Fundamental Strength of the U.S. Economy is a Bullish Sign

Sentiment about the U.S. economy is overwhelmingly negative, even as growth fundamentals continue to point to expansion. In my view, that's bullish.[1]

In a recent *Wall Street Journal*-NORC poll[2], conducted with the University of Chicago, a staggering 83% of respondents said the economy was in a poor or 'not so good' state. 35% of respondents reported being unhappy with their financial situation, which marks the highest level of dissatisfaction since 1972 – the first year of the survey.

Consider this: According to the poll's findings, people are more unhappy today *than they were in the aftermath of the 2008 Global Financial Crisis*, when the jobless rate was double-digits and millions of people lost their homes. Today's inflationary pressures, and in particular higher food and gas prices, are a major thorn in folks' sides. I get that. But thinking the economy today is worse off than it was in 2008 and 2009 feels like sentiment has become overly pessimistic. If economic growth exceeds these hyper-low expectations, even by just a little, I think that's great for stocks.

Early data in Q2 point to this better-than-expected growth outcome.

The most important growth factor in the U.S. economy – consumer spending – continues to exceed expectations. Data shows consumer spending increased 0.9% in April, with March's figure revised higher from 1.1% to 1.4%. Consumers are also increasingly shifting from goods spending to services spending, which should bode well for inflationary pressures in the second half of 2022. Goods spending was up 0.8% in April, while services spending in areas like hotels and restaurants moved up 0.9%.

The U.S. Labor Department[3] also reported that employers added 390,000 new jobs in May, with wages increasing 5.2% year-over-year. For the year leading up to May, the economy added a robust 400,000 jobs per month, *the strongest period of job gains dating back to 1939*. Initial jobless claims also fell to 200,000 in the final week of May, indicating that employers are holding on to workers in hopes of avoiding further shortages. The unemployment rate remained steady at 3.6%, a far cry from the 10+% unemployment rate reached during the

2008 Financial Crisis and the Covid-19 pandemic.

Manufacturing and services in the U.S. continue to demonstrate resilience. The May Manufacturing PMI was 56.1%[4], which marked an increase of 0.7% from April and firmly suggests the economy remains in expansion mode. Manufacturing activity has been expanding for 24 straight months now in the U.S., and businesses surveyed continue to point to strong demand looking ahead. For every cautious comment made in the survey, there were five positive growth comments.

The U.S. services sector also posted strong activity in May, with the Services PMI[5] registering at 55.9%. Services have also expanded for 24 months straight. A close read of the May jobs report offers a hint that the services sector could feel additional tailwinds heading into summer—retailers cut nearly 61,000 jobs in May, but leisure and hospitality employers added 84,000.

Finally, the inflation issue – while still a negative force in the economy – improved slightly in April. The personal consumption expenditures (PCE) price index ticked up by 0.2%, which marked the smallest rate of increase since November 2020. The 12-month rate of increase in April (+6.3%) was also a step down from March's +6.6%. Excluding food and energy prices, the PCE rose +4.9% year-over-year in April, which marked the smallest increase since last December. It's still too early to call 'peak inflation,' but April showed the issue getting better – not worse.

Bottom Line for Investors

My goal with this week's column was not to demonstrate that the U.S. economy is in perfect shape and that no one should worry. Plenty of headwinds persist.

But I do firmly believe the positives outweigh the negatives, with key growth fundamentals nearly confirming expansion in the months ahead. Perhaps the obvious revelation here is that inflation is a very powerful negative force for sentiment, but it also may be so powerful that it causes many people to miss or ignore the parts of the economy that are working well and growing. In my view, that creates a bullish setup: any time a strong or modestly strong economy is under-appreciated to this degree, even the tiniest upside surprise can send stocks rallying.

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. News. May 27, 2022. https://money.usnews.com/investing/news/articles/2022-05-27/u-s-consumer-spending-beats-expectations-in-april-inflation-likely-peaked

[2] Wall Street Journal. June 6, 2022. https://www.wsj.com/articles/inflation-political-division-put-u-s-in-a-pessimistic-mood-poll-finds-11654507800?mod=djemRTE_h

[3] Wall Street Journal. June 6, 2022. https://www.wsj.com/articles/u-s-jobless-benefits-fell-last-week-extending-stretch-of-low-filings-to-four-months-11654174339

[4] ISM. 2022. https://www.ismworld.org/supply-management-news-and-reports/reports/ism-report-on-business/pmi/may/

[5] ISM. 2022. https://www.ismworld.org/supply-management-news-and-reports/reports/ism-report-on-business/services/may/

Weekly Market Update

Important Market News We Think Worth Considering

IN FOCUS THIS WEEK

- **Stagflation worries rise**
- **Increased pessimism about the U.S. economy**
- **Big retailers stuck with high inventory**

Stagflation Fears are Back

Or to state it more accurately for 2022, stagflation fears never left. For much of the new year, market prognosticators have been warning that the global economy was setting up for a year of rising inflation and slowing, and eventually negative, growth. Skeptics seemed to be vindicated in Q1 when the U.S. economy posted -1.5% GDP growth and record year-over-year inflation rates, and the warnings of stagflation have persisted since. A 'major warning' came last week from the World Bank, which significantly lowered its global GDP forecast and warned of *several years* of high inflation and slow to negative growth. Comparisons to the 1970s period of stagflation abound. But there was one glaring issue with this gloomy forecast – the World Bank still expects the global economy to grow by 2.9% in 2022. The alarm bells were ringing because the bank's original forecast was for 5.7% growth, but few pointed out that the expectation is still for sturdy growth for the balance of the year and next. For investors, these drastically lowered expectations can ultimately be a good thing – if everyone fears the worst, but the economy does even a tiny bit better than expected, that is sometimes all stocks need to stage a rally.[1]

No Love for the U.S. Economy

For 12 months straight, the U.S. economy has added a robust 400,000 jobs per month, *the strongest period of job gains dating back to 1939*. Wages are higher and workers hold many of the chips, with the unemployment rate sitting near a historic low of 3.6%. But few Americans are happy about it. In a recent *Wall Street Journal*-NORC poll, conducted with the University of Chicago, a staggering 83% of respondents said the economy was in a poor or 'not so good' state. 35% of respondents reported being unhappy with their financial situation, which marks the highest level of dissatisfaction since 1972 – the first year of the survey. According to the poll's findings, people are more unhappy today than they were in the aftermath of the 2008 Global Financial Crisis when the jobless rate was double-digits and millions of people lost their homes. If anything, the survey seems to underscore just how much Americans dislike higher gas and food prices, because thinking the economy is worse off today than it was in 2008 and 2009 is simply not objectively correct. Much like stagflation fears, this survey shows just how much sentiment has turned negative even when there are many strong economic fundamentals – a bullish setup, in our view.[2]

Big Retailers are Stuck with The Wrong Inventory

Major U.S. retailers like Target, Walmart, and Macy's have an inventory problem. Over the course of the last year, these companies adjusted to shifting consumer behavior, which saw Americans spending more on home furnishings, electronics, and casual clothes. The pandemic fueled a work-from-home movement that was also accompanied by a rush to buy homes and remodel them, which played well for big

purchases of the aforementioned goods. But because of some miscalculation on retailers' parts, coupled with supply chain snags that are seeing many of these goods being delivered on delay, companies like Target and Walmart are stuck with inventory that consumers are not necessarily demanding as much. Inventory in the April quarter rose by 43%, and has saddled retailers with goods that are likely past the ideal selling window. That has led to earnings adjustments to the downside for many of the key players, with many companies indicating they will be marking down many goods in the current quarter to try and clear inventory. That likely means smaller operating margins for retail players, but could also mean some bargain buys for consumers in the coming weeks and months.[3]

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[1] Wall Street Journal. June 8, 2022. https://www.wsj.com/articles/what-is-stagflation-meaning-explained-global-economy-worldbank-11654723092?mod=djemRTE_h

[2] Wall Street Journal. June 6, 2022. https://www.wsj.com/articles/inflation-political-division-put-u-s-in-a-pessimistic-mood-poll-finds-11654507800?mod=djemRTE_h

[3] Wall Street Journal. June 7, 2022. https://www.wsj.com/articles/target-warns-profit-will-drop-because-it-has-too-much-stuff-11654599664?mod=djemRTE_h

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