Too Much Demand is the Key U.S. Economic Issue

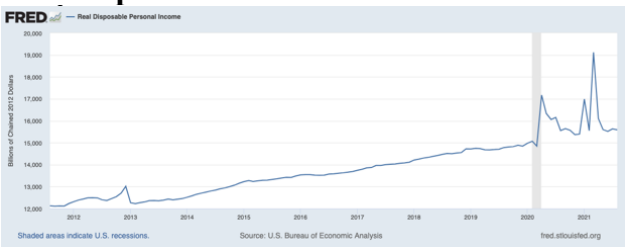
In a typical recession, households lose employment, disposable income levels fall or plateau, consumer spending declines, credit markets tighten up, and banks issue fewer loans. The result is that demand falls across the economy, with less money going towards goods and services.

We see the opposite happening today.

In the U.S., the unemployment rate is hovering around 5%, disposable incomes are higher, and households are sitting on roughly $1.6 trillion in savings. That's because the pandemic was not a typical recession, nor did it trigger a credit event, a financial crisis, or damage to household balance sheets. In fact, U.S. households are largely better off today than they have been at any point in history.[1]

Allow me to offer a quick analysis in charts. First, real disposable incomes (adjusted for inflation) are close to $16 trillion in the U.S., which has been driven higher by direct transfers from the federal government through stimulus programs but also via higher wages. There have been many reports of labor shortages in the U.S., but it is also true that many workers are finding they can easily switch jobs for higher wages. Desperate to fill positions, many employers have been raising wages as a result. According to the Labor Department, private-sector hourly wages were up 4.6% year-over-year in September.

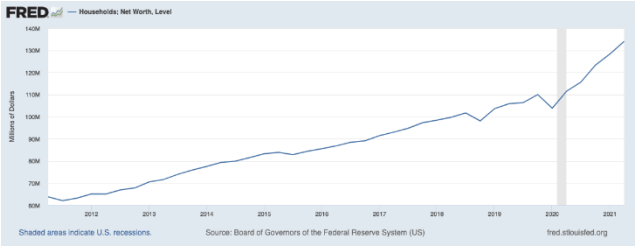
Real Disposable Personal Income



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

These higher wages, combined with accumulated savings, a rising stock market, and the strongest housing market in over a decade have also given way to record household net worth in the U.S.:

Household Net Worth



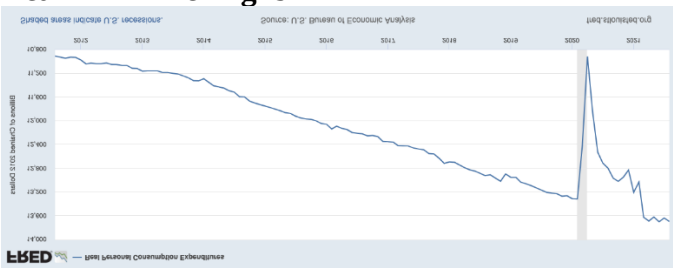
Source: Federal Reserve Bank of St. Louis[3]

Put these fundamentals all together, and you have a situation where the U.S. economy has what I would call a good problem: *too much demand.*

In my view, the biggest driver behind snarled supply chains and shortages of goods and services is not policy failures or systemic economic issues – it's that the U.S. and global economy simply do not have the current capacity to meet this wall of demand. And that's a good problem.

Consumers are showing few signs of slowing down. According to the Commerce Department, inflation-adjusted retail spending has soared by 14% in the last two years, which is a bigger increase than the previous seven years combined. Retail sales rose 13.9% in September from a year earlier, and sales at retail stores, restaurants, and online sellers were up nearly 1% month-over-month. The momentum favors even more spending – in the first week of October, retail spending was up 8.8% compared to the average week in September.

U.S. Consumption Expenditures: Still at or Near All-Time Highs



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

To be fair, the 'good problem' of too much demand does not automatically have a happy ending. Persistent supply chain issues could continue to drive prices higher, which could discourage spending and result in declining consumer sentiment for future quarters. The economic calculus is in determining which might happen first: inflation drives consumers away, or corporations and the global economy expand capacity and ultimately catch up to demand. In my view, it's the latter.

Bottom Line for Investors

The U.S. consumer is in a historically strong position, and I would argue the current cash glut in the U.S. economy is a key determinant in supply chain issues. Simply stated, there is so much demand that supply can't keep up.

In my view, this is a good problem. U.S. consumers' financial position is not likely to change significantly in the next six months or so – if anything, it could get even better as more enter the workforce and wages continue to move higher. Meanwhile, corporations and supply chains are likely to find ways to catch up relatively soon, which should give way to sustained levels of higher spending. A good problem, with a good outcome.

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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] Wall Street Journal. October 24, 2021. https://www.wsj.com/articles/economy-week-ahead-central-banks-gdp-consumer-spending-11635102000

[2] Fred Economic Data. October 1, 2021. https://fred.stlouisfed.org/series/DSPIC96

[3] Fred Economic Data. September 23, 2021. https://fred.stlouisfed.org/series/BOGZ1FL192090005Q

[4] Fred Economic Data. October 1, 2021. https://fred.stlouisfed.org/series/DSPIC96

Weekly Market Update

Important Market News We Think Worth Considering

IN FOCUS THIS WEEK

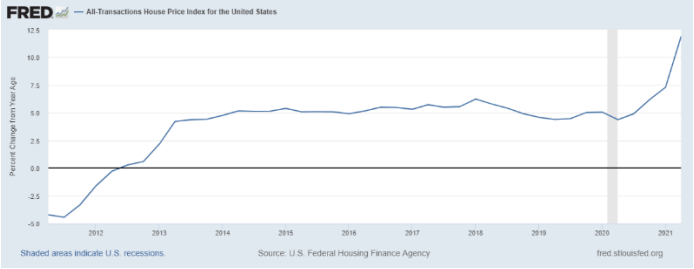
- **Is the Fed poised to accelerate the 'Taper?'**
- **The U.S. housing market is still hot**
- **Status of the U.S. labor market**

Is the Fed Poised to Accelerate the 'Taper'?

According to the Labor Department, the consumer price index (CPI) rose 5.4% year-over-year in September, which continues the trend of above-expectation inflation in the U.S. economy. Fed officials have stuck to the narrative that inflationary pressures will likely be 'transitory' as supply chain issues abate, but more recently Fed Chairman Jerome Powell and other Fed governors have been shifting their tone. On Friday of last week, Chairman Powell said explicitly that supply-chain disruptions would likely last longer-than-expected, and that the Fed "will need to make sure that our policy is positioned for a range of possible outcomes." If that sounds like the Fed starting to hedge their 'transitory' position, it's because they are – officials have now confirmed they will start reducing the $120 billion monthly QE purchases at their November 2-3 meeting, and some officials have suggested unwinding purchases faster while also moving up the potential timeline for higher rates. In our view, the equity markets have already priced in the reduction in monthly bond and mortgage security purchases, but a quicker timeline to raise the fed funds rate may generate volatility in the short term. Minutes from November 2-3 will be telling.[1]

Another Month, Same Headline: The U.S. Housing Market Stays Hot

Headlines often focus on issues with sticky inflation and snarled supply chains, but one area of the economy that has stayed hot virtually throughout the pandemic has been U.S. housing. Whether or not the strength of the housing market is a good thing depends largely on whether someone is a buyer or a seller. Many first-time homebuyers are having a particularly challenging time – the S&P CoreLogic Case-Shiller National Home Price Index soared almost 20% in August from a year earlier, with the median existing-home sales price up 13% year-over-year in September. Higher prices have in many cases led to higher-than-expected sales prices for sellers, but it has also reduced the share of first-time buyers in the market down to 28% – the lowest level since July 2015. As you can see from the chart of the national home price index below, prices have surged since the pandemic started, and have not let up since.[2]

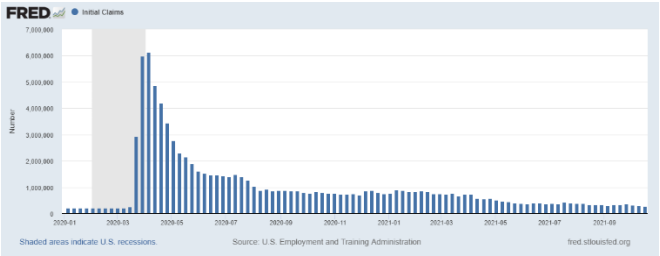


Source: Federal Reserve Bank of St. Louis[3]

What Data from the U.S. Labor Market is Telling Us

Jobless claims in the U.S. dropped to 290,000 last week, which marks a new low within this pandemic-influenced economy. Jobless claims are perhaps a better metric than the unemployment rate to consider when

determining the health of the labor market, as claims serve as a proxy for layoffs. In 2019, a year when the U.S. economy was considered quite strong and before the pandemic struck, the weekly average for jobless claims was 218,000, meaning the U.S. economy is approaching a level of health in-line with the previous expansion. Continuing claims, which measure how many people are still unemployed and receiving benefits, also fell to a pandemic low. As unemployment benefits eventually expire for those who are in the continuing claims category, a labor market with ample jobs awaits. In our view, we should continue to see improvement in the jobs market as a result.[4]



Source: Federal Reserve Bank of St. Louis[5]

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[1] Wall Street Journal. October 22, 2021. https://www.wsj.com/articles/fed-chairman-jerome-powell-says-supply-side-constraints-are-creating-more-inflation-risk-11634917630?mod=djemRTE_h

[2] Wall Street Journal. October 26, 2021. https://www.wsj.com/articles/home-price-growth-holds-at-record-in-august-11635253603?mod=djemRTE_h

[3] Fred Economic Data. August 25, 2021. https://fred.stlouisfed.org/series/USSTHPI#0

[4] CNBC. October 24, 2021. https://www.cnbc.com/2021/10/21/us-jobless-claims-total-290000-vs-300000-estimate.html

[6] Fred Economic Data. October 28, 2021. https://fred.stlouisfed.org/series/ICSA#0

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Past performance is no guarantee of future results. Inherent in any investment is the potential for loss.

*This information is supplemental to GIPS and is based off the composite
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