

## Debt-Laden Companies? #FakeNews?

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Remember the weak May payroll report – just 138,000? Didn't think so. But, back then, that first report on May was reported as a massive economic slowdown that should stop the Fed from further rate hikes.

But the weak May number was due to a calendar quirk that led to an undercount of college kids getting summer jobs. Payrolls jumped 222,000 in June, were revised up for May and, now, the two month average is 187,000. That's exactly the same as the average in the past twelve months and almost exactly the same as the 189,000 average in the past seven years. In other words, the negative story from a month ago was misleading.

So, guess what? The Pouting Pundits of Pessimism are pivoting! It's not jobs anymore, now it is "high debt levels among nonfinancial corporations." They say this happens near the very end of an economic expansion, so brace yourself.

It is true that nonfinancial US corporation debt is at a record high of \$18.9 trillion. It's also true this debt is the highest ever relative to GDP. But these companies don't pay their debt with GDP. They hold debt against assets and incomes.

Since 1980, nonfinancial corporate debt has averaged 44.9% of total assets (financial assets, real estate, equipment, inventories, and intellectual property). Right now, these debts total 44.5% of assets, or slightly less than average. The record was 50.6 in 1993. Think about that, 1993 was right at the beginning of the longest economic expansion in US history.

Some say that the value of corporate financial assets is inflated by financial alchemy. So, let's take financial assets, which include record amounts of cash, out of the equation.

Before we do that, please realize that the financial assets of nonfinancial companies exceed total debts by \$1.4 trillion, a record gap. But let's look at ratios without them, anyway. The debt-to-nonfinancial asset ratio is at 85%. This is right in the middle of the past 25-year range – roughly 74% to 95%.

Debt relative to the market value of these companies has averaged 82.2% since 1980 and currently stands at 80.0%. If you calculate net worth using historical costs for their nonfinancial assets (instead of market value), the debt-to-net worth ratio is 121%, but has averaged 128% since 1980, 125% since 1990, and 119% since 2000. Again, nothing abnormal.

What about interest payments? The most recent data show that interest and miscellaneous payments are 11.2% of these companies' profits versus an average of 13.2% since 1980, 12.2% since 1990, and 11.6% since 2000. What happens if interest rates keep rising? Less than you think. Only 28% of the debt is short-term versus an average of 44% in the 1980s, 41% in the 1990s, and 33% in the 2000s.

None of this means the economy is safe forever. Another recession is inevitable. It's just not coming anytime soon. In the meantime, beware of stories that take one simple measure – like corporate leverage – and spin it pessimistically.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
7-10 / 2:00 pm	Consumer Credit– May	\$13.5 Bil	<b>\$16.0 Bil</b>		\$8.2 Bil
7-13 / 7:30 am	Initial Claims – July 8	245K	<b>244K</b>		248K
7:30 am	PPI – Jun	0.0%	<b>0.0%</b>		0.0%
7:30 am	“Core” PPI – Jun	+0.2%	<b>+0.1%</b>		+0.3%
7-14 / 7:30 am	Retail Sales – Jun	+0.1%	<b>+0.2%</b>		-0.3%
7:30 am	Retail Sales Ex-Auto – Jun	+0.2%	<b>+0.2%</b>		-0.3%
7:30 am	CPI – Jun	+0.1%	<b>0.0%</b>		-0.1%
7:30 am	“Core” CPI – Jun	+0.2%	<b>+0.2%</b>		+0.1%
8:15 am	Industrial Production – Jun	+0.3%	<b>+0.3%</b>		0.0%
8:15 am	Capacity Utilization – Jun	76.8%	<b>76.8%</b>		76.6%
9:00 am	Business Inventories – May	+0.3%	<b>+0.3%</b>		-0.2%
9:00 am	U. Mich Consumer Sentiment- Jul	95.0	<b>95.6</b>		95.1

*Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.*

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