integrity asset management

Market Synopsis – November 2021

Global supply constraints

For two decades the global economy has faced a persistent aggregate demand shortfall. However, since the start of the pandemic, the issue has not been a lack of spending, but rather a lack of production. Unlike the 2009 Global Financial Crisis, governments around the world have been quick to roll out multiple support programs for affected workers and businesses. Due to these unprecedented fiscal programs, US households have accrued over USD 2.2 trillion in income since the start of the pandemic, over USD 1.2 trillion more than what we would have expected based on pre-pandemic trends – see Figure 1.

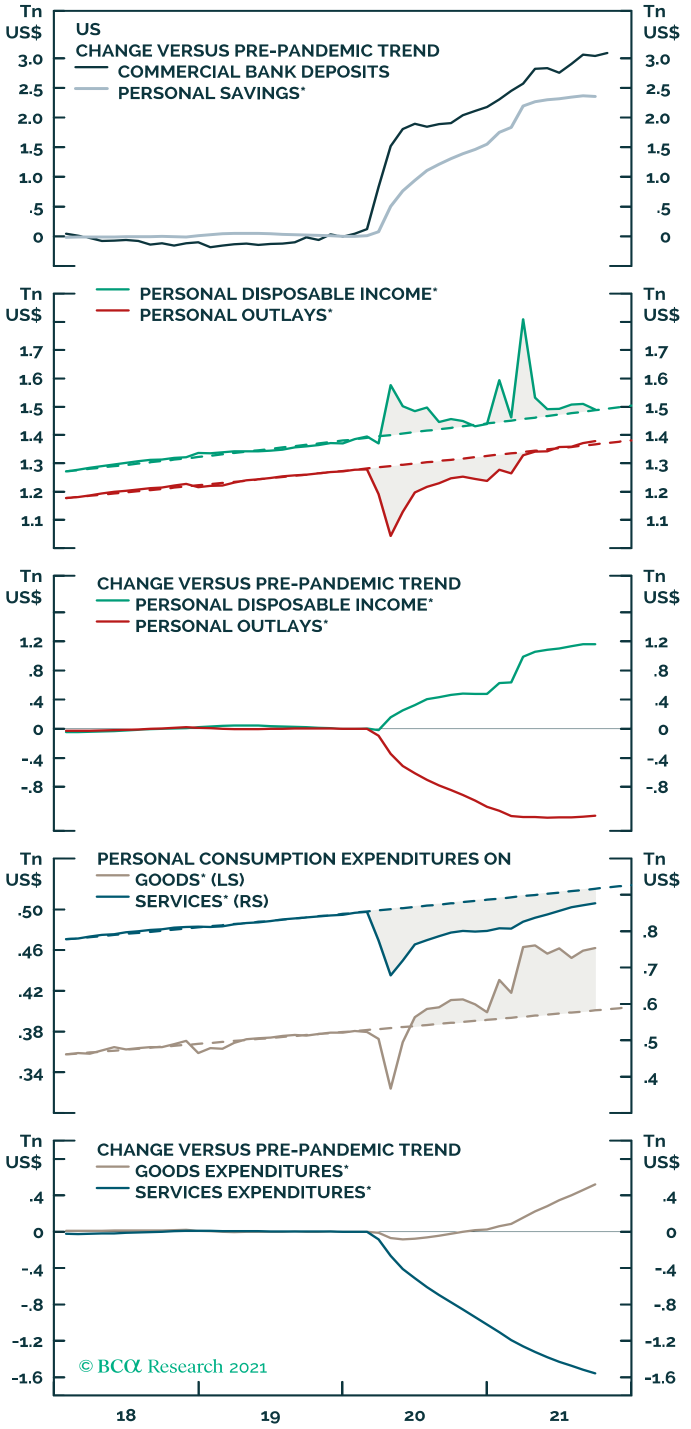
Lockdowns across the globe restricted consumers access to an array of services. Lockdown boredom coupled with stimulus cheques diverted consumer spending towards manufactured goods. Initially sellers were able to meet demand by dipping into their inventory. However, by early 2021 inventories had largely been depleted. Shortages across the global supply chain soon followed.

While a large portion of empty warehouses can be attributed to surging demand for goods, disruptions on the supply-side have also played a crucial role. We have identified the following four factors as having the largest impacts: Semiconductor shortages; transportation bottlenecks; inadequate energy supply; and reduced labour force participation.

Semiconductor shortages

The global supply chain was not properly equipped to handle a disruption as large as the COVID-19 pandemic. The rise in popularity of just-in-time inventory systems, and supplier networks traveling across the planet ensured that a bottleneck in any part of the system quickly filtered to other parts of the global economy. However, few industries are as integral to this system as semiconductors.

The automobile sector has borne the brunt of the chip shortage, as production lines have had to stall to a crawl without this critical component. Prices of used vehicles have soared over 40% since the start of the pandemic as dealer inventory has emptied out – see Figure 2 on the following page. The resultant dip in vehicle spending removed 2.4% of US real GDP growth in Q3. Semiconductor makers have ramped up production to try and meet demand.



* MONTHLY, NOT ANNUALIZED.
NOTE: DASHED LINES REPRESENT PRE-PANDEMIC (2018-2019) TRENDS.

Figure 1 - Stimulus income's impact on savings and expenditure

These plants are now operating an average of 25 hours longer per week, compared to prior the pandemic. Japan has been able to rebound fully, while production in Korea has remained subdued due to COVID-19 lockdowns.

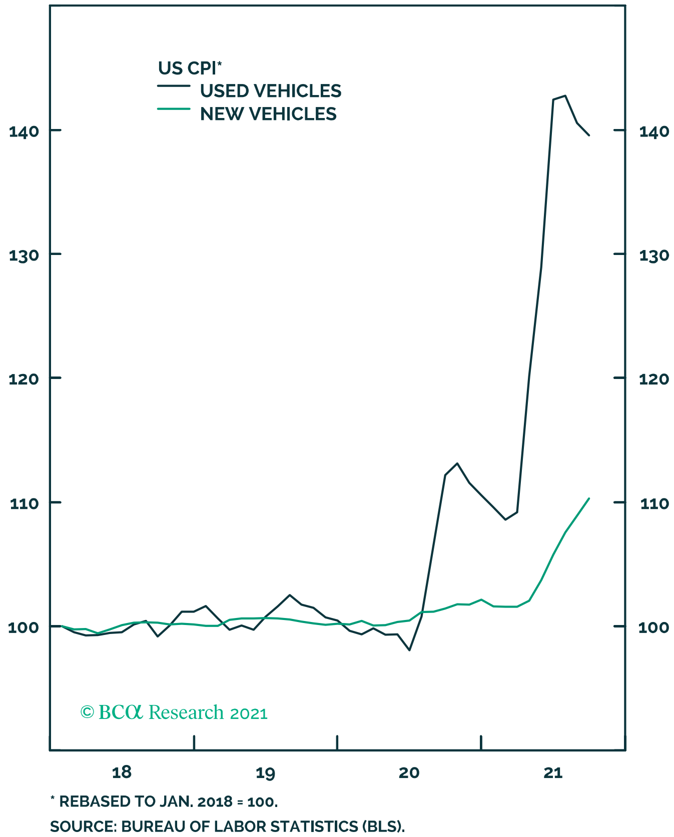


Figure 2 – Used and new vehicle price inflation

However, increasing vaccination rates in both regions imply further improvement. The onset of Omicron might hinder the momentum of the mentioned supply chain normalisation. Comments from management of semiconductor and automotive companies have suggested that chip shortages will ease over the coming months, allowing for increased vehicle production. Unfortunately, the overall chip market is unlikely to be back to normal until 2023.

Transportation bottlenecks

While lightweight expensive products like electronics are normally transported by air, the majority of the world's items are shipped by sea. Congestion in ports, a lack of warehouse space, and even insufficient truck chassis have all contributed to bottlenecks. Similar to the semiconductor issue, the world is most likely past the worst points of the shipping crisis – see Figure 3. The Drewry's composite World Container Index has fallen some 11% from its peak, but is still over 400% higher than its mid-2020 levels. The number of container ships in line to unload cargo remains near all-time highs, but this congestion is expected to abate over the next few months.

Throughput in ports does follow a cyclical pattern, declining in late September and remaining subdued until February. Even at the current level of congestion, it should return to normal by mid-2022. Looking past the next few months, shipping costs will face further downward pressure as the number of new container ships on order has risen to a 10-year high.

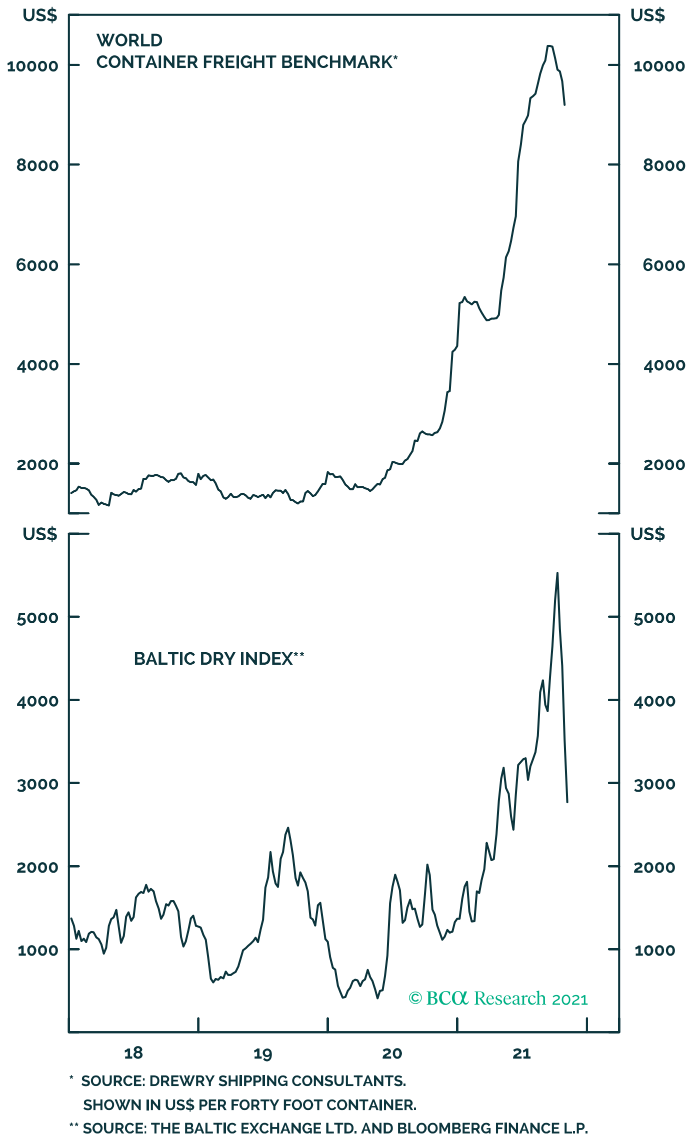


Figure 3 – Cost of shipping

Inadequate energy supplies

After an explosion in price since the start of 2021, energy prices are finally falling back to more normalised levels. Since their October peak brent oil and natural gas have fallen 14% and 18% respectively. However coal has seen the most dramatic move, falling over 43% – see Figure 4 on the following page.

Years of underinvestment into energy production has led to tight supply conditions in the global energy sector. With little spare capacity, the energy market has become far more vulnerable to shocks. Unfortunately for Europe, the past year was a perfect storm: A particularly cold spring across the Northern Hemisphere resulted in natural gas supplies depleting; lower than average speed winds decreased European wind farm output; and the dispute over the Nord Stream 2 pipeline further reduced overall supply. This pipeline has become increasingly popular with German voters over the past 4 years, meaning it is becoming more likely to be approved. China, who has been investing massive amounts into nuclear energy, has restarted 170 coal mines and may have to restart importing Australian coal to manage their own electricity crisis. While this shift may only be short term, these countries have increasingly moved away from renewable energy and more to cheaper alternatives such as coal and natural gas.

Reduced labour force participation

Despite an incredibly rapid economic recovery, the US employment rate remains over 5 million below the pre-pandemic peak. Recent surveys from businesses would seem to contradict this however as a record 51% of small businesses have indicated they are experiencing difficulty in finding and retaining qualified employees. Both the quitting rate and job opening rates are far higher than their pre-pandemic levels – see Figure 5 on the following page.

The increased level of unemployment is the result of two major factors. Firstly, over 1.3 million more workers than demographic trends predicted retired since the pandemic began. Secondly, there are far more young people that have been unwilling to re-enter the work-force. The exact reason for this hesitancy is up for debate, but the expiration of enhanced benefits should encourage more of these individuals to get back into the job market.

According to recent surveys there are still over 2.5 million people that are not returning to work due to Covid-19 related concerns. Even though it may encourage the previous group to return to work, vaccine mandates may exacerbate the issue. According to the *Census Household Pulse Survey* roughly 8 million of the 100 million US workers that are subject to the vaccine attest that they will refuse the jab. Many have argued that the hesitance is due to how the pandemic changed people's perspectives on work/life balance.

Work related burnout, the reluctance to restart the daily commute to an office, and the desire for more family time have all contributed to what people are referring to as "The Great Resignation". Ultimately, wages may be the deciding factor. When the labour market tightened in the late 90s, accelerated wage growth attracted many people, especially less skilled workers, back into the labour force. With wage growth recently escalating at the lower end of the income distribution, many low-skill workers may start to seek employment.

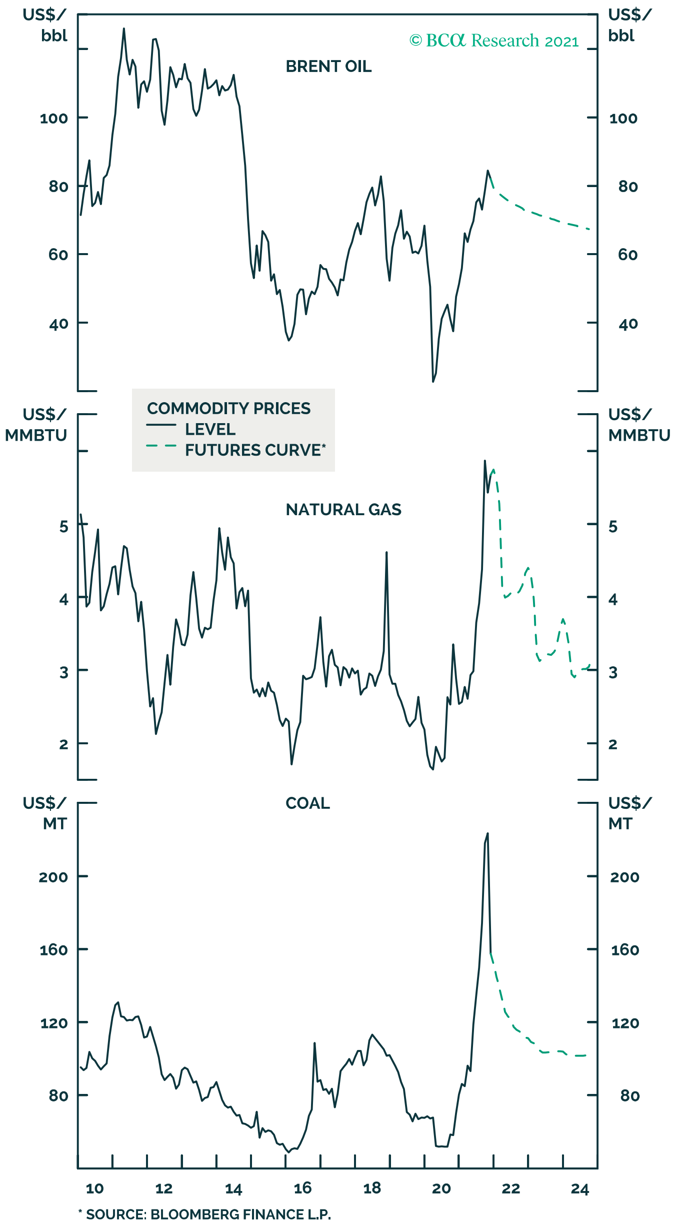


Figure 4 – Energy input prices

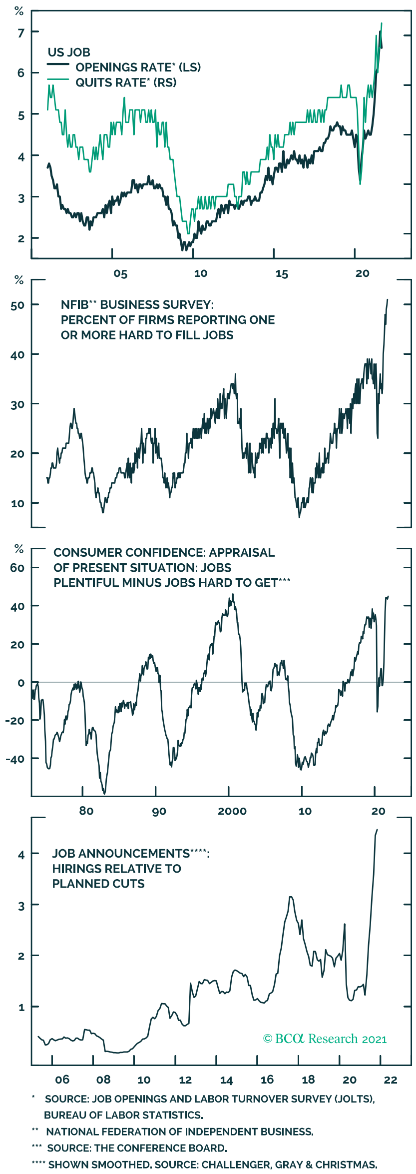


Figure 5 – Job activity and sentiment

Investment implications

Supply-side pressure will most likely ease over the coming months as semiconductor production ramps up, transportation bottlenecks abate, energy prices return to normalised levels, and more workers return to the labour force - all factors, which have contributed to elevated levels of inflation, hence abating. However, this respite from inflation will be short lived. The easing of fiscal and monetary policy will result in US unemployment falling below its equilibrium levels, with other major economies expected to follow suit shortly after. This will be consistent with our inflation expectation from last month of consecutive higher highs and higher lows. Currently we appear to be at the end of a high, meaning inflation will most likely trend downward in the short term.

Increasing bond yields should benefit value shares over growth in the longer term. Specifically banks stand to gain from rising yields, and tech shares will take a knock. If any further supply shocks occur, advertising giants such as Facebook and Google may suffer as companies cut spending. What's the point of advertising if you cant produce enough to meet demand? The current tight supply conditions should also spur more capital investment spending, benefiting industrial shares.

For more information on this Market Synopsis or to discuss solutions provided by Integrity Asset Management, please contact us at:

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Indicator	Spot	MTD	YTD	Y-o-Y
Gold	1 774,52	-0,5%	-6,5%	-0,1%
Brent Crude	70,57	-16,4%	36,2%	48,3%
USDZAR	15,9705	4,8%	8,9%	3,4%
EURZAR	18,0636	2,6%	0,7%	-2,1%
GBPZAR	21,1826	1,5%	5,8%	2,7%
JSE All Share TRI	11 426,32	4,5%	23,3%	28,5%
JSE Resources TRI	5 125,09	6,8%	25,4%	37,0%
JSE Industrials TRI	19 064,71	6,4%	21,1%	19,8%
JSE Financials TRI	8 818,13	-2,6%	16,8%	26,6%
JSE Listed Property TRI	1 560,81	2,2%	26,9%	44,3%
S&P 500	4 567,00	-0,8%	21,6%	26,1%
Euro STOXX 50	8 970,07	-4,3%	16,6%	18,6%
FTSE 100	6 981,71	-2,2%	13,1%	16,8%
Nikkei 225	46 685,33	-3,7%	2,9%	7,0%
Hang Seng	72 012,42	-7,4%	-11,6%	-8,6%

Source: Bloomberg, as at 30 November 2021