Market Commentary: The Effects of Onshoring on the US and Its Consumers

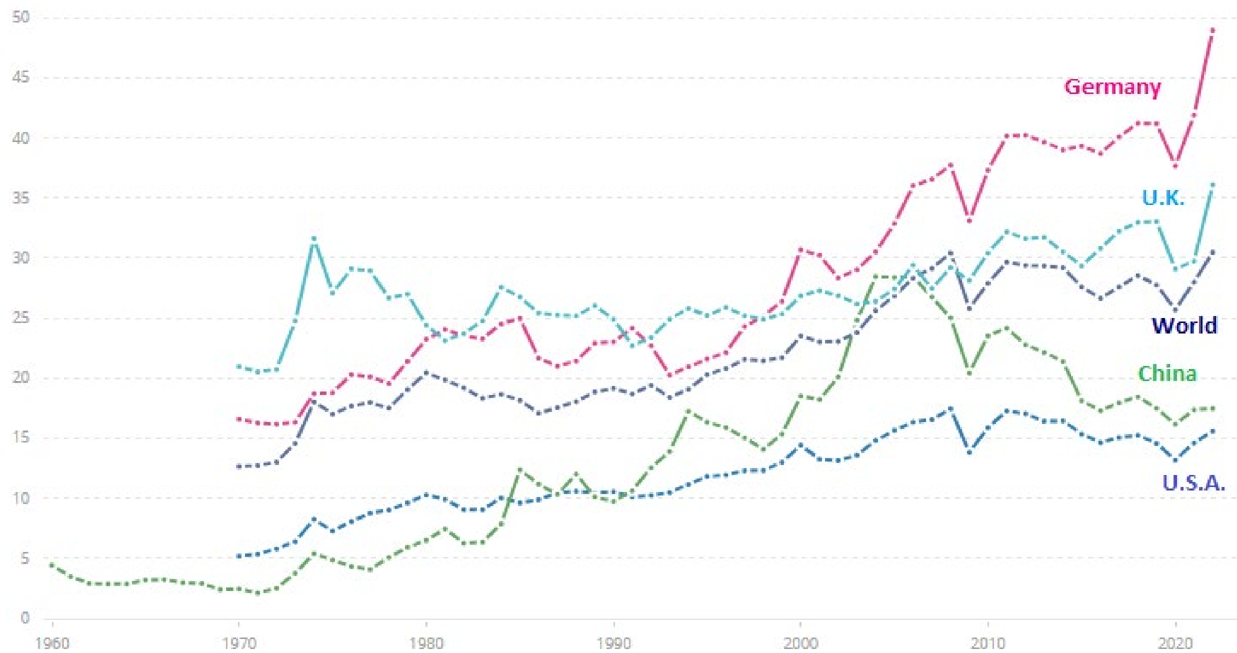
March 2024

We are a consumer-led economy. And boy, do we do a good job consuming! As of 2022, the United States consumed roughly $18 trillion of goods and services, representing ~32% of global consumer spend[1]. That makes America a primary export market for the world. However, given the broad strokes of (1) supply chain disruptions and (2) an increasingly bellicose geo-political environment, it feels like policy makers and citizens alike agree[2] that onshoring[3] its goods and services is a worthy consideration.

What does this shift in sentiment actually mean for our collective pocketbooks? Does the move away from Chinese goods, along with the supply chain disruption experienced, spell risk (e.g., inflation) or opportunity (e.g., US investment; jobs)?

One may be surprised to learn that despite our impressive spend, imports of goods and services are relatively low as a % of GDP compared to the world.

Imports of Goods and Services (% of GDP)[4]



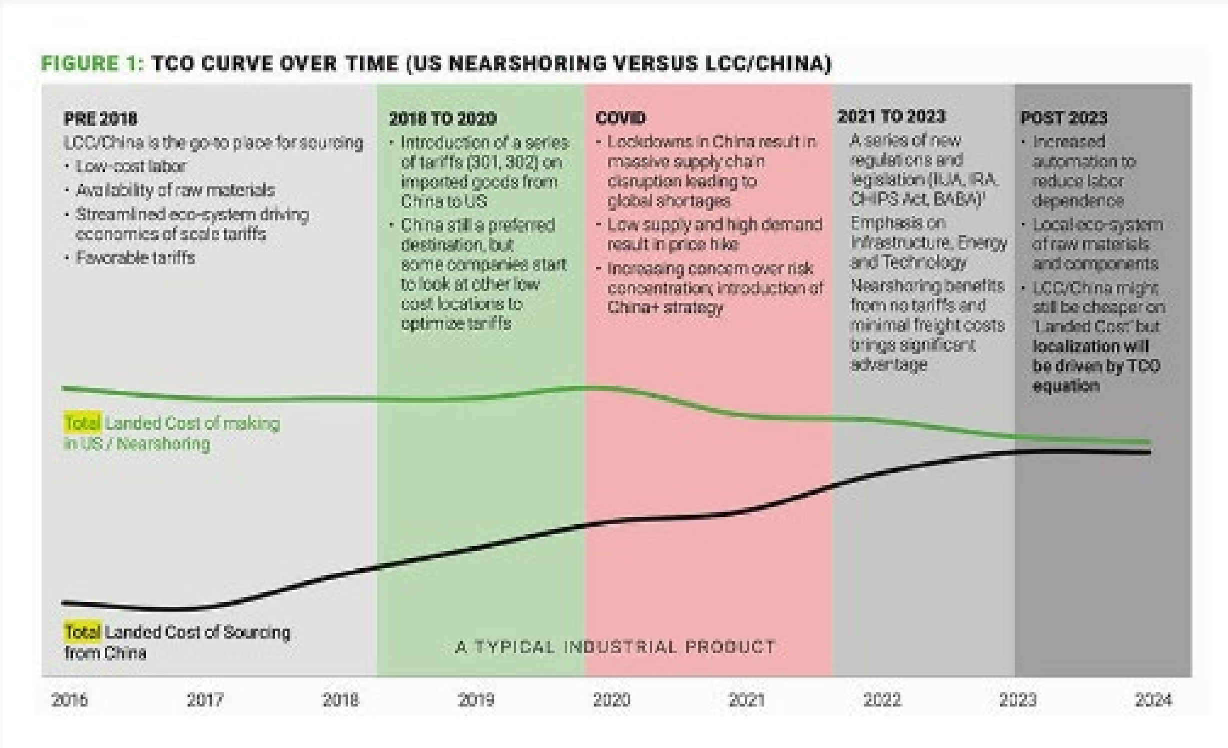
[1] The World Bank: data.worldbank.org: Households and NPISHs final consumption expenditure (private consumption)

[2] Bipartisan agreement? Citizens, Democrats and Republicans all on the same page!? Yes. It is possible.

[3] "Onshoring" means to bring back manufacturing and production to the U.S. "Nearshoring" means to bring back manufacturing and production to the region – primarily Mexico and Canada, who are top trading partners of the U.S.

[4] Imports of goods and services (% of GDP) - United States, China, World, Germany, United Kingdom | Data (worldbank.org)

Maybe even more surprising is that the US is quite competitive when comparing the total cost of manufacturing and getting a product to its end market. This last point was the main topic of the conversation I recently had on our Investment Wars Podcast titled "[How Strong is the Trend Towards Reshoring of Manufacturing](#)[5]" with our guest Chris Semenuk – a worthwhile listen!



Markedly rising wages in China, increasing use of automation in the U.S., and new trade policies have reduced the total cost gap between Asian production and near-shoring to almost zero.[6]

Tailwinds for increased onshoring is now coming from two directions. First, our government is increasingly getting involved in encouraging this trend due to global geopolitics heightening concerns about reliance on foreign production partners. Second, companies are coming to their own natural conclusions based on efficiencies and the bottom line that perhaps a move back to the US or, at least closer ("nearshoring") is an optimal solution.

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[5] Investment Wars: 14. How Strong Is the Trend Towards Reshoring of Manufacturing? on Apple Podcasts

[6] Reshoring Unpacked: A Transformational Shift From Global To Local - STI/SPFA (stispfa.org)

Government Actions

- **The Infrastructure Investment and Jobs Act**[7] provides $1.2 trillion in spending, allocated over the next 5 years, with the goal to materially shore up and increase our country's infrastructure. The big picture takeaway is that it creates more robust supply chain and logistic infrastructure, while also creating efficiencies for individuals through enhanced public transportation and internet. The Act also seeks to provide resiliency to our infrastructure for a variety of reasons.
- **The CHIPS Act** was signed into law on August 9, 2022, to strengthen domestic semiconductor manufacturing, design, and research, while fortifying the economy and national security by investing roughly $280 billion on R&D, commercialization, and manufacturing.
- **The 2022 Inflation Reduction Act** budgets roughly $370 billion in energy security and climate change. The US is now the largest energy producer in the world. This act assists in ensuring that we remain primarily energy independent while maintaining our cutting edge from a technology standpoint – and reduce emissions at the same time. The "Inflation" title is primary due to the goal of allowing for more efficient, cleaner energy, but also initiatives surrounding taxing larger corporations (15% corporate minimum tax) and providing Medicare more negotiating power over pricing. At the least, it was a good marketing name for the Act during a period of high inflation.

Semiconductors – Oil Equivalent of the 21st Century

Semiconductors have taken on the strategic importance of energy given the reality that literally everything we use contains chips. Your kitchen, car, tv, Wi-Fi. Our government's military vehicles, drones, and the list goes on. Wide ranging issues with semiconductors would effectively stop our lives as we know it – think a blackout or Covid in regard to the effect on human productivity. Therefore, semiconductors are of extreme strategic importance to every country.

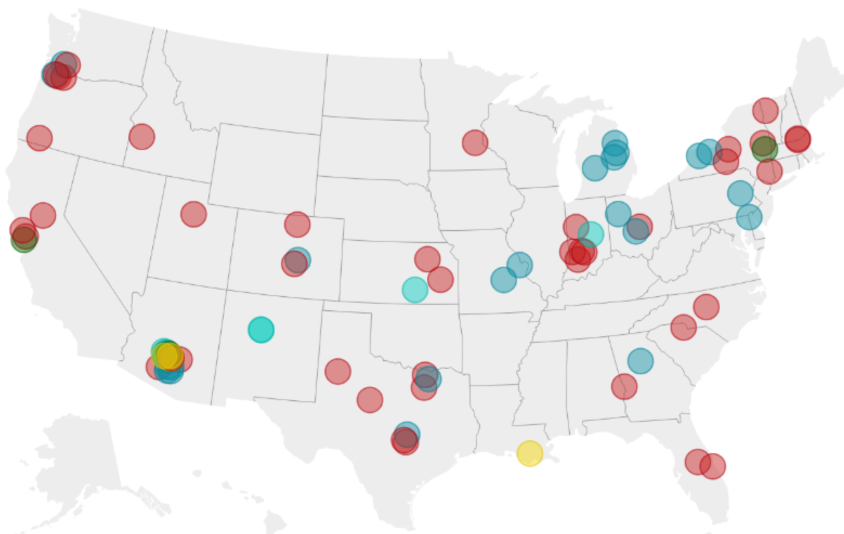
Meanwhile, there is one company[8] in the world that creates the machines that further build machines with the capabilities to create a semiconductor chip with transistors smaller than a covid molecule. And the most advanced manufacturer of those chips with tiny transistors with incredible capabilities is in Taiwan – not the safest location given China-US-Western relations.

[7] Fact Sheet: The Bipartisan Infrastructure Deal | The White House; Infrastructure Investment and Jobs Act | EY - US
[8] ASML | The world's supplier to the semiconductor industry

The CHIPS Act in Action

Semiconductor supply chain manufacturing investments announced from May 2020 to March 2024

Equipment Materials Packaging R&D Facility Semiconductors



Source: Semiconductor Industry Association analysis • Created with Datawrapper [9]

The CHIPS Act swung into action to allow the US the required capabilities to research and manufacture chips onshore. The chart above represents $300+ billion in local investment which is expected to add at least 50,000 high paying jobs to the US economy.[10]

A fantastic, very readable book on the subject is [Chip Wars by Chris Miller.]

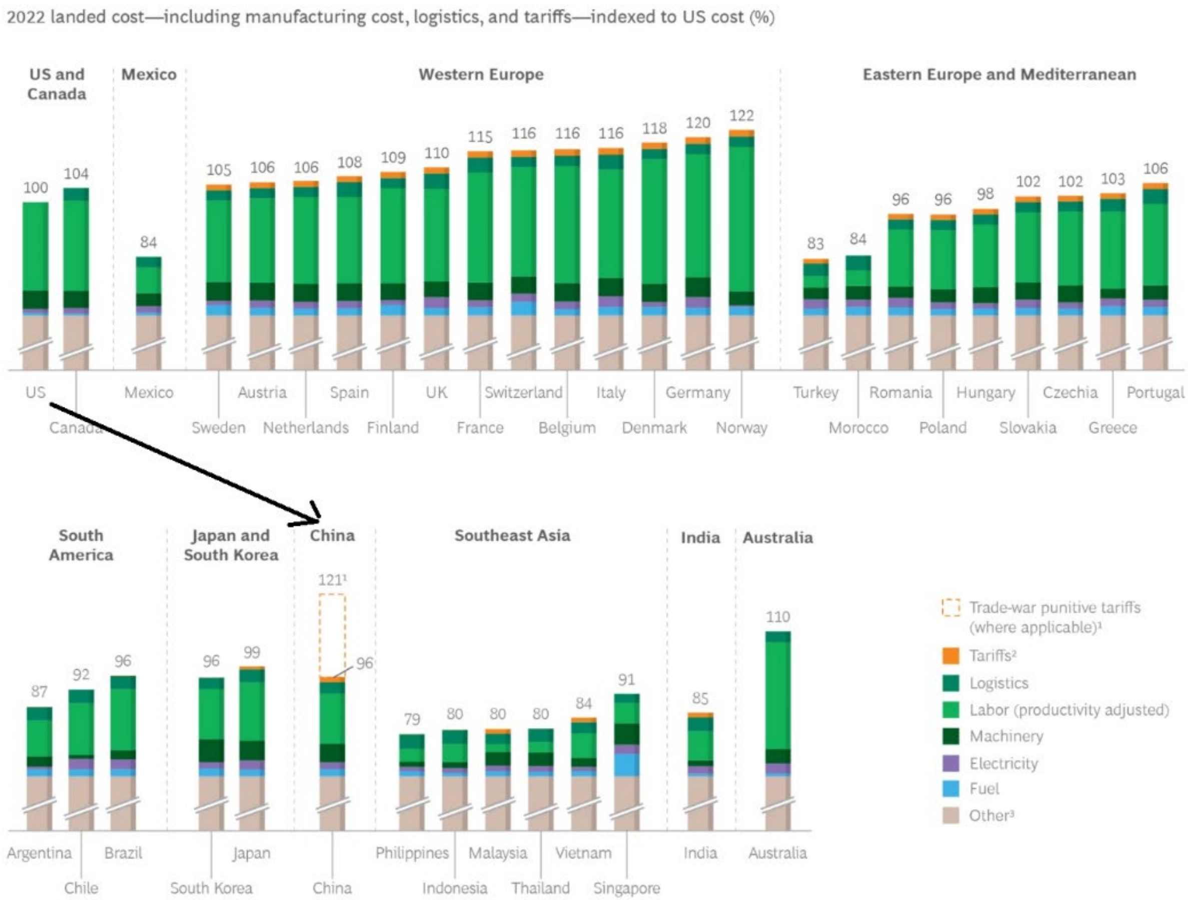
Manufacturing: A Real Awakening

The concept of total cost of ownership, also known as "landed costs" as highlighted in the following chart, highlights that there is an actual cost premium in producing in China vs the US. Mexico, a nearshoring opportunity, still holds a discount of roughly 15% - which we would expect to narrow over the next few years. When considering all of the relevant data, the math increasingly favors shifting manufacturing back to the States.

[9] The CHIPS Act Has Already Sparked $300 Billion in Private Investments for U.S. Semiconductor Production - Semiconductor Industry Association (semiconductors.org)

[10] The CHIPS Act Has Already Sparked $300 Billion in Private Investments for U.S. Semiconductor Production - Semiconductor Industry Association (semiconductors.org)

Landed Cost Competitiveness for Goods Shipped to the US



Sources: World Bank; US Census Bureau; World Trade Organization; US Bureau of Labor Statistics; EnerData; Economist Intelligence Unit; International Labor Organization; International Federation of Robots; Drewry; National Bureau of Statistics of China; BCG analysis.

[1] Refers to US Code §301 tariffs on Chinese imports; graph displays maximum value of 25%.

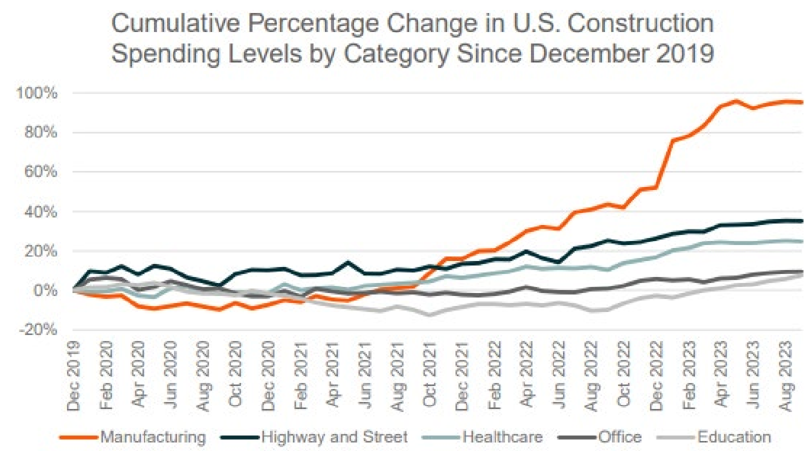
[2] Includes WTO, most favored nation, and preferential tariffs. Excludes anti-dumping, countervailing duties, and all safeguard tariffs except US trade-war tariffs on China.

[3] Includes materials, capital expenditures on facilities, taxes, and other operating expenses.

[11]

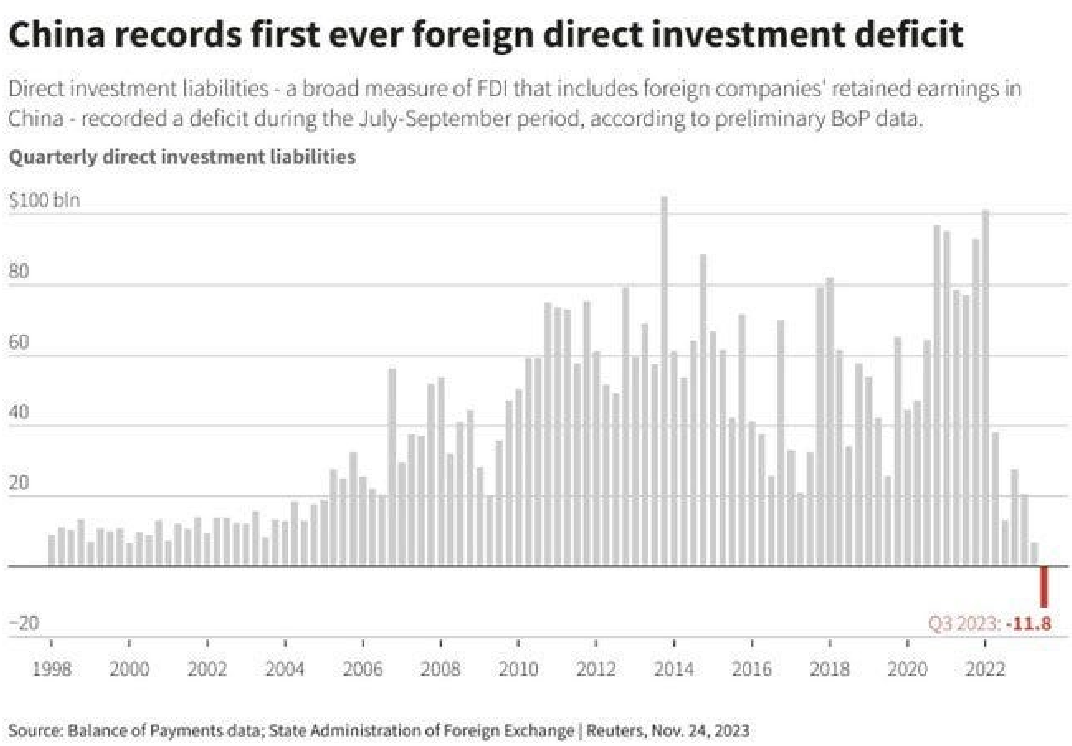
Between the math above and the aforementioned government acts, manufacturing construction has increased dramatically:

[11] Harnessing the Tectonic Shifts in Global Manufacturing | BCG



[12]

Which is basically a polar opposite in comparison to foreign direct investment in China as highlighted in our [November Market Commentary](#):



While we cannot directly connect these data points, total cost of ownership is only a portion of the decision tree leading to whether one shuts down an international factory in favor of building a new local one. These are data points supporting this narrative.

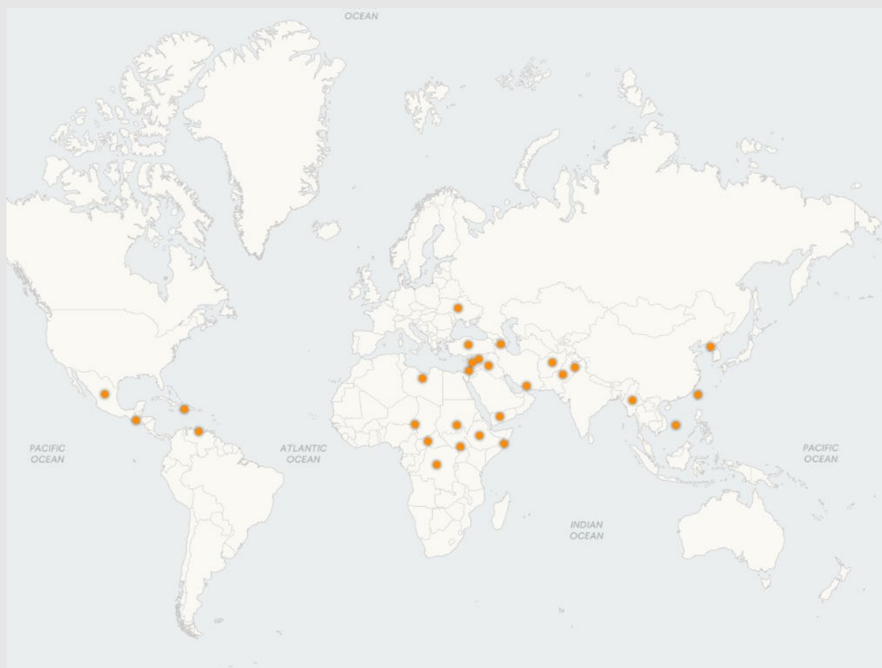
[12] Global X; sourced from the US Census Bureau

Provoking Perspectives: Ubuntu Philosophy – Can we all just get along!?

Pascah Mungwini, a prominent African Philosopher: "***Ubuntu is rooted in the realization that 'human beings must assume the responsibility of creating a humane environment within which they exist together.'***"

Conflict has been an unfortunate reality from at least the time that humans shifted from hunter/gatherer to agrarian organization. There have been notable shifts in populations dead-set on killing other populations prior to finding a path to long term, meaningful, peaceful coexistence. Examples include Germany and Japan after World War II, and Rwanda after the genocide of the minority Tutsi population at the hands of the Hutu.

The map to the right illustrates global conflicts tracked by the Council on Foreign Relations.[13] Using the link in the footnote, one can click on the dots to review details of the highlighted conflict.



Can Ukrainians and Russians coexist in the future? How about Israelis and Palestinians in the West Bank and Gaza?[14]

Ubuntu philosophy, whose roots are in Africa, was instrumental in allowing members of the Hutu and Tutsi tribes in moving on from the genocide in Rwanda. It is yet another tool / philosophy to perhaps assist in tamping down conflict on local, regional, national and government levels.

While geopolitical tensions have been rising steadily, there are always off-ramps.

This deep thought is borrowed heavily from: "African Thought Can Rescue Western Philosophy".[15]

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[13] Global Conflict Tracker I Council on Foreign Relations (cfr.org)

[14] As opposed to the 20% of Israeli citizens and permanent residents who are Arab (and primarily Muslim) and identify as either Israeli, Palestinian, or both, and live in reasonable harmony with Jewish Israelis.

[15] African thought can rescue Western philosophy | Emmanuel Chiwetalu Ossai and Lloyd Strickland » IAI TV

The combination of government and corporate initiatives should allow for additional goods and services to be manufactured and delivered in the US. Therefore, US consumers should be fine as should the economy! However, there are still a number of risks worth flagging:

- **Labor capacity**: We are in an era of tight labor already. What happens when all these new jobs come online? Can we see labor inflation, which will lead to general inflation? Or will some combination of shifts in immigration policy, an increase in fertility rates (unlikely) or robots fill in the gap of anticipated needed workers? (This is a topic discussed in our podcast episode titled "Will Robots Take over the World?[16]")
- **Globalization**: Globalization is more than simply the sourcing of the cheapest product. It is the exchange of ideas and innovations. Ultimately, human civilization has been built on the backs of the generations above us (thank you parents and grandparents). We have 8 billion humans inhabiting the world with many making iterative or huge leaps in knowledge or invention that will help us all. An interconnected world, exchanging ideas, products and the like is way better than an all out for themselves mentality.
- **Isolationism**: The world is simply too small to believe isolation works. Japan tried it. China tried it. The US, given the luxury of its geography, has tried it. Evil will always find the isolationists and the lack of the exchange of ideas makes a country dull. I for one believe strongly in the moral fiber of this country and believe it should contribute (appropriately) given its position in the world.

In summary, government initiatives combined with the math favoring corporations to increasing onshoring, or at least nearshoring, should result in a boon for our economy which should translate to positive market performance over the longer term. As always, there are risks, such as a labor shortage which can result in inflation, or risks in execution. But overall, we view this trend as a real positive.

Market Highlights

The rally in equities that began 2024 continued in March, with all three major US indices managing to close higher. Officially one quarter into the year, the start of 2024 has been eerily similar to the start of 2023. Recall that at this time last year two regional banks had gone under, inflation was a concern, and markets were calling for the Fed to cut rates towards the end of the year due to an expected decline in the economy (with arguments abounding concerning "soft" or "hard" landings).

Regional banks continue to remain under pressure[17], the market still expects the Fed to cut rates though the economy has remained quite robust despite the vast majority of prognosticators in 2023 and inflation is still a concern, albeit much less of one since those early days of 2023.

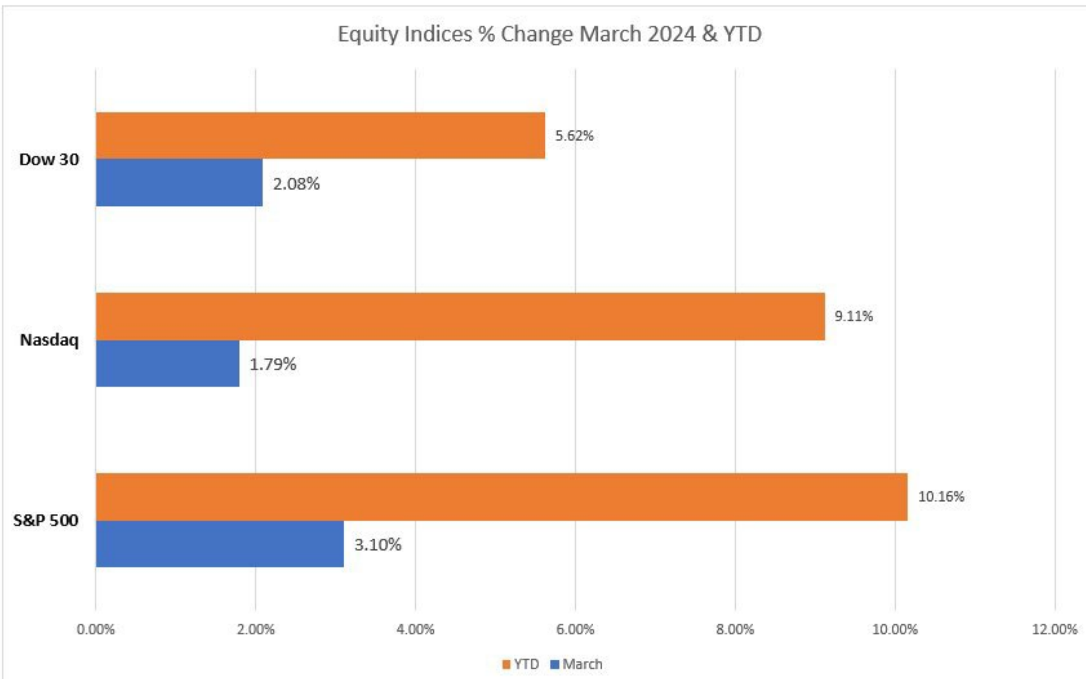
While there are similarities, there are also key differences - the most evident, and probably the most insightful being that the Nasdaq is not leading the charge. The rally to start 2023 was a tech driven rally, the Nasdaq had already posted double the returns of the blended S&P 500 by the end of March (even as banks were failing). This year however, the rally has been more "broad based" in that

[16] Investment Wars: 15. Will Robots Take over the World?! on Apple Podcasts

[17] And now New York Community Bancorp, which acquired assets of Signature bank, one of the regional banks that went under, is struggling.

the major indices are not being driven up or down by just the performance of the technology sector. Another important key difference to note is that in March of 2023, markets were still in the process of digesting the swift rise in interest rates from 0% to 4.75%. Since then, the Fed has only hiked rates on two occasions, allowing markets more time to react and digest life and investing in a higher rate environment.

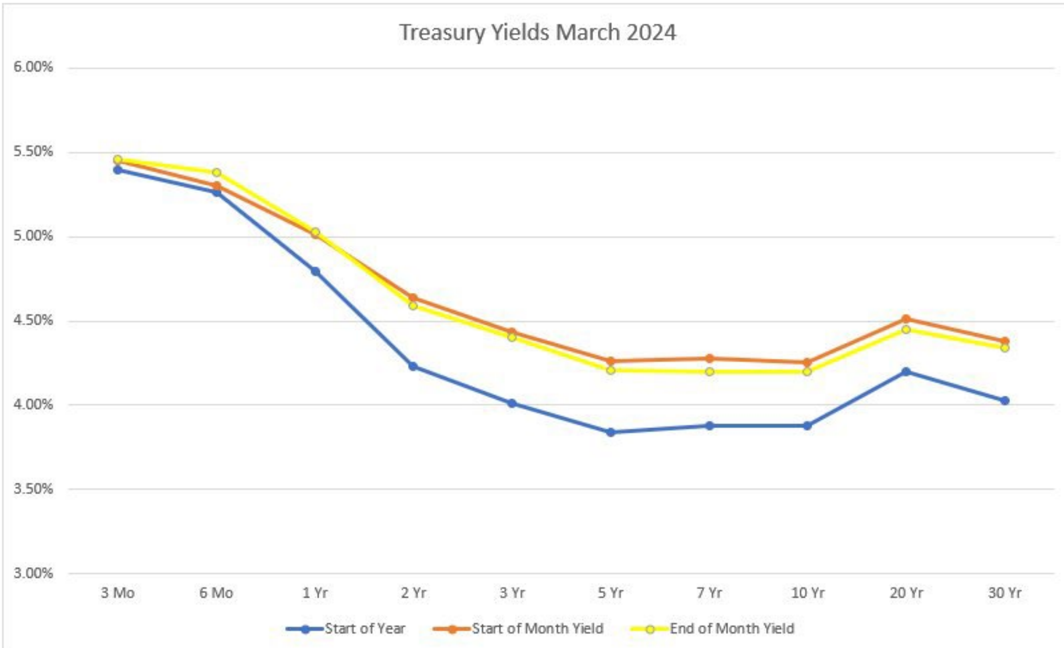
Select US Index performance[18]



While the market had forecast 6 cuts this year, the Fed has prevailed in its view of 3 cuts, which we believe can come down further, resulting in a steepening of the longer end of the curve (yellow line compared to blue line in the chart below). Recent comments by Fed chair Powell conditioning the market to further delays in that first anticipated cut aligns with our thinking given a relatively strong economy and market data points. In summary, we do not expect the Fed to rush to cut as it feels like there is more risk in that action given where the economy and related data points currently measure.

[18] www.investing.com Used equity index closing values to create graph.

[19]



Our favorite table, though, highlights how quickly investor sentiment can change on major themes affecting the economy and/or market. For instance, in January, markets were expecting 6 rate cuts, but the Fed only communicated three which was bearish relative to market sentiment. Over the next couple of months the market aligned with Fed expectations of three and Fed chair Powell reconfirmed expectations for lowering rates in the second half of the year, which was bullish. Fed Powell had similar messages in both January and March but based on market expectations one was deemed bearish and the other bullish. [20]

2023	January	February	March	April	May	June	July	August	September	October	November	December
Inflation Data	BULLISH	BEARISH	MILDLY BULLISH	MILDLY BULLISH	MILDLY BEARISH	MILDLY BULLISH	BULLISH	NEUTRAL	MILDLY BEARISH	NEUTRAL	BULLISH	BULLISH
- Broad Measurements	BULLISH	BEARISH	BULLISH	MILDLY BULLISH	MILDLY BULLISH	MILDLY BULLISH	MILDLY BULLISH	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	MILDLY BULLISH	MILDLY BULLISH
- Employment Data	BULLISH	BEARISH	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL	MILDLY BULLISH	NEUTRAL	MILDLY BEARISH	MILDLY BULLISH	MILDLY BULLISH
- Fed Speak	MILDLY BEARISH	BEARISH	MILDLY BULLISH	NEUTRAL	NEUTRAL	MILDLY BEARISH	NEUTRAL	MILDLY BULLISH	BEARISH	MILDLY BEARISH	BULLISH	BULLISH
Bank Run/Banking Turmoil			BEARISH	NEUTRAL	MILDLY BEARISH	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL		
Earnings	NEUTRAL	MILDLY BEARISH	NEUTRAL	BULLISH	BULLISH	NEUTRAL	MILDLY BULLISH	BULLISH	NEUTRAL	BEARISH	NEUTRAL	NEUTRAL
Global Events	MILDLY BEARISH	MILDLY BEARISH	NEUTRAL	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	BEARISH	NEUTRAL	NEUTRAL
Macro Events	MILDLY BULLISH	MILDLY BEARISH	MILDLY BEARISH	MILDLY BULLISH	MILDLY BULLISH	MILDLY BULLISH	MILDLY BULLISH	BEARISH	BEARISH	MILDLY BEARISH	BULLISH	MILDLY BULLISH
Debt Ceiling Standoff				NEUTRAL	BEARISH	BULLISH						
Israel-Hamas War										BEARISH	NEUTRAL	NEUTRAL

[19] Resource Center | U.S. Department of the Treasury Used treasury rates to create graph.

[20] Chart created by Fountainhead Asset Management.

2024	January	February	March
Fed	MILDLY BEARISH	MILDLY BEARISH	MILDLY BULLISH
Interest Rate Decisions	NEUTRAL	n/a	NEUTRAL
Commentary	BEARISH	MILDLY BEARISH	BULLISH
Economic Data	NEUTRAL	MILDLY BEARISH	MILDLY BEARISH
Inflation	NEUTRAL	MILDLY BEARISH	BEARISH
Employment/Labor Market	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH
Housing/Real Estate	NEUTRAL	NEUTRAL	MILDLY BEARISH
GDP	BULLISH	n/a	NEUTRAL
Consumer Spending	MILDLY BEARISH	NEUTRAL	NEUTRAL
Consumer Sentiment	MILDLY BULLISH	NEUTRAL	MILDLY BEARISH
Global Events/News	NEUTRAL	NEUTRAL	NEUTRAL
China	MILDLY BEARISH	NEUTRAL	NEUTRAL
Europe	NEUTRAL	NEUTRAL	MILDLY BULLISH
Russia Ukraine War	NEUTRAL	NEUTRAL	MILDLY BEARISH
Israel Hamas War	NEUTRAL	NEUTRAL	NEUTRAL
US Politics	NEUTRAL	NEUTRAL	NEUTRAL
2024 Election	NEUTRAL	NEUTRAL	NEUTRAL
Budget Negotiations	NEUTRAL	NEUTRAL	NEUTRAL
Earnings	NEUTRAL	MILDLY BULLISH	MILDLY BEARISH
Banking Turmoil	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH
Crypto	BULLISH	BULLISH	BULLISH

[21]

__IMPORTANT DISCLOSURE:__ The information contained in this report is informational and intended solely to provide educational content that we find relevant and interesting to clients of Fountainhead. All shared thoughts represent our opinions and is based on sources we believe to be reliable. Therefore, nothing in this letter should be construed as investment advice; we provide advice on an individualized basis only after understanding your circumstances and needs.

[21] Chart created by Fountainhead Asset Management.