Episode 3: Let Them Eat Cake

John Pagliacci

[00.00.01]

Hey everyone, welcome back for episode number three of Guardian Capital's "Buy The Way" podcast. I'm your host, John Pagliacci, joined once again by my favorite economist and yours, David Onyett-Jeffries. He's back with us for a discussion on all things macro in-and-around markets over the past month. David, how are you doing? You're out west right now, bright and early from your Vancouver hotel room. Things going okay?

David Onyett-Jeffries

[00.00.24]

It's beautiful October weather and the Jays are still playing baseball. What is not to like?

John Pagliacci

[00.00.29]

Absolutely. Definitely a buzz here in the city of Toronto. You'll be back shortly, I'm sure, to get right back into the swing of it with us, but glad to hear. We've got also, obviously now we're recording in October, so Halloween is around the corner. What going on this year with you and the fam? What's the plan?

David Onyett-Jeffries

[00.00.48]

I think this actually might be the first year that my kids don't want me to sort of trail around behind them, so I'll be at home in my skeleton onesie, keeping our 12-foot skeleton, that is currently on our front lawn, keeping it company. We'll see how that goes, how about yourself?

John Pagliacci

[00.00.59]

Awesome. For whatever reason, my boys have now really gotten into Star Wars. So we've watched, I think, 7 or 8 of the movies in the past two weeks. So, I think we're going to have a Stormtrooper or two, we'll see. Stormtrooper or two for the boys and for me, I don't know, I'm trying to think of ideas. Something maybe a bit more sinister. Like a like a cross between a Sith Lord and Stephen Miller. We'll see. Okay, David. Well, we've certainly got a lot to discuss today. As I said, this is our macro roundup for the month with lots going on. And really, thematically, I wanted to maybe focus in on a few areas, but really centered around this idea of wealth inequality and a narrative that I'm seeing more and more in terms of rich Americans or the wealthiest cohort of Americans, really driving the stock market based on all the spending that they're doing and obviously driving the economy with their spending as well. So to start things off, why don't I start us with a statement that I've got here and I want you to get your response to it. So, this past month, we saw that Moody's Chief Economist that we've referred to in the past, Mark Zandi, he posted to his X account, and was also in an interview that I was listening to saying that the his firm has found that the top 10% of income earners in the US are accounting for about 50% of consumer spending, and the top 3% of income earners are accounting for 25% or a quarter of spending. So, I mean, that seemed like pretty big numbers to me. And here's how I would sort of interpret those figures as I sort of logically work my way through what that means. You've got second quarter US GDP growth that came in at 3.8%. This was an upward revision driven by, as I mentioned, stronger than expected consumer spending. You've got an inordinate amount of spending that is coming from wealthy Americans. These wealthy Americans are spending more of their money because they feel even wealthier as their stock portfolios continue to climb. Obviously, we refer to that as the wealth effect. And as they spend more, it's driving GDP growth. And this sort of cycle seems to be repeating itself. So really, it seems to me like the stock market is driving the economy, which is usually the reverse of what happens. Is it normal in your standpoint to see economic growth driving stocks higher? Sorry, let me rephrase that. It's normal that you would see economic growth driving stocks higher not the inverse, right? So does this logic that I lay out sort of accurately portray what we're seeing from your standpoint.

David Onyett-Jeffries

[00.03.32]

Well, so one of the realities of markets and economies and how they're intertwined is it's a virtuous cycle. If the economy is doing well, then the markets are doing well. And if the markets are doing well, you talk about the wealth effect. There's positive repercussions from that. And it is a self-fulfilling prophecy of sorts. Just as recessions and negative bear markets go hand in hand. One of the things I'll emphasize, so I've heard mention of the Mark Zandi chart that produced by Moody's. And I'm a huge nerd. And anytime I see an interesting chart, I try and go and parse the data and go and dive into it myself. So I haven't actually been able to locate the data. So I'm assuming it's Moody's proprietary data. But the important thing is any sort of US government publications that I'm able to find looking at US consumer spending, and they tend to be, especially when we're doing the segmented distributional spending, released with a fairly significant lag. It's not showing a drastic shift from what's historically normal because you're talking about the top 10% representing 50% of spending. Well, that's not like horribly uncharacteristic. The reality is that the top 10% have the most actual money, and therefore they have the most ability to spend, and they tend to spend in larger proportions. So, I can't go and corroborate whether or not from the time series perspective it's drastically out of line with what we've historically seen. But this is sort of a normal sort of playing out of the economy. We talk about the inequality that exists. But I will sort of emphasize and when I have these discussions and what makes sort of the last five years is a consistent narrative of the resilience consumer. One of the key characteristics of this cycle is it hasn't just been a situation in which the rich are getting richer. So we get regular data put out from the US Federal Reserve that dives into household balance sheets. So we get aggregate data, and then with a couple weeks lag, we get sort of the distributional financial accounts. And what that does is it breaks down sort of household wealth, looking at assets less liabilities by looking at the various components or cohorts of the wealth spectrum. And the thing I find fascinating, and it really sort of explains a lot about what we've seen from the global macro over the last five years, is that the bottom half of the wealth spectrum, like the less well-off 50%, have drastically outperformed on a relative basis but outperformed the other cohorts, right? So since the start of 2020, the people in the bottom half of the wealth spectrum have seen their wealth double. Now for, the equivalent is saying someone who's got 5000 worth of dollars in savings is now has 10,000. Which for people in the higher end of the wealth spectrum, may not seem like a big deal. But if you know that you have a couple months rent put away, that frees up a lot of your spending, right? The wealth effects and talking about wealth effect. And, you know, we call it the marginal propensity to consume out of wealth. The likelihood that each added dollar of wealth that you get people at the lower end of the wealth spectrum tend to spend more of it. Right? So it has been this situation where consumer spending has been so strong because the bottom half of the population has done well. And now for sure they are far less exposed to financial markets. But their exposure is rising. And the big thing is with the pandemic, the nature of the cycle, there is this huge amount of involuntary savings that happen, right? People lost their jobs for sure. Involuntary unemployment. But governments shelled out a whole bunch of money to try and make people whole. And people who maintain their jobs as well, they weren't able to spend as they normally would. So traditionally, two thirds of the household budget goes towards services. Leisure entertainment, these high capacity environments that were shut down disproportionately during the pandemic and people tried desperately to sort of fill that void with other areas. But there was this huge buildup of savings and it was put into real estate. It was put into other areas and we've seen valuations, so even real estate markets, we're not seeing the 10% per year growth that people have become accustomed to over the last decade. But housing prices haven't fallen. And so I would emphasize like a big reason why we've seen this persistent resiliency of the consumer, and it's not just in the US, it has been because the broad economy participation, like the lower end consumers, have actually end up being fairly well off as a result of this. And when you have that larger nest egg, your necessity to save is less. Out of your current income, you're saving less of it, you're able to spend more of it. And just as a comparison, if we go back to that pre-pandemic decade, which was constantly characterized as lackluster and terrible consumer, low consumer spending and stagnant growth, it was because that bottom half of the wealth spectrum saw their balance sheets, their household finances decimated, their savings were blown out, especially if we're talking to the US because the housing market collapsed. The biggest asset on the balance sheet tends to be real estate. When it takes a decade to get back to square one, that makes sense, right? Well, people are having to save more of their income. Whereas in this last go round, the household aggregate net wealth, distributional net wealth has improved drastically. So I'm not quite sold on this argument that it's disproportionately been the wealthy households that have been driving everything, because the data sort of supports the idea, it's been fairly broad based.

John Pagliacci

[00.08.53]

Interesting. Okay. Well, let's keep with our line of thinking then with regards to income cohorts and move on to the next thing I was going to ask you about. It relates to consumer sentiment, we saw for the month of September, despite equity markets performing really really well, the University of Michigan Consumer Sentiment Index seems to be sort of the leading gauge of how people are feeling about things and their finances. That index actually declined by 5% in September, and where it's sitting now is near its lowest point over the past decade. So it's interesting that the comments that the University of Michigan put out with the data were that and I quote here, “consumer sentiment fell broadly across age, income and education groups, except for steadiness shown among wealthier stockholders.” So it seems like the wealthiest Americans, which we know participate more heavily in the stock market, are, let's say, neutral-ish. But the rest of the whatever that is, 80 to 90% of Americans in the lower income rungs say that things are actually getting worse. I mean, does that reconcile to you that we can have a market like this that is hitting new highs, and the bulk of Americans are saying that things just feel worse?

David Onyett-Jeffries

[00.10.03]

Well, that is another key characteristic of this economic cycle that we've had, so the last five years. Every sentiment survey is basically saying that things are terrible, and it's hard to argue with that, right? We had the global pandemic, we had high inflation, we had high interest rates, the constant discussion and narrative about an impending recession, which impacts people's livelihood because suddenly they're concerned about their jobs. But again, labor markets have maintained firmness. But there's been this unbelievable divide between what people are saying and what they're doing. So a lot of these surveys, on the headline numbers, they ask, what are your views and assessments of current economic conditions? And it's pretty terrible, right? We're talking record lows and you look at the data for the OECD, for the major industrialized economies, it's the lowest that it's been in the 60 years of these surveys. But then you sort of switch it and ask about their personal financial situations, which is included in the surveys. And you talk about spending plans and vacation plans in particular. And the stuff is actually pretty buoyant, right? And traditionally, if you look at an overlay chart of sentiment and you have the recession shading, typically when people are saying that they're downbeat, that filters into their spending behavior, because if they're concerned about the outlook, they're going to spend less. But we've had this huge sort of divergence between the soft data, which are these surveys and the hard data, which is what the actual activity is. It's made it very difficult for forecasters. And a lot of the time when you've had this narrative about an impending recession, a lot of it is relying on sort of these soft metrics. However though, the actual spending activity, what people are doing, like putting their money where their mouth is, it's continued to be fairly resilient, right? This is again, coincides also with the fact that the individual household spending, financial position is in good shape because the average person now, they're not paying attention to the 24 hour news cycle other than what they hear through the grapevine, things along those lines, their focus is keeping a roof over their head, food on their table, gas in their car, and God willing, we could go and do a nice date night or get a new TV or buy a new car or go on vacation. And people are doing that. If you look at anything related to air travel or leisure, I always focus on what I'm trying to get a huge gauge what actually is happening in the economy. I focus on the more discretionary areas of spending, like the stuff that are the wants, not the needs. And if the needs are met and you have more money to spend on the wants, globally what we're seeing right now is like concert sales, concert attendance, ticket sales, we're on trend for an all time high year, right? We are over and above last year, when we had the Taylor Swift driven arena concert tours. The attendance is actually above that. You look at air travel, there are more airplanes in the sky right now than there ever been in human history. You look at the number of air passengers. There are more people in the sky than there have ever been in human history. And studies show that people who are traveling by airplane versus any other method of travel tend to spend 5 to 10 times more. So while you can't ignore these sentiment surveys, you have to pay attention to what people are doing versus what they're saying. And if you have that gap, especially when you have pessimism in the marketplace, that's actually a healthy environment rather than the euphoria, and everybody's throwing good money after bad. When you have people saying that they're cautious, but then continuing to, their personal situation is fine. So they're continuing to spend. That's actually kind of constructive for markets. And sort of it goes ways to explain why we continue to see these incremental gains on like a daily, monthly basis.

John Pagliacci

[00.13.32]

Well, I can confidently say that my wife and daughter have helped contribute to the Canadian GDP with all the concert spending, whether that's Taylor Swift, Noah Kohn, Sabrina Carpenter, Gracie Abrams. Just killing me. Anyways, so let's move on to the next one here where we talk about markets. We've talked about, I think it was last month, you and I chatted briefly about how the market continues to hit new highs and what valuations looked like, this so-called AI trade and everything that's sort of tangentially related to AI seems to be propelling the entire market at this point. That might be a bit of hyperbole, but that's certainly how it feels. I saw a chart this month which showed the price of all US companies divided by their after-tax profits. So in other words, it's essentially a price to earnings multiple for the entire US market. And that chart is basically now at levels that we've not seen since the dot-com bubble. So again, I know we touched on valuations a bit last month, but can you give us an updated read on sort of the state of play here when it comes to these these lofty levels.

David Onyett-Jeffries

[00.14.32]

So again I'm having these conversations regularly. People obviously are concerned about valuations. And honestly in a marketplace, concern is constructive. But I don't think the comparison with the dot-com bubble of the late 1990s is necessarily apt. If you think about that point in time, there were a whole bunch of unprofitable companies that were getting bid up consistently by the market. You had this irrational exuberance in the marketplace, and investment enthusiasm was at extremes. And there was a lot of good money being misallocated to bad companies. In the current environment, it is a very small handful of companies that are getting bid up to these extreme levels, and they are, happen to be these giant mega cap behemoths that, quite frankly, are high quality, revenue generating companies that are very much exposed to the secular trend of the AI theme, which, if you listen to some tech evangelists, if this is going to be transformational on so many levels in terms of productivity and revenue generation, and if you know the extremes play out, it could end up being the fact that if you're looking on a forward basis, we're underestimating the positive impact that could possibly play out. But, it is not the full market that is seeing this. Like markets, it's not a euphoria that is going and pushing everything up because it happens to have a .com associated with it. If you strip out those big tech names like overall market aggregates for sure are elevated valuations. But if you go and remove those mega cap names which are having a disproportionate impact on valuations, the rest of the market, whether we're talking US or globally, is not particularly aggressively valued, right? We're within those normal bands that we would see. And the big thing is that investors have been highly discriminating. For sure, there's more money going towards these tech behemoths. But again, these are quality companies that have leadership in this possibly new industrial revolution trade. But it has not been a scenario where rising tide is lifting all boats. And even taking into consideration, you know, the concentration of passive investments where, you know, these mega cap names are taking up a disproportionate and historically high share of the general market index, and you're dealing with those concentration issues, in the rest of the marketplace, you're not still seeing this aggressive bid up. So, you know, valuations in aggregate are high. But if you are a discriminating investor who is taking sort of a more active approach, there are value opportunities that exist out there. And there are companies that maybe are being overlooked because of all the money that's going in other scenarios. So, you know, I'm not as concerned at this moment. Obviously, it's always something on the radar, but the aggregate measures aren't necessarily telling the story of the market as a whole. It's not the individual stocks.

John Pagliacci

[00.17.13]

Okay, well that's reassuring. Let's take us to the lightning round here on asset classes, which we did last month. Certainly recognizing that you and the asset mix committee here at Guardian take a longer term view, you're not necessarily tactical sort of month to month making wild swings by any stretch. But has anything changed from last month with regards to broad asset classes? You know, from an equity standpoint, which we broke out last time. Canada, US and international equities. Any sort of changes in sentiment or what the team is thinking about that way.

David Onyett-Jeffries

[00.17.46]

So there hasn't been a heck of a lot of change over the last month. But one of the things that is consistently developing is this emphasis on Canadian markets and the resources that exist there. It's no longer just about energy, right? And just about base metals, the exposure, it's sort of this perfect environment for gold, this yellow commodity that has historically been viewed as a safe haven. We're in this environment where US dollar is declining and there's, you can argue a loss of faith in terms of what the US government is doing. Interest rates are coming down, which means the opportunity cost of holding something that doesn't generate cash flows is more attractive. And given the ongoing geopolitical angst and concerns that are there, you see gold continuing consistently getting bid up because it is viewed as a traditional safe haven asset. And that is one of the reasons why you've seen Canadian markets as a whole continue to outperform this year, right? Despite the fact that the Mag seven gets all the headlines, the top performing market globally is actually Canada. And half of the big reason of that outperformance are gold stocks. And so, it gives reason, we're a small open economy in Canada, and our markets are disproportionately skewed to some sectors, but the current backdrop right now is actually constructive for those sectors, which speaks to maintaining exposure to Canada, which is largely overlooked, especially by international investors. You're seeing more and more people who are suddenly paying attention there. But more broadly, not a heck of a lot of change in terms of our views. We are still cautious but constructive over the outlook. Interest rates are coming down. Growth is and continues to outperform expectations. But we're seeing this positive if unspectacular growth, moderating inflation still coming off the boil and interest rates coming down. And that's constructive for equities. From a fixed income perspective, getting a little bit more exposure to duration and a falling interest rate environment makes sense. So we're still maintaining our tilts that we're a little bit overweight equity, not aggressively so, we're not looking to hit home runs. In our last sort of discussion, we took a little bit of the growth exposure off, not aggressively so, we're still tilted towards these global equities and quality growth strategies. But at the margin just from a risk management perspective, maybe tilting towards these other areas of the market that are, from our view, have more potential upside in the marketplace because they are just being ignored and undervalued. But yeah, so there hasn't been a heck of a lot of change. The positives of the reduced uncertainty because the fire hose of information has sort of calmed down, especially relative to where we were earlier in the year. And it's, things in general are, knock on wood, somewhat constructive, and we don't see a specific catalyst for things to really change in the near term.

John Pagliacci

[00.20.33]

Okay, good to hear, appreciate the update. So as always we're going to wrap up our session here today with our "Oh, by the way" segment, which is a little segment which we highlight some interesting tidbits of information that might be less widely known by the general public. So I'll kick us off here, David. Coming back full circle to our initial discussion on Halloween and Star Wars, C-3PO's iconic golden appearance, did you know, was actually not achieved by the use of pure gold, it was spray paint. Maybe not a surprise after all. Based on the current value of gold today, ChatGPT tells me that it would conservatively cost about $4.5 million to produce an adult sized replica C-3PO costume made entirely of gold. So that is, of course, based on the fact that, like I said, gold is at a record high. Actually, as of recording, we're now through $4,000 an ounce, I believe. It's having its best year in terms of price increases since 1979. And as you alluded to here in Canada, the materials sector more broadly is having a lights out year. It's up about 80% this year. That is its best, again, the sector's best year so far since 1993. And you alluded to this a little bit, before we moved to your interesting tidbit, David, let's spend another second here on gold. I think you touched on some of the points that I was curious about, but I did want to highlight that we're in this environment now where both the stock market, let's just go with US stocks, the S&P 500 as our as our base case example there. US stocks and gold are just roaring. They're both kind of hitting new highs in tandem. And that's not normal, is it? I mean to your point earlier gold is supposed to be this safe haven type of asset class. So why are they moving in tandem? Is it strictly based on sort of this, as you mentioned, geopolitical mess or this geopolitical dumpster fire that we're witnessing unfold, coupled with low interest rates and people's belief that the US dollar is going to continue to decline. I mean, does that sum it up?

David Onyett-Jeffries

[00.22.34]

Yeah, quite frankly, that is more or less the scenario that's playing out. And yeah, traditionally you know gold and equities, so it's, you've got the conservative, it's always viewed as like the safe haven. And where if you're concerned about things imploding, you want to put your money in gold because that's going to be more valuable than your equity portfolio in the event of a catastrophic event. But one of the things I will highlight is when you have these more cautious, traditionally risk averse asset classes performing, it does emphasize that the markets are not this overwhelming level of euphoria. There's caution being put in place. People are taking or doing what they can to mitigate risks and manage their exposures, whether it's US dollar or US interest rates or trying to hedge the concern about the geopolitical flare ups that tend to happen. So it is interesting developments. It's interesting times. But it is the situation where it is the perfect storm for gold to play out, right? That's what we're seeing play out now. And whether or not it keeps going is really dependent on investors, because the intrinsics and fundamentals of gold are quite different than broad equities. But yeah, that pretty much sums it up.

John Pagliacci

[00.23.49]

Yeah. I mean, to your point, gold doesn't pay you anything like it's a store of value based on people's perception. But you're not getting an interest payment from holding gold or anything like that. So anyways,

David Onyett-Jeffries

[00.24.02]

And from a fundamental perspective too, it does have its uses in jewelry and industrial processes, because it is a very good conductor of electricity. It's just super expensive to do that. So there is that intrinsic value. Butobviously we've deviated from it and it is now the investment aspect that is driving the price rather than any sort of industrialized or a uses.

John Pagliacci

[00.24.21]

Okay. Well, I took us on a bit of a tangent there with gold. So let's bring us back here. I'm interested to hear what you're interesting tidbit of the month is?

David Onyett-Jeffries

[00.24.29]

Again, staying with the Halloween theme and again keeping with commodities as well. Emphasizing, so Reese's Peanut Butter Cups are the number one selling candy by weight for Halloween over the last three years. And it's estimated that 1 million pounds worth of Reese's Peanut Butter cups are given out at Halloween and consumed over the season. And number two is peanut M&Ms. So I think that Reese's Peanut Butter Cups and peanut M&M's being one and two, just allergies be damned. But chocolate actually makes up eight of the top ten. The other ones are sour kids and gummy bears are number six and number ten, based on the list that I was looking at. And this could be a boon for commodity producers. So anybody who specifically is involved in making the chocolate because cocoa prices have fallen 50% from their highs last year. So just something to consider.

John Pagliacci

[00.25.18]

Alright. Well, the economics of Halloween, I love it. Great wrap up to our discussion today. Thank you so much, David for your time. We're going to keep it to a tight 30 minutes today recognizing again that you are out in Vancouver bright and early in your hotel room. So we will leave it there. Have a safe flight back. Great chatting with you. And for our listeners, thank you so much for tuning in yet again. If you're enjoying the podcast, we certainly hope that you are. Please consider subscribing to get all of our latest episodes. We'd also love to hear from you with regards to feedback or areas of discussion that you'd like us to focus on in future episodes, you can email us with those questions or comments at insights@guardiancapital.com. Join David and I next month for another round of our macro musings. Until then, take care and Happy Halloween!

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