Wentz Weekly

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Backlogs Building In U.S. Ports

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Thanks to a much stronger recovery from the pandemic-induced recession than expected, businesses have been dealing with substantial supply issues. Businesses kept inventories low coming out of the recession, but demand picked up quickly thanks to easy monetary policy and government stimulus, and businesses were left scrambling to restock their shelfs. Now, global supply chains are jammed as businesses scramble to restock for the upcoming holiday season. In fact, inventories are near record low levels, according to data by the Federal Reserve Bank of St. Louis and noted by Barron's. For the last four months the inventory-to-sales ratio has been near record low levels of 1.24, last seen in March 2011, which also indicates consumer demand is very strong. The fact companies cannot restock quick enough had a negative impact on 2nd quarter gross domestic product (GDP), a measure of economic growth. The change in inventories in the 2nd quarter was low enough that it resulted in 1.13% to be subtracted from GDP (however this could prove to be a tailwind going forward).

Now, the restocking is causing a massive backlog in the country's largest ports. The WSJ reported at least 37 container ships are anchored off the ports of Los Angeles and Long Beach, which combined handle more than a third of U.S. marine imports, that are bound for U.S. businesses restocking and preparing for the holiday shopping season. In a normal environment there are none or very few. Leaders of the ports have said the surge in imports is due to the now unpredictable global supply chains and shippers importing goods for the holidays earlier to avoid delays later on. The surge in maritime trade is pushing up shipping costs as well, another factor for higher inflationary pressures. The Baltic Dry Index, a proxy for dry bulk shipping costs, is up 189% since the beginning of the year. The backlogs have been closely monitored by the Federal Reserve. In the latest FOMC meeting minutes, Fed members agreed that supply disruptions would likely continue for the remainder of the year which, along with higher input costs, could put further upward pressure on prices into 2022. As a result, some Fed members suggested it would be appropriate for the Fed to start reducing its pace of asset purchases this year as inflation is proving to be more persistent than previously anticipated. We expect strong demand to continue as consumers are still sitting on a significant amount of dry powder and believe some businesses will continue to struggle meeting demand. Start your holiday shopping early this year!

As mentioned last week after several public appearances from Fed members, the timeline for tapering has been pulled forward to the end of 2021. Tapering refers to the reduction in the Federal Reserve's bond purchases, or an unwinding of quantitative easing. The Fed is currently purchasing $120 billion in bonds every month, a program it implemented in March 2020 in effort to stimulate the economy by improving demand. The tapering plan will likely include reducing its pace of purchases by about $15 billion per month and ending the program after about 8 months. Minutes from the Fed's most recent meeting confirm members have been discussing tapering and more member prefer to start the process before the end of the year. Most said "it could be appropriate to start reducing the pace of asset purchases this year," and some said "economic and financial conditions would likely warrant a reduction in coming months." We expect some details to emerge at the upcoming Jackson Hole Economic Symposium later this week. Jerome Powell is set to speak at the (virtual) event this Friday where the topic is "Macroeconomic Policy in an Uneven Economy."

Amazon's Prime Day may be the prime reason retail sales missed expectations in July. The Census Bureau said retail sales fell 1.1% in the month, below the expectations of just a 0.2% decline. Most of the decline could be attributed to a drop in vehicle sales and online sales which declined 4.3% and 3.1%, respectively, in the month. People have had to deal with the shortage of cars due to extreme shortage in semiconductors that are used in vehicles. Many dealership lots are close to empty and Toyota even said last week its production will be 40% lower in September due to the chip shortage. Online sales may have been pulled forward to June as Amazon's Prime Day fell in June and July faced tougher comparisons. In addition, the rollout of the Covid vaccine and reopening of businesses has shifted consumer's shopping habits back to in-store shopping. Bars and restaurants saw the largest increase, with sales growing 1.7% in the month and are now 38% higher than July 2020. Compared to a year ago, retail sales as a whole are 15.8% higher.

Not only are companies profits growing, but revenues are growing as well and companies are reporting revenue growth at a much higher rate than was estimated. So far in the second quarter earnings season, with about 91% of S&P 500 companies reporting to date, 87% of those have beat revenue expectations, which is well above the historical average of about 65% and the highest beat rate since FactSet began tracking the data. In addition, those that are reporting revenue above expectations are beating by 5%, also above historical averages. The revenue growth rate for the second quarter compared to the second quarter a year ago now stands at 24.9%. This compares to a 16.6% growth rate that was expected on March 31 when the quarter started and compared to 19.4% when earnings season start the beginning of July. If the quarter finishes with at least 24.9% revenue growth, that will be the highest revenue growth rate since data began. The record high sales growth can be attributed to a much stronger recovery from the pandemic than expected, base effects from coming off a low point a year ago, and substantial support from the Fed and federal government.

Company News

- The chip shortage continues to weigh heavy on the auto sector. Toyota said last week it plans to cut global production in September by 40% compared to its previous plans due to the shortage of chips. Despite the update, Toyota said it will keep its previous annual sales and production targets in place.
- Target reported second quarter results that exceeded expectations driven by "really strong" traffic in stores, with revenues growing 9.5% and comparable store sales growing 8.9% from the same period a year ago. Margins shrunk 0.5% reflecting higher merchandise and freight costs. Management increased its forecast for 2021 and said it is not seeing a slowdown due to the delta variant.
- Stanley Black & Decker said it will buy the remaining 80% stake in MTD for $1.6 billion. In 2019 Stanley Black & Decker acquired a 20% stake in MTD for $234 million.

The Week Ahead

The calendar this week includes more second quarter earnings reports, several economic data reports, and a much anticipated Fed event. Several more retail companies will report earnings this week. Notable reports include; Best Buy, Advanced Auto Parts, and Toll Brothers on Tuesday, Ulta Beauty, Dick's Sporting Goods, Snowflake, salesforce.com, and Intuit on Wednesday, and Dollar General, Dollar Tree, Gap, and JM Smucker's on Thursday. On the economic calendar we will see a couple housing indicators including the existing home sales report Monday and the new home sales report on Tuesday. Then on Thursday we will see the second revision on second quarter GDP and an update on unemployment benefit claims and ending Friday with the Bureau of Economic Analysis' consumer report on income and spending. The main event for the week will be the Fed's Jackson Hole Economic Symposium (in a virtual format again), where the topic of discussion will be "Macroeconomic Policy in an Uneven Economy." While we do not think we will get an official announcement until its September or November meeting, investors will still be looking for more hints on a taper timeline.