MORNING BRIEFING
January 18, 2024

Shipping, Steel & Solar

Check out the accompanying chart collection.

Executive Summary: With traffic through both the Panama and Suez canals disrupted for different reasons, shippers are shouldering higher costs to go the slow way around the tips of South America and Africa. Impacts could include supply-chain delays, inventory shortages, and inflationary pressures. Jackie reports on the reactions of shippers and companies with goods to ship. … Also: Commodities prices remain depressed by the economic malaise in China and Europe. The price declines are broad-based, although steel's price is up y/y, reflecting strong demand from the rapid construction of US factories by companies capitalizing on government incentives. … And in our Disruptive Technologies segment: Solar innovators compete.

Industrials: Global Trade Under Pressure. For most of the past century and a quarter, global trade has expanded, with new markets opening and shipping volumes increasing. Global export volume has more than doubled from 2000 through October, up 107%, leading to growing revenue for international corporations, falling prices for goods produced in emerging markets, and increased standards of living (*Fig. 1*). Global trade—and its benefits—now face two threats, one from Mother Nature and one from terrorists.

Fresh water stored in an artificial reservoir is used to help guide ships through the Panama Canal, which handles 40% of US container traffic each year. This year, a drought has drained the reservoir's water to record-low levels, limiting the number of ships that can pass through the canal as well as the weight loads each ship can carry without getting stuck. Only 24 ships can pass through the Panama Canal, down from its normal capacity of 40 ships. The country's dry season typically runs from late December to April, so the problem may take time to resolve, and there's no guarantee it won't repeat in future years. Using the Panama Canal on a route from Shenzhen, China to Miami cuts out six days relative to the next best alternative, rounding the tip of South America (35 days using the canal versus 41 otherwise).

Shippers are also facing problems in the Middle East. Yemen-based Houthi rebels recently launched missile and drone attacks on ships sailing through the Red Sea to show support for Hamas in its war with Israel. About 12% of global trade travels via ship through the Red Sea and the Suez Canal because it is the fastest route between Europe and Asia (shortening a trip from Singapore to Rotterdam by ten days versus circumnavigating Africa).

The US and UK responded by striking anti-ship ballistic missiles in rebel-controlled territory, escalating the tensions. They've also put together a coalition to protect shippers in the area, albeit one considered weak because it doesn't include Saudi Arabia, the United Arab Emirates, and Egypt.

While their causes are vastly different, both disruptions are having similar effects: Ships are sailing longer routes to deliver their cargos. The new routes take more time to sail and use more fuel. And ships sailing in the Red Sea face skyrocketing insurance prices. If these conditions persist, companies around the world may have to pass on higher costs to consumers, and inventory shortages and inflationary pressures could result.

Here's a look at how affected companies are responding to the latest disruptions in trade:

(1) *Seeking new routes.* Shippers have begun to respond to the threat of Houthi attacks by opting to bypass the Red Sea and sail around the tip of Africa instead. Shell, BP, and Quatar Energy all suspended all shipments through the Red Sea. Shell feared that a damaged ship could spill massive amounts of oil and put its crew at risk, a January 16 *WSJ* *article* reported. Knutsen LNG's six tankers were instructed to use the longer route instead of sailing through the Red Sea, as were three LNG carriers that transport gas for QatarEnergy, a January 16 *FT* *article* reported. Other shippers are looking at rail routes from China to Europe; but prices for rail also have risen recently, and rail's capacity constraints limit how much of a solution it can be.

Shippers and companies are also looking for alternatives to the Panama Canal. Instead of going through the Panama Canal, Maersk ships with freight from Australia and New Zealand will unload their containers at a Panamanian port, where they'll be sent by rail 80 kilometers across Panama. When they reach the other side of the country, the containers will be reloaded on another ship, which will continue its journey, a January 11 CNBC *article* reported.

Instead of using the Panama Canal, US-based BDI Furniture asked its freight brokers to ship goods across the Pacific Ocean to California and then to transport the goods to its East Coast warehouse via rail. Doing so avoided the jump in Panama Canal shipping rates, a January 10 Reuters *article* reported. California ports have recently seen an uptick in activity (*Fig. 2*).

(2) *Delays expected.* The extra time it's taking to ship goods via routes that avoid the Red Sea or the Panama Canal has started to affect manufacturers with parts and/or materials

that are in transit.

Tiremaker Michelin halted output from four of its Spanish factories for two weekends due to Red Sea related shipping delays, a January 16 Reuters *article* reported. Volvo Cars halted production at its car factory in Belgium for three days this week due to a delayed shipment of gearboxes. Last week, Tesla said it will halt almost all operations at its German plant from January 29 to February 11 due to parts shortages resulting from longer transportation times.

Some shippers are scrambling because rerouted ships are taking longer to return to China. Ships might not make it back to China to take on new loads before the country shuts down on February 10 for the Lunar New Year holiday, which can last two weeks to a month. Products that should be on retailers' shelves in April or May may not arrive on time.

"Europe's Aldi Nord said it may receive items like household goods, toys and decorations later than planned, and is postponing the advertising of specific products as a result," the January 10 Reuters article stated.

(3) *Shipping prices mixed.* Shippers say they're hiking prices because their ships are traveling longer distances, which increases labor and fuel expenses. Rerouting a ship around Africa instead of sending it through the Suez Canal adds $1 million in fuel costs for just one leg of the voyage, a January 12 Reuters *article* estimated. The longer routes also increase the number of ships that companies need to move the same amount of cargo. So the disruptions in Panama and the Red Sea are shrinking the excess capacity in the shipping industry.

Ships that do brave the Red Sea face war risk insurance premiums that reportedly have risen to around 1.0% of the value of a ship, from around 0.7% last week, and are expected to move higher. "This translates into hundreds of thousands of dollars of additional costs for a seven-day voyage," a January 16 Reuters *article* reported. And if the US-led coalition protecting the area is unable to prevent further attacks, war insurance may become unavailable, which would force all ships to take the longer route around Africa, Morningstar research cited by Reuters said.

Shipping prices are rising most dramatically on routes affected by the Middle East hostilities and more modestly on routes affected by the drought in Panama, while prices on routes unaffected by either disruption are flat or down slightly.

More specifically, for the week ended January 11, the price to ship a 40-foot container increased 15%, on average, according to the *Drewry Composite Index*. Prices for shipping between Asia and Europe, normally routed through the Red Sea, rose the most: up 23% between Shanghai and Rotterdam and 25% between Shanghai and Genoa. Shipping normally routed through the Panama Canal rose more moderately, e.g., by 8% between Shanghai and New York. Shipping rates on undisrupted routes were about flat: up 1% between New York and Rotterdam, up 2% from Shanghai to Los Angeles, and actually down 1% from Los Angeles to Shanghai.

Materials: Commodities' Tough Start. Last year's downward trend in commodities prices has continued in the new year, as Chinese and European economies have remained sluggish. The Chinese economy expanded by 5.2% in Q4, its slowest pace of rise since 1990 excluding the years it was impacted by Covid shutdowns (*Fig. 3*). Meanwhile, the Eurozone's economic growth barely remained in positive territory, rising 0.1% in Q3 y/y (*Fig. 4*). Commodities prices don't indicate that upturns are imminent in either economy. Here's a quick look at where things stand as the new year begins:

(1) *Broad-based declines.* The CRB spot commodity price index has fallen 21.4% since hitting its peak in May 2022, and it's down 9.5% y/y and 0.8% ytd (*Fig. 5*). The declines are so broad based that it's easier to say which commodity prices have risen over the past year than which have fallen. Among the commodities we track, steel and gold are the only two with price changes in positive territory over the last year, up 48.0% and 6.3%, respectively.

Here's the performance derby for some of the commodities we track for the one-year period ended Tuesday: cotton (-1.2%), silver (-4.6), crude oil (-7.3), copper (-10.5), natural gas (-15.2), platinum (-15.9), gasoline (-16.2), aluminum (-16.7), soybeans (-20.2), wheat (-21.8), diesel (-23.4), corn (-34.3), palladium (-46.2), and lumber (-64.3) (*Fig. 6* and *Fig. 7*).

The ytd results aren't much sunnier. Energy-related products are up, helped by the cold weather in the US and the shipping disruptions in the Middle East; but elsewhere, prices have continued to slide as the year begins.

Here's the performance derby for commodity prices we track ytd through Tuesday's close: natural gas (15.4%), diesel (2.8), crude oil (1.6), gasoline (0.9), cotton (0.4), gold (-1.4), copper (-2.9), silver (-3.1), soybeans (-5.1), steel (-5.5), corn (-5.9), wheat (-7.3), aluminum (-7.8), platinum (-10.0), and palladium (-15.6) (*Fig. 8*).

(2) *Steel's strength.* The rising price of steel over the past year stands out compared to the

falling prices of most other commodities. Steel demand may have benefitted from the construction of new factories in the US, encouraged by government incentives to lure semiconductor manufacturers and others back to our shores.

The end of the US autoworkers' strike and the relatively robust sales of new cars despite higher interest rates may have contributed to strong steel prices as well. And lastly, the Trump-imposed tariffs that remain in place on steel imported from China have helped insulate the US from the overcapacity in the Chinese steel market.

US steel manufacturers' stock prices have received a boost from M&A activity. Nippon Steel agreed last year to a cash purchase of US Steel for $14.1 billion. The Japanese company beat out a rival bid from Cleveland Cliffs, but the deal still faces a national security review. The performances of steel stocks are mixed over the past year through Tuesday's close: US Steel (68.0%), Nucor (10.1), Steel Dynamics (1.3), and Cleveland-Cliffs (-13.6).

Nucor and Steel Dynamics are the only companies of the bunch that are members of the S&P 500 Steel industry. Analysts estimate that industry constituents' collective revenue will drop 6.1% this year and 1.3% in 2025 as earnings tumble 29.8% this year and 6.4% next year (*Fig. 9* and *Fig. 10*). The industry's forward P/E, at 12.7, is in the middle of its historical range over the past 20 years (*Fig. 11*).

Disruptive Technologies: Competing Solar Innovators. The Department of Energy is running a contest to encourage the development of new ideas in the solar industry. Twenty teams have advanced to the next stage of the Solar Prize competition and will turn their plans into a proof of concept, stated a January 11 *press release* from the National Renewable Energy Laboratory. Winners of the next round will develop a prototype and choose a pilot partner. At each stage, winners receive funding to continue their work.

Here are some of the most interesting ideas proposed by the winning teams:

(1) *Harnessing robotics.* Carports with solar panels on the roof are not new. But PowerMe is proposing a solar carport built using 3D concrete printing that will reduce costs, making it suitable for low- and moderate-income communities. Meanwhile, Gritt Robotics has converted off-the-shelf construction equipment into artificial intelligence-equipped robots used to automate and accelerate the construction of utility-scale solar projects.

(2) *Solar in transportation.* Developers are looking for new ways to use solar energy in transportation. Icon Energy is developing a "compact power converter for trucks to utilize

solar power for auxiliary systems, such as heating and cooling." A solar panel will be installed on the truck's roof. Meanwhile, Voltic Shipping is developing a foldable, rotatable, and retractable solar panel system that can power canal, lake, and marine cargo ships.

(3) *Helping at the solar farm.* Solar Unsoiled is developing software that creates optimized cleaning schedules for solar panels in large solar farms. Clean solar panels can produce more energy and require less maintenance than dirty panels. Keeping Solar Plants Green won for a robotic arm that kills weeds and other unwanted plants growing around solar panels on solar farms, which can reduce the panels' efficiency. The arm uses a light that disrupts photosynthesis.

Calendars

US: Thurs: Housing Starts & Building Permits 1.439mu/1.470mu; Initial Claims 207k; Philadelphia Fed Manufacturing Index -8.0; Natural Gas Storage; Crude Oil Inventories & Gasoline Production; Bostic. **Fri:** University of Michigan Consumer Sentiment Index 69.6; Existing Home Sales 3.82mu; Baker-Hughes Rig Count. (FXStreet estimates)

Global: Thurs: Eurozone Inflation Expectations; Eurozone Economic Sentiment 21.9; Germany ZEW Economic Sentiment 12.9; Germany CPI 0.1%m/m/3.7%y/y; Italy CPI 0.2%m/m/0.6%y/y; UK Unemployment Rate 4.2%; UK Claimant Count Change 18.1k; UK Average Earnings Including Bonus 6.9%; China GDP 5.2%y/y; China Industrial Production 6.8%y/y; China Retail Sales 8.1%y/y; China Unemployment Rate 5.0%; NBS Press Conference; ECOFIN Meetings; Nagel; Bailey. **Fri:** Germany PPI -0.5%m/m/-7.9%y/y; UK Headline & Core Retail Sales -0.5%m//1.1%y/y & -0.6%n/n/1.3%y/y; Lagarde; McCaul. (FXStreet estimates)

Strategy Indicators

Stock Market Sentiment Indicators (***link***): The *Bull-Bear Ratio* slipped for the second week to 2.54 this week from 3.32 two weeks ago—which was the highest since early August 2021. *Bullish* sentiment sank 8.6ppts (to 48.5% from 57.1%) over the two-week period to its lowest percentage since the week of October 31. Two weeks ago, the report urged caution when bullish sentiment reached 57.1%—equaling the late July 2023 peak. Meanwhile, *bearish* sentiment edged higher for the second week by 1.9ppts (to 19.1% from

17.2%), posting its lowest percentage since the summer of 2021 two weeks ago. The *correction count* climbed for the third week to 32.4% (the highest since early October) from 25.0% three weeks ago. Turning to the *AAII Sentiment Survey* (as of January 11), the short-term outlook for stocks was flat in the latest survey, while pessimism increased and neutral sentiment was little changed. The *percentage expecting stock prices to rise over the next six months* was unchanged at 48.6%, above its historical average of 37.5% for the 10th successive week, and the 11th time in 14 weeks. The *percentage expecting stocks to fall over the next six months* increased 0.7ppts to 24.2%, below its historical average of 31.0% for the 10th straight week. The *percentage expecting stock prices will stay essentially unchanged over the next six months* decreased 0.7ppts to 27.2%, remaining below its historical average of 31.5% for the sixth successive week and the 14th time in the past 15 weeks.

S&P 500 Earnings, Revenues, Valuation & Margins: The S&P 500's forward profit margin was unchanged w/w at 12.7% during the January 11 week, and is now just 0.1pt below its 11-month high of 12.8% during the September 21, 2023 week. That's up from a 24-month low of 12.3% during the March 30, 2023 week, but is down 0.7pt from its record high of 13.4% achieved intermittently in 2022 from March to June. It's now 2.4pts above its seven-year low of 10.3% during April 2020. Forward revenues ticked down 0.1% w/w from a record high. Forward earnings dropped 0.2% w/w from its first record high in four weeks. It had hit that mark during the September 21 week for the first time since the June 16, 2022 week. Revenues and earnings had been steadily making new highs from the beginning of March 2021 to June 2022; prior to that, they peaked just before Covid-19 in February 2020. The consensus expectations for forward revenues growth dropped 0.1pt to 5.0% from a 15-month high of 5.1% and is now up 2.7pts from its 33-month low of 2.3% during the February 23, 2023 week. That's down from a record high of 9.6% growth at the end of May 2021 and compares to 0.2% forward revenues growth during April 2020, which was the lowest reading since June 2009. The forward earnings growth forecast dropped 0.1pt w/w to 11.4% from a 26-month high of 11.5%, and is now 7.9pts above its 31-month low of 3.5% in mid-February. That's down from its 23.9% reading at the end of April 2021, which was its highest since June 2010, and up substantially from its record low of -5.6% at the end of April 2020. Analysts expect revenues to rise 2.0% in 2023 (unchanged w/w) and 4.9% in 2024 (unchanged w/w) compared to a revenues gain of 12.5% in 2022. They expect an earnings gain of 1.4% in 2023 (down 0.1pt w/w) and a 10.8% rise in 2024 (down 0.1pt w/w) compared to an earnings gain of 6.8% in 2022. Analysts expect the profit margin to fall 0.1ppt y/y to 11.9% in 2023 (unchanged w/w), compared to 12.0% in 2022, and to rise 0.7ppt y/y to 12.6% in 2024 (unchanged w/w). The S&P 500's weekly reading of its forward P/E rose 0.4pt w/w to 19.7, and is just below its 17-month high of 19.8 during the July 20 week. That's still up from a 30-month low of 15.3 in October of 2022. It also compares to 23.1 in early September 2020, which was the highest level since July 2000, and to a 77-month low of 14.0 in March 2020. The S&P 500 weekly price-to-sales ratio rose 0.04pt w/w to 2.50. That's just below its 20-month high of 2.51 during the December 28 week and is up from a six-month low of 2.22 during the October 26 week. That compares to a 31-month low of 1.98 in October 2022. That also compares to a record high of 2.88 at the end of 2021 and a 49-month low of 1.65 in March 2020.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins: Looking at the S&P 500 sectors, the January 11 week saw consensus forward earnings rise for three of the 11 sectors and forward revenues rise for six sectors. The forward profit margin moved higher for four of the 11 sectors. None of the 11 sectors have forward revenues at post-pandemic or record highs this week. That's down from these three sectors in that club a week earlier: Communication Services, Health Care, and Information Technology. Among the remaining eight sectors, just three have forward revenues more than 5.0% below their post-pandemic highs: Energy, Financials, and Materials. Utilities is the only sector with forward earnings at a record high this week. A week earlier, these three sectors had forward earnings at a record high: Communication Services, Consumer Staples, and Information Technology. Among the remaining seven sectors, only Energy and Materials have forward earnings down more than 10.0% from their post-pandemic highs, while Financials exited that club in early October. Among the 11 sectors, only Industrials has weathered a broad margin retreat from post-pandemic or record highs. Now nearly all of the sectors are showing signs of recovering from their early 2023 lows, and their recent stalling appears to be ending. Consumer Discretionary is the only sector with its forward profit margin at a record high this week. That compares to three sectors in that club during the past three months, which also included Industrials and Information Technology at that time. The forward profit margin of Communication Services also remains close to its post-pandemic high. Energy's is deteriorating again, while those of Consumer Staples and Health Care remain at or close to their record lows. Energy and Industrials were the only two sectors to have their profit margins improve y/y for full-year 2022. The annual profit margin is expected to be flat y/y in 2023 for Consumer Staples, but these six sectors are expected to see their margins improve: Communication Services, Consumer Discretionary, Financials, Industrials, Information Technology, and Utilities. Here's how the S&P 500 and its 11 sectors rank based on their current forward profit margin forecasts along with their record highs: Information Technology (25.8%, down from its 26.0 record high in December 2023), Financials (18.4, down from its 19.8 record high in August 2021), Real Estate (16.5, down from its 19.2 record high in 2016), Communication Services (16.6, down from its 17.0 record high in October 2021), Utilities (13.5, down from its 14.8 record high in April 2021), S&P 500

(12.7, down from its record high of 13.4 achieved intermittently in 2022 from March to June), Energy (10.7, down from its 12.8 record high in November 2022), Materials (10.9, down from its 13.6 record high in June 2022), Industrials (10.6, down from its record high 10.8 in September 2023), Health Care (8.9, a record low and down from its 11.5 record high in February 2022), Consumer Discretionary (8.4, a record high this week), and Consumer Staples (6.8, down from its 7.7 record high in June 2020).

US Economic Indicators

Retail Sales (*link*): Consumers keep shopping! *Total retail sales* beat expectations in December, climbing 0.6% (vs 0.4% expected), rising for the eighth time in nine months by a total of 4.1% to yet another new record high. Meanwhile, sales in the *control group*—which excludes autos, gasoline, building materials, and food services—rose 0.8%, versus 0.4% expected. This measure correlates closely with the consumer spending component in GDP. Of the *13 nominal retail sales categories*, eight rose in December while four declined and sales at food services & drinking places was unchanged: Here's a snapshot of the 13 categories' *December sales performance versus that of a year ago*: nonstore retailers (1.5 & 9.7), clothing & accessories stores (1.5 & 4.3), general merchandise stores (1.3 & 3.3), motor vehicles & parts (1.1 & 10.3), miscellaneous store retailers (0.7 & 6.9), building materials & garden equipment (0.4 & -2.3), sporting goods & hobby stores (0.3 & 0.9), food & beverage stores (0.2 & 1.3), food services & drinking places (0.0 & 11.1), electronics & appliance stores (-0.3 & 10.7), furniture & home furnishings (-1.0 & -4.7), gasoline stations (-1.3 & -6.6), and health & personal care stores (-1.4 & 10.7).

Business Sales & Inventories (*link*): Nominal business sales in November was fractionally below September's record high, while real business sales in October was unchanged at its record high. *Nominal business sales* edged up 0.2% in November after falling 1.1% in October, climbing back within 0.9% of September's record high. In the meantime, the real inventories-to-sales ratio was at 1.55 in October for the third month, down from 1.57 in March and April—which was the highest since mid-2020, though up from a recent low of 1.43 in fall 2021. Meanwhile, the nominal ratio remained at 1.37, below the 1.40 registered in the months from March through June—which was the highest since the mid-2020s.

Industrial Production (*link*): Production eked out a small gain in December, led by improvements in both manufacturing and mining. *Headline production* ticked up 0.1% (vs expectations of no change), following a downward revision of no change in November from the preliminary estimate of a 0.2% gain. Overall production remains within 0.8% of last

September's cyclical high and within 1.6% of the August/September 2018 record high. *Manufacturing* production ticked up 0.1% in December, following a 0.2% gain and a 0.8% loss the prior two months, as gains of more than 1.0% in both motor vehicles & parts and furniture and related products more than offset declines in other components. *Excluding motor vehicles & parts*, manufacturing production ticked down 0.1%. Meanwhile, mining output remains on a steep upward trend, though has weakened a bit in recent months; but it's still within 3.2% of its September 2019 record high. Utilities output remains in a volatile flat trend near the middle of its range, falling 3.6% over the past four months. By *market group, consumer durable goods* production rebounded 4.1% during the two months through December, after a 5.4% drop in October, driven by a 7.5% surge in automotive products as the auto workers' strike ended. *Business equipment* production remains in a volatile flat trend, though is near the bottom of the range, showing no change ytd. Production of information processing (3.0%) and transit (3.0) equipment are showing gains ytd, while industrial & other equipment (-2.1) remains in the red.

Capacity Utilization (*link*): The *headline* capacity utilization rate was unchanged at 78.6% in December after slipping to 78.7% in October from 79.5% during each of the prior two months; it peaked recently at 80.8% last September. December's rate is 1.1ppts below its long-run (1972-2022) average. The *manufacturing* utilization rate remained at 77.1% after falling to a 21-month low of 77.0% in October. It's currently 1.1ppts below its long-run average. It peaked at 79.9% last spring. Meanwhile, the *mining* utilization rate remains on a steep uptrend, holding just below September's 94.4%; it clocked in at 93.8% in December—7.4ppts above its long-run average. Meanwhile, the *utilities* rate remains on a volatile downtrend, falling to 70.0%—not far from February's record low of 69.6%. The utilities rate is substantially below its long-run average.

NAHB Housing Market Index (*link*): Confidence among US homebuilders climbs as mortgage rates fall; it now has advanced for a second month, from 34 in November to 44 this month, exceeding expectations that it would reach 39. All three components of the housing market index (HMI) improved in January: future sales (+12 points to 57), current sales (+7 to 48), and traffic of prospective buyers (+5 to 29). "Mortgage rates have decreased by more than 110 basis points since last October, lifting the future sales expectation component into positive territory for the first time since August," noted Robert Dietz, NAHB's chief economist. (Any reading below 50 is considered negative.) While optimism has picked up among homebuilders, NAHB notes that the housing market is facing new headwinds in the form of higher prices and shortages of labor and lumber. According to the report, 31% of homebuilders reported cutting prices this month, with an average price reduction of 6%, down from 36% in December—though the size of the rate reduction held steady. Overall, 62% of builders reported providing sales incentives, hovering between 60% and 62% since October.

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