

Bull Market Climax Summit



One Sector To Avoid At All Costs During The Bull Market Climax



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So, if the market is about to go crazy on the upside shouldn't a rising tide lift all boats? Shouldn't everything do well?

While that is generally true, it is not universally true. There is one sector that is a bigger risk than just about every other because it is at such a high risk of disruption, that I believe it is no longer investible. The risk is just too large. This is going to be a no-go area for at least the next three years and I expect that when we roll around to 2021 it will be so diminished as to be unrecognisable compared with today.

Every major bull market is disruptive. They reshape the economy around them and this one is no different. It is reshaping the economy around itself. It is creating technological leaders that are pushing the borders of what is possible and challenging what we even think of as impossible and then there are companies that just can't keep up. These former titans of industry are caught flat footed by the changing environment and are incapable of evolving because the pace of change just happens too fast.

The one sector that is most at risk of disruption today is automotive.

In 2016, the 10 largest car companies in the world by volume of cars sold were: Volkswagen, Toyota, Renault Nissan, Hyundai-Kia, General Motors, Ford, Honda, Fiat Chrysler, Peugeot Citroen, Suzuki,

The first thing that jumps to mind when we look at that list is how much consolidation has already taken place. The number of company names that are now hyphenated continues to grow because the industry is in a state of flux and it is capital intensive. That means when a company goes broke there is still a substantial rump of physical infrastructure that makes it attractive to someone somewhere. However, what happens to the industry when that changes?

The cost of automotive batteries is falling by 20% a year and massive new supply is under construction. The cost of producing a regular internal combustion car is not going down at anywhere close to the same rate. The big point here is that producing cars used to be a highly capital-intensive business. You needed massive factories and legions of workers because they were complicated to put together and cars are precision pieces of equipment. Today that is no longer true. Dyson is actively building a car factory from nothing because electric vehicles are easier to manufacture and require less capital to get started.

In just the same way that Apple and Google never made a phone before they released the iPhone and Android within a year of each other, it is now possible for companies that have never built cars before to do so and be successful. Tesla is the obvious name

that comes to mind but it will not be the only company to bring a marque to market out of nowhere.

By extension then, if these new car companies are the disrupters then the largest auto companies in the world today are the disrruptees. They have made massive investments in physical infrastructure that now need to be retooled. All that machinery and expertise in developing internal combustion engines is soon going to be worthless.

There has been a raging debate in the market about whether Tesla is going to survive. You know I think it will and it has a real opportunity over the coming three years to stamp its imprimatur on the global automotive sector. However, this argument does not depend on Tesla's success because these changes to the global automotive sector are going to happen regardless. If it is not Tesla then it will be some other company that completely disrupts the global industry.

Volkswagen announced in November 2018 they are going to spend \$50 billion on retooling for the electric age. That represents two thirds of the company's market cap. Volkswagen is in the relatively secure position that it is not as highly leveraged as some of the other manufacturers, so it is reasonable to think there will be still be VW cars in three years. However, the simple fact is that as of today there are no big battery factories in Europe and yet it is home to some major national champion automotive companies. That's a mismatch which cannot continue if the sector is going to survive.

Today all the big battery factories are being built in China, South Korea and Japan. China has eyes on becoming a wholly electric vehicle market and it is already insisting that half of all new cars sold there in 2019 will need to be at least hybrid electric. China has both a major need to import oil and some of the worst air quality in the world. Going electric is not a choice for them, but they are going to turn it into an opportunity.

China has every intention of doing to batteries what it did to solar cells. They are going to build more manufacturing capacity than anyone else combined and in the process drive prices down to unimaginably low levels in an attempt to capture market share and disadvantage emerging competitors. Within five years if you want to buy a battery it will probably come from China. Since the most important part of an electric vehicle is the battery that means China is going to be global leader in the automotive sector and a lot more vehicles are going to be manufactured there.

Not only is that going to create a massive new industry in China it is going to destroy industry in Europe. According to Eurostat about 3 million people are employed in manufacturing, 4.3 million in sales and maintenance and 4.8 million in transportation/driving. Let's conservatively estimate the continent loses about 1.5 million manufacturing jobs as the sector evolves to less complicated designs.

However, we have not even begun to talk about autonomous vehicles. It seems like every company today has an autonomy program but the really important ones are Alphabet/Google, Tesla and Uber. They realise that the car of the future is going to be a moving computer, everyone else still thinks about it as a car.

Alphabet's Waymo is trialing autonomous vehicles in Phoenix and has ordered 20,000

Jaguar SUVs to launch a full-service autonomous taxi service in 2020. There is no getting around the fact that autonomy is not ready yet but the day it is ready will spell the end of the automotive sector as we know it. If Uber is not the company that comes up with autonomy it will disappear. The only reason the company can survive today is because of the abundant capital at its disposal because of low interest rates. One way or the other all of its drivers are going to be unemployed within the next five years.

Therefore, stay clear of autos. They represent what is affectionately known in the investment sector as a value trap. They will look attractive from time to time but don't be tempted this is the riskiest sector in the world today.