

**Weekly Briefing**

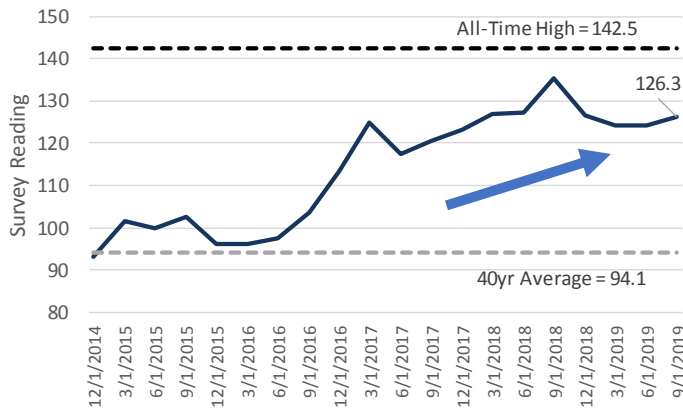
**SKYView: Confidence**

The growing divergence of consumer and CEO confidence levels has been topical over the last several weeks, particularly as investors ready themselves for evidence of a turn in the cycle. In this *Weekly Briefing*, we examine the economic drivers of both surveys and analyze asset class performance in similarly divergent periods over the last 40 years.

The Conference Board Consumer Confidence Survey is a monthly report that captures consumer attitudes toward prevailing business conditions. The index reading, which has generally increased over the last two years, remains closer to all-time highs than the 40-year average. The Conference Board CEO Survey gauges the economic outlook among business leaders from a variety of industries. In opposition to consumer confidence, the CEO survey has trended downward over the last 18 months, and at present is closer to all-time lows than its 40-year average.

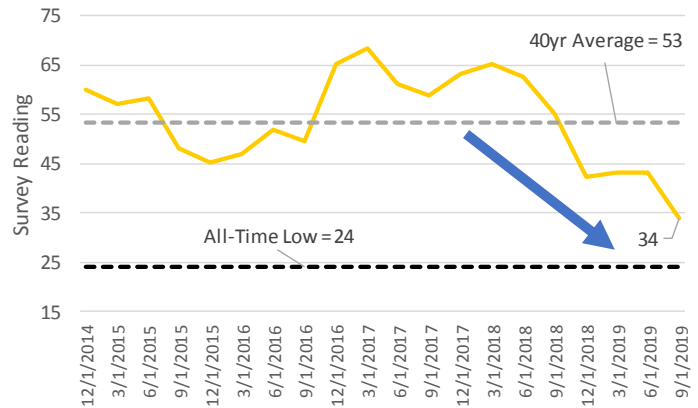
**Conference Board Consumer Confidence**

quarterly data, trailing 5 years



**Conference Board CEO Confidence Survey**

quarterly data, trailing 5 years

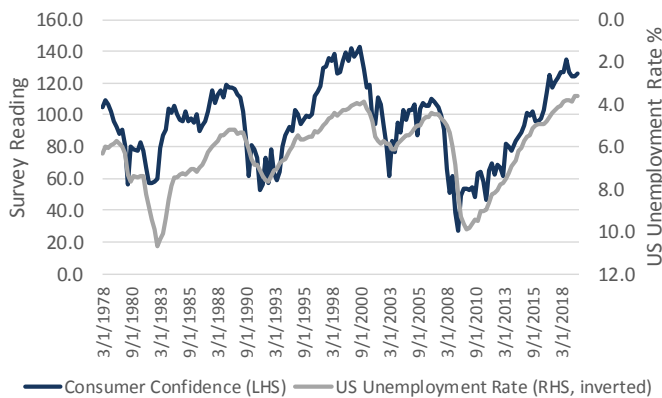


Source: SKY Harbor, The Conference Board

So, who is right? Perhaps both sides. Historically, US consumer confidence has been driven by the unemployment rate and relative levels of household income, both of which continue to trend positively. A strike at General Motors aside, the US economy was able to add 128,000 jobs in October, solidifying the unemployment rate in the mid-3% range. Furthermore, average hourly earnings continue to grow at 3%+ (within 40 bps of post-recession highs), which coupled with increasingly more manageable mortgage service burdens have served to reduce the ratio of household debt to disposable income. The confluence of these factors has boosted consumer confidence levels already approaching all-time highs, with broad equity indices moving very much in tandem (elevated consumer confidence typically bodes well for equity indices and the relationship continues to hold true with the S&P 500 Index achieving all-time highs in November '19).

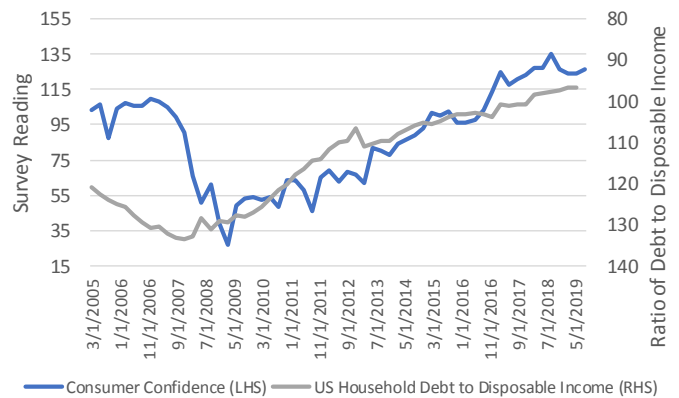
**Consumer Confidence Negatively Correlated to Unemployment...**

quarterly data, since 1978



**...and US Household Debt to Disposable Income Ratio**

quarterly data, since 2005

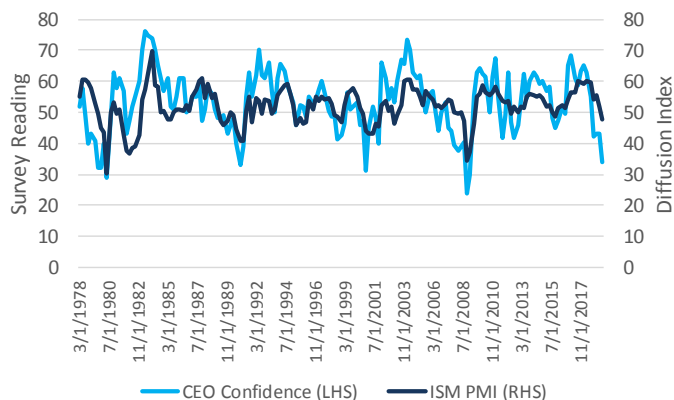


Source: SKY Harbor, The Conference Board, Bloomberg

CEO confidence, on the other hand, typically takes cues from different measures of economic health. A contraction in manufacturing activity over the last several months – the likely response to US/China trade tensions, or at least the uncertainty caused by ongoing protectionism – has dampened sentiment. This dynamic has induced inventory level reductions in several areas of the economy and contributed to a general unwillingness of management teams to embark on growth capital expenditures.

### CEO Confidence Positively Correlated to Business Conditions...

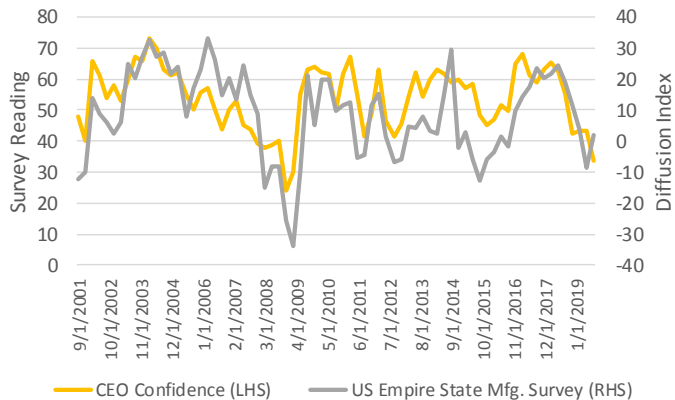
quarterly data, since 1978



Source: SKY Harbor, The Conference Board, Institute for Supply Management, Federal Reserve Bank of New York

### ...and Manufacturing Trends / Growth Capex

quarterly data, since 2005

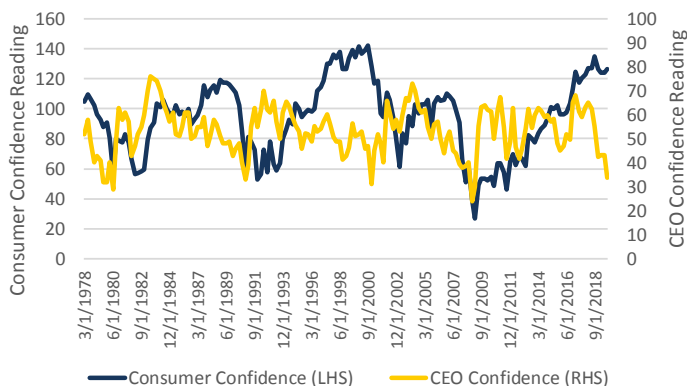


Where do we go from here? If trade resolution can materialize before the consumer, which makes up ~ 70% of the US economy, runs out of steam, CEOs may become more willing to increase business investment. In this scenario, CEO confidence readings should rise, closing the gap with consumers and supporting a further sustained expansion. If, however, CEO confidence remains muted (due to an absence of trade resolution or otherwise), expectations of economic contraction could become a self-fulfilling prophecy. Under this scenario, business leader pessimism in the economy further constrains business investment, wage growth slows, jobs are cut, and consumer confidence falls toward CEO confidence levels given tight correlations to the unemployment rate.

History, it appears, is on the side of the latter. As demonstrated below, periods of acute divergence between consumer and CEO confidence typically lead to recession, although the timing can differ broadly. Index reading differentials (consumer less CEO confidence, standardized to account for differences in methodology) presented below imply that CEO readings are typically leading indicators, with a recession (grey bar) often the consequence of consumer-led upward divergence.

### Consumer and CEO Confidence Readings Can Diverge...

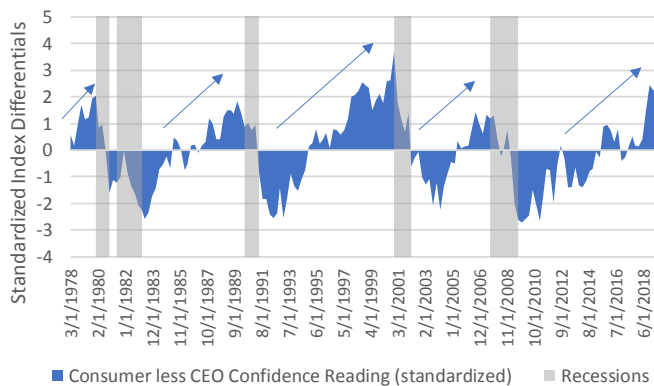
quarterly data, since 1978



Source: SKY Harbor, The Conference Board, The National Bureau of Economic Research

### ...Though Divergence Typically Precedes a Recession

quarterly data, since 1978

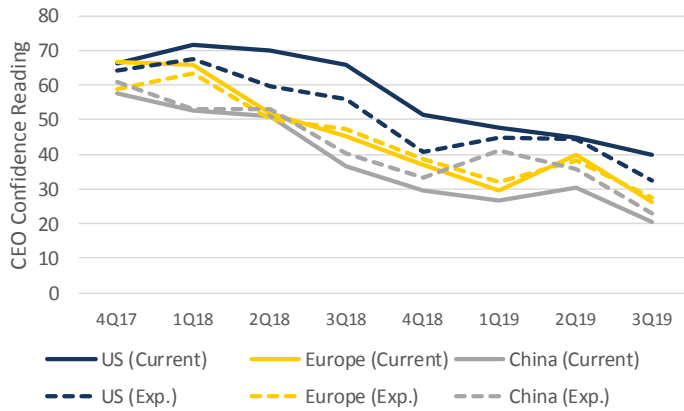


While the US and China continue to move closer to “phase one” of a trade deal (China has seemingly compromised on intellectual property rights protection, while the US seems willing to relax Huawei sanctions), full resolution seems unlikely a near-term event. Additionally, preliminary polls show no clear favorite in the 2020 US Presidential election (historically speaking, another source of business investment curtailment). These factors, as well as waning CEO confidence across multiple geographies (US, Europe and China, as demonstrated below), compel us to prepare for an environment in which confidence levels converge at lower levels.

Looking at quarterly total return data over the last 20 years, we find that broad US high yield, short duration US high yield and broad Euro high yield indices (we use the ICE BofAML US High Yield Index, the ICE BofAML 1-5yr US High Yield Constrained Index and the ICE BofAML Euro High Yield Index as proxies, respectively), have historically generated similar returns over all six-month periods (3% to 4%, as denoted by the dark blue bars in the chart below). Segmenting the dataset into high and low confidence differential periods (high differential periods defined as those in which consumer confidence exceeds CEO confidence survey data by a standard deviation, as it does now), we find that average Euro HY returns have gone negative, broad US high yield returns are diminished and short duration US high yield returns remain resilient in subsequent six-month periods (as denoted by the grey bars in the chart below). In a similar analysis, we find that leveraged loan returns (we use the Credit Suisse Leveraged Loan Index as our proxy) also remain resilient, albeit at lower absolute levels than short duration US high yield.

## CEO Confidence Degradation Across Geographies

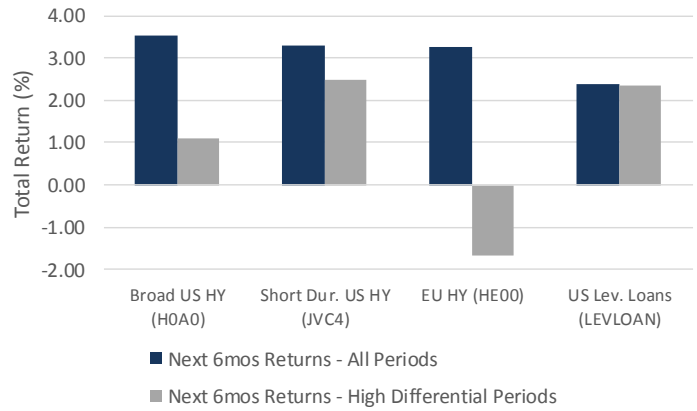
quarterly data, trailing 2 years



Source: SKY Harbor, The Conference Board, ICE BofAML Indices, Credit Suisse

## US Short Duration HY Best Positioned Within Leveraged Credit

quarterly data, trailing 20 years



In conclusion, consumer and CEO confidence level divergence is neither rare nor unfounded, the former driven by employment and relative household income levels (unambiguously strong), the latter by manufacturing data and business investment (decidedly weakening). Although we remain cautiously optimistic that trade resolution will come to fruition, we cannot ignore historical precedent that would imply CEO confidence levels are the more forward-looking of the two measures. With this in mind, we compared subsequent six-month total returns of various leveraged credit indices when differentials were elevated (as they are now) and found short duration US high yield to provide the greatest return resiliency for investors.

## On the Calendar

### Occurred

Event	Release Date	Period	Survey	Actual	Prior
NFIB Small Bus. Optimism	12-Nov-19	Oct	102.0	102.4	101.8
CPI MoM	13-Nov-19	Oct	0.3%	0.4%	0.0%
PPI Final Demand MoM	14-Nov-19	Oct	0.3%	0.4%	-0.3%

Source: SKY Harbor, Bloomberg

### Upcoming

Event	Release Date	Period	Survey	Actual	Prior
ISM Manufacturing	2-Dec-19	Nov	49.5		48.3
ADP Employment Change	4-Dec-19	Nov	140k		125k
Trade Balance	5-Dec-19	Oct	-\$48.9bn		-\$52.5bn

## Recommended Reading

Stirling, Craig and Ainger, John (2019, November 27). Global Risk-Taking Binge is Worrying Central Banks. *Bloomberg*, Retrieved from

<https://www.bloomberg.com/news/articles/2019-11-27/global-risk-taking-binge-gives-central-banks-cause-to-shudder?srnd=economics-vp>

Raice, Shayndi and Hilsenrath, Jon (2019, November 28). A Tight Job Market Insulates a Slowing Economy – and Perhaps Trump, Too. *The Wall Street Journal* (subs. req.),

Retrieved from [https://www.wsj.com/articles/a-tight-job-market-insulates-a-slowing-economy-and-perhaps-trump-too-11574971449?mod=hp\\_lead\\_pos6](https://www.wsj.com/articles/a-tight-job-market-insulates-a-slowing-economy-and-perhaps-trump-too-11574971449?mod=hp_lead_pos6)

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