Pricing Strategies For The Inflationary Economy

UHY Webinar

Chris Kuehl - Armada

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Black Swans in Abundance

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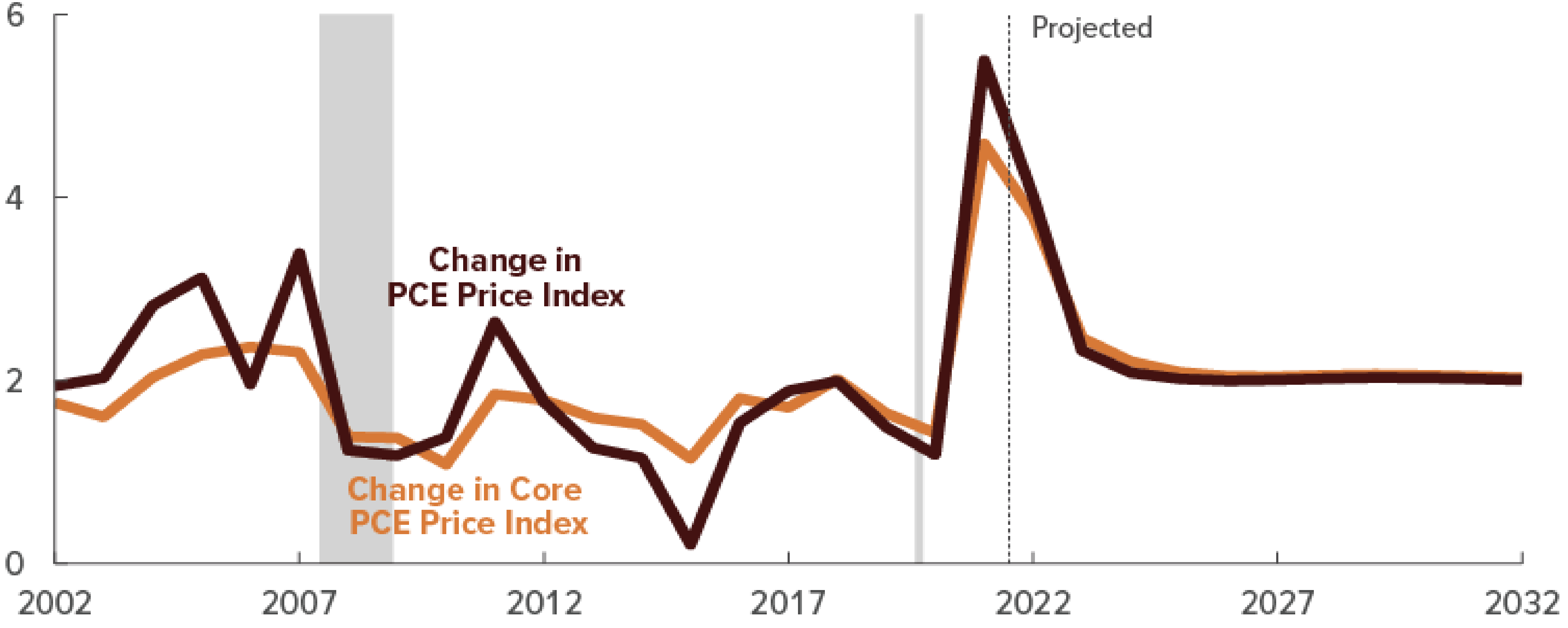
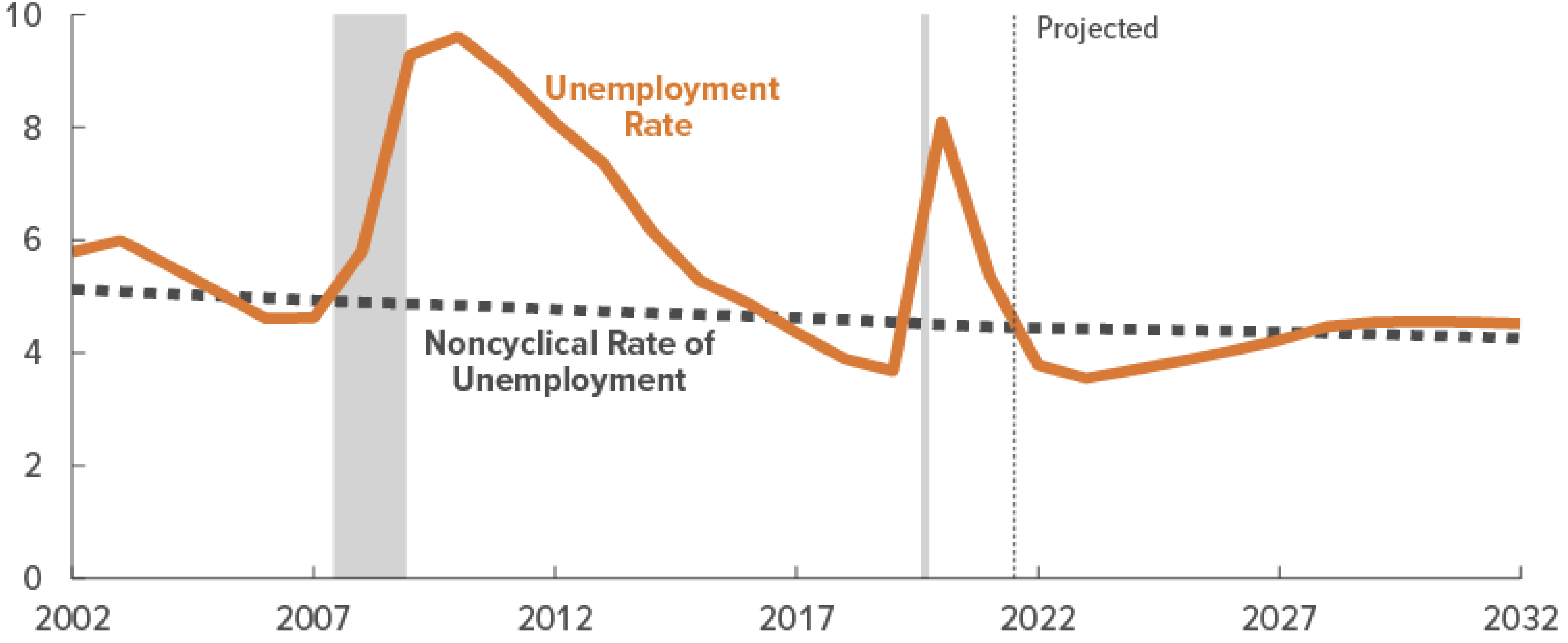
- **Still recovering from the Covid Pandemic and the threat is far from over**
  - Stimulus in 2020 created as many problems as it solved
  - Crash in 2020 gave way to boom in 2021 and both set up issues in 2022
- **Russian Invasion of Ukraine**
  - Immediate energy crisis
  - Most global inflation tied to higher fuel costs
- **Series of Little Black Swans**
  - Market chaos due to correction + end of low rates
  - China’s supply chain collapse due to “zero tolerance”
  - Latin America’s shift to the left
  - Labor shortage (should have been anticipated)

Ups and Downs Expected to Settle

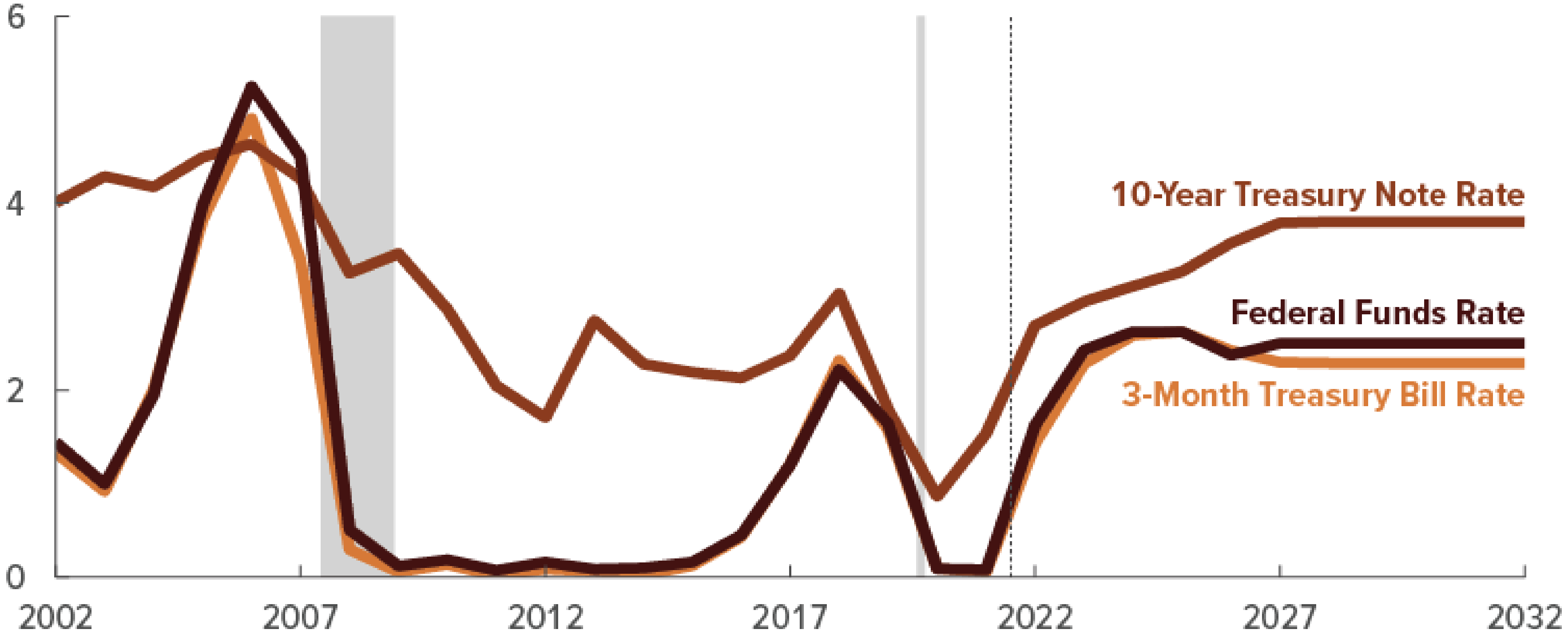
PCE Inflation Expected to Moderate



Unemployment Rising a Bit



Some Rate Stability?



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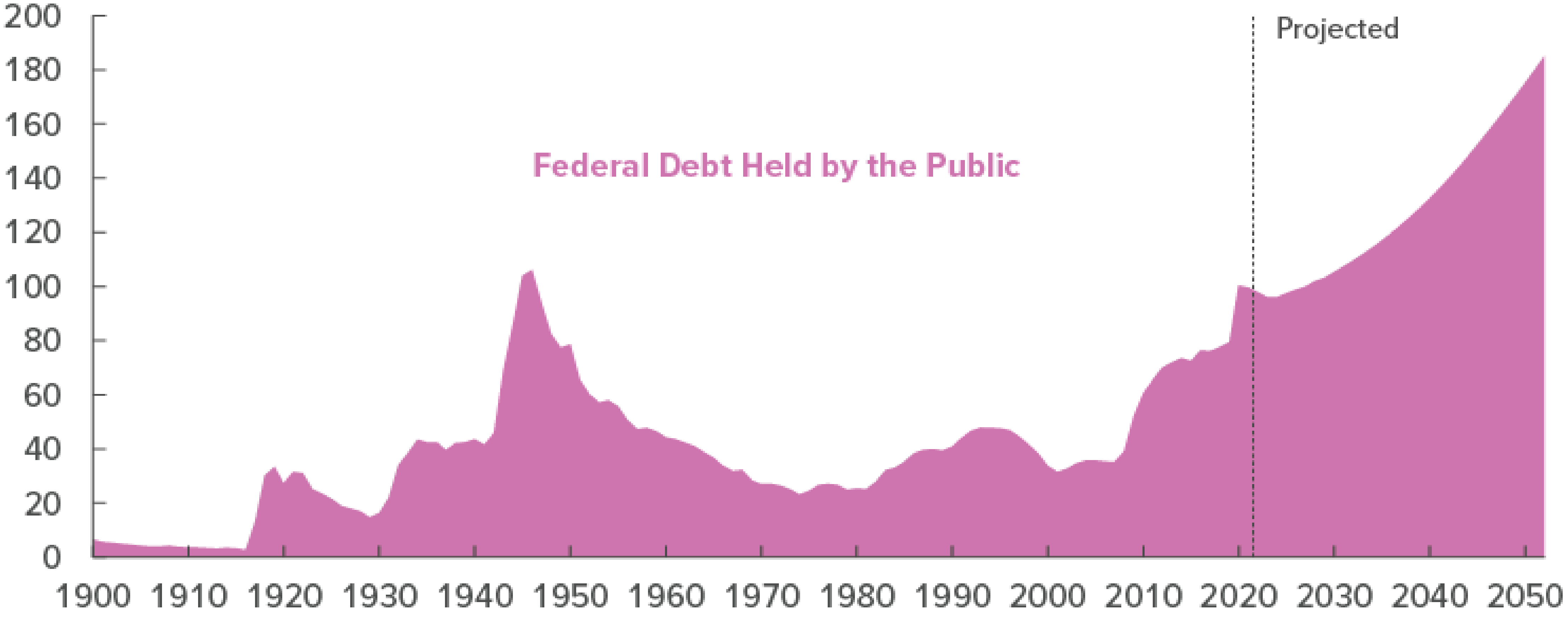
Debt Just Keeps Rising



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POLLING QUESTION

What are long-term effects of rising federal debt?

- Increased interest rates
- Decreased savings and income
- Risk of new crisis
- All of the above

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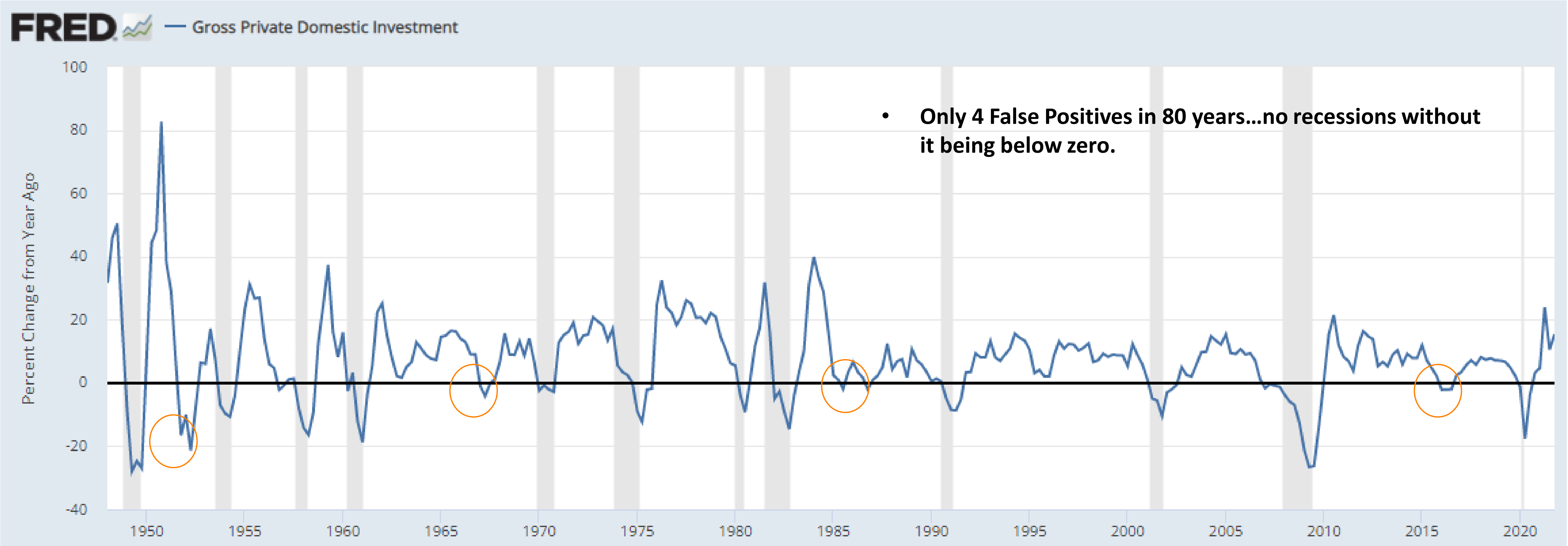
Recession: Gross Domestic Private Investment Another Good Indicator and Current Risk from Q1 was Very Low

- GPDI continued to trend in the right direction in Q1, rising by 18.7% Y/Y and was 3.0% higher Q/Q.



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Sticky and Flexible Price Consumer Price Index

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Consumer Credit Card Use Relatively Unchanged, Ratio of Services to Goods Spending Back to Pre-Recession Levels

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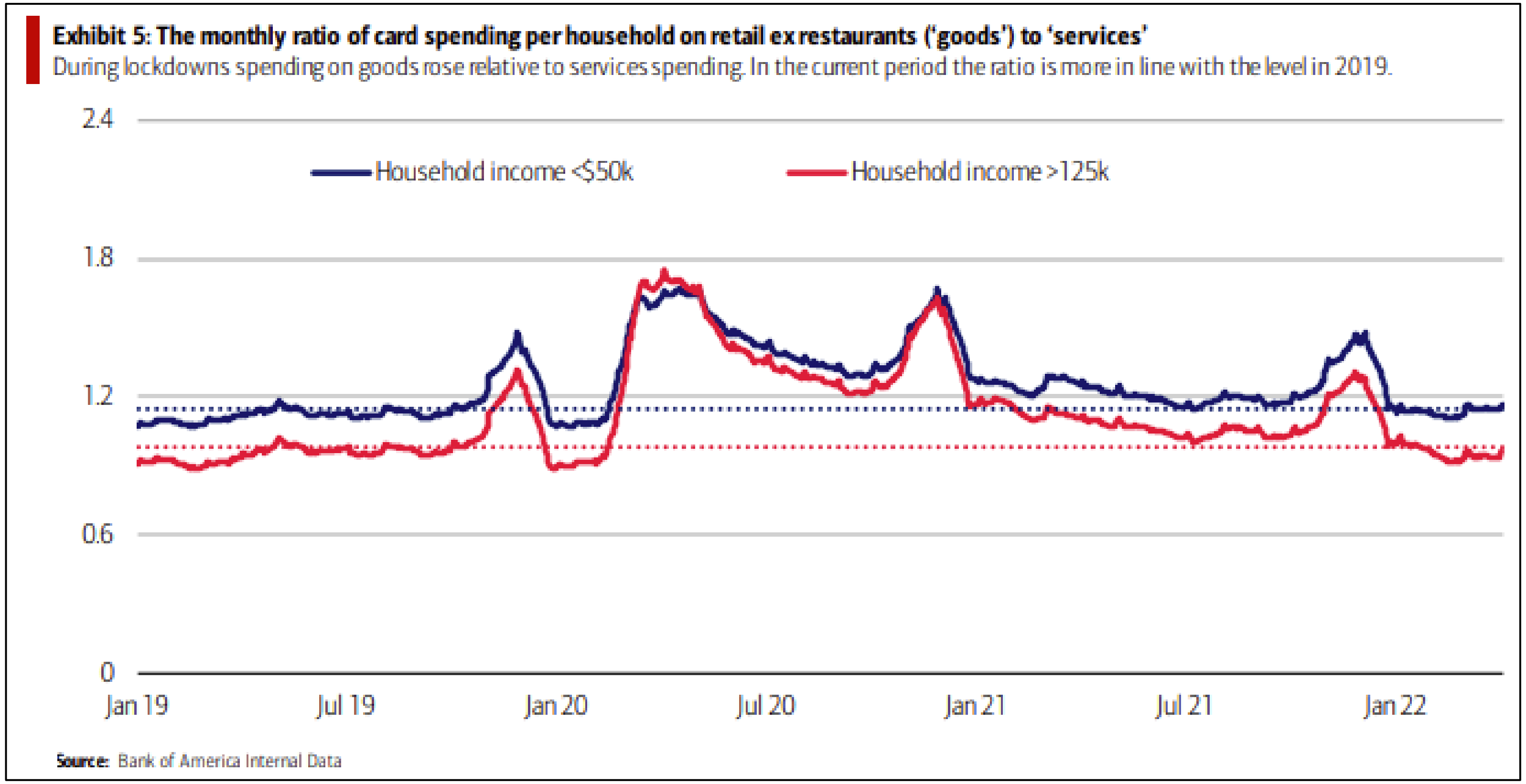
- The ratio of household spending between goods and services has returned to pre-pandemic ratios (source: Bank of America).

- Credit card debt, as a percent of household income, is still **not showing signs of overspending** (over-extending) through April.

- Credit card **delinquency rates** are also not showing a significant change relative to the last two years and remain historically very low.



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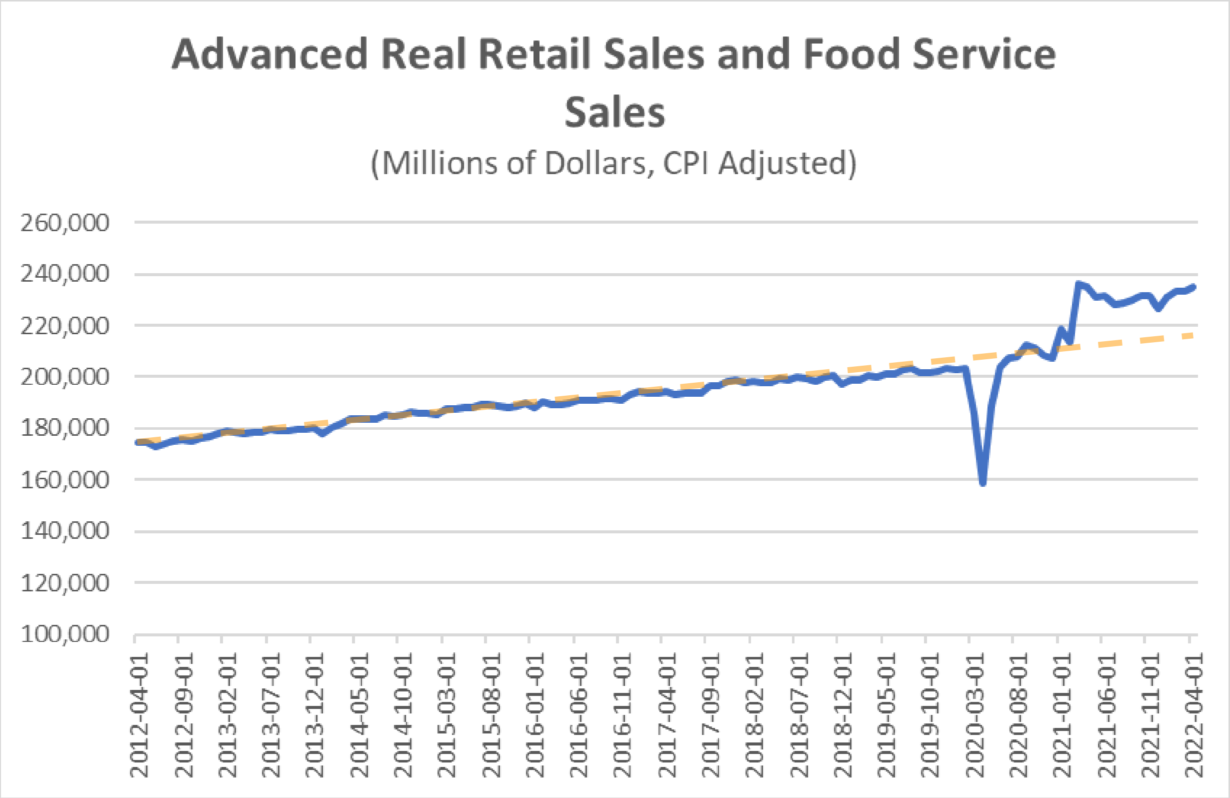
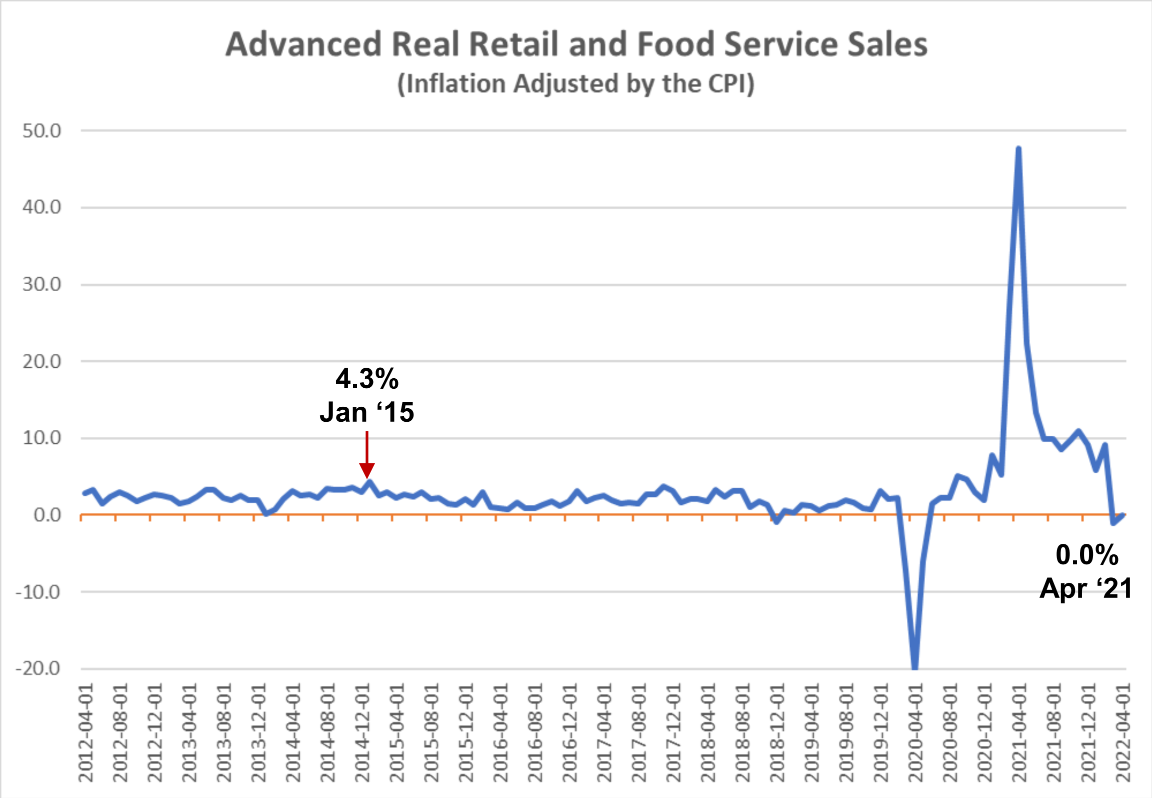
Inflation Adjusted Retail Sales Through April





1. **Retail sales, on a broad basis (including all sectors) shows consumer spending remaining robust – even when adjusted for inflation.**
2. **At this point, we could conclude that the consumer is spending despite inflationary pressure.**

1. **From a transportation perspective, we get concerned about the "number of units" sold through retail stores.**
2. **Walmart and Target both reported that the number of units were down, even though same-store-sales were up 3%.**
3. **Adjusted for inflation, retail sales have been flat since mid-2021. But low inventory levels until now have kept the retail supply chain stable.**

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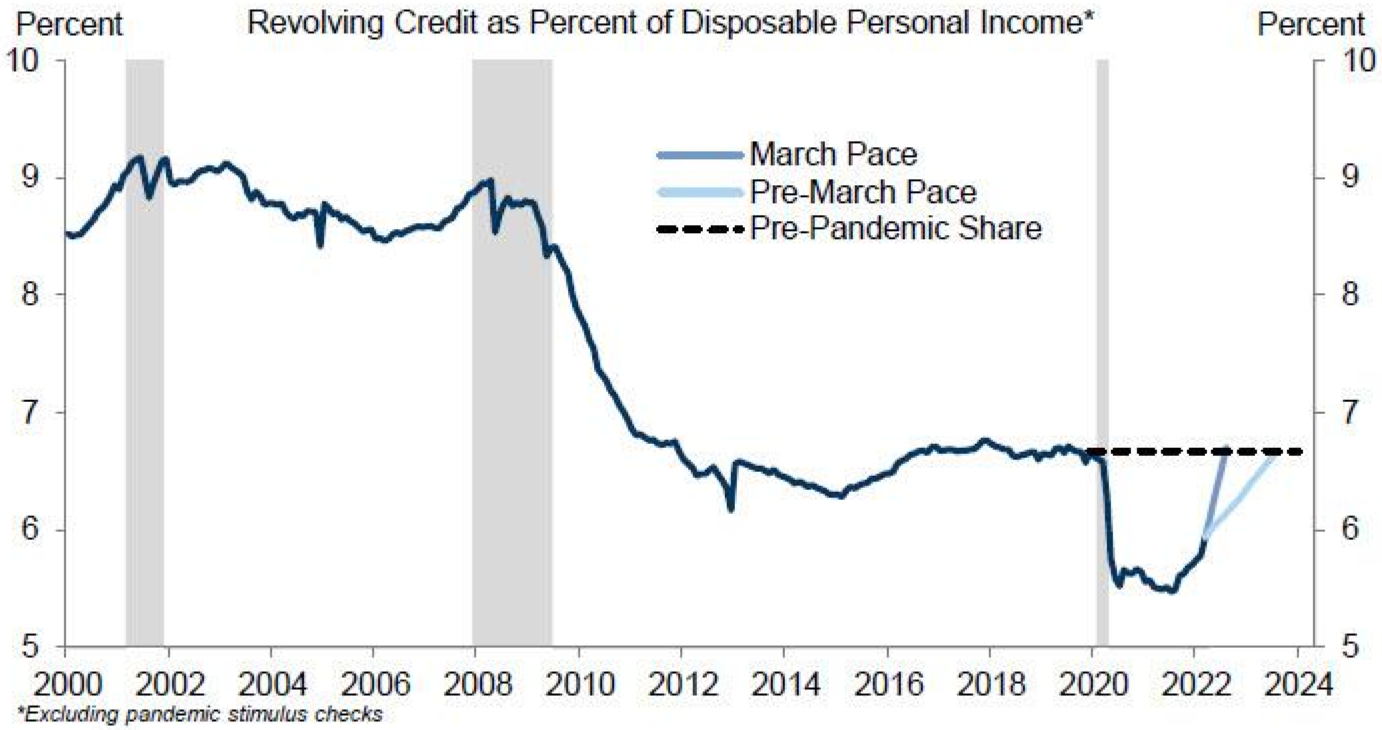
Demand: Consumer credit as a percentage of disposable personal income not a problem…yet.

- If consumers continue to use credit cards at rates set in March, they will return to pre-recession levels by the end of Q2. The implication is this: if food and energy inflation continues to be this high, it could lead to a drop in consumer spending at some point prior to the peak retail season.

Exhibit 2: Consumer Credit Levels Remains Low but Would Normalize in 2022Q3 If Credit Growth Continues at Its March Pace



Source: Federal Reserve Board, Goldman Sachs Global Investment Research

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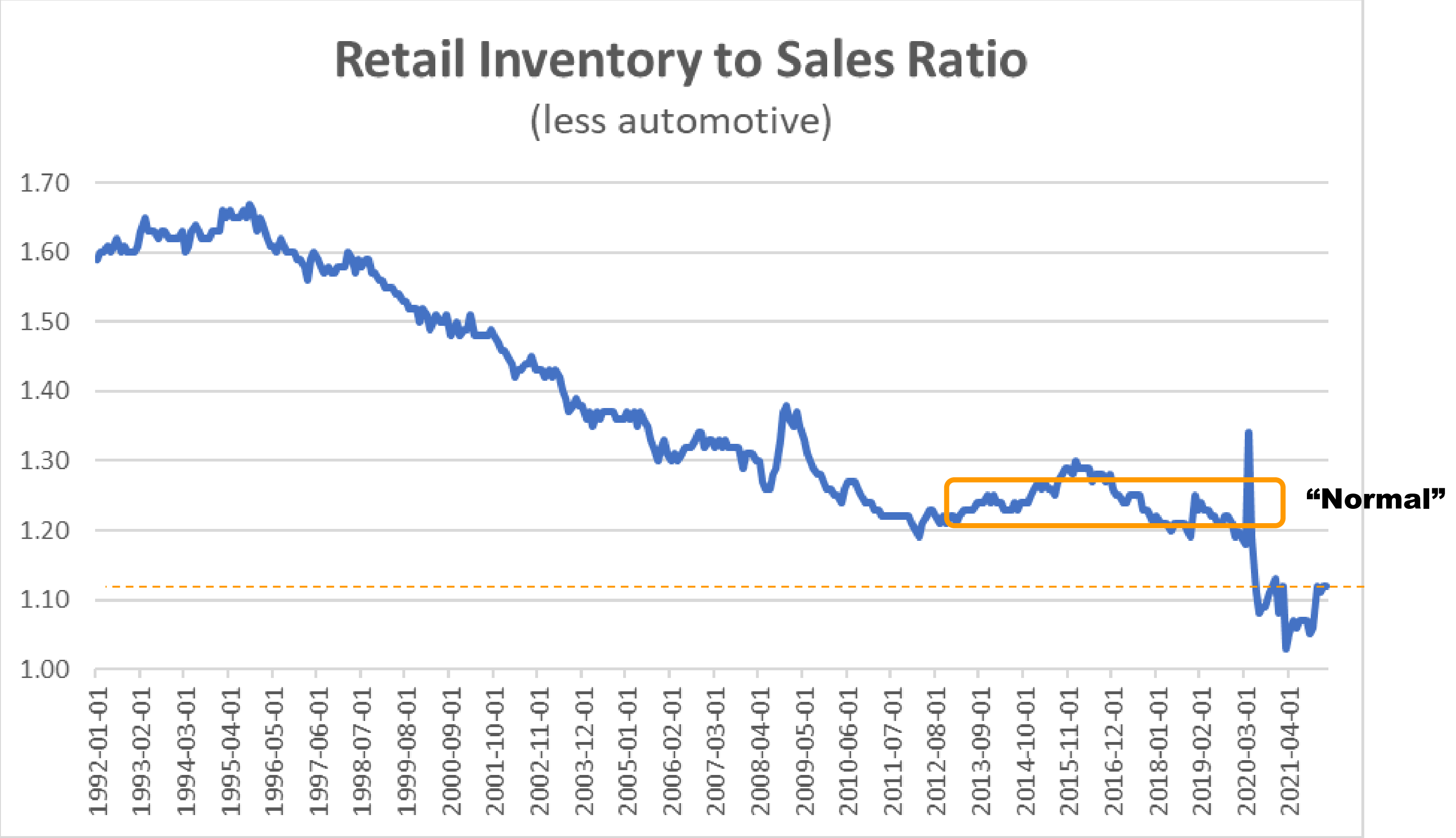
Retail Inventory to Sales Ratio

- Across the broadest measure of business inventories, the inventory to sales ratio appears to be low.

- But when stripping out automotive, the viewpoint is very different based on individual sectors.

- Manufacturers, merchant wholesalers, and retailers are back to levels that closely match pre-pandemic levels.

- This is also a lagging indicator, and the most current data is through March of 2022. There has been more inventory building activity since then.



Demand: Total Nonresidential Spending Strong Year-over-Year.

- **Despite what seems like sluggishness, construction spending was still growing at an 11.7% rate.**
- **Manufacturing continues to be the fastest growing segment on a year-over-year basis. Followed closely by commercial.**
- **Material supplies are still hampering total output and production potential. Inflation is also weighing on project cancellations and postponements.**
- **The infrastructure bill has seen 400 projects funded to date and that figure will accelerate late in 2022 and into 2023.**

Value of Construction Put in Place - Seasonally Adjusted Annual Rate (Millions of dollars. Details may not add to totals due to rounding.)					
				Percent change Mar 2022 from -	
	Mar 2022p	Feb 2022r	Mar 2021	Feb 2022	Mar 2021
Total Construction	1,730,469	1,728,565	1,548,555	0.1	11.7
Residential	891,280	882,414	754,139	1.0	18.2
Nonresidential	839,189	846,151	794,416	-0.8	5.6
Manufacturing	94,491	96,057	71,615	-1.6	31.9
Conservation and development	8,599	8,205	7,456	4.8	15.3
Commercial	98,307	100,177	85,722	-1.9	14.7
Sewage and waste disposal	29,145	28,918	26,398	0.8	10.4
Highway and street	103,908	104,355	96,300	-0.4	7.9
Health care	50,369	50,982	46,733	-1.2	7.8
Water supply	19,388	19,613	18,351	-1.1	5.7
Office	84,579	84,723	80,700	-0.2	4.8
Amusement and recreation	25,769	26,328	25,080	-2.1	2.7
Power	117,555	118,769	116,055	-1.0	1.3
Transportation	56,383	56,564	56,535	-0.3	**-0.3**
Communication	21,791	21,759	22,103	0.1	**-1.4**
Educational	98,544	99,478	101,305	-0.9	**-2.7**
Religious	2,761	2,865	3,069	-3.6	**-10.0**
Public safety	10,602	10,438	13,834	1.6	**-23.4**
Lodging	16,997	16,920	23,161	0.5	**-26.6**

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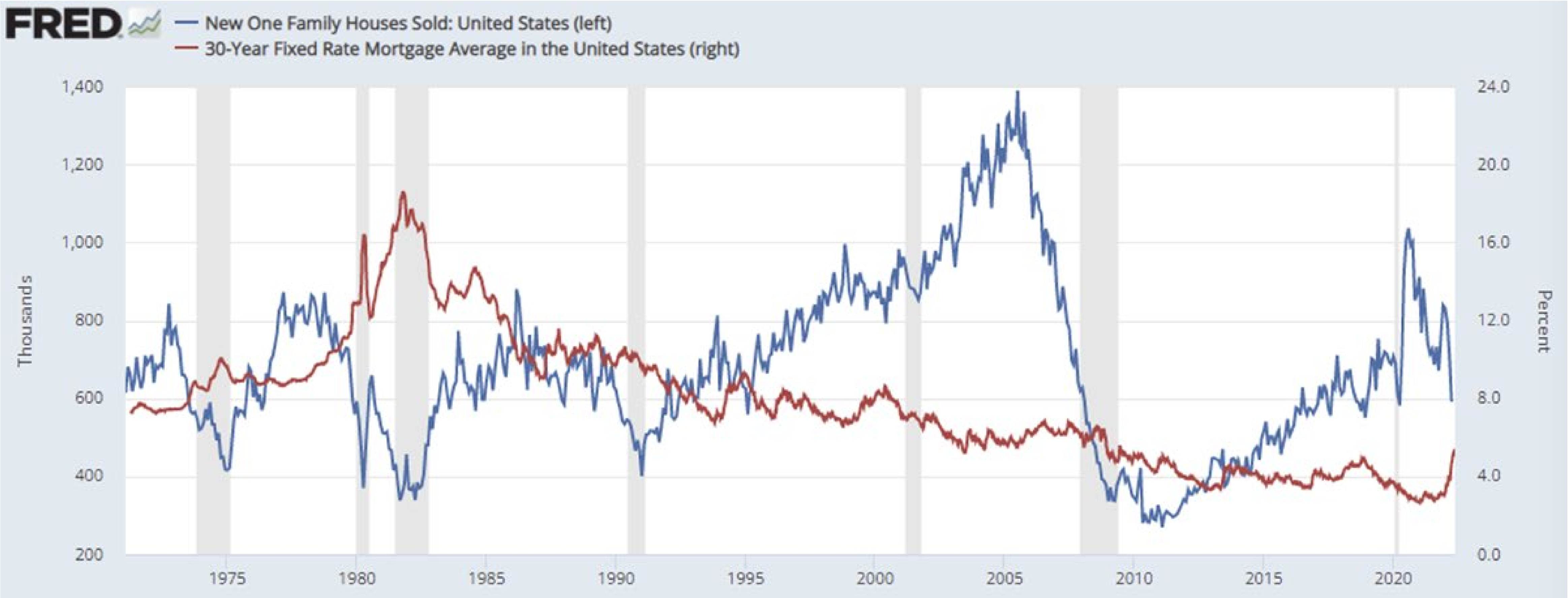
Source: Census Bureau

Demand: Concerns Over New Home Sales Data

- **Only a slight relationship between interest rates and new home sales – other factors like home prices, inflationary pressures on other types of spending, etc. playing a larger role.**



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POLLING QUESTION

What is causing the current decline in home sales?

- Increased interest rates
- Skyrocketing home prices
- Inflation
- All of the above

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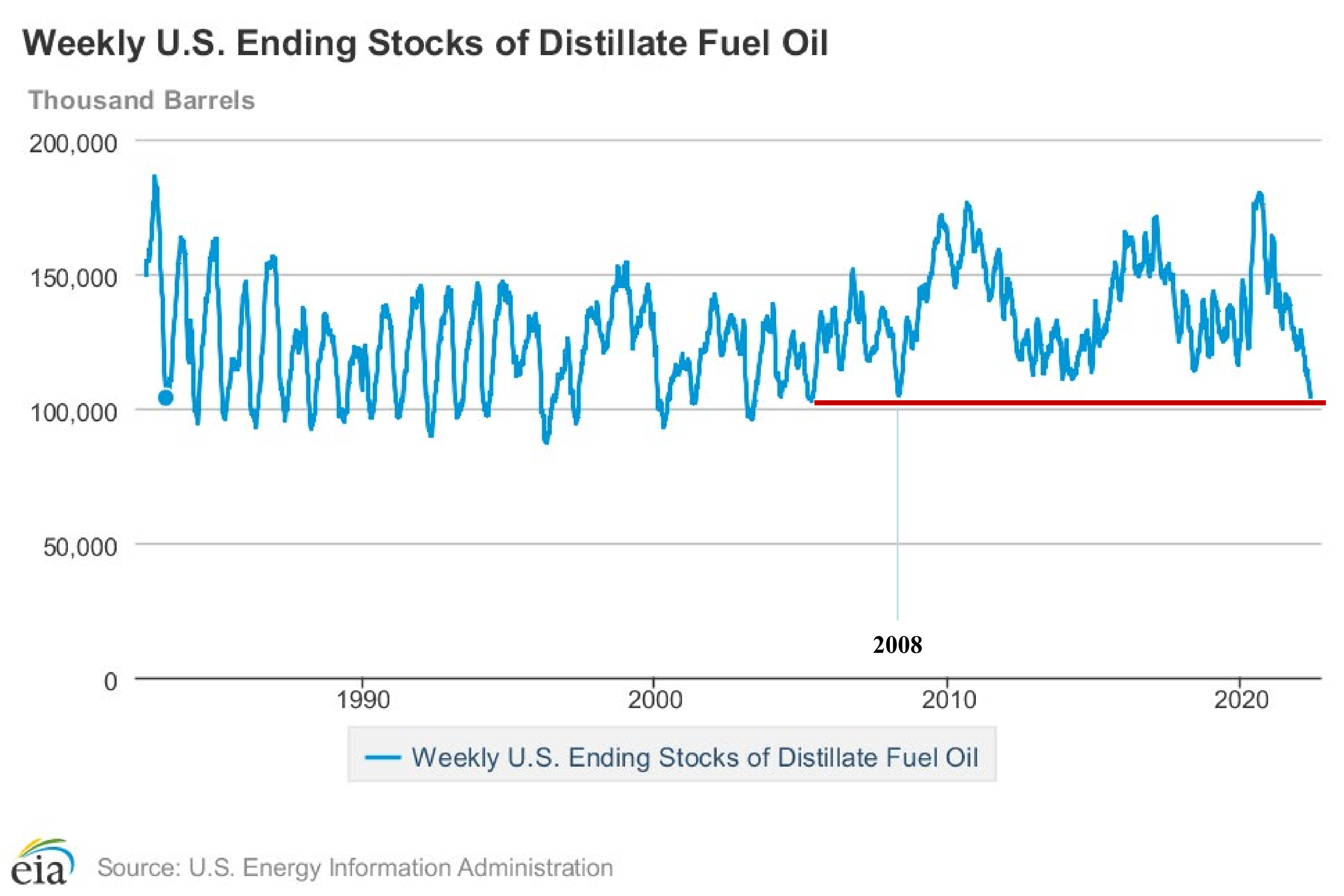
Inventories of Diesel Are Running Tight, Lowest in a Decade

- East Coast running at just 3 days of inventory on hand.
- Diesel levels are 22% lower than the 5-year average.
- With diesel at all-time highs (setting highs nearly daily), there is risk that a hurricane through the Gulf or a refinery maintenance issue that would create a significant super-surge in prices. Inventories are just too tight.
- The US is producing 9.6M BPD of gasoline and consuming about 9M. Not a lot of room for error.



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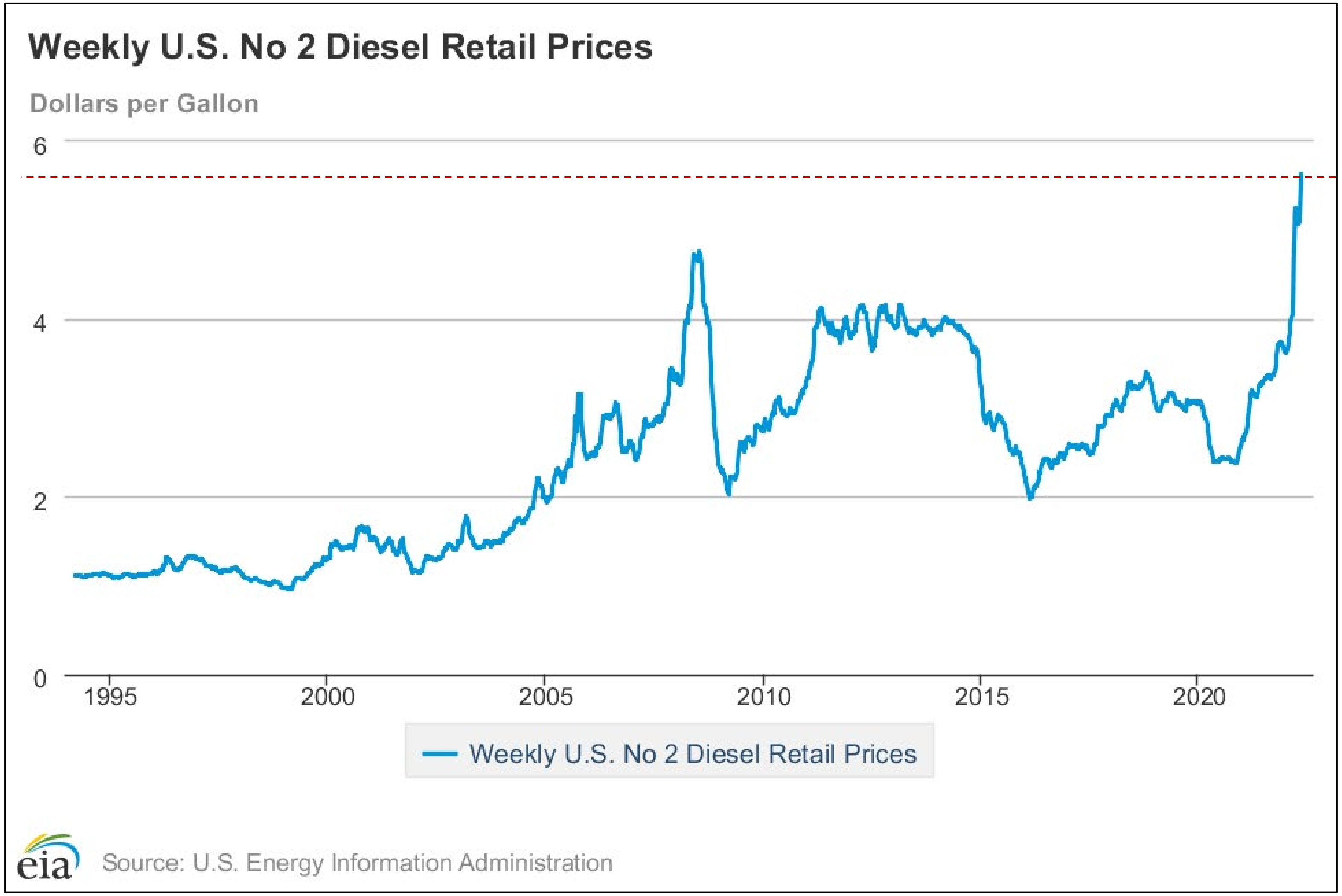
Source: EIA

US Exports of Diesel are Accelerating – Prices at All-Time Highs

- **US exported record volume of petroleum products in April with 10.6 million barrels per day outbound. Imports were 7.69 million.**
- **Gulf exports from 18K BPD to 1.3M BPD in April headed to Europe (Bloomberg). Highest all-time since the data has been tracked.**
- **Summer blend fuels may see slower conversions?**
- **Diesel prices in Europe the equivalent of $10/gallon**
- **Electricity is 10x more than in the US**



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Source: EIA

Depending on Sanction Policies

Oil price forecasts 2022

	Brent	WTI
Bank of America (BofA)	$110/bbl	$105/bbl
Fitch Solutions	$82/bbl	$73/bbl
Fitch Ratings	$100/bbl	$95/bbl
ANZ Research	$115.3/bbl	$112.3/bbl

Sources: Bank of America (BofA), Fitch Solutions, Fitch Ratings, ANZ Research

Import Demand: the US Dollar Continues to Gain Strength, Importing Will Continue to be Robust

- Risk: the developing world can't afford to purchase food, energy, etc. <u>Anything denominated in dollars</u>.
- Even Europe is struggling.
- This could eventually become a headwind, but for now it remains a tailwind for US importers.

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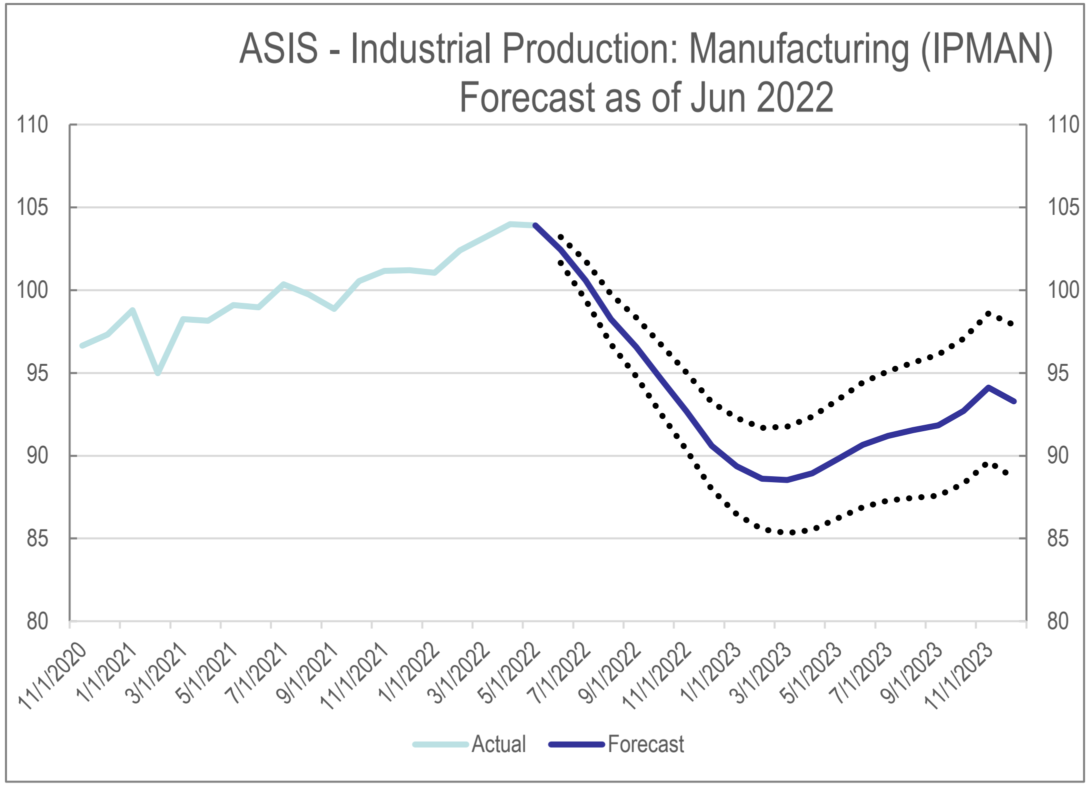
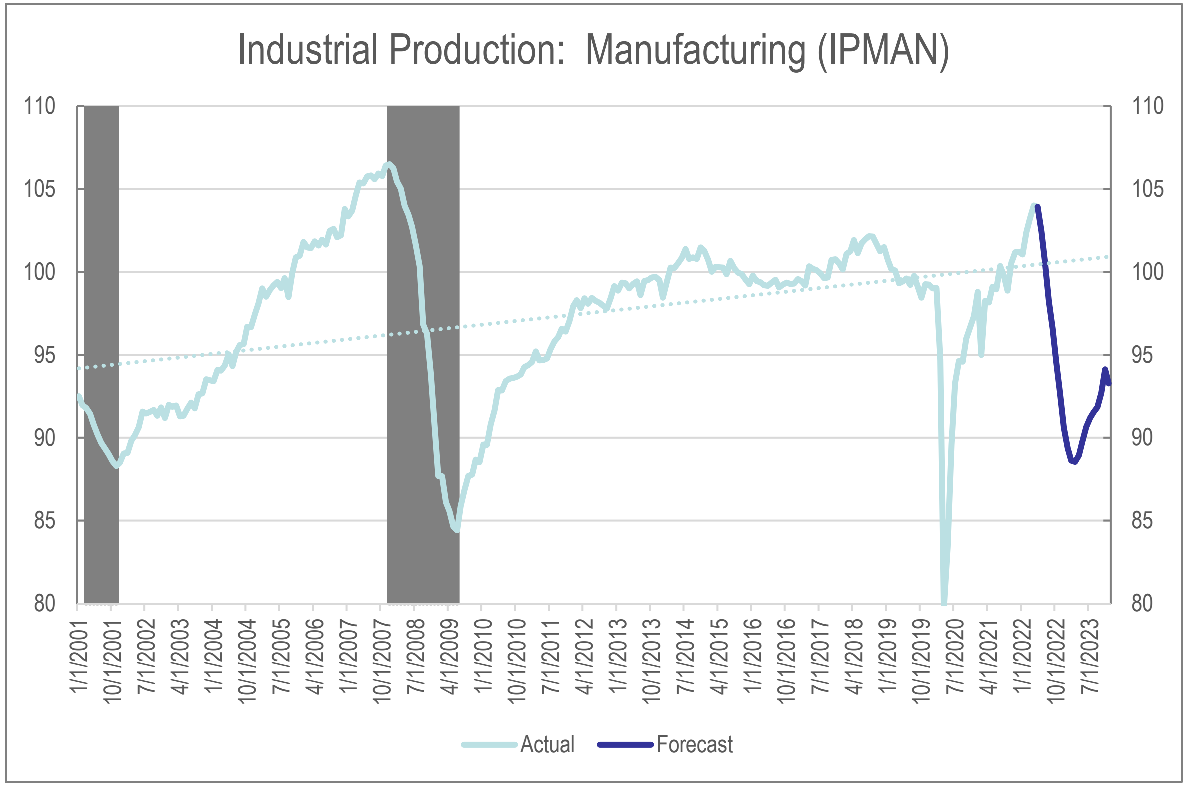
Source: US Dollar Index; MarketWatch Chart

Looking Forward: Industrial Production for Manufacturing Outlook





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POLLING QUESTION

Why is industrial production recovering?

- Increased demand
- Supply chain improvements
- Technology acceleration
- All of the above

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Demand: Infrastructure Bill +$550 Billion in Incremental Spending (front loaded over the first 5 years?)

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Earmarked Spending that could increase near term freight demand…

1. **$17B port infrastructure**
2. **$25B airports repair and maintenance**
3. **$110B roads, bridges, and major infrastructure**
4. **$40B repairs of bridges**
5. **$16B "special projects" that the White House will fund**
6. **$11B "crash mitigation" (special turn lanes to prevent pedestrian accidents)**
7. **$1B reconstruction of street grids**
8. **$39B "modernize public transit"**
9. **$66B passenger freight rail development**
10. **$65B improving nation's broadband infrastructure**
11. **$7.5B zero emission buses and ferries**
12. **$7.5B build a nationwide network of plug-in electric vehicle chargers**
13. **$65B rebuild the electric grid**
14. **$55B upgrade water infrastructure**
15. **$50B protect water systems from floods, drought, etc.**
16. **$21B clean up former land-based mining and orphaned gas well areas**

Impact:

- Expected to **boost construction spending by 7% annually for the first 5 years**.
- Overall, it's positive for the economy. Replaces some stimulus spending taking place now.
- But will **tighten labor market** for other types of businesses, especially CDL drivers.
- Will also push **raw material prices higher**.
- Spending on public/private partnerships will be slower but will **multiply the overall impact**.
- Heavy impacts could be seen later in 2022/2023.

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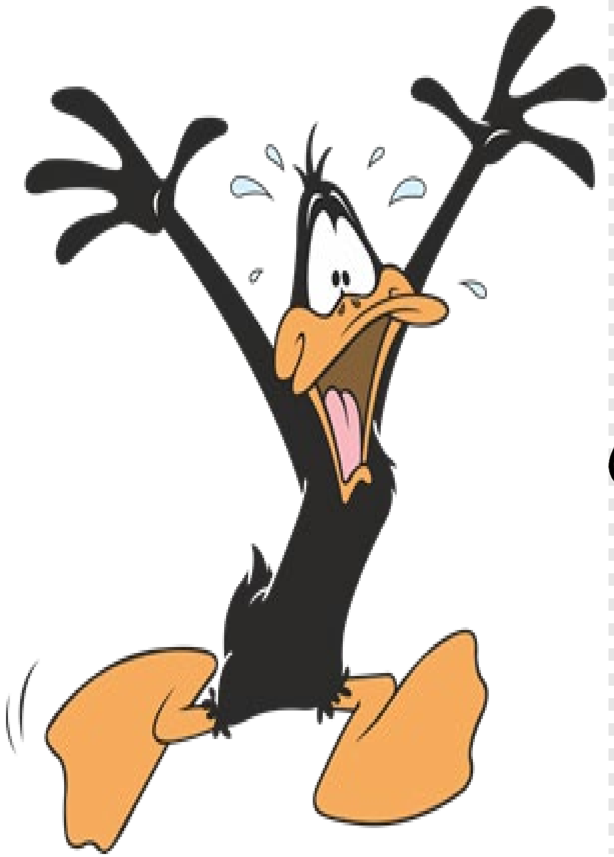
Which Way Are We Heading?



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