

Interpreting Labor Market Signals

MACRO INSIGHTS - AUGUST 2024

KEY TAKEAWAYS

- > Investors have a lot to digest following the early August market selloff
- > To obtain a better read on recession odds, our view is investors should pay more attention to the labor market and less on the day-to-day swings in interest rate expectations
- > We break down our favored employment indicators in this paper; our general takeaway is the labor market to this point has been normalizing off historically strong levels; an economic soft landing is our base case, but with some downside risk to employment

The market narrative on the US economy has quickly changed to a hard landing, driven by a weaker-than-expected employment report and market softness in countries such as Japan.¹ It strikes us that economic weakness to this point is exactly what a soft landing would look like – slowly decelerating economic growth instead of rapidly deteriorating and negative data points. There also appeared to be a technical aspect to the early August market selloff, specifically with respect to the unwinding of global carry trades.²

Calls for an inter-meeting interest rate cut from the Federal Reserve (Fed) seem premature and inconsistent with the current economic outlook, considering such cuts historically occurred during periods of much greater stress – COVID, Global Financial Crisis, etc. Fed Funds futures are now pricing in 100 bps in rate cuts over the last three meetings of 2024, including a 50-bp cut in September.³ We believe the bar for a 50-bp cut is quite high, given the still constructive economic backdrop. Our view is that the Fed would only engage in a more aggressive easing cycle if growth were to collapse.

As fundamentally-driven investors, we prefer to stay away from macro predictions that can change from day-to-day and invest in bonds on a bottom-up basis. This said, we are cognizant that the Fed's rate decisions are of significant importance to US fixed income investors. Lower rates have historically driven [positive total returns](#) in bonds while volatility can create opportunity to generate alpha for clients. Near indiscriminate de-risking is exactly the type of situation in which rigorous analysis and bond picking can make a material difference to returns on our clients' portfolios.

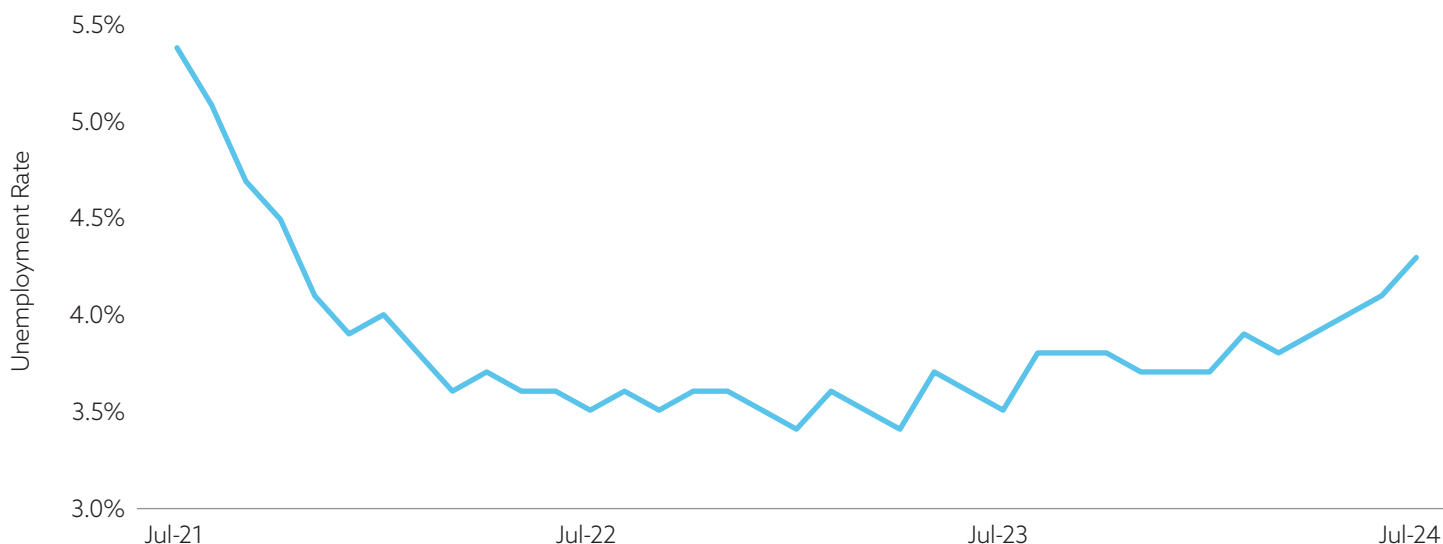
For the US economy, the state of the labor market may play a key role in determining if there could be a recession. Consumer spending [has driven economic growth](#) post-COVID, and employment is crucial to continued strength in consumer spending. Unfortunately, there is a plethora of data on the labor market that often sends mixed signals to investors.

To distill some of these signals, we present below what we believe to be some of the more insightful indicators. Our general takeaway is that employment has been normalizing off historically strong levels and an economic soft landing remains our base case. Although the labor market could weaken more significantly from here, the data do not yet point to a more problematic deterioration.

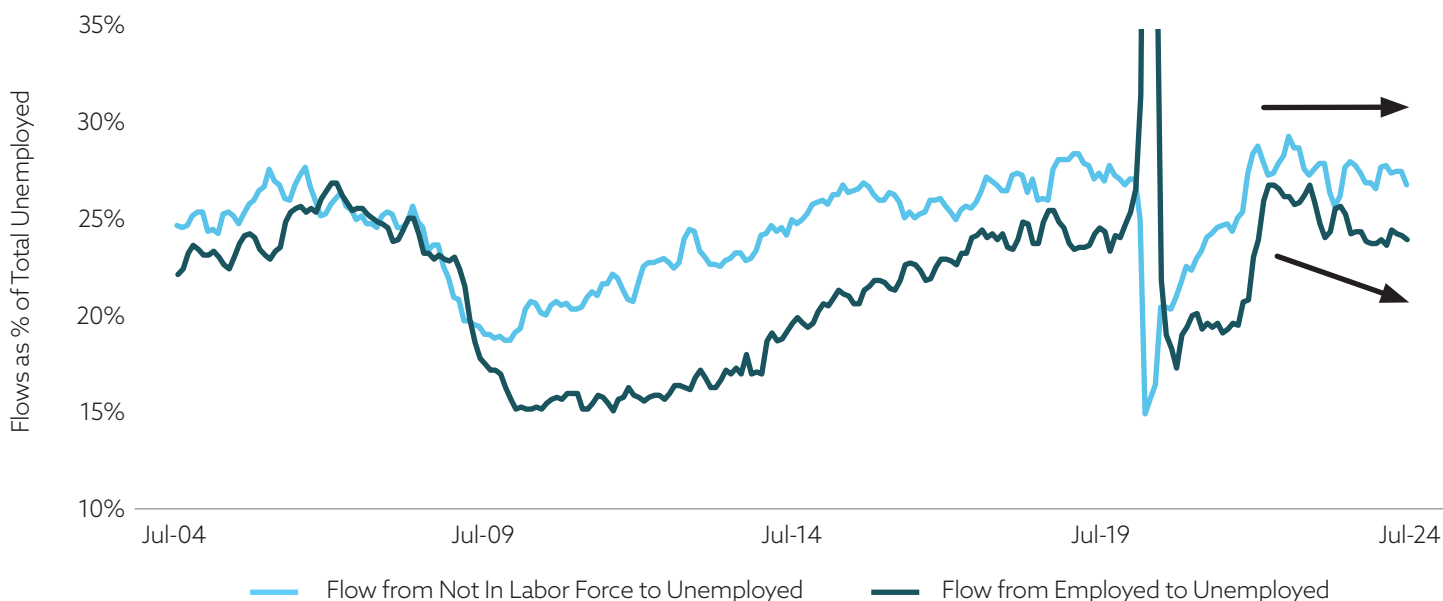
(1) As of 13 August 2024. Unless otherwise stated, the information presented has been prepared from market observations and other sources believed in good faith to be reliable. Information and opinions expressed by PPM are current as of the date indicated and are subject to change without notice. Past performance is no guarantee of future results. Forward-looking statements are subject to uncertainties that could cause actual developments and results to differ materially from the expectations expressed. (2) WSJ. "What Is the Yen Carry Trade?" 5 August 2024. (3) Bloomberg. 6 August 2024.

The unemployment rate has risen, but off a record low. The Sahm rule has also crossed its 0.5% threshold, implying an upcoming recession, but we feel the market is unduly focused on the Sahm rule.⁴ Chair Powell even called it a "statistical regularity" in his most recent press conference, and not an "economic rule."⁵ Furthermore, the spike in immigration in recent years appears to be at least partially responsible for the uptick. The percentage of workers moving from employed to unemployed have actually decreased since the beginning of last year. Meanwhile, the percentage of workers not in the labor force moving to unemployed has not decreased. That is an important concept, because people losing jobs represent a loss of income/consumption to the economy, but flows from workers not in the labor force to unemployed do not.⁶

UNEMPLOYMENT RATE NORMALIZING OFF A RECORD LOW⁷



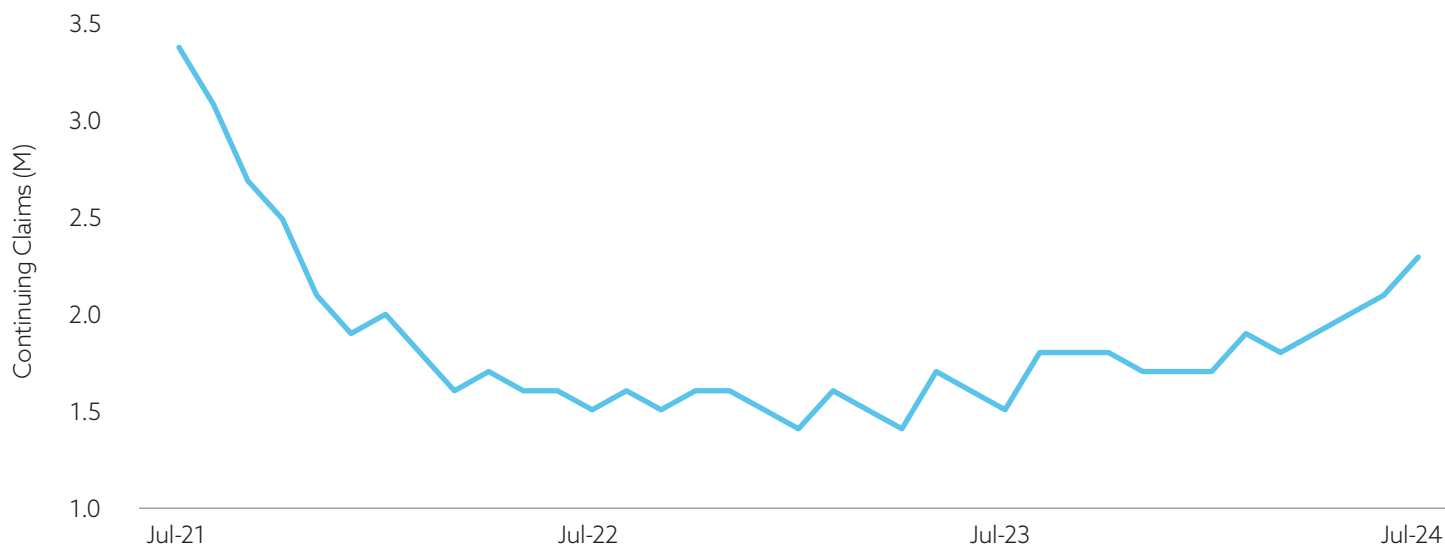
IMMIGRATION ONE DRIVER OF RECENT UNEMPLOYMENT RISE⁷



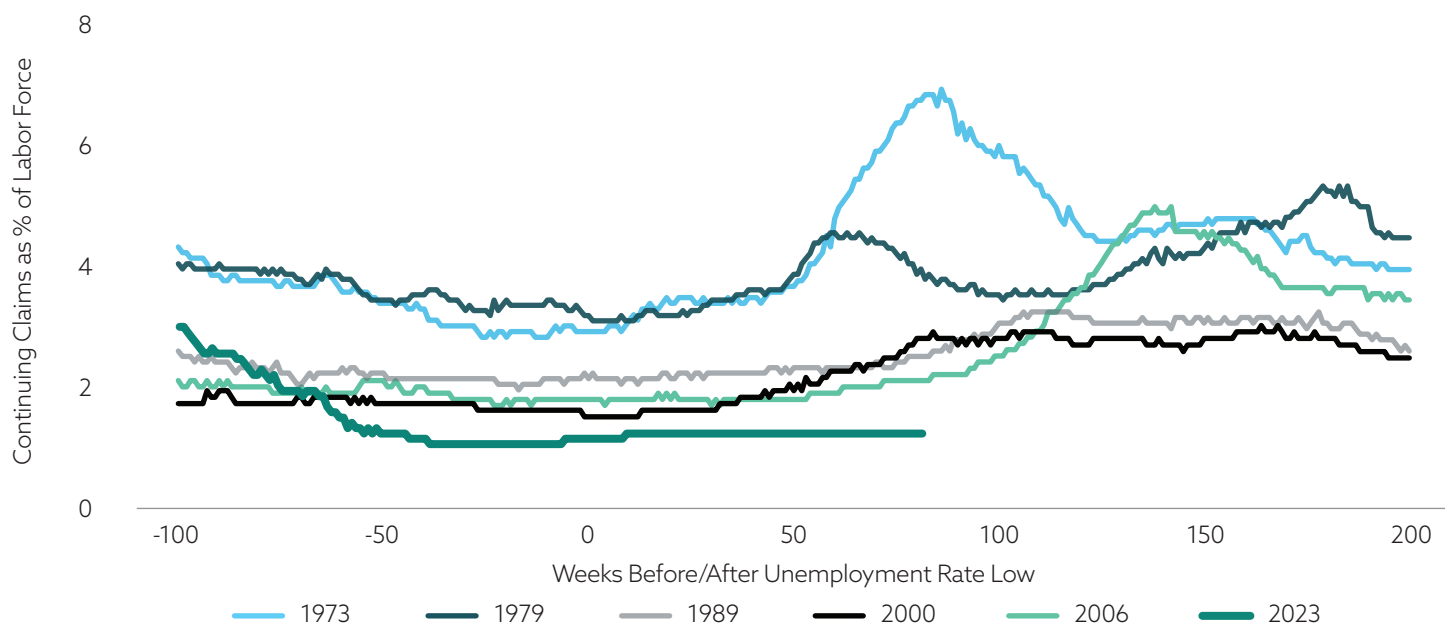
(4) Per the St. Louis Fed, "The Sahm Rule identifies signals related to the start of a recession when the three-month moving average of the national unemployment rate (U3) rises by 0.50 percentage points or more relative to its low during the previous 12 months." (5) Federal Reserve. 31 July 2024. (6) RBC Capital Markets. "Some Labor Dynamics at Play – Where Does the Pendulum Swing?" 18 July 2024. (7) FactSet. Monthly data through July 2024.

With respect to continuing claims for unemployment insurance, this data point has also risen, hitting a recent high. However, taking continuing claims as a percentage of the labor force shows a smaller uptick. Comparing that percentage to the five most recent bottoms in the unemployment rate shows that the trajectory this cycle is currently different compared to those prior periods that preceded recessions.

CONTINUING JOBLESS CLAIMS ALSO NORMALIZING⁸



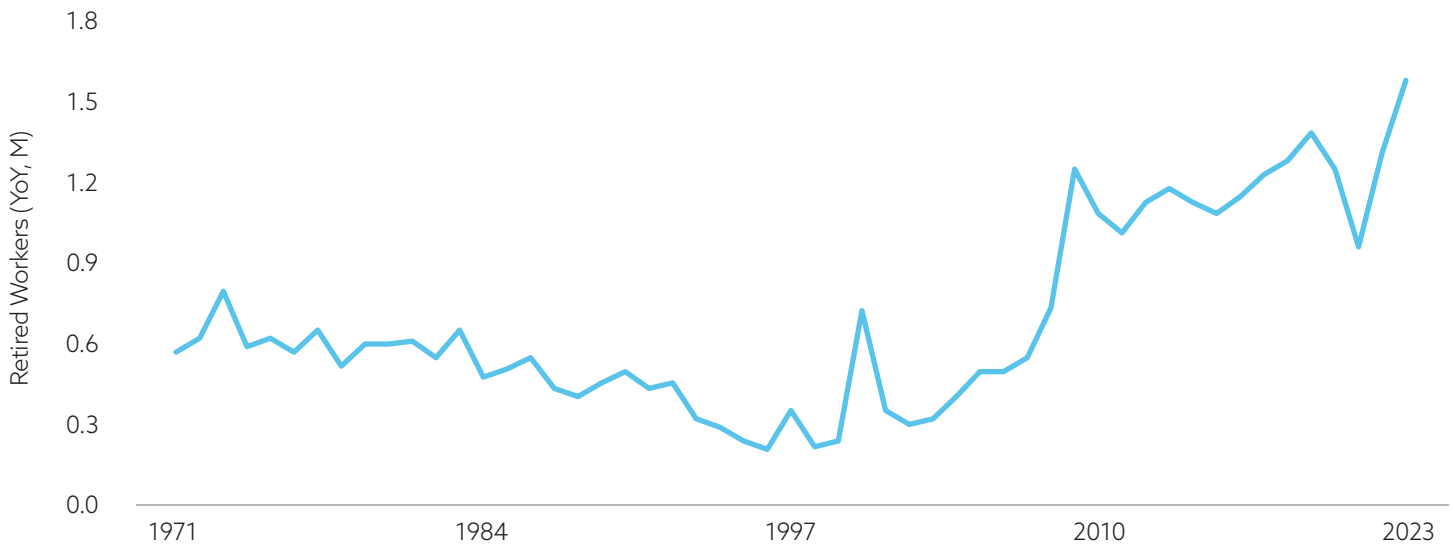
CONTINUING CLAIMS NOT INCREASING IN-LINE WITH RECENT CYCLES⁹



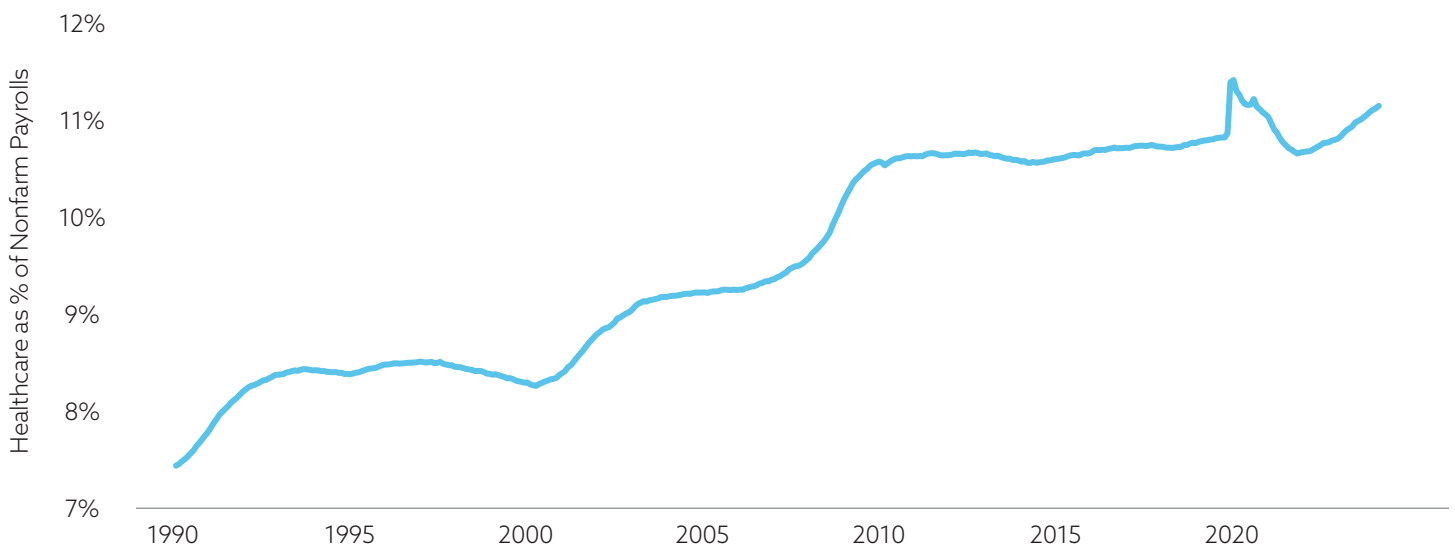
(8) FactSet. Monthly data through July 2024. (9) FactSet. Monthly data through July 2024. Continuing claims as a percentage of labor force comes from the ratio of unemployment insurance claimants to total number of workers.

There is a demographic component to today's labor market. The Baby Boomer generation is moving further into retirement age, leading to the largest increase on record in the number of retired workers.¹⁰ A demand effect may be created, as companies try to fill vacated roles. It is important to point out that this trend can occur even as job openings decline overall (job openings are also normalizing post-COVID). Related to the retiree trend is healthcare, a sector that has steadily increased as a percentage of the labor force and could continue to do so as the retiree rate climbs.

RECORD RETIRED WORKERS COULD CREATE REPLACEMENT DEMAND¹⁰



RETIRING BABY BOOMERS MAY EXPLAIN GAINS IN HEALTHCARE JOBS¹¹



(10) Social Security Administration. Annual data through 2023. (11) FactSet. Monthly data through July 2024.

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