To subscribe to our Newsletters www.palos.ca/register

PALOS

Macro View

Issue No. 43 | DECEMBER 11TH, 2023

CONTENTS

The Employment Situation Is Normalizing, Bringing the "Immaculate Disinflation" Narrative Alive: 1

Disclaimer & Contacts 4

By Hubert Marleau

The Employment Situation Is Normalizing, Bringing the "Immaculate Disinflation" Narrative Alive:

Fifteen years ago, macro commentaries were read by few investors, even institutional ones. Now, however, almost all economic prints have been commoditized by nerdy market strategists. Interpretations of these are pushed by high-profile investment banks to show how well informed they are; and, in turn, how they have integrated the data in their thinking to support their broadcast outlook for business activity and the financial markets.

This week was all about what was going on in the employment side of the economy. For now, there's nothing in this week's employment numbers that's inconsistent with the soft landing scenario, showing signs of cooling without falling into a recession. So far, that appears to be exactly what is happening. Nearly 1.9 million Americans have been applying for continuing unemployment benefits in recent weeks, the most in 2 years - a level that is still historically low, but approaching the pre-pandemic average. The labour market is conclusively rebalancing from pandemic extremes, helping heal the demand-supply mismatch that fuelled strong wage growth.

The Atlanta Fed GDPNow model estimate for real GDP growth in the 4th quarter of 2023 is 1.3% compared to a last 2 year 1.7% average. In fact, the Citigroup Economic Surprise index (CESI), has weakened of late, but has not fallen out of bed. The NY Fed Weekly Economic Index (WEI) - an index of 10 daily and weekly indicators of real economic activity, scaled to align with the four-quarter GDP growth rate - increased in the week of December 2nd to 2.48. This explains why the New York Fed Staff Nowcast stands at 2.3% for Q4/2023 and 2.1% for Q1/2024.

At full employment, these numbers would be considered normal. The bottom line is that equilibrium is here, which means that from hereon, conventional economic models can now be relied on to project economic outcomes. For example, the so-called Beveridge curve, which maps vacancy rates against unemployment rates, may start to move more in line with each other. (Incidentally, the NY Fed Global Supply Chain Pressure Index [GSCPI] stood at 0.11 in November, exactly where it should be, 0.00 being the norm.)

On Tuesday, the BLS reported favourable JOLTS numbers, making the soft read on job openings more difficult for forecasters to continue to believe that the labour market is too hot for the Fed to cling onto. The data itself, however, was a godsend to the "immaculate disinflation" narrative, and those who suggested labour market normalisation couldn't be outsourced to lower job openings were just plain wrong. The thing is that the need for the economy to

Macro View cont.

By Hubert Marleau

normalise the labour market through lower job openings is working out pretty well - an outcome few traditional economic models would have predicted. What’s interesting too is that layoffs are still

loitering near record lows, while quits are somewhat elevated, offering evidence that employers still want to keep their employees and that workers are still confident in their capacity to find new better paying positions. Nonetheless, the premium for switching jobs is at its smallest in 3 years. There were 617,000 fewer job openings in October versus the prior month. At 8.733 million, the total number of vacancies was the lowest since March of 2021 and considerably lower than the 9.3 million that was generally expected. What is particularly important here is that there were about 1.34 open jobs for each unemployed worker, the lowest since August of 2021 and close to pre-pandemic readings of 1.2 - structurally an ideal ratio, given the ageing population. Meanwhile, the rate of quits, which measures voluntary job-leavers as a share of total employment, held steady at 2.3%, basically where it spent all of 2018 and 2019.

On Wednesday, the markets digested more labour market data. ADP - a payroll processor - reported further signs of a cooling labour market. Private employers added 103,000 jobs last month from a revised mark of 106.000 in November and cooler than the 130,000 consensus, underscoring the message from Tuesday’s JOLTS release. According to the Macro Strategy Partnerships, its 3-month moving average dropped to 99,333, the lowest since the 3-months to March 2021. Meanwhile, the Bureau of Labor Statistics reported that Unit Labor Costs (ULC) in Q3 fell an annualised 1.2% Q/Q, pointing to higher productivity gains. ULC inflation matters a lot because it regulates the underlying inflation rate as determined by the labour market, suggesting that CPI inflation rate should continue to fall closer to the Fed's 2.0% target sooner rather than later, as generally forecast. Actually, bond futures are presently predicting that the CPI rate of inflation will be less than 2.0% in one year’s time.

Friday’s November payroll report was a mild surprise to the upside. Nonetheless, it gave another clue that jobs are coming back to a reasonable equilibrium. Additions accelerated to 199,000 from 150,000 in October, not because demand for labour increased strongly, but because 50,000 UAW workers, screenwriters and actors returned to work after a prolonged strike. A new dynamic in the labour market is also emerging. According to Goldman Sachs, extreme non-farm payroll results in either direction are bad, the sweet spot being 100,000, with 50,000 on either side. This makes sense, according to Heidi Shierholz, president of the Economic Policy Institute: the economy is at full employment, therefore approaching a state where the rate of job gains can only keep pace with the growth in the working-age population. - somewhere around 100,000.

The Bottom Line:

All of these employment indicators are closely watched by Fed officials. I’m sure they liked what they saw because their biggest headache is getting resolved. If, indeed, the US job market has turned a corner in a moderate fashion, it's a shift

Macro View cont.

By Hubert Marleau

that supports - perhaps not as soon as the swap market is suggesting - the market declaration that the next move by the Fed will be to lower interest rates. There was a hiccup, but that may not be obstructive: average hourly earnings, a

gauge of wage growth, rose by 0.4% in November to register a y/y increase of 4.0%, a bit more than what was expected; but fortunately, we are getting better productivity numbers than we used to. Should a 1.5% to 2.0% trend in productivity growth stick, the Fed might not use the 3.0% pre-pandemic wage growth rate as its baseline, making the 4.0% tolerable. We'll know more on that front by next Wednesday when it will provide an updated summary of economic projections.

Is the Oil Market Crying Wolf?

Perhaps. At this time, I cannot tell whether the falling prices in the global energy complex is signalling deep trouble in the world economy or oversupply issues like surging US exports, Russia's "shadow fleet" of abundant tankers reaching Asian ports or production disagreements within OPEC+. But what I do know is that the $10 drop in oil prices has reduced global oil energy bills as a percentage of world GDP to 2.5%, down 0.80% from the end of September. What is even more important is that, with this leg down, both oil and gasoline prices are where they were in 2018 and much of 2019. That is not bullish for oil stocks, but very helpful to reduce expected inflation and interest rates; and, in turn, eventually favourable for growth.

The Stock Market Outlook:

For the week ended December 8, economic indicators were deemed to be more bullish for stocks than bonds. The steep drop in oil prices spooked neither stock operators nor retail investors, for they were all net buyers. Consumer sentiment soared 8 points in December to 69.4%, because inflation expectations for the year ahead plunged to 2.1% from 4.5%, as the unemployment rate fell to 3.7%, killing the Sahm rule idea that the economy was in spitting distance of a recession. As a matter of fact, the Skew Index - a measure that calculates potential tail-risk in financial markets - fell to 134 on Friday. Meanwhile, the S&P 500 marked time again this week, consolidating its gains since the October 27 bottom and trading between 4550 and 4600. 2023 is teetering on the edge of another 20%-up year, reflecting falling inflation, rising productivity, sticky economic growth and a resilient labour market - plus a rate cut in 2024. Meanwhile, the stock market is forward-looking and has, therefore, priced in all of this good stuff. In other words, our 4650 objective for the S&P 500 for 2023 has already been reached. The market needs to digest the abundance of good news it has absorbed and stay put for the rest of this year.

As to income, Refinitiv reported that S&P 500 companies' third-quarter net income was 4.1% higher than a year earlier, after 3 straight quarters of declines, adding that, thanks to buybacks, earnings per share were up 7.1%. For now there

Macro View cont.

By Hubert Marleau

is no reason to believe a new upward trend in earnings has not resumed. Analysts are dour and yet earnings are expected to grow by 5.2% in Q4.

The upturn in productivity looks real, and the new yearly increases are probably around 2.5%. Such a projection would keep the economy rolling up without inflationary interference. I think the S&P 500 could touch 5100 at some point in 2024 because the economy has been dealt an ace.

Huber Marleau's Macro View

Issue **No. 43** | **DECEMBER 11, 2023**

Disclaimer:

This publication is proprietary to Palos Management Inc. (along with its affiliate Palos Wealth Management Inc., "Palos"). This publication may be copied, downloaded, stored in a retrieval system, further transmitted, reproduced, disseminated, and/or transferred, in any form or by any means, but only as long as it is unaltered and attributed to Palos. This publication and its contents may not be sold or licensed without Palos' written permission. The information and opinions contained herein have been compiled or arrived at from sources believed reliable but no representation or warranty, express or implied, is made or implied regarding accuracy or completeness. The information provided does not constitute investment advice and it should not be relied upon on as such. If you have received this communication in error, please notify us immediately by electronic mail or telephone. This document may contain certain forward-looking statements that are not guarantees of future performance and future results could be materially different. Past performance is not a guarantee of future performance. "S&P" is a registered trademark of The McGraw-Hill Companies, Inc. "TSX" is a registered trademark of TSX Inc. The Bloomberg USD High Yield Corporate Bond Index is a rules-based, market value weighted index engineered to measure publicly issued noninvestment grade USD fixed rate, taxable, corporate bonds. To be included in the index a security must have a minimum par amount of 250MM. Palos Funds are not available for non-Canadian residents.

PALOS

1 Place Ville Marie, Suite 1670
Montreal (QC) H3B 2B6, Canada

T. +1 (514) 397-0188
F. +1 (514) 397-0199

4711 Yonge St, 10th Floor
Toronto, Ontario M2N 6K8

T. +1 (647) 276-0110
F. +1 (647) 343-7772

www.palos.ca