

MARKET COMMENTARY

THE NECESSITY OF A STRONG CONSUMER



Consistency is a big part of quality. Our search for consistency leads us to companies that generate dependable growth. And the most consistent growth engine of the world's economy — decade after decade — has been the consumer. Household consumption sits at the center of our economy, accounting for over 70% of all activity in the United States. When threatened, government intervention has been there to help shore up consumption, come what may, and from administration to administration.

The reason for such policies are simple: employers all across the economy ultimately hire, invest, and produce to serve consumers. If consumption fails, employees are laid off, investment is cut, production falters, and businesses fail. Our history shows that the first priority is maintaining a steady “circular flow” of money throughout the economy by ensuring constant demand for goods and services — the main engine of which is the household consumer.

LONG HISTORY OF STEADY, DEPENDABLE GROWTH

Consider Chart A on page 3. Notice how consistent and steady growth in consumption has been throughout the years. It is hard to deny that there is strong evidence that, over time, consumption tends to grow along with personal income. Notice further that the graph shows income and consumption adjusted for inflation. From the early 1960s through today, there has been a solid and steady upward bias to these lines. Of course, the pandemic brought significant changes — more on that in a moment.

While there is clear and unequivocal evidence of growth decade to decade, there have been a few times when consumption and income faltered before resuming an upward climb. 1974, for example, real income and consumption declined by -2.5% and -2.2%, respectively. In 1980, real income stagnated (0% growth), causing consumption to drop by 1.5% that year. In 1991, real income and consumption both fell by about 1%. Finally, in the financial crisis of 2008-2009, real income fell by a whopping -5%, and consumption fell by -2.5%.

Over the past year through July, consumption is up 3.1% after 3.3% inflation according to newly released data from the Bureau of Economic Analysis (BEA). This growth rate is faster than the 2.4% trend growth rate since 2012. We expect consumption to return to the lower trend-line growth rate in the years ahead. If this happens as expected, real consumption growth will slow to about 1% for the next few years.

THE PANDEMIC ERA

The above scenario overlooks one glaring issue — the immense impact of the pandemic and government responses following 2020. As Chart B on page 3 shows, the annual change in both income and consumption around the pandemic produced unprecedented volatility. Incomes, which include government payments to households and consumption, went on a wild ride. Today, many pandemic-era subsidies and supports are either gone or going away. Hence, some businesses that benefited from government stimulus-aided sales to consumers are seeing softness in business.

On the plus side, however, wages are growing, while the unemployment rate of 3.6% is near a 50-year low. For example, payroll processor Automatic Data Processing (ADP) reports that job changers are seeing an average 9.5% wage increase. Hourly wages are also up 4.4% year-over-year through July, according to the Bureau of Labor Statistics (BLS).

CHART A | U.S. CONSUMPTION AND INCOME (INFLATION-ADJUSTED DOLLARS)

Source: NBER, WCA

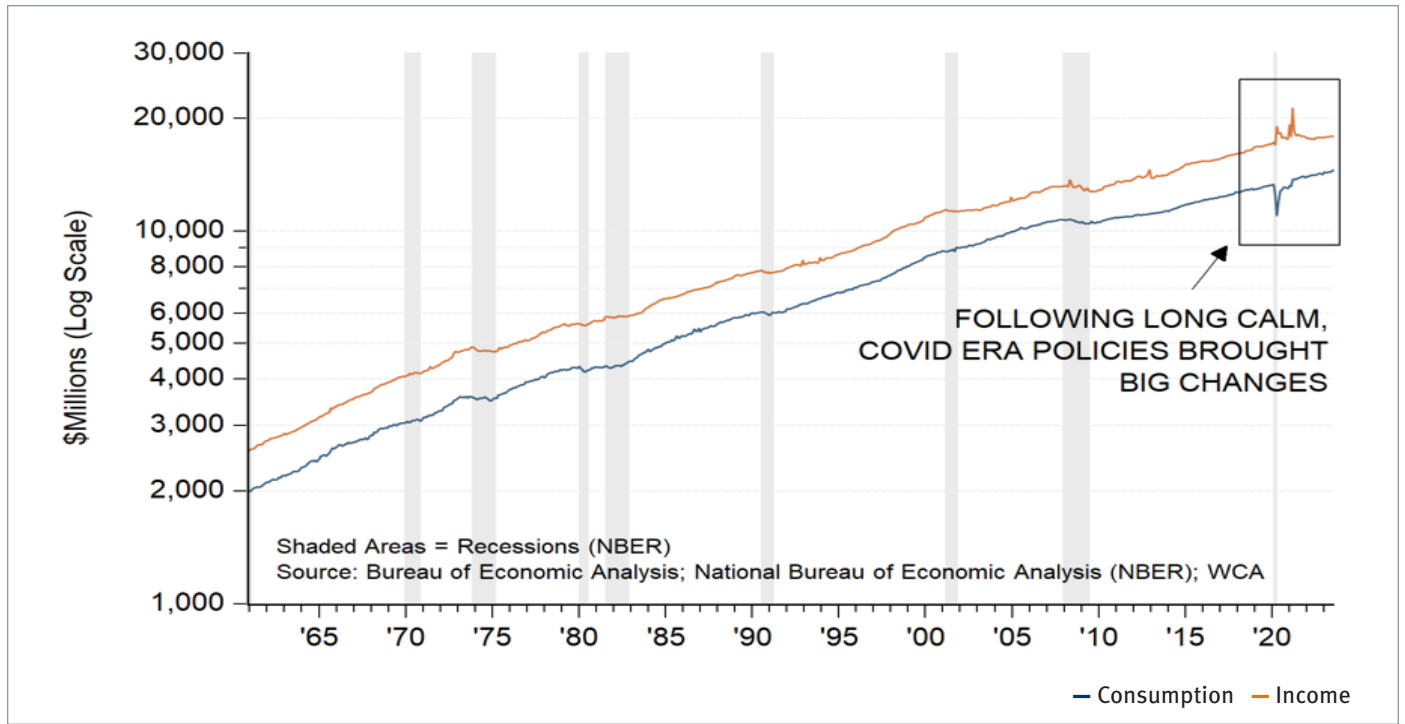
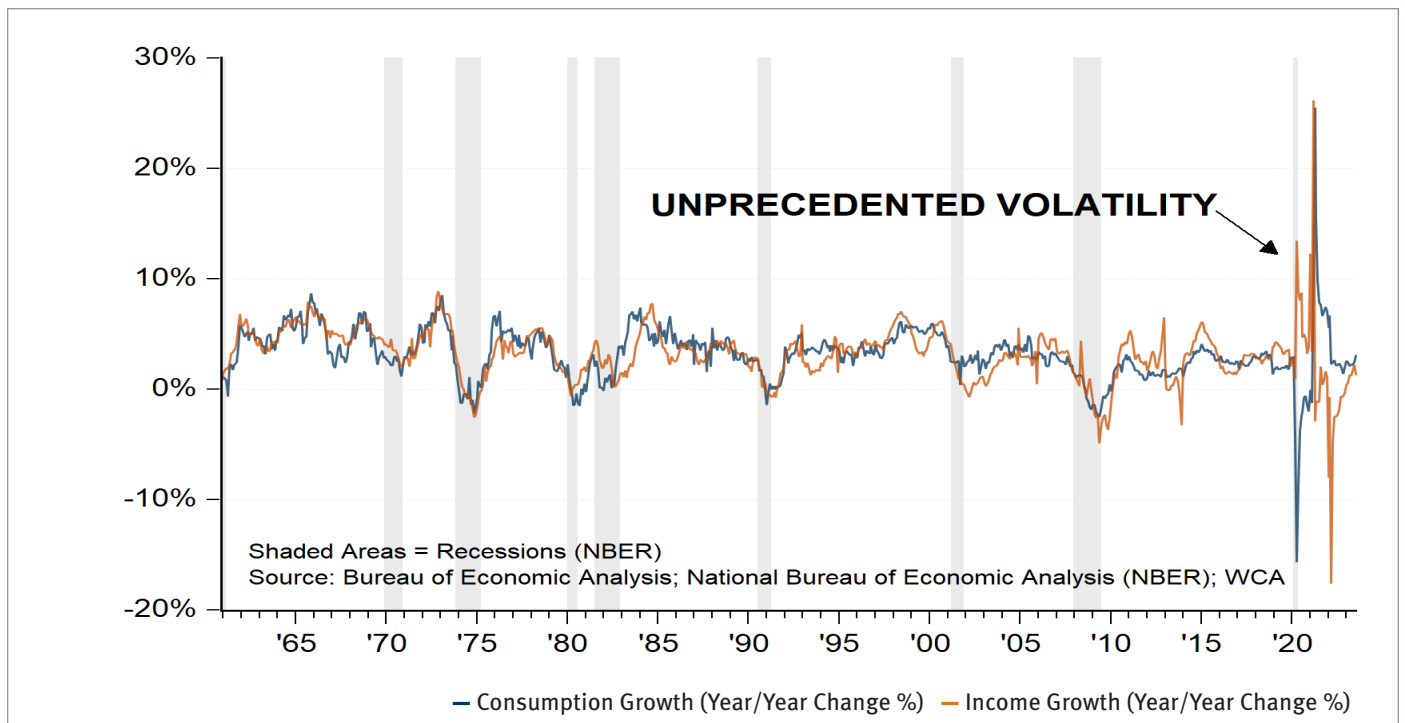


CHART B | U.S. CONSUMPTION AND INCOME (INFLATION-ADJUSTED ANNUAL CHANGE)

Source: NBER, WCA



CONCLUSION



Although recent years brought big swings in income and growth, the consumer has proven to be a consistent and dependable source of growth for many decades. That said, we understand that the level of consumer spending that accompanied unprecedented stimulus in 2021-2022 is set to fade. Now we see consumption returning to trend. We expect this process to continue over the next two to three years. We believe world-class, financially solid, consumer-focused franchises should be held for the long-haul. We will continue to look for opportunities in quality businesses of all kinds as the process of “returning to normal” unfolds.

WCA Fundamental Conditions Barometer Description: We regularly assess changes in fundamental conditions to help guide near-term asset allocation decisions. The analysis incorporates approximately 30 forward-looking indicators in categories ranging from Credit and Capital Markets to U.S. Economic Conditions and Foreign Conditions. From each category of data, we create three diffusion-style sub-indices that measure the trends in the underlying data. Sustained improvement that is spread across a wide variety of observations will produce index readings above 50 (potentially favoring stocks), while readings below 50 would indicate potential deterioration (potentially favoring bonds). The WCA Fundamental Conditions Index combines the three underlying categories into a single summary measure. This measure can be thought of as a “barometer” for changes in fundamental conditions.

Index Descriptions: WCA Quality Indices are based on Washington Crossing Advisors’ quantitative analysis of firms along three dimensions: asset profitability, consistency, and leverage. Higher quality companies are defined as those which fall in the top quintile of largest-cap U.S. companies and tend to have higher average profitability, greater than normal consistency, and low leverage. Lower quality companies are defined as those which fall in the lowest quintile based on the same criteria. Indices are reconstituted annually, continuously rebalanced, and presented on a total return basis, as calculated by Bloomberg. Indices are unmanaged and do not represent performance of any actual portfolio or portfolio strategy offered by Washington Crossing Advisors, LLC.

Standard & Poor’s 500 Index (S&P 500) is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market. S&P 500 Growth Index and S&P 500 Value Indices are designed to provide a comprehensive measure of global equity growth and value performance. **S&P High Beta Total Return Index** is designed to measure the performance of the constituents of the S&P 500 that are most sensitive to changes in market returns.

S&P Low Beta Total Return Index is designed to measure the performance of the constituents of the S&P 500 that are least sensitive to changes in market returns.

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Asset allocation and diversification do not ensure a profit and may not protect against loss. There are special considerations associated with international investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries. Due to their narrow focus, sector-based investments typically exhibit greater volatility. Small company stocks are typically more volatile and carry additional risks, since smaller companies generally are not as well established as larger companies. Property values can fall due to environmental, economic, or other reasons, and changes in interest rates can negatively impact the performance of real estate companies. When investing in bonds, it is important to note that as interest rates rise, bond prices will fall. High-yield bonds have greater credit risk than higher-quality bonds. The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage that is often obtainable in commodity trading can work against you as well as for you. The use of leverage can lead to large losses as well as gains.

All investments involve risk, including loss of principal, and there is no guarantee that investment objectives will be met. It is important to review your investment objectives, risk tolerance and liquidity needs before choosing an investment style or manager. Equity investments are subject generally to market, market sector, market liquidity, issuer, and investment style risks, among other factors to varying degrees. Fixed Income investments are subject to market, market liquidity, issuer, investment style, interest rate, credit quality, and call risks, among other factors to varying degrees.

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FOR MORE INFORMATION, PLEASE CONTACT US:

Washington Crossing Advisors

- Kevin R. Caron, CFA, Senior Portfolio Manager | (973) 549-4051
- Chad Morganlander, Senior Portfolio Manager | (973) 549-4052
- Matthew Battipaglia, Portfolio Manager | (973) 549-4047
- Steve Leric, CFA, Senior Risk Manager | (973) 549-4028
- Thomas Serzan, Senior Equity Analyst | (973) 549-4335
- Suzanne Ashley, Internal Relationship Manager | (973) 549-4168

Sales and Marketing

- Eric Needham, Director, External Sales and Marketing | (312) 771-6010
- Jeffrey Battipaglia, External Sales and Marketing | (973) 549-4031

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