SPDR FUND MATERIALS SELECTION SECTOR ETF (XLB) HOLDING ANALYSIS

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Chart, pie chart

Description automatically generatedETF OVERVIEW

Material Select Sector SPDR Trust is an exchange-traded fund on the NYSE. Its objective is to provide the investment result that corresponds to the performance of the entire Materials Sector Market Index. There are four main industries that are invested by the fund: chemicals, construction materials, containers and packaging, and metals and mining. Its portfolio is focused on the United States market (81.553%) and United Kingdom market (18.325%). There are a few other equities they own over the globe like Canada, Japan, Sweden, and Switzerland, but their percentage is not significant enough to affect the portfolio. The top number one holding is Linde PLC (LIN) whose stock price has recovered over 100% from the pandemic sell off. The analysts expect Linde to continue to hike their stock price and grow their buyers volume resulting in a sales growth around 6% in 2022. Majority of its financial ratios are better than the industry advantage: Price to Earnings ratio of 46.5x compared to 32.9x, Price per Book Value is 3.7 to 5.6 and Price to Cash Flow is 19.5 to 17.8.

CURRENT MATERIALS MARKET TREND

The Infrastructure Investment and Jobs Act that was signed into law in mid-November of 2021 provided $1.2 trillion in government spending creating a big tailwind for the material industry. The money was spent on new public work such as roads, bridges, other major projects, passengers and freight rails, broadbands and EVs had a big impact on the key commodity inputs, such as copper and steel. Not just copper and steel received a push, other basic materials necessary for construction also rebounded from their pandemic-level lows. Moreover, improved features and increased driving range for battery-charged cars could boost the sales of EV market leading to an increase in demand for battery materials like lithium and nickel, coating materials and copper as an EV contains 4 times as much copper as normal vehicles.

Building materials are also receiving a high projected growth rate for 2022 around 10% due to the increase in demand. People are shifting from traveling-to-work to work-from-home or hybrid, thus, they will spend more time under the roof. That will help to increase building materials as the customers are trying to refurnish their home, to build a new and better home. Moreover, residential real estate is not the only industry that helps drive the demand for building materials, commercial and industrial real estate projects are also one of the catalysts. Because of the supply chain issue and the growth of e-commerce sales, manufacturing facilities are trying to expand their portfolio to increase the limited supply for a persistently high demand for inventory space. These growth in the real estate industry leading to the increase in revenue for the materials industry can be made seamless by supportive policies. Housing loans and affordable housing schemes are making a surplus in funds in buyers’ hands, therefore, there is an increase in demand.

There are two more big trends in the materials market: Specialty Chemicals and Agricultural Chemicals. Chemical producers will benefit from higher demand and prices as economic reopening, government stimulus checks and less troublesome supply chains. Nevertheless, because of supply chain disruptions, there might be a boost in volume in early to mid 2022 as producers will be playing catch up. There is going to be a robust demand in 2022 for specialty chemicals used in coatings in the slow recovering end-markets such as coil, general industrials, electronics, automobile refurnish, wood coatings, and aerospace. Growth is also offered in companies that make disinfects, cleaning products, sanitizing equipment, personal protection, and medical supplies. Even though the specialty chemicals sector is receiving a tailwind, the agricultural chemicals market is struggling to make a good fortune. Farm cash inflow was surging, but costs were also jumping high leading to a concern for a revenue peak in the farming market. Farmers were able to spend significantly more on agricultural chemicals in 2021 by an increase in crop prices. Unless the commodity prices rise more, farm spending will likely face a sequential squeeze in 2022.

MATERIALS MARKET OUTLOOK

American Chemistry Council (ACC) forecasted that the US chemical volume will rise by 3.2% in the summer of 2022 compared to an estimated increase of 1.4% this year. Pharmaceutical industry continues to grow unabatedly due to strong demand which helps to boost the revenue of the specialty chemicals manufacturers. With the Delta and Omicron variants slowing down the reopening of the global economy, there is still significant pent-up demand, particularly across the industrial and consumer-end markets. As demand keeps on growing, employment is expected to recover this year, but it will not reach pre-COVID level until 2023. US chemical volumes are expected to grow by 3.2% in 2022, shipment will rise 8.2% in 2022 after a big fall of 13.5% in 2020. Industry capital spending will grow 3.1% in 2022 after falling 17.6% in 2020 and rise back to $30.6 billions in 2021.

US chemical exports are growing as major economies reopen and import demand in partner economies improves. After falling 7.6% in 2020, exports are increasing by 5.8% in 2021 and expected to be increasing 13.8% in 2022. The US chemical imports are expected to grow 13.7% in 2022 after a drop of 5.1% in 2020 and a rise of 1.6% in 2021. The US chemical industry will maintain its net exporter position, supporting the total US goods exports. By 2025, net exports of chemicals will reach $40.5 billion. General economic conditions like inflation, recession, changes in interest rates, credits, market liquidity, regulations, political events can cause the industry great volatility and fluctuation. 60% of chemical industry respondents saw volatile costs as biggest risks facing companies in 2022 because of the monetary inflation.

More people are shifting to more sustainable and eco-friendly alternative designs. Solar panels reduce electricity bills, make use of renewable energy, and are aesthetically pleasing. Smart Glass Window is currently a big trend in commercial and industrial construction, natural light, and large windows to reduce electricity consumption. Composite roofing shingles are sustainable, they do not require constant repairs and management or replacements. Bamboo floors are unique solutions to normal hardwood floors. Insulated concrete framing is a fundamental element in controlling heating and cooling costs. It is airtight blockage that can prevent any unwanted energy transfer like any wood panels that always come with cracks. Green building materials market is growing driven by the demand for eco-friendly buildings and these buildings require high capital investment compared to other conventional buildings. This results in an assumption of market growth in the forecast period.

In 2022, the chemical industry likely has a sharper focus on decarbonization strategies due to regulatory changes and technology innovations. European Union Green Deal, a commitment to carbon neutrality by 2050, gains steam from the shifting of fossil fuels to renewables in 2022. It creates a new market for carbon and other byproducts. Over the past year, the market showed that people are willing to switch to more environmentally friendly substitutes even if they cost slightly more and function less effectively. Moreover, chemical manufacturers are increasingly realizing that digitalization is about implementing better technologies and involves aligning the culture, people, structure, and tasks. The chemical industry is one of the industries that are reluctant to use cutting-edge technologies in their facilities. Now, they are trying to use technologies to support productivity, strengthening asset dependability with IoT devices and remote monitoring. Creating ecosystem collaborations with multiple entities, universities, companies to better serve customers through solving complex problems.

RECOMMENDATION

Due to reasons mentioned above, I believe we should **HOLD XLB** in the UIndy Student Fund portfolio for the time being. The fund has holdings of leading companies in both specialty chemicals and sustainable markets. The demand and pricing for those markets is rebounding from its pandemic-level lows. The fund is well-proportioned in both previous and upcoming industry trends. **That is why, I recommended a HOLD for XLB**

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