The global manufacturing cycle: Looking for the trough

3 July 2023

Dear Clients and Partners,

Having been in decline since spring 2021, global industry has recently moved into negative territory, with PMIs now below 50. Business cycle analysis suggests that a trough could be seen over the coming months.

In 1923, Economist Joseph Kitchin published a study showing that, on average, economics could be viewed as short cycles of about 40 months (or just over 3 years). He attributed the reason for this to successive stock accumulation and clearance by manufacturers. When stocks are low and there is sufficient demand, companies sell at higher prices, which encourages them to produce more. After a given length of time, which varies depending on the cycle, this production eventually raises stock levels and prices settle. As a result, the incentive to produce decreases and, ultimately, stock levels drop.

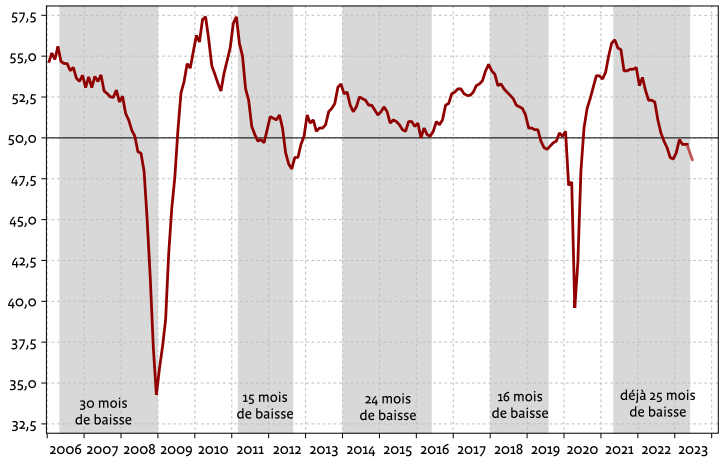
Although inventory management has evolved significantly since 1923, we still see relatively short economic cycles (3 to 4 years) in manufacturing. These are linked to inventory cycles, but are also influenced by other factors (including demand shocks). The global manufacturing PMI shows that the cycle has been descending since the peak in spring 2021, with a new trough seemingly reached in June 2023 (Chart 1). This equates to 25 months of deceleration, making it the longest period of decline in the manufacturing PMI since 2006/2008.

Is industrial contraction tailing off?

PMI index from surveys of global manufacturing companies

Le ralentissement industriel bientôt à son terme ?

Indice PMI issu des enquêtes auprès des entreprises manufacturieres mondiales



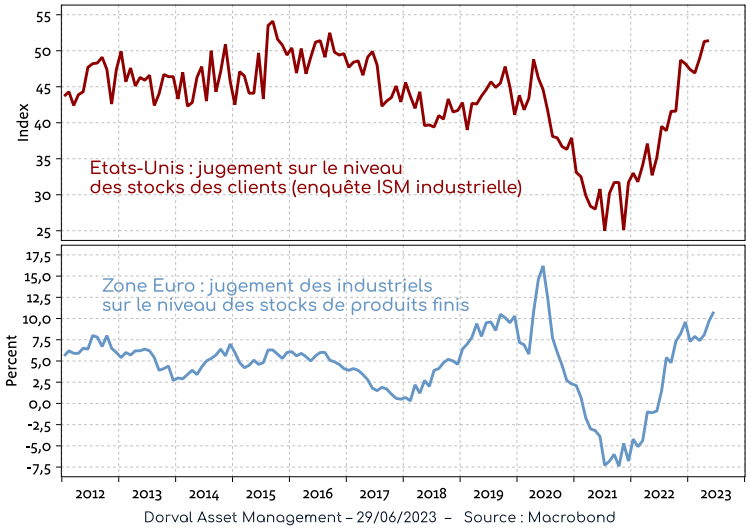
Dorval Asset Management – 29/06/2023 – Source : Macrobond

- *30 months of contraction / 15 months of contraction / 24 months of contraction / 16 months of contraction / 25 months of contraction so far*

Many factors have contributed to this long decline in the manufacturing PMI over the past two years, including, in particular, the impact of COVID. Nevertheless, Kitchin-style logic now seems to be at work, especially in developed countries. In recent months, manufacturers have considered both their own stock levels and those of their customers to be higher than the norm (Chart 2).

The restocking phase tailed off in 2021

Le fin du cycle de reconstitution des stocks débuté en 2021



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- *USA: view of customers' inventories (ISM Manufacturing survey)* / *Eurozone: manufacturers' view of finished product inventory levels*

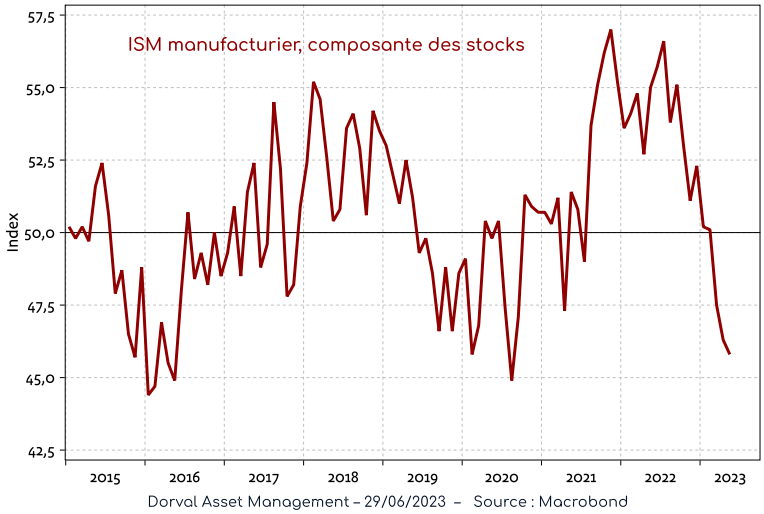
In the United States, this situation has been reflected in a manufacturer clearance movement since March 2023. This is becoming more and more widespread, reaching a magnitude similar to those of the 2016 and 2020 troughs (Chart 3). It could be the case for a few more months. This usually marks the final phase of a Kitchin cycle and precedes the next bullish phase (which may be seen from the autumn) unless demand is affected by an external shock.

Significant stock clearance in the United States since March 2023

Readings above 50 show rising stock levels and readings under 50 show falling levels

Fort déstockage industriel aux Etats-Unis depuis mars 2023

Au dessus de 50 d'indice, les stocks montent, en dessous de 50 ils baissent



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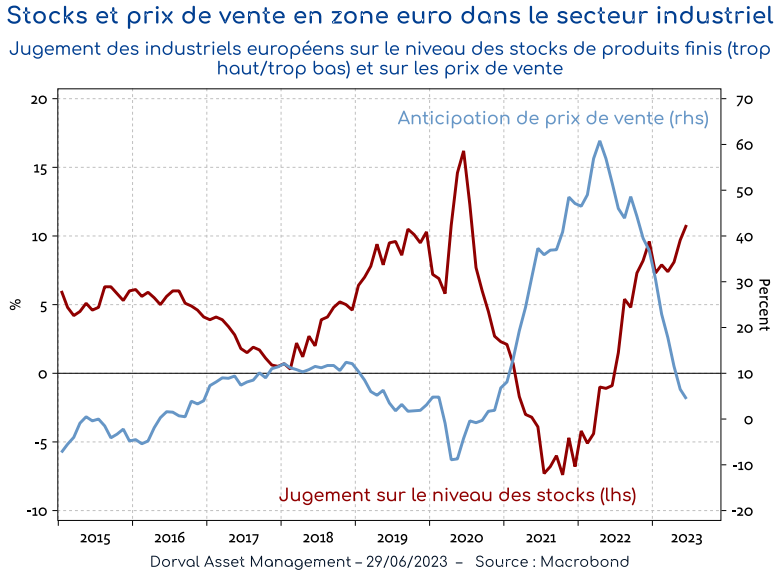
- *ISM Manufacturing: Inventories*

This somewhat unnerving phase is currently accompanied by a particularly welcome movement: disinflationary pressure in the manufacturing sector. In Europe, the latest surveys (June) show this effect on prices as stock levels are considered too high and this leads to a sharp deceleration in sales price forecasts for the coming months (Chart 4).

Eurozone manufacturing sector inventories and selling prices

European manufacturers' view of finished product inventory levels (too high/too low) and of selling prices



- *Sales price anticipation (rhs)* / *View of inventory level (lhs)*

Assuming that there are no external shocks, conditions for the gradual stabilisation of the manufacturing cycle are emerging thanks to falling stock levels and the boost in demand that disinflation affords (gains in purchasing power). This can already be seen in recent consumer confidence indices, which are on the rise in both the United States and Europe. Strong labour markets also support this by stabilising demand. In this scenario, the global manufacturing cycle is expected to reach a trough in the summer of 2023.

Our global funds retain equity allocation of a little over 20% for the prudent strategy, 43% for the balanced strategy and 100% for the long-only fund. The equity pocket is invested in an extremely diverse core basket of 200 stocks and in two complementary themes (Green Deal and defensive). We are continuing to earn increasing returns on the non-equity portion, via money market securities (TCNs) issued by companies and governments in the eurozone. Our bond duration remains close to zero.

Our exposure rates are as follows:

- Dorval Convictions: The equity exposure rate is 63%.

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