As Russ explains, the evolution of the consumer, still a pillar of the markets, has major implications for investors.

Despite suffering episodic bouts of volatility centered on politics and policy, two pillars continue to support the economy and markets: central banks and the U.S. consumer. With regards to the latter, although U.S. households never quite regained the housing-induced elation of the aught years, consumption continues to support not just the U.S. economy, but the global one as well.

I last wrote about the consumer in October. At the time, I suggested that a combination of solid real-income growth, rising wealth and lower interest rates would continue to support consumption. The most recent data supports this narrative. But with next year’s outlook clouded by lingering trade uncertainty and a potentially epoch-making election, it is worth highlighting what a steady U.S. consumer does and does not mean for the economy and markets. Three themes stand out:

1. A recession is highly unlikely.

Absent a trade or other exogenous shock, the U.S. economy looks to grow again in 2020. Real personal consumption has been growing every quarter since the end of 2009. While household consumption remains moderate relative to history, it is not decelerating as it was in late 2007.

2. But a boom is equally unlikely.

Unlike late 2017, no tax cut or fiscal stimulus is forthcoming. And in the absence of stimulus, the modern U.S. consumer tends to be more steady than euphoric. Looking at the October data, U.S. adjusted retail sales are growing at around 3%. The current rate is somewhat below the post-crisis average and a long way from the late 1990s or peak housing-boom years, when retail sales were growing by an average of nearly 6% (see Chart 1). In other words, an older more cautious consumer is less likely to binge shop.
3. A calm surface belies massive shifts in consumer behavior.

While steady at the top-line, there is much churn below the surface. Since the turn of the millennia, spending on travel, recreation and the internet has steadily grown at the expense of household goods and cars. Adding to the transformation, not only are spending patterns changing, shopping habits are evolving even faster. The boom in internet commerce is well known, but it is worth taking a step back and measuring the magnitude. According to the Commerce Department, e-commerce went from a few billion dollars in 2000 to over $120 billion in 2017. At the same time, department store sales continue to struggle, with even iconic brands trading at multi-year lows.

Bottom line

For investors, there are a few conclusions. A steady but cautious consumer suggests no economic break-out and range-bound interest rates. Both of those trends imply another year in which investors focus on earnings and cash-flow growth. At the same time, investors should be comfortable over weighting the broader consumer discretionary sector, but differentiation will be key. Consumers will continue to spend, but the chasm between winners and losers will only grow wider over time.

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