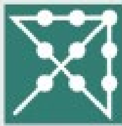

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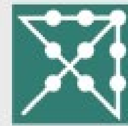

October 17, 2024

Morning Briefing

Mixed Emotions

Check out the accompanying chart collection.

Executive Summary: The US economy is doing well. So why do surveys suggest that consumers and small businesses are depressed about their financial situations? Among consumers, inflation remains a sore point, Dr. Ed explains. Falling y/y inflation rates are little solace when shoppers are perpetually sticker-shocked, remembering pre-pandemic prices. Other pressure points include less affordable homes than before the pandemic, higher mortgage and interest rates, and the need for parental patronage to help financially strapped adult children. … A persistent problem for business owners is lack of qualified job applicants. Inflation is a top complaint for them as well.

US Economy I: Misery Loves Company. A horse walks into a bar. The bartender says, "Why the long face?"

The bartender can ask both US consumers and small business owners the same question. They should be happier than they are. Why aren't they? It's an important question because unhappy consumers might reduce their spending, and unhappy small business owners might curtail their hiring. If both groups act on their current downbeat emotions, they collectively could cause a recession.

Of course, that's not our current economic outlook. We've based our no-hard-landing scenario for the past couple of years on our observation that recessions tend to be caused by tightening monetary policy causing a financial crisis, which turns into a credit crunch and a recession. We don't see that scenario playing out anytime soon. Indeed, the Fed started lowering the federal funds rate on September 18 in a move taking it from 5.25%-5.50% to 4.75%-5.00%. The Fed has plenty of room to lower interest rates further if necessary to avert a recession (*Fig. 1*).

Unhappiness isn't usually a cause of recessions even though a measure of consumer expectations is one of the 10 components of the Index of Leading Indicators, which has been misleadingly predicting a recession since late 2021 (*Fig. 2*). On the other hand, recessions invariably depress consumer confidence as unemployment increases. Again, the

Fed can always continue to lower interest rates if consumers and business owners start to retrench their spending and hiring because they are unhappy.

Debbie and I often have observed that Americans are born to shop. When we are happy, we shop. When we are depressed, we shop even more because it makes us feel better by releasing dopamine in our brains. Of course, to do so we must have purchasing power, which is eroded by unemployment during recessions.

Currently, however, that's far from happening: The unemployment rate was only 4.0% in September. The latest initial unemployment claims suggest that October's unemployment rate rose because of the month's hurricanes and strikes (*Fig. 3*). Indeed, in an October 14 *speech*, Fed Governor Christopher Waller observed that October's employment report "will most likely show a significant but temporary loss of jobs from the two recent hurricanes and the strike at Boeing. I expect these factors may reduce employment growth by more than 100,000 this month."

Let's have a closer look at the latest relevant data for US consumers and small business owners in the next two sections.

US Economy II: Should Consumers Be Happier? The Misery Index is the sum of the unemployment rate and the inflation rate (measured as the yearly percent change in the CPI) (*Fig. 4*). It was 6.5% during September, well below its average since 1947 of 9.1% (*Fig. 5*). So misery is relatively low. On the other hand, the Consumer Sentiment Index (CSI), which is inversely correlated with the Misery Index, was 68.9 during October, below its 82.5 average since 1978.

Debbie and I have found over the years that the CSI is more sensitive to inflation than is the Consumer Confidence Index (CCI), which also is inversely correlated with the Misery Index but tends to be more sensitive to labor market conditions. The CCI is showing a happier reading of 98.7 during September, solidly above its 92.7 average since 1978 (*Fig. 6*).

Inflation over the past two years remains a sore point with consumers even though it has been moderating since last summer and even though wage gains have mostly kept pace with price increases. Consider the following:

(1) Since the start of the pandemic during March 2020 through September of this year, the CPI is up 21.9%, with CPI goods and CPI services up 20.3% and 22.8%, respectively (*Fig. 7* and *Fig. 8*). Interestingly, the CPI goods price level has been flat since June 2022.

However, the CPI services price level has continued to rise since then, led by its shelter component.

The post-lockdown consumer buying binge on goods peaked during the spring of 2021 as consumers pivoted to spending more on services (*Fig. 9*). Roughly one year later, supply-chain disruptions dissipated, and consumer goods prices flattened, albeit at record highs.

(2) Wages stagnated relative to prices during the pandemic years of 2020-22 but started to slightly outpace prices during 2023 (*Fig. 10*). In fact, average hourly earnings for all workers rose 22.9% since the start of the pandemic during March 2020 through September of this year. That's slightly ahead of the CPI inflation rate.

(4) So why is the Consumer Sentiment Index still relatively depressed? Inflation remains a problem for lots of consumers. According to a September 11-16, 2024 Bankrate *survey*, 41% of Americans say inflation is their No. 1 economic issue. Economists (including most policymakers) measure inflation on a year-over-year basis and are pleased to see that it has subsided significantly since it peaked during the summer of 2022. They note that the headline CPI inflation rate peaked at 9.1% y/y during June 2022 and fell to 2.4% in 2024 (*Fig. 11*).

However, many consumers compare today's prices to what they were at the start of the pandemic. The CPI is up 21.9% since then (*Fig. 12*). That's actually slightly below the 22.9% increase in hourly wages for all workers over the same period. However, the prices of essentials have increased by more since the pandemic. The CPI components for energy and food are up 34.3% and 26.3% since March 2020. Here are the CPI price increases in various essentials since the pandemic: gasoline (36.1%), motor vehicle maintenance & repairs (35.2%), rent of primary residence (24.9%), furnishings (19%), and auto insurance (18.8%) (*Fig. 13*).

(5) In his March 15 *Barron's* *column*, Randy Forsyth also examined why consumers seem to be unhappy. He concluded: "The free lunch of historically low interest is over. Even as unemployment remains low and the CPI has receded from its four-decade pandemic peak, normalized interest costs weigh on Americans' budgets. And they're not happy about it, even with stock prices at records."

(6) Another concern about the outlook for consumer spending expressed by many economists is that consumer credit is at a record high of $5.1 trillion. That's true, but it isn't at a record high relative to disposable personal income (*Fig. 14*). Besides, the level of

consumer debt has never caused a recession, though it did exacerbate several recessions that occurred for other reasons.

(7) We note that the net worth of all US households rose to a record $163.8 trillion in Q2-2024 (*Fig. 15*). Almost half of that sum ($79.8 trillion) was held by the Baby Boom generation in Q2-2024 (*Fig. 16*). During Q2-2024, the Baby Boomers held a record $23.0 trillion in corporate equities and mutual fund shares, up a whopping $6.9 trillion since just before the start of the pandemic (*Fig. 17*)!

(8) Many of the Baby Boomers are retiring and spending their retirement savings on goods and services as well as supporting their young adult children, who are also spending money. Indeed, Census data show that in 2024, 30.2% of people between the ages of 25 and 34 years old are living in their parent's home (*Fig. 18*). The third annual review of parental patronage by *savings.com* (dated May 21, 2024) found that:

(i) 47% of parents with grown children provide them with some form of financial support (not including adult children with disabilities). This is a rate similar to that in last year's report.

(ii) On average, parents providing financial support give $1,384 to their children monthly. That's more than twice what the average working parent in the study contributed to his/her own retirement savings monthly ($609 on average).

(iii) Among parents who financially support adult children, 46% give them money for vacations and discretionary spending and 18% help their adult kids pay off credit cards.

(9) Consumers are unhappy for various reasons. The cost of living has increased significantly since the start of the pandemic. However, so have wages, especially for lower-wage workers. In any event, real consumption per household rose to a record high during Q2-2024 (*Fig. 19*).

The Baby Boomers have followed the advice of *Star Trek*'s Spock: They have lived long and prospered. They are mostly happy now that they have paid off their mortgages, finished with college tuition, and seen their asset values soar.

Many younger people, on the other hand, can't afford to buy a house, so they are living at home or sharing an apartment with roommates. Many probably can barely afford auto insurance. I just took my two recently employed college graduates off my auto policy. That raised the cost of their auto insurance close to $5,000 per year each! I'm helping them with

that outlay.

(10) Elevated mortgage rates and home prices have crushed housing affordability. The National Association of Realtors index of affordability is currently worse than it was during the lead up to the Great Financial Crisis and lower than at any time since the early 1980s. Getting priced out of the American Dream—or watching your kids struggle to achieve it—is depressing.

Home insurance premiums also are surging alongside other housing costs and more frequent extreme weather events. Home insurance rates have increased by more than 20% across most of the country since the start of last year, per *WSJ* reporting. Yet those increases do not make their way into CPI. Along with the wonky owner's equivalent rent measure, only renters' insurance is gauged by the Bureau of Labor Statistics. Renters' insurance is a fraction of the cost of true homeowners' insurance, hence why it represents less than half-a-percent of the overall CPI.

US Economy III: Should Small Business Owners Be More Optimistic? Small business owners have been depressed for a long time. The National Federation of Independent Business (NFIB) surveys its membership once a month. Its Small Business Optimism Index has been hovering between roughly 88 and 94 since mid-2022 (*Fig. 20*). That's more depressed than they were during the pandemic lockdown. Consider the following:

(1) Business can't be all that bad for small business owners given that they've reported relatively high job openings and hiring intentions since the second half of 2021 (*Fig. 21*). Perhaps they've been depressed about the quits rate and the shortage of qualified workers. But now that quits have declined and job openings are down (but remain as high as just before the pandemic), small business owners are still depressed. A persistent problem for small business owners is that there are no qualified applicants for their job openings. In September, 52% of those with positions to fill said so.

(2) In recent months, there has been significant weakness in the NFIB survey's series tracking the net percent of small business owners expecting higher real sales over the next six months and the net percent reporting higher earnings over the past three months (*Fig. 22* and *Fig. 23*). The forward revenues per share and earnings per share of the S&P 600 SmallCaps have been essentially flat around their respective record highs since mid-2022 (*Fig. 24*).

(3) Small business owners don't seem to be fazed by credit conditions. Only 8% said credit

was harder to get than last time (*Fig. 25*). Only 26% said that they are borrowing at least once a quarter.

(4) When asked about the most important problem they faced, the percentage of small business owners split up as follows in September: inflation (24%), quality of labor (19%), taxes (14%), cost of labor (9%), poor sales (8%), and interest rates (4%) (*Fig. 26*).

(5) Finally, we should note that small business owners include lots of proprietors and landlords. Collectively, they earned a record $3.1 trillion (saar) during August, with the former at a record $2.0 trillion and the latter at a record $1.1 trillion (*Fig. 27*). These sums are included in personal income, not in corporate profits. So their downbeat assessment of their earnings might be because they are taking their profits as income!

Calendars

US: Thurs: Retail Sales Total & Core 0.3%/0.2%; Initial Claims 241k; Industrial Production -0.1%; Capacity Utilization 77.9%; Business Inventories 0.3%; Atlanta GDPNow 3.2%; NAHB Housing Market Index 43; Philadelphia Fed Manufacturing Index 4.2; Fed's Balance Sheet; Crude Oil Inventories & Gasoline Production; Goolsbee. **Fri:** Housing Starts & Building Permits 1.35mu/1.45mu; Baker Hughes Oil Rig Count; Bostic; Kashkari; Waller. (FXStreet estimates)

Global: Thurs: ECB Interest Rate Decision & Deposit Facility Rate 3.40%/3.25%; Eurozone Headline & Core CPI -0.1%/m/1.8%y/y & 01%m/m/2.7%y/y; China GDP 4.6%y/y; China Industrial Production 4.6%y/y; China Retail Sales 2.5%y/y; China Unemployment Rate 5.3% EU Leaders Summit; McCaul; Lagarde; Woods. **Fri:** UK Retail Sales -0.3%; EU Leaders Summit. (FXStreet estimates)

Strategy Indicators

Stock Market Sentiment Indicators (*link*): The *Bull-Bear Ratio* climbed to 2.62 this week after falling to 2.35 last week from 2.62 the week before. *Bullish sentiment* climbed to 57.6% this week, the highest percentage since late July—when the report noted seven consecutive weeks with bulls over 60%, ending at 64.2%. Bullish sentiment was at 43.5% five weeks ago—which was the lowest percentage since last August. Meanwhile, *bearish sentiment*

edged down 0.6ppts to 22.0% after a small move up to 22.6% last week. Both are still far above the mid-July percentage of just 14.9%. The *correction count* fell to 20.4% this week, after rising from 23.0% to 24.2% last week. Recent readings are down from 33.9% at the start of September and nearing the low levels during early summer. In the *AAII Sentiment Survey* (as of October 10), both bullish and neutral sentiment among individual investors about the short-term outlook for stocks rose during the latest week, while bearish sentiment declined. *Bullish sentiment* rose 3.6ppts to 49.0%, unusually high and above its historical average of 37.5% for the 48th time in 49 weeks. *Neutral sentiment* climbed 3.2ppts to 30.4%, below its historical average of 31.5% for the 14th straight week. *Bearish sentiment* dropped 6.7ppts to 20.6%—now unusually low and falling to its lowest level since December 14. 2023 (19.3%). It's below its historical average of 31.0% for the eighth time in nine weeks.

S&P 500 Earnings, Revenues, Valuation & Margins (*link*): The S&P 500's forward profit margin was unchanged w/w at a record high of 13.4% during the October 10 week. It is now 3.1ppts above its seven-year low of 10.3% during April 2020. Forward revenues ticked down 0.1% w/w, and forward earnings fell 0.2%. Revenues and earnings have been steadily making new record highs for just over 12 months now. That compares to its prior 16-month string of record highs from March 2021 to June 2022; prior to that, they peaked just before Covid-19 in February 2020. The consensus expectations for forward revenues growth rose 0.1ppt w/w to 5.7% and remains close to its 23-month high of 5.8% during the August 1 week. It has gained 3.4ppts from its 33-month low of 2.3% during the February 23, 2023 week. That's down from a record high of 9.6% growth at the end of May 2021 and compares to 0.2% forward revenues growth during April 2020, which was the lowest reading since June 2009. The forward earnings growth forecast was steady w/w at a 36-month high of 14.1%. It's now 10.8ppts above its 31-month low of 3.3% during the February 16, 2023 week. That's down from its 23.9% reading at the end of April 2021, which was at its highest since June 2010 and up substantially from its record low of -5.6% at the end of April 2020. Analysts expect revenues to rise 4.6% in 2024 (unchanged w/w) and 5.7% in 2025 (unchanged w/w) compared to a revenues gain of 2.1% in 2023. They expect an earnings gain of 9.5% in 2024 (down 0.3ppt w/w) and a 14.9% rise in 2025 (unchanged w/w) compared to an earnings gain of 2.4% in 2023. Analysts expect the profit margin to rise 0.5ppt y/y to 12.4% in 2024 (unchanged w/w), compared to 11.9% in 2023, and to rise 1.1ppts y/y to 13.5% in 2025 (unchanged w/w). The S&P 500's weekly reading of its forward P/E rose 0.3pt w/w to a 42-month high of 21.7, and is up 2.0pts from a 14-week low of 19.7 during the August 8 week and 6.4pts from a 30-month low of 15.3 in October of 2022. It also compares to 23.1 in early September 2020, which was the highest level since July 2000, and to a 77-month low of 14.0 in March 2020. The S&P 500 weekly price-to-sales ratio rose

0.05pt w/w to a new record high of 2.91. That's up from a six-month low of 2.22 during the October 26, 2023 week and compares to 49-month low of 1.65 in March 2020.

S&P 500 Sectors Earnings, Revenues, Valuation & Margins (*link*): During the October 10 week, forward revenues rose for five of the 11 S&P 500 sectors and forward earnings rose for three sectors. This led to rising forward profit margins w/w for three sectors. Four sectors posted record-high forward revenues this week: Financials, Information Technology, Real Estate, and Utilities. These five sectors are not far from their record-high forward revenues recently during the past few weeks: Communication Services, Consumer Discretionary Consumer Staples, Health Care, and Industrials. Energy and Materials are the biggest laggards at 5.1% and 12.6% below, respectively. These three sectors had record-high forward earnings this week: Communication Services, Information Technology, and Utilities. These seven sectors are less than 2.5% below their recent records: Consumer Discretionary, Consumer Staples, Financials, Health Care, Industrials, and Real Estate. Forward earnings remains depressed for Energy and Materials; both are more than 20.9% below their post-pandemic highs. Looking at the forward profit margin, most of the sectors have recovered from their early 2023 forward profit margin lows to near-record high readings again. In recent weeks, the Consumer Discretionary, Financials, Industrials, and Information Technology sectors were in that club. Among the laggards, Energy's forward margin has cratered 1.2pts to a 31-month low of 9.7% from its six-month high of 10.9% in mid-June; Consumer Staples' 6.9% is 0.2ppt above its seven-year low in March 2023; and Health Care's 8.8% is up 0.3ppt since its record low in April. The annual profit margin is expected to fall y/y in 2024 for Energy, Materials, and Real Estate and to improve for the other eight sectors. Here's how the S&P 500 and its 11 sectors rank based on their current forward profit margin forecasts along with their record highs: Information Technology (26.4%, down from its 27.6% record high in September), Financials (19.3, down from its 19.8 record high in August 2021), Communication Services (18.0, down from its 18.1 record high during the August 8 week), Real Estate (17.2, down 0.1ppt w/w and from its 19.2 record high in 2016), Utilities (14.2, down from its 14.8 record high in April 2021), S&P 500 (13.4, a record high in five of the past six weeks), Materials (11.2, down 0.1ppt w/w and down from a 20-month high of 11.6 in July and from its 13.6 record high in June 2022), Energy (9.7, down 0.2ppt w/w to a 31-month low and down from its 12.8 record high in November 2022), Industrials (11.2, a record high this week), Consumer Discretionary (9.2, a record high this week), Health Care (8.8, up 0.3ppt from its record low at the end of April and down from its 11.5 record high in February 2022), and Consumer Staples (6.9, down from its 7.7 record high in June 2020).

US Economic Indicators

Import Prices (*link*): Import prices posted the biggest decline in nine months in September, reflecting lower fuel prices. *Import prices* sank 0.4% in September, the largest monthly decline since December 2023 (-0.7%), after a revised 0.2% drop in August, first reported as a 0.3% decrease. Import prices averaged monthly gains of 0.6% the first four months of this year, followed by average monthly declines of 0.1% over the five months ending September. On a year-over-year basis, import prices slipped below zero in September for the first time since February, falling to -0.1% in September from recent peaks of 1.6% during June and July. The yearly rate had jumped from -2.4% last December to the recent high of 1.6% during the summer. Fuel prices dropped 7.0% in September, the largest one-month decline this year. *Import prices excluding fuel* edged up 0.1% for the third successive month in September, not recording a decline since May. The yearly rate rose to 1.8% in September, the largest gain since December 2022.

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