

NOVEMBER 2023



# The Bottom Line

Relevant Insights for the Savvy Investor

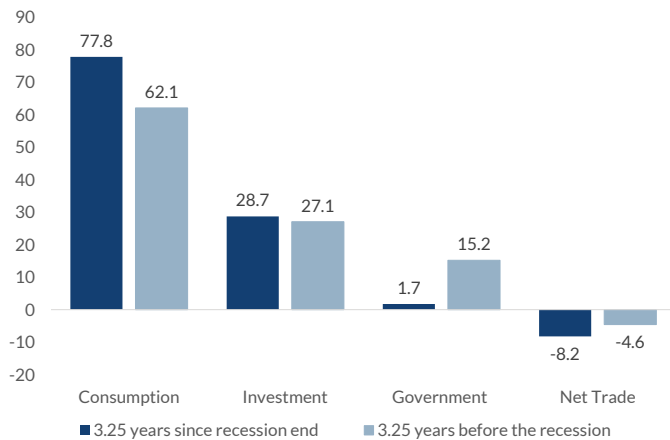
## Spending Has Been Strong, But Growing Headwinds May Squeeze Future Growth

For over a year and a half, the news has been full of articles forecasting a recession, yet one has yet to show up. Since the pandemic-recession ended, the economy has expanded 18.2% with consumer spending being the driving force behind the continued growth.

In the 3.25 years since the recession, consumer spending has accounted for 77.8% of GDP's growth, much stronger than the 62.1% of the 3.25 years before the pandemic (chart 1). Part of that might be due to the pent-up demand for purchasing that was curtailed during a recession. When comparing the pace of growth in this recovery to the past five, spending has been substantially stronger (chart 2).

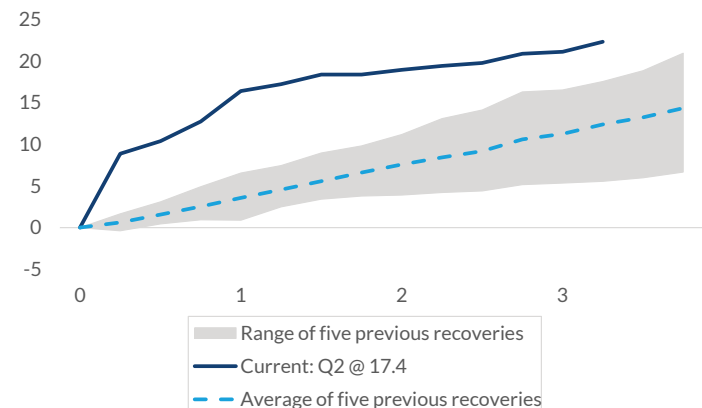
There are several reasons for this strong pace of spending. The primary one was the loss of household wealth during the

**CHART 1: Contribution to GDP**  
 % contribution of each major sector to overall growth seasonally adjusted annual rate



Source: Bureau of Economic Analysis, as of Q3 2023.

**CHART 2: GDP - Consumption**  
 % cumulative change, indexed at 0.0 at end of recession



Source: Bureau of Economic Analysis, as of Q3 2023.

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pandemic was short-lived due to the quick recovery of lost jobs (chart 3), aggressive stimulus programs (unemployment insurance that broadened the eligibility and length, and stimulus checks to individuals and small businesses, and even some big companies), and the recovery of the stock market. Households also benefited from increased savings due to less spending by working at home, increases in compensation, and refinancing debt (like mortgages) from the Federal Reserve Bank lowering interest rates.

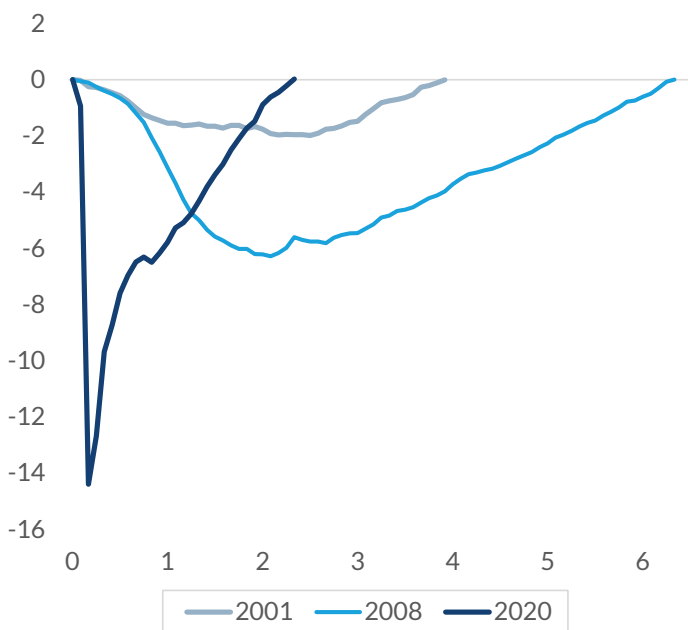
This gave households the financial wherewithal to afford to spend. And spend they did. Spending on goods was the first to recover as household members were at home 24/7 with other family members, and they bought products to keep the family amused. Once the vaccine was widely distributed, spending shifted to services, as consumers wanted “experiences” that they couldn’t enjoy during the pandemic.

All this wealth allowed inflation adjusted spending to maintain the same pace from before the pandemic. Before the pandemic, income and spending were very consistent, and spending accounted for about 90% of income (Chart 4). Following the pandemic, the tailwinds mentioned above pushed income upward. But as the pandemic got further in the rearview mirror, many of those tailwinds disappeared or became headwinds and inflation reduced purchasing power. So, consumers used their built-up savings to maintain their spending, but that was close to being depleted.

Looking forward, the economy will return to where it was before the pandemic, with consumer spending based on income and not on income plus stimulus from the pandemic. We believe the relationship between income and expenditure will return to the pre-pandemic relationship. This means the pace of spending will moderate from current levels. This is precisely what the Fed wants and is the impetus for its interest rate hikes since reduced demand should slow.

**CHART 3: Nonfarm Payrolls - Percentage Change**

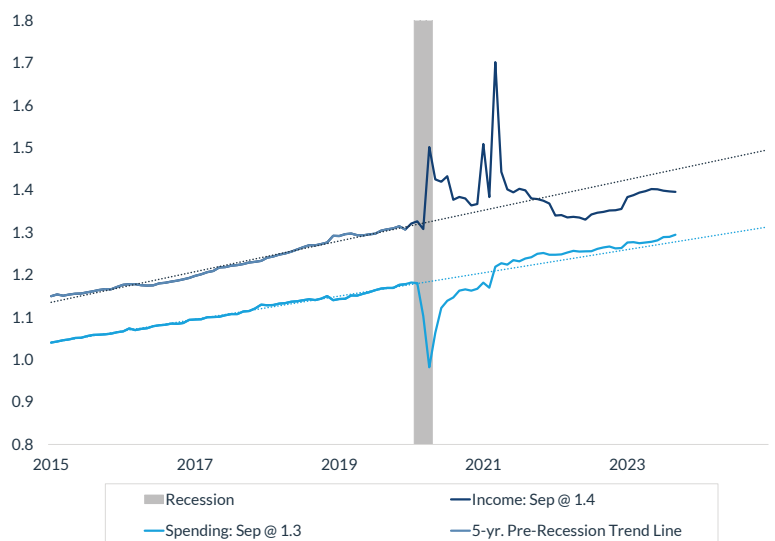
%, indexed at 0 to month before recession started, in years



Source: Bureau of Labor Statistics, as of October 2023.

**CHART 4: Monthly Income and Spending: Inflation Adjusted**

\$, trillions, seasonally adjusted, with 5-year pre-recession linear trend



Source: Bureau of Economic Analysis as of September 2023. Information is subject to change and is not a guarantee of future results.

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# Market Trends

Investor sentiment has been back firmly in risk on mode this month, with the market’s bullish response a reminder that the major drivers for equities remain bond yields, the trajectory of inflation, and the Fed’s policy direction within this tightening cycle. While the reaction in markets to recent positive developments, particularly on the inflation front, is understandable, we still advise caution near term. With economic growth set to slow markedly in coming quarters, we suspect negative earnings revisions ahead could be a renewed source of pressure on stock prices before a more durable rally takes hold.



After 19 months of tightening monetary policy and 525 basis points in movement of the federal funds rate, the Fed is finally seeing the labor market cool, with the unemployment rate moving up to 3.9% from January’s low of 3.5%.<sup>1</sup>



The Fed appears to be on hold concerning changes in the federal funds rate due to moderation in inflation and labor. Still, it will retain a hawkish bias to prevent speculation of it lowering interest rates in 2024.<sup>2</sup>



Record home prices and the highest mortgage rates in twenty years have pushed affordability to all-time lows, with the mortgage payment of an average home priced at 46% of disposable income.<sup>3</sup>



Despite the conflict in the Middle East, oil prices have declined, hovering around four-month lows due to expected lower demand from China and the U.S.<sup>4</sup>



There is a growing chance that the eurozone will enter a recession; Q3’s GDP contracted by 0.1% and further weakness in manufacturing and consumer spending is expected.<sup>5</sup>

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## Sources

1. Bureau of Labor Statistics, October 2023
2. City National Rochdale, November 2023
3. Bureau of Economic Analysis, National Association of Realtors, Bankrate.com, September 2023
4. Wall Street Journal, November 8, 2023
5. Eurostat, October 2023

## Index Definitions

The consumer price index (CPI) measures the monthly change in prices paid by U.S. consumers.

The S&P 500 Index is a market-capitalization-weighted index of 500 leading publicly traded companies in the U.S.

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