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Consumer Credit & Stocks Pull Back

May 11, 2024

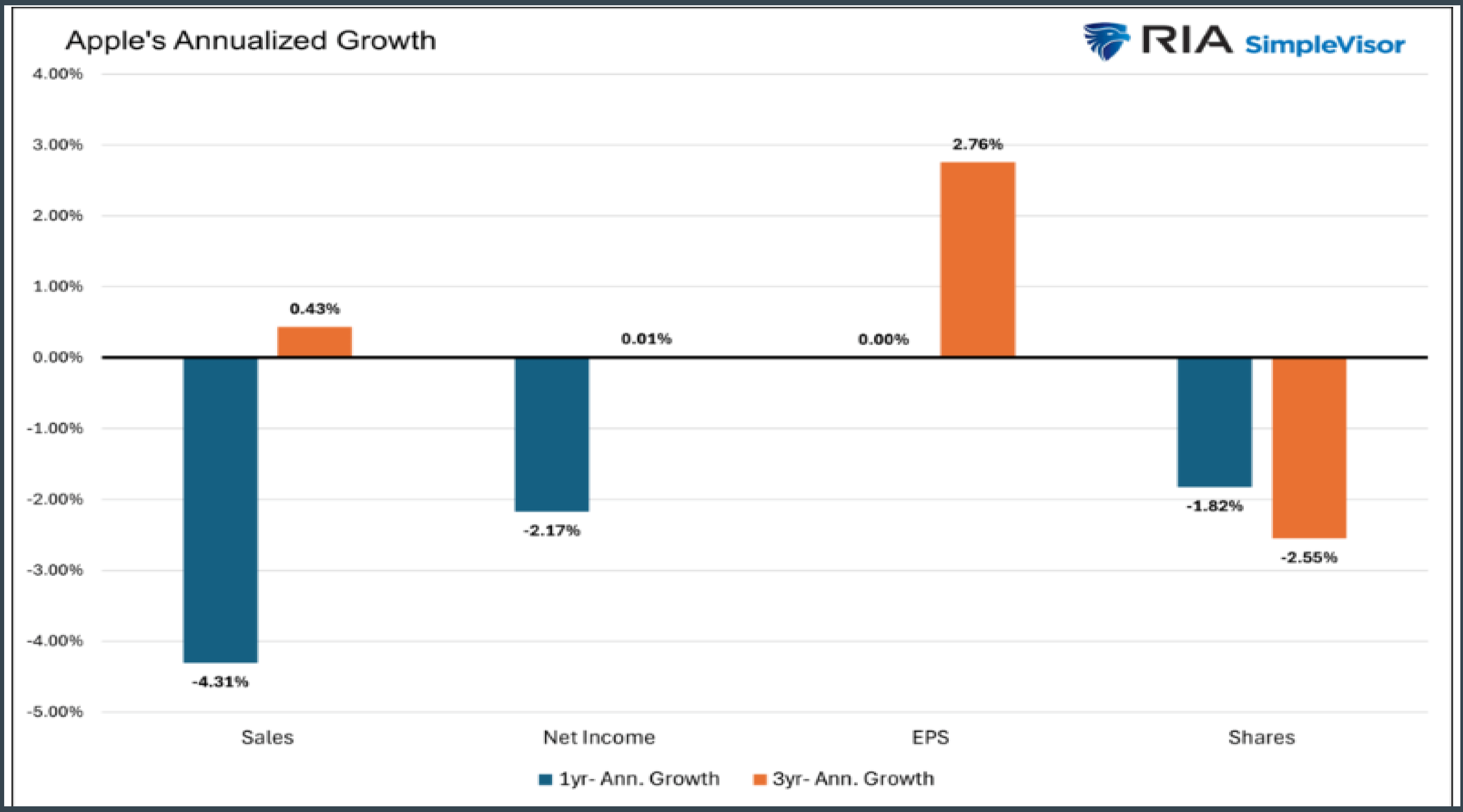
This week was relatively quiet on the economic data front, with only a few notable releases capturing the attention of market watchers. Among these were the weekly initial jobless claims, consumer credit data, and the University of Michigan's consumer sentiment index. Despite the sparse data, the stock market exhibited modest gains, with the S&P 500 inching higher amidst low volatility. The VIX, often referred to as the market's "fear gauge," retreated into the low teens. A significant development was observed in consumer credit, which saw a substantial decrease from $15 billion in February to $6.3 billion in March. This pullback aligns with recent trends in consumer stocks, many of which have experienced major declines following their earnings releases. The market has reacted sharply to this earnings season, with companies delivering lower earnings or softer guidance facing steeper penalties. Specifically, stocks that missed their estimates fell by over 3%, while those exceeding expectations saw minimal gains, with price movements generally less than 1%. Overall earnings season has been positive, and the S&P 500 is on pace for 5.4% EPS growth Vs. the estimated ~3% going into the start of reporting. On the sector rotation front, areas of the market like Energy, Industrials, Utilities and Staples are all above their 50 DMA's and trending higher while Tech lags behind. This explains the slow drift sideways/higher in the stock market because without Tech it becomes hard to pull the market higher even with outperformance from many of the other sectors.

The S&P 500 had no trouble piercing through its 50 DMA after its 5% pullback and now only faces resistance when it reaches the all-time high at 5,250. It has reached over bought territory and a small pullback to test its 50 DMA as support would not be surprising. CPI for April will be reported next week and this will be a major catalyst to determine how soon we see new all time highs. A hot CPI number will likely cause yields to rebound back towards 4.5% on the 10 year and create headwinds for equity pricing. But a soft number would help guide markets higher. It is all about rate cuts for the market and soft CPI numbers get investors closer to the first one.

Market breadth seems to be improving over the past month or two as new leadership shows up in the form of cyclical and defensive sectors. Over the past decade though when sectors like Energy, Utilities or Staples lead it usually means the market is flat or falling. These sectors are places to go that offer lower betas so you can stay in the game but lose less in a down market. This has not happened thus far, and it could just be profit taking from Tech to re-allocate capital but a prolonged period of leadership from these sectors would spell out some downside risk. An interesting anecdote I came across was when looking at the 1 year rolling performance of the Equal Weight S&P 500 index versus the Market Cap Weighted index, the performance has skewed further and further in favor of the Market Cap weighted index. I started from 2004 and charted this through today and what this shows is that there is higher risk in markets now than there was 2 decades ago. When performance is more reliant on a smaller number of names that concentration creates higher risk and potentially higher volatility.

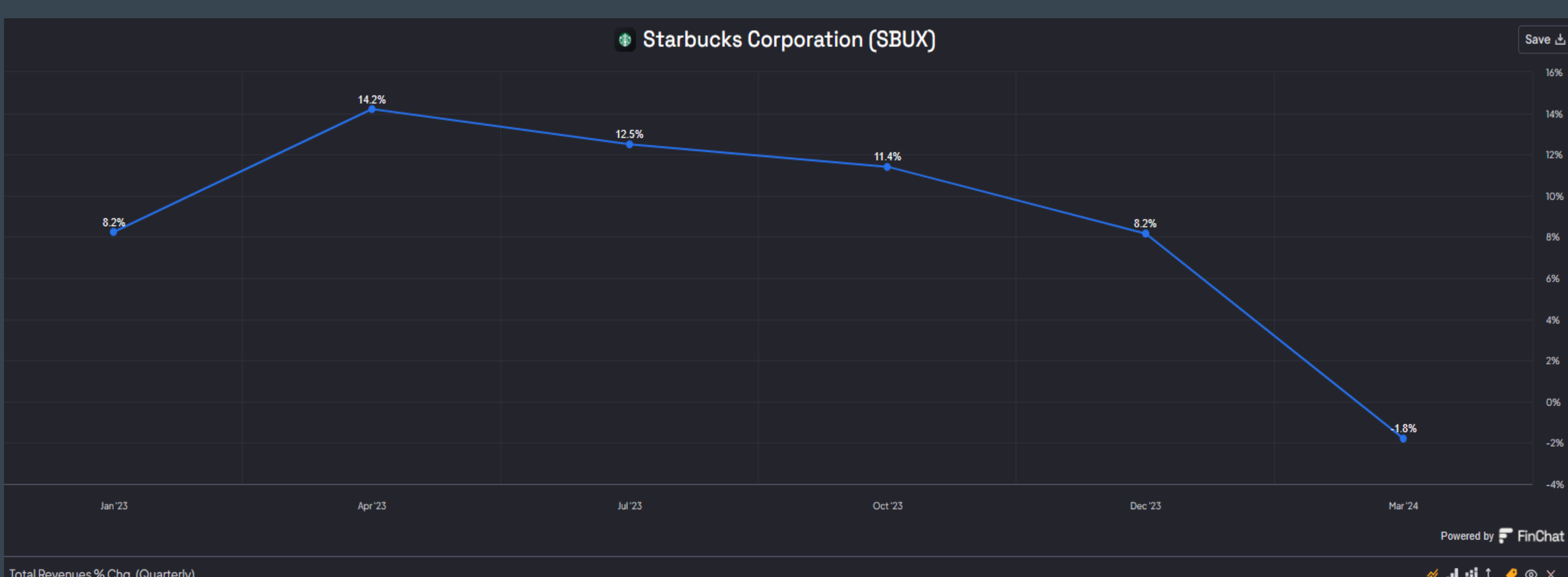
As mentioned above Total Consumer Credit for the month of March fell to $6.3 Billion from the $15 Billion reported in February. Credit Card spending was flat for the month. In this type of environment lower debt is not a good thing and usually means write offs are occurring as people cannot meet interest payments. Default rates at banks have been on the rise and for banks outside of the top 100 in the U.S. they reached 7.8% last quarter. To give you a reference point, in 2008 they peaked just below 6%.

Some of this has shown up in consumer stocks this earnings season and they have been punished for it. The market seems more inclined to move out of stock on bad guidance than lower earnings. The first one I wanted to point out is Apple. Apple trades at a price-to-earnings (P/E) ratio of 28. When you look at the fundamentals of the stock, over the past three years it raises questions about its sustained high valuation. Despite its historical classification as a growth stock, Apple does not have growth anywhere in its financial statements.



The stock price began to reflect this seeing that it peaked in December of 2023. Sales in China which make up just under a fifth of its total revenues fell double digits year-over-year. However, when Apple reported earnings, it jumped $180 Billion in market cap after announcing $110 Billion dollar buyback. If that doesn't tell you this market is disconnected from underlying fundamentals, then I don't know what will.

Starbucks revenue growth has been slowing since April of 2023. They reported this past week and for Q1 their revenue is down 1.8% from Q1 of last year.



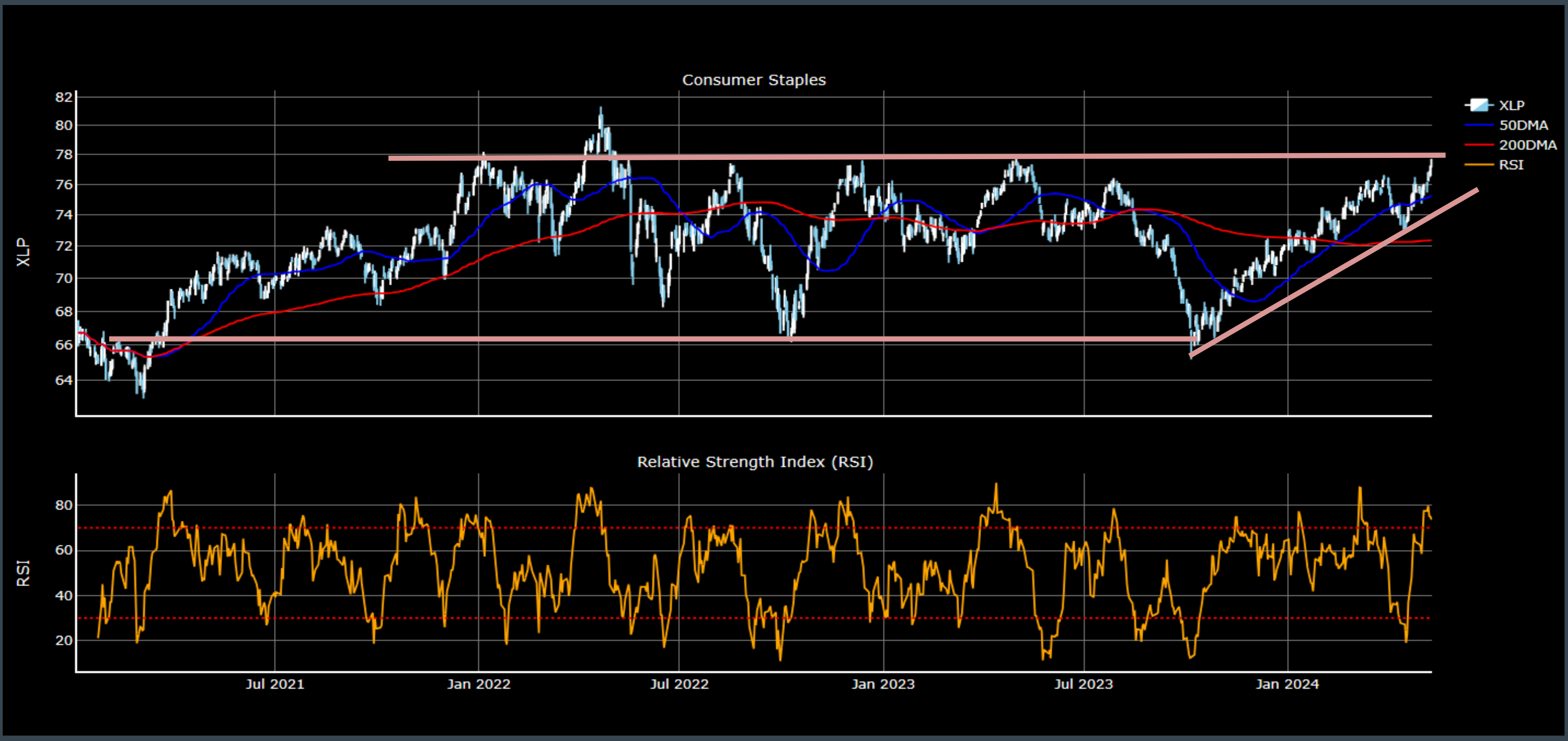
Starbucks stock fell from around $90 to the mid 70's

Much of the mainstream media has been using vacations and travel as the bellwether to support the argument that the economy is doing well. TripAdvisor reported slowing revenue growth and soft guidance, which caused their stock to fall over 25%.

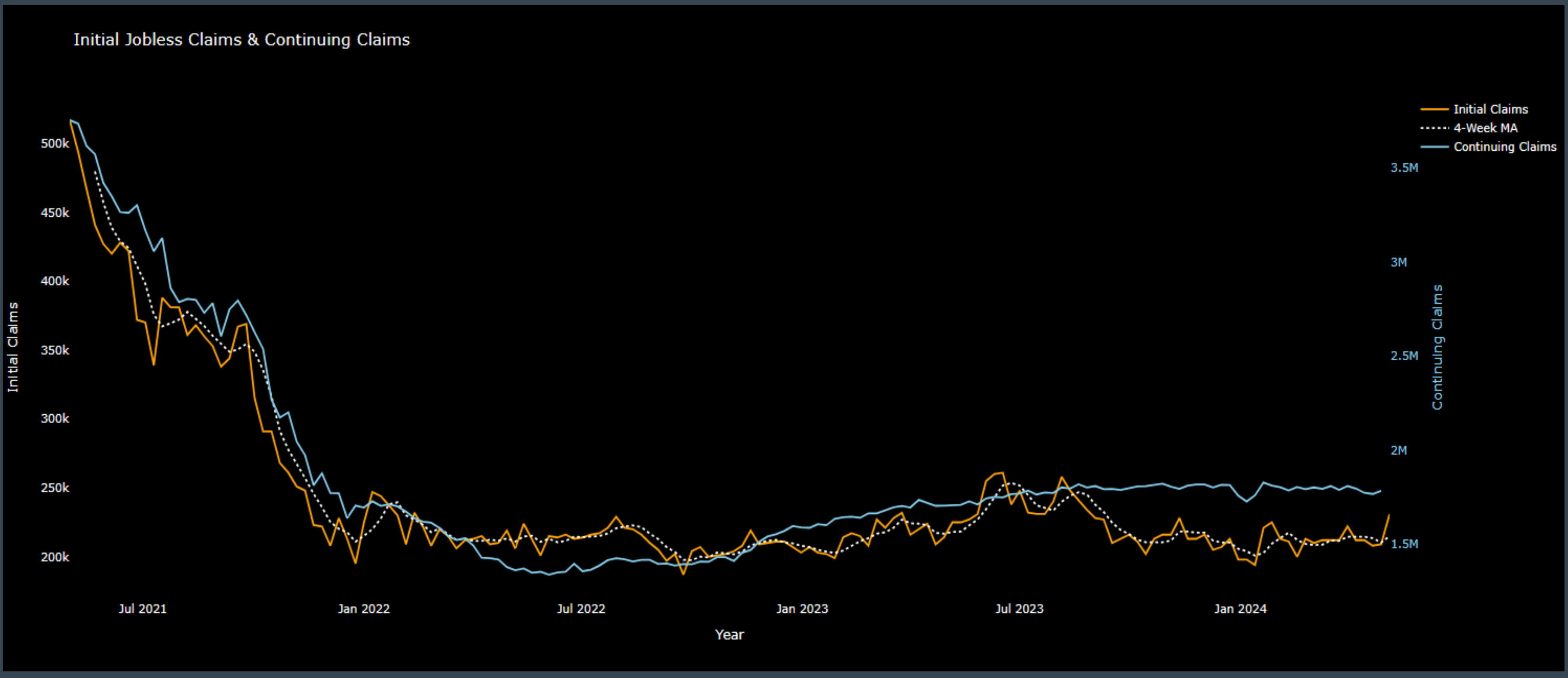
Nike is one of the poster children for discretionary spending. Since December 2023 the stock is down over 25% and their revenues have not grown more than 2% since their earnings report back in May of 2023

Utilities have fully broken out of a downtrend that began back in September of 2022. They have been the best performing sector over the last few weeks. Currently they have become overbought, which could mean a short-term pullback but there is opportunity as long as the trend stays intact.

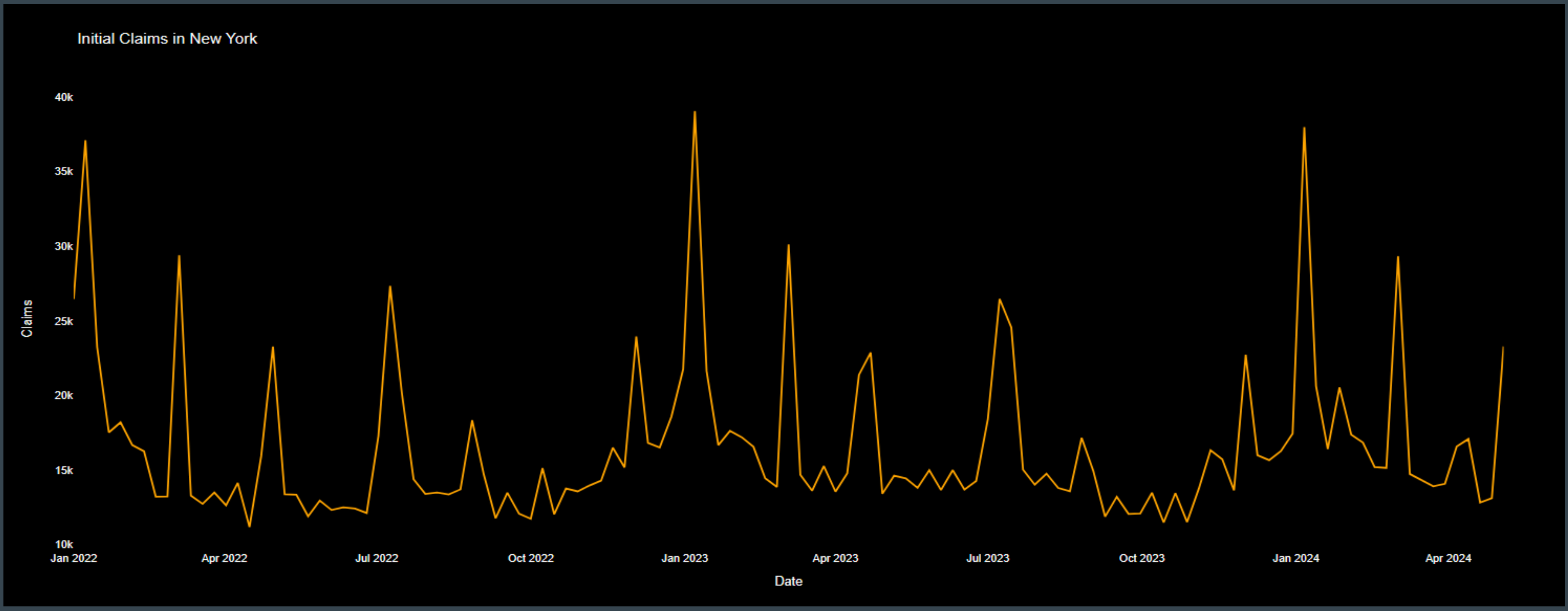
Consumer Staples has quietly followed suit as it recovered from its selloff that ended in October of 2023. The sector has been in a straight line higher but lagged the rest of the market in terms of returns. Now that the market has cooled off its performance to the upside has put it in the outperformer category for the time being.



The only real economic news that the market paid attention to this week was initial and continuing jobless claims. Initial claims were flat for numerous weeks and then this past week made a jump to 231,000. Continuing claims rose 17,000 to 1.785M.



The jump in initial claims came from New York and California. It seems like it is just noise as initial claims from New York tend to be volatile.



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