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Weekly Market Commentary
August 22nd, 2022

The Consumer Dead…. We Think Not!!

Last week brought a host of data shedding fresh light onto the state of the consumer. While recession worries have been stoked by high inflation, supply bottlenecks and Fed rate hikes, household finances have been a source of optimism. The economy is slowing, and plenty of challenges remain, but the outlook is not as bleak as headlines might suggest. And with personal consumption accounting for 70% of GDP, the broader economic path forward is in the hands of the consumer. Here are two important things the latest data tell us about consumers' prospects:

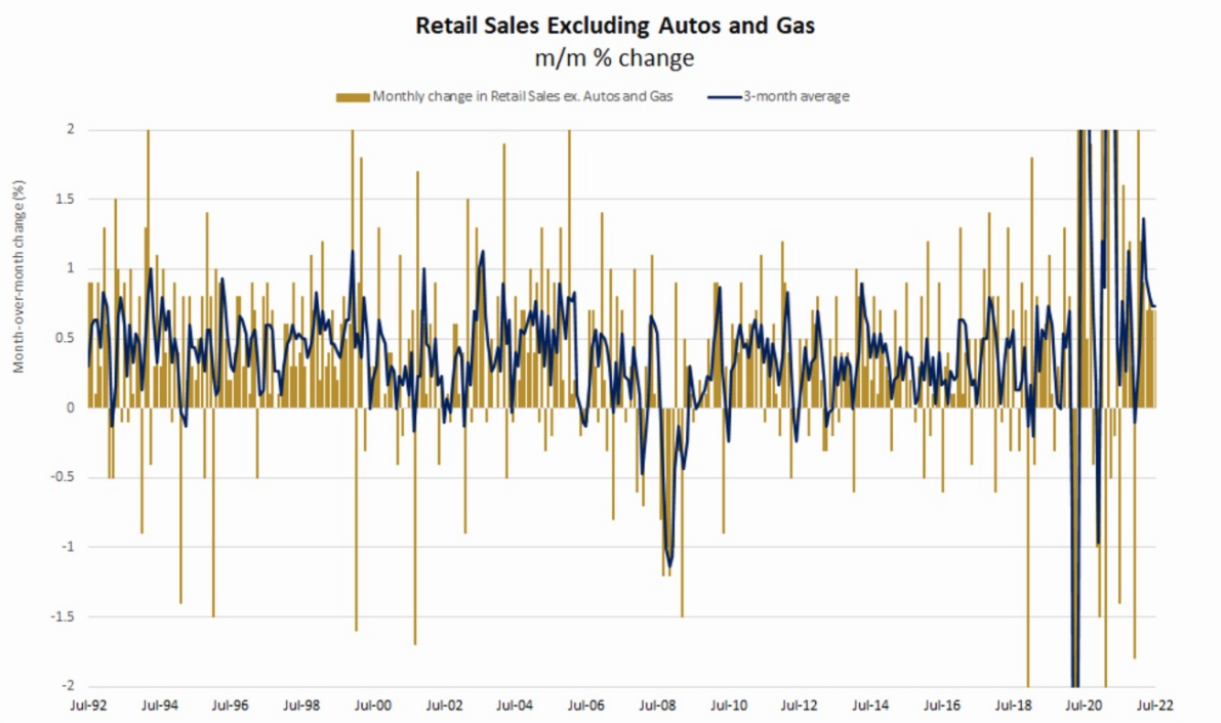
Retail sales indicate the consumer is not going into hibernation.

- The July retail sales report showed that overall spending was flat with June; however, a look under the hood reveals a more encouraging trend. The headline figure was suppressed by a material decline in gas station sales, a welcome trend resulting from the pullback in oil prices. On a positive note, underlying retail sales, excluding auto and gasoline sales, rose by a healthy 0.7% month-over-month. Online sales were up sharply, while restaurant sales also ticked higher, indicating a balance between goods and leisure spending. We already knew that price increases slowed in July versus June, which means the strong 0.7% jump in spending reflects an increase in nominal sales volumes. This tells us that consumers appear willing to redirect the benefits of lower food and gasoline costs toward other discretionary spending, as opposed to reducing overall spending. This suggests household consumption growth can remain a positive force in supporting economic output.

- While retail-sales activity indicates the consumer is still in fairly good shape, the housing market is an increasing source of vulnerability. Housing-market data last week showed that a broad-based deceleration is underway. Residential starts and permits are down, homebuilder sentiment has fallen, and mortgage applications declined to their lowest since November 2020. This trend is not surprising, as rising interest rates have a more immediate impact on home-purchase activity, whereas tighter monetary policy tends to have more lagged effects on other areas of the economy. We don't expect a crash in the housing market, but we do think conditions will continue to cool from the recent boil. That said, the retail-sales report showed that building supplies and home goods saw gains in July, which we suspect may indicate ongoing adjustments in residential spending habits, with consumers possibly shifting from new home purchases toward remodeling. While a more tepid housing market may have an impact on consumer confidence in the near term, we think there is a positive partial offset, in that slower home-price appreciation will help the much-needed overall moderation in core inflation, given shelter prices account for one-third of the overall consumer price index (CPI) basket.

- **Bottom line:** U.S. GDP declined in the first and second quarters, stoking worries of recession. However, inventory adjustments and net trade played outsized roles in the first-half weakness. Retail sales (excluding autos and gas) have risen consistently this year, growing for seven consecutive months, with the July data

telling us consumers are not behaving in recessionary fashion.



Source: FactSet.

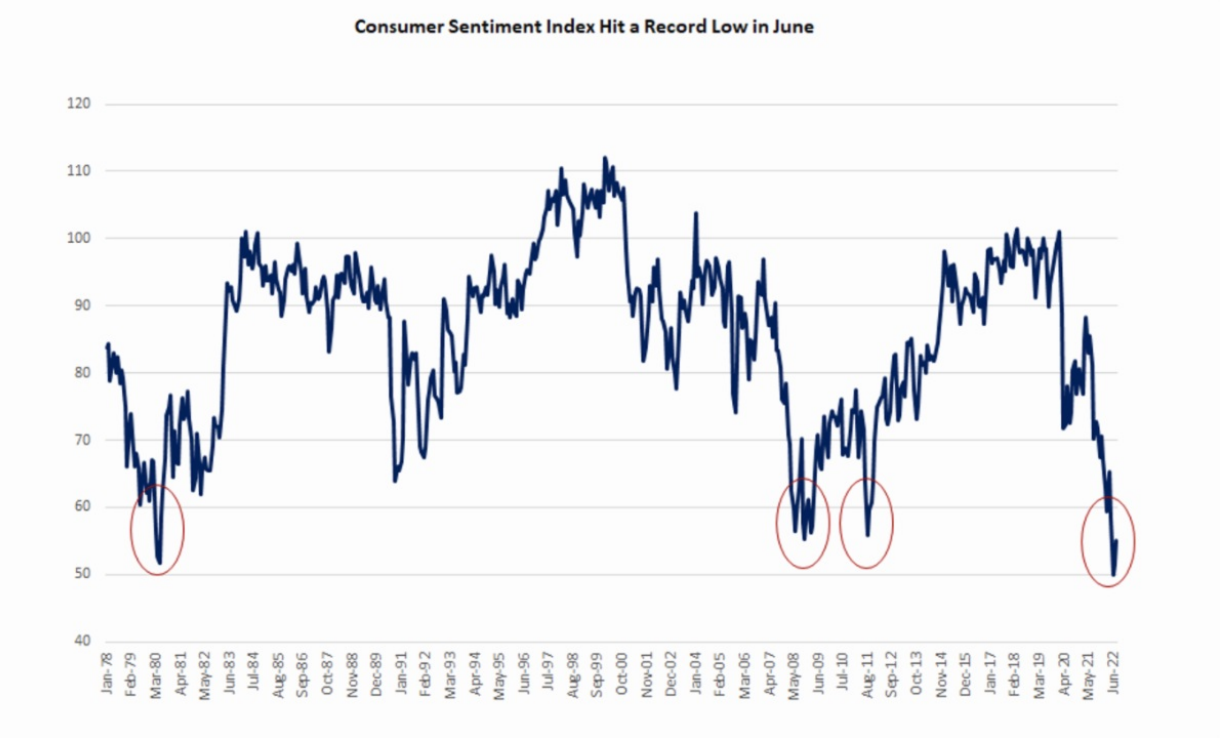
Chart 1 shows the month of over month and 3-month average change in Retail Sales, excluding Autos and gas. The chart highlights the latest release which came in with strong month-over-month growth, pointing to a resilient consumer.

Consumer Sentiment Has Plummeted, but Lower Inflation Should Improve Consumers' – and the Market's – Mood.

- Consumer sentiment is depressed, reflecting the pain from high prices at the pump and grocery store, along with higher borrowing costs from rising interest rates. However, historically low consumer confidence has not been accompanied by historically low consumer spending, which we'd attribute to a still-healthy employment environment, along with the abnormal and outsized impact of inflation on consumers' current mood.

- In 1980, the peak in inflation and the bottoming of the consumer sentiment index came within two months of each other. Similarly, we think inflation peaked and consumer sentiment bottomed in June of this year, and thus we expect an upcoming moderation in inflation pressures to be met with an improvement in consumer sentiment as we advance.

- The University of Michigan Consumer Sentiment Index fell to its lowest point on record recently, dropping below 60 for just the fourth time. On a positive note, a bottoming out in consumer attitude tends to be followed by favorable market performance. In the three previous instances when the sentiment index fell below 60 ('80, '08, '11), the stock market was higher in each of the following six- and 12-month periods, with the S&P 500 averaging an increase of 16.0% over the next six months and 20.9% over the following 12 months.



This chart shows how far the consumer sentiment fell in June amid high inflation. The last time we saw levels this low was in 2008 & 2009.

(Source: oXYGen & Jones)

Markets For The Week

INDEX	CLOSE	WEEK
Dow Jones Industrial Average	33,707	-0.2%
S&P 500 Index	4,228	-1.2%
NASDAQ	12,705	-2.6%
MSCI EAFE	1,947	-0.9%
10-yr Treasury Yield	2.97%	1.4%
Gold	$1,747	-3.05%
Bonds	$101.99	-1.1%

Earnings Highlights This Week

Kohl's: Kohl's said inflation has pressured its middle-income customers. The retailer cut its forecast for sales and profit. Kohl's quarterly results topped analysts' lowered expectations.

Cisco: Cisco gave better-than-expected guidance for its full 2023 fiscal year. Management touted strong demand despite a volatile backdrop.

Target: Target's profit plunged as it slashed prices to clear out a glut of unwanted

inventory. The retailer maintained its outlook for the year, however. "If we hadn't dealt with our excess inventory head on, we could have avoided some short-term pain on the profit line, but that would have hampered our longer-term potential," Target's CFO said.

Lowe's: Lowe's on Wednesday reported mixed second-quarter earnings Wednesday. The company said improved operations offset lower-than-expected sales that were hurt by a shortened spring. Lowe's saw an increase in sales to professionals such as contractors and electricians.

Walmart: Walmart topped analysts' expectations for earnings and revenue in the fiscal second quarter, even as consumers pulled back in discretionary categories like apparel.
The retailer's profits are under pressure, but it is wooing more middle- and higher-income customers who have turned to the discounter for low-priced food and essentials because of inflation. The company reiterated its outlook for the back half of the year.

News and Notes:

Are You Paying Too Much In 'Convenience Fees'?

What are merchants or consumers charged when they use their credit cards?

- It depends. There are always charges every time a card is swiped or processed (whether or not you knew it) called merchant fees.
- It's called an interchange fee and can be 2% to 4% -most of the money goes to the bank issuing the card and some goes to companies like Visa, Mastercard, or American Express.
- Where is gets tricky or sneaky is when you swipe online and see the term "convenience fee" which just means the merchant is passing this cost (the 2% to 4%) on to you. NOT so convenient.

Do we see any changes coming down the road that could help consumers with this?

- New bill introduced last month called the Credit Card Completion Act of 2022. (Bi-partisan Sens Durbin and Marshall)
- Mastercard and Visa account more than 70% of general-purpose credit cards which essentially allows them to act as a duopoly and set the rates merchants pay.
- If passed, this won't lower rates, but will increase competition. (Star, NYCE, Shazam)

What can you do about these fees today…is there a way to make them go away or complain?

- The best thing you can do is see if you can pay by check or cash where there are no transaction fees. One way or the other, you pay.
- Some stores now don't accept cash, and therefore the digital dollar or cryptocurrency may become bigger. Both the consumer and merchant can win.

- On the downside, your reward cards would fade away because the fees banks and credit card companies get fund these programs (therefore it's typically about 1% of spend).

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