

Is it Time to Buy Auto Parts Companies or Should Investors Stay Clear?

Description

There are some dark clouds on the horizon facing the auto industry. NAFTA negotiations and tariffs are just one aspect of the problem. The industry also faces potential economic headwinds. Sure, the economy seems to be running well with unemployment at multi-year lows in both Canada and the United States. Consumer confidence is at multi-year highs, as are corporate earnings. What's not to like?

Unfortunately, as is often the case, future problems may be lingering just below the surface. People have jobs and are buying new cars hand over fist. But many of these purchases are being made with credit. **TransUnion** recently reported that consumer, non-mortgage debt in younger generations, such as the millennials, has increased almost 23% over the previous year. A good portion of this debt was used to buy new cars — a depreciating asset.

The demand for cars has been, in part, debt-fueled. With rising costs from steel and aluminum increasing due to tariffs, the cost of a car will likely increase as well. The Alliance of Automobile Manufacturers recently reported that vehicles could increase by as much as \$9,000 in Canada if costs continue to rise and tariffs are applied. Will debt-ridden Canadian consumers continue to pay up at that point? Will they pay higher rates for larger loans if the Bank of Canada continues to hike interest rates?

Auto parts companies [are excellent businesses](#) that are very well run. **Magna International** ([TSX:MG](#))([NYSE:MGA](#)) has proven to be an excellent company with a strong dividend. Over the past 10 years, the company has continuously reported strong earnings. Its approximately 2% dividend has grown over the years as its earnings have risen, up by 23% recently, and sales have grown, up by 12%. But if the tide turns and it becomes hard to sell vehicles, will these companies maintain this level of growth?

A company like Magna, with its geographically diversified customer base and its desire to keep on the cutting edge of automotive parts, may do fine. It is a solid company with a solid balance sheet. And besides, there is the possibility that this will blow over and a deal will be reached with few consequences.

Do you want to take that chance? At this point, there is [no pressing need](#) to buy shares in auto companies. They look deceptively cheap with low P/E ratios, Magna's P/E is around eight times earnings. These are cyclical companies that often look the cheapest at the top of the cycle. The time to buy cyclical companies is when the cycle has ended, and the stocks look expensive as their earnings are compressed.

If you hold an auto parts producer like Magna currently, I wouldn't rush to sell it. These companies are generally well run, they simply face some market headwinds that may or may not materialize. Over the long term, Magna in particular remains an excellent company. But at this point, I would not recommend rushing out to buy it or overweight your portfolio either. The auto cycle may be ending, which may provide an interesting entry point for the stock further down the road. Wait for more turmoil before adding to your holdings.

CATEGORY

1. Investing

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1. NYSE:MGA (Magna International Inc.)
2. TSX:MG (Magna International Inc.)

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