

DIAMOND HILL

INVESTED IN THE LONG RUN

Headline Strength, Hidden Strain: A Closer Look at the Consumer

Mar 2026

Stubborn inflation, a cooling labor market and ongoing uncertainty surrounding tariffs have all made headlines of late, yet consumer demand has held up better than many expected. While the high-level data still supports the case for a healthy consumer environment, a closer look reveals more nuance: we're increasingly living in a bifurcated economy, where about 30% of the population accounts for the majority of total consumer spending, an imbalance that suggests many consumers are far more financially constrained than headline numbers imply.¹

From a bond portfolio creation standpoint, investors can gain exposure to the strongest consumers through high-quality credit card issuers and prime loan structures; however, the challenge is that these higher-quality areas often don't offer much incremental compensation. If you want more yield, you almost inevitably move down the credit spectrum into near-prime and subprime borrowers, where performance can deteriorate quickly if the economy weakens.

That trade-off is where strong, bottom-up credit analysis becomes crucial. Today, data indicates early signs of consumer stress, including a modest uptick in delinquencies, even within prime cohorts. While it's too soon to know whether that's simply noise or the beginning of a broader trend, we have been moving toward higher-quality tranches within consumer credit deals, and our bar for investing in subprime opportunities is higher than in previous periods. Additionally, our baseline assumption now incorporates more recessionary loss assumptions to ensure deals can remain resilient if economic conditions deteriorate.

Issuer selection also remains a key component in our investment process. With many issuers operating in consumer credit, our focus is increasingly on partnering with strong, proven issuers — particularly those with durable funding structures — that can continue operating without disruption in tighter markets and are therefore less likely to create servicing transfer risk in a downturn.

¹Source: Consumer Expenditure Surveys, U.S. Bureau of Labor Statistics, December, 2025.

The views expressed are those of the author as of March 2026 and are subject to change without notice. These opinions are not intended to be a forecast of future events, a guarantee of future results or investment advice. Investing involves risk, including the possible loss of principal. Past performance is not a guarantee of future results.