alloya INVESTMENT SERVICES

Weekly Relative Value

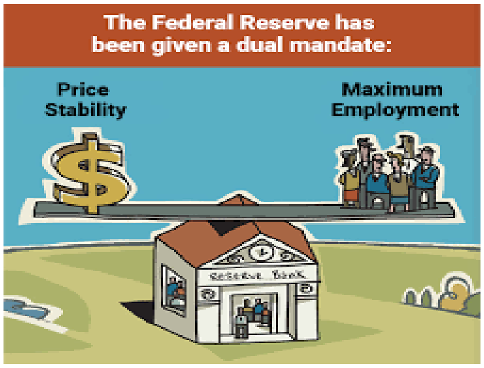
Tom Slefinger
Market Strategist

WEEK OF DECEMBER 9, 2024

The Job Straw Stirs the Fed

***"The downside risks appear to be less in the labor market**, growth is definitely stronger than we thought, and inflation is coming a little higher. So, the good news is that we can afford to be a little more cautious as we try to find neutral."- Jerome Powell, Chairman, Federal Reserve*

The Fed has a dual mandate to maintain "*price stability*" and *"full employment."*



Source: Georgia Public Broadcasting

Regarding *"price stability,"* sometimes Federal Open Market Committee (FOMC) members believe the risk to inflation is to the *upside* while other times they believe their outlook on inflation is to the *downside.* Historical tendencies show that FOMC members have a balanced view on the outlook for inflation.

This is a sharp contrast to their views on the unemployment rate. The historical tendencies show that number of FOMC members who are more worried about rising unemployment is always much higher than the number of FOMC members who think the risk to their unemployment rate forecast is to the downside. In other words, the Fed has a very asymmetrical view on its dual mandate, putting greater importance on low unemployment than on getting inflation to stay at 2%.

This is why: The strength of the job market is arguably the most important measure of the current health of a consumer driven economy. Strong labor demand, through rising employment and wages, reinforces consumption and economic growth.

THIS WEEK

- JOLTED AGAIN
- SOARING LAYOFFS AND SLUMPING HIRINGS
- PRIVATE JOB GROWTH SLOWS
- COOLING BUT NOT CONTRACTING
- MANUFACTURING REMAINS IN RECESSION
- SERVICE SECTOR SHOWS DECLINING MOMENTUM
- MARKET OUTLOOK AND PORTFOLIO STRATEGY

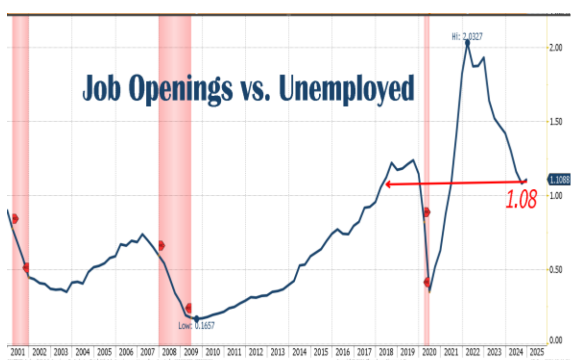
Because of the importance of job strength, the state of the labor markets, even with inflation above 2%, may well be the key to forthcoming monetary policy decisions.

With that said, in the following pages I review the key labor reports released last week.

JOLTED AGAIN

First up, the Bureau of Labor Statistics (BLS) Job Openings and Labor Turnover Survey (JOLTS), an important indicator of labor demand, showed a surprisingly strong rebound in job openings — soaring by a whopping 372,000, to 7.744 million. Even so, the +372,000 surge in October failed to offset the -489,000 plunge in September, and openings are still down -10.8%, or by -941,000, over the past year. Moreover, since the environment at the peak of the pandemic,, job openings have fallen by nearly five million.

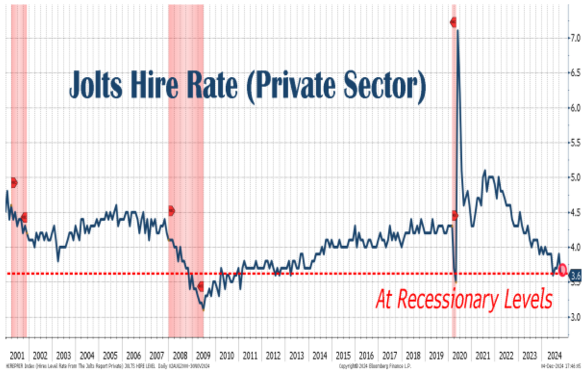
The following graph shows that the job openings are now in balance with the level of unemployed Americans. There are 1.1 job openings for every person counted as unemployed. In other words, the labor market has "normalized" back to pre-pandemic levels.



Interestingly, while the job openings surge was a surprising reversal, the number of hires tumbled -269,000 in October from 5.582 million to 5.313 million, a new post-pandemic low. U.S. hires (private companies) as a share of employment have dropped to 3.6%, the LOWEST since the 2020 pandemic CRISIS. Over the last three years, the hiring rate has declined by 1.3 %, the biggest decline on record.

I should also point out that all geographical regions were down, so this was not just a hurricane story.

In effect, the hiring rate has been below the pre-pandemic average of 4.5% for 14 straight months. This also puts the hiring rate significantly below the 2001 recession levels. Outside of the pandemic, we are now seeing the biggest drop in the hiring rate since 2008.



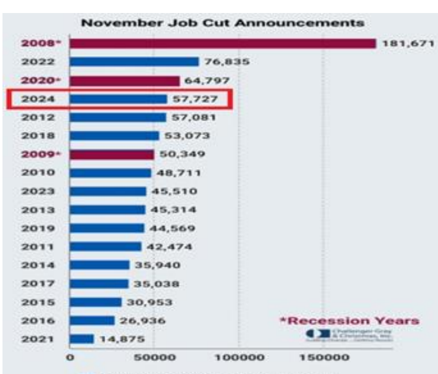
While hirings are on their way down, the number of firings remains at rock bottom levels as companies continue to hoard labor. Layoffs plunged -169,000 in the sharpest falloff since April 2023 to a four-month low of 1.633 million.

Bottom line: Slow to hire and slow to fire continues. That said, the key takeaway from the JOLTS report is that while firings may be down -20,000, hirings are down a multiple of that at -501,000, and openings are down a whopping -941,000. This trio of data reveals a labor market that is visibly cooling off.

Finally, as a friendly reminder, no matter what the "data" shows, let's not forget that it is all just “estimated.” As the BLS itself admits, while the response rate to most of its various labor (and other) surveys has collapsed in recent years, nothing is as bad as the JOLTS report where the actual response rate remains near a record low 33%. In other words, some 70% of this report is guesswork.

SOARING LAYOFFS AND SLUMPING HIRINGS

Moving on. Challenger, Gray and Christmas, the largest outplacement firm in the country, is having a banner year. According to the latest report, layoff announcements surged +26.8% (57,727 pink slips) in November. Year-to-date there have been 722,566 job cuts, the largest amount since the 2009 Financial Crisis, excluding the 2020 pandemic crisis.



Some of the sectors with the sharpest increase in layoff announcements over the past year included automotive, construction, consumer products, energy, technology, media, electronics and leisure/hospitality. Call it a wave.

When drilling deeper into the data, here are a few takeaways:

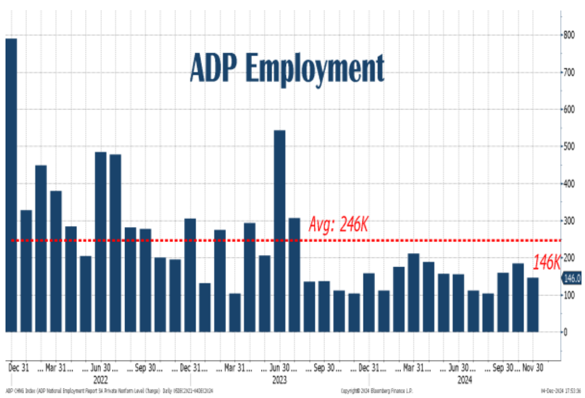
- Layoffs due to bankruptcy surged more than tenfold to 3,011.
- Layoffs due to business closings also more than doubled from a year ago to 16,288.
- Layoffs owing to consolidation/restructuring nearly doubled to 7,619.

In total, more than half the layoffs in November came from these sources, which reflect the true state of affairs of the economy.

Bottom line: The mantra from Powell is how great the labor market is doing! Not according to this data series. In no way does this report confirm the “strong labor market” narrative espoused by Wall Street and the Fed**.**

PRIVATE JOB GROWTH SLOWS

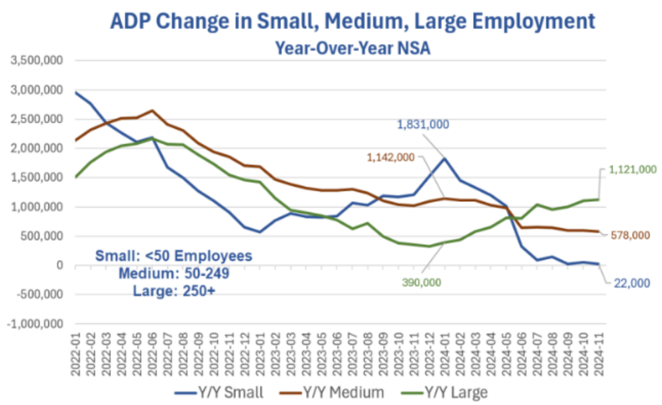
The ADP payroll report (private jobs only) continued to indicate a gradual cooling off of the labor market. In November, private jobs rose 146,000, which was below consensus. Not only that, but there was a sharp downward revision to October’s headline, to a +184,000 advance instead of +233,000.



While overall growth for the month was healthy, industry performance was mixed. Manufacturing was the weakest since spring. Financial services and leisure and hospitality were also soft.

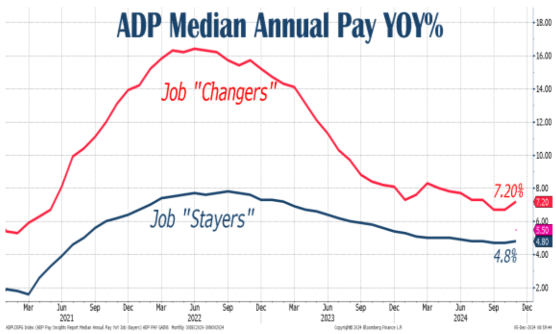
The report also highlighted the weakness in the small business community.

- Year-over-year employment in small businesses (blue line) employment is down from 1.8 million in January to a mere 22,000 in November.
- Medium-sized firms (red line) have seen employment decline from 1.1 million to 578,000.
- On the other hand, large businesses (green line) saw jobs rise by +860,000.



Simply put, small businesses, the backbone of the U.S. economy, which employ 43% of total employees show that labor growth has stalled. This may be yet another factor as to why Trump won the election.

On the wage front, the year-over-year trend in wages for "job-stayers" ticked higher for the first time since September 2022 to +4.8% from +4.7% while the pace among "job-changers" jumped to a three-month high of +7.2% from +6.7%. That was the first acceleration since last March.



Bottom line: ADP data continues to indicate a gradual cooling off of the private labor market. Notably the small business community is in a world of hurt.

COOLING BUT NOT CONTRACTING

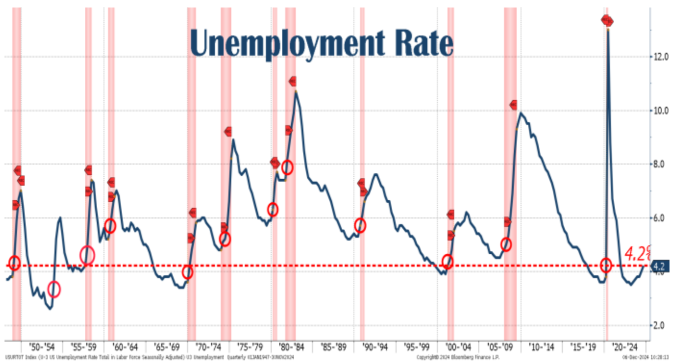
"Something else is going on last month other than storms and strikes."
- Anna Wong, Bloomberg, Economist

The final labor report for the week (and for the year) was the closely followed November non-farm payroll report (aka Establishment Survey), which is a survey of large employers and is a measure of jobs — both part-time and full-time — but not of actual workers.

As widely expected, payrolls recovered smartly, coming in at +227,000. This follows October's jobs report, which showed jobs rising by ONLY by 27,000 jobs — the weakest since 2020. The rebound in November reflects swings related to the end of the Boeing strike and the hurricanes that skewed the October data.

To get a more realistic view of the labor market, one should take the two-month average, which shows a +132,000 tally. When compared to the average of +190,000 over the past twelve months, the data are consistent with a pace of job creation that is cooling but not yet contracting.

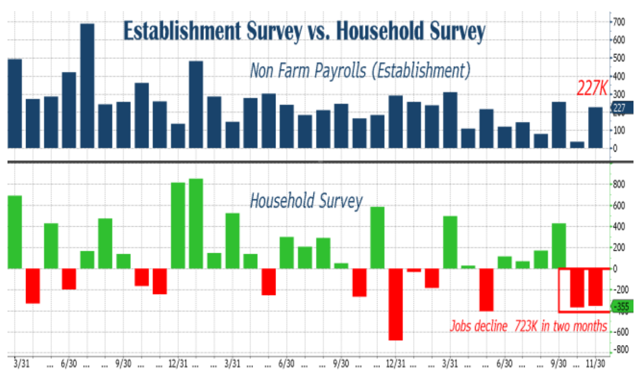
The unemployment rate ticked back up to 4.2% (4.26%) from 4.1%, and that is the Fed's long-term estimate. While still low from a historical perspective, it is the rate of change that matters the most. Since bottoming out at 3.7%, the unemployment rate has risen by .5%.



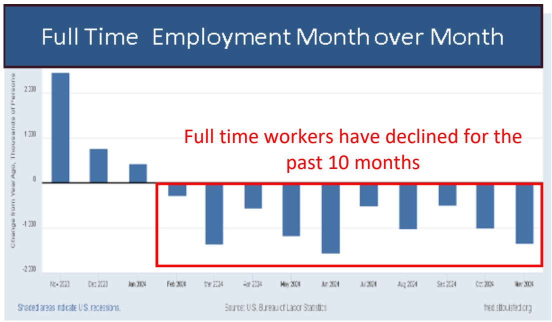
Many media outlets described this latest report as a "rebound" of sorts from October's weak numbers. Unfortunately, if we look beyond the headline establishment survey number, we don't find much evidence of a rebound at all.

According to the BLS's household survey, which measures employed workers and not jobs, we find that the total number of employed workers fell for the second month in a row.

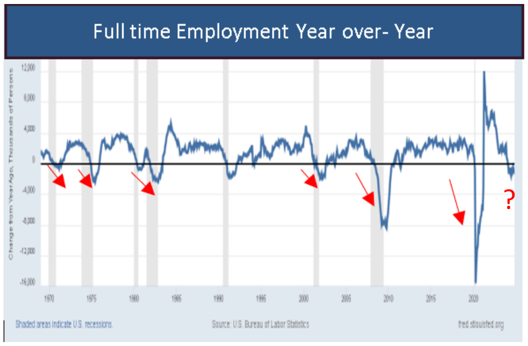
As shown below, while the Establishment reported a solid gain of 227,000 jobs, the household survey indicated much more weakness, with the number of people employed collapsing -355,000 after a -368,000 October in contraction in the worst successive performance since the spring of 2020, when the economy was in lockdown mode.



The household survey also indicated that both the full-time and part-time workers showed a notable drop, with full-time jobs dropping by 111,000 and part-time jobs down by 268,000 after declining -164,000 the prior month. In fact, over the past twelve months, the U.S. economy shed a WHOPPING 1.34 million full-time jobs.

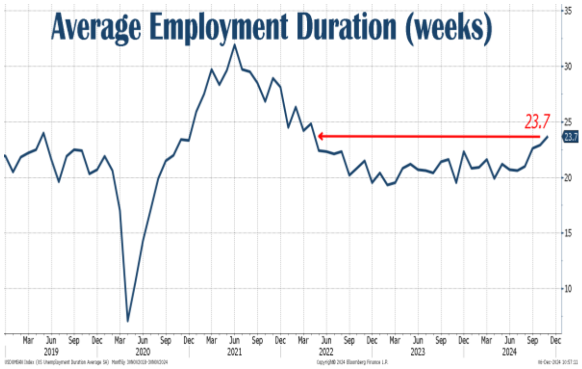


Persistent drops in full-time workers has been an indicator of impending recessions for at least 50 years. Whenever year-over-year full-time work has gone negative for three months or more (see red arrows in graph below), the U.S. has either been in recession or approaching a recession. As of November, full-time employment has been down year-over - year for ten months in a row!



There was some good news for workers as wages rose +0.4% month over month for the second month in a row. Many pundits using this data have argued that rising wages will lead to wage inflation. However, as I see it, this should not really be a source of concern, given that the share of unemployed Americans searching for a job for at least 15 weeks has jumped by approximately 8% to 40%, the highest in three years.

Meanwhile, there are now 1.6 million Americans that have been unemployed for 27+ weeks, the highest since February 2022. Thus, the competing backlog of frustrated joblessness surely is willing to take a position at a lower wage.



Finally, let's not forget the Quarterly Census of Employment and Wages (QCEW) data — the broadest employment measure. The most recent report for the second quarter slowed to just a +0.8% year-over-year rate from +2.5% a year ago and +4.5% two years ago. That is otherwise known as a growth downturn and renders the non-farm payroll report as residing somewhere between obsolete and misleading.

As I've noted previously, the QCEW shows how much the BLS birth-death adjustment is artificially stimulating the closely watched, but often-revised, non-farm payroll report, thereby providing an illusion of labor market verve. But everyone still bows down to the holy grail of non-farm payroll. Go figure.

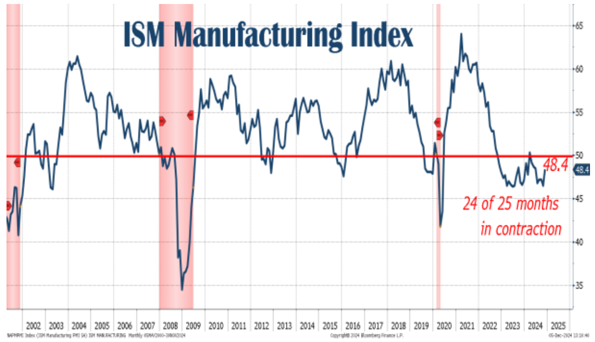
Bottom line: The incoming labor data are mixed and downright confusing. While the non-farm payroll report showed the US added +227,000 jobs in October, other metrics disagree. The household survey showed significant weakness, with the number of employed people falling by -355,000 in November. Meanwhile, the U.S. lost -111,000 full-time jobs and268,000 part-time jobs. There are now 1.7 million people in long-term unemployment, up from 1.2 million last year.

That said, when looking at all of the recent reports, it is safe to say that the labor market is weakening. As such, Fed policy, to be consistent to its mandate of full employment, will inevitably have to be calibrated to "neutral," even if a meeting is skipped here and there. If so, this means that the Fed funds rate should be closer to 3% than 4.75%.

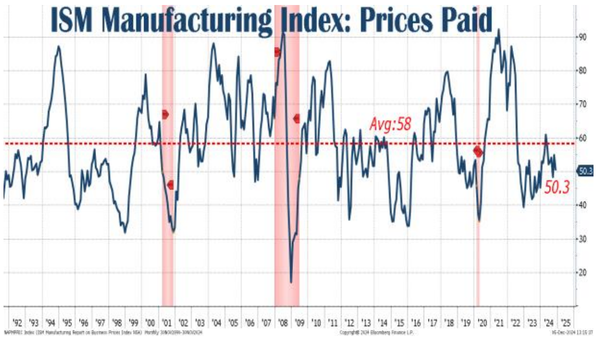
While not a lock, the Fed is very likely to cut rates on December 18 by -25 basis points. The futures market seems to have a similar read now, pricing in almost 90% odds of a December 18 rate cut.

MANUFACTURING REMAINS IN RECESSION

In other news, the Institute for Supply Management's (ISM) manufacturing Purchasing Managers' Index (PMI) came in stronger than expected in November, rising to 48.4 from 46.5 in October and beating the consensus estimate of 47.5. Unfortunately, that is the only positive thing about this report. After all, this is the eighth consecutive month that manufacturers have reported a contraction in economic activity (a score below 50.0) and the twenty-fourth time in the last 25 months. The manufacturing sector has yet to find its way out of its prolonged recession.

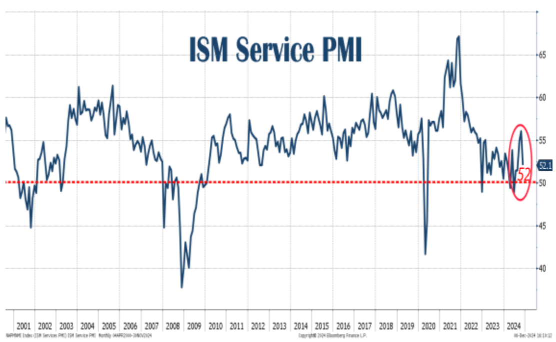


The prices index fell from 54.8 in October to an essentially flat 50.3 in November (the long-run average back to 1990 consistent with 2% inflation is 58). With price pressures staying neutral, bond markets should be encouraged by this report.

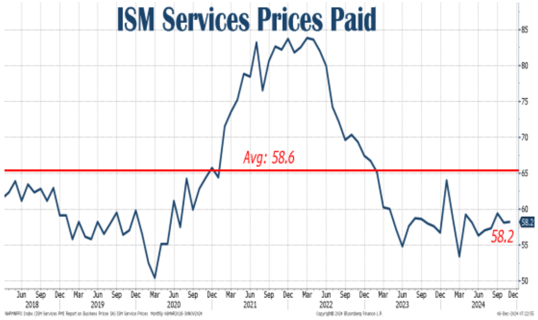


SERVICE SECTOR SHOWS DECLINING MOMENTUM

The ISM services' PMI fell hard to 52.1 from 56.0 in October, a three-month low and the biggest falloff since last June.



The pressure points on inflation slowed nicely as the prices' paid index was fairly steady at 58.2 (It kicked off the year at 64.0, by way of comparison).



Bottom line: The service sector is visibly slowing while price pressures are abating. Another positive development for the bond market.

MARKET OUTLOOK AND PORTFOLIO STRATEGY

"Employment levels were flat or up only slightly across Districts."

"Hiring activity was subdued as worker turnover remained low and few firms reported increasing their headcount."

"Contacts indicated they expected employment to remain steady or rise slightly over the next year, but many were cautious in their optimism about any pickup in hiring activity."

— Fed Beige Book, December 4, 2024

I find it extremely interesting and disingenuous to have heard Powell describe the U.S. economy as "strong" last Wednesday when the Beige Book used the words "weak," "modest" or "slight" to describe the macro economy 146 times.

A question for the Fed Chairman is why bother spending the time, money and resources on the Beige Book (a 51-page document, no less!) if you're not even going to listen to it?

That said, I was unimpressed with the latest rounds of economic data from last week. The JOLTS data show hirings on a notable downtrend. The ADP report showed acute job weakness in the key small-business sector. The ISM services' PMI was quite soft, and the pressure points on inflation receded. And the Beige Book, as noted above, revealed a softening underbelly for the labor market, with wage growth receding and the wage outlook also under some downward pressure.

And lo and behold, I'm not the only one noticing. The Citi Economic Surprise Index is starting to roll over and is now well off the mid-November peak and down to the lowest level since October 25. Ironically, the data is starting to disappoint just as the consensus buys into the "resilient" economy narrative and talk of a Fed pause is on the rise.

As I see it, incoming data paints a picture of cooling labor markets and moderating underlying inflation. Barring an ugly Consumer Price Index release this week, the Fed is likely to cut at the December meeting and signal further gradual cuts ahead.

Indeed, the U.S. bond markets posted another weekly gain, with the 10-year yield falling -2 basis points to end the week at 4.15% — now 29 basis points below the post-election peak.

The reason why the Treasury market has behaved well of late is because the futures market is back to pricing in three rate cuts next year from two just a week ago — odds of a 25-basis point cut on December 18 are now up to 87% from 70% prior to Friday's jobs data. The futures market is now pricing in a year-end 2025 federal funds rate of 3.70%.

Bottom line: While my concern over the Fed's reaction function with respect to Trump's tariff and immigration policies has not totally abated, a cloud or two has started to part. Trump's picks for key economic positions (especially regarding trade policy) have me, at the margin, less concerned than I was a few weeks back.

In terms of portfolio strategy, continue to maintain a risk-appropriate ladder strategy while capitalizing on periodic sell offs.

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 (630) 276-2753.

As Alloya's Market Strategist, **Tom Slefinger** leverages nearly 40 years of investment strategy expertise to deliver insightful commentary on the economy and market events to optimize balance sheet performance at the credit union level. With thousands of subscribers, Tom's daily and weekly publications are widely read amongst credit union executives.

Prior to becoming the corporate's Market Strategist, Tom served as the Senior Vice President of Institutional Fixed Income Sales at Alloya Investment Services, a division of Alloya Solutions, LLC. In this role, Tom developed and managed operations associated with institutional fixed income sales in addition to developing investment portfolio strategies, identifying appropriate sectors and securities, and optimizing portfolio performance at the credit union level.

Tom holds a B.S. in business administration from the University of Maine. In addition, he holds a Series 7 and 63 through ISI.