



Mitch on the Markets

Portfolio Manager Investing Insights

WEEKLY CLIENT COMMENTARY

December 16, 2022

Assessing Fears of De-Globalization

Depending on who you ask, the globalization trends of the last 30+ years are either still pushing forward, grinding to a halt, or are in the early stages of outright reversing. But I think committing to just one of these narratives is problematic.

That's because globalization is not an on-off switch – it's a complex and layered set of relationships between countries regarding trade, investment, financial systems, immigration, technological networks, supply chains, and so on. At any given time, a country may be seeing more cooperation in some of these areas, and less cooperation in others.¹

Much of the consensus that de-globalization is underway comes from the rippling effects of the pandemic and the Russia-Ukraine war. The proximity of these two shocks has led many corporations and some western governments to prioritize the resilience of supply chains – i.e., domestic production – over the benefits that globalization affords, like efficiency and low costs. For readers who have heard the term “reshoring,” that's what this trend refers to.

But the other key factor driving de-globalization fears is the increasingly strained relationship between the U.S. and China. Some worry that the global economy will become fragmented into two blocks – countries that do business with the U.S., and countries that do business with China. With the U.S. and China currently levying tariffs and ‘playing defense’ when it comes to capital flows and access to technology, these concerns are certainly warranted.

It should be noted, too, that history is playing an important role in how economists and other experts are viewing current globalization trends. If we look back to the early 1900s, globalization was accelerating with tailwinds from the industrial revolution and the adherence of major economies to the gold standard, which the U.S. joined in 1900.

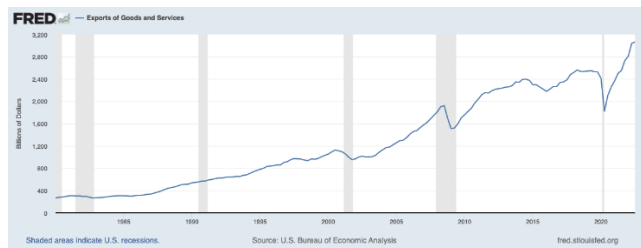
What brings nations together economically can sometimes drive them apart in political and social terms, however, as nationalism and other domestic priorities push back against the forces of globalization. In the early 1900s, World War I essentially thwarted all of globalization's momentum, with global trade as a percent of

GDP peaking in 1914. Trade wouldn't return to those 1914 levels until the mid-1970s.

The 2008 global financial crisis, the Covid-19 pandemic, and the Russia-Ukraine war may be the new factors that will ultimately drive a secular slowdown in global trade. No one can know for sure. What I can say is that there is not much hard evidence that de-globalization – at least in terms of global trade – is firmly underway. In 2021, global trade growth accelerated so quickly that it shot back up to the pre-2008 trendline. It's also true that in 2022, global trade volumes reached a new record, posting figures nearly 10% higher than they were pre-pandemic. If de-globalization is happening, it cannot be explained by trade.

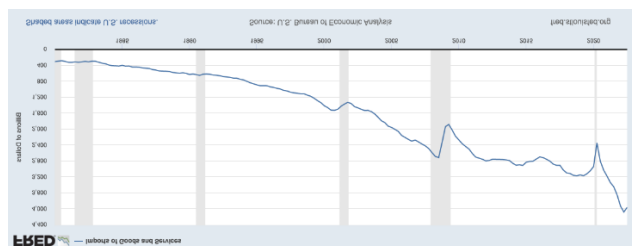
The U.S. economy fits into this global trade pattern as well. As readers can see in the two charts below, total U.S. exports and total U.S. imports have recovered from pandemic lows and are now well into record territory. I have written before that in my view, it's total trade – not trade surpluses or deficits – that paint a clearer picture of how robust overall activity is.

U.S. Exports at Record Levels



Source: Federal Reserve Bank of St. Louis

U.S. Imports Close to Record Levels



Source: Federal Reserve Bank of St. Louis

Finally, I think it's important to make the point that many tend to think of globalization as the

free movement of goods and labor across borders, but it is also true that services can be imported and exported between economies. More so than ever, countries are cooperating and trading by opening access to technology, financial markets, and other services that exist in the non-goods economy. By these measures, one could argue that globalization is not reversing or corroding, and may even be accelerating.

Bottom Line for Investors

De-globalization would be a major negative for the global economy if the worst fears come to fruition, and it would also be longer-term inflationary. Turning inward economically generally means paying higher input costs, which would also imply having to charge more to consumers.

These trends are worth watching closely, but the worst-case scenario outcome is far from assured. Global trade data suggests it should not currently be an economic fear at all.

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 Goldman Sachs. May 2, 2022. <https://www.goldmansachs.com/insights/pages/de-globalization-ahead.html>

Weekly Market Update

Important Market News We Think Worth Considering

IN FOCUS THIS WEEK

- **Slowing of inflation**
- **U.S. oil prices under pressure**
- **China's economic stumble**

Inflation Slows in November, and Fed Raises Rates by 50 Basis Points

The November inflation figures were released last week, and consumer prices were seen trending in the right direction. According to the Labor Department, the consumer price index (CPI) measure of inflation rose by 7.1% year-over-year in November, which was a marked improvement from the 7.7% rate posted in October and is a significant decline from June's 9.1% peak. Of course, a year-over-year inflation rate of 7.1% is well above the 2% average the Fed is targeting, but it also suggests that inflation's peak in this cycle may be in the past – not the future. The Federal Reserve also met this week and announced a 50-basis point rate increase, which was a welcomed step down following four consecutive 75-basis point increases. The fed-funds rate now stands at a range between 4.25% and 4.5%, which marks a 15-year high for the benchmark interest rate. The step down from 75 basis point hikes to 50 bps signals that the Fed may be ready to continue scaling down their aggressive approach to monetary tightening, with Chairman Jerome Powell saying in the press conference that it was “broadly right” that the Fed could shift down further to 25 basis point increases in 2023 to allow for a smooth exit and also to manage the risk of over-tightening. As has been the case throughout 2022, the Fed also increased their forecast for the terminal fed funds rate – i.e.,

where the fed funds rate would peak in the cycle. That figure now stands at between 5% and 5.5%, with plans to hold it there until 2024. Investors should take these forecasts with a grain of salt, however. They're almost always wrong.¹

Keystone Pipeline Leak May Pinch U.S. Oil Reserves

A rupture in the Keystone pipeline in Kansas has spilled an estimated 14,000 barrels of oil, marking one of the largest spills in the U.S. in over 10 years. The pipeline has been shut down since December 7 as repairs are being made, which has cut off a key source of crude for Gulf Coast refiners. Hundreds of thousands of barrels have not flowed in the time the pipeline has been shut down, which appears likely to accelerate a decline in oil reserves at the key Cushing, Oklahoma storage hub. About 622,000 barrels of oil flow through the pipeline every day. Some analysts believe falling supply could put upward pressure on prices, but it remains to be seen whether this translates to higher prices at the pump. Demand for gas tends to fall in the winter months, and refiners can also source oil from other places to make up for lost supply.²

China's Economy Stumbles at Year-End, But Looks to Rebound in 2023

China's economy is finishing the year with a whimper, an extension of troubles experienced throughout 2022. In November, due to continued restrictions and lockdowns associated with “zero-Covid,” China's economy suffered setbacks as retail sales plummeted by 5.9% year-over-year. Unemployment in major cities rose from 5.5% in October to 5.7% in November, and the youth unemployment rate remains above 20%. Industrial production also plateaued in the month as factories were hit with the double-whammy of Covid restrictions and

falling global demand. There is good reason to believe that China could experience a turnaround in 2023, particularly as protests and urging from businesses has led to an easing of Covid restrictions and a shift to broader economic reopening. China's government is forecasting 5% GDP growth in the new year, and many Wall Street banks and economists see the growth even higher.³

Weekly Market Update

Important Market News We Think Worth Considering

ZACKS INVESTMENT MANAGEMENT, INC.

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¹ Wall Street Journal. December 13, 2022. https://www.wsj.com/articles/us-inflation-november-2022-consumer-price-index-11670883405?mod=djemRTE_h

² Wall Street Journal. December 14, 2022. https://www.wsj.com/articles/u-s-oil-prices-under-pressure-from-keystone-pipelines-largest-ever-leak-11671051020?mod=hp_lead_pos3

³ Wall Street Journal. December 15, 2022. https://www.wsj.com/articles/chinas-economy-struggled-in-zero-covids-final-month-11671083136?mod=djemRTE_h

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