INDUSTRY TIMELINESS: 57 (of 96)

The Auto Parts Industry has made a strong recovery since the last recession. However, the industry, as a whole, has lost some of that momentum in the past three months. In fact, the group's Timeliness rank is now 57 out of 96, and moved to the bottom half of all the industries covered by *The Value Line Investment Survey*. (It was ranked 14 in our June report.) Price momentum of late has moderated, which we believe was mostly caused by recent volatility in the broader market, due to slowing economic growth and currency devaluation in China. We now have a more cautious near-term outlook. Still, the big picture has not changed much, and the industry's long-term prospects remain relatively favorable.

Indeed, our discussion is generally centered around automotive sales and production levels, as they are directly correlated with industry fundamentals. These trends differ greatly on a regional basis. There is a clear contrast between strength in North America and, to a lesser degree, Asia, improvement in Europe, and significant weakness in South America.

The sector, as a whole, has seen solid organic growth, indicating good underlying business trends of late. However, unfavorable currency translation rates, due to the strong U.S. dollar, have offset much of this growth, and will likely continue to do so in the year ahead. Specifically, these headwinds have muted reported sales and earnings, and have prompted many companies to temper their top- and bottom-line outlooks.

North America

The automotive market in North America, particularly in the U.S., is solid. In fact, in the U.S., which is the world's second-largest market for cars, the seasonally adjusted annual rate (SAAR) of light-vehicle sales for August was 17.8 million, which was the highest rate reported since July 2005. We believe the SAAR will remain above the 17 million-unit mark in the coming months, and that auto sales, which have been on an upward trajectory since 2009, will continue to grow at a healthy clip. This assumes demand and production levels will continue to climb.

We have raised our 2015 and 2016 total light-vehicle sales projections, to 17.1 million and 17.4 million units, respectively. For 2015, this implies a 4% year-over-year advance, and would mark a ten-year high. Overall, this outlook is largely based on improving economic conditions, particularly related to credit availability, interest rates, fuel prices, consumer confidence, and employment figures. The average vehicle age (which is over 11 years), the number of vehicles in operation, and miles driven should also drive demand for both replacement parts and new vehicles. All told, this positive auto sales/production momentum ought to continue in the years ahead, though the rate of recovery may moderate.

China

There are growing concerns surrounding China, which is the largest automotive market in the world, largely due to a deceleration in economic activity and the recent devaluation of the yuan. As a result, there are some uncertainties here, and sales/volume growth may soften in the near term. Nevertheless, this region continues to outperform and still presents plentiful opportunities. The country's impressive growth story over the last few decades should not be ignored. We believe companies will continue to have a large presence, or expand their footprints, in this emerging market.

Europe and South America

Economic conditions in Europe, particularly related to the automotive industry, continue to stabilize, especially in the western region. Auto sales/production, which were at a 20-year low in 2013, will likely continue to grow, albeit at a gradual rate. However, growth in Western Europe has been largely masked by economic and geopolitical concerns in the eastern region, namely Russia. This has put a damper on the European market, and have tempered our recovery expectations.

Meanwhile, South America, particularly Brazil, remains the weakest performer. This reflects economic deterioration, high inflation, currency losses, import restrictions, and lower demand, among other things. Going forward, we expect soft and volatile market conditions to persist in this region.

A Technology Boom

Auto parts suppliers have been working to satisfy customer demands and gain a competitive edge by enhancing and developing new products and technologies that improve safety, enhance fuel economy, lower emissions, and support in-car connectivity, among other things. These "safe, green, and connected" market trends have prompted an impressive period of technological advances. However, these companies seem to be in a race to the finish, which has caused an increased number of vehicle recalls.

Conclusion

Although the Auto Parts Industry has lost some of its short-term appeal, as the majority of equities in this industry are now expected to track the broader market averages over the coming six to 12 months, there is a large selection of stocks to choose from that offer wide upside potential. Nevertheless, investors should be able to endure some volatility, as most equities covered here carry Below Average Safety ranks, above-market Betas, and low Price Stability scores.

We encourage investors to read the individual reports for a more detailed evaluation before committing funds.

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