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MARKET SIGHT LINES

The Ides of March: Watching for a Slowdown

By Michael O'Keeffe, *Chief Investment Officer*

Warren Buffett, the chairman of Berkshire Hathaway, is known as a legendary investor, followed and admired by many. During 2008, amid a deep financial crisis, he shared sage advice that has since inspired investors: "Be fearful when others are greedy and be greedy when others are fearful." So, facing what seems to be unwavering economic optimism in the media and among some market watchers, we challenge ourselves to think differently. In this week's Sight|Lines, we share some insights on the current environment as we watch for a slowdown.

THE TAKEAWAY: THE CONSUMER MAY WELL DRIVE THE SLOWDOWN

We're watching the consumer carefully for signs of a slowdown in economic growth.
In summary:

- The consumer has been a major driver of stronger-than-expected economic growth, really the result of the forces of the pandemic reopening.
- Even as the Federal Reserve (Fed) pointed out in its January meeting, while the labor market remains tight, we're seeing signs of normalization.
- The major shifts during the pandemic closing and reopening have obscured our view of longer-term trends, and the effects of the secular, longer-term decline in our workforce should be brought back into focus.
- With the job market beginning to soften and the lag effects of tight monetary policy starting to be felt, we're seeing some consumer data signaling a slowdown.
- Consumer sentiment, a measure designed to gauge an individual's perception of her/his own financial circumstance, surged in January but fell in February and remains low.
- Consumer confidence, which measures consumers' perceptions about the overall economy, has declined since July and remains well below pre-pandemic levels.
- While still early, the environment may be setting up for a slowdown.

IN-DEPTH: WE'RE WATCHING THE CONSUMER FOR SIGNS OF A SLOWDOWN, GIVEN POSSIBLE CRACKS IN THE LABOR MARKET AND WEAKENING STRUCTURAL SHIFTS

A resilient consumer has been a key driver of recent economic strength. Given that consumption makes up about two-thirds of GDP, we're watching the consumer carefully for signs of a slowdown. Going deeper:

- In the pandemic reopening, the consumer has fueled stronger-than-expected economic growth thanks to:
  - Pent-up demand, after spending ground to a halt during the pandemic shutdown.

    - $2.1 trillion in excess savings, most of which has been spent.
    - A stronger labor market during the reopening, in the sense of more jobs available than workers willing to fill them, pushing up wage growth and consumers' willingness to spend.
- However, the Fed pointed out in its January meeting that we're seeing signs of labor market normalization:
    - Powell said that "the labor market remains tight, but supply and demand conditions continue to come into better balance, (with) payroll gains (at) a pace well below that seen a year ago …"
- Major pandemic labor shifts have obscured our view of the secularly declining workforce participation:
    - The participation rate was 67.3% at the start of 2001 and has declined to 62.5% at the start of 2024. The rate's decline reversed from 2015 to early 2020, a strength that may not return.
- With the tight job market beginning to soften, we're seeing some signs of weakening consumer data:
    - Retail sales rebounded in February following January's decline, but the growth was less than economists expected (0.6% versus 0.8%).
        - The retail sales control group, which is often seen as a more precise measure of consumer spending, was flat over the month, whereas economists expected a 0.4% increase.
    - Credit card and auto loan delinquencies have increased to pre-pandemic levels.
- Consumer sentiment and consumer confidence are used interchangeably, but they mean different things:
    - Consumer sentiment, a measure designed to gauge an individual's perception of her/his own financial circumstance, sits at 76.9, well below the pre-pandemic level of 99.8.
    - Consumer confidence, which gauges consumers' perceptions about the overall economy, has declined to 106.7 since a July local high of 114.0, but it remains well below the 115.3 pre-pandemic average level.

CONCLUSION

Warren Buffett said, "Be fearful when others are greedy, and be greedy when others are fearful." We've been recently struck by the optimism about the economy in the media and with some market watchers. As part of our investment process, we challenge ourselves to think differently. While our base case for 2024 calls for positive economic growth, nonetheless we have a less positive view than the consensus. A softening labor market, and consumer data like retail sales and personal spending, show that we may be setting up for a slowdown soon.

Michael P. O'Keeffe, CFA
Chief Investment Officer
michael.okeeffe@stifel.com
www.stifelinsights.com

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