BOAT

SonicShares™ Global Shipping ETF

A Primer

Outlook for the Global Maritime Shipping Industry

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Importance of the Maritime Shipping Industry

Maritime shipping underpins global supply chain linkages and economic interdependency with shipping and ports estimated to handle 90% of world trade.[1] Despite its vital role in moving the global economy forward, the maritime shipping sector can be quite challenging for investors. Even a slight economic slowdown, not to mention a "black swan" event like the COVID-19 pandemic, can have an outsized impact on sector profitability.

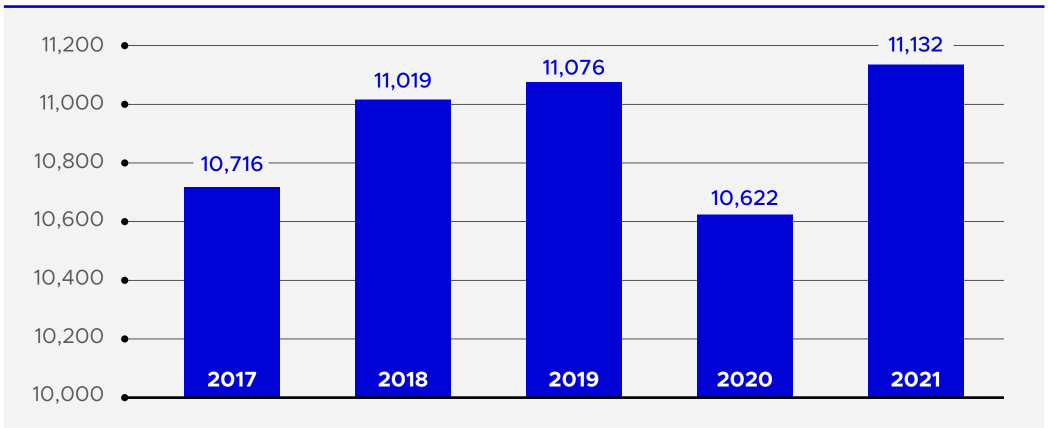
International maritime trade has grown steadily at a compound annual growth rate (CAGR) of almost 3% over the past half-century, reaching a volume of 11.08 billion tons in 2019.[2] Before the pandemic disrupted the global economy and trade flows, freight volumes had been expected to continue to grow as demand rose from both developed and emerging markets. Consolidation within the industry appeared likely to diminish price competition over time, which would help improve profitability.[3]

Impact of the COVID-19 Pandemic

The global health and economic crisis caused by the COVID-19 pandemic has changed the landscape for maritime shipping and trade and significantly lowered short-term growth prospects. The United Nations Conference on Trade and Development (UNCTAD) estimates that the volume of international maritime trade fell by 4.1% in 2020.

Trends in Maritime Freight Volumes

(Million Tons)



Source: UNCTAD. Review of Maritime Transport 2020

The negative impact of the pandemic on overall maritime freight volumes is expected to be short-lived. As COVID-19 continues to wane in many of the world's largest economies, UNCTAD anticipates that the volume of maritime trade will more than recover in 2021, ending the year 4.8% higher than 2020.[4]

However, behind this optimistic overall picture there are some less favorable realities. In the first place, different freight segments have had varying degrees of success during the pandemic. The maritime freight trade can be divided into container, dry bulk, and liquid bulk (tanker) segments.

Containerized freight volume contracted by 6.8% in the first two quarter of 2020, before staging a strong recovery in the second half that left volume for the whole year just 1.2% below 2019. 2021 is expected be even better for container shipping than 2020, as the current backlog will take months to clear and carriers are using the current strength of the market to lock in long-term contract rates for the coming 12 months at higher levels than in 2020.[5]

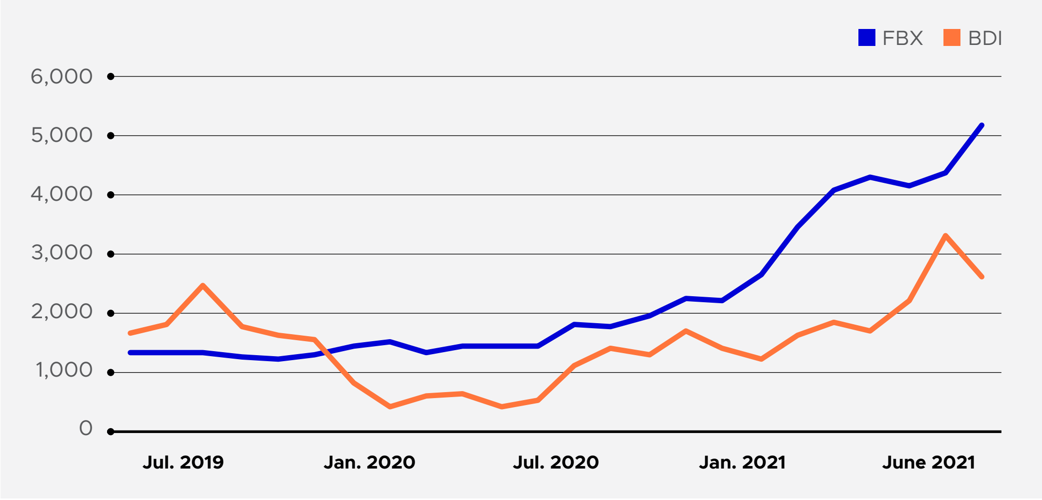
Reductions in mining and industrial activity had a negative impact on the dry bulk trade in 2020, but to a lesser extent than containerized trade. Most experts are optimistic that fundamentals are in place for a resurgence of dry bulk shipping volumes in 2021 and beyond. Such fundamentals include rapid urbanization, industrialization and economic growth. Increased investment in transportation and other infrastructure, which requires large quantities of steel products, will be a major growth driver. Annual growth rates of 4%- 6% are forecast.[6]

The pandemic has had a significant impact on trade in oil and gas. Global oil demand fell with the interruption of large parts of the global economy, restrictions on travel and transport, and cuts in industrial activity and refinery output. On the supply side, surplus oil production nearly exhausted all oil storage capacity, with many vessels being used as floating storage. The gloomy outlook for the tanker segment is expected to continue at least until the second half of 2021 or, more likely, 2022 when the U.S. Energy Information Agency (EIA) projects global oil demand will again exceed pre-pandemic levels.[7]

Freight rates sank along with volumes in the first half of 2020. Shippers responded with a combination of temporary and longer-term measures designed to mop up excess capacity, ranging from canceling scheduled sailings to laying up or scrapping ships and postponing or canceling new ship orders. Tanker operators resorted to hiring out their unused tankers as floating storage tanks for oil when it became increasingly difficult to find land-based storage.

Recent Container and Dry Bulk Shipping Rate Trends

July 2019-June 2021



Sources: https://tradingeconomics.com/commodity/baltic; https://fbx.freightos.com

Partly as a result of these capacity management measures, the Baltic Dry Index (BDI), which reflects shipping rates for major dry bulk cargos, such as coal and grain, hit a low of $411 in May 2020, then began a strong recovery that would take it as high as $3,295 a year later.[8,9] Container ship demand, as well as rates, increased dramatically in the second half of 2020, with the Freightos Baltic Index (FBX), which is based on average container shipping rates, nearly tripling between June 2020 and June 2021, reaching a level of $5,165. This dramatic increase was driven by two factors. One was that customers scrambled to restock shelves and inventories as the world's economies restarted. The second was that firms that usually shipped goods in the holds of passenger jets were forced to use container vessels due to the grounding of much of the global air fleet due to the pandemic. The latter highlights both the susceptibility to disruption of air freight transportation and the resilience of maritime shipping. When the pandemic hit, air cargo ground to a halt while maritime shipping continued unimpeded.

The outlook for the maritime shipping industry will largely be determined by developments in the world economy as they affect trade flows, as well as trends in shipping rates and regulatory developments. The global economic recovery from the pandemic is expected to accelerate through 2021 and continue through 2024. The International Monetary Fund (IMF) is projecting an economic growth rate of 6.0% in 2021, moderating to 4.4% in 2022 and 3.3% in 2023-2024, thereby boosting the demand for ocean shipping services.[10]

Container shipments, measured in TEU (twenty-foot equivalent units), are expected to grow at least in proportion to GDP.[11] One analyst expects growth in the container trade to outstrip global GDP growth, growing by as much as 8.5% per year between 2021-2025.[12]

Dry bulk commodities, in particular minerals and ores, are closely linked to industrial and steel production, as well as manufacturing and construction. As the main industrial economies of the world return to growth in 2021 and beyond, the dry bulk market is expected to experience annual growth rates as high as 5% over the next three years.[13]

The outlook for a recovery in the liquid bulk trade is more guarded. Demand for tanker transport started to recover in the second half of 2020 with the easing of lockdown measures, and scheduled 2021 deliveries are more than double the 2000 numbers. However, global oil demand is still 4-6 million barrels per day below pre-pandemic levels and analysts do not expect global oil demand to return to the 2019 level of 99.7 million barrels per day until 2022. An additional negative for the tanker shipping market is the overhang of floating storage.[14]

It is not clear how much higher container and dry bulk rates may rise. Fitch Ratings expects container ship rates to remain high in the short term, but believes that they should moderate in the longer term once shipping supply-chain disruptions are cleared and more new ships are deployed.[15] Another source, Drewry's Container Forecaster, expects container rates to remain elevated until at least 2023.[16] Like container rates, dry bulk rates are expected to remain high at least until 2022.[17] Tanker rates have declined steeply since the onset of the pandemic and are expected to stay depressed for some time to come, as U.S. Energy Information Administration (EIA) and other sources are still forecasting lower petroleum demand in 2021 than in 2019.[18]

At the very least, we believe container ship lines and dry bulk shippers should benefit financially in the short term from the combination of growing freight volumes and continued high shipping rates. However, the cost of compliance with increasingly stringent environmental regulations, such as the International Maritime Organization's limit on vessels' sulfur emissions (known as "IMO 2020"), will place significant pressure on shipping companies' bottom lines.

The shipping industry operates in a challenging environment, so it is important for investors to do their due diligence before plunging in. Investors who decide that the shipping industry is an attractive investment opportunity have several options, including buying freight futures, shipping company stocks and/or ETFs. A new global shipping ETF, launched in August 2021, is the **SonicShares™ Global Shipping ETF (NYSE Arca: BOAT)**. BOAT is designed to track the performance of over 50 global companies engaged in maritime shipping.

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