First to Market

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COULD THE U.S. DRONE EFFORT ADD PROPULSION TO AUTO SUPPLIER STOCKS?

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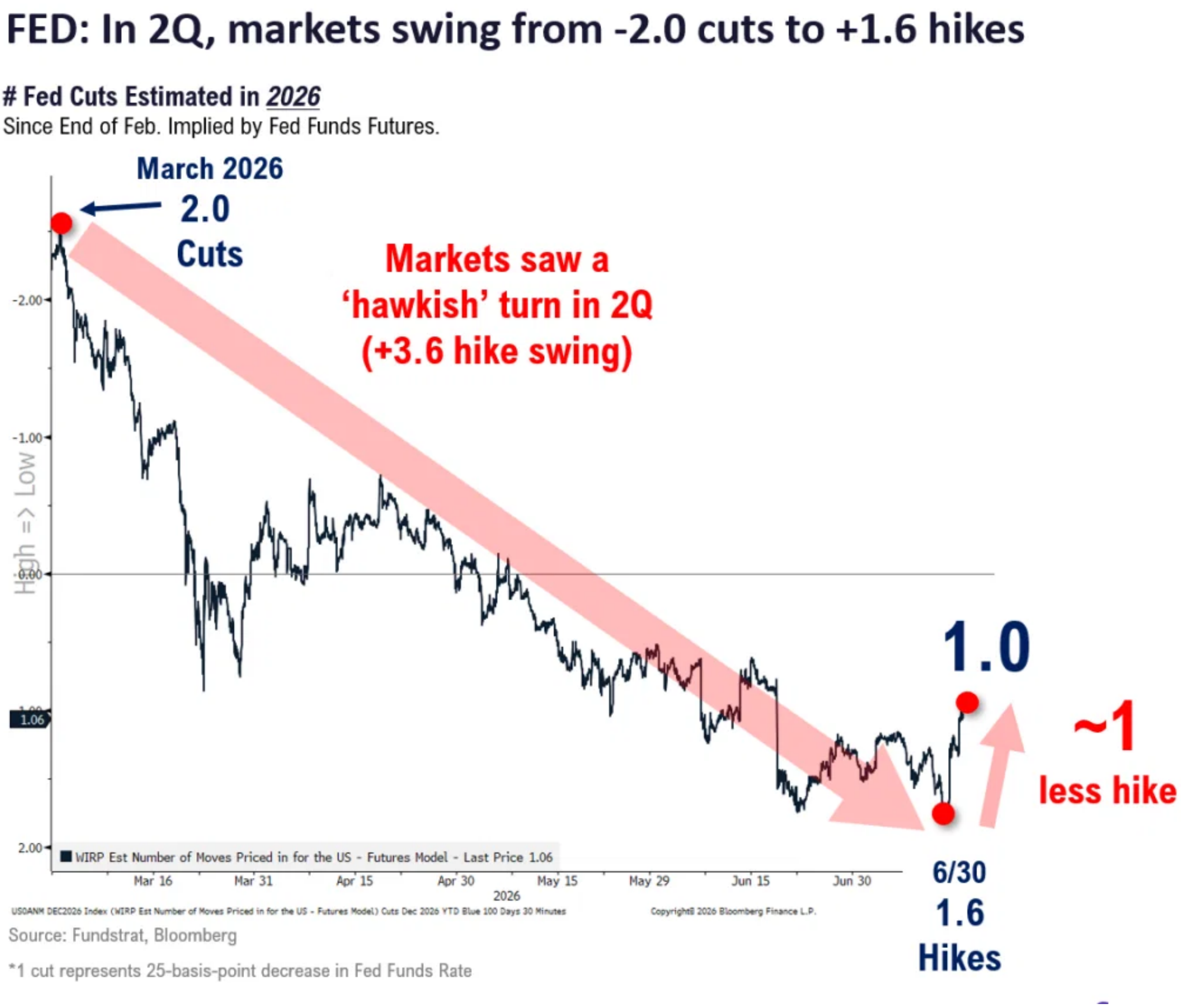
Chart of the Day



Good morning!

In 1940, President Franklin D. Roosevelt foresaw that the U.S. was likely to eventually be sucked into World War II, and foresaw that control of the skies would become increasingly important to victory. In a May 1940 speech to Congress, he told lawmakers, "I should like to see this nation geared up to the ability to turn out at least 50,000 planes a year." U.S. annual plane output at the time was just 6,000, and it looked like FDR would come to rue setting such an ambitious growth target. In 1941, U.S. manufacturers managed to put only 26,277 planes in the air, far short of the 50,000 goal. Yet by 1944, the U.S. had rocketed past Roosevelt's target, making 96,318 planes in that year alone.

This was achieved in large part by ~~convincing~~ ordering the Big Three automakers – Ford, Chrysler, and General Motors – to halt carmaking and pivot to planes. Ford built a factory that could produce a complete B-24 bomber every 63 minutes; General Motors became a major maker of fighter-plane engines (and a major manufacturer of Grumman-designed military aircraft); and Chrysler became a master at producing fuselages, wings, and other aircraft body parts. The enemy – Nazi Germany – did much the same, with Daimler-Benz and BMW putting their automaking facilities to use in building the country's airpower.

Ukraine and Russia, along with Iran and Israel, have each demonstrated what cheap military drones can accomplish in battle, in the process redefining the concept of air superiority for military strategists. That's an area in which the U.S. and its other allies have lagged. Perhaps looking to history, U.S. allies are doing it again hoping to rectify the situation. Last month in Germany, Mercedes Benz $$MBGAF announced a partnership with Tytan Technologies to manufacture drone-defense systems, while in January, France's Renault $$RNLSY partnered with Turgis Gaillard to manufacture long-range aerial strike drones for the French military.

Mind you, the effort has its critics. Eisaku Ito, chief executive of Mitsubishi Heavy Industries $$MHVIY, opposes the idea of using idle car factories to manufacture drones. Drones are different, he said, because they "change their specifications constantly depending on the situation. Automobile factories, by contrast, are designed to manufacture tens of thousands or millions of the same units." Ito might be motivated by self-interest – his company is involved in Japan's drone-manufacturing initiative, after all. Anduril disagrees: the privately held U.S. defense contractor is reportedly in talks to acquire an old Nissan auto-assembly plant in Yokosuka, Japan, hoping to repurpose it into a military drone factory.

Ito's view also has a historical precedent – and a response. Henry Ford ran into serious difficulties in initial efforts to help build U.S. airpower in the 1940s, in part because the U.S. military constantly changed its design specs and requirements, preventing Ford's vaunted mass-assembly lines from ever gaining any kind of momentum. He and his industrial engineers solved this by convincing the military to agree to production in blocks or batches, locking in designs for each block. Urgent design changes that could not wait for the next block were separately implemented at modification centers.

Yet sometimes, historical precedents fail because the differences are more important than the similarities. A drone is not quite the same thing as a plane, obviously, and when it comes to drones, the Big Three are not necessarily positioned to easily shift to drone manufacturing. What knowledge would they have about warheads and aerial guidance systems?

Automotive suppliers on the other hand, might be another story. Some of the components that go into the kinds of drones we're talking about also go into modern automobiles – components such as brushless DC motors, circuit cards, and precision-machined structural casings. Some of the automotive suppliers that could potentially be tapped include Magna International ($$MGA), a maker of automotive camera modules and Milacron (of which Hillenbrand $$HI owns 49%), manufacturer of injection-molding machines; BorgWarner $$BWA, a pioneer in designing and producing the types of brushless DC motors that are ideal for high-performance drones; and Flex Ltd. $$FLEX, an electronics contract manufacturer with expertise in circuit cards.

Outside of pureplay drone companies like the ones we have discussed in the past, I would thus theorize that such automotive components manufacturers are better positioned than the Big Three automakers to benefit from a growing emphasis in ramping up U.S. drone capabilities.

Economic Data Report:

The Empire State Manufacturing Survey showed manufacturing activity in New York strengthening in July, with the headline general business conditions index jumping to 15.6 from 5.7 in June. New orders surged 19 points to 22.2, and shipments rose 16 points to 24.4 – a 4-year high. Alongside notable increases in orders and shipments, employment rose for the sixth consecutive month to 11.4, its highest reading since December 2022, with the average workweek slightly increasing to 2.8, a healthy sign for the labor market in the state's manufacturing sector. Forward-looking sentiment remains optimistic, with the 6-month outlook coming in at

27.9. Half of respondents expect persistent growth in new orders and shipments, headcount, and are hopeful that supply friction will ease up in the coming months. – *Dean Park*

The Federal Reserve Beige Book showed that 11 of 12 Districts grew at a slight to moderate pace, one better than June. Five Districts reported employment gains versus just one last report. Price growth held the same or went down, mostly as the Iran-based fuel shock started to ease and push gas prices down. Several Districts nonetheless flagged consumers spending less on discretionary items due to elevated spending on gas. Data center construction drove real estate gains in several districts, with data center orders leading manufacturing demand and firms are hiring tradespeople and technicians. The Beige Book is anecdotal by design, but the anecdotes are converging on the same conclusion: the AI buildout continues to move behind the screen and hitting the ground. – *Jaime Lee*

The June **Producer Price Index** fell 0.3%, thus reversing the trend from the past three months when energy demand has been so high. As a result, the unadjusted 12 month producer's inflation has eased to 5.5%, down from 6.5% last month. The pullback was driven almost entirely by goods, which fell 1.4% with energy coming down 6.4% following the news of the Iran ceasefire. Excluding food and energy and looking at the core PPI, June was only up 0.1%, sharply down from May's 0.8%. Core PPI is still up 4.7% year over year, well above the fed target of 2%. Overall, this number shows how short-lived the shock from the Strait of Hormuz was on suppliers. However, Iran tensions have reignited and crude has jumped 11% this week alone. It won't be a surprise if we go back to those high energy prices we saw in April and May. – *Kieran McBride*

Share your thoughts

What's your opinion on how the U.S. can ramp up military drone production? Click here to send us your response.

✍Here's what a reader commented ✍

Q: Should U.S. companies even be using Chinese-developed AI models in the first place?

A: Initially my answer was no. China has stolen a lot of technology as well as processes which is how they eventually went from producing a lot of plastic junk to being the premier manufacturer. Try to hire a manufacturer to build something for your company and you will see that it is very hard to find any that are not from China. Even manufacturing machines are mostly made in China. So if you want your AI products and processes stolen by China then go ahead and use their AI models. However, their top models are so cheap, maybe I could find a way to use them for some mundane tasks and use US models for the proprietary stuff to cut costs as the U.S. models are quite expensive. I have found that using Opus 4.7/4.8 is all I need so the recent Fable issues did not affect me.

Catch up with Fundstrat

The June CPI and PPI report show inflation is weakening and our take is that Fed odds of a hike will continue to diminish. Moreover, we believe the AI story remains intact and this should be .evident as we move through 2Q26 earnings season.

Technical

Breadth has retreated ever so slightly over the last two to three weeks, but only because of technology waning, and the underlying trend in participation remains healthy.

Crypto

Yesterday's CPI report materially improved the near-term macro backdrop for crypto by increasing the likelihood of a dovish repricing in rates markets. At the same time, ETH's relative strength continues to build, supported by cleaner flow dynamics and possible Clarity-related tailwinds.

News We're Following

Breaking News

- U.S. to Impose 25% Tariff on Certain Goods From Brazil WSJ

Markets and economy

- Wall Street Traders Are Having Their Best Year Ever WSJ
- AI is so big, it's now impossible for investors to avoid MW
- Trump blasts New York AI data center moratorium, says state should change policy 'immediately' CNBC
- Fed Chairman Warsh says he meets 'often' with Trump administration, defends independence CNBC
- The U.S. oil reserve is at a 40-year low — but the government says there's still plenty of breathing room MW

Business

- UnitedHealth Results Handily Beat Wall Street Expectations WSJ
- Turbo-charged SK Hynix volatility shows no sign of abating as AI euphoria swings to fatigue MW
- Energy IPOs surge as investors hunt for ways to play AI boom FT

Politics/U.S.

- The Mystery Money Powering Trump's Second Term WSJ
- U.S. Weighs Bond of $100,000 for Some Green-Card Applicants Abroad WSJ

Overseas

- Iran warns U.S. of Hormuz 'red line,' says it will retaliate to Trump's strike threats CNBC
- Vote on US aid to Israel shows divide in Democratic Party FT

Of Interest

- The AI Backlash Has Tech Executives Fearing for Their Lives WSJ
- Smoke Floating Far From Canada's Wildfires Will Darken Skies Again on Thursday NYT

Overnight	
S&P Futures	-5 ▼ point(s) (-0.06% ▼)
overnight range:	-21 ▼ to +17 ▲ point(s)

APAC	
Nikkei	-2.79% ▼
Topix	-1.45% ▼
China SHCOMP	-1.85% ▼
Hang Seng	+1.33% ▲
Korea	-6.37% ▼
Singapore	-0.37% ▼
Australia	0.00%
India	+0.02% ▲
Taiwan	-0.01% ▼

Europe	
Stoxx	50 -0.18% ▼
Stoxx	600 -0.39% ▼
FTSE	100 -0.37% ▼
DAX	-0.49% ▼
CAC	40 -0.56% ▼
Italy	-0.30% ▼
IBEX	-0.27% ▼

FX

Dollar Index (DXY)	+0.08% ▲ to 100.56
EUR/USD	+0.03% ▲ to 1.1466
GBP/USD	-0.23% ▼ to 1.3509
USD/JPY	+0.01% ▲ to 162.17
USD/CNY	+0.01% ▲ to 6.7675
USD/CNH	0.00% to 6.7690
USD/CHF	-0.25% ▼ to 0.8073
USD/CAD	-0.01% ▼ to 1.4043
AUD/USD	-0.09% ▼ to 0.6998

UST Term Structure

2Y-3M Spread widened	1.8bps to 36.2bps
10Y-2Y Spread widened	0.5bps to 41.6bps
30Y-10Y Spread widened	0.6bps to 53.4bps

USD HY OaS

All Sectors	-0.4bps ▼ to 298bps
All Sectors ex-Energy	+0.1bps ▲ 291bps
Cons Disc	-0.5bps ▼ to 441bps
Indu	+2.4bps ▲ to 230bps
Tech	+2.8bps ▲ to 216bps
Comm Srvcs	-1.8bps ▼ to 284bps
Materials	+0.8bps ▲ to 265bps
Energy	+2.5bps ▲ to 277bps

Energy	+2.3bps ▲ to 277bps
Fin Snr	+1.3bps ▲ to 197bps
Fin Sub	-0.4bps ▼ to 306bps
Cons Staples	-4.1bps ▼ to 451bps
Healthcare	+0.2bps ▲ to 305bps
Utes	+0.4bps ▲ to 205bps *

DATE	TIME	DESCRIPTION	ESTIMATE	LAST
7/16	10:00 AM	Jul Homebuilder Sentiment	35	35
7/17	8:30 AM	Jun Import Price m/m	-0.6	1.9
7/17	10:00 AM	Jul P UMich 1yr Inf Exp	4.5	4.6
7/17	10:00 AM	Jul P UMich Sentiment	51	49.5

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