DUCENTA SQUARED
ASSET MANAGEMENT

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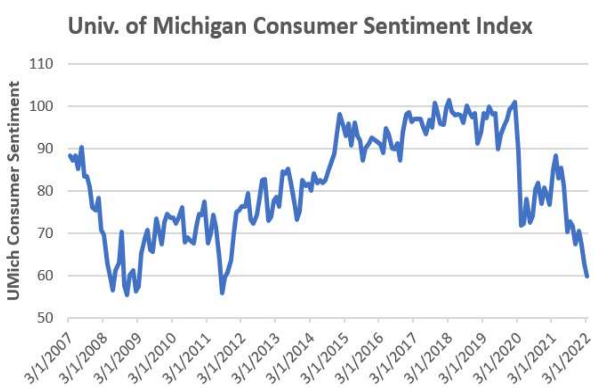
555 W. 5th Street, Suite 3700
Los Angeles, California 90013
www.ducentasquared.com

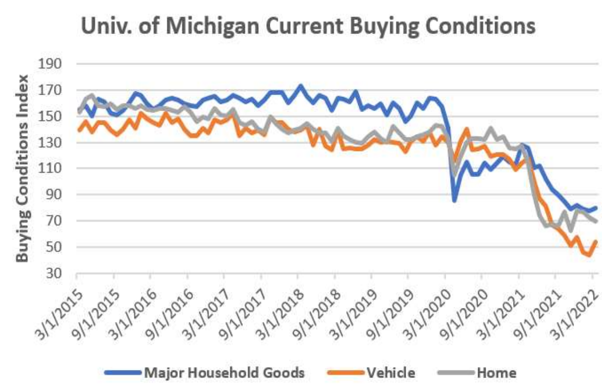
Checking in on the US Consumer

Consumer spending comprises the largest component of US GDP, accounting for approximately 67% of annual economic output. Last year, government stimulus checks and other transfers dramatically increased incomes and personal savings during the pandemic, which helped produce a sharp increase in personal consumption in 2021. With stimulus checks and much of the pent-up demand from the COVID lockdown now behind us, we thought it would be timely to provide a quick check-up on the health of the consumer and discuss our outlook for spending in 2022.

Consumer confidence – why so gloomy?

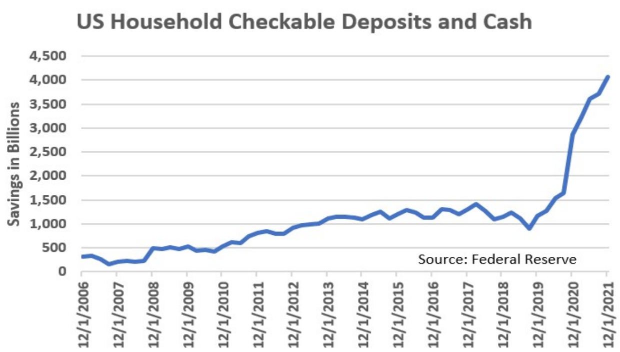
Despite a strong labor market, record level personal savings, and net worth gains from home and stock price appreciation, the recent University of Michigan consumer sentiment survey shows US consumers in a bad mood. Specifically, consumer sentiment resides at a level lower than the initial post-pandemic decline and approaching the all-time low in 2008 following the financial crisis (see graph below, left). Indices that track the "good time to buy" household durables, vehicles, and homes also reside at record low levels (see graph below, right). Higher prices are clearly taking a toll on consumer sentiment with gas prices up 51%, home prices up 19%, and new and used car prices up 12% and 41%, respectively, over the past year.

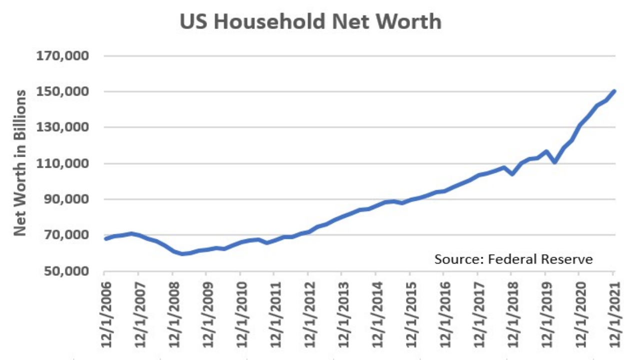




Healthy consumer balance sheets

Household balance sheets usually deteriorate in an economic downturn as unemployment climbs and asset prices typically decline. However, the economic downturn triggered by the COVID pandemic, was anything but normal. The labor market quickly recovered, and generous government stimulus plans raised incomes and savings above pre-pandemic levels. In addition, aggressive fiscal and monetary policy responses combined to push home and stock prices to record highs. The graphs below illustrate the ample savings available to consumers and the record increase in household net worth following the pandemic.

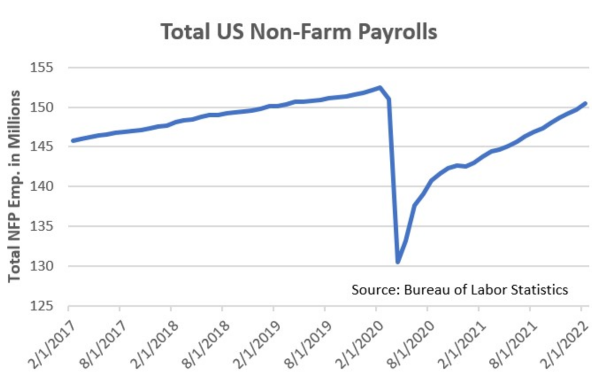


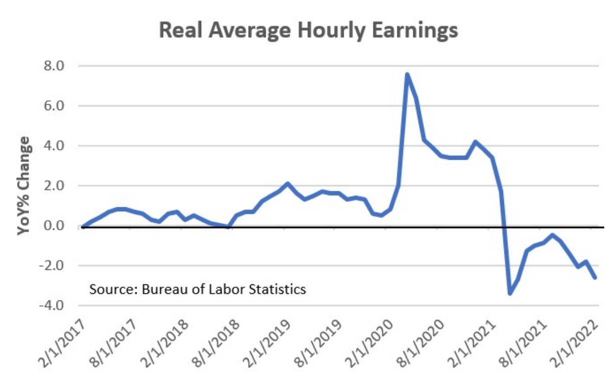


Government transfers in support of the COVID economic lockdowns caused households savings to surge to $4 trillion, approximately $2.5 trillion higher than normal levels. Since the beginning of the pandemic, US household net worth rose 36% and has reached a record high of $150 trillion. Although overall consumer debt levels are rising, the combination of low interest rates and increasing incomes have improved the consumer's ability to finance higher debt levels. Both debt-to-income and debt service indicators have improved significantly since the 2008 financial crisis and remain at historically low levels.

Strong labor markets offset by negative real wages

US consumers are benefiting from the sharp rebound in the labor markets as the pandemic wanes. The US economy has recovered nearly all the jobs lost from the pandemic shutdown (see graph below, left). Over the past year, the US economy added 6.7 million jobs, the unemployment rate fell to 3.8%, and wages climbed 5.1%. Unfortunately, even with the strong demand for labor, the rise in wages has not kept pace with the increase inflation (see graph below, right), diminishing consumer purchasing power.





Conclusion

In the short term, positive fundamentals from high savings and net worth gains provide some cushion against rising prices. As the Omicron variant infection counts fade, we expect some pent-up demand to drive spending with a shift away from goods spending towards services as the economy reopens. Strong demand for labor and rising wages also support near-term consumer spending. As we move into the second half of 2022, however, consumer spending should slow significantly in the face of headwinds from higher prices, tighter fiscal and monetary policy, and negative real wage growth. The slowdown in consumer spending is a big reason we expect a below consensus GDP growth of 2.5% for 2022, versus the 5.6% rate achieved in 2021.

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