The Four Most Dangerous Words:
A look at the U.S. Economy

Since World War II ended, almost 73 years ago, the U.S. economy has experienced 10 recessions, averaging one every seven years. The longest period of time between the end of one recession and the beginning of the next was 10 years, from March 1991 to March 2001. It has been almost nine years since the Great Recession ended in June 2009, and yet no one seems concerned that we're overdue for a recession. Why is that?

The next few paragraphs are going to answer that question, give you a glimpse into the current state of the economy, and identify two weak spots that could play a part in the next recession. To narrow the focus, I'll use the last 30 years of data, which includes three recessions and two substantial economic booms.

Let's start with the stock market. Over the last 30 years, the S&P 500 is up nearly 1,000%. In just the last nine years, since the bottom of the last recession, it's up almost 300%. Stocks are at all-time highs*, with the S&P hovering at almost double where we saw market resistance prior to the 2001 and 2007 recessions. Anyone with money in the stock market is probably worth more now on paper than they ever have been. Only time will tell us if the mild correction we saw in February 2018 was the start of a larger sell-off, or if it's just a pause to greater heights, but investors aren't panicking and you aren't hearing many people talking about pulling money out of the markets and preparing for a big drop. Why not?

Since World War II ended, almost 73 years ago, the U.S. economy has experienced 10 recessions, averaging one every seven years.

Because it's different this time. People will tell you the recovery from the last recession has been slow and steady; inflation isn't a concern right now; interest rate are still very low; the Price/Earnings multiple of the stock market indices are within historic norms. They'll say it's different this time. And those are the four most dangerous words: It's Different This Time. Because it's always different this time.

The next recession won't happen for the same reason and in the same way as the last one, but it will still happen, and usually every six to nine years. The ultimate result will be the same as the last time: a stock market correction, conservative lending, and a sluggish economy. Yet despite being "due" for a recession, very few people are talking about it or preparing for it. Let's take a look at the economy to find out why.

I believe that growing consumer debt in the U.S. is our next economic weak spot, with student loans and credit card debt being the potential linchpin of the next recession.

The U.S. Economy

Consumer confidence is at an all-time high.* The University of Michigan surveys households monthly, asking them questions about the economy. For the Current Economic Conditions Index, they ask two questions: 1) "Would you say that you and your family are better off or worse off financially than you were a year ago?" and 2) "Generally speaking, do you think now is a good or bad time for people to buy major household items such as furniture, a refrigerator, stove, television, and things like that?" The results of the March 2018 survey show the highest level since they began tracking the data in 1960 and the Consumer Sentiment Index, a similar survey of five questions, is near an all-time high, yielding only to the "irrational exuberance" of the late 1990's. So why are Americans so confident?

One big reason is they've got good jobs. When the economy has an unemployment rate of 4%, it's considered "full employment," which essentially means that everyone who wants a job has a job. In the last 30 years, we've been at or near full employment three times. The first two times were in 2000 and 2007, and both times a recession followed within 12 months. And third time is right now. For the last six months, the unemployment rate has been 4.1%.*

Historically, Americans save very little. Also, their savings rate decreases when times are good because they're confident in the economy and the future. At the end of 2017, America's personal savings rate was 2.4%, the lowest it's been over the past 30 years with the exception of two months in 2005. It's at the same level as late 2007, immediately before the Great Recession.

Right now Americans have good jobs, are extremely confident in the economy, and their retirement funds are looking strong. So what do they do? The University of Michigan survey is telling us what they're going to do. They're going to buy stuff, and since they have no savings, they're going to buy it on credit.

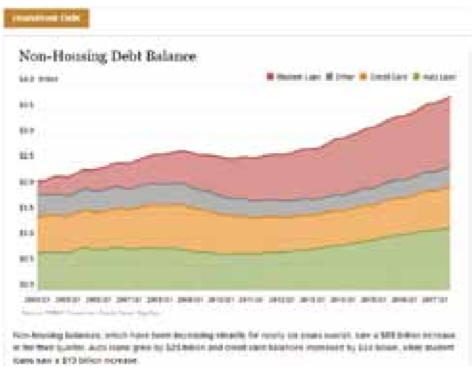
America's Debt

Let's look at America's debt. Not surprisingly, the vast majority (71%) of America's debt is tied up in their home mortgages and home equity lines. That percentage is below the average over the past 15 years (76%) and home-related debt defaults are relatively low, so let's focus on the rest of America's debt.

Six percent of America's debt is credit card debt, and that percentage has slowly been increasing over the past four years. Credit card debt is defaulting at a 7% rate and, despite that percentage creeping higher over the past 18 months, it is still close to the lowest levels in the past 15 years. However, it's worth noting that credit card defaults tend to be a lagging indicator, not a leading indicator. Americans use credit card availability as a lender of last resort and those defaults take a while to catch up. Credit card defaults didn't jump until halfway through the Great Recession and they didn't peak until close to a year after the recession ended.

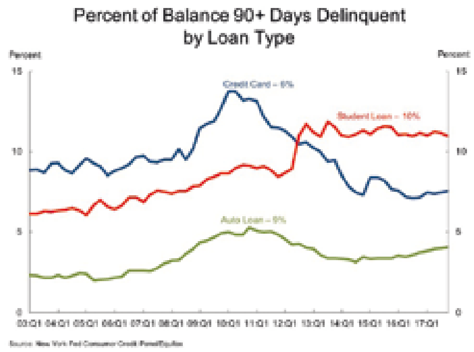
Nine percent of America's debt is auto loan debt, and that percentage has been steadily increasing over the past five years. Auto loans are defaulting at a 4% rate and have been relatively secure because of American's reliance on their vehicles. This segment doesn't appear to be a high-risk area.

Finally, ten percent of America's debt is student loans. As a percentage of total debt, student loans have tripled over the last 15 years, and as a gross number student loans are 10 times greater than they were in 2003. The performance of that debt is particularly telling. Student loans are defaulting at an 11% rate,



almost double the rate from 15 years ago. This means that the greatest source of America's non-mortgage debt also has the highest default rate.

Finally,



Economic Concerns – Student Loans and Credit Cards

I believe that growing consumer debt in the U.S. is our next economic weak spot, with student loans and credit card debt being the potential linchpin of the next recession. More than 25% of Americans have student debt for themselves or a family member, with an average debt amount of $27,000. Almost half of them are concerned they can't pay it back and 25% have been late on a payment more than once. The increasing prevalence of student loans leads to lower wealth accumulation, decreased ability to make major purchases, and an overall decrease in the availability of credit.

While credit card usage is just starting to rise, credit limits have been steadily increasing over the last five years. This means that consumers have a lot of credit available to them. Not only will this facilitate those major household purchases, but it's also worth noting that consumers are placing an increasing amount of recurring debt on credit card autopay. Charges like the cable bill, utilities, mobile phone, Netflix subscription, and sometimes even timeshare payments are a quickly growing portion of the average American's credit card statement.

Vendors are pushing autopay more and more, and this leads to consumers not fully realizing how much recurring debt they pay each month. Instead of each vendor's statement receiving individual consideration each month, consumers simply make one large credit card payment, sometimes for the full amount and sometimes just the minimum payment.

Why Should You Care?

The vacation ownership industry is reliant on the American consumer's ability to purchase our product, and purchasers rely on developer financing 75% of the time. The vast majority of developers, 82%, use FICO scores when making those credit decisions. As student loan and credit card debt balances increase, and as defaults increase, FICO scores are going to go down along with the consumer's overall ability to purchase.

Developers also push autopay through credit cards and auto debits to a bank account, which is great until the consumer's bank account is empty, the credit card is maxed out, or the consumer can't make their credit card minimum payment. Then the payments stop, and they won't start again.

Previous recessions have shown that even during downturns timeshare owners are willing to keep paying for their vacation ownership. However, there is a difference between being willing to continue paying and being able to continue paying. A consumer debt crisis could impact a consumer's ability to purchase or to continue paying. A recession driven by consumer debt would be different than any recession to date and it has the potential to change segments of our business very significantly.

Perhaps the scariest part about growing consumer debt is that it's not just an American problem. A

February article in the Wall Street Journal categorized countries into four quadrants based on the rate of growth of their household debt (consumer debt plus mortgage debt) and the amount of household debt as a percentage of each country's GDP. Despite our low savings rates and high debt levels, the United State wasn't even in the riskiest quadrant; however, Switzerland, Australia, Norway, South Korea, Canada, New Zealand, and Sweden were. In fact, their level of household debt leverage was similar to the U.S. in 2007, just before the Great Recession. This means that accumulating consumer debt has the potential to be a global problem, too.

A Consumer Debt Downfall?

I believe America is facing a consumer debt crisis. The relationship between consumer debt and a thriving economy is a balancing act, one that will eventually tip. The resulting imbalance could be the catalyst for the next recession or perhaps a smaller contributing factor. There may be an unidentified economic weak spot lurking in the shadows, or a myriad of geopolitical events could spur a downturn in the next twelve months. For the sake of my retirement fund and my job, I hope that we continue to have a prolonged period of economic prosperity. Based on history, that seems unlikely. While it's true that "it's different this time," it doesn't mean it's not going to happen again, just that it's going to happen differently.

The next recession won't happen for the same reason and in the same way at the last one, but it will still happen, and usually every six to nine years.

*Writer's Note: This article was adapted from an oral presentation and written in mid-March, so economic indicators are limited to data available at that time.

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Brydge graduated from the University of Virginia with a Bachelor of Arts in Economics with a concentration in Finance. He is also a graduate of the 2014-15 ARDA LEAPS leadership program and the 2013-14 Leadership Charlottesville program. Over the past decade, Shawn has spoken or moderated at industry events including ARDA World, GNEX, and the Shared Ownership Investment Conference, and has appeared in multiple articles in Developments and Vacation Industry Review. He is a member of ARDA's Meetings Committee, Finance Committee, and is the co-chair of the ARDA LEAPS Alumni Task Force.

Shawn and his wife, Ellie Sharp, are founders of Hoos Care, a charitable organization that supports the UVA Children's Hospital, UVA Cancer Center, and other causes in the Charlottesville area. He is co-founder and lead organizer of Cavaliers Against Cancer, an organization that raises funds for a research fellowship at the UVA Cancer Center. He is Treasurer of the Board of Directors for 91.9 WNRN, vice-Chair of the UVA Children's Hospital Committee, coaches his daughter's softball team, and sits on multiple local boards.