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Markets

Are the wheels falling off the autos sector?

Auto stocks have hit the skids as investors fear earnings have peaked. We discuss the sector's outlook, including areas where we see potential for continued earnings growth, and whether stocks are now "cheap enough" regardless.

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The autos sector has experienced a severe de-rating over the last year as investors believe earnings are at a cyclical, and possibly structural, peak. We agree that consensus expectations for auto manufacturers in aggregate are overly optimistic, though earnings for some companies will move higher due to geographic exposure and share shifts.

In this paper, we explore the outlook for earnings growth for the sector. For OEMs, we focus on top-line growth prospects by geography, cost structures, and drivers of potential market share shifts. For suppliers, we address the debate over the degree to which industry value-add has shifted from OEMs to suppliers, and the potential for sustainably higher growth.

Overall, we expect volumes to rise over the next few years, barring a broader economic downturn, but the of global auto sales to be flat-to-down due to price and mix pressure. Combined with structural cost inflation, this is likely to erode industry profitability. Despite cheap headline valuations, we do not believe most auto stocks are attractively priced on mid-cycle earnings, and see further downside risk to the sector. However, we are beginning to see value emerging in some cases, especially for companies with a better track record of delivering in a downturn.

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