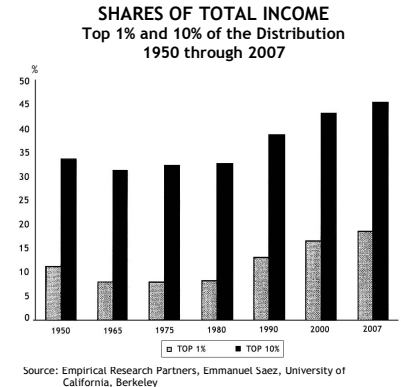


CONSUMER SPENDING OUTLOOK: THE WEALTHY ARE KEY

It has been a year since the demise of Lehman Brothers, and investors are now beginning to focus on prospects for the budding economic recovery. U.S. consumer spending is at the core of every discussion surrounding near and medium-term trends for the global economy. In this edition of the Natcan Marker, we review the importance of the highest income earners on overall consumer spending trends in the U.S., and highlight factors to monitor when assessing what the future may hold.

HIGH EARNERS: A POORLY UNDERSTOOD COHORT

One of the statistics that is most often referred to is the fact that consumer spending represented 70% of GDP at its peak in 2007. Most observers stop at that point, failing to analyze the composition of consumer spending itself. One interesting angle on this subject is the breakdown of spending by income levels. In statistics and economics, any group that represents over 30% of a total is known to be a trend-setting force. The most recent data available is from 2007. Several surveys have been published recently, and all confirm the domination of high-income earners on consumption. We cite Empirical Research Partner's analysis: "In 2007, the top decile of the income decile took in 46% of all income"¹. The accompanying chart illustrates how the top 10% and 1% of U.S. income earners have commanded an outsized and growing share of the total for over 50 years.



The least understood factor about high earners may be how volatile their incomes and spending are relative to the overall population. One can understand that such high incomes (over \$100,000) include a large share of variable items like bonuses, stock options and dividends from private corporations. With large variable components to income, one better understands why spending by the top 5% of income earners is five times as volatile as that of the population taken as a whole! In the most recent downturn, the top 10% of earners saw their net worth drop by close to a fifth¹, and their level of confidence in the future dropped below that of less wealthy consumers, something that had not occurred in prior cycles.

HIGH EARNERS: THE KEY TO A RECOVERY IN CONSUMER SPENDING

Many commentators depict the U.S. consumer as unemployed, overly leveraged and likely to hold the title to a home with a market value below that of the debt it supports. All of the above are true to some extent for the bottom 75% of income earners. Conversely, such a focus leads to ignoring the all-important top 10% (46% of total income in 2007). The vast majority of their net worth and spending power consists of real estate, publicly listed equities and private company values. All three categories suffered significant mark-downs over the past 12 to 15 months. An improving outlook for those three asset categories - combined to less uncertainty on income taxes - is probably the true requirement for the much awaited resumption in consumer spending.

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The outlook for the global economic recovery once again depends on the U.S. consumer. In handicapping the prospects for a return to growth in personal expenditures, one cannot afford to ignore the situation of the highest income earners. Rather than listening to more judgmental editorials about profligate spending by the median family, investors will be well served to focus on indicators of a return to form of the top earners, for therein lies the answer to future consumer spending trends in the U.S.

Michael Quigley, CFA, CAIA
Senior vice president, Distribution

FINANCIAL MARKETS

RETURNS AS AT SEPTEMBER 11, 2009 (%)	MTD	QTD	YTD	RATES AS AT SEPTEMBER 11, 2009
S&P/TSX	3.69	9.08	28.24	CAD/USD
S&P 500	0.72	5.69	4.15	CAD/Euro
S&P/TSX Small Cap	5.55	16.32	37.16	US Treasuries yield 10-yr/30-yr
Russell 2000	2.26	8.58	6.45	GOC bond yield 10-yr/30-yr
MSCI EAFE	1.36	10.29	12.00	Fed Fund Rate (target)
MSCI World	0.87	7.74	7.79	
DEX Universe Bond	0.28	2.08	4.94	

Note: Returns in Canadian dollars, London 4h exchange rates. Source: Datastream, PC Bond, MSCI-Barra, and Bloomberg. PC-Bond, a business unit of TSX Inc. Copyright © TSX Inc. All rights reserved.

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¹ Empirical Research Partners - Portfolio Strategy August 2009