BBA Monthly Promontory

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October 2019

Third Quarter Check-Up: Is the US Consumer Still Healthy?

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In the United States, the consumer accounts for approximately 70% of national GDP, which is why the health—or sickness—of the US consumer is so vital to our economy.

It may seem like a simple question with a simple answer, but there's a lot more to it than you might think. Financial trade publications and cable television networks often discuss the importance of "GDP" or Gross Domestic Product, a measure of a country's (or group of countries') economic output. In the United States, the consumer accounts for approximately 70% of national GDP, which is why the health—or sickness—of the US consumer is so vital to our economy. In fact, the US consumer is also an integral part of the global economy, as the US consumer accounts for 17% of global GDP, surpassing the world's second largest economy (China), according to some estimates *(source: US Bureau of Economic Analysis, World Bank).*

Understanding the behavior of the U.S. consumer is a function of knowing the consumer will continue to spend as long as: 1) they have a job, 2) they think they will keep their job, 3) they can count on stable or rising wages, 4) asset prices for stocks, bonds, and real estate continue to rise, 5) they can pay their bills and monthly expenses on time, and 6) they have access to (more) credit should they need it.

Therefore, when assessing the health of the consumer, I like to break it out into six different categories and make a report card—taking us all back to our glory days, or for some of us, our not-so-glorious days:

Sector	Our Grade
Employment:	B+
Disposable Income:	B
Sentiment / Expectations:	B-
Wealth Effect:	B
Indebtedness:	B
Access to Credit:	B+
Overall Grade:	B

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When assessing the health of the consumer, I like to break it out into six different categories; Employment, Disposable Income, Sentiment/Expectations, Wealth Effect, Indebtedness and Access to Credit.

1. Employment: The unemployment rate is currently 3.5%, a 50-year low not seen since 1969 *(source: US Bureau of Labor Statistics)*. It is important to note, however, that the month-over-month job-creation rate has been slowing. For the first time since early 2019, there were less hires in manufacturing jobs, one of several sectors that have taken a hit as a result of the trade wars. Overall, we grade this section a "B+".

2. Disposable Income: How much money do consumers actually have to spend? A good measure of this is Real Personal Disposable Income, which has been growing in the 3.0-3.5% (year-over-year) range thus far in 2019 *(source: US Bureau of Economic Analysis)*. Retail sales, while not to the moon, are pretty solid. If you've been to Costco or Home Depot on the weekends, you know there's no shortage of folks trying to improve their home or purchase an oversized trampoline for their backyards. Because we see headwinds down the road such as slowing wage growth and increasingly high debt levels, our current grade is a "B".

3. Sentiment / Expectations: Are people feeling good about their living situation and where the economy is going? Uncertainty is paramount both politically and economically. The constant barrage of negativity coming from financial and political pundits certainly has an impact on everyday consumers, and we believe it is possible to "talk" the economy into recession. Amongst other indicators, the University of Michigan (who publishes the closely watched Index of Consumer Sentiment) recently released a report showing signs of erosion in consumer confidence and for this and other reasons, we give sentiment a B- (and you could talk us into a C+).

4. Wealth Effect: What is the "wealth effect"? Simply put, people spend more money as the value of the items they own goes up; as the saying goes, it takes money to make money. As it stands now, the averages are pretty positive since many of the houses that had negative equity post-financial crisis are now positive, and people are still paying off their credit and monthly bills. The flipside is that only a small percentage of the population has benefited from the surging stock market over the last decade and approximately 45% of people are not able to cover a surprise $400 expense, according to CNBC. Overall, however, we feel comfortable with a "B" here, though uncertainty can erode the wealth effect rather quickly.

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5. Indebtedness: How much debt do you carry? There is a growing amount of student, auto, housing and credit card debt among the broad population, although the cost to service said debt is relatively low due to extremely low interest rates. According to the Federal Reserve, US consumers hold a record $1.3 trillion in automobile debt, almost double from that held just a decade ago. The latter point is one we are watching closely, and therefore rate this area a "B", with a possible downgrade if the cost of debt rises materially or the job market takes a turn for the worse.

6. Access to Credit: How difficult is it for someone to get a loan? While not as easy as the early 2000s, access is pretty good, with the caveat that the cost of credit to retail users is actually very high. Strictly speaking, the amount of options for people to get financing are numerous and convenient—that being the case, we assign a marking of "B+".

Overall, we are arguably in the best position possible given that we are in the 11th year of an expansion, and relative to consumers across the globe, the US consumer is generally in much better shape.

After considering all of the above, we come to a picture of a consumer who is employed with money to spend. Though they might think twice about adding another streaming service to their TV bundle or opt for takeout on Friday evening instead of a weekend on the town, the average consumer is still willing and able to spend. The uncertainty in the markets seems to be one of most pressing items on the minds of the consumer—take a look for example at the increase in the personal savings rate, according to the Wall Street Journal: the average rate is higher now at 8.2% than for any full year since 2012. Overall, we are arguably in the best position possible given that we are in the 11th year of an expansion, and relative to consumers across the globe, the US consumer is generally in much better shape. We will be watching all of the above closely as we decide the most prudent ways to allocate to our models.

Our final grade for the US consumer is a "B", but the best days are almost certainly behind us; this grade was an "A" just a few quarters ago. With the "peak consumer" behind us, it is important to put this simple report card into perspective.

A straight "A" consumer typically spends at or above the long run rate of wage and income gains, call that 3%, which contributes something like 2% to total GDP. A "B" grade consumer spends more like 2%, contributing 1.25% or so to total GDP—still not bad.

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But should the health of the US consumer deteriorate further from here and become a "C" rated spender, this implies more of a maintenance-level spending rate of 1%, contributing only 0.5% to 0.75% to GDP.

With less than 1% GDP from consumption, the risk is the economic expansion approaches stall speed, becoming much more vulnerable to further negative developments. In turn, negative overall GDP is not far away when the consumer spends at below a 1% growth rate, especially when concurrent with a rapidly slowing manufacturing sector—which we are seeing right now. We are not at this time calling for a recession, but if the consumer continues to slow, the second half of 2020 could threaten the end of this expansion.

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