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COMMENTARY

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The Consumer Will Decide the Shape of the Economic Recovery

- Consumer spending accounts for roughly 70% of U.S. gross domestic product.
- The amount that consumers have to spend, and their mobility may decline soon.
- We continue to expect a longer economic recovery than many investors anticipate.

All eyes are on the consumer (that is to say, all of us) as investors look for clues to the shape of the economic recovery. While the stock market's recovery currently looks like a V-shape, the economic and corporate earnings recoveries are just starting to come off their lows and may not look like a V. We think the economic recovery will be longer and look more like a U, which could cause more stock market volatility as investors adjust their expectations. But enough with the letters and shapes—the consumers who make up roughly 70% of gross domestic product in America will decide how the recovery looks.

Consumer spending will be determined by two main factors: how much the consumer has to spend, and how much mobility the consumer has to spend the money they have. There has been a rise in online spending, but consumers will need the ability to get out of their homes to spend money on big-ticket items like vacations, restaurants and bars, and sporting and entertainment events.

The first factor, the amount people have to spend, has been mostly augmented by the government through a program that encouraged employers to keep their workers employed and additional unemployment benefits for those that were unfortunate enough to lose their jobs. These programs kept money in the hands of consumers, but they are set to expire soon. If the government does not extend them, consumers will have less money to spend, and we anticipate more layoffs and hardship for people that are already laid off. Jobless claims for new unemployment benefits have been gradually declining from record highs, but are already at extremely elevated levels compared to before the pandemic.

We've been tracking the second factor, social distancing, through unique metrics that we generally don't follow in typical recessions. For example, we've been looking at data on TSA check-ins to monitor airport traffic, and the number of restaurant reservations across the country. There are a couple of components to social distancing—the virus being the predominant one. With the recent uptick in COVID-19 cases, local governments are rolling back their eased restrictions and would-be consumers are back at home. Once the virus is more under control and local governments loosen restrictions again, the next obstacle will be people's fear of the virus and how comfortable they are using their new- (or perhaps old-) found freedom of going out and enjoying different activities. With the new restrictions imposed by local governments and rise in virus cases, we have seen sharp spikes in social distancing metrics, which does not bode well for consumer spending. Retail sales recently spiked, but our social distancing indicators may be pointing towards more declines in retail sales ahead.

The implications of the consumer having less money to spend with fewer opportunities to spend it are enormous. We are already seeing major retailers and many small businesses file for bankruptcy protection. U.S. retailers are on pace to close over 20,000 stores this year, compared to 9,000 last year. We are also seeing an increase in mortgage delinquencies. Banks, who loan money to businesses and consumers, are taking note. Three major U.S. banks set aside almost $28 billion for bad loans last quarter; a level only surpassed by the last quarter of 2008.

The American consumer is so important to the economy that we will be paying close attention to data that relates to them and their activity. And while we do see challenges ahead, we don't want to paint a completely dire picture. Consumer spending *is* coming back, and we don't think there will be another nationwide shutdown. We do feel there will be more equity volatility, though, as investors reassess the shape of the recovery, which we believe will take longer than many investors are anticipating. We continue to recommend sticking to risk tolerances consistent with your long-term goals and objectives and being diversified among sectors and asset classes. These are challenging and uncertain times, but your financial professional can help you stay on course.

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