Market Commentary

Retail Therapy

November 2023

Summary

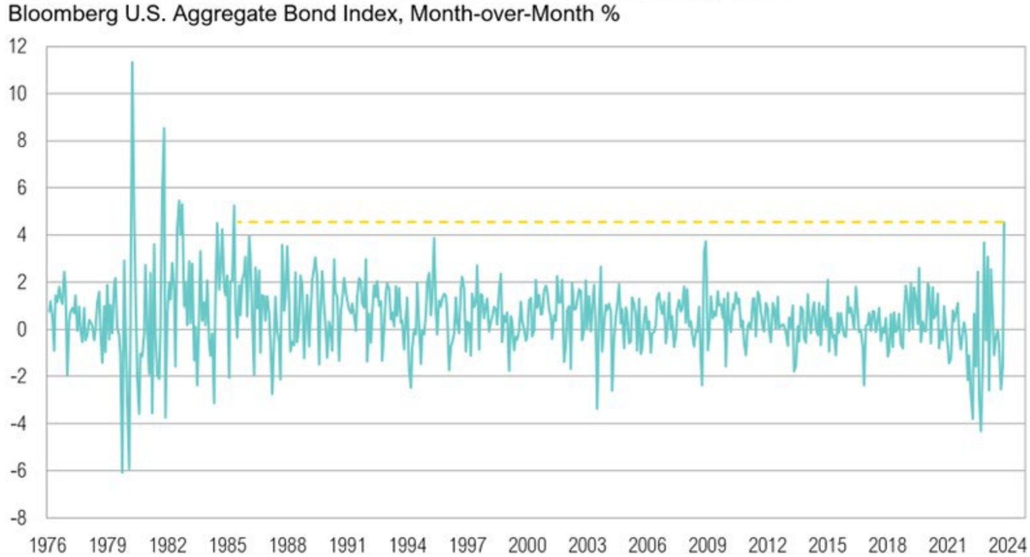
- Stocks and bonds ended November in positive territory. Both U.S. small cap and large cap stocks increased 9.1%, and the Bloomberg U.S. Aggregate Bond Index had its best month since 1985, rising 4.5%.
- The S&P 500's Q3 earnings grew by 4.3% year-over-year, and revenues increased 2.4%. However, earnings growth is expected to slow in the coming quarters.
- Although consumer sentiment remains unusually negative, Thanksgiving weekend broke records for U.S. travel, and online shopping levels were robust.
- Underneath strong consumer spending levels lies growing credit reliance, hinting at an unsustainable trend that could foretell increased economic and market volatility.

Overview

Both stocks and bonds ended November on a distinctly positive note. The S&P 500 Index, a proxy for U.S. large cap stocks, ended the month up an impressive 9.1%. This was the second-best November since 1988, bested only by November 2020's 10.9% gain, which was fueled by optimism surrounding the impending COVID-19 vaccine rollouts.[1] U.S. small cap stocks had a great month and also ended up 9.1%. Bonds had their best month since May 1985, and the Bloomberg U.S. Aggregate Bond Index ended November up 4.5%.

November was the Best Month for U.S. Bonds Since May 1985

Bloomberg U.S. Aggregate Bond Index, Month-over-Month %



Source: Bloomberg

Nearly all S&P 500 companies have reported third-quarter earnings for 2023. The third-quarter earnings growth estimate for the S&P 500 was 4.8% year-over-year, the first increase since the third quarter of 2022.[2] Third-quarter revenues grew 2.4%, exceeding the 1.6% growth expected in September. However, despite the recent market rally, analysts are projecting a more modest earnings growth of 3.0% for the fourth quarter, which is significantly lower than the 8.1% growth initially expected in September.[2] Earnings estimates for the fourth quarter decreased by 5.0% between September 30 and November 30. The healthcare sector experienced the most significant decline, with a decrease of 19.9%. Despite the decline, forward earnings growth in the healthcare sector is anticipated to improve, partly due to the introduction of new GLP-1 weight-loss drugs like Ozempic, which have been boosting sales prospects for companies such as Centene, Cencora, and Eli Lilly.[2]

Annualized third-quarter gross domestic product (GDP) was revised even higher in November, to 5.2%, up from the first estimate of 4.9%. Although the government component's contribution to GDP was revised higher (from 4.6% to 5.5%), third-quarter personal consumption was adjusted down to 3.6% from an initial 4.0%.[3] However, fourth-quarter real GDP growth estimates have been declining. The Atlanta Federal Reserve's GDPNow estimate for the fourth quarter was revised down to 1.2% on November 30, from a prior reading of 1.8%, as poor construction spending and weak ISM Manufacturing Purchasing Manager Index (PMI) reports weighed on the outlook for economic growth.[4]

The ISM Manufacturing PMI for November registered 46.7, its 13th consecutive month of contraction—the longest stretch since the Global Financial Crisis.[5] The Federal Reserve's latest *Beige Book* (which tracks economic conditions across the 12 Federal Reserve Districts), released on November 27, recorded a slowdown in economic activity, and Oxford Economics' Beige Book Activity Index recorded a negative reading in November.[6,7] This is the first time that the Index has turned negative without the U.S. economy being in a recession.[7] The Conference Board's Leading Economic Index (LEI) recorded another negative reading in October, driven by deteriorating consumer expectations and lower ISM data. The LEI continues to indicate a short recession, fueled by still-elevated inflation, high interest rates, and contracting consumer spending.[8]

Consumer sentiment remains at low levels. The University of Michigan's Consumer Sentiment Index for November recorded its lowest reading since May—the fourth consecutive decline in consumer sentiment and its longest straight decline since 2016.[9] Despite turning positive in May after a record 24 consecutive months of negative wage growth, average hourly wages have dropped to a two-year low.[10] Further, real disposable income levels have been flat since May.[11]

With all this seemingly negative news, one may expect that consumer spending would also turn negative, but U.S. consumers are continuing to spend, albeit more selectively.[12]

Retail Therapy

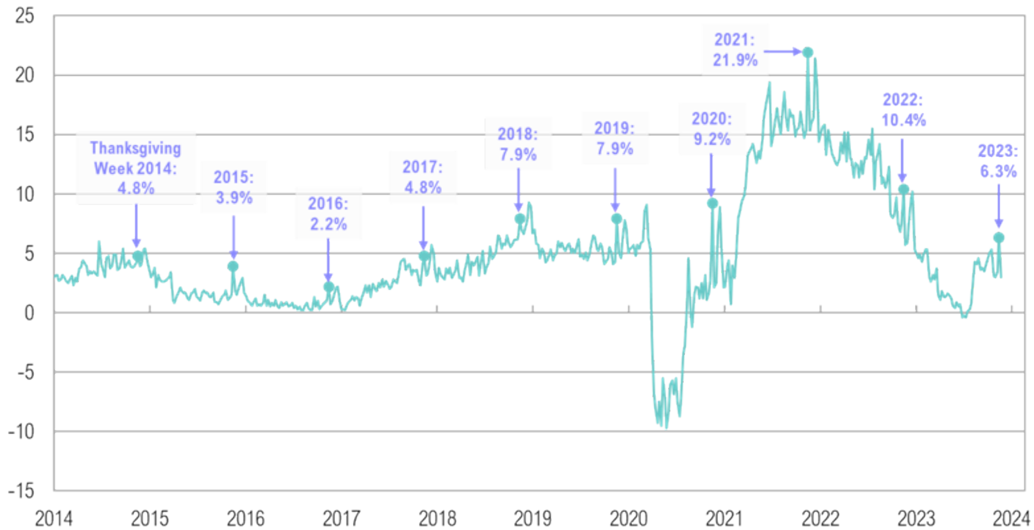
Amid economic uncertainties, consumers are engaging in their own form of retail therapy and are focusing their spending on travel and experiences. For instance, nearly three million people were screened by TSA on Sunday, November 26, marking the busiest day on record at U.S. airports and the second time TSA broke its own travel record this year.[13] The agency previously recorded its busiest day in history on Friday, June 30, ahead of Fourth of July.[14] U.S. consumers also spent a record $9.8 billion in online sales, a 7.5% increase from the prior year. A Mastercard analysis of this year's Black Friday sales found that while online sales increased by 8% year-over-year, in-store sales rose only 1% year-over-year.[15]

However, as online sales have increased, so has the reliance on buy-now, pay-later (BNPL) platforms. According to a report by Adobe Analytics, BNPL methods of payment increased by 47% year-over-year during the Black Friday spending period.[15] BNPL services allow consumers to divide their spending into several interest-free installments. A recent study by the Bank of International Settlements (BIS) found that BNPL services have become increasingly popular, particularly amongst younger generations and those with riskier credit profiles who have higher delinquency rates across various consumer credit products.[16] When U.S. government stimulus checks ended in 2021, the BIS study identified a notable spike in failed BNPL loan payments, whereas credit card loan failures did not increase as much. The rate of failed BNPL loan payments is almost four times higher than that of credit card loans.[16] Revolving consumer credit, which includes credit cards, has been rapidly climbing, reaching $1.29 trillion in October, despite average U.S. credit card interest rates reaching a record high of 24.3%.[17,18,19] Average credit card interest rates were 14.5% in February 2022 and have increased by more than 60% in less than two years.[20]

November has historically marked the start of the holiday spending season. However, many months of accumulated inflation are placing more and more pressure on consumers, and spending habits are changing. Notably, while retailers saw their largest sales gains of the year during the recent Thanksgiving week, November was the worst start to the holiday spending season since 2017. The Johnson Redbook Index of retail sales (a weekly measure of same-store sales growth) increased 6.3% during the 2023 Thanksgiving week and promptly dropped down to 3% in the week after Thanksgiving, reiterating the slow start to the holiday spending season.[12, 21]

On a more positive note, oil prices declined nearly 6% throughout November to end the month at $75 per barrel. The decline in oil prices contributed to the U.S. national average gasoline price dropping to $3.30 at the end of November, nearly 15% lower than the almost $4-per-gallon prices of early October.[22] This may boost consumer confidence heading into the holiday season. According to Moody's Analytics, a $1 decrease in gas prices equals about $125 billion a year in savings for U.S. households, amounting to more than $10 billion per month.[23]

November was the Worst Start to the Holiday Spending Season Since 2017
Johnson Redbook Index

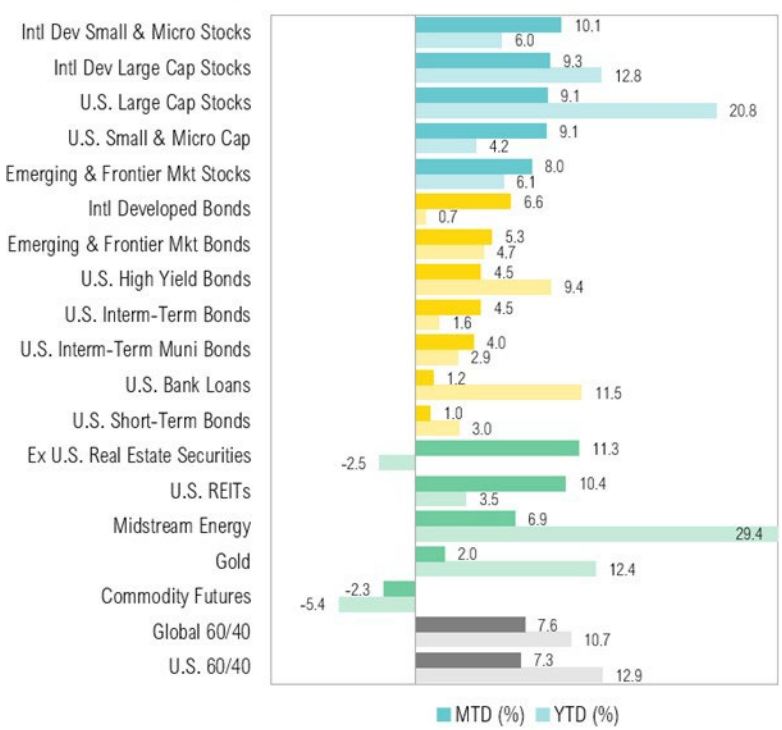


Source: Bloomberg, Johnson Redbook. The Johnson Redbook Index measures year-over-year changes in same-store sales of large U.S. retailers.

Markets

In November, only one asset class reported a negative return: commodity futures, which declined by 2.3%. U.S. large cap stocks and international developed market large cap stocks showed nearly identical positive performance. Specifically, the S&P 500 Index and the MSCI EAFE Index ended the month up by 9.1% and 9.3%, respectively. A similar trend was observed in small cap stocks, with the Russell 2000 Index and the MSCI EAFE Small Cap Index closing November with increases of 9.1% and 10.1%, respectively.

November 2023 Key Market Total Returns



Source: Bloomberg

Following this robust monthly performance, U.S. small cap stocks, represented by the Russell 2000 Index, finished November in positive territory for the year, showing a year-to-date gain of 4.2%. Bonds also performed well, as the 10-year Treasury yield dropped sharply lower throughout the month, ending November down 70 basis points at 4.2%.

In international markets, Japanese inflation rose to 3.3% year-over-year in October, up from 3.0% in the previous month. Despite his best efforts, including a $113 billion economic stimulus package, Japanese Prime Minister Fumio Kishida's approval rating has continued to decline, reaching a low of 16%—the lowest among the 22 leaders tracked in the Morning Consult Global Leader Approval Rating Tracker.[24]

In China, despite the announcement of a fiscal stimulus package aimed at bolstering sectors such as advanced manufacturing and renewable energy, economic recovery remains sluggish. Factory activity sank further into contractionary territory in November, affected by declining domestic and foreign orders. The country's manufacturing PMI dropped to 49.4.[25] Additionally, the services sector activity (which includes the construction and services sectors) fell to 50.2, edging closer to contraction territory.[25]

The economic slowdown in the Eurozone has accelerated over the past two months. Output from the manufacturing sector output contracted for the seventh consecutive month in October.[26] Services sector activity in the Eurozone also contracted, reversing the surge in activity seen earlier in the year.[26] Excluding early pandemic months, new orders for both goods and services declined at the fastest pace since May 2009.[26]

The COP28 summit was held in the United Arab Emirates, starting on November 30. More than 20 countries, including the U.S., Britain, and France, launched a declaration to triple global nuclear energy capacity by 2050. The initiative recognizes the significant role of nuclear energy in achieving net-zero greenhouse gas emissions. A key element of the declaration is the collaborative effort to triple nuclear energy capacity from 2020 levels by 2050.[27]

In other international news, Argentina elected a new president, Javier Milei, on November 19. Milei is planning radical economic reforms in response to the country's triple-digit inflation, a looming recession, and rising poverty.[28] Part of his plan includes the possible dollarization of Argentina's economy.[28]

Looking Forward

Robust headline consumer spending masks an increasing and unsustainable reliance on high-cost credit. Not only is spending moderating even with the economy at or near full employment, but it is being financed by a notable shift toward more credit card debt and other high-cost financing. We believe this all points to a more volatile economic and market environment in the quarters ahead. The delayed impact of the Federal Reserve's aggressive rate-hiking cycle, higher long-term interest rates, the unfolding of two wars, and the upcoming U.S. presidential election all have the potential to disrupt markets. While lower gas prices serve as a welcome offset, we do not believe this will be enough to fully offset growing stresses across the economy. As such, a diversified approach with higher-than-normal allocations to short-term bonds and other diversifiers seems prudent.

Disclosures

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Performance Disclosures

All market pricing and performance data from Bloomberg, unless otherwise cited. Asset class and sector performance are gross of fees unless otherwise indicated.

Asset Class Definitions

Asset class performance was measured using the following benchmarks: U.S. Large Cap Stocks: S&P 500 TR Index; U.S. Small & Micro Cap: Russell 2000 TR Index; Intl Dev Large Cap Stocks: MSCI EAFE GR Index; Emerging & Frontier Market Stocks: MSCI Emerging Markets GR Index; U.S. Interm-Term Muni Bonds: Bloomberg Barclays 1-10 (1-12 Yr) Muni Bond TR Index; U.S. Interm-Term Bonds: Bloomberg Barclays U.S. Aggregate Bond TR Index; U.S. High Yield Bonds: Bloomberg Barclays U.S. Corporate High Yield TR Index; U.S. Bank Loans: S&P/LSTA U.S. Leveraged Loan Index; Intl Developed Bonds: Bloomberg Barclays Global Aggregate ex-U.S. Index; Emerging & Frontier Market Bonds: JPMorgan EMBI Global Diversified TR Index; U.S. REITs: MSCI U.S. REIT GR Index, Ex U.S. Real Estate Securities: S&P Global Ex-U.S. Property TR Index; Commodity Futures: Bloomberg Commodity TR Index; Midstream Energy: Alerian MLP TR Index; Gold: LBMA Gold Price, U.S. 60/40: 60% S&P 500 TR Index; 40% Bloomberg Barclays U.S. Aggregate Bond TR Index; Global 60/40: 60% MSCI ACWI GR Index; 40% Bloomberg Barclays Global Aggregate Bond TR Index.

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