Yardeni Research

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Morning Briefing

On Travel, Semis & AI's IQ

Check out the accompanying chart collection.

Executive Summary: While Americans have been traveling a lot and by all modes available, the flight paths of travel industries' stock indexes so far this year are all over the map. Jackie explores what's up—and down. … Also: The S&P 500 Semiconductor stock price index has been volatile this year, knocked akilter by the tariff turmoil. Yet analysts' expectations for company fundamentals have been steady and impressively so, with nearly 40% earnings growth expected this year and 30% next. The caveat is a historically high P/E. … And in our Disruptive Technology segment: The debate over how intelligent artificial intelligence realistically can ever become.

Consumer Discretionary: Everyone's Traveling for the Fourth. If you're planning a trip over the 4th of July weekend you certainly won't be alone. AAA *expects* the number of folks traveling domestically by 50 miles or more to increase by 2.4% y/y to 72.2 million. Increases are expected for those traveling by car (2.2% y/y), plane (1.4%), and other modes, including bus, train, or cruise (7.4%).

Travel industry stocks present a more mixed picture. The S&P 500 Hotels Resorts & Cruise Lines industry's stock price index has jumped 11.5% ytd through Tuesday's close, bringing it to a new all-time high (*Fig. 1*). Conversely, the Casinos & Gaming industry has dropped 0.6% ytd, close to the bottom of its 15-year range, and Passenger Airlines has lost 14.4%, placing it roughly in the middle of the range in which it has traded the past decade (*Fig. 2* and *Fig. 3*).

Here's a look at what's moving the travel indexes in different directions:

(1) *Airlines pull out of a nosedive.* The S&P 500 Passenger Airlines stock price index cratered in March during peak uncertainty about President Trump's proposed tariffs and consumers' response to them. A focus on cost cutting throughout the federal government added to concerns about airline travel. Since then, many of the proposed tariffs have been

reduced or decisions about them have been pushed into the future, helping consumer confidence to recover. The much feared recession has yet to arrive.

Likewise, one of airlines' largest costs—fuel—has remained remarkably low given the tensions in the Middle East. After a brief spike, the price of Brent crude oil futures has fallen below $70 per barrel, back to its levels of earlier this year but lower than it was from 2021 to 2024 (*Fig. 4*).

Despite the resilient economy, airline analysts decided to cut their estimates first and ask questions later. Analysts' 2025 consensus revenue estimate implies growth of 1.8% y/y, down from more than 7% estimated for the year in early March and their 2025 consensus earnings estimate implies a 6.7% y/y decline—a drastic change from the 36.2% growth they originally targeted back in early March (*Fig. 5* and *Fig. 6*).

Even though the economy appears to remain on solid footing and airline stocks have recouped about half of their lost ground since April 8, analysts' consensus earnings and revenue estimates have not rebounded.

(2) *Still cruising.* Optimism about the hotel and cruise industry has returned, most recently bolstered by Carnival's Q2 earnings beat and its full-year profit guidance increase to $1.97 a share, up from its March guidance calling for earnings of $1.83 a share. The company acknowledged some softness related to the Israel-Iran war but noted that demand has since rebounded and remains strong.

"The company's cumulative advanced booked position for the remainder of the year remains strong with occupancy the second highest on record and pricing (in constant currency) at historical highs. While early, the company's booked position for 2026 is in line with 2025 record levels (at the same time last year) and at historical high prices (in constant currency)," the company stated in its *press release*.

Analysts' optimism about the S&P 500 Hotels, Resorts, & Cruise Lines industry has returned as well. While the industry's forward revenues per share has almost entirely recovered after cratering during the pandemic, the industry's operating earnings per share has more than recovered—it has attained new highs (*Fig. 7* and *Fig. 8*). Analysts trimmed their forecasts for companies in this industry earlier this year, but the cuts weren't nearly as dramatic as those for the Passenger Airline industry. Even after the cuts, analysts see revenues growing 6.5% this year and 7.3% in 2026 and earnings leaping 16.7% this year and 15.4% in 2026 (*Fig. 9* and *Fig. 10*).

(3) *Casinos have a hot roll.* Casinos with exposure to Macau rallied on Tuesday after Macau's Gaming Inspection and Coordination Bureau reported a 19% y/y increase in June gaming revenue, well above the 9.4% that analysts were expecting. Macau's gaming revenues have rebounded to 88% of what they were in 2019 prior to the pandemic, a July 1 Investing.com *article* reported. It attributed June's strong results to a series of concerts given by Cantopop icon Jacky Cheung in mid-June through early July.

Macau's overall tourism has improved as well. Q1 visitor arrivals increased 11% y/y, and the hotel occupancy climbed to 90.1% from 84.9%, according to Macau's Statistics and Census Service data cited in a July 1 *Barron's* *article*.

The S&P 500 Casinos & Gaming stock price index has been hitting lower highs ever since 2015, but it has also stopped making lower lows. The industry's revenues have been gradually recovering since 2021, and its earnings were recovering until last year when they started sliding again. Analysts appear optimistic about a revival. They're expecting revenues to inch up 0.8% this year and 2.7% in 2026 (*Fig. 11*). Earnings growth is expected to rebound more sharply, by 10.5% this year followed by an impressive 22.5% in 2026 (*Fig. 12*).

Semiconductors: Breaking Out. The S&P 500 Semiconductors stock price index had a tough spring. It fell by 35.1% from this year's record high on January 6 to this year's low on April 4. But it since has rebounded nearly 67% from the low and broken out to a new high. The index is now up 14.0% ytd through Tuesday's close even after pulling back by 2.2% on Monday and Tuesday (*Fig. 13*).

Why the rollercoaster ride? Fears about President Trump's tariffs that initially soured investors on the industry have given way to optimism about AI's future and continued strong demand for high-end semiconductor chips.

Supporting the S&P 500 Semiconductor index's gains are its two dominant members: Nvidia, which represents 61.3% of the index's market share, and Broadcom, which kicks in 19.4% of the market cap. Each company's stocks have gained 14.2% ytd (*Fig. 14*).

Despite the stock price volatility, analysts' revenue and earnings forecasts have remained remarkably steady for this fast-growing industry. Semiconductors revenues are forecast to climb 26.5% this year and 18.9% in 2026 (*Fig. 15*). Analysts did trim their 2025 consensus earnings growth forecast from a peak of 48.1% expected last year to a still impressive 39.9%. Meanwhile, their 2026 earnings growth forecast has been gradually increasing over the past year to the recent estimate of 31.8% (*Fig. 16*).

One note of caution in this otherwise optimistic story: The industry's forward P/E—at 29.1 as of Tuesday's close—has climbed closer to its June 18, 2024 peak level of 35.5 (*Fig. 17*).

Disruptive Technologies: Thinking About AI Thinking. One of the hottest debates in the tech world right now is about whether programs using artificial intelligence will be able to think like humans. While there are many opinions on this subject, two notable arguments come from OpenAI's CEO Sam Altman and from long-time friend Gary Smith, the Fletcher Jones Professor of Economics at Pomona College and senior fellow at the Walter Bradley Center for Natural and Artificial Intelligence. The correct answer to this question is important because it will determine whether companies that are building out their AI infrastructure to prepare for the future are investing their money wisely or throwing it away on a fool's errand.

Meanwhile, Chinese companies are focused on providing inexpensive, open-source AI programs. The latest, from Baidu's Ernie, was introduced this week. While the Chinese AI programs might not be as good as those of US competitors, the cost differential could make them attractive alternatives to US offerings, particularly for buyers in developing nations—potentially leaving US providers behind.

Here's a look at these important AI developments:

(1) *How smart can AI get?* There's no denying that AI is rapidly changing our lives. Chatbots have gotten better at answering our shopping questions. Children have learned to use ChatGPT to write their school papers. Google search summaries have become more readable and authoritative sounding even when they're not correct. The ability to execute those tasks is impressive, but it doesn't yet mean that AI is capable of thinking like a human. AI programs have ingested tons of information and are excellent at pattern recognition, but that's still a far cry from thinking.

Apple researchers recently published a *paper* noting that large reasoning models—large language models trained to break tasks into a series of steps—are unable to solve puzzles that they've never been trained to solve (e.g., two known as "The Tower of Hanoi" and "River Crossing"). AI programs can't reason independently because they can't actually think.

Likewise, an AI program would never be able to advise a client accused of murder on whether he should settle his case to receive a reduced sentence or go to trial. “As an experienced trial lawyer, you consider the evidence, the composition of the jury, the competency of the prosecutor, whether your client will testify and how that might go, and other relevant information. You tell your client the possible outcomes and your assessment of the likelihood of these various possibilities,” wrote Smith in a June 13 *article* published in *Mind Matters*.

“How could an LLM—no matter the amount pre-training and post-training—offer equally well informed and trustworthy advice? An LLM has no way of understanding the relevant information and no means of coming up with subjective probabilities,” Smith concludes.

OpenAI’s Altman is more optimistic about AI’s future capabilities. He waxed poetic in a June 10 *blog post* about the next wave of AI development: Artificial Super Intelligence (ASI), featuring machines that officially are smarter than humans. “2025 has seen the arrival of agents that can do real cognitive work … 2026 will likely see the arrival of systems that can figure out novel insights. 2027 may see the arrival of robots that can do tasks in the real world,” he predicts. “We do not know how far beyond human-level intelligence we can go, but we are about to find out.”

(2) *Introducing Ernie.* China’s Baidu will gradually be making its generative AI program, Ernie, open source—available for free to the public. It follows in the footsteps of Chinese AI-provider DeepSeek. Their free open-source approach is the opposite of most US AI providers’ business models and puts pressure on US AI companies to justify their high prices.

It’s also an approach that typically appeals to developers—and AI companies want developers to create apps that use their AI programs. As Microsoft learned early on, the software company that attracted the most developers ultimately attracted the most users. Though we haven’t seen it yet, OpenAI’s Altman has said the company plans to offer an open-source version of ChatGPT. Last week, Google introduced Gemini CLI, and Elon Musk’s xAI and Meta’s Llama models are also open source.

Whether governments will allow a Chinese company to offer AI services in their nations will be something to watch. In general, Chinese AI programs provide answers that are acceptable to the Chinese Communist Party. If the US government wants to ban TikTok from teenagers’ cell phones, it’s unlikely to embrace Ernie no matter how inexpensive the program is. That said, many developing nations may not have the same qualms about the Chinese government’s values, especially if they lack the financial luxury to turn down free

AI.

Calendars

US: Thurs: Nonfarm Payroll Employment 120k; Average Hourly Earnings 0.3%; Average Weekly Hours 34.3; Unemployment Rate 4.3%; Initial Unemployment Claims 239k; Trade Balance -$69.6b; Factory Orders 7.9%; ISM NM-PMI 50.8; S&P Global Composite C-PMI & NM-PMI 52.8 & 53.1; Bostic. **Fri:** Independence Day. (Source: FX Street)

Global: Thurs: Eurozone, Germany & France C-PMIs 50.2, 50.4 & 48.4; Eurozone, Germany & France NM-PMIs 50.0, 49.4 & 48.7; UK C-PMI & NM-PMI 50.7 & 51.3; Japan Household Spending 0.4%m/m, 1.3%y/y; ECB Publishes Account of Monetary Policy Meeting Balz. **Fri:** Eurozone PPI -0.6%m/m, 0.3%y/y; Germany Factory Orders 0.4%; France Industrial Production 0.4%; Italy Retail Sales 0.5%; Elderson. (Source: FX Street)

Strategy Indicators

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward revenues attained a record high during the June 26 week, but its forward earnings edged down to 0.1% below its April 4 record high. The forward profit margin edged down too, to 0.1pt below its record high of 13.6% a week earlier and is now 3.4ppts above its seven-year low of 10.3% during April 2020. The consensus expectations for forward revenues growth was unchanged w/w at 5.5%, just 0.3ppt below 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 was steady w/w at 11.4%, just 0.5ppt above its 15-month low of 10.9% during the May 29 week. From a longer-term perspective, that's in line with its 20-year average of 11.4% and slowing from a 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 4.5% in 2025 (unchanged w/w) and 6.1% in 2026 (unchanged w/w), compared to a 4.9% rise in 2024. They expect an earnings gain of 9.2% in 2025 (up 0.1ppt w/w) and a 13.8% rise in 2025 (unchanged w/w) compared to 2024's earnings gain of 11.4%. Analysts expect the profit margin to rise 0.5ppt y/y to 13.0% in 2025 (down 0.1 ppt w/w) and 1.0ppt y/y in 2026 to 14.0% (unchanged w/w), compared to 2024's 12.5%. Looking at valuation data as of June 19, the S&P 500's weekly forward P/E rose 0.4pt w/w to an 18-week high of 21.9, up 2.7pts from a 16-month low of 19.2 during the April 17 week and just 0.5pt below its four-year high of 22.4 during the February 20 week. It's now 6.6pts above its 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 0.05pt w/w to an 18-week high of 2.97, up 0.38pt from a 12-month low of 2.59 during the April 17 week and 0.06pt below its 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 Revenues, Earnings, & Margins (*link*): During the June 26 week, forward revenues rose for nine of the 11 S&P 500 sectors and forward earnings rose for five sectors. The forward profit margin rose for two of the 11 sectors. These four sectors had record-high forward revenues this week: Communication Services, Consumer Staples, Health Care, and Information Technology. These three are less than 0.6% from their recent record highs: Financials, Real Estate, and Utilities. Among the remaining four sectors, which are also rising lately, Consumer Discretionary has improved to 1.4% from its mid-March record-high forward revenues, Industrials' is 1.7% below its early September record, and both Materials and Energy are the biggest laggards at 6.0% and 16.6% below, respectively. These three sectors had record-high forward earnings this week: Communication Services, Information Technology, and Utilities. These six sectors are a bit further from their highs: Consumer Discretionary (4.8% below its March 6 record), Consumer Staples (2.1% below its January 2 record), Financials (0.1% below its June 19 record high), Health Care (1.4% below its April 3 record), Industrials (0.6% 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 40.2% and 26.2% below their respective highs during 2022. Looking at the forward profit margin, two 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 (27.2%, down 0.1ppt w/w and 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 (20.4, down 0.1ppt w/w from a 20.5 record high), Communication Services (19.1, down 0.1ppt from its 19.2 record high a week earlier), Real Estate (16.5, up 0.1ppt w/w and down from its 19.2 record high in 2016), Utilities (14.7, up 0.1ppt w/w and down from its 14.8 record high in April 2021), S&P 500 (13.5, down 0.1ppt w/w from a record high), Materials (10.6, down 0.1ppt w/w and up 0.2ppt 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), Consumer Discretionary (9.1, down 0.1ppt w/w and from a record high 9.4 in early April), Energy (8.6, up 0.1ppt from a 55-month low during the during the May 15 week and down from its 12.8 record high in November 2022), Industrials (11.1, down from its 11.3 record high in early January), Health Care (8.3, 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).

US Economic Indicators

ADP Employment (*link*): "Though layoffs continue to be rare, a hesitancy to hire and a reluctance to replace departing workers led to job losses last month," noted Dr. Nela Richardson, chief economic ADP. "Still, the slowdown in hiring has yet to disrupt pay growth." *Private payroll* employment was a surprise on the downside, with ADP showing a 33,000 drop in jobs in June, much weaker than consensus estimates of a 95,000 gain. It was the first decline in payrolls in more than two years. The *service-providing* sector accounted for June's decline, sinking 66,000, with employment in professional & business services (-56,000) and education & health services (-52,000) posting steep declines; financial activities (-14,000) jobs were also in the red. Leisure & hospitality added to payrolls, climbing 32,000, while trade, transportation/utilities added 14,000—with information and other services posting gains of 5,000 each. *Goods-producing* jobs climbed 32,000, led by a 15,000 gain in manufacturing jobs, while construction and natural resources/mining jobs climbed 9,000 and 8,000, respectively. According to the report, the yearly pay increase for *job-stayers* was little changed in June at 4.4% compared with 4.5% in May, while pay gains for *job-changers* was at 6.8%, down slightly from May's 7.0%.

Global Economic Indicators

Global Manufacturing PMIs (*link*): "Global manufacturing moves back into expansion as output rises and new orders stabilize" was the headline of the June report. The *JP Morgan*

Global M-PMI (to 50.3 from 49.5) rose back above the breakeven point of 50.0 for the first time in three months. Three of the five PMI components were at level consistent with an improvement in operating conditions—output, new orders, and supplier deliveries' times—while both employment and stocks of purchases fell during the month, though the declines were marginal. Worth noting is the 2.3-point increase in the manufacturing output index to 51.3—the best month-on-month gain in its level since June 2022. *By sector*, output advanced across consumer, intermediate, and investment goods categories. *By country*, the rebound in worldwide production volumes was underpinned by returns to growth in China, the US, and Japan. Output in the Eurozone continued to increase, though at a slower pace, while India registered the fastest growth. The UK, Brazil, Mexico, and Russia were among the countries that contracted during the month. *Global employment* fell for the 11th straight month in June, with China, the Eurozone, and the UK posting job losses, though these were partially offset by employment gains in the US, Japan, and India. *Business optimism* remained relatively subdued in June—below the long-run survey average for the 15th straight month. *Turning to prices*, the survey notes another "month of diverging price pressures globally." Rates of inflation for factory input cost and selling prices rose sharply in the US from the already strong rates in May. In contrast, input costs and prices charged by factories fell, on average, in mainland China and the Eurozone, and elsewhere they remained far more subdued than seen in the US.

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