Yardeni Research

June 26, 2025

Morning Briefing

Industrials, Homebuilders & Dancing Robots

Check out the accompanying chart collection.

Executive Summary: Aircraft-related stock prices have been soaring recently, making the S&P 500 Industrials sector the number-one performer this year to date among the index's 11 sectors. Jackie examines the reasons and highlights some of the sector's standout industries and companies. … Also: KB Home's shares barely reacted when the homebuilder reported disappointing quarterly results. That could mean investors are looking forward to a more hospitable environment for homebuilders, with lower mortgage rates and greater home affordability, notwithstanding what Fed Chair Powell has been telegraphing. … And in our Disruptive Technologies segment, humanoid robots are advancing—and dancing—by leaps and bounds.

Industrials: Transports Get a Lift. The Nasdaq 100 hit its second straight record high on Wednesday, but that doesn't mean that the S&P 500 Technology sector is the best performing sector in the S&P 500 this year. For a change, it's the S&P 500 Industrials sector that's been leading the broader index higher.

Here's the performance derby for the S&P 500 and its 11 sectors ytd through Tuesday's close: Industrials (10.1%), Utilities (7.7), Financials (6.7), Communication Services (6.1), Consumer Staples (5.6), Information Technology (4.6), Materials (4.5), Real Estate (3.8), S&P 500 (3.6), Energy (-0.8), Health Care (-2.8), and Consumer Discretionary (-5.1) (*Fig. 1*).

Here's a look at what's driving the Industrials' strong performance:

(1) *Flying higher.* Behind the Industrials index's strength are the outperforming stocks of aircraft-related companies. They're flying higher thanks in part to Boeing's getting back on track and cranking out an increasing number of aircraft. The shares of Howmet Aerospace, which sells aircraft parts to Boeing and others, have soared 61.4% ytd, followed by GE Aerospace's 49.1% gain. The shares of both shipbuilder Huntington Ingalls Industries and aerospace and defense company RTX have climbed 22.6% ytd.

Here's the performance derby for some of the industries in the Industrials sector ytd through Tuesday's close: Aerospace & Defense (22.2%), Industrial Conglomerates (4.8), Electrical Components & Equipment (3.5), Transport Composite (3.1), Construction Machinery & Heavy Equipment (-0.3), and Industrial Machinery (-1.0) (*Fig. 2*).

(2) *The gem in Transports.* Hiding behind the mediocre performance of the Transports industry is the standout performance of the Passenger Ground Transportation industry; its sole constituent Uber Technologies has risen 51.9% ytd. The shares gained most recently on news that Alphabet's self-driving division, Waymo, and Uber have extended their partnership. Waymo will be launching service in Atlanta that passengers can access via an Uber app. Uber's share price movements have outsized impacts on the S&P 500 Transportation index because Uber's market capitalization is roughly a quarter of the Transportation index's total (*Fig. 3*).

The other industries in the S&P 500 Transportation index haven't fared as well ytd: Transport Composite (3.1), Rail Transportation (2.2), Cargo Ground Transportation (-10.4), Passenger Airlines (-15.4), and Air Freight & Logistics (-16.9) (*Fig. 4*). Many of the laggards are suffering from the ill effects of Trump's Tariff Turmoil.

(3) *The impact of tariffs.* FedEx highlighted the drag that tariffs are having on its shipping business in its earnings call with analysts on Tuesday. The company estimates that "global trade policy impacts" will amount to a $170 million "headwind" in its fiscal Q1 (ending August 31), a headwind that should continue through the year. Tariffs are materially impacting the company's business in China and across the Pacific.

FedEx reported operating EPS of $6.07 for its fiscal Q4 (ended May 31), above analysts' $5.82 consensus forecast and up from an adjusted $5.41 a year earlier. In a break from past practice, the company didn't offer fiscal 2026 guidance. But for fiscal Q1, management expects sales to be flat to up 2%y/y and adjusted EPS to be $3.40-$4.00; analysts are targeting $3.83.

FedEx shares dipped roughly 2% on Wednesday due to the earnings report, deepening their ytd decline to about 20%. They're part of the S&P 500 Air Freight & Logistics industry's stock price index, which has fallen 16.9% ytd, primarily dragged down by FedEx and UPS (*Fig. 5*). The industry's forward revenues and forward EPS peaked in 2022 after consumers' pandemic buying binge and have been falling ever since (*Fig. 6* and *Fig. 7*).

Analysts are forecasting a turnaround next year. Their consensus projections call for revenues to fall 1.6% this year but rise 2.5% in 2026 and earnings to drop 1.4% this year but climb 12.8% in 2026 (*Fig. 8* and *Fig. 9*). If such a turnaround comes to pass, the stock could perform well given that a lot of pessimism is priced into the shares at their current valuation: The forward P/E of 13.4 is near a 30-year low (*Fig. 10*).

Consumer Discretionary: Are Homebuilders' Stocks Bottoming? Homebuilders' shares are showing remarkable resilience in the wake of their disappointing Q2 earnings reports. In last Wednesday's *Morning Briefing,* we discussed Lennar's results. This week, it was KB Home reporting the dour news. Its sales forecast for the fiscal year ending November 30 was reduced for the second time this year. But its share price barely budged on Tuesday in response.

KB's shares, which are down almost 40% from their September 19 high-water mark, may have held their ground because they already reflect a hearty amount of bad news. It's also possible that shareholders were heartened by the company's repurchase of shares at a price below their book value. And it's likely that investors have grown more hopeful that the Federal Reserve's next move will be lowering interest rates, which could mean lower mortgage rates in the future.

Here's a look at KB Home's disappointing earnings report and what the stock market responded to instead:

(1) *KB reduces 2025 outlook.* KB Home, which sells entry-level new homes, warned investors to lower their expectations for the current fiscal year. It's targeting fiscal 2025 sales of $6.3 billion-$6.5 billion, down from the ranges it gave in March ($6.6 billion-$7.0 billion) and January ($7.0 billion-$7.5 billion). The company's updated sales forecast for this year is slightly below analysts' consensus forecast of $6.55 billion.

Management also told analysts to expect the average selling price of a KB home to drop into the $480,000-$490,000 range this fiscal year from $501,000 in fiscal 2024.

"[W]hile longer term, the outlook for the housing market remains favorable, driven by demographics and an undersupply of homes, consumers are continuing to demonstrate a lack of confidence about the short term, which has impacted their home purchase decisions," said CEO Jeffrey Mezger on the company's earnings *conference call*.

Mezger added, "Affordability challenges have persisted, compounded by the variability in mortgage interest rates, which remain elevated, as well as macroeconomic and geopolitical uncertainty. These factors resulted in a more subdued demand during the spring selling season." While the company's net orders were strong in March, they declined in April and May, which is not the normal trajectory in the spring home selling season.

KB Home is battening down the hatches. It canceled contracts to purchase about 9,700 land lots that no longer meet the company's underwriting criteria. Instead, it repurchased $200 million of outstanding shares at an average price of $53.55 a share, below the company's current book value of $58.64 a share.

(2) *Housing has an affordability problem.* As we've noted in the past, the housing market has an affordability problem. Rising home prices in recent years combined with rising mortgage rates are a double whammy that's causing potential home buyers to stay put instead.

The 30-year mortgage rate has been unusually high over the past three years, at 6.81% (*Fig. 11*). Despite higher financing costs, new and existing home prices remain at or near record highs (*Fig. 12*). That's led to the sharp drop in housing affordability in October 2023 to levels not seen since the 1980s. Affordability has improved only modestly since (*Fig. 13*).

The latest read on the new housing market reflects the growing affordability problem. Sales of new single-family homes in May fell 13.7% m/m and 6.3% y/y (*Fig. 14*). The months of new home supply on the market rose to 9.8 from 8.3 in April. About four to six months of supply is considered normal (*Fig. 15*). The news weighed on the S&P 500 Homebuilding industry's stock price index, which dipped 1.7% on Wednesday while the S&P 500 was unchanged.

(3) *Reasons for hope.* Investors may be willing to tiptoe into the sector in hopes that interest rates will fall. This week, oil prices fell sharply as President Trump appeared to successfully broker a ceasefire between Israel and Iran (*Fig. 16*).

Additionally, three Fed officials favor lowering the federal funds rate this year: Fed Governors Christopher Waller and Michelle Bowman, who are Trump appointees, have called for cuts as early as July, and Fed Bank of Boston President Susan Collins expects cuts later this year assuming that any inflation shock resulting from tariffs "dissipates quickly."

However, these three are in the minority among Fed officials, as interest rates weren't changed at last week's meeting of the Federal Open Market Committee. Moreover, Fed

Chair Jerome Powell in congressional testimony this week emphasized the Fed's responsibility to keep inflation in check and his expectation that the Fed will leave interest rates at current levels until the impact of tariffs on prices can be assessed. That said, the yield on the 10-year Treasury bond has been falling in fits and starts from its peak of 4.79% in January to a recent 4.30%.

Disruptive Technologies: Tracking Robots. Humanoid robots are advancing at a rapid clip, looking and acting more human every time we check in on them. In today's update, let's consider ARK Investment Management's latest market forecast for humanoids and watch a few kick up their heels:

(1) *Humanoids seize the day.* After years of development, humanoid robots are poised to be successful because of three converging trends, according to a June 17 *report* by the folks at ARK: 1) technology breakthroughs in artificial intelligence (AI), vision recognition systems, and neural networks have improved humanoids' ability to "think" and interact with humans; 2) declining component costs are making humanoids cheaper to produce; and 3) global labor shortages have increased demand for humanoids.

The upshot will be massive productivity increases, particularly for small businesses. Historically "[s]pecialized robotic solutions required significant upfront capital and worked best in the precise, discrete and repetitive workflows of large, highly scaled organizations," the ARK report states. With their ability to "learn" to do a variety of tasks, humanoid robots will be more affordable for small businesses to adopt. "[H]umanoid robots could level the playing field significantly enabling smaller enterprises to automate numerous tasks that previously were not affordable to address through automation machinery."

The demand for humanoids has increased just as the technology has improved and costs have been dropping. ARK calls humanoids a "demographic imperative" at a time when declining birth rates, particularly in China and developed nations, limit labor availability.

Tesla is targeting eldercare and home assistance as key areas for its Optimus humanoid robot, the report notes. Intuitive Surgical's robotic surgical systems and Amazon's fulfillment center robots help reduce the demand for labor in an era when workers are growing scarce. John Deere's automated farm equipment is reducing the need for farm hands, and Teradyne's Universal Robots can help keep manufacturing plants operating even when workers are scarce.

(2) *Robot video of the day.* It wouldn't be right to discuss humanoid robots without offering

up the latest *entertaining video*. This one involves Boston Dynamics' four-legged robots performing a dance routine on a recent *America's Got Talent* TV show earlier this month.

The judges and audience were charmed, looking past one of the five robots malfunctioning, and focusing instead on the robots' dance moves to Queen's "Don't Stop Me Now." The dance routine was preprogrammed, and humans behind the stage controlled the robots after the performance. All the judges voted "yes," so the dancing robots will perform again in the next round of the talent competition.

Calendars

US: **Thurs:** GDP & Price Index -0.2% & 3.7%; PCED Headline & Core 3.6%q/q & 3.5%q/q; Initial Claims 247k; Kansas City Fed Manufacturing Index; Goods Trade Balance -$91.9b; Durable Goods Orders 0.1%; Chicago Fed National Activity Index; Barkin; Barr. **Fri:** Personal Income & Spending 0.2% & 0.2%; University of Michigan Consumer Sentiment Total, Current Conditions & Expectations 60.5, 63.7 & 58.4; Expected Inflation One-Year & Five-Year 6.1% & 4.1%; Atlanta Fed GDPNow; Williams. (Source: FX Street)

Global: **Thurs:** Germany Gfk Consumer Confidence -19.3; EU Leaders Summit; Lagarde; De Guindos; Schnabel; Greene; Bailey; Breeden. **Fri:** Eurozone Sentiment Indicator 95.1; France CPI 0.2%m/m, 0.7%y/y; Spain CPI 0.4%m/m, 2.0%y/y; UK GDP 0.7%q/q, 1.3%y/y; France CPI 0.2%m/m, 0.7%y/y. (Source: FX Street)

Strategy Indicators

S&P 500 Sectors Revenues, Earnings, & Margins (*link*): During the June 19 week, forward revenues rose for eight of the 11 S&P 500 sectors and forward earnings rose for six sectors. The forward profit margin rose for four of the 11 sectors. These four sectors had record-high forward revenues this week: Health Care, Information Technology, Real Estate, and Utilities. These three are less than 1.0% from their recent record highs: Communication Services, Consumer Staples, and Financials. Among the remaining four sectors, Consumer Discretionary has dropped 1.6% from its mid-March record-high forward revenues, Industrials' is 2.1% below its early September record, and both Materials and Energy are the biggest laggards at 6.8% and 17.6% below, respectively. These four sectors had record-high forward earnings this week: Communication Services, Financials, Information

Technology, and Utilities. These five sectors are a bit further from their highs: Consumer Discretionary (4.4% below its March 6 record), Consumer Staples (1.9% below its January 2 record), Health Care (1.2% below its April 3 record), Industrials (0.5% below its April 3 record), and Real Estate (3.3% below its August 2022 record). Forward earnings remains depressed for the last two sectors, Energy and Materials, which are 40.9% and 26.2% below their respective highs during 2022. Looking at the forward profit margin, four of the 11 sectors rose w/w, and these two remained in the record-high club: Communication Services and Financials. From late 2024 through mid-May, these three sectors were also in that club, and they still remain close: Consumer Discretionary, Industrials, and Information Technology. These four sectors are struggling, with their forward profit margins at or barely above cyclical or record 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 (27.3%, down from its 27.6% record high in September, prior to low-margin Dell's addition to the index, which lowered the margin 1.3ppts then to 26.3%), Financials (20.5, up 0.1ppt w/w to a record high), Communication Services (19.2, at a record high), Real Estate (16.4, down from its 19.2 record high in 2016), Utilities (14.6, down from its 14.8 record high in April 2021), S&P 500 (13.6, at a record high), Materials (10.7, up 0.3ppt from 51-month low in late February and down from a 20-month high of 11.6 in July 2023 and a 13.6 record high in June 2022), Energy (8.6, up 0.1ppt w/w from a 55-month low and down from its 12.8 record high in November 2022), Industrials (11.1, down from its 11.3 record high in early January), Consumer Discretionary (9.2, down from a record high 9.4 in early April), Health Care (8.4, down 0.1ppt w/w to a record low and down from its 11.5 record high in February 2022), and Consumer Staples (6.7, a 21-month low and down from its 7.7 record high in June 2020).

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US Economic Indicators

New Home Sales (*link*): New home sales (counted at the signing of a contract) was a surprise on the downside in May, tumbling to a seven-month low and remaining in a very volatile flat trend. New home sales tumbled 13.7% to 623,000 units (saar), below the consensus forecast of 694,000 units, while April sales were revised to 722,000 units—down from the preliminary estimate of 743,000 units. *Compared to a year ago*, sales were down 6.3%. The estimate of new homes for sale was 507,000 units at the end of May, representing a 9.8 months’ supply at the current sales pace, up from 8.3 months in April. Regionally, only the Northeast (+32.1% to 37,000 units) posted an increase in sales during May, while the South (-21.0 to 349,000) recorded the largest decline, followed by the Midwest (-7.1 to 78,000), and West (-5.4 to 159,000). Of the 623,000 *homes sold* during May, 338,000 were completed, 215,000 were under construction, and 70,000 weren’t started. Of the 507,000 *homes for sale* during May, 119,000 had been completed, 271,000 were under construction, and 117,000 hadn’t yet broken ground.

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