The Wrap Up

They Have the Plant but We Have the Power

A relatively calm week in markets risks being disrupted as the United Auto Workers are set to go on strike. Today, we provide insight into what has happened and what the potential consequences can be.

Unionization in the Untied States has declined considerably over the last 50 years; just 6% of private sector jobs are unionized, down from 30% in 1970. Although not the only factor, it has been argued that this decline has contributed greatly to the decline of the middle class. The financial crisis of 2008 set workers back even further, although the post-crisis environment did allow for steady, real wage gains over a 10 year period. Real wage gains is another way to say increase in purchasing power; if your salary goes up by 3% while inflation is at 2%, your real wage has increased by about 1%. These numbers are not too far off from what we experienced over the last decade and then the pandemic happened.

Initially, pandemic related shut downs caused large changes in employment; people had their working conditions change, their hours reduced or their job cut altogether. The majority of the job losses were short lived, however, and employment rebounded fairly quickly. Regardless of the rebound, not all sectors were at full employment; some industries dealt with higher than anticipated early retirement where replacing people is not always so straight forward. Other industries experienced rapid demand growth, often exceeding their ability to increase their staffing. Lastly, because of the ability to work from home, or simply due to a change in worker`s expectations, many blue collar jobs were left unfilled.

This new reality is what lead to tight labour markets and the tight labour markets contributed to the inflation problems that started in late 2021. Today, we can understand that the post-Covid inflation was caused by the initial and temporary disruptions in production and the supply chain, the artificial increase in demand caused by direct stimulus payments and the opportunism of some firms who increased their margins. In response to the initial inflation, labour began to demand higher compensation to offset the increase in the cost of living. Wages are a function of demand and supply within the labour market; when a large pool of available workers compete for

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a small number of jobs, this competition reduces wages. Conversely, when the number of jobs exceeds the number of available workers, competition pushes wages up.

Although individuals are logically going to respond to inflation by demanding higher wages, by the time we are in a high inflation cycle, this only compounds the inflation problem. Eventually, governments are supposed to cut their spending (we are still waiting for further narrowing of the budget deficit both sides of the border) and central banks raise interest rates in order to cool down demand long enough until supply (be it of labor or of production) catches up. We do have higher rates, cooling demand and lower inflation but the cost of living still remains above target (2%) and labor markets are still tight. For this reason, labor can still squeeze concessions from their employers.

Earlier this year, UPS drivers threatened a strike and ended up walking away with a hefty pay raise (with pay and benefits for its drivers reaching $170,000). As it stands today, Hollywood writers and actors are also on strike; outside of sports, Youtube and Tiktok, we risk running out of new content to entertain us! And now, 146,000 United Auto Workers are going on strike until they can resolve their pay disputes. While we explained the demand side to the story it is worth noting the car markers' side too; the big three (GM, Ford and Stellantis) are all undertaking massive investments in order to facilitate the shift towards electric vehicles. Not only are the engines within the cars changing but as we head towards driverless cars, more investment will be needed. Lastly, car companies like Tesla or China`s Nio, are positioning themselves to take their share of the car sales pie. In summary, required investment is increasing, competition is heating up and uncertainty is ever more present.

We can understand the hesitancy of the car markers; if they mismanage their affairs and finances they risk bankruptcy and everyone risks losing their jobs permanently. That being said, the car makers are currently benefitting from elevated profits, therefore, they can afford to offer more to their workers. Why this matters to everyone is that a disruption in car production brings risk to many segments of the economy: the consumer loses in many ways and many adjacent jobs are also at risk. The recovery in car inventories will certainly be delayed, keeping auto prices elevated for longer. Renting a car will also become more difficult and expensive for that same reason. Workers in the auto parts industry will see their hours reduced and business such as restaurants and bars will see their visits drop as fewer workers report to work (it will be even worse for those business in proximity to auto production plants as they will see all workers temporarily disappear). The strike fund is estimated at $850 million, meaning workers will be able to draw about $500 per week from the fund for about three months before this runs out. In the interim, the drop in income will put pressure on household balance sheets at a time where they are already deteriorating.

No one wins in a strike yet everyone will benefit when a deal is eventually struck. What the car makers should understand is that their sales will suffer if purchasing power continues to decrease and especially if a prolonged strike hurts the broader economy. However, the UAW representatives should recognize that the labor market, along with inflation, is cooling down and they should avoid overplaying their hand. From a portfolio management perspective, there are no major moves to make for now; our year-long cautious stance should help our portfolios hold up better than the market if things sour further from here.

Healthy distraction

We haven`t spoken about AC Milan in a few months, however, the stars are aligning for an interesting set of days ahead. Firstly, they will face their cross town rivals, Inter Milan in the renowned Dery della Madonnina, on Saturday. Milan and Inter are two of the most storied and successful clubs in all of football and every time they clash, the fans get spoiled.

On Tuesday, Milan will face Newcastle in the first leg of the Champions League group stages. This summer, Milan saw a dramatic overhaul of their squad with many players leaving and new ones entering. In order to fund this overhaul, they sold one of their starlets, Sandro Tonali. This was particularly painful as Tonali was a boyhood fan of the club who had previously accepted a pay decrease to join them. The club that he was sold to? Newcastle.

Have a great weekend!