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TRENDMACRO LIVE!

On the January Jobs Report, and the Yield Back-Up

Friday, February 2, 2018

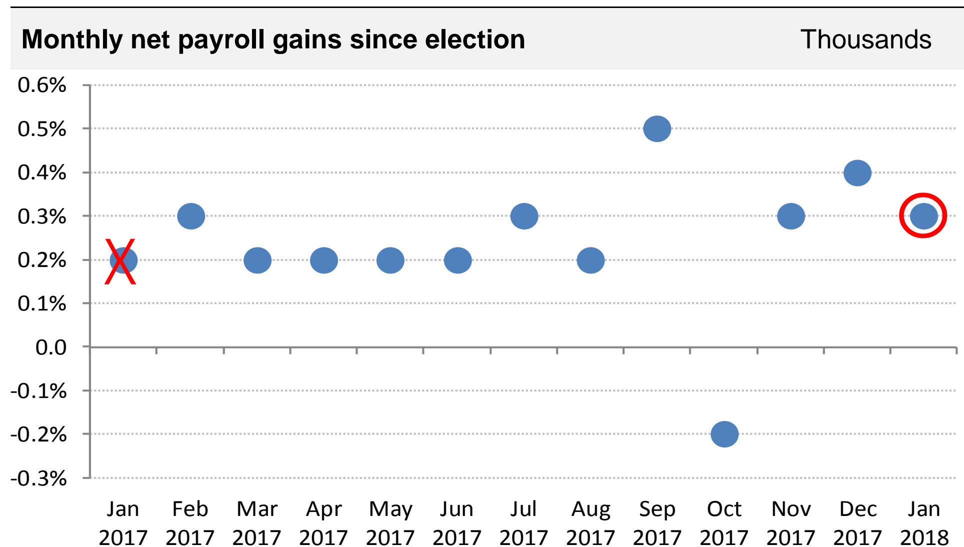
Donald Luskin

Fake news! Wage growth actually slowed last month, and rising yields don't mean a tighter Fed.

It's slightly hard to tell what happened with this morning's January Employment Situation report, – with 200,000 net payrolls seeming to beat the consensus expectation for 180,000 – because of the annual "benchmark revision" ritual. On an apples-to-apples basis, data revisions for the two prior months lowered the bar by 24,000 payrolls, which more than explains the beat, leaving it actually a small miss of 4,000. The headline 200,000 net gain is below our model-estimate of 229,000, based on other contemporaneous labor market data (please see the chart on the following page), so we suspect there is some under-reporting here.

- *The big scare-story, all cued up for a coordinated headline-drop the moment the embargo was lifted this morning at 8:30 was "America gets a raise: Wage growth fastest since 2009."* It's designed to play into the risk-off narrative that that Fed has suddenly become "further" hawkish (see "On the January FOMC" January 31, 2018).
- *It is pretty much fake news. Monthly average hourly earnings growth contracted in January from 0.4% to 0.3%* (please see the chart below). The headline is technically true only because it refers to *year-over-year growth*, which is the best since 2009 only because last January's weak reading was replaced by this January's slightly stronger one (again, please see the chart below).

Monthly net payroll gains since election Thousands



Source: BLS, ADP, Challenger, NFIB, ISM, TrendMacro calculations

Update to strategic view

US MACRO, US FED, US STOCKS, US BONDS: The scare-headline about rising hourly wage growth is fake news. Month-over-month it fell in January. It is narrowly true that the year-on-year growth is the best since the Great Recession, but that's only because a weak data-point last January was replaced with a slightly stronger one this January. There's nothing new in this jobs report that should move the Fed's policy posture "further" to the hawkish. Stocks have reacted by continuing what we think was a long-overdue inevitable correction. But bonds and USD are, and have been, in risk-on mode – they are safe-haven assets that are becoming less valuable in a less deflationary and more risk-on world. Higher long-term yields don't have to be a threat to equities; historically, higher yields and superior equity returns have generally gone hand-in-hand.

[Strategy dashboard]

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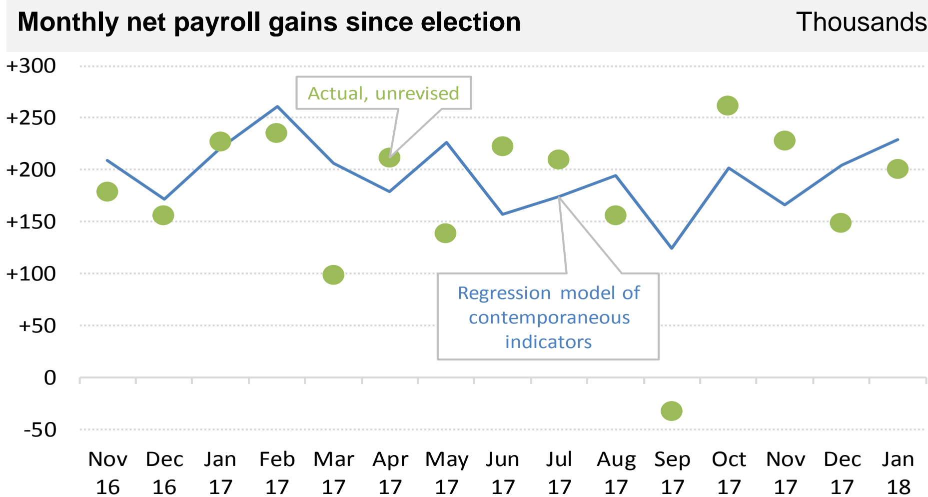

Source: BLS, ADP, Challenger, NFIB, ISM, TrendMacro calculations

- *That means there is actually no new information this morning that ought to move Fed policy "further" hawkish.*
- Let's reality-check the market reaction – which could be mistakenly seen as confirming the idea of "further" hawkishness.
- *If the Fed isn't getting "further" hawkish, then why are curve-implied funds rate expectations rising?* The level of policy rates, actual or expected, has nothing to do with whether a central bank is tight or loose. That can only be determined by comparing the policy rate to the natural rate of interest – if the policy rate is above, then it is tight; if its below, then it is loose.
- *In this framework, the funds rate now – at 1.38% – is precisely neutral* with respect to the latest reading of the Laubach-Williams model for estimating the real natural rate of interest (at negative 0.08%) plus core PCE inflation (at 1.5% year-over-year).
- *Rising policy rate expectations, we think, only reflect the market's estimation that the economy and inflation expectations will strengthen, that the natural rate of interest will rise, and that the Fed will index to it – this keeping policy neutral, as it is today.*
- *If the Fed were really getting more hawkish, why has the dollar been weak* versus every other major currency in the world? A tighter Fed ought to strengthen the dollar.
- *If the Fed were getting more hawkish, why have long-term bond yields moved higher*, based on increasingly healthy inflation and growth expectations, and the yield-curve steepened? A tighter Fed ought to diminish inflation expectations, causing long-term yields to fall and the yield-curve to flatten (see "Bull Market, Meet Your New Fed" January 29, 2018).
- By the way, we have to chuckle at how the conventional wisdom was fretting about the flattening yield curve late last year – and now it's fretting about a steepening one. Apparently the conventional wisdom just likes to fret.
- *If the Fed isn't getting more hawkish, the why are equities falling?* Equity *prices* have been overdue for a correction – though *valuations* have, in fact, been correcting all year even though stock

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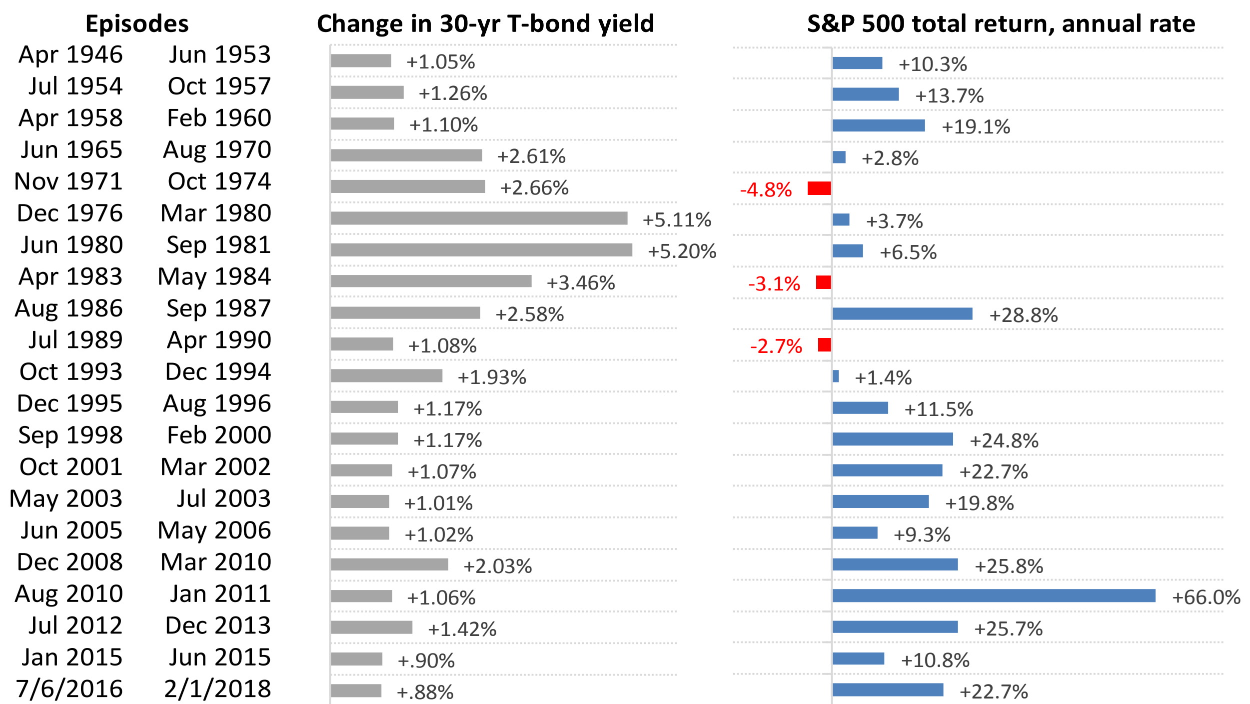
prices have moved to new highs, because forward earnings have grown even faster.

- *This is not a coordinated risk-off move in markets*. While falling equity prices could be interpreted that way, rising bond yields and a weakening dollar are reflections of risk-on sentiment (USD and bonds are safe-haven assets, which are both being valued less highly now). Markets seem to be giving us a contradiction – risk-off in equities, risk-on in bonds and USD.
- *Can we square the circle by arguing that higher bond yields make equities less valuable – reducing the present value of future earnings, or by narrowing the equity risk premium?* It's an argument, but history doesn't bear it out.
- *In the 21 episodes of significant yield back-ups since 1945, stock prices have only fallen in three of them – they have rallied in the other 18, with generally better-than-average returns (and rising multiples)* (please see the chart below).

Relation of major back-ups in bond yields to stock market returns



Source: Bloomberg, TrendMacro calculations

- *This is because, generally speaking, rising inflation expectations and rising growth expectations are good for earnings and multiples. It's really only counter-intuitive if you think of bond yields as a randomly formed endogenous shock. They are in fact endogenous.*

Bottom line

The scare-headline about rising hourly wage growth is fake news. Month-over-month it fell in January. It is narrowly true that the year-on-year

growth is the best since the Great Recession, but that's only because a weak data-point last January was replaced with a slightly stronger one this January. There's nothing new in this jobs report that should move the Fed's policy posture "further" to the hawkish. Stocks have reacted by continuing what we think was a long-overdue inevitable correction. But bonds and USD are, and have been, in risk-on mode – they are safe-haven assets that are becoming less valuable in a less deflationary and more risk-on world. Higher long-term yields don't have to be a threat to equities; historically, higher yields and superior equity returns have generally gone hand-in-hand.