

WEEKLY CLIENT COMMENTARY | OCTOBER 6, 2023

Mitch on the Markets

Portfolio Manager Investing Insights

3 More Critical Tests to U.S. Economic Resilience

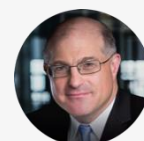
For the better part of two years, the U.S. economy has been hobbled, troubled, unbalanced, and destined for recession—by the media and many economists’ telling.

But data tells us that the U.S. economy has been resilient.

Most readers are aware of the numerous headwinds that have challenged economic growth recently. Inflation soared past 9%, interest rates marching higher with aggressive Fed tightening, regional bank stress that tested the financial system, the threat of a debt ceiling calamity, and the list goes on. Pundits have yet to cease worrying and warning of the U.S. economy’s imminent downturn.¹

And yet, the U.S. economy has kept growing. We know that real GDP turned negative in Q1 and Q2 2022, but not necessarily because of a collapse of demand or actual output. Trade deficits, falling government spending, and plummeting inventory investment (following Q4 2021’s significant inventory build-up) played key roles in 2022’s negative GDP prints. This is arguably why the National Bureau of Economic Research (NBER) decided not to characterize it as a recession.

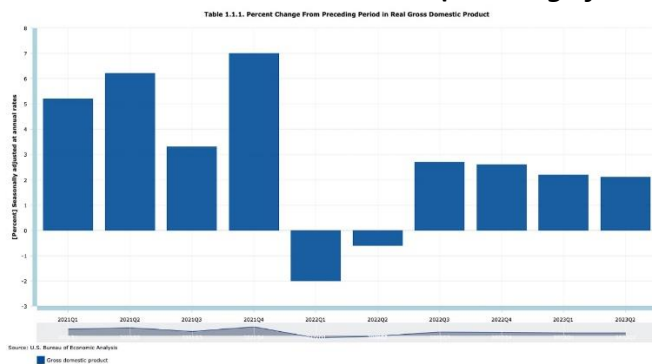
ABOUT MITCH ZACKS



Mitch Zacks, MBA
CEO, Senior Portfolio Manager

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.

U.S. Real Gross Domestic Product (% Change from Preceding Period)



Source: Bureau of Economic Analysis²

Heading into the end of the year, new warnings are emerging about the fate of the U.S. economy. This time, it's the quadruple threat of the auto workers' strike, the resumption of student loan payments, rising oil and gas prices, and a government shutdown. If one of these factors doesn't sink the economy on its own, the argument goes, the aggregate impact of them will.

Let's take a look at these 'critical tests' one by one.

First is the auto workers' strike. The concern here is that work stoppages will hurt the inflation fight via higher car prices (which could then result in higher rates), while also dinging overall economic output. I'm not convinced either will happen.

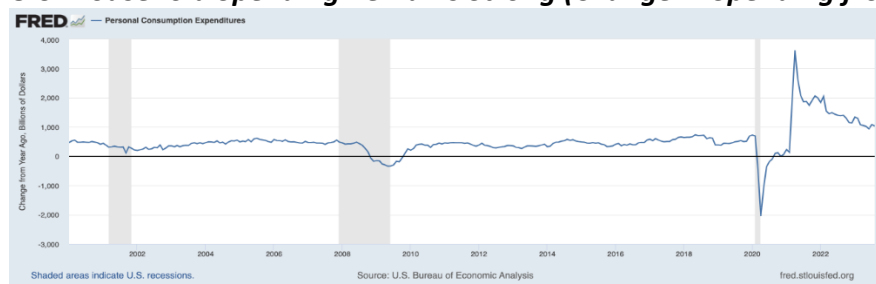
A worker strike that lasts a long time is certainly not a positive outcome. But it's important to note that it would not shut off U.S. output completely, as there are many foreign-owned and non-UAW plants across the country. Strikes would also not affect production across Mexico, Asia, Europe, and the rest of North America, which I would argue tempers the inflation impact. What's more, all new cars make up just 4% of the U.S. CPI basket, which means price pressures should not have a disproportionate effect on overall inflation.

This is not to say that worker stoppages will come without pain. I think if we were to look at the impact on local economies and state economies where many major plants are located, there could be enough impact to turn output negative for the quarter in those states. The national economy, however, is too diverse for the U.S.-based, UAW-powered auto market to sink, in my view.

Next is the return of student loan repayments, effective October 1. By some estimates, loan repayments will divert about \$100 billion from American's pockets over the next twelve months, which is money that could have otherwise gone to spending on goods and services. The timing of the payments could be meaningful too, coming just a month before the holiday shopping season kicks into high gear.

While \$100 billion seems like a big number, it is very small relative to the \$18 trillion U.S. consumers spend each year. It's also worth noting that the average student loan payment before the moratorium was \$265, which is not likely to break the bank for most U.S. households. According to the New York Federal Reserve, the median student loan balance at the end of 2021 was \$18,767, and about 60% of households owed less than \$25,000. Overall, analysis suggests that student loan payments could subtract about 0.8% from consumer spending growth in Q4, which would only slow it to 1.4%.

U.S. Household Spending Remains Strong (Change in Spending from a Year Ago, \$Billions)



Source: Federal Reserve Bank of St. Louis³

The final test to the U.S. economy is higher oil prices. The economic impact of higher oil prices was the subject of my column last week, so I won't rehash my argument here. But the overarching point is that consumer spending on gas – as a percentage of total disposable income – is quite small for most households. If a household spends \$400 a month on gas and that number moves up to \$450 or even \$500 with higher prices, I don't see that moving the needle too much on total spending.

BOTTOM LINE FOR INVESTORS

The one 'test' I left out of my commentary above was a government shutdown, which has been cited as an economic concern but was also resolved as I was researching and writing this column. To be fair, however, Congress reached an agreement to only extend government spending for 45 days, so it won't be long before we're right back here talking about its impact on the economy. We'll cross that bridge when we get to it.

Recent downside volatility in the stock market has many economists, pundits, and investors drawing a causal link to the 'critical tests' mentioned above. When market returns are negative, it's often that investors look for more reasons to be negative. Economic concerns become potential economic calamities, which allude to more negative returns.

But it's important for investors to remember that the economy has overcome much bigger obstacles, in my view, and remains in a resilient state. I would also call out that widely cited, discussed, and known fears like the ones I've detailed above generally don't have much pricing power. The stock market has already digested their respective impacts. A final note to add is that from an investment perspective, August and September's weaknesses don't foretell October's weakness – returns one month do not have any statistical significance on returns in the next month.

¹ Wall Street Journal. September 24, 2023. <https://www.wsj.com/economy/u-s-economy-could-withstand-one-shock-but-four-at-once-8312ba51>

² BEA. 2023. <https://apps.bea.gov/iTable/?reqid=19&step=2&isuri=1&categories=survey#eyJhcHBpZCI6MTksInN0ZXBzIjpbMSwyLDNdLCJkYXRhIjpbWYjYXRIZ29yaWVzIiwiaU3Vydml0sWYjOSVBBX1RhYmxlX0xpc3QlICxll1dfQ==>

³ Fred Economic Data. September 29, 2023. <https://fred.stlouisfed.org/series/PCE#>

STEADY INVESTOR WEEK

- **The strikes in the summer and fall**
- **Rising rates**
- **Americans keeping their jobs**

The Summer and Fall of Strikes

Workers have been walking off the job in significant numbers in 2023. The Hollywood writers' strike garnered a lot of attention this summer, only to be followed shortly after by walkouts orchestrated by the United Auto Workers (UAW). Then, on Wednesday, more than 75,000 Kaiser Permanente employees – which included nurses, pharmacists, and others – went on strike, marking the largest healthcare strike ever recorded. Kaiser's hospital workers, which for the strike are mostly based in California, are striking over contract negotiations related to pay, but also issues with staffing, arguing that Kaiser needs to hire more personnel to address work demands. The auto workers are focused largely on pay, and strikes to date have been measured but could amp up from here. While auto worker stoppages can have a measurable impact on domestic production, it's important to note that it would not shut off U.S. output completely, as there are many foreign-owned and non-UAW plants across the country. Strikes would also not affect production across Mexico, Asia, Europe, and the rest of North America.¹

Rising Rates Creating Headwinds for Stocks, Economy

The yield on the 10-year U.S. Treasury bond has been rising, and stocks have been falling. That has been the takeaway for many investment prognosticators over August and September, and recent action in the Treasury bond market has arguably made the volatility more pronounced. As seen in the chart below, yields have been moving up rather quickly – rising to their highest levels since 2007 – while the S&P 500 sold off -4.8% for the month of September.²



Source: Federal Reserve Bank of St. Louis²

There's a good argument that a spike in long-duration Treasury yields could be caused by one of three things or a combination of them. First is better-than-expected economic growth, second is rising inflation expectations, and third is investor concern over rising federal deficits, which require more bond issuance and that the marketplace needs to absorb. With inflation trending lower, rising yields appear to be a combination of the other two factors, which we view as a positive for markets looking forward. We think investors can absorb new debt issuance and that the economy is growing better-than-expected, which factors as a good thing.

Americans are Keeping Their Jobs

In April 2022, Americans were quitting their jobs in large numbers. The labor market was so tight – with the number of job openings far exceeding the number of unemployed – American workers had plenty of choice and bargaining power. That dynamic is starting to change. While the labor market is still strong and historically tight, the number of job openings has fallen from peaks and layoffs have started to appear mostly in the knowledge economy, with white-collar workers in technology feeling the biggest sting. Americans appear more reluctant to quit their jobs today, perhaps because they think it's the best they'll get, but also because overall satisfaction has improved – likely a result of more flexibility and higher pay. According to the Conference Board, worker satisfaction is the highest it's ever been, and the quits rate has fallen from a peak of 3% last April to 2.3% as of July 2023.⁴

¹ Wall Street Journal. October 4, 2023. https://www.wsj.com/health/healthcare/healthcare-worker-strike-kaiser-permanente-b404e9d5?mod=djemRTE_h

² Wall Street Journal. October 4, 2023. https://www.wsj.com/economy/central-banking/bond-selloff-threatens-hopes-for-economys-soft-landing-80bb152a?mod=djemRTE_h

³ Fred Economic Data. October 4, 2023. <https://fred.stlouisfed.org/series/DGS10#>

⁴ Wall Street Journal. October 3, 2023. https://www.wsj.com/economy/jobs/americans-growing-reluctance-to-quit-their-jobs-in-five-charts-e72b58ce?mod=djemRTE_h

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