Basis Points – November 27, 2018

westwoodgroup.com/weeklyblog/basis-points-november-27-2018/

Above the Fold

- General Motors announced yesterday that it plans to dramatically cut production at many plants in the U.S. next year and reduce its salaried workforce by 15 percent, in a large restructuring that will cost up to $3.8 billion. GM said plants in Ohio, Michigan, Maryland, and Ontario, Canada, will be closed in 2019 and it will cease operations at two additional plants outside of North America by the end of next year. GM also plans to reduce its executive staff by 25 percent. GM CEO Mary Barra said in a statement: “The actions we are taking today continue our transformation to be highly agile, resilient and profitable while giving us the flexibility to invest in the future.” GM stock rose 7 percent on the news.

- A major shake-up in the sectors of the S&P 500 index was implemented this summer as a new sector was created — the Communications Services sector. This new sector was created to hold the stocks of companies in the entertainment, media and telecommunications industries. Many large companies that were previously grouped in the Technology sector, such as Facebook and Google, are now large members of the new Communications Services sector. However, this new sector is not off to a strong start thus far. The sector began trading on June 19 and saw its 2018 high only a day later. Since June 20, the sector has declined 13.2 percent and is the weakest performing sector since that date. Facebook has declined 33 percent since the inception date of the sector, and Google has also performed poorly, down 11 percent, so the addition of these formerly popular stocks has certainly hindered the new sector's performance.

Three Things

- Bloomberg notes the concentration in online holiday sales. Cyber Monday yesterday was likely the biggest day for U.S. online shopping ever, with customers expected to spend $7.8 billion at e-commerce websites. While that is a large amount of money, all those sales dollars will probably be spent on a surprisingly narrow list of items. In its forecast for the 2018 holiday season overall, Adobe Analytics projects that 70 percent of online sales will be driven by just 1 percent of individual products. This small but popular list includes 4K TVs, retro video consoles, Fortnite Monopoly and Hatchimal Hatchibabies toys. Sales are estimated to be even more concentrated than they are during the rest of the year when Adobe has found 1 percent of items account for 54 percent of sales. The winner of the e-commerce battle won't necessarily be determined by who has the biggest selection, but who has the right selection. Being in stock on hot products matters much more than having every product available.
- The trend of "cord-cutting" in the pay-TV market continues unabated. More than 1 million consumers canceled their cable-TV or satellite subscriptions in the past quarter, one of the largest seasonal drops ever. This decline increases the pressure on pay-TV providers to generate revenue in other parts of their businesses. Since 2010, when the share of households with traditional cable and satellite TV service peaked, more than 10 million U.S. homes have either cut the cord or never subscribed to a pay-TV distributor in the first place.
- Some have theorized that the large correction in energy prices this year presages a global slowdown in industrial demand for energy, that will lead to a recession. While that sounds reasonable, it has never happened before. The last five recessions, in 1973, 1980, 1990, 2001 and 2008, all began with a sharp *increase* in the price of oil, not a decrease. A rise in energy prices is usually concurrent with the onset of a recession, but a sharp rise in energy prices is never the *only* cause of an economic recession. And recessions clearly do not begin because a major cost for both consumers and businesses declines, like energy costs have lately.

Did You Know

The market closed last Friday down 10.1 percent off its recent high, which is officially “correction” territory. While the equity market rallied yesterday, there is one thing that the Fed could do prior to their next meeting in December that could help calm investor fears and get the market back on an upward track: The next Fed meeting is December 19, and the market has fully priced in another rate increase at that meeting. But in a speech next week, Fed Chairman Powell could reiterate the need for that December rate increase, but also say that due to changes in economic conditions recently, the Fed’s rate hike plan in 2019 will be data dependent, and the Fed will weigh economic conditions in real-time at each meeting, prior to hiking rates in 2019.

“Data dependent” was a familiar and consistent theme of the prior two Fed chiefs, Yellen and Bernanke, and the market would much prefer that stance now. With the midterm elections behind us, the Fed would not seem to be favoring anything other than sound financial thinking.

The Fed board would have a lot of cover in changing its stance on coming rate increases, for these reasons:

- The threat of inflation, which the Fed has used as a primary reason for raising rates, has declined recently. Energy prices are way down, which will cause inflation to decline over the next few months, so an impending inflation spike is just not apparent right now.
- Housing construction and sales have slowed, as have auto sales, due to higher interest rates. Mortgage rates have hit the 5 percent level, which has caused buyers to pause.
- Industrial production has slowed, and corporate confidence around the trade war has affected the spending plans of large global industrial companies.
- The Chinese economy has certainly slowed, as have many other emerging market countries, which has negatively affected global tech companies such as Apple and chipmakers.
- European countries have not raised interest rates as the U.S. has, and many countries have delayed that decision until next year while being data dependent.
- Corporate credits have sold off sharply recently, specifically energy, housing and insurance bonds.

A modification of the Fed’s stated plan for 2019 rate increases would certainly be a reasonable change in its stance and would be seen very favorably by the financial markets.

solicitation, or recommendation to buy or sell or otherwise invest in any of the securities/sectors/countries that may be mentioned.