Capital markets perspective

Index/ Security	Asset class	Level (close)	% Change (Friday close) 1 WK.	YTD	Index/ Security	Asset class	Level (close)	% Change (Friday close) 1 WK.	YTD
Dow Industrials	Lg. Cap Eq.	33,390.97	1.75%	0.83%	FTSE 100	UK Equity	7,947.11	0.87%	6.65%
S&P 500®	Lg. Cap Eq.	4,045.64	1.90%	5.37%	Nikkei 225	Japan Equity	27,927.47	1.73%	7.02%
NASDAQ Comp.	US Equity	11,689.01	2.58%	11.68%	EEM:US	Emkt. Equity	$39.54	3.24%	4.33%
S&P Midcap 400©	Mid-Cap Equity	2,684.27	3.21%	10.45%	EFA:US	Non-US Equity	$70.88	2.67%	7.89%
Russell 2000®	Sm. Cap Eq.	1,928.26	2.00%	9.48%	UST 10y (yield)	US Treasury	3.96%	+0.01%	0.08%
Stoxx 50	Europe Eq.	4,294.80	2.78%	13.21%	Bloomberg U.S. AGG	Fixed Inc.	2,054.52	0.12%	0.28%

Suddenly, I'm not feeling so good.

I've said that line plenty of times. Usually it's after eating something that's been in the fridge too long, or maybe after a long ride in a hot car over twisty roads, or – and I'll bet some of you have had this same experience, too – **after celebrating a little too hard the night before**.

Pity the poor US consumer, because it's starting to look like that's exactly the situation they find themselves in today: after a long binge on stimulus-fueled liquidity, they may finally be starting to feel the impacts of the long-feared **post-pandemic hangover.** Take this sampling of comments from last week's long list of retailer earnings calls as evidence[1]: "**higher income consumers are trading down**" (Dollar Tree,) "consumers are more cautious" and "**wary of a recession** in the short-term" (Lowe's) and "elevated inflation is **beginning to impact or lower- and middle-income consumer**" (Ross). I could go on.

When all (or least most) of the executive teams in a sector seem to be saying the same thing, they're probably trying to tell you something. When that sector is retail, it's pretty easy to read between the lines: **January's big surge in retail spending might well have been the last gasp of a post-COVID party that probably went on too long in the first place**.

And it wasn't just the worried musings of a cabal of merchandising tycoons that drove the point home last week, either – it also showed up in the numbers. Take for example Tuesday's update on **consumer confidence** from the Conference Board[2]: the expectations component of that closely-watched survey deteriorated further and is now **unambiguously signaling recession**. Anecdotally, that same survey also showed that consumers are suddenly a little less likely to do things like buy dishwashers, splurge on a new car, or take the family to Fiji.

In the bungled-up, shook up world that is economics, **that should represent *good* news** for the simple reason that it shows all this tightening by the Federal Reserve is finally reaching down into the spending habits of Mr. and Mrs. America. That, in turn,

[1] Company reports, Zacks.com, Bloomberg
[2] https://www.conference-board.org/topics/consumer-confidence

should **help keep inflation at bay** by at least partially removing the "demand impulse" that helped ignite the inflationary flames in the first place. But as pretty much all of the inflation data released in February suggests, these things take time, and we're **still a long way away from the point at which anyone – certainly not the Fed – should be comfortable**.

Besides, the aforementioned "demand impulse" is only half the inflation equation (at best.) These days, **inflation seems to be coming from an altogether different place** than the double-whammy of supply- and demand-side shocks that accompanied the pandemic and caused prices to bloat so horribly in its immediate aftermath. Where, you might ask, is that pressure coming from? Well, **wages** are as good a candidate as any.

With the labor market so strained (more evidence of that last week in the form of still-too-low jobless claims[3] and an improvement in the jobs easy/jobs hard to get ratio in the Conference Board's survey discussed above[4]), it should surprise no one that **wages are now beginning to catch up to prices**. Maybe it *shouldn't* surprise anyone, but apparently it *did*: the Bureau of Labor Statistics' most recent update of unit labor costs and productivity showed that **labor costs rose** at 3.2% during the fourth quarter – **almost exactly twice the rate economists had expected**.

Now, skeptics will point out that unit costs are a less-than-perfect way to measure wage pressures, and they're right (not least of which because there *is* no perfect way to measure wage pressures.) But the fact that **wages may finally be taking the inflationary baton away from COVID-inspired supply chain stress and stimulus-fueled consumption** at this stage in the race has a nice, logical feel of inevitability to it: labor, like any market, is beholden to supply and demand. When demand outstrips supply, prices will eventually rise until balance is restored. Why is that only just happening now? Well, like virtually every important relationship in economics, there is a "variable and uncertain lag" between cause and effect. After all, there aren't too many people (*employed* people, anyway,) that are bold enough to storm into their boss's office and shout "hey, man, I just paid $8 bucks for a dozen eggs…you need to give me a raise." But eventually, the boss figures that out for herself and decides that it might be wise to start inflating a few paychecks or risk having to reach out into the impossibly tight labor market to replace a few disgruntled workers.

If that's truly where we're at in this cycle, it represents a tipping point. To recap: the consumer seems to be slowing, and that's mostly a good thing. But wages probably aren't, and that's a bad thing, because it means **inflation may be entering an even more dangerous phase that could become self-reinforcing**. For example, two of the more troubling anecdotes in last week's final Purchasing Manager's Index (PMI) data was an expansion in employment within both the manufacturing- and services sectors, together with word that selling prices for services reaccelerated last month as companies sought to defend profitability amid rising wages and costs[5,6]. If Chairman Powell is truly on watch for "sticky" inflation, this might be where he finds it.

So what it probably comes down to is this: the labor market has to chill, or we risk going down a rabbit hole where the Fed has no choice to tighten rates until the economy squeals. That puts even more emphasis on this week's marquee release, Friday's labor situation report, where we'll get the latest read on all sorts of things that matter a lot right now: the unemployment rate, payroll growth, hourly earnings, and the willingness of people to engage with the labor market.

It always feels a little weird to say this, but probably the best thing we could hope for when this week's jobs reports roll in is a little more pain in the labor market.

[3] https://www.dol.gov
[4] Ibid.
[5] https://www.pmi.spglobal.com/Public/Home/PressRelease/f982d001dbbe4b4daec4f54d2260874e
[6] https://www.pmi.spglobal.com/Public/Home/PressRelease/e608e2be35cd44799c677b56b2d976fa

What to watch this week

Economic Events, March 6th – 10th

Monday: Factory orders
Tuesday: Powell Congressional Testimony (Senate)
Wednesday: Powell testimony (House); ADP payrolls, JOLTS
Thursday: Challenger job cuts, weekly jobless claims
Friday: Employment situation report.

Jobs, jobs, jobs.

I vaguely remember that being a campaign slogan for one presidential candidate or another when I was just a young 'un (maybe George H.W. Bush?) Although as pointed out above, **the hope for most thoughtful economists is for a significant moderation in the still historically tight market for jobs** – not exactly the kind of thing that makes for great campaigning. Anyway, jobs are what matter most to the economy right now, and jobs are what will set the tone this week.

As always, the monthly jobs data dump starts on **Wednesday**, when payroll processor **ADP** releases its estimate of payroll growth. We'll also get the Job Openings, Leaving and Turnover Survey, commonly known as **JOLTS** (lately for its ability to jolt the market into action when the number of openings once again surpasses the number of workers available to fill them.) Then on **Thursday**, outplacement firm Challenger Gray and Christmas will release its **estimate of how many workers have been displaced** so far – a survey that probably doesn't get the attention it deserves, especially when the economy is teetering on the brink of change as ours currently seems to be doing.

Then on Friday comes "the big burrito" the Bureau of Labor Statistics' monthly read on all sorts of job-related stuff like the unemployment rate, payroll growth and hourly earnings. **Pay particular attention to the so-called "participation rate,"** which attempts to measure the willingness of working-age adults in the US to engage with the workforce. That figure – specifically, its inability to achieve its pre-pandemic level – has been **singled out by Chairman Powell** as one lynchpin of his staff's current view of the economy. While it's been difficult to find much to cheer about in data relating to employment trends lately, one interesting anecdote in last week's PMI reports[7] was an acceleration in hiring related to the "better availability of candidates" – a **tentative sign that the long-depressed labor participation rate might be improving**.

That's **definitely a "silver-lining" kind of argument**, because it came alongside an acceleration in employment in both sectors that's probably unwelcome in the grand scheme of things because it could continue to exert upward pressure on wages. But at this stage, we'll take what we can get (and be happy about it.)

Okay, moving on...

If **job market trends** – and specifically wage pressure and its ability to re-stoke the fires of inflation – are crucial to the market narrative right now, it's important to point out that they're **only half of the equation**. After all, what matters most to markets in the near-term isn't necessarily what's happening with payrolls or wage growth for their own sakes, but **rather how the Fed interprets (and, more importantly, *reacts*)** to them. That brings us to the second most important event on this week's calendar, Chairman **Powell's semi-annual trip to Capitol Hill** to update the Congress on monetary policy and the state of the economy. While his two-day testimony – previously known as "Humphry-Hawkins testimony" for the 1978 Act that requires it – is often a highly political affair, **Powell will likely use the stage to set (or *re*-set) expectations** about the pace, peak and

[7] Ibid.

duration of the Fed's current rate tightening campaign. **That makes it must-see TV for anyone interested in where markets might trend in the near-term**.