
THE HANDOFF TO NORMAL?

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A little over four years ago, the global economy was suddenly shuttered. Flush with stimulus payments, U.S. consumers found their only consumption outlet was goods. Of course, there was a problem. The reason for the stimulus payments was that the economy was shutdown, including factories. The “from the couch” goods boom caused a series of global economic ripples. From toilet paper shortages to counting ships off the coast of California, the world was made radically different overnight and every economic indicator became instantaneously useless.

For the first time in a long time, it was a goods-driven U.S. economy. Prices were rising, and used cars became a popular topic of conversation. Trucking companies were booming and fretting about an impending driver shortage. Manufacturers were unable to keep pace with demand as their supply chains proved fragile. UPS, FedEx and Amazon strained to keep pace with deliveries. U.S. retailers stocked up on inventories to meet consumer demand. As the U.S. economy reopened, these issues slowly dissipated.

And there was rampant angst about whether or not the U.S. economy would be able to hand off the economic baton from goods to services in time to avoid a [recession](#). Spoiler: the handoff was executed without issue. Services boomed. Manufacturing entered a lingering downturn alongside trucking and logistics as retailers suddenly found themselves with an inventory glut. In fact, the transition went so well that “revenge travel” entered the vernacular. And—according to Carnival and other cruise lines—the revenge continues.

Nothing lasts forever, though. There are signs of consumer exhaustion, with foot traffic at restaurants waning and consumer packaged goods companies signaling their pricing power has largely run its course. The commentary from Pepsi to Kraft-Heinz to Kimberly-Clark has shifted over the past 12 months from one of *pricing* to one of *volume*.

Importantly, that volume is not coming at the expense of past price increases. At least, not yet. As Unilever conveniently stated in its latest investor presentation, the previous pricing actions taken increased gross margin dollars. Where are those gross margin dollars flowing? Advertising and marketing. There was little need to advertise when revenue gains were all about pricing. There is an imperative to advertise when revenue growth is all about volumes.

At a first glance, this is beneficial for a specific swathe of U.S. technology giants. But it is not the whole story. While it will certainly be beneficial to that cohort, it will also be a tailwind to an emerging group of firms. Amazon’s advertising business has been an impressive growth engine for the retailer. For its part, Walmart was not going to be left behind. On its latest earnings call, Sam Walton’s creation stated that advertising was a growth area and purchased a television maker to further its initiative. Even grocery retailer Kroger has a play for advertising dollars with its [AI](#)-focused 84.51° subsidiary.

Then comes the statements from the advertising platforms themselves. Where are those revenues going? Aside from the bottom line, Meta and Alphabet both increased their outlook for capital expenditures to build out their AI capabilities. Higher prices at the grocery store are, in part, funding the AI boom.

There are more than a couple of winners with increasing advertising and marketing spending. And not all the winners are obvious. This makes the current environment

particularly interesting. After all, chasing volumes means manufacturing more stuff, which suggests retailers are—finally—beginning to find their inventories “right sized.”

All of this points to an important question—is the next handoff here? The latest ISM Manufacturing Survey would suggest it has arrived. The gauge pointed to growth both in current output and new orders. This time around should not be as dramatic as the previous post-COVID episode. More of a “handoff to normal,” with a stable and growing manufacturing sector and a services industry doing the same. That would be a welcome development for the U.S. economy after the last few years of sharp shifts between economic drivers.

The investment consequences are far reaching as well. Typically, an improving manufacturing sector coupled with a healthy services economy is associated with higher medium to long-term yields and a buoyant equity market. But this is the post-COVID world. Equities have not struggled with elevated interest rates. An economy with broadening “winners” and a resilient economic outlook is likely to benefit some of those companies that have been left behind. On the other hand, the Federal Open Market Committee’s “[higher-for-longer](#)” and “[wait-and-see](#)” mantras are also reinforced with a more of the same for interest rates across the curve .

The handoff to normal will be beneficial for investors willing to look beyond the market-weighted winners toward the companies with quality moats poised to benefit from a more balanced outlook for U.S. growth.

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