Zacks INVESTMENT MANAGEMENT

Mitch on the Markets

Portfolio Manager Investing Insights

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Supply Chains Improve, But Does Anyone Notice?

Supply chains and inflation were likely hot topics at Thanksgiving dinners around the country this year. Most Americans are likely noticing the same things – higher prices for many goods, labor shortages at local businesses, more expensive gasoline, etc. Supply chain problems are a key factor driving price pressures, in addition to robust consumer demand tied to a strong labor market, higher wages, and accumulated savings.[1]

Simply put, there is too much money chasing too few goods and services.

Consumer demand seems unlikely to abate significantly in the near future. The jobs market has been improving, wages have been ticking higher, and entrepreneurs are starting new businesses at a rapid clip. According to the Census Bureau, applications for 4.54 million new businesses were submitted in the first three quarters of 2021, the most on record and with a 56% leap from the same period in 2019 (before the pandemic).[2]

That leaves the supply side of the equation – of goods, services, and labor – as a key determinant of whether price pressures will ease in the coming months or quarters. In my view, we should see improvements across the board relatively soon, but I also expect these improvements to be underappreciated and underacknowledged by investors and the media, at least at first. And that could be bullish for stocks.

In fact, there are already signs supply chain problems are easing, but my guess is that few readers have heard about them. In Asia, energy shortages and port capacity limits have eased, and ocean freight rates have fallen from record highs. China has resumed manufacturing largely at normal capacity since October. In the United States specifically, major ports are still congested and ships are still waiting to offload goods, but at the same time, major retailers like Target, Home Depot, and Walmart were all well-stocked for the holiday shopping season.

Oxford Economics surveyed "country experts" across 45 economies and found that nearly everyone believed supply chain disruptions had peaked. This assessment does not mean the issues are over – but it does confirm emerging evidence that global supply chain bottlenecks are at least easing, which could lower logistics costs and allow production to begin catching up with demand.

There is also a distinct possibility that supply shortages could ultimately become supply gluts in the next couple of years. A great example is in the auto industry, where there is a significant amount of partially built vehicles parked around the country just waiting for the delivery of semiconductors. Once the chips are installed and the vehicles move into dealerships, supply could potentially outweigh consumer demand. Similarly, the Bank for International Settlements recently noted that many companies are establishing 'precautionary stockpiles' of parts, which could be exacerbating shortages. Supply could easily overshoot demand once it catches up.

My point here is not that supply chain and inflation reporting is overblown – there are of course major issues that are creating shortages and rising prices. But I think many investors are starting to assume these problems – and the inflation that comes with it – is more permanent than temporary. So even when improvements start to take hold, which I think we are starting to see now, few are likely to notice. And that could be good news for stocks.

Bottom Line for Investors

The notion that supply-demand imbalances will persist longer than expected is becoming a widely-held belief. I'm not saying this belief is wrong, but I have been starting to notice several, underappreciated improvements to supply chain problems that few people are noting. And anytime a gap starts to form between how worried people are and how worried they actually should be, that tends to be bullish for stocks. I think that's what we're seeing now.

ABOUT MITCH ZACKS

Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

[1] Wall Street Journal. November 22, 2021. https://www.wsj.com/articles/todays-shortages-could-soon-become-tomorrow-s-gluts-11637580600?mod=markets_lead_pos13

[2] Wall Street Journal. November 27, 2021. https://www.wsj.com/articles/workers-quit-jobs-in-droves-to-become-their-own-bosses-11638199199?mod=hp_lead_pos5

IN FOCUS THIS WEEK

- **Strong U.S. consumers during this holiday season**
- **Omicron variant's impact on the economy**
- **Current labor shortages**
- **Good news in the job market**

Holiday Shopping Data Signals a Strong U.S. Consumer

The Thanksgiving holiday and Black Friday are generally key shopping days for retailers, and 2021 delivered. RetailNext, a research firm that tracks in-store shoppers, said that foot traffic in stores was up 61% this Black Friday compared to 2020, when many consumers were still skittish about the spread of Covid-19. Interestingly, consumer enthusiasm to get out and shop meant that online sales fell slightly year-over-year, falling from $9 billion in 2020 to $8.9 billion this year. Even with more consumers visiting stores in person, Black Friday store shopping was still down about 25% from 2019 levels, before the pandemic struck. Overall, the National Retail Federation expects that U.S. November-December retail sales will jump by approximately 10% from a year ago, bringing the total to as much as $850 billion or more. Despite all the challenges brought by the pandemic, labor shortages, and some inventory issues, consumers have increased spending by about 4.4% on average over the last five years. Inflation remains a concern, but consumers are also benefiting from a strong labor market and higher wages, which have somewhat offset the effect of higher prices.[1]

Will the Omicron Variant Hurt the Economy?

Readers by now have likely heard of the new Covid-19 strain called Omicron, which seems likely to be the source of the next wave of global infections. Public health uncertainties abound, but a key economic question is: will this new strain result in another pullback of activity, spending, manufacturing, etc.? In our view, the scale of the economic impact is likely to depend on the severity of the strain, and whether or not the vaccines continue to be effective in avoiding severe illness. It is too early to know, but there is one reason to remain hopeful – with each new wave of Covid-19, the economic impact has declined. In other words, businesses and governments have adjusted to the pandemic in a way that the economy can continue to function even as the virus spreads, versus March 2020 when the entire global economy was shut down. Vaccination rates also continue to notch higher, which should hopefully reduce overall health risks posed by Omicron.[2]

One Potential Driver of the Labor Shortage: More Entrepreneurs

One headline that appears often is that there is a shortage of workers in the U.S. But what we do not hear often is that the pandemic has also led to a historic surge of entrepreneurship and self-employment. There are now 9.4 million self-employed workers in the U.S., according to the Labor Department, which marks a 500,000 increase since the start of the pandemic. Many workers are eschewing service sector jobs to set out on their own, as consultants, freelancers, and other types of small business owners. In 2021, the share of U.S. workers who are employed by a large company (more than 1,000 employees) fell for the first time since 2004, while the number of self-employed workers is at its highest level in 11 years. Chances are the number of self-employed workers will continue rising from here – in September alone, 4.4 million people resigned from jobs, a record.[3]

Another Piece of Good News in the Jobs Market

For the week ending November 20, the number of workers filing for unemployment benefits (jobless claims) fell to 199,000, the lowest level in 52 years. Jobless claims serve as a proxy for layoffs, and it makes sense why they would be so low – employers that have workers don't want to lose them. In the following week, claims rose slightly to 222,000, which also signals a very tight labor market.[4]

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[1] Wall Street Journal. November 28, 2021. https://www.wsj.com/articles/black-friday-brought-shoppers-back-to-stores-11638111602?mod=djemRTE_h

[2] Wall Street Journal. November 30, 2021. https://www.wsj.com/articles/covid-19-variant-omicron-threatens-u-s-global-economies-11638268200?mod=djemRTE_h

[3] Wall Street Journal. December 1, 2021. https://www.wsj.com/articles/supply-imbalances-continued-to-hold-back-u-s-growth-this-fall-feds-beige-book-says-11638386787?mod=Searchresults_pos4&page=1

[4] Wall Street Journal. November 24, 2021. https://www.wsj.com/articles/weekly-jobless-claims-11-24-2021-11637701570

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