-week low of 2.75, down 0.24pt from a record-high 3.03 during the February 20 week. 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 March 20 week, forward revenues rose for six of the 11 S&P 500 sectors and forward earnings rose for three. This led to rising forward profit margins for one of the 11 sectors. These four sectors posted post-pandemic or record-high forward revenues this week: Communication Services, Health Care, Information Technology, and Utilities. These four are less than 0.2% from their record highs: Communication Services, Consumer Discretionary, Consumer Staples, and Financials. Among the remaining four sectors, Real Estates' is down 1.3% from its record high a week earlier, Industrials' has stalled at 3.0% below its early September record, and both Materials and Energy remain the biggest laggards at 6.1% and 15.1% below, respectively. Looking at forward earnings, Utilities was the only sector at a record high this week, but these six sectors are less than 0.7% from their record highs:

Communication Services, Consumer Discretionary, Financials, Health Care, Industrials, and Information Technology. A little further behind are Consumer Staples at 1.6% below its January 2 record, and Real Estate weakening to 5.0% below its record high in August 2022. Forward earnings remains depressed for the last two sectors, Energy and Materials, which are 34.4% and 27.0% below their respective highs during 2022. Looking at the forward profit margin, five of the 11 sectors are at or near record highs. Financials returned to the record-high forward profit margin club after a week's absence, re-joining the Communication Services and Consumer Discretionary sectors. In recent months, the Industrials and Information Technology sectors were in that club. These four sectors are struggling, with their forward profit margins at or barely above cyclical lows: Consumer Staples, Energy, Health Care, and Materials. 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 (27.1%, down 0.1ppt w/w and 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 (20.2, a record high), Communication Services (18.7, a record high), Real Estate (16.5, down 0.2ppt w/w and from its 19.2 record high in 2016), Utilities (14.4, down 0.1ppt w/w and from its 14.8 record high in April 2021), S&P 500 (13.6, a record high), Materials (10.5, down 0.1ppt w/w to a four-year low, and from a 20-month high of 11.6 in July 2023 and a 13.6 record high in June 2022), Energy (9.3, a 36-month low and down from its 12.8 record high in November 2022), Industrials (11.2, down from its 11.3 record high in early January), Consumer Discretionary (9.4, a record high), Health Care (8.6, only 0.1ppt 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 (6.7, down 0.1ppt w/w to a 20-month low and from its 7.7 record high in June 2020).

US Economic Indicators

Durable Goods Orders & Shipments (*link*): Durable goods orders were a surprise on the upside in February, climbing for the second straight month, ahead of the Trump administration's tariffs on foreign steel and aluminum. *Durable goods* orders rose 0.9% last month, beating expectations of a 1.0% decline and following an upwardly revised surge of 3.3% in January. *Transportation equipment* orders once again led the increase, climbing 1.5%—accounting for nearly half of February's overall durable goods growth—with *motor vehicles* (4.0%) and *defense aircraft & parts* (9.3) posting sizeable gains. *New orders excluding transportation equipment* rose 0.7%, more than double the expected 0.3% increase, with orders for electrical equipment, appliances & components (2.0%), computers (1.1), primary metals (1.2), and fabricated metals (0.9) in the plus column, while capital goods order slumped 1.5% during the month. Meanwhile, *nondefense capital goods orders*

excluding aircraft (a proxy for future business investment) fell 0.3% last month (vs +0.2% expected), posting the first decline in four months, following an upwardly revised gain of 0.9% in January. However, *shipments of core capital goods*, used in the calculation of the GDP component of business equipment spending, rebounded 0.9% in February following January's 0.2% shortfall.

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