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Weekly perspective on current market sentiment September 29, 2021

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Last week's S&P 500 Index: +0.5%

Chips

Key takeaways

- The semiconductor chip shortage is negatively affecting a wide swath of industries and helping create growth headwinds.
- Unfortunately, the timeline to resolve production and logistics issues keeps getting pushed out and may not be resolved until 2023.

No, for all you old-timers, this week's commentary is not about the late-1970s California motorcycle police action show starring Erik Estrada. It's about a very current real world issue that is negatively affecting the global economy in a wide swath of industries. Semiconductor chips are used in everything from computers, toys, and appliances to garage door openers and all types of motorized vehicles. A shortage of chips has created massive headwinds (and headaches) for producers of products using semiconductors.

The root of the problem combines the closed or partially closed semiconductor fabrication plants due to COVID-19 and the big surge in demand that has occurred as the world climbs back from the deep pandemic-induced recession. Many investors might be surprised to hear that a number of semiconductor fabrication plants in Southeast Asia have still been seeing sporadic shutdowns due to outbreaks of the Delta variant. This is more than just playing catch-up from lengthy closures last year.

This weekly comment piece can't cover all the angles of the chip shortage; the problem is too widespread. And there are indications that for some industries the problem is getting worse, not better. As our semiconductor analyst stated when asked about the current state of semiconductor production, "It's a mess." Let's take a quick flyby of a couple of industries that use a lot of chips.

Have you driven by any new car dealer establishments lately? Have you noticed that there are not many vehicles on the lot? It's all about the chips. Auto sales are an important part of the economy, and vehicle production has been cut back by a number of major producers due to a lack of needed semiconductor chips. According to recent research by consulting firm AlixPartners, CNBC, the global auto industry will likely lose out on more than $200 billion in revenue this year with a nearly 8 million unit production shortfall relative to demand. Those are huge numbers.

The gaming/electronics industry has also been hurt by the chip shortage. This is likely to be an issue as we approach the holiday season and many retailers are wondering if electronics stores are going to have enough inventory on the shelves to meet demand. Holiday shopping season results could be lackluster without enough inventory.

The semiconductor chip shortage, combined with logistics snafus in getting product from production facilities in Asia to end users in the U.S. and elsewhere, has been a meaningful factor in recent downgrades of domestic and global economic growth estimates for this year (along with COVID-19 headwinds). In the meantime, look for the chip shortage to add to inflationary pressures as low inventories of many semi-dependent products lead to higher prices and create growth headwinds.

Inflation should slow as inventory catches up to demand, but the persistently strong factory activity is one reason why we foresee above-average economic growth and favor equities over bonds through 2022.

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