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The Economy, 2019: A Microcosm of a Decade in Which Growth Was Slow and Market Gains Fast

By Lisa Beilfuss   Dec. 20, 2019 7:00 pm ET

Illustration by Joel Arbaje; Getty Images (Source)

The most remarkable moment of the last decade, as far as the economy goes, is the one that didn't occur.

For the first time since the Civil War, a decade went by without the U.S. economy falling into a recession. That fact reflects how extraordinary—and how confounding—the economy has been since the financial crisis and recession ended. The reason that the decadelong expansion is still going, one could argue, is that it hasn't been good enough to end.

"This economy all the way through has been a tortoise rather than a hare," says David Kelly, chief global strategist at JP Morgan Funds. "It's been a very slow expansion and a constant underachievement."

Growth since the expansion began in June 2009 has been slow enough that it hasn't sparked meaningful inflation, letting the Federal Reserve leave interest rates at historically low levels over the past decade. While the Fed did begin gradually lifting rates in 2015, it reversed course this year with what officials have called a “midcycle adjustment” and undid three of their nine quarter-point rate increases. The Fed’s benchmark rate now stands at range of 1.5% to 1.75%, up from 0% to 0.25% at the beginning of the decade.

From the perspective of monetary policy—and where it has led the economy—2019 has been a microcosm of the last decade. “It’s a persistent failure to launch,” Kelly says, referring to the shift in Fed policy this summer.

From the perspective of investors in U.S. stocks, however, the low rates and slow-but-steadily growing economy have been to their great benefit. Easy money from the Fed has helped the stock market rocket to one record high after another, reminding anyone who might have forgotten that the U.S. economy and the nation’s stock market are two different animals.

The contrast in the growth of the U.S. economy and market gains is perhaps best shown through Americans’ earnings and the S&P 500’s performance over the past decade. The growing wealth gap is at once cause and effect of the growing divergence in wages and investment gains.

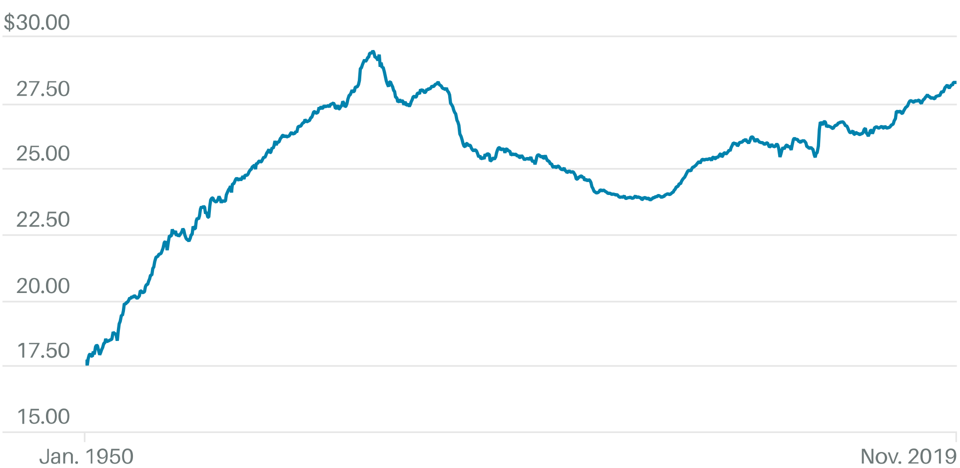
In its most recent reading, the Labor Department said the average hourly wage across the country was $28.29 in November. Looking back at real, or inflation-adjusted, wages over the past decade, they’re barely keeping up with inflation. The average annual rise in real wages has been just 0.6%.

At the same time, the S&P 500 has risen 189% since the start of the decade—running up to 3221, where it stands today, from 1137 on Dec. 31, 2009.

Growing Disparity

Wages, as measured in 2019 dollars, have climbed only slightly over the past 70 years...

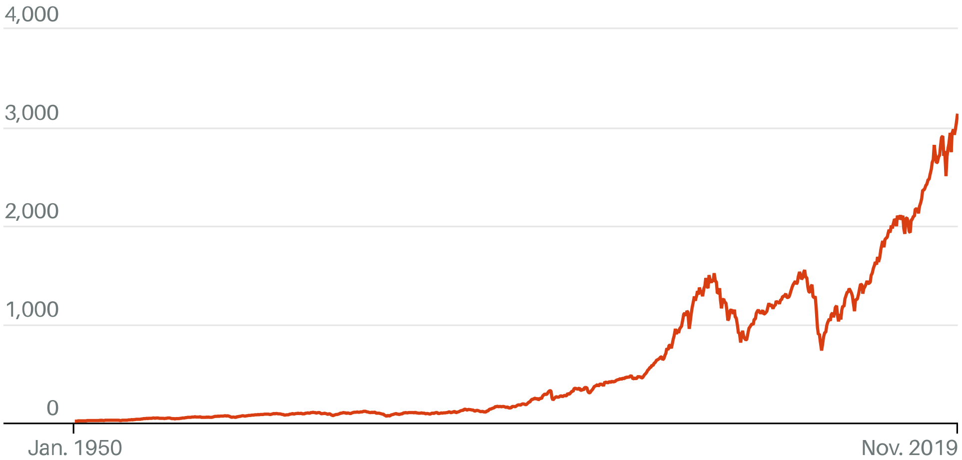
Real Hourly Wages



Sources: Bloomberg; The Leuthold Group

...while investors in the broad stock market would have scored blockbuster returns.

S&P 500 Closing Price



Sources: Bloomberg

The impact of inflation on workers' earnings is especially relevant when you consider how the consumer-price index, or CPI, has been tracking as opposed to the personal consumption expenditure index, or PCE. The Fed started explicitly tying monetary policy to the PCE a little over 10 years ago. This matters because the CPI measures health-care costs like premiums and deductibles, arguably giving a truer inflation picture than the PCE, which measures government-set Medicare and Medicaid reimbursement rates.

The PCE has consistently run below the Fed's 2% inflation target, last registering at 1.4% (or 1.6% when you back out volatile food and energy prices). By contrast, the core CPI has held at or above 2% since early 2018. That divergence is crucial when you consider that the key to lifting consumers' purchasing power is low inflation. Thus, the argument goes, the Fed is using an artificially low inflation gauge to set interest rates.

The wealth gap isn't new, but it is widening and in recent years it has become a bigger part of the national economic conversation.

To illustrate, consider the Labor Department's yearly consumer expenditures data. In 2010, the bottom three quartiles of the U.S. population held 26.3% of total consumer pretax income, down from 31% in the early 1970s. Fast-forward to 2018, the most recent year for which data are available, and that share stood at 24.8%.

The slipping share of income among the less-wealthy helps explain why sluggish economic growth has been accompanied by a stock market that has never seen better days. Less-wealthy households spend more of their paychecks, meaning there is a more immediate movement of these workers' pay into the economy.

Fed policy, Kelly says, has to some extent cemented this dichotomy. “There is a leak in the plumbing,” Kelly says. “Money is being diverted from goods and services because rich people are directing their money to investments.” Returning to his original analogy, Kelly says “we have a tortoise-like economy and a hare-like stock market.”

Fifty-five percent of Americans own stock, a Gallup poll earlier this year found, which is in part thanks to holdings in 401(k) plans. That share has been steady over the past 10 years, but it’s down from 62% in the years leading up to the financial crisis. The number of people who owned a piece of the stock market fell during the recession and hasn’t fully rebounded, Gallup said.

More important than the relatively large share of Americans who aren’t exposed to the market is just how concentrated stock-market wealth has become among those who are.

The Fed’s survey of consumer finances, which it conducts every three years and most recently updated in 2016, shows how stock-market gains are increasingly concentrated among the wealthiest Americans. In 2016, the top 10% of American households held 93.2% of all stock and mutual-fund assets, up from 91.2% in 2010 and 86% in 1989. Even when you figure in indirect ownership, which would include 401(k) plan exposure, the top 10% holds 84% of investment assets, up from 80.6% in 2010 and 80.8% in 1989.

The question, says Torsten Sløk, chief economist at Deutsche Bank Securities, is for whom is the stock market working? “Is it just relevant for the top 10%?” Sløk says, adding that this concentration on its own isn’t likely to restrain further market gains.

There is another question worth asking as the expansion gets set to enter its second decade: Can the U.S. market remain this strong if income and wealth becomes even more concentrated?

Many economists, including Sløk, expect the U.S. stock market to continue to do well next year, largely thanks to the Fed’s intention to leave rates low for the foreseeable future. But for companies to keep growing earnings and do what’s necessary to attract investors, they need customers to buy their goods and services.

Investors, then, might be wise to consider the growing divergence between the economy and the market, and what that means for future returns.

Write to Lisa Beilfuss at lisa.beilfuss@barrons.com