

Upbeat Consumers Are Likely to Face Headwinds

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Key takeaways

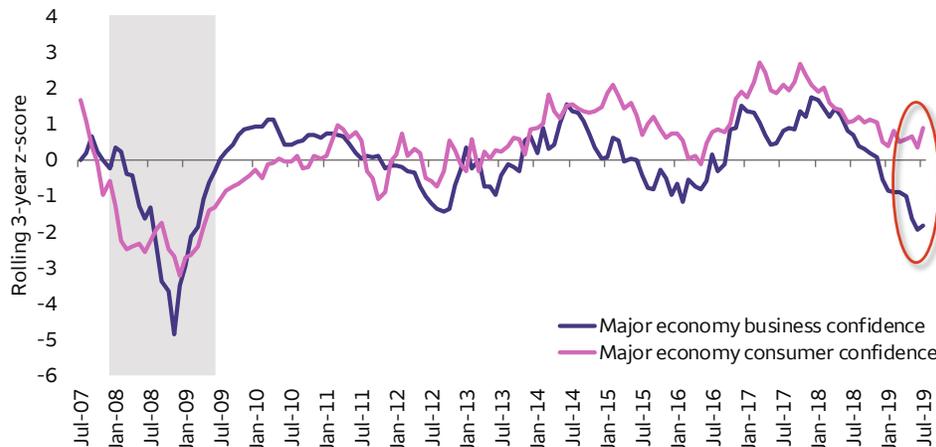
- » Consumer confidence in the U.S., China, and the eurozone has remained relatively resilient this year, despite a downturn in business sentiment.
- » Nevertheless, we believe that consumer sentiment is likely to wane later this year, putting downward pressure on household spending and providing a greater headwind to global growth.

What it may mean for investors

- » Such a view would suggest a more cautious positioning in financial markets. We therefore reiterate some of our guidance changes shared this week.

Consumer confidence in the U.S., China, and the eurozone has remained relatively resilient this year, despite a downturn in business sentiment. This is important, because household spending plays a critical role in supporting economic growth in these key economies—while driving demand for goods and services globally. And when consumer confidence is upbeat, spending tends to follow suit. Looking ahead, however, we expect the effects of ongoing trade disputes and other geopolitical issues pressuring business sentiment to eventually spill over into the household sector. Such an outcome is likely to put further downward pressure on global economic activity and corporate earnings growth—and contribute to periods of heightened market volatility in the months ahead.

Chart 1. Consumer confidence declines often follow business confidence downturns



Sources: Wells Fargo Investment Institute, Markit, The Conference Board (CB), China National Bureau of Statistics (NBS), Eurostat (ES). Monthly data from July 2006 through July 2019. Shaded bar represents global economic slowdown as defined by the Organisation for Economic Co-operation and Development (OECD). Major economy business confidence = weighted average of U.S., China and eurozone manufacturing purchasing manager indices (PMIs). Major economy consumer confidence = weighted average of U.S.CB, China NBS and eurozone ES consumer confidence indices. Z-score measures the number of standard deviations a current observation is above (or below) its rolling 3-year average.

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Upbeat consumers are likely to face challenges

Historically, a sustained slowdown in business sentiment has preceded a consumer confidence downturn in the U.S., China, and the eurozone by a few months (Chart 1). Lately, however, consumer confidence has been more resilient as households have reported being mostly optimistic about the future, despite growing pessimism in financial markets and the manufacturing sector. One explanation for this buoyant sentiment has been a relatively favorable consumption environment as policymakers have telegraphed lower interest rates in the U.S. and eurozone, while they have created other incentives to spend in China. Cracks are nevertheless beginning to form in this narrative.

To be sure, lower oil prices and higher gold prices—along with developments in U.S. Treasury and European sovereign debt markets last week—signal that economic conditions may be more fragile than the Federal Reserve’s (Fed) July “mid-cycle rate adjustment” would suggest. This comes as loan officer surveys from the Fed and European Central Bank (ECB) point to tighter consumer lending standards that likely will make it harder for households to borrow, even as central banks plan more rate cuts. Moreover, the strength exhibited in labor markets earlier this year is giving way to signs of weakness as payroll growth has softened in the U.S. and eurozone, while unemployment has risen in China. Indeed, as business executives look ahead to 2020, we expect that their discretionary spending and hiring plans will come under increased scrutiny.

Investment implications

Household spending has played an increasingly important role in supporting global economic growth this year. Yet, we foresee the potential for firms—already challenged by an uncertain planning environment—to curb their hiring plans in the months ahead. This is likely to be an important contributor to weaker consumer sentiment in the second half of 2019. Subsequently, we would expect a decline in discretionary household purchases to accompany softer consumer sentiment, which is likely to dampen spending in an already weak economic growth environment.

Such a view would suggest a more cautious positioning in financial markets. Indeed, earlier this week, we adjusted some of our asset-class guidance and year-end targets to account for greater levels of financial-market volatility. This includes a less favorable view on cyclical equity sectors and a more favorable view on investment-grade credit in fixed-income portfolios.¹ We also reiterate our desire to become more opportunistic in portfolios, aligning exposure closely with long-term investment goals, while raising cash to provide optionality during periods of heightened market volatility.

¹ For more information, please see our August 19, 2019, Institute Alert titled “*Economic Concerns Signal a More Conservative Stance*”.

Economic Calendar

Date	Country	Report	Estimate	Previous
8/20/2019	GERMANY	PPI YoY	1.00%	1.20%
8/20/2019	JAPAN	Convenience Store Sales YoY	--	0.00%
8/21/2019	JAPAN	Nationwide Dept Sales YoY	--	-0.90%
8/21/2019	MEXICO	Retail Sales YoY	2.00%	2.80%
8/21/2019	JAPAN	Jibun Bank Japan PMI Mfg	--	49.4
8/21/2019	US	MBA Mortgage Applications	--	--
8/21/2019	US	Existing Home Sales	--	5.27m
8/21/2019	US	Existing Home Sales MoM	--	-1.70%
8/21/2019	US	FOMC Meeting Minutes	--	--
8/22/2019	EUROZONE	Markit Eurozone Manufacturing PMI	46.3	46.5
8/22/2019	JAPAN	Natl CPI YoY	0.50%	0.70%
8/22/2019	US	Initial Jobless Claims	--	--
8/22/2019	US	Continuing Claims	--	--
8/22/2019	US	Bloomberg Consumer Comfort	--	--
8/22/2019	US	Bloomberg Economic Expectations	--	55
8/22/2019	US	Markit US Manufacturing PMI	--	50.4
8/22/2019	US	Markit US Services PMI	--	--
8/22/2019	US	Markit US Composite PMI	--	--
8/22/2019	US	Leading Index	--	-0.30%
8/22/2019	US	Kansas City Fed Manf. Activity	--	-1
8/23/2019	MEXICO	GDP NSA YoY	-0.70%	-0.70%
8/23/2019	US	New Home Sales	--	646k
8/23/2019	US	New Home Sales MoM	--	7.00%
8/26/2019	JAPAN	Leading Index CI	--	93.3
8/26/2019	GERMANY	IFO Expectations	--	92.2
8/26/2019	CHINA	Industrial Profits YoY	--	-3.10%
8/26/2019	US	Durable Goods Orders	--	1.90%
8/26/2019	US	Dallas Fed Manf. Activity	--	-6.3
8/26/2019	US	Chicago Fed Nat Activity Index	--	-0.02
8/26/2019	US	Cap Goods Orders Nondef Ex Air	--	1.50%

Source: Bloomberg, as of August 16, 2019.

Risk Considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors.

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