2 Troubling Developments for Canadian Auto Stocks

Description

The S&P/TSX Composite Index gained eight points on June 4, as markets have been digesting news over the past week. In late May, I'd discussed whether or not investors should avoid auto stocks as we headed into the summer. Recent events may drive investors even further away from the auto sector.

Let's take a look at two reasons to be cautious when it comes to auto stocks going forward.

Trade war threatens automotive manufacturers

The prevailing hope in Canadian business circles is that the steel and aluminum tariffs imposed by the Trump administration are a negotiating tactic, rather than the first shot fired in a prolonged trade war. White House officials referred to the development as a "family squabble," which could lend credence to this interpretation. However, NAFTA talks have deteriorated of late, and investors should not rely on the best-case scenario playing out.

In May, President Trump ordered an investigation on auto imports that could lead to tariffs on Canadian auto imports into the United States. **Linamar Corporation** (TSX:LNR) has plunged 11.3% month over month as of close on June 4. The company has strongly lobbied against changes to auto content rules, as NAFTA negotiations have chugged along. Reports indicated that auto content was a key point that led to talks stalling in May.

If Canada elects to make concessions with tariffs applying pressure, Linamar could suffer. The company has approximately a third of its business within the United States, which would fall below the 50% marker that the U.S. has demanded for auto content in negotiations. This is unfortunate, as Linamar looks attractive after being oversold following a Q1 earnings release.

Auto sales fall for third consecutive month

According to DesRosiers Automotive Consultants, auto sales fell 0.7% year over year in May. This represented the third consecutive decline after the record months of January and February. Shares of **AutoCanada Inc.** (TSX:ACQ) increased 0.3% on June 4. However, the stock has plunged 25.6% in 2018 so far.

A total of 215,407 vehicles were sold in May, which exceeded the 191,900 sold in April. Industry experts had blamed the bad weather for the slow start in spring. Total vehicles sold in 2018 is still approximately 1,000 units above the amount in the same time last year. However, DesRosiers projects that the pattern of market declines will likely bring this number down going forward.

This broad slowdown is bad news for AutoCanada and the industry at large. Trade concerns may hold off a rate hike from the Bank of Canada, which is good for auto financing, but the overall picture is worsening.

It is difficult to justify buying low on AutoCanada stock at this time, even after its dramatic plunge in the first half of 2018. There are simply too many headwinds for automobile dealers as we head into the summer season.

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