



MACRO COMMENTARY | June 2024

PORTFOLIO ANALYSIS & CONSULTING

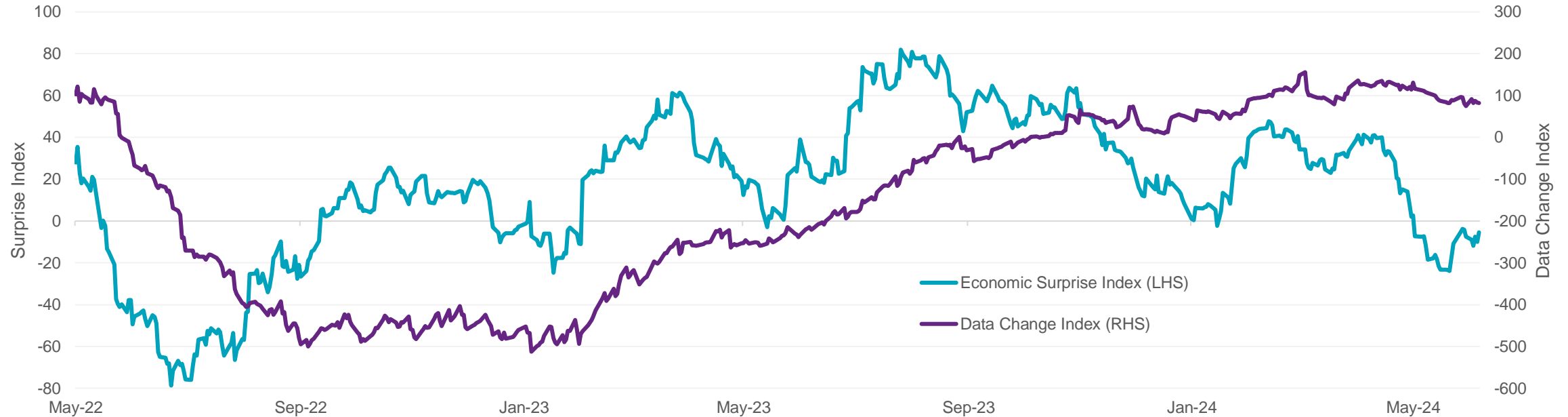
Charts and Smarts®

Jack Janasiewicz, CFA® - Portfolio Manager and Portfolio Strategist

Garrett Melson, CFA® - Portfolio Strategist

Won't Get Fooled Again

Citi Economic Surprise vs Data Change Index (5/2/22–6/7/24)

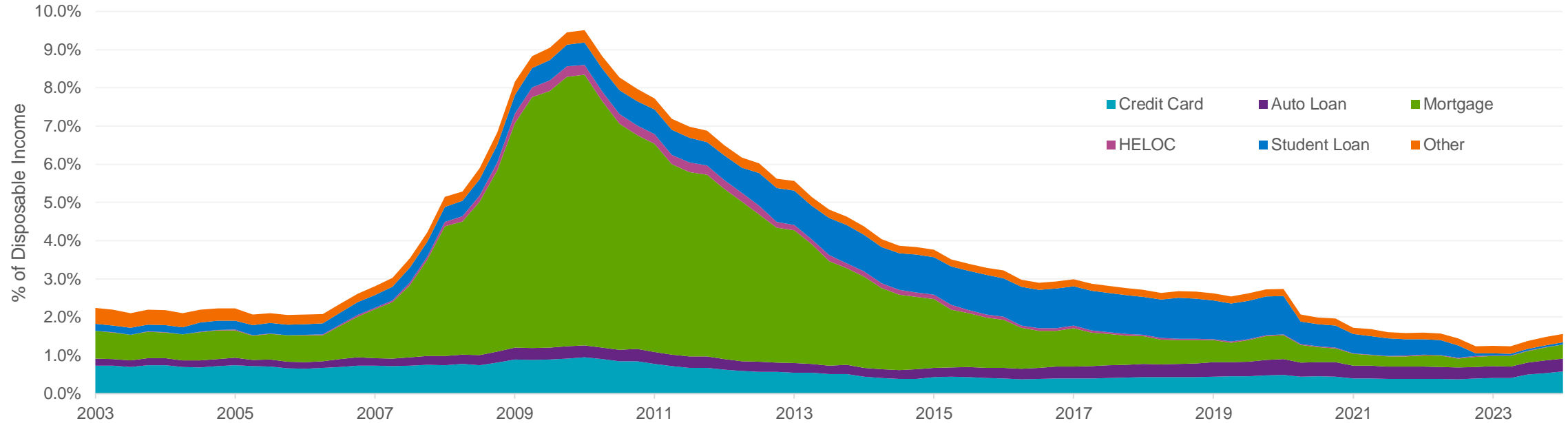


As we approach the halfway mark of 2024, the prevailing narrative has slowly begun to swing back from the no landing extremes of April after consensus furiously scrambled to revise their growth expectations higher. That mad dash looks to have culminated in another inevitable overshoot of expectations. Just as the consensus is falling hook, line, and sinker for the reaccelerating growth narrative, the data flow is giving way to a backdrop of strong and stable growth with some signs of modest cooling. While it was only 6 weeks ago the market was marking up the probability of incremental rate hikes in the wake of the string of warm inflation prints to kick off the year, the market has been attempting to price in a growth startle in the opening sessions of June as we've seen a string of downside surprises on growth data, namely with respect to consumer spending and manufacturing PMIs. The Citi Economic Surprise Index, which measures incoming data relative to consensus expectations, has softened materially in recent weeks and on the surface certainly suggests a moderating growth backdrop. But while the Surprise Index has declined, the Data Change Index, a composite of that incoming data flow, has been essentially range bound for the past 4 months, cooling only modestly after charging relentlessly higher since January 2023. The decline in the Surprise Index has been a function of an expectations overshoot rather than a marked cooling in economic data. Despite what the emerging narrative may suggest, economic growth continues to hold up. And with consensus expectations now largely in line on the growth front, the risk of surprises on growth data is more symmetric. We're just as likely to see upside surprises as we are surprises to the downside. That's likely to keep any potential growth concerns from growing into anything more than a modest startle.

Source: Portfolio Analysis & Consulting, Bloomberg.

Behind Blue Eyes

Delinquent Debt as Share of Disposable Income (3/31/03–3/31/24)

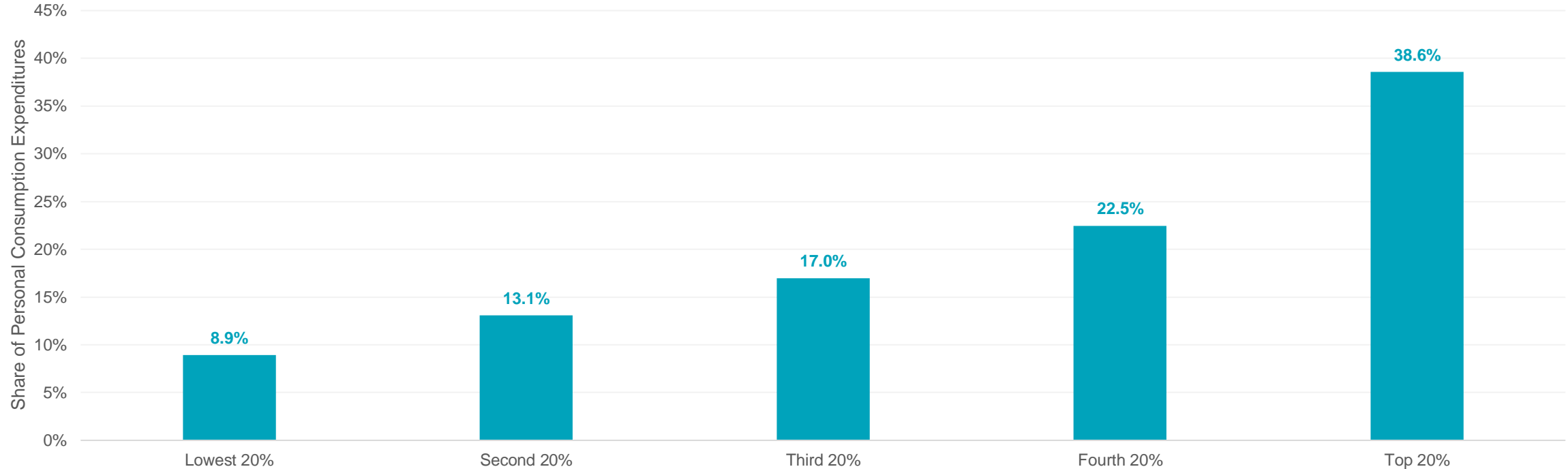


While growth data is likely to remain resilient, that certainly won't stop the bears from crafting newer and better narratives. And by newer and better narratives of course we're referring to dusting off the cobwebs from old, failed bear cases. After a few quarters of robust consumer demand, it seems like the perfect time to roll back out the cracking consumer narrative. The usual data points are being referenced in support of this effort: surging credit card debt, price sensitivity of consumers, and of course rising delinquencies. Much of the deterioration in delinquency rates we've witnessed has been a function of normalization back to pre-pandemic levels or trends, a theme we've heard repeatedly from the major banks and card issuers. Nonetheless, credit card delinquencies as measured in the New York Fed's Household Debt and Credit report have risen to their highest levels since 2012, triggering fears of a cracking consumer. Indeed, there are households in the lower income cohorts that are straining under credit card balances and higher rates, but that bifurcation is an unfortunate feature of our economy, not a bug due to the inflationary experience of the past few years. And more importantly, that burden is simply too small to completely derail the aggregate consumer. Even with serious credit card delinquencies rising to nearly 11% of balances, at only 6% of total consumer debt it represents just 0.6% of disposable income. Aggregate delinquencies across all consumer credit as a share of disposable income remain below pre-pandemic levels even after adjusting for student loans, missed payments for which will be unreported to credit bureaus until the second quarter of this year. Consumer balance sheets are simply too robust, income growth too strong, and the share of delinquent debt too small to derail the US consumer as long as the labor market remains resilient. Bet against the consumer at your own risk.

Source: Portfolio Analysis & Consulting, Federal Reserve Bank of New York

The Kids Are Alright

Share of Consumption Expenditures by Income Cohort (as of 2022)

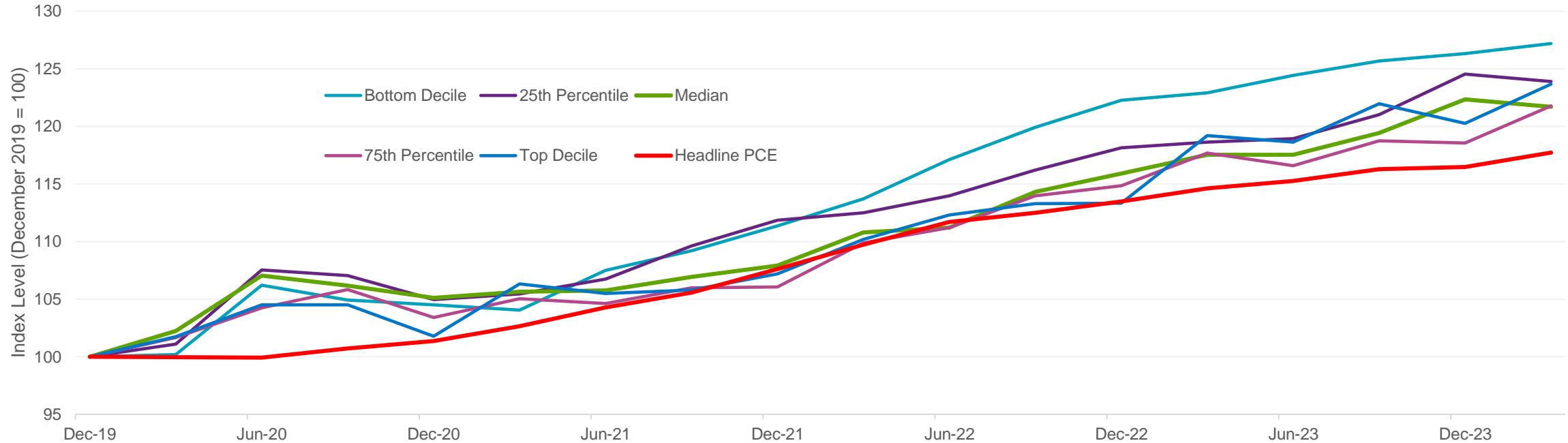


Not only is the share of delinquent debt too small to present a material headwind for consumer spending, but the share of consumption expenditures driven by those lower income consumers responsible for the bulk of the rise in delinquencies is simply too small to derail the growth engine of the economy. Lower income consumers certainly have a higher marginal propensity to consume and tend to spend a greater portion of their income, but they represent under 9% of total consumption expenditures. Upper income consumers, on the other hand, are responsible for the lion's share of spending, with the top 20% accounting for almost 40% of spending and the top 40% fueling over 61% of aggregate consumption. The lowest income consumers are most important in the sense that their consumption patterns can influence the marginal rate of growth, but it's the rest of the consumer base that remains robust and provides a high floor for consumption and for broader economic growth. The bears may harp on depleted excess savings, the cumulative burden of the inflationary period, record levels of consumer credit, and rising delinquencies, but the broad consumer remains alive and well with strong balance sheets, low credit utilization, and rising real wages. As we've stressed time and time again, this is an income driven cycle which has helped to fuel a robust positive feedback loop for the economy. While there may be some pockets of stress, those pockets are simply too small to materially dim the outlook as the labor market remains resilient.

Source: Portfolio Analysis & Consulting, Bureau of Economic Analysis.

The Real Me

Usual Weekly Earnings by Income Quartile vs PCE Inflation (12/31/19–3/31/24)

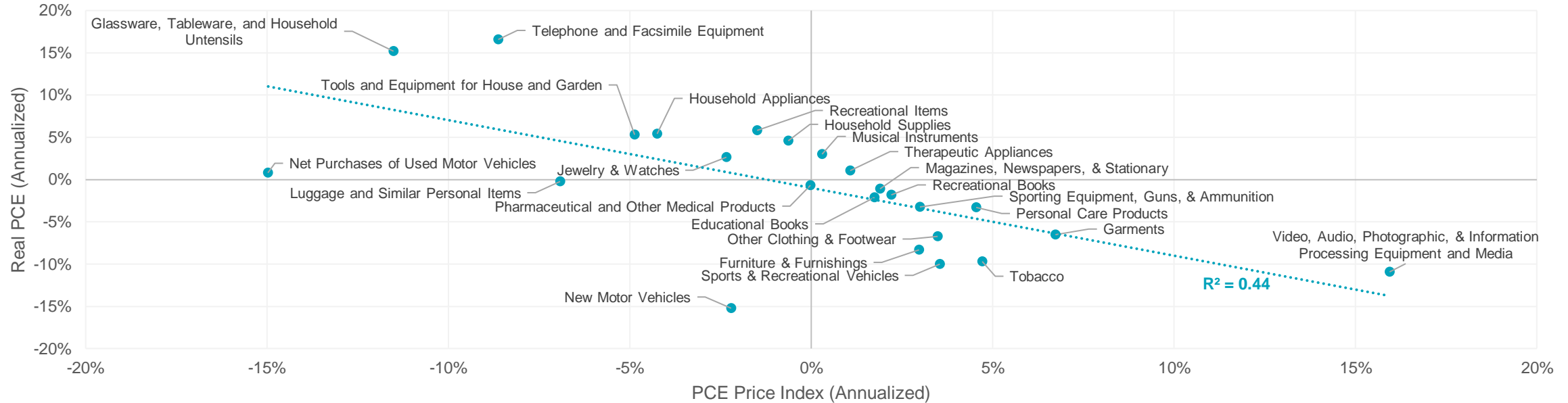


Perhaps the biggest reason to remain optimistic on the outlook for the consumer, and hence, the economy, is the fact that despite the normalization in wage growth, inflation has fallen faster, helping to fuel rising real wages. But that's not a recent development. There has certainly been month to month volatility in real wage growth given the residual noise and compositional effects of average hourly earnings paired with the bumpy disinflationary path, but the trajectory has been clear for nearly 2 years now: real incomes are growing. Furthermore, this has been true across income groups as all income cohorts of consumers have seen real incomes outpacing headline PCE inflation over the entirety of the COVID triggered inflationary era. Recent research by the nonpartisan Congressional Budget Office arrived at a similar conclusion: incomes are going further to cover household expenses. In other words, consumers across income groups have more real disposable income even after the inflationary experience of the past few years. While there is some valid pushback in the sense that the composition of the consumption basket is different for lower incomes than for higher income earners, it is also true that lower income consumers have seen larger cumulative wage increases since 2019. And the consumption baskets of lower income earners, which tend to be skewed more towards goods, have benefitted from the rapid normalization in core goods and food prices which have returned to their pre-pandemic trend of oscillating between modest inflation and deflation. Any way you slice it, consumers, in aggregate, are in a stronger financial position than they were prior to the pandemic, and the outlook continues to improve, not deteriorate, as real incomes rise.

Source: Portfolio Analysis & Consulting, Bureau of Labor Statistics, Bloomberg.

Substitute

Personal Consumption Expenditures: Price vs Volume (12/31/23–4/30/24)



While consumers have shown very little elasticity in demand with respect to prices over the past few years, at long last it appears that price sensitivity has returned. This has been yet another brick in the wall of worry around consumers as the logic goes that budgets are stretched and as a result consumers, even at the upper end of the income bands, are searching for value and trading down on some items to stretch their dollars further. While that may be true for some lower income earners, a return of price elasticity and value consciousness doesn't in and of itself prove that consumer budgets are straining. Instead, that consumers are showing a willingness to seek value for some items and pushing back on price increases in others seems to be just another case of normalization from the distortions of the past few years. Evidence of the return of value consciousness can be clearly seen when looking at changes in prices vs volumes for major expenditure categories. A clear trend has emerged over the first 4 months of the year, as categories with larger price increases are seeing greater reductions in volumes. In other words, real expenditures are smaller where price gains are larger and vice-versa. Consumers are making tradeoffs, spending more where price increases have been smaller and spending less where prices are rising more aggressively. This strong and growing relationship provides compelling evidence that the firm inflation prints of the first quarter were not demand driven in nature and further implies that there are growing risks to firms who decide to push further price increases. Firms that raise prices risk losing share to competitors as well as other products, a dynamic which disincentivizes aggressive price hikes and helps to further support real income gains. Nothing to worry about here.

Source: Portfolio Analysis & Consulting, Bloomberg.

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Adtrax: 1438702.11.66
Expiration Date: 12/31/2024