KAULKIN GINSBERG

The KG Index

Q4 2019

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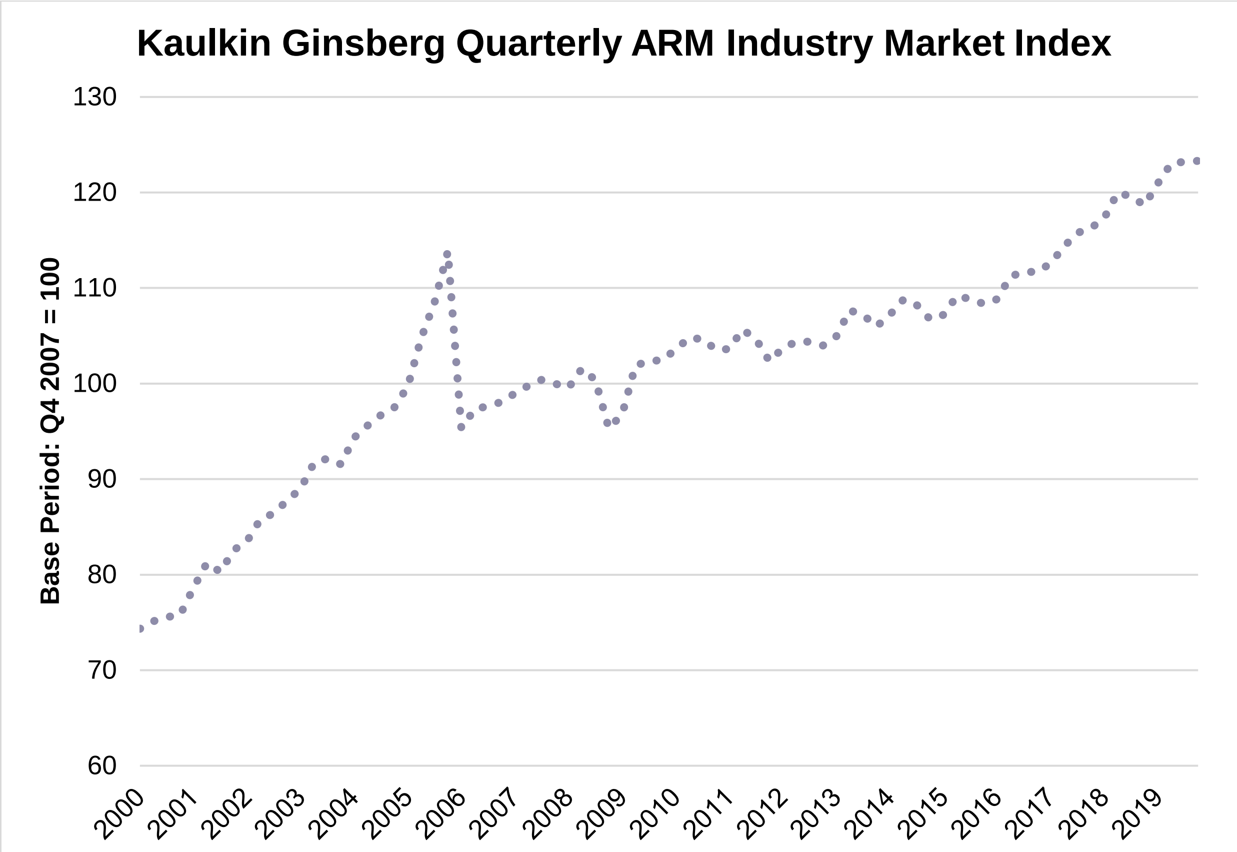
The Economy's Effect on the ARM Industry: The KG Index



Q4 2019 data releases are complete, and that means it's time to review fourth quarter market conditions for the U.S. accounts receivable management (ARM) industry and discuss what you should look for in the first quarter of 2020. Following a few historical revisions to prior quarters' data points, we saw continued growth in market conditions for the fourth straight quarter (albeit at a moderate level), with consumer demand and home values as the growth drivers.

More importantly, Q4 2019 came in at an index value of 123.31. This indicates that the ARM index grew by 0.1% on a quarter-over-quarter basis with an annualized growth rate of 0.3%. While these rates are down significantly from the previous quarter, they do align with historical trends for weak-to-negative fourth quarter performance. That said, it's still four straight quarters of declining growth rates with not much more room to decline before it turns negative, which likely speaks to market instabilities.

Overall, the four key indicators contributing to our index – consumer bankruptcy filings, retail sales, official civilian unemployment rate (U3), and home price index (HPI) – should be closely monitored as the year progresses. Here are a few of our notes on the current trends within each variable:

Consumer Bankruptcy Filings

In any given year, the first and second quarters tend to be the highest points, while the third and fourth quarters trend downward through the remainder of the year. However, in 2019, the second and third quarters were up and the first and fourth were about flat to the previous year which led to the first net increase in consumer bankruptcy filings since 2010. While some volatility and growth in bankruptcy filings is considered good for the ARM industry, more systemic increases are an indication of an overheated consumer credit market that is trending towards a recession. As such, increases in bankruptcy filings in the fourth quarter of 2019 (as we just experienced) and into 2020 would serve as an indication of deteriorating market conditions and warrants a closer look at monetary policy by the Federal Reserve.

Retail Sales

While retail sales tend to maintain a long-term steady growth rate, the greatest period of growth is, unsurprisingly, concentrated in the third and fourth quarters of the year, while the first and second quarters are, on average, flatter. As of Q4 2019, retail sales are up on a quarter-over-quarter and relative to the same quarter last year basis. Furthermore, net growth in retail sales for the year was 4.1% which is relatively strong when compared to the five-year average of 3.7%. It's not clear if this has more to do with an overextended consumer segment, misplaced consumer confidence, or some combination of factors. That said, consumer spending patterns are essential to the growth of the U.S. economy and ARM industry, so a slowdown is never a good sign – especially when the consumer market is the primary driver for economic growth. Therefore, retail sales will be an even more important consideration in the first quarter of 2020 as the full effect of the global Coronavirus outbreak isn't truly known but early signs suggest it could force some economies into a recession.

Official Unemployment Rate (U3)

The unemployment rate came in at 3.5% for Q4 2019 – the same as last quarter – which is also the lowest rate recorded in the last 20 years. As always, the quality of employment and corresponding labor force participation should be examined since they call into question the value of the official unemployment rate. Although the labor force participation rate didn't increase from its 63.2% level last quarter - the highest it's been since Q3 2013 – it didn't decrease either, despite adding over 500,000 participants in the fourth quarter. Additionally, real median weekly earnings for 2019 increased marginally for a third straight quarter, though an uptick in the fourth quarter is relatively consistent with historical trends. While the state of the U.S. labor force could be better (or worse) depending on the analyst's interpretation, the labor market data is generally strong. However, consumer delinquency data coupled with concerns of a global slowdown due to the Coronavirus increase the potential for an economic downturn in the U.S. and corresponding increase in consumer bankruptcy filings.

Home Price Index

The home price index (HPI) is positively correlated with the ARM industry and facilitates consumer confidence – especially in their ability to leverage debt – since homes represent the greatest percentage of most individual's wealth. In Q4 2019, the index increased from 212.14 in Q3 2019 to 212.59. On the surface, this increase suggests a strong housing market. However, a closer examination of comparable quarter-over-quarter growth for the last 10 years shows a decline in the growth rate for HPI that may suggest a weakening housing market – something that aligns with a pending recession. Given current housing trends, Coronavirus outbreak, and other economic indicators, it appears likely that the Federal Reserve will launch expansionary monetary policies in the first quarter of 2020.

Expansionary monetary policy would lower interest rates to incentivize borrowing and investment at the commercial and consumer level which would, in turn, drive prices for the housing market – especially if consumers fear they'll miss a "good deal". More than likely, the HPI will increase over the first two-to-three quarters in 2020, but it's likely overheated and will need to reset sometime in the near future.

What to Look for in the First Quarter of 2020

2019 was a stronger year for the ARM industry than many expected and calls for a recession haven't come to fruition. However, a recession will eventually arrive. The cumulative data suggests that the ARM industry is well-positioned for growth in early-2020 given strong fourth quarter 2019 spending by consumers and the likely expansionary monetary policy by the Federal Reserve. If the Coronavirus outbreak results in nothing more than a moderate slowdown to economic growth, then the ARM industry should see increased opportunities in 2020. Therefore, the inverse would also be true and a prolonged downturn would lead (in the long-term) to a deterioration in the ARM industry. Keep in mind that the ARM industry lags the U.S. economy so a poor economy in late 2020 will impact ARM firms in early 2021.

Contact us at hq@kaulkin.com if you have any questions.