InvestingChannel

3 Investment Trends for 2023 & Beyond

From 1970 to 1980, the S&P 500 returned 82.99% overall, or 6.23% per year.
Adjusted for inflation, real returns were -2.2% overall, or -0.22% per year.

The similarities between then and now are spooky.

Consider the following:

- Out-of-control inflation
- Skyrocketing prices due to oil supply constraints
- Armed conflicts
- Unpopular leaders
- Tense domestic politics

These led to stagflation – consistently high inflation and unemployment with low growth.

Inflation finally came to heel in the early 1980s when Federal Reserve Chairman Paul Volcker hiked interest rates over 15% until demand collapsed. This sent the U.S. into a recession.

Nearly a half century later, history is repeating itself as the Federal Reserve embarks on a rate hike scheme we haven't seen since.

Most investors have accepted this and the looming recession as a foregone conclusion.

Now, everyone wants to know what's next.

As we surveyed the market landscape, three key investment trends stood out from the rest.

This report dives into those areas and highlights some investments to consider.

Onshoring

Restarting after the COVID-19 pandemic taught the world a hard lesson. Our global economy relied on fragile supply chains that couldn't bend when demand changed.

It also became abundantly clear that the U.S. and other countries depended on China's manufacturing strength to fulfill their needs.

When Chinese President Xi Jinping and his government instituted strict COVID policies, end users felt the pinch.

Retailers like Walmart (WMT) and Dollar General (DG) battled stock outages, eating higher transportation costs on fewer goods. Automotive and high-end technology manufacturers shut down production when they couldn't get their hands on microprocessors.

Homebuilders struggled to procure roofing tiles, copper, and other basic materials. Is it any wonder that cars and homes were two of the biggest inflation drivers in the last year?

Congress finally passed legislation to support the nascent U.S. semiconductor industry. But many fear it doesn't go far enough.

And there's another interesting outcome from all this.

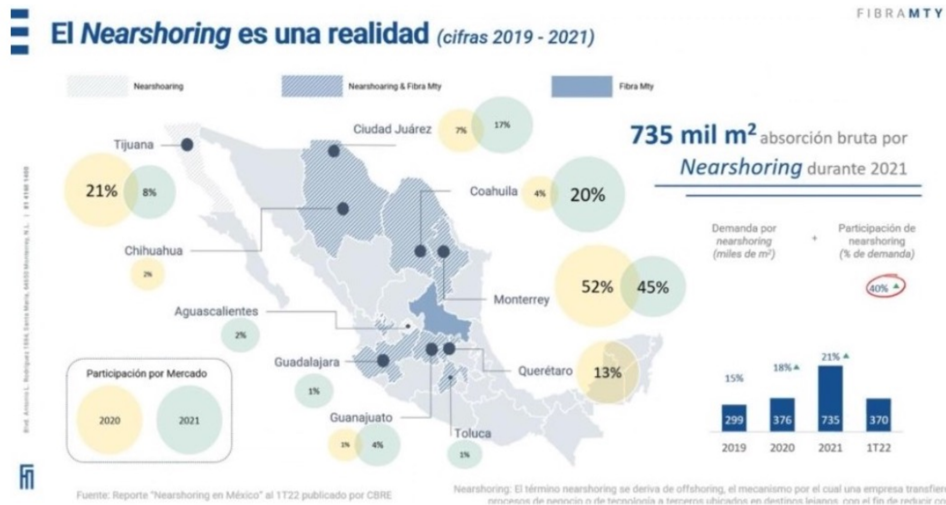
More and more manufacturers are reverting to a strategy from the 1990s and pushing production to Northern Mexico.

An updated NAFTA has led them to move manufacturing capacity out of Asia and into nearby countries, a concept called "nearshoring."

Real Estate group CBRE highlighted the development on the following graphic.

The yellow and green circles represent nearshoring's square meterage market share in 2020 and 2021, respectively.

But the key focus is in the bottom right corner. It shows that total new nearshoring projects occupied 735,000 square meters in 2021. Then in the first quarter of 2022 alone, these new projects occupied 370,000 square meters, massive growth on already staggering numbers.



Transport, warehouse, and logistics providers between the U.S. and Mexico stand to benefit from the trend.

Despite the name, Canadian Pacific Railway (CP) is set to be a key player. In 2022, the company merged with Kansas City Southern, whose assets included rail and intermodal transportation in Mexico and the U.S.

Werner Enterprises (WERN) also has a long-standing history in Mexico. The company provides trucking and logistics services across Mexico, Canada, and nearly every U.S. state.

And real estate trust companies holding industrial properties along the U.S.-Mexico border should do well from the transition.

As always, the main impediment is politics.

The border has become a flashpoint and ideological symbol of division, not between the countries but between U.S. political parties. That centers mainly around Texas.

Although fewer problems present themselves when the Texas governor and the White House come from the same party, the opportunity to gum up the works for political gain remains on the table.

As more investment pours into Mexico, the strain between business and government will become more apparent.

Exclusive Energy

Energy is the lifeblood of global commerce. Our ability to harness it is arguably the greatest achievement of the modern era.

In the early days, people could find unproven fossil fuel reserves anywhere. Today, we're much more limited.

Most crude oil production is within the Organization of the Petroleum Exporting Countries (OPEC) and a few other key players, including Russia.

In 1973, OPEC imposed an oil embargo on Israel allies, resulting in higher oil prices (adjusted for inflation) than we see today.

And at the end of that decade, the Iranian Revolution turned a Western ally into an adversary.

It's hard not to draw comparisons to the Russian invasion of Ukraine.

Although Russia's crude oil impact is marginal, the country's natural gas supply has been the lifeblood of Europe, especially Germany.

Yet echoes of WWII forced North Atlantic Treaty Organization (NATO) members and other regions to curtail, if not outright ban, the purchase of Russian energy.

The problem is no country, save for Iceland and Costa Rica, generates 100% of its energy from renewable sources.

That leaves many with growing needs and fewer supplies.

Many investors fail to realize that global growth didn't stop during the pandemic.

Baseline energy needs in 2022 and 2023 are higher than in 2019.

Central banks can try to raise interest rates as they did in the early 1980s. However, they'll find they curtail only more discretionary energy usage.

Consumers are far likelier to pull back on spending in other areas first. Plus, investors will look for cheap sources of new supply.

That means energy volume is unlikely to decline markedly.

The current U.S. administration is reluctant to incentivize domestic oil and gas exploration. And Wall Street isn't interested in funding ventures after getting burned in 2020, when a lot of bank-funded oil and gas companies' projects shut down with the rest of the world.

This situation offers a few investable opportunities.

The first is master limited partnership (MLP) oil and gas transportation companies such as Energy Transfer LP (ET). These midstream players act like toll collectors, earning profits on the volume they move.

MLPs have a unique taxable structure. Because of this, they give 90% of their profits to investors as dividends.

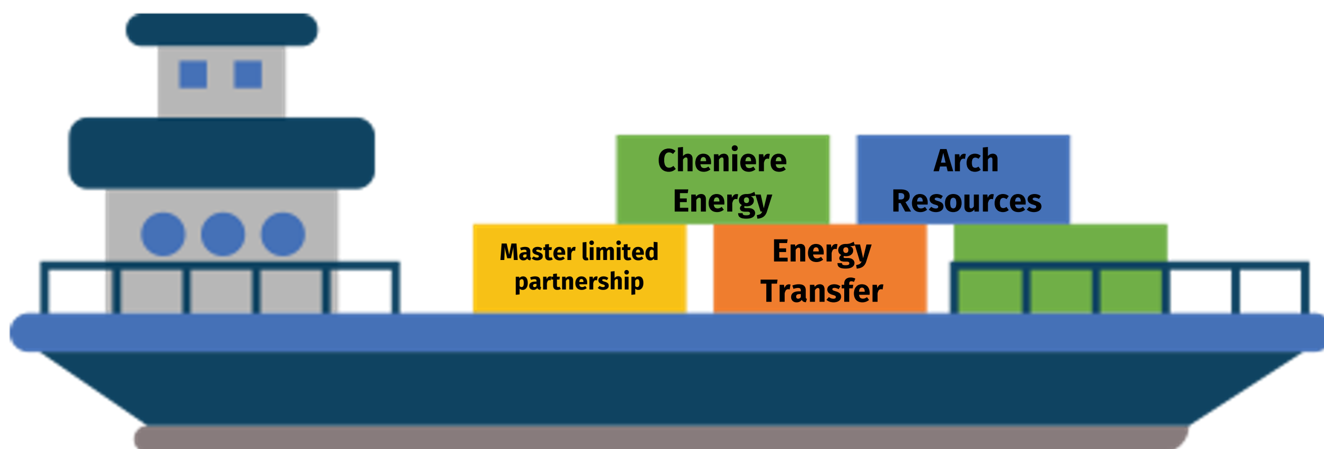
The second opportunity is in U.S. natural gas. With Europe desperate for new suppliers, the U.S. natural gas industry is set to step up and fill the void.

Cheniere Energy (LNG) is one company expanding its business by introducing a new natural gas export facility.

And there's one dark horse player people often forget: coal.

Though environmentalists lambast it, experts don't expect global coal demand to decrease substantially in the coming decades.

As countries reevaluate their energy needs, coal will likely get a boost in the next few years. Chief among the players is Arch Resources (ARCH).



Suburban Sprawl

In the two decades prior to the pandemic, millennials flocked to urban centers, gentrifying neighborhoods with small-batch everything and trendy food trucks.

Eliminating state and local tax (SALT) breaks severely hampered the population-dense New York tri-state area.

COVID put the nail in the coffin.

In 2021 and 2022, migration has increased substantially from urban areas, particularly in New York and California, to more suburban areas, particularly in Texas and Florida.

It's less about politics and more about the cost of living.

While the economy stopped during COVID, population growth didn't.

Today, the U.S. faces a housing shortage – ironic given the saturation that led to the 2008 collapse.

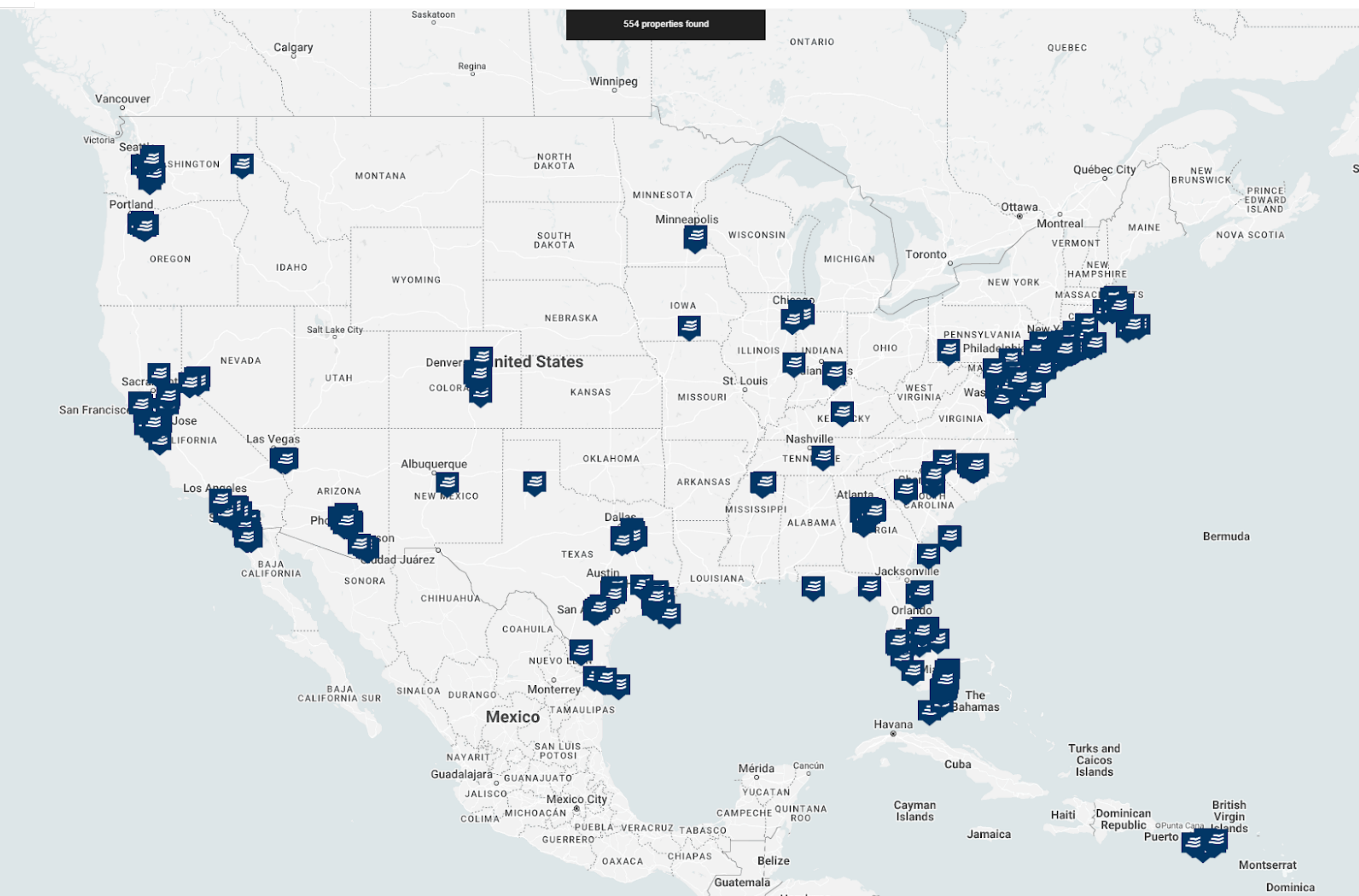
Work-from-home policies exacerbated the exodus from urban centers to the suburbs.

Now, while office centers in the largest cities are under serious pressure, residential REITs (real estate investment trusts) are exploding, as are commercial REITs invested in strip malls.

Kimco Realty (KIM) is a great example of a commercial REIT that directly benefits from this trend.

With over 550 properties across the U.S., the company's focus on shopping centers fits squarely into the suburban center explosion.

Like MLPs, REITs pay out most of their profits as dividends. Kimco currently yields north of 4% annually.



Each blue pin represents one of Kimco's properties. Source: Kimco Realty

On the flip side, New York City REIT (NYC) owns a portfolio of commercial properties in New York City.

Although it may look attractive with dividend yields over 10%, it's likely to cut those payouts given the struggle to find tenants.

Similar situations are playing out in San Francisco and Chicago.

Yet the Fed could quickly change things in favor of these REITs.

Should the Fed stop or even reverse its course, these same REITs stand to make a pretty penny.

2023 & Beyond

Central banks can influence only demand, not supply.

Unfortunately, supply problems drive global economic problems.

The Fed aims to reduce demand to levels that match supply, thus eliminating inflation.

However, that doesn't mean prices go back down. They simply stop rising.

Permanent solutions require substantial investment in decentralized manufacturing capacity that isn't subject to one country or region.

Based on current construction plans, we're unlikely to see marked shifts until 2025 at the earliest.

However, even if we reach the dreaded stagflation, it's unlikely to last as long or be as severe as what we saw in the 1970s. The U.S. and global economies are more dynamic and innovative than ever.

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