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## Industrials: boom or bust?

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**The starting point for industrials has been weak for the last two years, as pandemic-era demand for goods and supply chain issues abated while costs and interest rates rose.**

The outlook for industrials was enthusiastic post-election, as companies were optimistic about U.S. reshoring and reindustrialization, traditional energy production and a resurgence in M&A. While those policy items may come into greater focus over time, downside risks from tariffs, federal spending cuts and the possible repeal of the CHIPS Act have management teams striking a more cautious tone.

The starting point for industrials has been weak for the last two years, as pandemic-era demand for goods and supply chain issues abated while costs and interest rates rose. The ISM manufacturing index contracted for 26 consecutive months until expanding in the last two months. New orders resumed contraction after a three-month expansionary streak that may have reflected front-running of tariffs. Nonresidential construction, the second largest driver of industrial capex, remains mixed, with the Architectural Billings Index, which reflects demand for architectural services, slumping since 2022.

This subdued starting point is shrouded by policy uncertainty that could lead businesses to pause capital spending decisions. The NFIB's small business survey showed the biggest monthly drop in capital outlay intentions since 1998 in January and slipped further in February.

However, while the recent past and the near-term outlook inspire less confidence, the industrial sector is particularly diverse, sporting an array of "haves" and "have nots" for long-term investors:

### "Haves":

- **Aerospace** – Global demand for travel continues its upward march. Fleet capacity hasn't recovered as quickly post-COVID so a rich stream remains of sales, earnings and free cash flow from equipment manufacturing, maintenance, repairs and parts.
- **Commercial HVAC** – Energy efficiency and cost savings are supporting investments across nonresidential markets with an extra boost from education and health care construction and data centers.
- **Railways** should benefit from the recent lift in industrial production and may capture market share from trucking. Valuations are attractive.
- **Electrification and grid upgrades** – The **power grid requires upgrades** to incorporate renewables and to cope with rising electricity consumption from electric vehicles and data centers, as well as increasing demand for transmission capacity.
- **Data centers and utility spending** will demand power generation, leveraging both traditional and renewable energy and construction. However, risks have emerged due to efficiencies, competition, and headwinds to capex within AI.

### "Have nots":

- **Traditional industrials and machinery** – Manufacturing weakness coupled with policy uncertainty has weighed on core industries within the sector, particularly those with **meaningful exposure to China**. **Warehouse and industrial manufacturing automation** have been sluggish after a pandemic boom and face headwinds if capex slows as companies await policy clarity.
- **Automotives and consumer electronics** – After the pandemic boom, durable and non-durable goods demand has been muted and tariffs are likely to have direct and indirect impacts.
- **Defense** – Global defense is surging, but U.S. federal spending cuts leave key U.S. defense contractors and services companies vulnerable as procurement is scrutinized.

We are still overweight the sector, but it requires an active approach, with an eye towards companies with above-industry growth that can leverage that growth into faster EBITDA growth, while responsibly allocating capital to protect earnings.

## Manufacturing and construction have been sluggish since 2022

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Source: AIA/Deltek, ISM, J.P. Morgan Asset Management. Data are as of March 27, 2025.

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