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Market Commentary

Weekly perspective on current market sentiment

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Last week's S&P 500 Index: -2.4%

Savings and spending

Key takeaways

- How much longer will the consumer be able to give the economy a big push forward?
- The bottom line is a large majority of households are running low on resources to spend and the lowest income earners are nearly tapped out.

Throughout this year, consumer spending has kept the U.S. economy moving ahead. And always remember that consumer spending represents around 70% of domestic economic growth. Employed consumers with money to spend are what drives the American economy. The rate of unemployment is not far from a 50+ year low, and retail sales have been, for the most part, better than expected.

Yet, we all know that goods and services generally cost a lot more than they did prior to the pandemic. Saying that, many, if not most, wage earners also know from personal experience that compensation has not kept pace with the rise in prices for most of the last couple of years. A quick glance at Bloomberg data shows the year-over-year change in the Consumer Price Index (CPI) was far higher than the year-over-year increase in average hourly earnings (wages) from the middle of 2021 until the middle of this year. Then finally, in May of this year, the 12-month change in consumer-level inflation fell below the rise in hourly earnings. More recently, as of their respective September reports, the increase in earnings is just above the 12-month change in CPI (4.2% vs. 3.7%).

To a large extent, people are spending more but getting the same or less for their money. So the question is, how much longer will the consumer be able to give the economy a big push forward? And while the labor market remains tight, keep in mind that much of the spending we have seen this year has been based on borrowing. You may have heard that Americans are carrying north of $1 trillion in credit card debt based on the latest data from the Federal Reserve (Fed) Bank of New York. That is a record high and will likely climb even higher into the end of this year. Households have drawn down their savings and increased card usage in order to increase their consumption of goods and services. Delinquency rates are now rising, especially for the lowest income earners.

The bottom line is that the large majority of households are running low on resources to spend and the lowest income earners are nearly tapped out. Recent data has shown that only the top 20% of income earners have more cash on hand now compared to before the pandemic after adjusting for inflation. That means that the bottom 80% of earners have less cash on hand now than in 2019 even after the government put trillions of dollars into the pockets of consumers and businesses during the pandemic. We believe the pace of consumer spending is not likely to hold up in coming quarters.

Our economic outlook calls for a slowing economy and falling inflation over the next 12 months. A recession appears likely. We believe that eventually the Fed will be able to cut interest rates and the economy will rebound starting at some point in the second half of 2024. For now, continue to position portfolios defensively.

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Definitions

Consumer Price Index (CPI) produces monthly data on changes in the prices paid by urban consumers for a representative basket of goods and services.

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