Empower Investments Capital Markets Perspective

Week in Review: August 29th – Sept. 4th

INDEX/ SECURITY	ASSET CLASS	LEVEL (CLOSE)	% CHANGE (THROUGH FRIDAY'S CLOSE) 1 WK.	YTD		INDEX/ SECURITY	ASSET CLASS	LEVEL (CLOSE)	% CHANGE (THROUGH FRIDAY'S CLOSE) 1 WK.	YTD
Dow Industrials	Lg. Cap Eq.	31,318.44	-2.99%	-13.81%		FTSE 100	UK Equity	7,281.19	-1.97%	-1.40
S&P 500®	Lg. Cap Eq.	3,924.26	-3.29%	-17.66%		Nikkei 225	Japan Equity	27,650.84	-3.46%	-3.96%
NASDAQ Comp.	US Equity	11,630.86	-4.21%	-25.66%		EEM:US	Emkt. Equity	$38.76	-3.12%	-20.66%
S&P Midcap 400©	Mid-Cap Equity	2,393.10	-4.29%	-15.80%		EFA:US	Non-US Equity	$60.47	-3.57%	-23.14%
Russell 2000®	Sm. Cap Eq.	1,809.75	-4.74%	-19.40%		UST 10y (yield)	US Treasury	3.19%	+0.15%	+1.68%
Stoxx 50	Europe Eq.	3,544.38	-1.65%	-17.54%		Bloomberg U.S. AGG	Fixed Inc.	2,097.46	-1.02%	-10.94%

Past performance is not a guarantee of future results. Investing involves risk, including possible loss of principal.

In honor of yesterday's Labor Day holiday, let's spend most of this week's *Perspective* riffing on the jobs market.

Last week's long list of **labor market data** accomplished at least one thing: it **made an already confused situation even less understandable**. Consider these key phrases from Wednesday's ADP payrolls report[1]: "…our data suggest a shift toward **a more conservative pace of hiring**, possibly as companies try to decipher **the economy's conflicting signals**…" and "…(w)e could be **at an inflection point**, from super-charged job gains to something more normal."

Okay, so far so good: in fact, it's almost as if ADP's press department picked up the proverbial bat-phone and speed-dialed Jerome Powell to ask what he and his pals at the Fed would like to see in terms of forward-looking trends for the US labor market. "Sunny with a chance of rain," Powell might have told them, "…clear skies for now, but make sure everyone sees a few storm clouds building on the horizon."

But Wednesday's press release from ADP came only 24 hours after the Bureau of Labor Statistics released its famed **JOLTS report** – the one that details who's hiring, firing, quitting and otherwise bouncing around inside the US labor market[2]. That report **was almost definitely *not* what Powell wanted to see**: job openings in the US rose to 11.24 million, about 200,000 more than last month's report, higher than economists expected and just a stone's throw from March's all-time record of 11.85 million. It was all sun and no clouds inside that report.

At least some of the disconnect between ADP's Fed-friendly message and JOLTS' dissonance has to do with the fact that **ADP's numbers are more current than JOLTS**: ADP's survey focused on trends for August, while JOLTS is always lagged by a month (meaning last week's JOLTS release detailed trends in place during July.) But as stale as they might be, the **JOLTS numbers still matter a lot** in an economy where one of the biggest, most important controversies is **a job market that is in perpetual danger of overheating**.

So how do we break the tie between a slightly stale but still too-strong JOLTS report and a just-right ADP number? Well, **Friday's employment situation report**[3] – the "big burrito" of labor market data – **probably deserves the final say. But it, too, was a little confusing**. For example, employers added 315,000 new jobs last month – more than economists

[1] https://adp-ri-nrip-static.adp.com/artifacts/us_ner
[2] https://www.bls.gov/news.release/jolts.a.htm
[3] https://www.bls.gov/news.release/empsit.nr0.htm

expected and an undoubtedly strong result, but **a clear (and welcome) step down** from the prior month's addition of more than half a million new jobs. **Meanwhile, nearly 800,000 new potential workers entered the US labor force**. That allowed the so-called participation rate to expand a little bit and in turn caused the overall unemployment rate to tick higher, from 3.5% in July to 3.7% in August.

Like ADP, that's a pretty Fed-friendly result: more workers engaging with the economy and soaking up some of those open positions is precisely what Dr. Powell ordered. But it might also be a great example of what I fear might be the next risk markets will have to deal with: a rapid reversal of fortunes that catches everyone off guard. Here's what I mean: if, as Friday's jobs report suggests, **more people are engaging with the economy by re-entering the workforce, that's a good thing**. But if they're doing it during a period when, as ADP tells it, "…companies are shifting toward a more conservative pace of hiring" in response to "the economy's mixed signals," then all those new entrants might be sorely disappointed in a few months when they see the near-record number of job openings begin to evaporate quickly. A case of really bad timing for all those poor, reinvigorated souls stepping back in to reengage with the labor market just as its starting to soften – sort of like stepping out onto the beach wearing Bermuda shorts and a tank-top, only to find it beginning to rain.

I guess the bottom line is this: it's really hard to know what to wish for right now when it comes to the labor market.

Little wonder, then, that **capital markets didn't really know what to make of all this** either. At first, Friday's payrolls report was met with optimism: stocks and other risky asset classes traded notably higher after the release, probably in hopes that it might cause the Fed to slow its roll. But by noon markets took a turn for the worse, with the S&P 500 Index eventually ending Friday's session a full percent below where it opened (and a full 2.4% below its intra-day peak.)

So I guess the message I'm trying to relay with **this long, confusing rant about jobs isn't really about the jobs market at all, but rather about the unsettled state of just about *everything*** related to the macro environment right now. Is the jobs market overheated, or at risk for slowing too much when the skies eventually *do* turn gloomy? Is manufacturing in retreat, as last week's factory orders report[4] and Dallas Fed[5] (as well as a handful of other regional Feds before it) seem to suggest, or is it mostly holding its own, as last week's manufacturing ISM, PMIs seem to be saying[6,7]? Are consumers too pessimistic about the future, or too optimistic? (For what it's worth, last week's consumer confidence release from the Conference Board[8] followed the University of Michigan's numbers from the previous week at least a little higher from still-depressed levels.)

Until the answers to those and other questions are answered in a more satisfying way, **markets will probably remain as unsettled as they were last week**. To invoke one of the biggest hard rock hits of my youth[9]:

> *"What we've got here is…failure to communicate. Some men you just can't reach. So you get what we had here last week, which is the way he wants it. Well, he gets it. I don't like it any more than you do…"*

"He" of course, is Jerome Powell and "the way he wants it" is a market that is kept guessing (and appropriately volatile as a result, or exactly "what we had here last week.") And, if you're wondering who "doesn't like it anymore than you do," well, you probably haven't been paying close enough attention.

From an editorial perspective that would've been a great way to finish this week's commentary, but unfortunately we should probably at least mention **two overseas developments** from last week that could impact markets moving forward. The first is **China's shutdown of massive manufacturing and IT hub Chengdu**, a city of 21 million people that was locked down after officials discovered 150 new cases of COVID-19[10]. **Hopes that President Xi might abandon** (or at least soften) his economy-denting "**zero-COVID**" policy during the run-up to his country's all-important 20th Party Congress (during which Xi is set to argue for a rare third term as President) **appear to have been mis-placed**.

[4] https://www.census.gov/manufacturing/m3/prel/pdf/s-i-o.pdf
[5] https://www.dallasfed.org/research/surveys/tbos/2022/2208q.aspx
[6] https://www.ismworld.org/supply-management-news-and-reports/reports/ism-report-on-business/pmi/august/
[7] https://www.pmi.spglobal.com/Public/Home/PressRelease/4a630bc3c76342e1b104ad2a125051e9
[8] https://www.conference-board.org/topics/consumer-confidence
[9] *Civil War*, by Guns 'n Roses (who were in turn quoting the classic 1967 movie *Cool Hand Luke*)
[10] https://www.scmp.com/news/china/politics/article/3191085/i-am-optimistic-chengdu-locks-down-residents-remain-calm

Xi's zero-COVID policy matters to markets because it has only added to concerns that the global economy is quickly tipping its way toward a synchronized recession. The same is true for a **burgeoning energy crisis in Europe**, which became a little more real last week when Russian energy giant Gazprom announced that the **NordStream** pipeline that carries huge volumes of Russian natural gas to markets in Western Europe would **remain shut indefinitely** so crews could conduct unspecified repairs. Yeah, right. **For the sake of our friends in Europe, let's hope it's a mild winter**.

What to Watch This Week: September 4th – 11th

Notable economic events (September 5th – 9th)

Monday*: US markets closed for Labor Day*

Tuesday: ISM/PMI services

Wednesday: Federal Reserve's *Beige Book;* Bank of Canada rates decision

Thursday: Weekly jobless claims; ECB rates decision

Friday: No major economic releases; EU emergency meeting (energy)

Source for index data: Bloomberg.com; GWI calculations.

It's a **very light week** from a planned economic release perspective, with **Tuesday's services sector ISM and PMI reports** really the only scheduled data that might be worth a close read.

That said, there **are a few important central bank announcements** that could help set the tone for the next meeting of the Federal Reserve's rate-setting committee on September 20th-21st. Market consensus is beginning to crystalize around a third consecutive 0.75% increase during that meeting[11], but lots can change in a very short period of time, so stay tuned.

The first of these potentially path-shifting developments comes on Wednesday when the **Bank of Canada** will issue its latest decision on rates. The BoC surprised markets by boosting its main rate by a full percent to combat inflation in **July**, making it **one of the most aggressive moves by a major developed market central bank so far** and a clear statement that Canada, for one, wouldn't tolerate out-of-control inflation. A step down from that aggressive stance **might give the Fed air cover if it, too, decides to calm down a bit** on this whole "let's tighten until it hurts" policy.

Also on Wednesday the Federal Reserve will issue its **Beige Book** of economic anecdotes, which has become sort of a *de facto* **study guide for markets and fed officials alike** ahead of the FOMC's meeting later this month because it peeks into how the regional economies are performing in an on-the-ground, region-by-region kind of way that provides insight that published economic data simply can't. Look for any signs that the labor market in particular is still out-of-joint in any one of the Fed's 12 districts when the Beige Book is released.

And then there's the **European Central Bank's rate decision**, scheduled for Thursday. Like the Fed, the BoC, and just about every other global central bank with a brain, the ECB has been aggressively tightening rates to hold back once-in-a-generation inflationary pressures that are only just now beginning to abate. But the **ECB** suddenly **has another, unique challenge that the Fed and its other peers don't: an energy market that has been weaponized by Vladimir Putin**'s Russia. The **EU's energy ministers will meet on Friday** to try and concoct a response to this stark reality, but for now Russia's shutdown of the NordStream pipeline puts the ECB in a tight spot: should it continue to tighten rates aggressively to combat the inflationary impacts of spiking energy prices, or should it hold its fire to avoid inflicting even more damage to a European economy already on the ropes? Tune in Thursday to find out.

[11] Cmegroup.com