ATLANTIC FINANCIAL GROUP

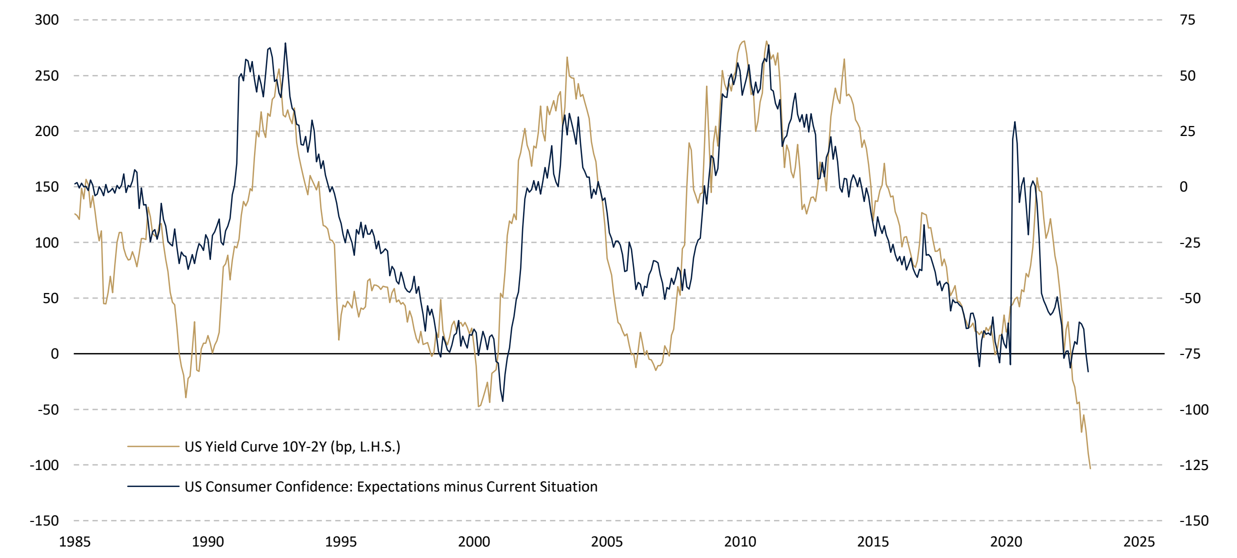
Weekly Investment Focus

13 March 2023

"CAN THE CONSUMER KEEP GROWTH FROM FLOUNDERING?"

- Good employment figures proffer reassurance about households' ability to spend
- This is an illusion, as wages have risen only slightly and layoffs are in sight
- The financial situation for households has become precarious, with rising prices and rates
- Consumers will now focus on essential goods and services

CHART OF THE WEEK: "Consumer confidence erodes with the bond market"



Source: Bloomberg, Atlantic Financial Group

ECONOMIC ANALYSIS

In developed countries, economic growth is mainly driven by household consumption. On average, household spending accounts for 60% of Gross Domestic Product (see Fig. 2). In the United States, it has been rising steadily since the Second World War and the advent of the consumer society, reaching 71% of GDP (see Fig. 3). In the Eurozone, the phenomenon is less pronounced, and the trend is downward, but the ratio of consumption to GDP still reaches 52%.

Fig. 2 – Weight of private consumption in GDP

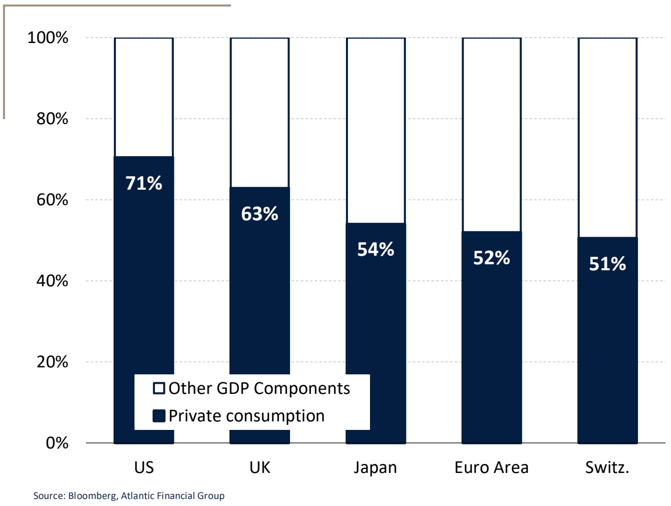
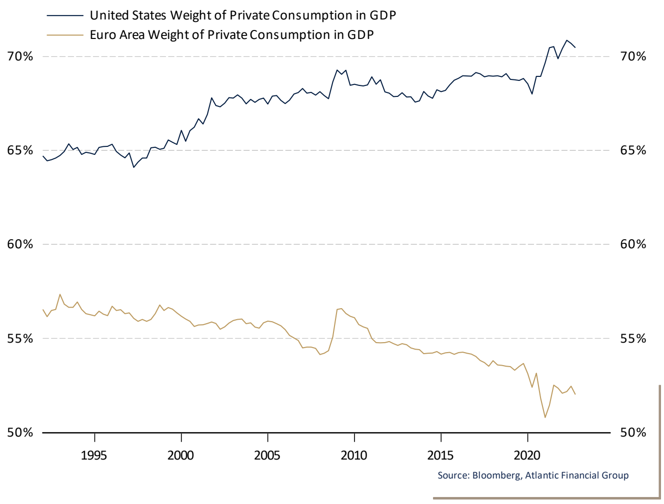


Fig. 3 – Evolution of consumption over time



As the consumer is the main driver of economic activity, **investors pay particular attention to the level of household confidence.** Household confidence depends mainly on labour income, developments in savings and financial markets, and credit conditions.

Usually, as long as job creation is strong, investors have little to worry about in the event of a recession. Yet the labour market is a lagging indicator of the business cycle. It is only when companies have seen that their order books are empty, that they have stockpiled, and that they have stopped investing in new machinery, that they lay off some of their staff. By the time employment contracts, it is already too late to worry: the recession is in place. **This time, not only are companies late in reducing their workforces, but they have over-hired** (see Fig. 4).

Fig. 4 – Job creation in the US

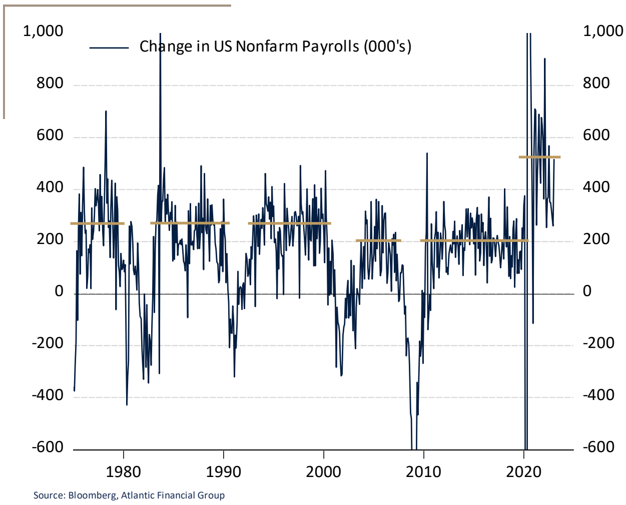
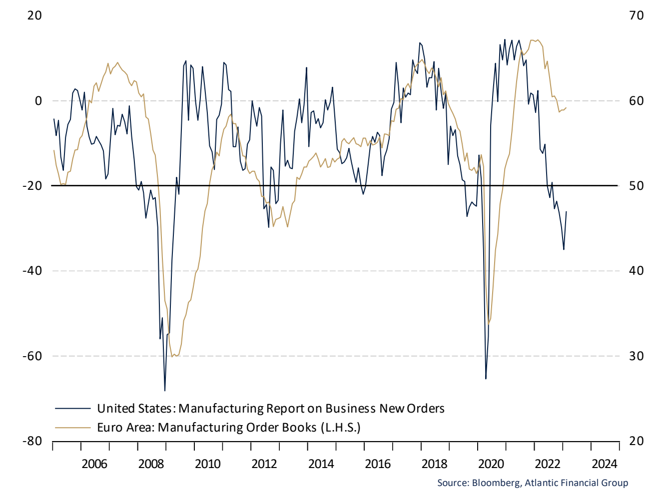


Fig. 5 – Manufacturing order books



For several quarters now, order books have been weakening (see Fig. 5), capacity utilisation rate has been falling, capital expenditures have been declining (see Fig. 6), but companies are still hiring. In the US, employment growth is peaking at 3.2% per year while output is stagnating at 0.9%. The corollary of this situation is that productivity has never fallen so much: -2.3% (see Fig. 7). This phenomenon will reduce margins and force companies to lay off more than usual in order to get back into balance.

Fig. 6 – Capital and labour expenditure

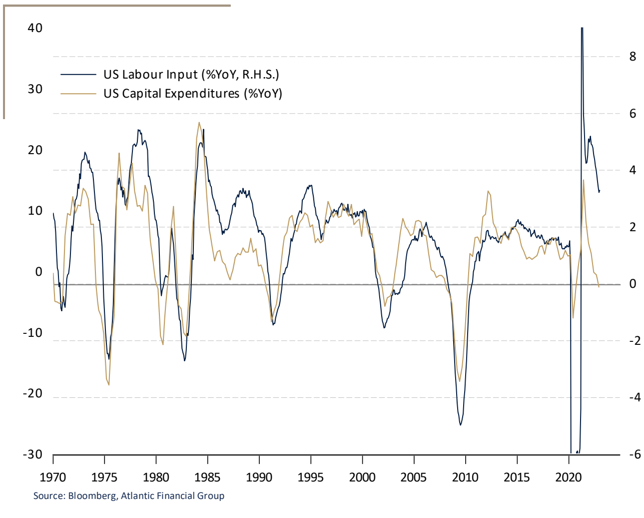
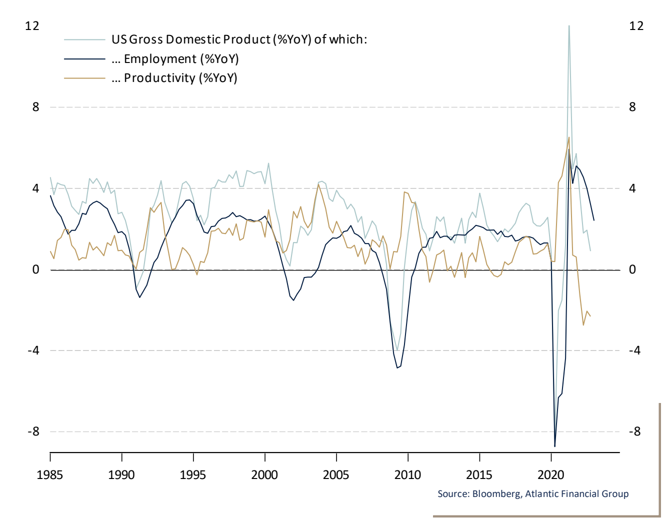


Fig. 7 – GDP = Employment + Productivity



Recent labour market dynamics have seen wages rise by 4.4% in the US. This increase in income could have been a boon to households, but this was without considering the even more rapid increase in inflation for goods and services. Unlike in the 1970s, when the previous major inflation shock occurred, the labour market is not tight enough today for households to hope to negotiate wage increases to offset rising prices. **In the end, consumers have lost 2.4% of their purchasing power** (see Fig. 8).

Fig. 8 – Nominal and real wage growth

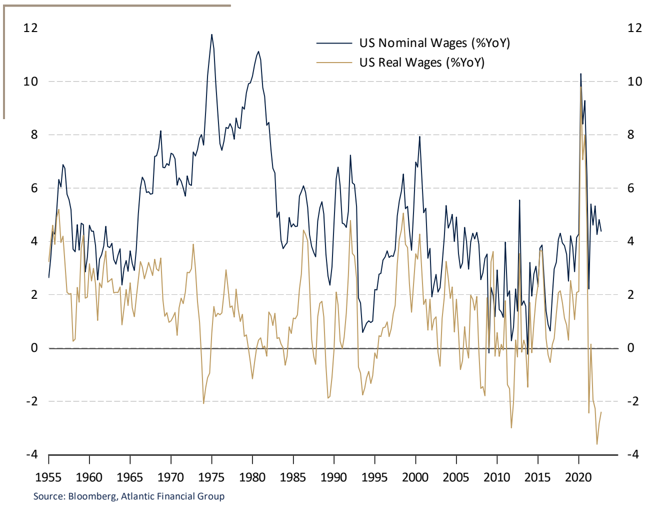
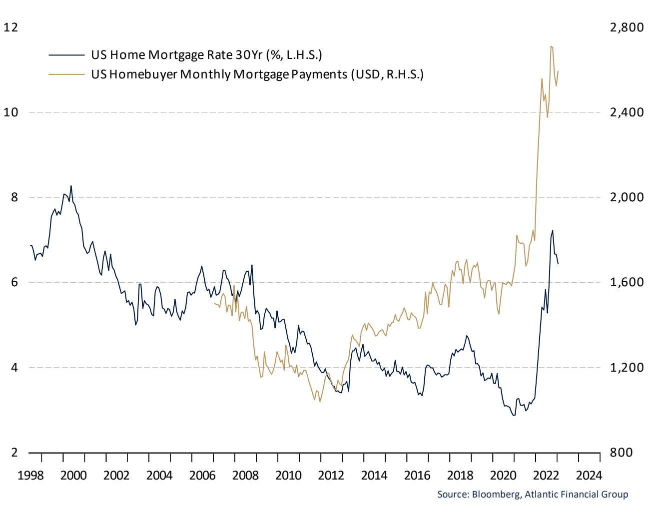


Fig. 9 – US mortgage rates and payments



Household savings had grown rapidly during the periods of lockdown, when governments provided fiscal packages. In the US and Europe, **80% of the remaining excess savings are held by the richest households.** It is therefore unlikely to be spent. Instead, it will probably remain invested in the financial markets, at the risk of evaporating if the latter fall further.

Changes in mortgage rates also have a major impact on the ability of households to spend. As their interest burden increases, their ability to consume decreases. A US household with a 30-year mortgage was paying $1,600 per month in 2021. This amount has risen to USD 2,600 in 2023 (see Fig. 9). The difference will not be saved or spent. Worse still, as real estate prices contract, households will see their wealth shrink. They will increase their precautionary savings and curb their consumption even more.

To make ends meet, some households have no choice but to take on consumer credit. In a survey conducted at the end of October 2022, 7 out of 10 Americans said they were worried about their finances over the next 12 months. Their number one concern (31%) is having to take on more debt to meet necessities, with 19% having already done so in 2022.

Fig. 10 – Consumer confidence

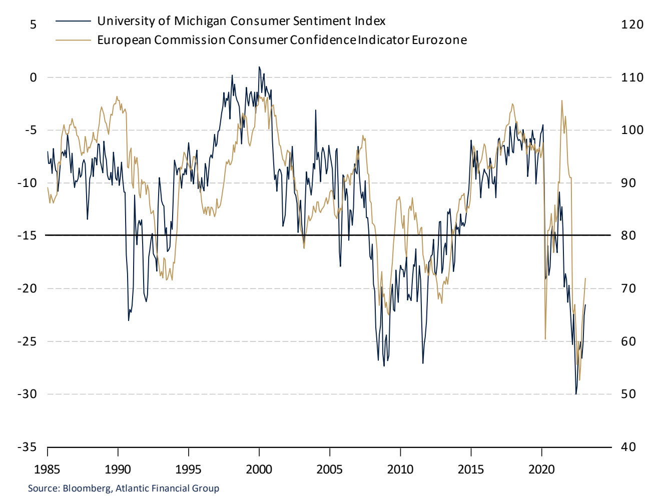
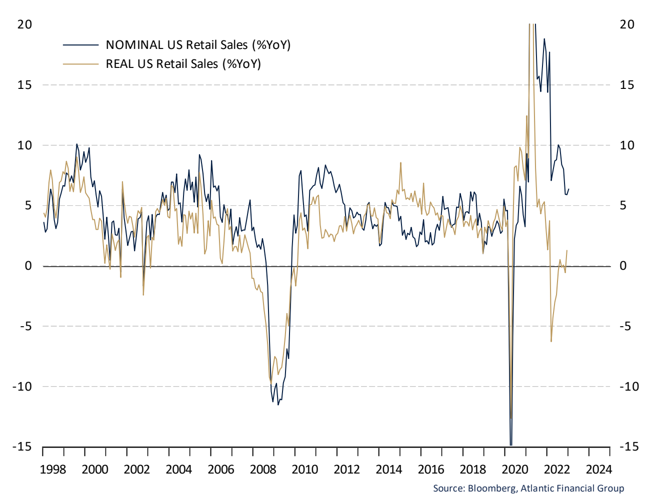


Fig. 11 – Retail sales by value and volume



Despite the strength of job creation, it is therefore no surprise that consumer confidence is eroding (see Chart of the Week & Fig. 10). In both the US and Europe, it hit an all-time low in 2022. In recent months, it has rebounded but remains at a depressed level, consistent with a contraction in private consumption. The loss of purchasing power, the fall in savings, the rise in interest charges and the future wave of layoffs are forcing households to be careful. **The growth of retail sales, both in value and volume terms, reflects the situation perfectly. While nominal retail sales** have risen by 6.4% over the past 12 months, real retail sales have stagnated (see Fig. 11), **indicating that households have been spending more but consuming the same.** Similarly, in the Eurozone, major purchases are becoming increasingly rare (see Fig. 12). Priority is given to basic needs: food, health care and debt repayment.

Fig. 12 – Major purchases in the Eurozone

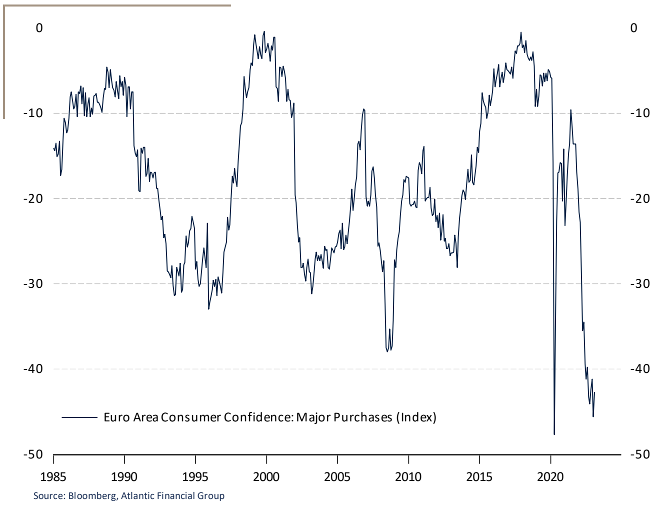
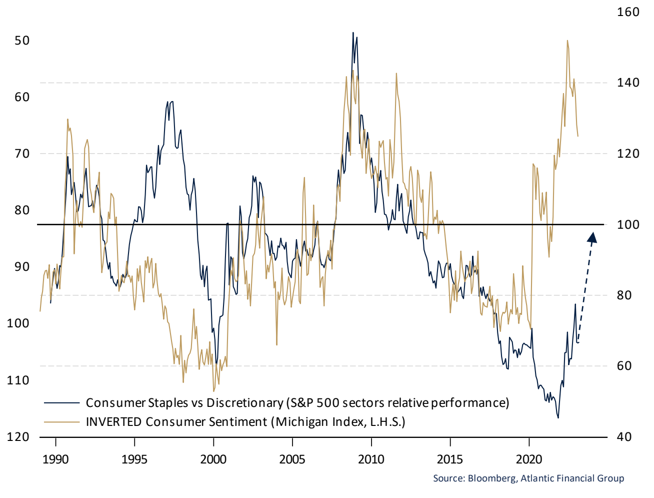


Fig. 13 – Consumer staples vs. discretionary



Conclusion:

Given the state of financial health of households and their loss of confidence, companies selling basic goods and services, consumer staples and health care, will be more resilient than those selling discretionary items (see Fig. 13).

RETURN ON FINANCIAL ASSETS

Markets Performances (local currencies)	Last Price	Momentum Indicator (RSI)	1-Week (%)	1-Month (%)	2023 Year-to-Date (%)	2022 (%)	2021 (%)
Equities							
World (MSCI)	616.6	33.48	-3.5%	-4.5%	2.2%	-17.9%	19.0%
USA (S&P 500)	3 862	34.60	-4.5%	-5.4%	0.9%	-18.1%	28.7%
USA (Dow Jones)	31 910	31.25	-4.3%	-5.4%	-3.2%	-6.9%	20.9%
USA (Nasdaq)	11 139	39.29	-4.7%	-4.8%	6.6%	-32.5%	22.2%
Euro Area (DJ EuroStoxx)	452.7	47.46	-1.8%	0.4%	10.7%	-11.4%	23.5%
UK (FTSE 100)	7 748	36.08	-2.4%	-1.0%	4.8%	4.6%	18.4%
Switzerland (SMI)	10 765	28.99	-3.2%	-2.6%	1.0%	-14.3%	23.7%
Japan (Nikkei)	27 833	59.42	0.8%	1.8%	7.9%	-7.3%	6.7%
Emerging (MSCI)	955	33.48	-3.3%	-5.7%	0.0%	-19.8%	-2.3%
Brasil (IBOVESPA)	103 618	38.75	-0.2%	-4.1%	-5.6%	4.7%	-11.9%
Russia (MOEX)	2 289	58.98	0.2%	0.6%	6.0%	-36.9%	21.9%
India (SENSEX)	58 627	41.16	-1.1%	-2.5%	-2.6%	5.8%	23.2%
China (CSI)	4 009	36.61	-4.0%	-3.4%	2.5%	-19.8%	-3.5%
Communication Serv. (MSCI Worl	74.89	37.85	-3.7%	-4.7%	6.5%	-35.3%	10.9%
Consumer Discret. (MSCI World)	295.4	34.62	-4.2%	-5.2%	6.7%	-31.5%	9.2%
Consumer Staples (MSCI World)	261.6	35.73	-1.3%	-1.5%	-1.8%	-6.0%	11.7%
Energy (MSCI World)	233.3	38.23	-3.8%	-5.8%	-2.3%	34.6%	37.5%
Financials (MSCI World)	131.7	25.19	-5.5%	-6.7%	0.1%	-9.2%	25.1%
Health Care (MSCI World)	319.3	26.09	-3.0%	-5.4%	-6.4%	-5.7%	18.0%
Industrials (MSCI World)	294.7	41.56	-2.7%	-1.7%	4.2%	-12.7%	16.6%
Info. Tech. (MSCI World)	428.7	44.00	-2.8%	-3.6%	9.4%	-30.9%	27.6%
Materials (MSCI World)	316.0	33.97	-4.9%	-3.7%	2.0%	-11.0%	15.4%
Real Estate (MSCI World)	168.1	26.15	-5.7%	-9.0%	-2.1%	-24.0%	23.6%
Utilities (MSCI World)	142.0	35.68	-1.4%	-3.5%	-5.6%	-3.8%	11.1%
Bonds (FTSE)							
USA (7-10 Yr)	3.70%	61.24	2.4%	0.7%	1.9%	-14.5%	-2.4%
Euro Area (7-10 Yr)	3.16%	53.02	2.0%	-0.9%	1.7%	-19.4%	-2.9%
Germany (7-10 Yr)	2.46%	52.65	1.8%	-0.8%	0.7%	-17.8%	-2.7%
UK (7-10 Yr)	3.64%	55.91	2.0%	-0.6%	1.8%	-17.1%	-4.9%
Switzerland (7-10 Yr)	1.35%	56.00	1.4%	0.1%	2.1%	-12.5%	-2.3%
Japan (5-10 Yr)	0.34%	61.29	0.4%	0.4%	0.5%	-2.8%	0.0%
Emerging (5-10 Yr)	8.14%	47.08	-0.1%	-0.9%	0.9%	-17.4%	-2.3%
USA (IG Corp.)	5.41%	52.70	0.9%	-0.7%	1.7%	-15.8%	-1.0%
Euro Area (IG Corp.)	4.31%	49.13	0.9%	-1.0%	1.2%	-13.6%	-1.0%
Emerging (IG Corp.)	7.68%	49.57	0.4%	-0.7%	1.3%	-14.9%	-3.0%
USA (HY Corp.)	8.83%	41.40	-1.2%	-1.2%	1.9%	-11.2%	5.3%
Euro Area (HY Corp.)	7.63%	42.15	-0.4%	-1.2%	2.9%	-10.6%	3.4%
Emerging (HY Corp.)	11.15%	40.88	-0.7%	-1.4%	1.0%	-12.4%	-3.2%
World (Convertibles)	369.3	33.13	-2.1%	-2.7%	3.0%	-18.2%	2.4%
USA (Convertibles)	486.7	33.78	-2.8%	-3.2%	2.7%	-20.1%	3.1%
Euro Area (Convertibles)	187	44.12	-0.4%	-0.5%	3.6%	-12.1%	1.2%
Switzerland (Convertibles)	173.5	44.70	0.2%	-0.6%	0.9%	-7.5%	-0.5%
Japan (Convertibles)	206.4	63.47	0.6%	2.0%	4.3%	-1.3%	3.3%
Hedge Funds (Crédit Suisse)							
Hedge Funds Indus.	748	69.52	n.a.	1.8%	1.8%	1.0%	8.2%
Distressed	937	54.77	n.a.	1.4%	1.4%	-4.5%	12.5%
Event Driven	774	36.27	n.a.	2.2%	2.2%	-6.8%	12.9%
Fixed Income	395	51.15	n.a.	1.4%	1.4%	-1.0%	5.2%
Global Macro	1435	66.53	n.a.	2.7%	2.7%	15.9%	9.6%
Long/Short	903	47.98	n.a.	3.3%	3.3%	-5.8%	8.3%
CTA's	396	61.87	n.a.	-2.6%	-2.6%	19.1%	8.2%
Market Neutral	297	66.15	n.a.	0.8%	0.8%	1.7%	6.2%
Multi-Strategy	710	63.40	n.a.	0.5%	0.5%	1.3%	7.0%
Volatility							
VIX	24.80	65.80	34.1%	20.8%	14.4%	25.8%	-24.3%
VSTOXX	21.17	58.37	16.9%	3.5%	1.4%	8.4%	-17.6%
Commodities							
Commodities (CRB)	542.7	n.a.	-1.1%	-2.0%	-2.2%	-4.1%	30.3%
Gold (Troy Ounce)	1 875	58.21	1.5%	1.1%	2.8%	-0.3%	-3.6%
Oil (WTI, Barrel)	76.68	47.52	-3.8%	-3.8%	-4.5%	4.2%	58.7%
Oil (Brent, Barrel)	82.73	n.a.	-3.6%	-2.9%	-2.6%	9.7%	51.4%
Currencies (vs USD)							
USD (Dollar Index)	103.89	46.47	-0.4%	0.5%	0.4%	8.2%	6.4%
EUR	1.0728	55.37	0.4%	0.0%	0.2%	-5.8%	-7.5%
JPY	134.53	50.39	1.0%	-1.6%	-2.5%	-12.2%	-10.2%
GBP	1.2110	53.89	0.7%	-0.2%	0.2%	-10.7%	-1.0%
AUD	0.6673	40.96	-0.8%	-4.2%	-2.1%	-6.2%	-5.6%
CAD	1.3731	38.18	-0.9%	-2.9%	-1.3%	-6.8%	0.7%
CHF	0.9161	60.80	1.6%	0.4%	0.9%	-1.3%	-3.0%
CNY	6.8975	49.33	0.5%	-1.1%	0.0%	-7.9%	2.7%
MXN	18.362	51.66	-1.9%	1.1%	6.2%	5.3%	-3.0%
EM (Emerging Index)	1 666.4	39.44	-0.5%	-1.3%	0.4%	-4.3%	0.9%

Source: Bloomberg, Atlantic Financial Group

Total Return by asset class (Negative \ Positive Performance)

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