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Investment Institute

Market Commentary

Weekly perspective on current market sentiment October 4, 2023

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Last week's S&P 500 Index: -0.7%

Credit and the American economy

Key takeaways

- Credit and the availability of credit are the lubrication that allows the gears of the U.S. economy to run smoothly.
- Tougher credit standards are hampering the ability of the consumer to drive the economy forward in coming quarters.

When consumers buy cars, most take out a loan. Same with houses. While some buyers might pay cash for their abode, the vast majority take out a mortgage. After all, cars and houses are clearly "big ticket" items that require a hefty outlay of funds. And don't forget about those home equity lines of credit that many consumers are fond of.

How about businesses? While overall business balance sheets are in good shape with good amounts of cash "on the books," many businesses, big and small, frequently make use of operating loans, lines of credit, and equipment loans on a day-to-day basis. It's a major part of doing business. Many smaller banks cater exclusively to small community businesses.

The bottom line is the American economy runs on credit. Credit and the availability of credit are the lubrication that allows the gears of the U.S. economy to run smoothly. If credit isn't available to consumers and businesses when they need it, economic growth is negatively affected. Economic gears won't operate smoothly. Vehicles, homes, and equipment are not bought as readily. Business inventories are not financed. Less available credit creates big-time headwinds for economic growth.

Based on the quarterly "Senior Loan Officer Opinion Survey on Bank Lending Practices," last published by the Federal Reserve (Fed) in April, respondents said that standards were tighter for virtually all categories of business loans as well as consumer loans. In other words, it was tougher for consumers and businesses to get loans. The rationale behind these more stringent lending standards was largely due to lenders seeing a more "uncertain economic outlook" and a "deterioration in collateral values" looking ahead over the balance of this year. Note that this was the third consecutive quarter that survey respondents reported tighter credit standards for consumers and businesses. The next quarterly report is due to be published later this month and will cover the third quarter. We expect the third-quarter survey to show further tightening.

Better-than-expected consumer spending has continued to help push the economy ahead. But a meaningful portion of this spending has been fueled by borrowing as credit-card debt hit a record level exceeding $1 trillion according to a report published by the Federal Reserve Bank of New York in August. In addition, note that the savings levels for the bottom 80% of household incomes is below their pre-pandemic levels according to the latest Fed data. The combination of these two data points is telling us that the ability of the consumer to drive the economy forward in future quarters is faltering. Hence, we continue to see a weakening trend for the economy and a likely moderate recession coming.

With consumer spending expected to stumble and credit harder to get and more expensive, we recommend that investors take a more defensive approach in portfolio allocations. We see more equity downside from current levels and better buying opportunities ahead.

Risk considerations

Forecasts are based on certain assumptions and on views of market and economic conditions which are subject to change.

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors.

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