The Daily Feather

May the 4th Be With You

VIPs

- The NACM's Credit Manager Index had a fifth consecutive print above 70 in April for manufacturing sales; the record 65.4 reading from the Accounts Placed for Collection subindex suggests balance sheets have strengthened for manufacturers in recent months
- ISM's April Report on Business cited record-long lead times and materials shortages as hurting the manufacturing operating environment; backlogs hit records in March and April, while Customers' Inventories saw a record low due to the scarcity of supply chain goods
- The inflation rate for vehicles and other durable goods hit 2.0% YoY in March, the highest since 1995; undersupply conditions will need to rebalance before durables return to their deflationary trend, which should be aided by rising services spend and the vaccine rollout

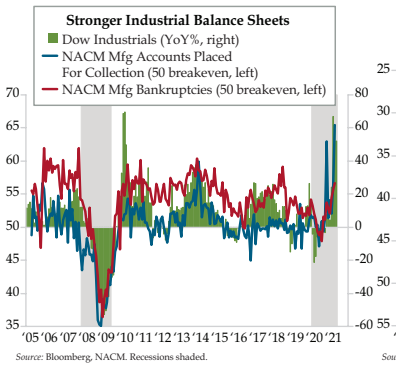
Happy Star Wars Day! Today, commemoration of George Lucas' Star Wars media franchise may be an informal holiday, but not for hardcore Star Wars fans. Darth Vader garb will be donned, and Princess Leia honeybun hairdos will be conspicuously present. To each other, they will say: "May the 4th be with you," the origin of which stems from the Tories, England's conservative party. On May 4, 1979, Margaret Thatcher became the U.K.'s first female prime minster. To mark history, the Tories took out a newspaper ad that simply stated, "May the Fourth be with you, Maggie. Congratulations." While not an overnight sensation, by 2011, the first organized celebration of Star Wars Day took place at the Toronto Underground Cinema. Media giant Disney then supercharged awareness after acquiring Lucasfilm and the rights to Star Wars. In 2019, the California legislature made it official, naming May 4th Star Wars Day once and for all.

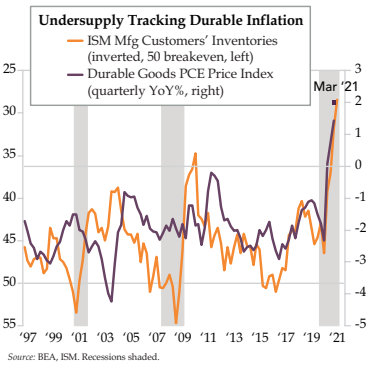
Science fiction has no place in judging the state of U.S. factories. This most cyclical of sectors is the definitive determinant of the economy's speed. While focus has shifted to the recovery in consumer-facing services, manufacturing remains a key marker of broader trends.

While we've flagged post-pandemic survivor bias, which tends to be reflected as over-optimism, the persistent strength of credit managers' views on revenues for industrials leaves little doubt those left standing need no help from the Force. The National Association of Credit Management (NACM) Credit Manager Index revealed manufacturing sales north of 70 (on a 50 breakeven scale) for a record fifth consecutive month in April; it's been above that threshold in six of the last seven months. NACM notes there are no problems getting paid in many sectors these days. Not only are companies paying what they owe, they are doing it on time. It helps to have top-line activity humming like the Millennium Falcon on the Kessel Run.

Two specific indications from the manufacturing complex also imply balance sheets have strengthened notably in recent months. The first is the record 65.4 reading from the Accounts Placed for Collection subindex (blue line), the highest ever breadth of manufacturers having less trouble collecting accounts. Throw in the fact that Bankruptcies (red line) rose to the best level, as in negligible, in three years, a reflection that the credit cycle is advancing into a re-leveraging phase following last year's crunch and subsequent stabilization. These credit manager guides of a robust industrial backdrop have been ratified by the strong double-digit annual gains in the Dow Industrials (green bars).

One other NACM series not illustrated but worth an honorable mention is the manufacturing Dollar Amount Beyond Terms. This metric hit an





all-time high of 61.3 in April, incontrovertible evidence of industrial firms' capacity to remain current with creditors. As the recovery continues apace, producers don't want to be caught short.

That said, the Institute for Supply Management's (ISM) April Manufacturing Report on Business cautioned as to how rough the operating environment has become. A tally of the impediments includes recent record-long lead times, wide-scale shortages of critical basic materials, rising commodities prices and difficulties in transporting products.

Some companies have hit their pain thresholds. Over the weekend, we learned that Mooresville, North Carolina-based Tristone is closing its plant after a mere two years in operation. The auto industry supplier was awarded more than $1 million in 2017 to open its first U.S.-based operation; some 302 employees were to be hired over a five-year period. Instead, the firm will be relocating its projects to lower-cost Mexico.

Against this backdrop of bottlenecks and crunched cost structures, production has been crimped. Backlogs rose to back-to-back records in March and April. And scarcity of supply chain goods pushed the Customers' Inventories index to a record low (orange line). Late last week, Belvidere Chrysler in Illinois announced that due to the semiconductor shortage, it was extending through May 9th the layoffs of 3,600 workers which began March 29th.

Would-be buyers of a new set of wheels will have to wait it out or pay up, which they've increasingly done. Last Friday, we learned that in March, the inflation rate for vehicles and other durable goods rose to a 2.0% year-over-year (YoY, purple line marker), the highest since January 1995, the same month the O.J. Simpson murder trial began in Los Angeles.

The ramp up in durable goods inflation runs counter to a 25-year deflationary run from 1995 to 2020. Note that this is the part of the inflation narrative that is different this time given March prints for nondurable goods inflation at 2.7% YoY and services inflation at 2.3% were not unusual when viewed in a historical context.

ISM's unmatched undersupply signal has tracked the move in durable goods inflation from the dark side to the light side. In past cycles, Customers' Inventories had longer lead times with turning points in durable inflation. However, the accelerated historic tightening in the supply chain has coincided with additional COVID-induced demand for durable goods.

In 2021, the vaccine rollout and an anticipated return to service spending (read: leisure travel) should result in a demand rotation away from durable goods. Throw in the fact that April should mark the peak in durable inflation due to base effects. However, to solidify durable prices' return to the dark side, undersupply conditions will need to rebalance. Use the Force.