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Automakers Face a Rocky Road to Recovery

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Detroit automakers are set to resume limited production on May 18 after being shuttered for the last six weeks. Over the next two weeks, Ford, GM, and Fiat Chrysler will work with the United Auto Workers on safety protocols and coordinate with their supply chains. Several foreign automakers, based primarily in southern states (and typically non-union) will resume production earlier with Toyota employees returning this week and Honda next. This is good news for furloughed workers, but the outlook for the auto industry may be as dark as it's been in generations. The heart of the problem, as in so many industries right now, is an overabundance of supply paired with doubtful future demand. Problems in the auto sector are further compounded by the shuttered travel and leisure industry as car rentals are at a virtual standstill.

Rental companies typically lease their fleets, using day-to-day rental revenue to make payments. Last week, after missing a series of payments, Hertz announced it could be facing bankruptcy as soon as this week if it is unable to negotiate a deal with creditors. Hertz, as well as other rental car companies, have been purging auto inventories in recent months which is greatly increasing the volume of available used cars and trucks thereby dragging prices lower. Although the notion of lower prices on used vehicles doesn't sound like such a bad thing, it's likely to crush new car business in several ways. The first is obvious: cheaper is always better when unemployment is high and savings are low. But, there are other factors to consider, perhaps the most significant being an estimated 90% of new auto purchases involve either a dealer trade-in or a private sale of a used vehicle. Trade-in values are likely to be pitiful and private sales will face much more competition. What's gained on the buy side is lost on the sell side…and often times, it's a deal killer. On an ironic note, leasing costs could get more expensive since a major factor in calculating the lease price is future resale value; just another reason for buying used instead of new.

In the auto sector, troubles are further compounded by the shuttered travel and leisure industry as car rentals are at a virtual standstill

Late Friday, U.S. auto sales numbers were released for the month of April. To a degree, the overall number was better than forecast at an 8.58 million annualized unit pace, but the cold reality was the slowest sales pace in four decades and more than a 50% drop from 2019. The April report did include some interesting data: Toyota sales dropped 54%, primarily a result of the brand being popular on the east and west coasts, regions disproportionately affected by the virus. In-person sales were either limited or restricted in 27 states last month, which prompted a surge in internet transactions. Toyota reported that for the first time, online sales accounted for the majority of monthly business. Dealers were also forced to roll out the incentives with a record 26% of buyers taking advantage of zero percent financing in April, the highest level on record. While cars struggled mightily, truck sales were much more resilient, with sales missing pre-virus levels by only 10-12% according to JD Power. Part of this relative strength is likely related to the fact that many southern states closed later. The trends could easily flip in the coming months.

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As more and more recession era programs are being revisited, "cash for clunkers" has reentered the conversation as an idea to jumpstart growth. Unfortunately, although the original program may have benefited thousands of Americans willing and able to purchase new vehicles in the summer of 2009, it was never effective as stimulus for the nation as a whole. According to analysis conducted at Texas A&M University, the greatly-reduced number of vehicles sold after the program ended completely negated any earlier advantage. Aggie analysts went on to point out that since most of the spending was on

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smaller, cheaper and more fuel efficient cars, total spending on new passenger vehicles actually fell in 2009-2010. In fact, total spending dropped by $3 billion during that period, which coincidentally equaled the total amount allocated to the program.

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Over the previous five years, U.S. auto sales have topped the 17 million mark every year. This year started out much as 2019 ended with annualized sales of 16.8 million units in both January and February before nosediving to an annualized pace of 11.4 million units in March and 8.6 million in April. Automakers could break even with sales volume as low as 10 million to 12 million, according to the Center for Automotive Research, but this estimate is contingent on continued operations, *which are unlikely*. Making all this worse is the fact that on average, it takes around 30,000 parts to build a finished vehicle. Many of these parts come from factories all around the world that are currently closed due to the virus threat.

The good news, according to a recent CNN report is that the industry was in far better financial shape entering this crisis than before the Great Recession. Since U.S. automakers began the year with relatively strong balance sheets, they're expected to have five to seven months of cash and borrowing capacity to weather the storm.

Market Indications as of 3:30 P.M. Central Time

DOW	Up 26 to 23,747 (HIGH: 29,551)
NASDAQ	Up 106 to 8,711 (HIGH: 9,817)
S&P 500	Up 12 to 2,843 (HIGH: 3,386)
1-Yr T-bill	current yield 0.15%; opening yield 0.16%
2-Yr T-note	current yield 0.18%; opening yield 0.19%
5-Yr T-note	current yield 0.36%; opening yield 0.35%
10-Yr T-note	current yield 0.63%; opening yield 0.61%
30-Yr T-bond	current yield 1.27%; opening yield 1.25%

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