Zanetti Monday Missive 2022.08.08
Auto Industry Travails Ahead

"I spent a lot of money on birds, booze, and fast cars.
The rest I just wasted."
~ George Best, North Irish Soccer Star

Hello Everyone,

Today's missive isn't about birds or booze. But we will look at what is going on in the automobile market.

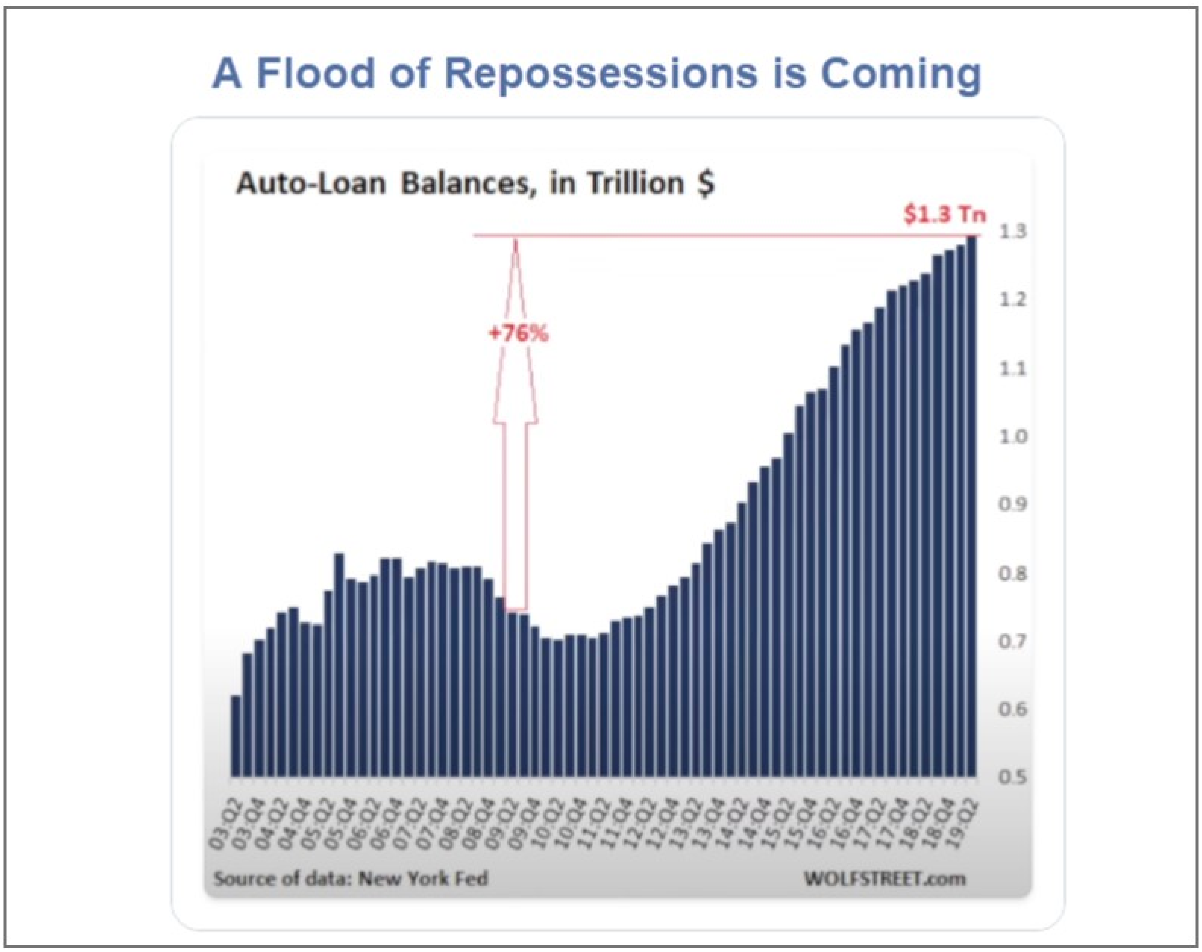
No, we are not going to talk about Ford's or GM's sales.

Rather than the usual big-picture fare, let's ask whether you should be buying a car right now.

BTW, the motivation for this subject is selfish. During my campaign, I traveled the State multiple times. I beat the daylights out of my Ford Edge. The writing is on the wall. It's either frequent future repair bills---- or find another “new” used car.

Thus, I began the research. And it was article by Mish Shedlock over at mishtalk.com that led me to some surprising results.

Let’s start with a chart showing auto-loan balances. The chart below shows the accumulated dollar amount of auto loans across the US. Ignore the title for now. Just focus on the $1.3 trillion in loans.



What this tells me is a whole bunch of people got Covid-era stimmy checks and decided, *“Hey, I deserve a new car. C’mon honey, let’s go shopping!”*

So, with all this demand, and rather limited supplies (remember, those pesky supply chain issues?), car prices soared. And, clearly, the loan amounts soared as well.

Then something new (and a bit strange) happened.

What had previously been a depreciating asset (a car) suddenly performed better than most stock portfolios.

Two years ago, the average new car cost $38,000. The average used car sold for around $20,000.

Today? The average new car costs $50,000 (up 24%). And, the average used car $31,000 (up 35%!).

Instead of people saying, “As soon as you drive off the car lot, you’ve lost thousands in depreciation,” you heard, “Wow! I can sell my 2019 for more than I bought it!” As the kids say, “True that.”

But wait, there’s more…

Do you remember the days when you went to a dealership and they offered you discounts---or factory rebates--- of $5,000? $7,000? Even more? Not now.

Recently, some dealers have been asking for higher “market adjustments” of up to $10,000 to get you into a sporty new Toyota Supra or Kia Telluride. Nothing against Supras or Tellurides, but $10,000 mark-ups? Most of us are not used to that.

So, besides the supply chain issues, what else drove the price increases? (Pun intended.)

Well, super-low interest rates contributed.

Many car dealers offered 0% interest on $100,000 trucks or sports cars. Oh, and loan durations went out as far as 7 years! That time frame may seem crazy, but 84 months was what was needed to get the monthly payments low enough to meet people's budgets.

And since people don't buy cars as much as they buy payments, why not splurge?! It's free money after all.

BTW, in 2010, a 48-month car loan was deemed scandalous.

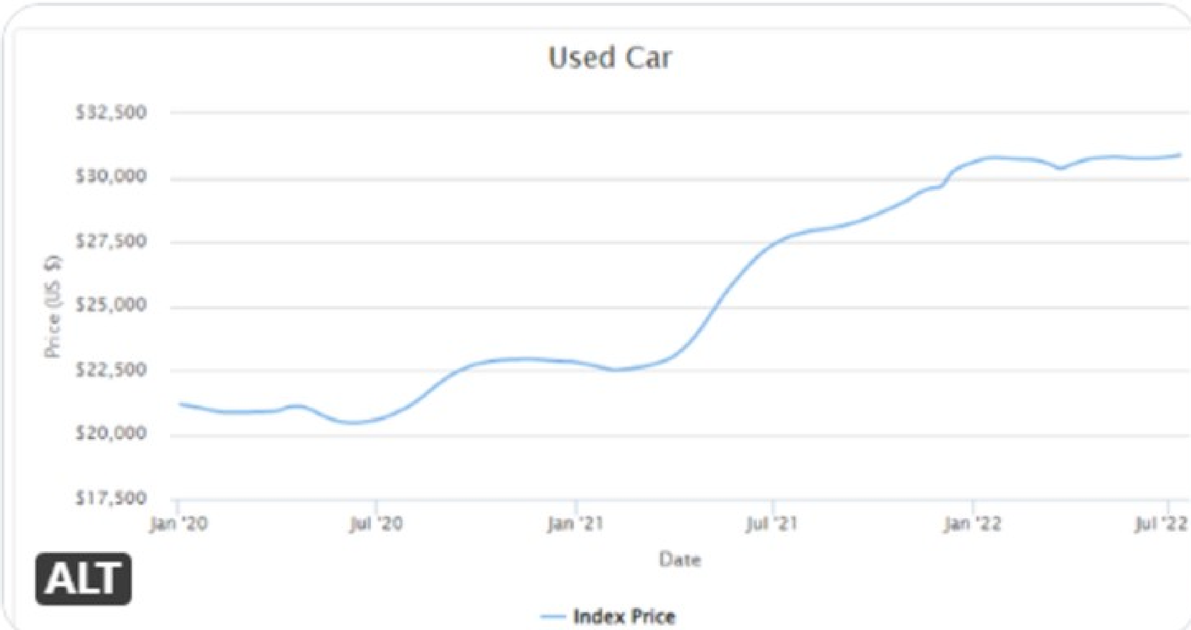
Ah, but now things are changing.

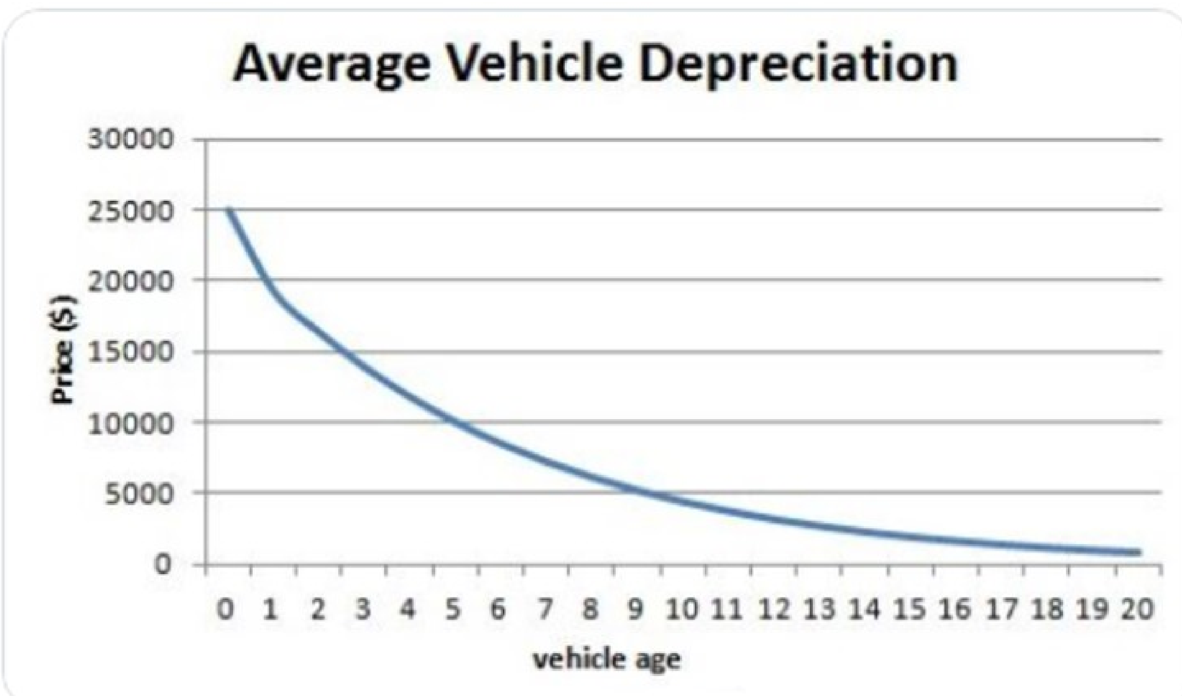
- Interest rates are rising.
- There aren't many 0% rates out there anymore.
- The stimmy checks are gone.
- Inflation is rising.
- And it's costing more to gas-up that "sick" monster pick-up…or the sporty mid-life crisis.

Therefore, looking ahead, you don't have to be Nostradamus to predict dealers will find it more difficult to sell autos. New and used car inventories will likely rise. The car lots will fill up again. That trend has already begun.

Eventually, you can expect autos will depreciate like they always have. Look below. The first chart shows how autos did not appreciate over the past two years. The one underneath it shows how autos usually depreciate.

Used Car Prices and Depreciation





Therefore, for those who bought a used vehicle at a 30%-40% premium, you can expect some tears.   Many will find themselves “upside down” on a car they can no longer afford, but cannot afford to sell.

Moving on. Enter the repo man.

Now you can appreciate the **"A Flood of Repossessions Is Coming"** title on the first chart.

In normal markets, a 2%-3% delinquency rate on car payments was typical. Today, in Washington DC, almost one in every four auto loans (23%) is in default. Uh oh.

The default rate in California is hovering near 9%. Texas 10%. Once a payment is 90-days delinquent, the lender can repossess the vehicle.

Oh, and one more factor. Besides the delinquent rate being a record, the auto industry is not known for doing extensive background checks to see if someone can really afford the vehicle they are buying.

And since 85% of cars purchases are financed, the income stream that the car industry has come to rely on is now suspect. Translation: Bottom line profits for the big auto makers may shrink substantially once car payments stop being made.

The bottom line is----between reckless government Covid policies and the Fed's unnaturally low interest rates, the automobile market has been badly distorted.

Now, those distortions are starting to rectify. And snapback corrections tend to go too far.

Therefore, you may want to wait a bit to buy your next automobile. There is a good chance you will be much happier buying several months from now.

Signed, Your My-Son-Wants-Me-To-Get-A-Cool-Car-And-Rolled-His-Eyes-When-I-Said-“What-About-A-Hybrid?” Financial Advisor,

Greg

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