



Basis Points – July 23, 2019

westwoodgroup.com/weeklyblog/basis-points-july-23-2019/

Above the Fold

Earnings Shaping Sentiment – On average, stocks trended modestly lower last week as investors began to learn more about sales and profits from domestic and internationally exposed companies. And while executive commentary on earnings calls is always an important data source, asset owners are likely to listen a little closer to the words of business leaders for clues into sentiment, risk and particulars about future expectations and challenges.

It's still too early to tell how second quarter earnings will fare as less than 18% of S&P 500 companies have reported thus far, but this is a heavy week for earnings with 580 reports due out, 136 of which are S&P 500 members. Amazon's results are due out Thursday and is coming off four consecutive quarters of record profits.

As we've stated previously, the expectations for growth this quarter are extremely low, so don't expect too many major earnings disappointments. It's also important to remember that growth is relative. As a comparison to last quarter, or more commonly, the same quarter last year, growth numbers don't always tell the full story and often the real details are buried in the fine print, not the headlines.

When it's all over, total second quarter earnings for the S&P 500 index are expected to be down -1.7% from the same period last year on +4% higher revenues. This follows a similar pattern from first quarter, where stocks in that index reported a -0.1% earnings decline on +4.4% higher revenues.

And even though sales and earnings results are handily beating analysts' estimates, targets for third quarter 2019 growth continues to drop. Analysts now expect negative year-over-year growth of 2.3% in the third quarter, compared with expectations for a decline of just 1.3% in late June. Ironically, stocks are still holding their ground, likely due

to hopes for economic stimulus in the form of low rates and government spending on certain items like infrastructure. A successful trade deal also seems to be baked into the equation.

Risk seems to be building in geopolitical stability and energy as tensions continue to escalate in the Middle East, specifically with Iran. The large Arab nation, crippled by global sanctions, seized a British ship Friday and said yesterday that it had arrested 17 Iranian citizens on charges of spying for the U.S., and had already executed some. While we hope for a diplomatic solution, those chances seem to be fading.

What's Ahead

Flash Manufacturing Purchasing Managers' Index data is due out tomorrow. Economists are looking for a modest rise to 50.9, which is just above the expansion level of 50. Durable Goods Orders are set for release Thursday with analysts expecting a sharp rise of 0.8% at the top line, and 0.2% at the core.

Three Things

1. *Baltic Dry Booms* – The Baltic Dry Index, which tracks global commodity shipping costs, hit its highest level since 2014. At first glance, this data suggests a pickup in global economic activity, but experts say that the rally may be skewed by a sudden uptick in shipments from mines in Brazil that were closed for months following a fatal accident early this year. The sudden demand and price increases may only be temporary.
2. *Ford's Asia Problem* – The maker of the Mustang had big plans for China, unfortunately, they don't seem to be materializing for the second-largest U.S. automaker as sales in China plummeted 27% in the first half of 2019 compared with the same period last year. Overall, auto sales in China have dropped for 12 consecutive months.
3. *Hushin' Harley-Davidson* – As a company with a long history of classic heavy, fuel burning, loud pipe designs, Harley is changing its tune with the mass production of an all-electric bike called the Livewire. Starting around \$30,000, the Livewire is fast, cool and nearly silent. The company is hoping to reinvigorate sales and capture market share with its transmissionless wonder that does 0-60 mph in 3 seconds, which is faster than any production bike made.

Did You Know?

China's economy may be the second largest in the world, and its growth may also have massive influence over global markets, but its stock market is NOT a good indicator of its economic health. Less than 8% of China's population own stocks, with the vast majority

of ownership held by a small minority of wealthy individuals and government entities. Most Chinese consumers who have the money to invest do so with real estate, which stands in stark contrast to the more than 50% of U.S. consumers who own stocks. This thinly held structure can lead to elevated volatility and potential disconnects between stock values and real earnings results.

China's two major exchanges, the Shanghai Stock Exchange and Shenzhen Stock Exchange, have market caps of \$4.61 trillion and \$2.96 trillion, respectively. Comparatively, the NYSE and the NASDAQ alone have total market caps of \$22.82 trillion and \$10.86 trillion. The U.S. stock market accounts for nearly half of the world's stock market value, while China is far less than 10%.