Key Questions

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What Created Chaos in Supply Chains and Why Are Shortfalls so Acute?

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The Key Wealth Institute is a team of highly experienced professionals from across wealth management, dedicated to delivering commentary and financial advice. From strategies to manage your wealth to the latest political and industry news, the Key Wealth Institute provides proactive insights to help grow your wealth.

Disruption of global supply chains has been undeniable, with price increases felt by consumers across various markets and goods. From COVID-19 to geopolitical forces to extreme weather, things might worsen before they get better. But higher revenues can fund higher wages, translating into higher incomes and spending. The real question is whether the Federal Reserve's current view on inflation will hold.

Reports of chaos within the global supply chain are rampant and price increases are evident across a wide variety of goods and commodities from copper to coffee. Seemingly, few industries have been spared. In the meantime, the number of ships waiting to unload at the Port of Los Angeles has continued to grow, and businesses and consumers alike are experiencing strains. What created this situation? In our view, there are three proximate causes: COVID, geopolitical forces, and extreme weather. We discuss each of these in the following.

Supply chains were designed for predictable patterns of demand and built for achieving maximum efficiency; resiliency was arguably a secondary concern. The notion of "just-in-time" inventory management methodologies exemplify this idea. Once predictability and precision are broken, however, the weakest link in the "production-to-consumption chain" cause disruptions to cascade from country to country and send ripples from one industry to another. COVID-19 and the severe economic restrictions imposed last March in attempt to contain it have caused this very scenario to play out.

When the pandemic first hit, most factories around the world either completely shut down or severely slashed production. Yet, once COVID-related restrictions were lifted, demand surged thanks to aggressive fiscal stimulus policies. This dynamic (inadequate supply followed by surging demand) is straining global supply chains today. To illustrate this point further, consider the situation involving the global auto industry and one of its largest, most critical suppliers: the semiconductor industry. As the pandemic spread and car sales abruptly fell, most automakers cut back on semiconductor (or chip) orders, anticipating depressed demand for new cars for an extended period.

But when car sales bounced back quicker than expected, automakers found they couldn't replenish their chip inventories. The tech industry had snatched up the supply for laptops, tablets, phones, and other consumer electronics as a result of unprecedented demand spurred by online learning and remote working. As a result, that lack of computer chips is now plaguing the auto industry, forcing plants to shut down, delaying auto shipments, and sending car prices through the roof.

In addition, each link of the supply chain has its own unique challenges, also caused by COVID-19.

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The global supply chain is made up of shipping containers, ports, trucking, railroads, airfreight, and warehouses. As a result of unparalleled supply/demand mismatches, fewer containers are in circulation and some are being moved without cargo. “Our biggest export is air,” the head of the Port of Los Angeles recently quipped. Elsewhere, trucking is impacted by labor shortages, and warehouses are also short-staffed and space-constrained. These are two other examples of the vexing challenges amongst supply chains themselves.

The second factor impacting global supply chains en masse are geopolitical forces, as illustrated by a few examples. In March 2021, the retailer H&M announced it would pause placing new orders in Myanmar in light of daily political protests combined with manufacturing difficulties that included procuring raw material imports and transporting finished goods. Similarly, the UK was hit by supply shocks tied to the pandemic while simultaneously adjusting to new post-Brexit complexities. Furthermore, ongoing power struggles and trade tensions between the US and China have created huge volatility on both sides. Clearly, there are no shortages of geopolitical events impacting the global supply chain.

As if these weren’t enough, the last and perhaps most unpredictable influence over the global supply chain has been extreme weather shocks. To wit, Hurricane Ida wreaked havoc across the Gulf Coast and the East Coast, temporarily shutting down several ports; extensive wildfires have sharply slowed rail traffic in Canada; and extreme flooding has hampered barge-related traffic throughout much of Europe. All have further stressed an already overwhelmed supply chain.

So, what does all of this mean for investors? Realistically, things might get worse before they get better. Recent power shortages in China and the upcoming holiday season could strain supply chains even more. Consequently, this will likely lead to more price hikes that affect both commercial and consumer products, resulting in higher inflation.

A silver lining exists in the fact that with inflation comes higher revenues.

Higher revenues can fund higher wages, and higher wages typically translate into higher incomes and spending. This is an often-overlooked positive. But higher inflation could also result in higher borrowing costs in the form of higher interest rates if the Federal Reserve determines such inflation is no longer transitory, which is its current view.

Investors must ask themselves, therefore, whether this view will hold. At this point, we can’t clearly say for sure, but that will be on our mind while sipping morning coffee that we can presently still afford.

For more information, please contact your advisor.

About the Authors

As Chief Investment Officer, George Mateyo is responsible for establishing sound investment strategies for private and institutional clients, expanding internal and external research capabilities, and managing the delivery of solid risk-adjusted investment performance.

In previous roles, George spent more than 15 years in investment management and investment consulting, where he acquired firsthand knowledge and insights into the capital markets and the stewardship of investment portfolios for institutional and high net-worth investors.

George received his MBA from the Weatherhead School of Management at Case Western Reserve University and completed additional studies at the London School of Economics.

Scarlett Liu provides research support for the equity team and produces monthly equity performance, and risk analytic reporting packages used in managing equity strategies. Her current area of focus is the industrial sector. On the fixed income side, Scarlett shares responsibilities for conducting surveillance of all individually held fixed income investments at Key Private Bank. Before this role, Scarlett worked as a commercial underwriter for KeyBank in Buffalo, New York.

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