TRENDS & IDEAS

2016 AUTOMOTIVE PREVIEW AND STOCK PICKS

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TAKEAWAY: We see attractive valuations in an expanding automotive industry.

POSITIVE IMPLICATIONS:

Ford Motor	★★★★★	[F]
General Motors	★★★★★	[GM]
Group 1 Automotive	★★★★★	[GPI]
Johnson Controls	★★★★★	[JCI]
Lear Corp	★★★★★	[LEA]
Magna International	★★★★★	[MGA]
Toyota Motor ADS	★★★★★	[TM]

NEGATIVE IMPLICATIONS:

Tesla Motors	★★	[TSLA]

The recommendations contained in this Takeaway box are current, and may have changed since the original story was published. For full S&P Research Reports on these securities (when available), please click on the ticker and download the report.

We think new U.S. light vehicle sales will peak in 2016. We forecast a 1.0% rise in volume to 17.6 million after gaining an estimated 5.9% to 17.4 million in 2015. We think sales could soften in 2017, after a trough-to-peak run we forecast to reach nearly 70% between 2009 to 2016. So what does this mean for automotive companies? We think peak U.S. industry sales levels means individual car makers will compete for market share gains to stimulate volume growth and put pressure on margins for all vehicle producers. However, we see a greater proportion of more profitable light truck sales and opportunities to grow outside the U.S., partly offset by some regional weakness, helping sales and profits grow again in 2016. Also, we don't expect U.S. sales to weaken much in 2017.

Our fundamental outlook for automobile manufacturers and their parts suppliers in 2016 is positive. We see U.S. automotive demand trending higher year-over-year. While we expect to see uneven geographic progress, we look for global demand to rise. Europe has pressured General Motors and Ford in the regions due to depressed volume and intense competition, but the companies have shown progress in sales and cutting losses, and we see industry sales volume continuing to recover there from years of declines. Russia and parts of South America, and commodity dependent countries, still look likely to be challenged areas, and the strong dollar is hurting profit and sales translation from international operations.

In addition to U.S. light vehicle sales as rising to 17.4 million units in 2015 and 17.6 million in 2016, we expect gains in most other regions too. Rising prosperity in emerging markets, led by China (even as growth there slows), should drive higher global demand. European sales should also rise, with declines in some emerging markets partly offsetting. We think higher volume in the U.S. and abroad will help corporate profits and cash flows, although currency swings impact companies' profitability. Positive factors we see in the U.S. include widely available access to consumer credit, rising consumer confidence and employment, a strong stock market, more miles being driven and lower gas prices. The average vehicle is now about 11.5 years old, an industry record, meaning more people should be interested in fresher styling and technology available in news vehicles.

We think lower gasoline prices - now averaging only about $2.00 nationally in the U.S. - and economic growth will support expansion in the highly profitable light truck segment. Also, greater availability of new and refreshed pickup trucks, combined with improved construction, housing and contractor activity should boost overall truck sales. Luxury vehicle sales in the U.S., should show improvement, in our view, as wealthy consumers become more confident. Luxury sales should be strong in China.

Despite rising profits and offering above-average dividend yields, automakers share price movements were disappointing in 2015. In 2015 through December 24, the S&P Automobile Manufacturers Index was down 4.3%, while the S&P Auto Parts & Equipment Index fell 6.3%, versus a 0.1% decline for S&P 1500 Index. The S&P Automotive Retail Index, however, was up 7.9%.

We think a favorable fundamentals should help profits, cash flows & dividends expand in 2016, supports attractive total return potential for many of the automakers and parts suppliers that we follow analytically.

Among our Strong Buys that we expect to outperform on a total return basis are automobile manufacturers General Motors (GM 34*****), Ford Motor (F 14*****) and Toyota Motor (TM 125*****). GM and

Ford each yield more than 4.0%, while Toyota's dividend yield is 2.9%.

Our Strong Buys among automotive suppliers include Lear (LEA 125*****), Magna International (MGA 41*****), and Johnson Controls (JCI 40*****).

We have a Strong Buy on Group 1 Automotive (GPI 76*****), an automobile retailer.

The lone auto industry Sell opinion we have is on fast growing (but we believe richly valued) Tesla Automotive (TSLA 226**).

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