Quarterly Point of View
Coming Home II

April 10, 2023

Banking system stress, both domestically and abroad, drew most investor attention in the first quarter of 2023. Silicon Valley Bank's high-profile collapse, after losing $42 billion of deposits in a single day, sparked a wider scare that engulfed much of the U.S. regional banking system, before jumping the pond to Switzerland. There, UBS Group agreed to purchase 167-year-old Credit Suisse, on the brink of failure, in a historic, government-brokered deal at a value 99% below the latter's all-time pre-Global Financial Crisis peak[1].

Given the seriousness of these matters and the headlines they're making, the initial reaction is to try to write about it, but we're going to defer for now. Those that have read our letters the past 13 years know that we have often espoused a belief that monetary policy in the United Sates, and abroad, had veered off course and down an ominous path wrought with moral hazard. At the core of it, zero interest rate policy (ZIRP) since the GFC, and bailouts of all shapes and sizes over the last quarter-century, has reduced resiliency, creating a fragile system not easily capable of dealing with stress when it arises.

Overall, banks in the United States are in a stronger financial position than they were prior to the GFC. Banking, like fiat currency, however, is ultimately about confidence, and the past few months that confidence has been debased. Time will tell if it's an overreaction to a few isolated events, or something deeper. In the meantime, we'll remain attentive to further developments in the fluid situation, which we may discuss it in a future letter, but for now we will analyze another important economic dynamic.

Five years ago, we wrote a quarterly piece entitled *Coming Home*, where we laid out a case that after a generation of manufacturing leaving the United States, the opportunity existed for a potential renaissance in this country.

The primary reason for our view was the recently passed Tax Cuts and Jobs Act (2017), that amongst other things reduced the corporate tax rate from 35%, where it had been for the previous quarter-century, to a new rate of 21%. After years of having a well above-average levy, helping foster a decades long trend by corporate management toward the offshoring of manufacturing, the country now immediately possessed a competitive rate, impacting that dynamic. Notwithstanding the primary structural advantage the United States maintains, that of the rule of law, other positive factors were contributing to our view that a tipping point for domestic manufacturing was at hand, including:

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- Overall manufacturing cost disadvantages were abating, mainly due to double-digit wage growth in many emerging economies. China, for example, has seen labor costs rise over 12% annually since 2010[2].
- Due to technological advances such as fracking, America had undergone a revolution in the production of cheap oil and gas, producing feedstock cost advantages.
- Feverish innovation cycles had moved beyond just electronics and was present in an assortment of consumer categories, incentivizing companies to reduce time to the wealthiest end-market, the United States.

All these factors remain in place, and in the last five years a reshoring of manufacturing jobs has continued, albeit at a modest pace. There are currently just shy of 13 million manufacturing jobs in the U.S., up from 12.5 million when we first covered this topic. For reference, the post WWII low was 11.4 million jobs in 2010, after reaching its peak 31 years earlier in 1979, at almost 20 million[3].

We are revisiting this now due to the addition of another factor, possibly more important than any we've already discussed, that could accelerate this trend. The tenuous, even combative, geopolitical situation, is creating an environment that will now impose significantly more risks upon corporations looking to squeeze any last cost possible out of the manufacturing process through off-shoring.

The primary geo-political risks we see impacting re-shoring decisions now include:

Supply Chain Disruption. Covid brought this to the surface and the Russia/Ukraine war is heightening fears surrounding this issue. Businesses may now be understanding that slightly higher total costs are inexpensive "insurance" relative to being cut off from components.

China/U.S. Continued "Decoupling." The tensions around Taiwan, Russia and a myriad of other issues raise the probability of an abrupt termination of shipments in a broad range of products. Many companies are beginning to shift work from China, attempting to avoid this risk.

Direct Policy Action by Government. There is now an increasing awareness of the possibility of government actions (from both sides) to reduce national dependence on key imports, particularly in areas such as semiconductors and medical products. The CHIPS Act, signed into U.S. law in 2022, is a prominent example of incentives to stay home. The cornerstone of this legislation is a $39 billion manufacturing program, aimed at revitalizing the domestic chip-making ecosystem by providing funding and incentives to build 15 new chip fabrication facilities, and the expansion of nine existing fabs, in 12 states[4]. There is also the risk of direct government mandates on investment. One of the most recent examples was news in early March that the Biden Administration was preparing new rules that could prohibit investment in certain industries in China, moving to guard U.S. technological advantages. According to the Wall Street Journal, a Treasury report said the program would focus on "preventing US capital and expertise from being exploited in ways that threaten our national security…"

These are all extremely influential factors that could maintain, if not accelerate, the re-shoring of manufacturing in this country.

There is, however, one major caveat that could limit the job growth potential in this scenario, and that is continued workforce shortages, as all of the factors outlined above will be limited if companies cannot find workers to fulfill their re-shoring job announcements.

One example, Intel's first major domestic project in four decades, it's proposed Columbus, Ohio based chip fab due for completion in 2025, will permanently employ 3,000 people, and an additional 7,000 workers will be required to build the complex. The lead contractor, Bechtel, says the need for electricians and pipefitters is "significantly outstripping the supply of labor in the local area," and expects to import almost half of the needed labor from outside the area, including other states[5].

Awareness of this problem is expanding, and there are signs of positive change. The Lowes Foundation, for example, recently invested $50 million to address "critical" tradespeople worker shortages, seeking to boost education in fields including electrical, plumbing, HVAC, construction, appliance repair and carpentry[6]. There will need to be sustained movement in this direction in large swaths of industry, as the biggest challenge will be strengthening our skilled workforce. Continued improvement in education programs in this area is of immense importance.

Though the additional geo-political factors we discussed above in and of themselves are not "positive", they could end up creating an optimistic situation for American manufacturing labor, if enough can be found and trained. Provided that the U.S. can be sufficiently competitive on this front, re-shoring should be the country's priority, based on economic self-interest.

As we concluded five years ago, it may be too early to tell if the U.S. will experience a true manufacturing renaissance, but the legitimate potential exists. Many factors in place have supported a trend reversal from the previous decade's nadir in manufacturing employment, and the myriad of geo-political issues presenting ever-growing risks to U.S. corporate interests should reinforce, or even accelerate this trend.

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Respectfully,

Cameron K Martin
Chief Investment Officer
Martin Capital Partners, LLC

1. Contagion, Net Interest, Marc Rubinstein, 3/17/2023.
2. Haver Analytics, The Economist, February 2023 .
3. U.S. Bureau of Labor Statistics, FRED.
4. State of the U.S. Semiconductor Industry, SIA 2022.
5. Bloomberg, America's $52 Billion Plan to Make Chips at Home Faces a Labor Shortage, 3/8/2023.
6. Fox Business, Lowe's Foundation Invests $50 Million To Address Critical Tradespeople Worker Shortage, 3/2/2023.

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