The EV Implosion

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Over the past year, we have written many times about how China came out of nowhere to become the world's largest auto exporter. China did this mostly by seizing dominance of the electric vehicle market and of the market for ultra-cheap US$10,000 internal combustion engine cars, capturing new markets across Latin America, South East Asia and the Middle East.

Along with booming exports, China's domestic auto market was also strong, with car sales hitting new all-time highs in 2023. In short, the impressive performance of the automobile sector seemed to be the one silver lining to the dark cloud hovering over the Chinese economy last year. As China moved up the value chain and became an auto-producing powerhouse in its own right, it meant hiring and training more skilled workers, who would earn more than the workers toiling in shoe, toy, or textile factories, and who would therefore consume more.

Shareholder returns in Chinese EV makers have been derisory

What this did not mean, however, was glorious returns for shareholders in the big Chinese automobile companies. Over the past year, most Chinese automakers have either delivered negative equity returns for shareholders—Dongfeng, SAIC, Nio—or returns that have been only marginally positive—Xpeng, BYD. So why the paltry performance?

The biggest concern is that the market for EVs has quickly become super-saturated and that a vicious price war is just around the corner (see **Industry Gets A Credit Surge**). Now that auto makers have ready access to generous bank credit, the path of least resistance is to try and gain market share and kill off competition by slashing prices and margins.

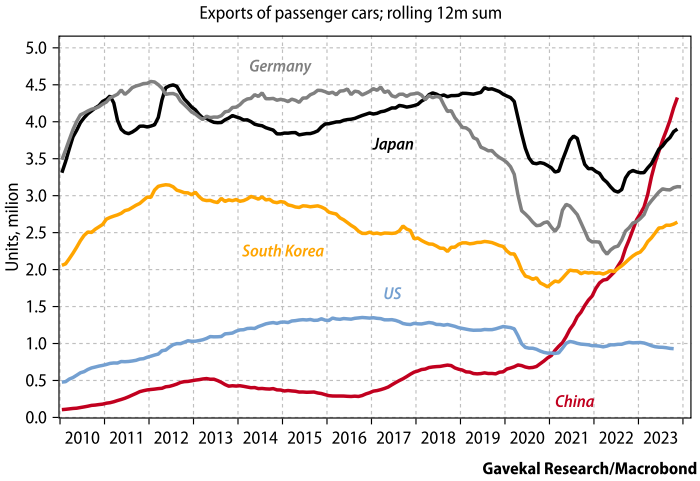
This is not great news for competitors—or shareholders. It recalls the investment mantra of the first decade of this century, which was that the path to riches was to avoid any businesses that competed with the Chinese, while buying any business that sold stuff—commodities, luxury goods, wine, high-end real estate—to Chinese buyers.

Checking The Boxes

Our short take on the latest news

Fact	Consensus belief	Our reaction
US New York Fed Empire State manufacturing index fell to -43.7 in Jan, from -14.5 in Dec	Below expected reading of -5	Plunge concerning; watch other regional Fed indexes for confirmation
ECB consumer survey 3y-ahead CPI expectations 2.2% in Nov, versus 2.5% in Oct	Expectations below expected 2.4%	Consumers reacting to lower energy prices; ECB needs to see easing labor costs before cutting
China's GDP rose 5.2% in 4Q23, versus 4.9% in 3Q	Weaker than expected 5.3%	Downside risks to growth abound amid continued stress in property sector
China industrial production rose 6.8% YoY in Dec, versus 6.6% in Nov	Stronger than expected 6.6%	Infrastructure and manufacturing are holding up well, but the drag from property persists

In just three years, China has become an auto export powerhouse...



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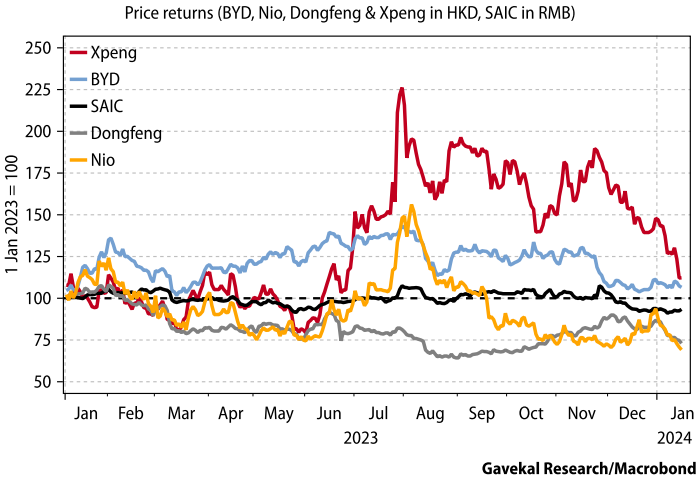
...yet shares in Chinese EV makers delivered paltry returns in 2023



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Part of the reason the market for EVs has become saturated so quickly may be that demand for electric vehicles is starting to stall, both in China and around the world. In China, while EV sales to state entities—provincial governments, municipalities, state-owned enterprises—have remained strong, sales to individuals have been disappointing, as Chinese households appear to have turned more towards hybrids. This is probably because few among China's urban population—the class that can typically afford an EV—own designated parking spots where their cars can be charged (see **Even China Hasn't Solved Range Anxiety**).

Another concern is the rapid depreciation of EVs relative to ICE cars. Just a few years ago, most people expected the opposite. As more and more EVs appeared on the roads, who would want to buy a polluting, noisy and costly-to-maintain second-hand ICE car, when the future was clearly electric?

As it turns out, the second-hand market for EVs is even worse than that for ICE cars. Not only do people worry about the lifespan of batteries—replacing a battery is almost as expensive as buying a new car—but continued improvements in battery technology mean that cars just a few years old are already obsolete. This hurdle will be cleared once replacing car batteries becomes cheaper and more efficient. But that moment has not yet arrived.

In China, another factor may amplify the unfolding price war: growing shipping difficulties. Shipping EVs has always been more of a logistical challenge than shipping ICE cars. An EV fire is almost impossible to put out. This means EVs loaded onto a roll-on, roll-off vehicle carrier must be spaced further apart than ICE cars to reduce the risk that a fire in one car will spread to the entire cargo (as happened last summer off the Dutch coast).

Shipping EVs around the world is getting a lot more expensive

This would not be a great problem in a world of excess fleet capacity and cheap cargo rates. But with a water shortage limiting traffic through the Panama Canal (see **The Inflation-Deflation Tug Of War**) and conflict forcing ships to avoid the Red Sea and Suez Canal (see **The Middle Eastern Kink In Global Supply Chains**), we no longer live in such a world. Today, shipping rates are rising in a way that threatens China's main comparative advantage in cars: the price for the end consumer.

Tesla has lagged the Magificent Seven in the last six months

One of the drivers of China's auto export boom has been its ability to manufacture cheap EVs and ICE cars. The BYD Seagull, a full EV, sells for as little as US$11,000. If the shipping costs for an individual car double or triple, it may not matter much for a Porsche or Ferrari, but for a BYD Seagull, it may make all the difference between exporting to Europe or selling in China.

All this brings me to one of the big surprises of 2023: the face-plant in lithium, the collapse in nickel, and the meandering performance of copper. But given the dynamics in the EV market, maybe this makes sense. And maybe it also makes sense that the performance of one of the all-conquering Magnificent Seven tech stocks—Tesla—has been looking a lot less magnificent lately.

Since the start of 2024, the best-performing stock in the world's top-100 market caps is Mag-7 stock Nvidia, with a 13.9% year-to-date gain. And over the same period, the worst-performing major market cap is Tesla, which is down -11.5%. Is this a short-term anomaly? Or is it another sign that the outlook for the broad EV space is set to become a lot more challenging?

In the Magnificent Seven, Tesla is the Brad Dexter character

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