

FABULOUS CARS and FABULOUS BULL MARKETS

October 29, 2002 Update of April, 2000 Study



Glowing stories about sensational automobiles have been frequently published. "Auto Makers Are Cruising Down the Road to Excess" was a headline of a WSJ article which included a description of the Mercedes Gelaendewagon, a SUV with a sticker price of U.S. \$135,000 (leather interior optional at \$35,000). Arnold Schwarzenegger drives one.

However, a tough-go anywhere vehicle was not the subject of a story on "James Bond" cars such as the new V-12 engine for Aston Martin. After suffering a setback with the 1990 recession, Ferrari was "enjoying the best financial position in history". That goes for Porsche as well. Extravagant cars and great bull markets do go together.

With the good times of the financial boom, traditional manufacturers have been acquiring the exciting names. Fiat owns Ferrari, and Ford took over Aston Martin and Jaguar. Particularly ambitious, VW's shopping spree picked up Lamborghini as well as the Bugatti and Bentley brand names. The latter's concept car features a V-16 engine, the first for a proposed production car since the magnificent examples of the booming 1920s.

However, this ostentatious part of the boom now seems particularly vulnerable. Despite the worst markdown in stock market capitalization since the early 1930s, the consumer maintained the spirit of the 1990s bubble by aggressively buying the median home and grand cars. This has provided 4 consecutive years of outstanding vehicle sales.

Following 9/11, this accelerated with price discounting, "zero" cost financing, and rapid introduction of "new" models to defer saturation, some, such as a Cadillac "pickup truck" and a Porsche SUV, seem to be novelties.

However, threats to the action have been mounting.

Today's cars boast the greatest longevity in history and the price of used cars has been pushed down to economically attractive levels by the discounting. The dramatic credit

downratings for Ford and GM are forcing their borrowing rates up, which will impair their ability to continue "0" financings.

As JD Power & Associates reported, sales were down "dramatically" through October.

Are these indicating the end of the unprecedented extension of the boom in cars well after the new financial era expired? If so, what's the significance? Perhaps the pattern of the last example will provide some guidance.

Unintended saturation dramatically reversed automobile sales in the U.S. in the spring of 1929. The importance is that it surprised management and was accompanied by a reversal to unusually weak industrial commodity prices.

For example, although enjoying outstanding sales growth in the 1920s' new era, any concerns about market saturation were dispelled. In 1928, the head of the Society of Automotive Engineers thought that it could be offset by "changing automobile appearance frequently as to obsolete those in the hands of owners".

In the same year, Knudsen, President of Chevrolet, estimated that saturation couldn't be seen even by 1930.

General Motors observed it would tough out the possibility of saturation and "keep ahead of the competition by offering more models with more features than anyone else". Over-capacity and rationalizations seem to be the consequence of a great boom. This was rapidly dashed in the contraction.

Beyond plunging unit sales, a change in fad now could have more profound consequences. The expansion of SUV production has been phenomenally profitable and a change to conservatism would likely result not only in dropping unit sales, but a shift to lighter as well as used cars. Another serious decline in most industrial commodities seems possible.

In the last great financial boom, the epitome of automobile fashion was not exaggerated ground clearance and four-wheel-drive, but length and weight for a luxurious ride as well as multi-cylinder engines for quieter running. The big car offered bragging rights about "hugging the road" and accelerating from 0 to maximum speed (about 90 mph) in top-gear only.

Behind the claims was the practical matter of a balky non-synchromesh manual transmission with a heavy and tricky clutch. Minimizing lunging starts and grinding gears required practice and concentration.

The desirability of a smooth start in top gear was obvious to both engineering and marketing people. For a given engine displacement, torque (for acceleration) is increased by a longer stroke and more cylinders.

Moreover, the latter provided smoother running and engines went from the straight sixes to eights with the V-sixteen being the ultimate in design and sales pitches of the late 1920s.

Whether then or now, the heavier the car, the greater the profit margins prompted similar business decisions and the accomplishments in the late 1920s' luxury market in engineering and coachwork were magnificent.

While the Duesenberg, with an in-line eight, was the most formidable car of the era, the theme of this article is automotive fads and booms. Both peaked together and the esteemed cars were V-16s; two production models and one prototype.

Possibly both inspired by and symptomatic of the boom, the concept of the sixteen cylinder luxury car arrived in 1927. In America, work began on the Marmon Sixteen in early 1927. Shortly after that, one of the engineers left to design one for Cadillac and in July, 1929 another left to design the prototype Peerless V-16.

During the 1920s, Cadillac had lost leadership to Packard's V-12 and, rather than expanding their V-8 to the next configuration and merely match competition, management legend Alfred Sloan insisted on the V-16. Seeming to ignore the bust, 2,500 were sold in 1930.

The engine displaced 452 cubic inches and the car, with a wheelbase of 148 inches, weighed 6,200 pounds. By comparison, the figures for today's popular Ford Contour are 106 and 3,100 respectively.

Sensitive to changing popular attitudes towards extravagances, management quickly produced a more modest V-12. Only 750 V-16s were sold in 1931 despite heavy discounting down to almost the price for the V-12. Indicating rejection of ostentation, only 346 V-16s were sold in 1932 while 1,709 of the "unextravagant" V-12s were bought. In 1933, the numbers were 125 and 1,000 respectively.

Although the line, in this case between ostentatious and merely conspicuous consumption, was narrow, post-boom moderation was a compelling fashion - especially when the song Brother, Can You Spare A Dime? described the times. (Bing Crosby's 1932 recording has it right.)

For the last two decades, General Motors' Suburban was the big SUV, but Ford's Excursion, at 19 feet, is almost a foot longer and weighs 8,800 lbs. This provoked GM's acquisition of the Hummer in 2000, which press releases described as a "monster vehicle" and "image builder". It seems that management, in also planning to make the Suburban bigger, was responding to forces similar to those during the last great boom when it was compelled to trump Packard's V-12 with a V-16.

The big SUV's status is size, height with plenty of ground clearance, and rugged four-wheel drive. Other than making a dramatic statement, their unique design function is

little used in rough terrain. Owners enjoy the up-high authority, but fewer than 6% take them "off road" and don't seem to mind getting half the fuel mileage that the average car gets.

In making up only 15% of new car sales, they deliver 60% of North American industry profits. A \$58,000 price tag generates about \$19,000 in profit, which is the equivalent to the entire sticker price of many small cars.

The numbers are irresistible and, in 1996, there were 26 models and there are plans to have 68 different labels by 2004.

In 1929, Cadillac developed the synchromesh transmission which eventually, with the smoothness of a well engineered V-8, made the features of the V-16 redundant. That fad for grand cars, with overall attitudes becoming more conservative after the boom, ended and bankrupted many of their manufacturers.

Today's wonderfully fast supercars have top speeds of around 200 mph. This compares with the 1932 Duesenberg SJ which, in showroom trim, could do 135 mph. With an improved intake manifold (which became stock), it accomplished 145 mph. In either era, speed is more important as a boast rather than a practice.

For enthusiasts, the two new eras produced some fabulous cars but, beyond that, they are symptomatic of a great financial boom. And, despite (or because of) the enthusiasms, satiation was achieved, which contributed to the contraction.

Still caught up with the spirit of the greatest bull market in history, engineers and marketing types at Bugatti are talking up more cylinders - this time in a W-18 configuration. Meanwhile, over in Stuttgart, Porsche is touting its Cayenne and the WSJ headlined "Long Used to Going It Alone Porsche Joins the SUV Crowd". The turbo-version produces 450 horsepower and does 160 mph. This is a "sports-utility" vehicle? Recalling the brutal cars of 1929, the Bentley pitch is that its Arnage model is "The Most Powerful Sedan In The World". In the racing world, "Arnage" is one of the sections at Le Mans, which Bentley won from 1927 to 1930.

It seems that "what goes around comes around".

Post Script: The April, 2000 study was part of our recommendations to sell Ford and GM shares. This was correct on the stock, but more than two years early on the collapse of the car mania.