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INVESTMENT SERVICES

Weekly Relative Value

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WEEK OF SEPTEMBER 5, 2023

Jolted!

The Job Openings and Labor Turnover Survey (JOLTS) data showed that job openings plunged -338,000 to 8.827 million in July. Making matters worse, June was revised sharply lower by 400,000 to 9.16 million. In the past three months, openings have plunged nearly -1.5 million. This is the sharpest drop since April 2020 and the second most on record. It is now down -3.2 million from the March 2022 peak. In fact, openings are at the lowest level since March 2021 — this is when the Fed was telling us it would never be raising rates again in our lifetime (oops!).

The reduction in job openings is notable in several sectors:

- Professional and business services experienced a decrease of 198,000 openings.
- Health care and social assistance saw a decline of 130,000 openings.
- State and local government (excluding education) had a reduction of 67,000 openings.
- State and local government education reported 62,000 fewer openings.
- Federal government job openings decreased by 27,000.

In contrast, certain sectors observed growth in job openings:

- The information sector saw an increase of 101,000 openings.
- Transportation, warehousing and utilities reported an uptick of 75,000 openings.

The regional distribution of job openings displayed the following trends:

- The South experienced a decrease of 356,000 job openings.

THIS WEEK

- A CHALLENGE
- UNEMPLOYMENT RATE SPIKES HIGHER
- GDP vs. GDI
- CONSUMERS GO ON A SPENDING SPREE
- INTEREST RATE CRUNCH
- MARKET OUTLOOK AND PORTFOLIO STRATEGY

SUBORDINATED DEBT: (SIMPLIFIED)
Partnership has its perks.
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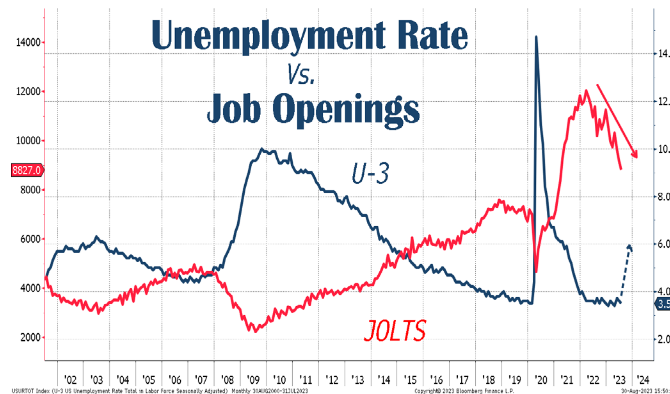
- The Midwest witnessed a decline of 69,000 job openings.
- The West reported an increase of 57,000 job openings.
- The Northeast saw growth with 29,000 more job openings.

Also, note the strong correlation between jobless openings and the unemployment rate below. If history is prologue, look for the unemployment rate to finally ascend off its historic low of 3.5%.



Not just that, but new hires contracted -167,000 in July and that followed a -291,000 slide in June. The two-month decline of -458,000 is the steepest since December 2020! And the hiring level is back down to where it was in January 2021.

The number of quitters is plummeting! This followed a -253,000 plunge in quits in June to the lowest level since February 2021 — essentially back to pre-COVID-19 levels in 2019. Interestingly, the vast majority of the decline occurred in the once-hot leisure/hospitality space (-183,000), which was the biggest monthly fall-off since April 2020 and the third most pronounced slump on record.

For the Fed hawks and bond bears, the voluntary quit rate leads to wage growth.

Bottom Line: In sum, all four components of the JOLTS survey showed deterioration (job openings down, hirings down, voluntary quits down and layoffs up).

Can the Fed really ignore this?

How long will Chairman Jerome Powell and his brethren continue to fight yesterday's battle?

A CHALLENGE

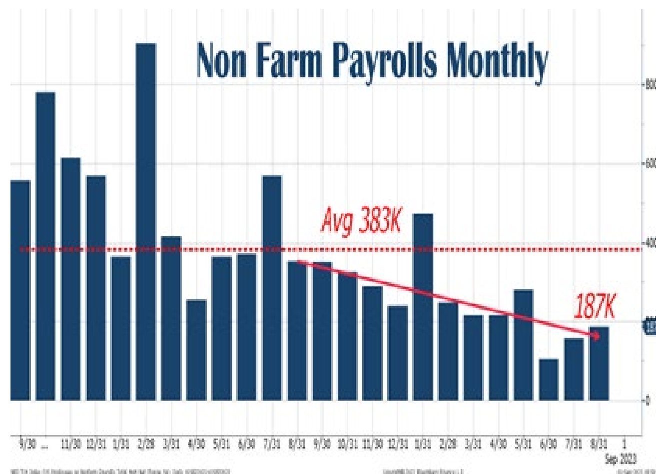
The Challenger job layoff data showed a huge +267% surge in pink-slip announcements in August to 75,151. Outside of the COVID-19 pandemic in 2020, this was the highest number for any August since 2009.

In terms of sectors, construction layoffs soared from 225 a year ago to 1,304 last month. Likewise, consumer products saw pink slips rising from 786 to 3,271. The financial sector layoff announcements soared from 153 layoffs in August 2022 to 1,776 in August 2023. Finally, the retail sector job loss has tripled from 1,724 to 6,262.

As to why the layoffs? Job layoff announcements due to bankruptcy were zero — last month, try a record 30,607! Not one company a year ago stated that "economic conditions" were a factor behind any layoffs — last month, try 1,819. The number of layoffs owing to business closures has surged three-fold to 15,883 from 5,350 a year ago. This is the second highest level for any August on record!

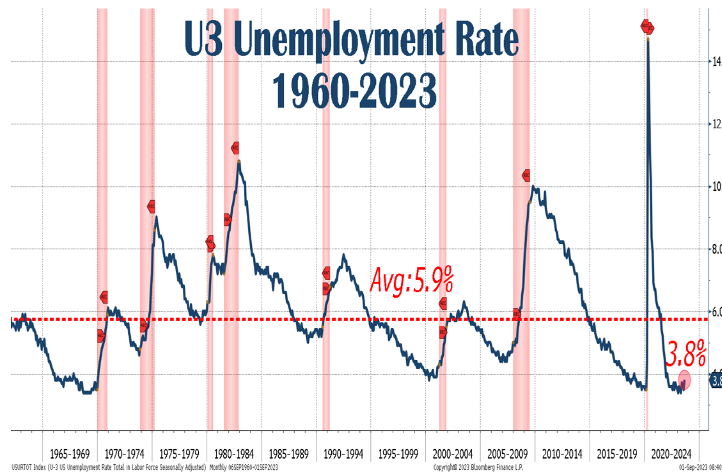
UNEMPLOYMENT RATE SPIKES HIGHER

The good news: The Bureau of Labor Statistics (BLS) reported that in August, the U.S. added 187,000 jobs, which beat the consensus estimate of 170,000.



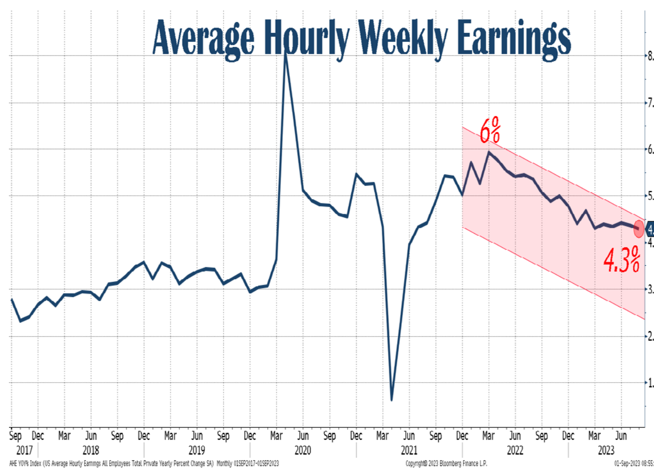
Superficially, this would have meant an unchanged print from last month when the BLS also reported 187,000 jobs. However, in keeping with recent trends that number was revised — drumroll — lower. July and June were revised down by a combined 110,000 jobs than previously reported. This means that every single monthly payroll print in 2023 has been revised lower.

Turning to the unemployment rate, things here took a turn for the worse. Instead of the 3.5% expected print in August, the unemployment rate jumped to 3.8%, which is up sharply from 3.5% in July. This was the result of 514,000 newly unemployed workers as the total civilian labor force increased by 736,000 individuals. The jump in the unemployment rate means that the economy was only able to absorb a net 77,000 of them in August.



The silver lining is that the participation rate actually rose from 62.6% to 62.8%, gradually catching up to where it was before the COVID-19 pandemic.

Turning to wage growth, August payrolls rose 0.2% month-over-month. This is down from 0.4% last month and missing expectations of 0.3%. On an annual basis, the 4.3% print came in as expected, and is down modestly from 4.4% last month.



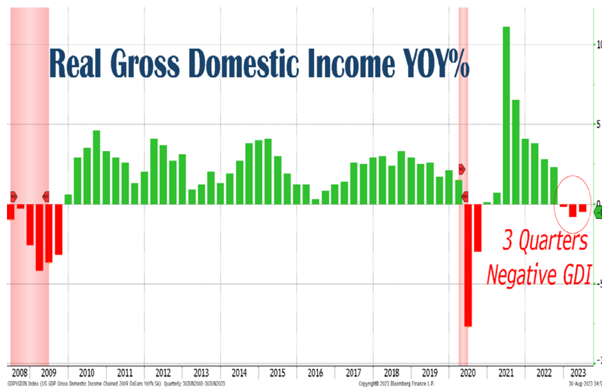
Bottom Line: As the most recent JOLTS and Challenger report strongly hinted, we have reached peak labor. Most importantly, wages are moderating. All in all, the Fed should be pleased with the data.

GDP vs. GDI

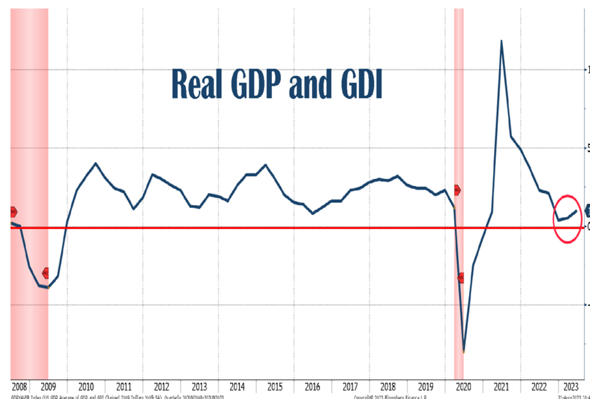
Gross domestic product (GDP) and gross domestic income (GDI) are two measures of the same thing, one from a product perspective and the other from an income perspective. Over time, they merge.

Quarter two GDP was revised lower to 2.1%, down from an initial "red hot" print of 2.4%. The last three quarters of GDP, starting with the fourth quarter of 2022, are 2.6%, 2.0% and 2.1%.

The last three quarters of GDI, starting with the fourth quarter of 2022, are -3.3%, -1.8% and -0.5%.



The National Bureau of Economic Research's (NBER) official arbiter of recessions averages the two measures. The result is inconclusive for the fourth and the first quarter combined.



Bottom line: GDI is still consistent with a recession starting in the fourth quarter of 2022. GDP isn't. The average of real GDP and GDI are non-confirming. However, don't be surprised if the NBER declares we had a recession, and it is already over.

CONSUMERS GO ON A SPENDING SPREE

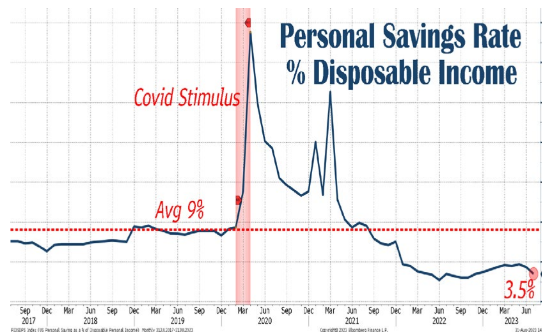
"This is about credit card balances. This is about student loans, which we know is going to come into focus in the next month or two, auto loans, mortgages," "So we just believe that the customer is coming under pressure because these are new realities that they have to continue to deal with as we get through the back half of this year and move into next year."

— Adrian Mitchell, Chief Financial Officer and Chief Operating Officer, Macy's

Largely on the back of Amazon's record sales on Prime Day, July was a blockbuster month for retail sales with the biggest monthly increase since January.

What's interesting is that strong retail sales occurred as real disposable personal income (DPI) declined 0.2% in July.

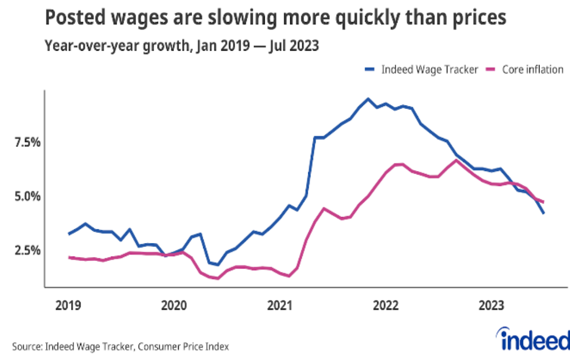
It appears that the shopping spree was a function of Americans tapping into their savings. In fact, the U.S. household savings rate collapsed by a whopping 0.8% from 4.3% to 3.5% — the biggest one-month drop since the start of 2022. In dollar terms, the total amount of personal savings collapsed by almost $150 billion from $852 billion to $706 billion with a seasonally adjusted annual rate (SAAR). This is the biggest one month drop since January 2022.



Worse, this rapid savings depletion comes at a time when the "excess savings" from the post-COVID-19 stimmy bonanza, all $2.1 trillion of them, have finally been depleted.

It is not just lower saving rates, but other measures of consumer stress are worsening — higher borrowing and more delinquencies.

Finally, despite all the hype in some headline union wage settlements, the reality is that labor cost growth is slowing down. See the graph below.



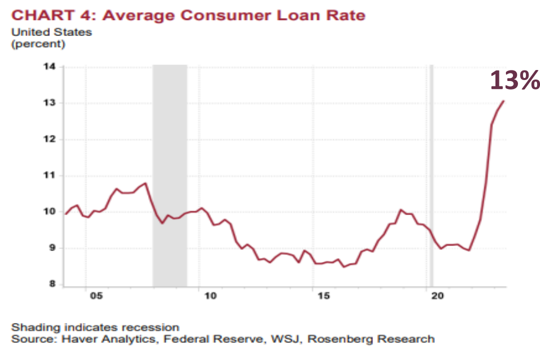
Bottom line: I keep expecting real consumer spending growth to slow more than it has but so far it is holding up remarkably well. The bigger problem going forward is that it is not just lower saving rates, but other measures of consumer stress are worsening like higher borrowing costs and more delinquencies.

Moreover, once consumers realize they have to spend several hundred dollars each month on their student loans, which are again due and payable, the aggregate data will then show a material slowdown in consumer spending.

INTEREST RATE CRUNCH

According to today's Wall Street economists and many CNBC pundits, interest rates don't matter. But they do.

Take a look at the chart below courtesy of Rosenberg Research. The average interest rate on credit cards, mortgages, auto loans and personal loans has jumped almost 400 basis points to over 13%!



This is a big deal because many big-ticket items require credit. Thus, these sharply higher rates will impinge on consumer spending.

Bottom line: Fiscal policy and Taylor Swift, as powerful pro-growth forces as they may be, are no match for the two most important words in economics and finance: interest rates. The economy is so debt-laden that these borrowing cost levels will not be maintained. Something is going to break and the regional bank failures earlier this year were very much the proverbial "canary in the coalmine."

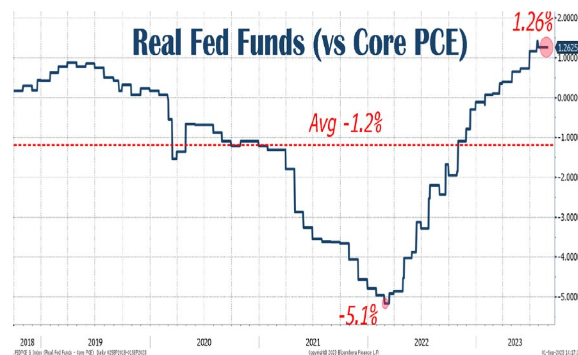
MARKET OUTLOOK AND PORTFOLIO STRATEGY

"Where we part ways (materially) is just how much pain will be administered in the months and quarters ahead, as the weight of higher interest rates falls squarely on the shoulders of a tapped-out economy."
— Daryl Jones, Hedgeye, Director of Research

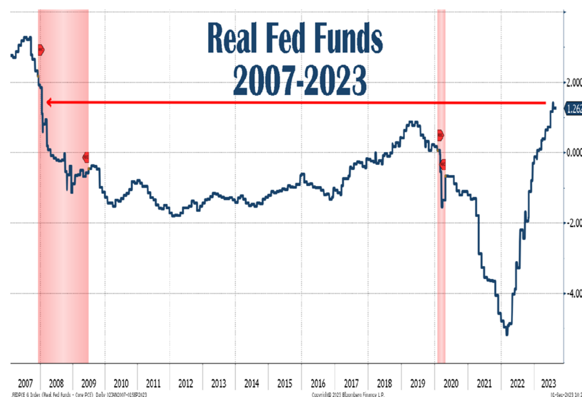
The American consumer will be heading into the fourth quarter free of all stimulus. In the meantime, the Fed is likely underestimating the lagging impact of their tightening program in the future and has set the table for a major event in the credit markets.

The "real" fed funds rate, using core Personal Consumption Expenditures (PCE), has swung dramatically from -5.1% to +2% currently**.**

Further, the last time real interest rates were so far above the Fed's own estimate of neutral (0.5%), we were already knee-deep in the 2008-2009 recession.



This is precisely where it was in September 2007, January 2001 and August 1990. For the record, these were periods when we were heading into recession or already there.



But everyone is convinced that there will not be a recession and that complacency is unsettling. And dangerous.

In terms of portfolio strategy, for those credit unions that have excess liquidity, the most prudent approach is to continue building a risk appropriate ladder strategy of high-quality securities.

MORE INFORMATION

For more information about credit union investment strategy, portfolio allocation and security selection, please contact the author at tom.slefinger@alloyacorp.org or (800) 782-2431, ext. 2753.

Tom Slefinger, Senior Vice President, Director of Institutional Fixed Income Sales, and Registered Representative of ISI has more than 40 years of fixed income portfolio management experience. He has developed and successfully managed various high profile domestic and global fixed income mutual funds. Tom has extensive expertise in trading and managing virtually all types of domestic and foreign fixed income securities, foreign exchange and derivatives in institutional environments.

At Alloya Investment Services, Tom is responsible for developing and managing operations associated with institutional fixed income sales. In addition to providing strategic direction, Tom is heavily involved in analyzing portfolios, developing investment portfolio strategies and identifying appropriate sectors and securities with the goal of optimizing investment portfolio performance at the credit union level.

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