Here's Why You Should Stay Away From Auto Stocks Next Year

Description

In late November **General Motors** (NYSE:GM) announced that it would lay off thousands of workers across North America as it moved to accelerate its cost-cutting campaign. In October, GM saw third-quarter operating profits rise 37% year-over-year to $2.8 billion even in the face of an 11% decline in sales. Under tremendous pressure from shareholders, GM elected to pull the trigger and move forward with layoffs.

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GM has plans to cut $6.5 billion in costs over the next few years. **Ford** has also unveiled an $11 billion "fitness" cost-cutting plan that one **Morgan Stanley** analyst estimated would result in a 12% reduction in its global workforce. The announcement from GM sent shockwaves through the political landscape. President Donald Trump and Prime Minister Justin Trudeau both lobbed criticisms at GM and suggested that future subsidies could be cut off.

Broader economic headwinds and the ongoing trade war between the United States and China also represent huge risks to the auto sector.

AutoCanada (TSX:ACQ) fell 1.36% on December 6. Shares have plunged 48% in 2018 so far. The company operates car dealerships across Canada.

In early October I'd discussed why AutoCanada was still a dangerous option going forward. The ratification of the USMCA is good for stability, but the new agreement will do nothing to curb the steady slip in auto sales that we have seen in 2018.

Auto sales fell 9.4% in November, marking the ninth consecutive month of declining sales. This will mark the first year since 2009 that auto sales failed to expand, an ominous sign as market turmoil has erupted in the fall. Passenger car sales dropped 11.4% year-over-year to 30,031 sold. Light truck sales fell 8.7% to 104,737. Light truck sales have been a strong point in the North American market, but the year-over-year decline demonstrates that even this segment is starting to feel the pinch.

General Motors saw its sales drop 18.3% to 12,366 vehicles, while Ford and Fiat Chrysler reported declines of 10.7% and 35.1%, respectively.

AutoCanada managed to power through these worrying trends in the third quarter. Revenue rose 3.9% year-over-year to $866.9 million and new and used vehicles sales rose 3.8% and 24.8%, respectively. The company announced its Go Forward Plan earlier this year in a bid to improve its profitability after several disappointing quarters.

Shares of AutoCanada have climbed 14% month-over-month, but investors should look elsewhere as the auto industry will face similar challenges in 2019. The dovish turn from central banks could be a positive for auto dealers in 2019, but debt-to-income ratios remain dangerously high. This is not an ideal environment for an industry which has seen a gigantic increase in auto loans since the financial crisis.

Investors looking for potential discounts should steer clear of the auto sector in the final weeks of 2018. A pullback into recession will have even more dire consequences for an industry wrestling with several challenges, and auto equities will be subject to volatility.

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