Mitch on the Markets

Portfolio Manager Investing Insights

WEEKLY CLIENT COMMENTARY June 25, 2020

Consumer Spending Will Drive Economic Recovery

Many readers have probably seen this stat-line before: U.S. consumer spending accounts for roughly two-thirds of total GDP.[1] With U.S. GDP crossing $20 trillion in 2019, that means the consumer doled out approximately $13 trillion last year. As a category, that makes the U.S. consumer nearly as big as *the entire Chinese economy* (~$14 trillion) and is almost three times bigger than Japan's economy (~$5 trillion).

The United States has exponentially more spending power than any other country in the world, and investors shouldn't underestimate the U.S. consumer's ability to drive the recovery forward.

To be fair, quite a lot hinges on people being able to return to work in the coming weeks and months, and it may take years for the labor market to fully recover. But early data indicates that federal stimulus programs – coupled with some pent-up demand established during the lockdown – have led to a stronger rebound in consumer spending than almost everyone anticipated.

It may be difficult to fathom, but real personal incomes in America actually went *up* during the month of April (14% year-over-year), as IRS payments and super-charged unemployment benefits hit millions of mailboxes and bank accounts.

Real Personal Income Jumped in April

Source: Federal Reserve Bank of St. Louis[2]

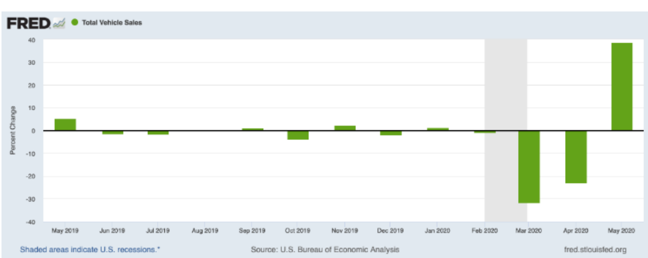
This income boost is temporary, of course, but it's proven to be effective. Advance real retail and food services sales saw a jump in April and May, creating a "v-shaped" bounce from the record lows experienced during lockdowns. A significant portion of spending came from online shopping, accelerating a trend to e-commerce that has been underway for years now. Walmart's online sales soared +74% in the first quarter, posting its highest sales growth on record in e-commerce. Amazon enjoyed a similar tailwind, with net sales from online shopping hitting $36.7 in Q1 – a +25% year-over-year increase.[3]

The Consumer's Pent-Up Demand + Stimulus Payments Boosting Spending

Source: Federal Reserve Bank of St. Louis[4]

Other spending categories are seeing signs of life again as well. Pending home sales in April were brutal, with figures falling 34% from a year earlier. But according to the National Association of Realtors, a seasonally adjusted measure of home-buying demand was up +16.5% by mid-May, and mortgage applications have been climbing every week since May. With the U.S. 30-year fixed mortgage rate averaging 3.15%, it's as good a time as any to finance.[5] Auto sales also rebounded strongly in May, coming off record-setting declines in March and April:

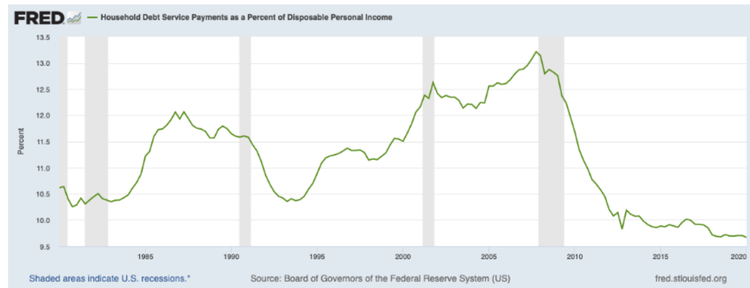
Auto Sales Saw a Strong Rebound in May



Source: Federal Reserve Bank of St. Louis[6]

Finally, I think it's important to acknowledge that going into this crisis, the U.S. consumer was in *far better shape* as compared to household finances before and during the 2008 financial crisis. Starting in the early 1990's, households in America have been seeing rising debt payments as a percent of disposable personal income. In other words, an increasing share of Americans' paychecks were going towards paying off debt. In the aftermath of the financial crisis, however, debt payments as a percent of income have plummeted, putting households in a better position to recover more quickly this time around.

Household Finances Have Improved Over the Last 10 Years



Source: Federal Reserve Bank of St. Louis[7]

Bottom Line for Investors

Does all this mean that the U.S. consumer is poised to rescue the economy and bring back strong growth? Not necessarily. As mentioned before, quite a bit hinges on how quickly people can return to work and also on how much longer fiscal stimulus will last – the extra unemployment benefit is currently set to expire on July 31, and Congress and the White House are mulling another stimulus. Time will tell, but I wouldn't underestimate the U.S. consumer.

ABOUT MITCH ZACKS

Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

[1] U.S. Bureau of Economic Analysis, Shares of gross domestic product: Personal consumption expenditures [DPCERE1Q156NBEA], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/DPCERE1Q156NBEA, June 23, 2020.

[2] U.S. Bureau of Economic Analysis, Real Disposable Personal Income [DSPIC96], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/DSPIC96, June 23, 2020.

[3] BlackRock, June 11, 2020. https://www.blackrockblog.com/2020/06/11/the-u-s-consumer-is-bowed-not-broken/

[4] Federal Reserve Bank of St. Louis, Advance Real Retail and Food Services Sales [RRSFS], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/RRSFS, June 23, 2020.

[5] The Wall Street Journal, May 28, 2020. https://www.wsj.com/articles/pending-home-sales-plunge-but-housing-market-shows-signs-of-recovery-11590686143

[6] U.S. Bureau of Economic Analysis, Total Vehicle Sales [TOTALSA], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/TOTALSA, June 23, 2020.

[7] Board of Governors of the Federal Reserve System (US), Household Debt Service Payments as a Percent of Disposable Personal Income [TDSP], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/TDSP, June 23, 2020.

Weekly Market Update

Important Market News We Think Worth Considering

IN FOCUS THIS WEEK

- Manufacturing rebounds across the globe
- Saving rate increased during the pandemic
- What does global demand for commodities say about current and future economic activity

Manufacturing and Services Rebound Around the World

A survey of manufacturing and services PMIs across the globe shows a similar pattern: a very steep decline in March and April activity, followed by a “v-shaped” bounce in May. This resurgence of activity took place across the U.S., Europe, and Asia, as the global economy slowly but surely pushes forward following pandemic-induced lockdowns. The U.S. composite index (produced by IHS Markit) rebounded to its highest level in four months, though to be fair still remains in contractionary territory (readings lower than 50). The United Kingdom and France saw rebounds in manufacturing, though demand remains weak. Japan’s services sector is showing bright spots, while its manufacturing rebound is lagging.[1] Taken together, the manufacturing and services picture is mixed, but signs of life are returning, and it’s safe to say the worst of the economic crisis is now in the rear-view mirror – at least for now.

Savings Rates Shot Higher

Americans shifted spending to essential goods and e-commerce during the height of the pandemic, but they also saved more. In a surprising data quirk released this week, the savings rate in America shot higher last month, as households stayed home (and therefore reduced spending) and as government stimulus actually resulted in pay *increases* for many. As the economy reopens, many consumers will be out shopping again, and it should also be noted that the $600 unemployment boost ends on July 31.[2] As such, the pop in the savings rate is likely to be short-lived, but hopefully, the experience encourages more households and save and invest for the long-term.

Source: Federal Reserve Bank of St. Louis[3]

Commodities Prices Firm Up, Indicating Demand Returning

Looking at global demand for commodities is a quick way to gauge current and future economic activity, particularly in the realm of global manufacturing. A good sign that demand is returning can be seen in the prices for raw materials, like oil, copper, and tin – all of which have seen strong rebounds over the last couple of weeks.[4] To be fair, producers have also cut supply in response to the full-stop to global economic growth, but rising prices now appear to be spurred by increasing factory activity and the resumption of global trade.

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[1] The Wall Street Journal, June 23, 2020. https://www.wsj.com/articles/european-economic-data-is-v-shaped-but-the-economy-isnt-11592915161

[2] The Wall Street Journal, June 23, 2020. https://www.wsj.com/articles/the-coronavirus-savings-glut-11592905053

[3] U.S. Bureau of Economic Analysis, Personal Saving Rate [PSAVERT], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/PSAVERT, June 25, 2020.

[4] The Wall Street Journal, June 22, 2020. https://www.wsj.com/articles/rally-in-raw-materials-signals-economic-rebound-11592818201

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