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TRENDMACRO LIVE!

On the August Jobs Report

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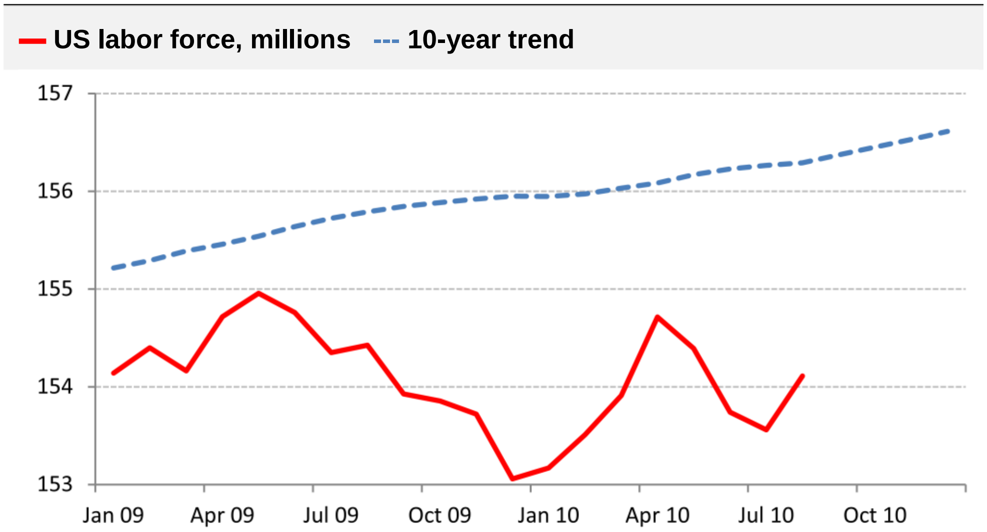
Donald Luskin

This morning's jobs report should be the cure for double-dipsomania.

This morning's August jobs report was good. It wasn't great, but it didn't have to be great. Markets beset by "double dip" recession fears have been perfectly set up to rally on the smallest upside surprises, and we've had several this week. The tell that pessimism was at its climax was the story in Monday morning's *Wall Street Journal*, "The Decline of the P/E Ratio." According to the story, P/E's are too low to fit in with the prevailing pessimism, and so they must be ignored. This is just like 1999, when P/E's were too *high* to fit in with the prevailing *euphoria*, so they had to be ignored. But we're not that pessimistic, and we're not ignoring value. Twice this quarter at about 1040 on the S&P 500 we've said it was time to buy stocks (see "Betting Against a 'Double Dip'" June 30, 2010 and "On Bernanke at Jackson Hole" August 27, 2010). We're not calling for any kind of runaway to the upside, but hopefully the jobs report will be the cure for double-dipsomania, and we can move on to understanding the challenges of what we continue to believe is an "expansionless recovery." Under that strategic scenario, there's not a lot of downside -- but the upside will be painfully difficult to obtain.

The most telling statistic in the August jobs report was the increase in the



Source: Bureau of Labor Statistics, TrendMacro calculations

Update to strategic view

US MACRO: This morning's jobs report was good, not great -- showing an economy not in a "double dip" recession but rather in an "expansionless recovery." The growth of the labor force by 550 thousand persons is the key statistic indicating that Q2's soft patch won't get any softer.

US STOCKS: This morning's jobs report caps a week that included several positive data surprises, enough to rescue deeply oversold stocks at 1040 on the S&P 500 for the second time. The "buy the dip" theme continues to be the right play in this "expansionless recovery."

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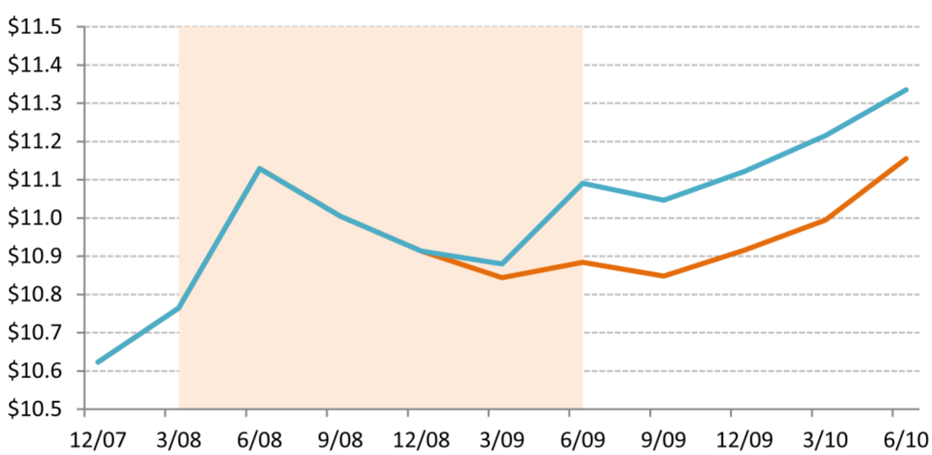
civilian labor force by 550 thousand (please see the chart on the previous page). This follows three months of sharp declines, corresponding to the period in which "double-dip" fears came to the fore. Of the 550 thousand new entrants to the labor force, 290 thousand came in with jobs -- for the first positive change in employment for the household survey in four months. At the same time, another 261 thousand entered the labor force without jobs. So just as we were experiencing consistently when the economy was expanding more rapidly in Q4 2009 and Q1 2010, we are again seeing increases in employment *and* unemployment at the same time.

Considering just these new entrants, employed and unemployed, the unemployment rate is 47%. When this population is added to the existing labor force, it naturally raises the overall unemployment rate -- from 9.5% in July to 9.6% in August. *But this is a good sign*. The labor force is so massively below trend -- by 2.8 million persons -- as workers become encouraged to re-enter it, we can't expect the economy to employ them all immediately. The important thing is that they are entering at all, after three months of leaving. We can't see jobs growth without a coming together of labor demand and labor supply, and this morning's numbers are a nice step toward that necessary confluence.

- Remember, by definition, GDP growth has to be the sum of labor force growth and productivity growth. For the economy to stabilize and start growing again, it is absolutely necessary for the labor force to grow, even if in the short term this creates a higher unemployment rate as it did this month.

There were many other small positive signs in this morning's report. We take special notice of the increase in aggregate earnings by 0.5% in August. This builds on July's increase of 0.3%, and in fact this key driver of disposable personal income (please see the chart below) has only

Disposable personal income **Without stimulus** **Recession**
USD trillions, SAAR



Source: Bureau of Economic Analysis, NBER, TrendMacro calculations

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Recommended Reading

The Small Business The 97% Fallacy
Kevin Hasset and Alan D. Viard
Wall Street Journal,
September 3, 2010

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Key documents

Employment Situation Report, August 2010

[Client Resources home]

declined once this year. Growth here is critical as we look ahead to the drop-off in income supports under the 2009 stimulus bill. At Q2 2010, DPI moved to new all-time highs even without stimulus from temporary tax breaks and transfer payments. Gains in aggregate earnings this month and last will therefore propel organic -- i.e. ex-stimulus -- DPI to further new highs in the current quarter. DPI growth is very highly correlated to consumption growth, so this small but positive progress plays into our contrarian theme in opposition to the conventional wisdom of a "new normal" of consumer retrenchment (see "The Consumer: QED" April 16, 2010).

While we celebrate the important good new in this morning's jobs report, we can't lose sight of the fact that nothing here paints a picture of a future any rosier than the "expansionless recovery" we've been talking about for the last year. Yes, it's good news that job gains in the household survey outpaced those in the payroll survey, indicating an uptick in small business hiring. It's good that hours worked continued to rebound. And yes, it's good that average weeks of unemployment fell, driving down the percentage of long-term unemployed. But at the same time an unemployed person has only a 19% probability of getting a job within one month -- and this *fell* from an already low 21.5% last month. And the number of persons working part-time involuntarily rose by 331 thousand, moving up to 6.26% of the employed work-force, the highest percentage in four months. It's a recovery. But it's an "expansionless recovery."

If one wanted to really see the glass half-full, one could appreciate how remarkable the avoidance of a "double-dip" recession is, given the multiple Swords of Damocles that overhang the economy. One could say that this shows great underlying strength and resilience, or one could just say that we've fallen so far already there just isn't any room on the downside. For us, it means that positive resolution in uncertainty about the tax, regulatory and monetary risks that beset us could have powerful upside impact. We're unlikely to get that in *all* those domains, but it's an out-of-the-money option that gets embedded in times of stress, and shouldn't be forgotten.

Bottom line

This morning's jobs report was good, not great -- showing an economy not in a "double dip" recession but rather in an "expansionless recovery." The growth of the labor force by 550 thousand persons is the key statistic indicating that Q2's soft patch won't get any softer. This morning's jobs report caps a week that included several positive data surprises, enough to rescue deeply oversold stocks at 1040 on the S&P 500 for the second time. The "buy the dip" theme continues to be the right play in this "expansionless recovery."