Ropes Wealth Gauges GDP as Good as It Gets

The U.S. economy expanded by less than expected in the first quarter due to stronger inflation and a drag from inventories. Real GDP grew just 1.1%, short of the 1.9% economists expected and a slowdown from the 2.6% increase recorded in Q4 2022. The pace of activity was the weakest of the post-pandemic era excluding outright contractions in the first half of 2020 and 2022. Inflation was partially responsible for weaker real growth, with the core PCE price index rising 4.9% after a 4.4% increase in 4Q22. Inventory declines were the primary culprit, dropping -2.3% for the first time since 2021.

If there was a silver lining in the report, it was that real final sales rose 3.4% after a 1.1% increase in the final quarter of 2022. This was the second strongest pace for sales since the first half of 2021 and highlights the resilience of the U.S. consumer against a backdrop of moderating business investment and another quarterly contraction for housing. Consumer spending on goods rose for the first time in five quarters and services activity picked up after a fourth quarter slowdown. However, we have to consider that this is going to be as good as it gets in 2023 for the consumer, given higher borrowing costs and tighter credit conditions in the aftermath of the Silicon Valley Bank crisis.

To that point, the Conference Board's Consumer Confidence Index weakened more than forecasted in April as an improvement in current sentiment was offset by softening expectations. The headline index fell from 104.0 to 101.3, its lowest level since July 2022. The present situation index rose from 148.9 to 151.1, near the top of its range since the second half of 2021, but this reading was countered by a drop in the expectations index from 74.0 to 68.1, the third lowest level since 2013 behind back-to-back readings last summer. The 83-point gap between the present situation and expectations indexes is the fourth widest in records since 1967 behind a set of readings leading into the 2001 recession. The improvement in current optimism captured small net improvements in consumers' assessment of both general business conditions and the labor market. The worsening outlook, on the other hand, reflected broadly softer expectations, including notable declines in consumers' plans to purchase autos, homes, and appliances.

One possible reason portending worries is the debt ceiling debate, which is heating up as House Speaker Kevin McCarthy introduced and passed legislation that would allow for an increase if certain conditions related to curtailing long-term debt and reducing the administration's climate change agenda were met. McCarthy's package requires that unspent – but approved – COVID-19 funding is recalled, the Biden administration's energy regulations and clean-energy tax breaks are removed or reformed, and work requirements imposed on adults without children who receive food stamps and Medicaid. Democrats, of course, assert the debt ceiling should not be tied to budget negotiations, and describe the proposed cuts as draconian.

As a reminder, the debt limit for the U.S. is currently capped at $31.4 trillion. On January 19, the technical debt limit was reached, but the Treasury Department implemented "extraordinary measures" to continue to perform on its obligations. Such accounting measures, however, are only a temporary stalling mechanism, and unless the cap is lifted – and soon – the federal government is poised to fall short of the funds needed to cover its commitments, potentially as early as June, though additional measures could be used to hold off the worst case until about August.

If the U.S. were to default, restructuring would be nearly impossible. Investors may have to wait longer than expected or agreed upon to receive full payment, or they may be forced to take a partial payment with some loss of interest or principle. The consequences of a default would have negative implications for future Treasury issuance and the government's ability to function properly. In short, it would be a disaster.

For now, stock markets remain mostly nonplussed, confident that a partisan showdown will not go so far as to risk an actual default. It is notable though that credit default swaps (CDSs), a form of insurance against a borrower not making full or on-time payments on their debt, rose to the highest level since the financial crisis. Up 141 basis points since the start of the year, the cost of insuring U.S. debt against default is now over 150 basis points. As for stocks, they have seesawed over the course of this week, with tech shares surging especially from the big bellwether names that were routed in last year's selloff. Banking and energy stocks also struggled, while consumer staples and healthcare remain solid given their defensive characteristics. We are maintaining vigilance here, for all the risks and dynamics described and given the market's narrow breadth and strong first quarter performance that has made valuations less compelling overall. We recommend being conservative with short-term cash needs, encourage you to take required minimum distributions from retirement accounts and make planned charitable gifts, and continue to beat the drum for maintaining balance and diversification in your long-term plan. Markets might be as good as they are going to get, for now, until we clear some of these hurdles. Or valuations change enough to warrant more of our short-term optimism for taking on risk.

Thank you as always for your interest in our investment commentary. If you would like to speak personally with a member of our team at any time, please click **here**.

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