Capital markets perspective

Index/ Security	Asset class	Level (close)	% Change (Friday close)	
			1 WK.	YTD
Dow Industrials	Lg. Cap Eq.	33,485.29	0.63%	1.11%
S&P 500®	Lg. Cap Eq.	4,105.02	-0.10%	6.92%
NASDAQ Comp.	US Equity	12,087.98	-1.10%	15.49%
S&P Midcap 400©	Mid-Cap Equity	2,447.09	-2.59%	0.69%
Russell 2000®	Sm. Cap Eq.	1,754.46	-2.66%	-0.39%
Stoxx 50	Europe Eq.	4,309.45	-0.13%	13.60%

Index/ Security	Asset class	Level (close)	% Change (Friday close)	
			1 WK.	YTD
FTSE 100	UK Equity	7,741.56	1.44%	3.89%
Nikkei 225	Japan Equity	27,472.63	-2.03%	5.28%
EEM:US	Emkt. Equity	$39.39	-0.18%	3.93%
EFA:US	Non-US Equity	71.94	0.59%	9.60%
UST 10y (yield)	US Treasury	3.31%	-0.16%	-0.57%
Bloomberg U.S. AGG	Fixed Inc.	2,132.95	1.12%	4.11%

Not cool enough.

That phrase describes my teenaged self almost perfectly, and it also goes a long way toward building context around last week's economic data: there's little doubt that **last week's labor data was refreshingly cool**. Job growth slipped to its lowest level in nearly three years, with a **relatively modest 236,000 jobs added to US payrolls** in March[1]. Meanwhile, **job openings fell below 10 million** in February, representing the first time that figure has had fewer than eight digits since the Spring of 2021[2]. At the same time, the number of **layoffs** cataloged by Challenger Gray and Christmas in March rose 15% month-over-month, leaving the **year-to-date total more than three times higher than it was last year**[3]. (Weekly jobless claims rose significantly, too, but seem to have been distorted by a big change in how the Department of Labor applies its seasonal adjustment factor now that COVID-related disruptions have faded so we'll leave that one alone for now…)

In the messed-up world that is economics, **that should be good news** – primarily because the labor market has so far been stubbornly immune to the Federal Reserve's efforts to cool the economy: but if labor market indicators are finally starting to point downward in something approaching unison, it might suggest that **the Fed might finally be able to sit back and watc**h as inflation (and, unfortunately the economy, too) cool enough for the Fed to drop its alert level by a notch or two.

But how cool is cool enough? While all the above-mentioned data are evidence of progress, there are **still almost 2 jobs available for every would-be job seeker** in the US (for context, that ratio has spent most of its life below 1.0.) Meanwhile, payroll processor ADP noted last week that **compensation** may finally be decelerating, but is **still growing at nearly 7%** per year – and more than *twice* that for those who leave their current jobs for greener pastures[4]. But that still hasn't been enough to motivate some segments of the US workforce to re-engage: the workforce **participation rate remains mired in the low 60s**,

[1] https://www.bls.gov/news.release/empsit.nr0.htm
[2] https://www.bls.gov/news.release/jolts.nr0.htm
[3] https://www.challengergray.com/blog/job-cuts-rise-15-in-march-2023-up-319-from-same-month-last-year-highest-q1-since-2020/
[4] https://adp-ri-nrip-static.adp.com

having never regained its pre-COVID levels. That conundrum, as much as anything, has made the tea leaves extremely hard to read for the Fed and other market observers.

Besides, even if the labor market *is* finally starting to get the message, **getting the timing right is devilishly hard for the Fed**: the relationship between when the Fed starts tightening policy and when it begins to impact the economy is impossible to calculate with precision (Chair Powell's stock phrase for this phenomenon is that **"a large and variable lag"** exists between the implementation of monetary policy and broad macroeconomic aggregates.) And perhaps nowhere is that as true as it is with labor market data, which is often among the last species of economic data to react to the Fed's efforts.

That's why it's so always been **so easy for the Fed to "over-shoot" by tightening too much** and tipping both the economy and the labor market into recession when it might have otherwise avoided it. Even under the best/most ordinary of circumstances, it's hard for the Fed to get the timing right. But these are neither the best nor the most ordinary of circumstances: the **COVID** pandemic and efforts to minimize the damage it might otherwise have done to the global economy **created all sorts of distortions**, including once-in-a-generation inflation, the tightest job market since at least the Vietnam war, and a consumer that was made temporarily bulletproof by what will probably be remembered as probably the most generous and globally far-reaching stimulus effort in history. All that **has made the Fed's already difficult job of knowing exactly when to back off nearly impossible**, while at the same time making the risks associated with backing off before inflation is decisively defeated even more severe.

Translation? Last week's uniformly weak(er) jobs data was **probably a step in the right direction, but may not be quite cool enough to fully satisfy the Fed** just yet. Unfortunately, something else may have to break first.

But at the same time, **it's also possible to argue that Fed policy no longer matters all that much** when it comes to markets. Sure, a much-bigger-than-expected increase at the next FOMC meeting in May would probably tank markets, just like a surprise cut might spark a big rally. But it's probably safe to say that the Fed is no longer driving market sentiment in the same way it did just over a year ago when Powell & Co. first embarked on their rate-rising adventure. We've made that case in these pages before, and I think it's probably even more true now that the labor market might finally be showing signs of weakness with no sign of remorse from the Fed anywhere on the horizon.

So what *is* driving sentiment? Increasingly, it's recession. Last week's ISM and PMI data[5,6] reconfirmed that the manufacturing sector is already contracting. No surprise there, that's been true for months. New this week, though, is word that the **services sector** – a much bigger portion of overall economic activity – **might be tipping over as well**: both surveys indicated that activity in the sector plunged toward breakeven in March, perhaps removing the best chance the US economy had for avoiding an honest-to-goodness recession if trends continue to weaken[7,8].

And then there are markets themselves. A quirk of the calendar prevented investors from reacting in real-time to Friday's payrolls report (a Good Friday market closure saw to that…), but if you're the kind of person that reads anything at all into which areas of the market are doing well and which aren't, then last week's moves may have helped convince you that investors are perhaps more concerned about what happens to economic growth than anything the Fed may or may not be up to. For example, those **sectors of the large-cap equity universe** that are logically most connected to near-term economic growth (namely, industrials, consumer discretionary and materials,) sold off alongside mid- and small-caps, while sectors commonly thought to hold up better during times of weaker growth (utilities, healthcare and staples) outperformed. Add to that a persistent – and by one measure, deepening – **inversion of the US treasury curve** (thought by many to be a tell-tale sign that recession is near,) and **its not hard to imagine that the market's new obsession isn't the Fed, its recession**.

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[5] https://www.ismworld.org/supply-management-news-and-reports/reports/ism-report-on-business/pmi/march/
[6] https://www.pmi.spglobal.com/Public/Home/PressRelease/70b28232e2b943e9ba0cc7b4fe1d6ffe
[7] https://www.ismworld.org/supply-management-news-and-reports/reports/ism-report-on-business/services/march/
[8] https://www.pmi.spglobal.com/Public/Home/PressRelease/c9479e7315af4c8e98992177848e5ba1

What to watch this week

Economic Events, April 10th – 14th

Monday: *No major economic releases*
Tuesday: NFIB small business sentiment
Wednesday: CPI inflation, Atlanta Fed business inflation expectations, Fed minutes
Thursday: PPI inflation, weekly jobless claims
Friday: Retail sales, UofM consumer sentiment, industrial production, EXIM prices, financial earnings

Annnnnnnd, they're off….

First quarter earnings season begins on Friday, with **big banks** like Citigroup, JPMorgan and Wells Fargo announcing results for the March quarter on Friday morning. As usual, the first installment of big bank earnings will be followed by other big banks, alongside a handful of smaller banks, retailers, airlines, and a smattering of other macro-relevant companies, early next week. What banks say and do at the outset of the quarterly earnings derby is always relevant to the economy, but this quarter's results will be **even more closely scrutinized**: in the wake of the Silicon Valley Bank failure, markets will be **primed for any color at all that executives are willing to provide surrounding the health of the banking sector as a whole**.

Top of mind for everyone within earshot will be **whether the issues encountered by Silicon Valley might also be lurking on other balance sheets** (both big and small,) as well as any thoughts on **how the regulatory or enforcement environment might change** in its wake. Potentially even more impactful from an economic perspective will be **any indication that banks in general are pulling in their horns and becoming more conservative when extending credit** – anecdotally, there was already evidence that some degree of pullback was happening even before the regional bank issues hit newswires in anticipation of a weaker economic environment. If fallout from the Silicon Valley debacle exacerbates that or pulls it even further forward, add that to the list of things that will begin constraining economic growth in the very near future.

Beyond that, we'll get at least **three separate inflation-related releases** to chew on this week. The latest consumer price index (**CPI**) numbers are due out on Wednesday, followed by producer prices (**PPI**) on Thursday. In both cases, economists **are expecting numbers to moderate substantially** on the headline even if core prices hold in at or near current rates. Markets seem **unlikely to react violently unless the figures come in substantially different** than those estimates would imply.

But forward-looking expectations about where inflation might be headed are arguably more important than backward-looking index numbers at this stage of the cycle. Toward that end, the **business inflation expectations release from the Atlanta Fed** on Wednesday might be the better read. This high-quality survey attempts to take the inflation question one step further by asking business executives where they expect inflation to be in the future. That can provide important context by providing read-through into how likely businesses are to do things like boost prices to **defend profit margins**, as well as allowing economists to triangulate **whether or not inflationary attitudes are becoming entrenched**. If anything about this week's inflation data might be expected to change the Fed's thinking, this could be it.

Speaking of Fed thinking, the **minutes from last month's Fed meeting** will be released Wednesday afternoon. As always, the minutes provide far deeper context into what was top-of-mind for Fed policymakers during their last two-day confab than the sparse written statement or highly pressurized press conference ever could. This edition will also include discussions surrounding the once-per-quarter "**staff economic projections**" (and the now-famous "**dot-plot**") which makes it a must-read for econo-geeks.

Finally, in terms of consumer trends, Friday will bring both the mid-month update of the University of Michigan's **consumer sentiment** survey as well as March's **retail sales** report. Until recently, consumers have been **remarkably durable with their spending habits and remarkably fickle with their survey responses**. Let's see if that continues this week when consumers have a chance to express their views, both with their mouths and with their wallets.

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