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Macro Strategy

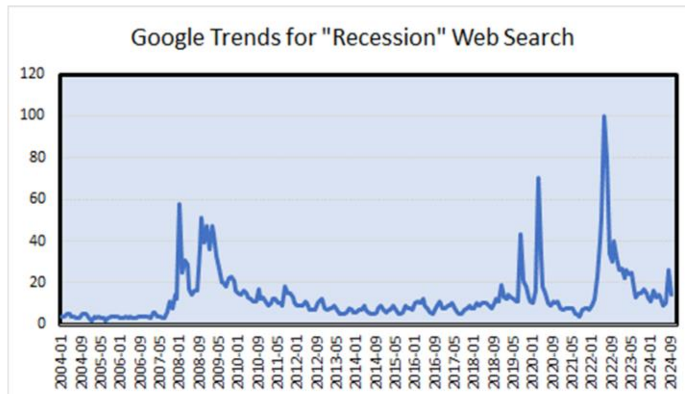
THE GOOD AND BAD ON EMPLOYMENT

Inflation has slowed and employment has as well. Will a soft landing be achieved, or will slowing employment lead to a recession? The market clearly believes the former given (1) high stock market valuations, (2) mid-teens earnings growth forecasts for 2025, and (3) low credit spreads; however, as shown in "Anatomy of a Correction" and "The Bond Market Says...," equity and credit markets are quite poor at predicting recessions.

The data may support both views, at least before looking under the surface. The soft-landing theory is supported by low initial unemployment claims and slow, but positive, job gains. However, claims may understate unemployment because of gig workers, and recently, job gains are all part-time and many want full-time roles. Let's investigate…

this changed suddenly in the Sept NFP

Recession Fears Popped in August and Now Retreating



ISS EVA, Google Trends

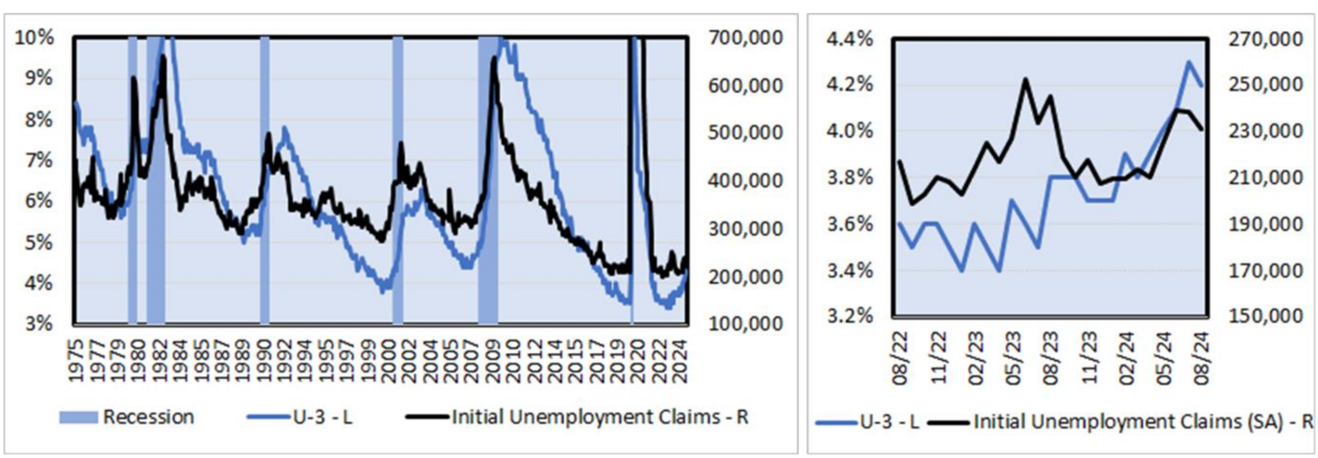
Good News

1. Claims low
2. Job gains
3. Rising unemployment rate largely because of higher participation

Bad News

1. Low claims due to gig workers and productivity?
2. All job gains are part-time roles, and they want to work full-time, and jobs-to-unemployment nearing parity
3. Participation rises in tough times

Unemployment Rate Rising, but Claims are Lowish



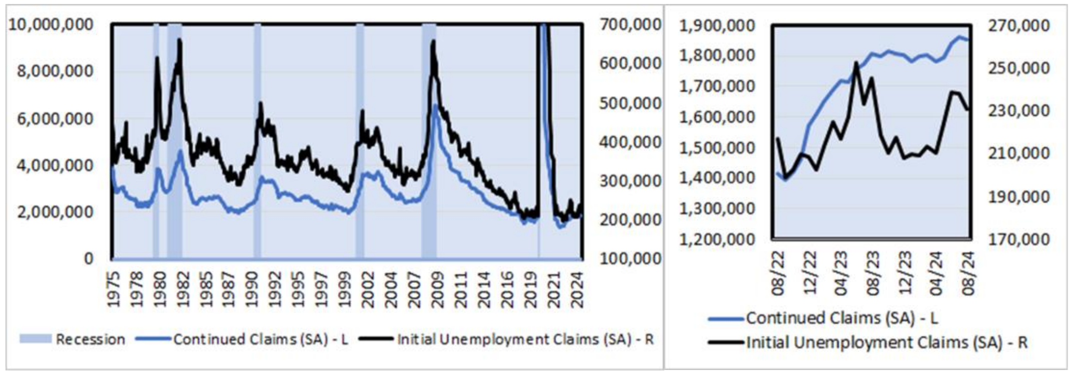
ISS EVA, FactSet, DOL, NBER

1. Claims Appear Low

Good News: Claims Are Low

A good soft-landing argument is that weekly initial unemployment claims are low. Given a rising employment base over the decades, even though claims are up from lows, they are still low versus history. However, they spike higher in recessions.

Weekly Initial and Continuing Unemployment Claims are Low



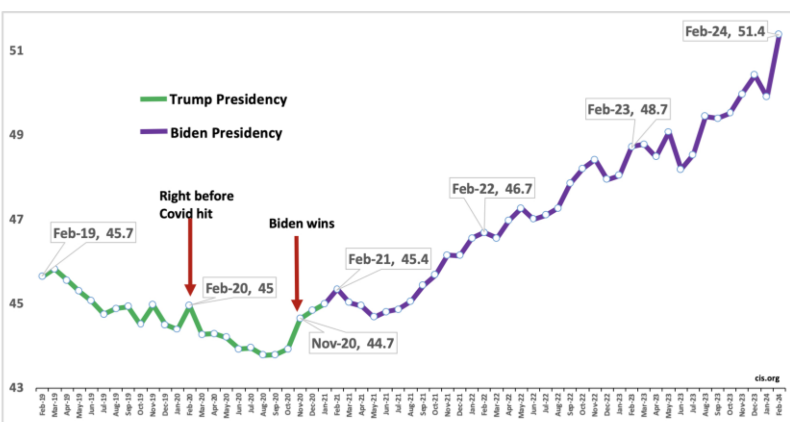
ISS EVA, FactSet, DOL, NBER

Neutral: Immigration Modestly Lowers Claims

Undocumented immigration – or an increase in the labor supply – was cited earlier this year as a reason for slowing inflation. A greater supply of workers slows wage gains. However, unauthorized immigrants are not eligible for unemployment claims, so I decided to check if the rise in undocumented immigrants can explain the low claims data. The impact is modest (5,000).

Apprehensions have been up significantly in the last few years, but it's the total number of immigrants that matter, and they have also risen. The Migration Policy Institute estimates that there were just below 40 million immigrants (foreign born) in 2010 and there were 51+ million in February (see graph below), so the total is up about 12 million. The Immigrant Learning Center, sourcing other research, notes that 22.3% of immigrants are in the United States illegally (Pew Research Center and 2021 U.S. Census Bureau) and more than 76.4% (U.S. Census 2022 American Community Survey 5-year Estimates) of immigrants participate in the workforce. Given that illegal crossings are up, perhaps we can argue that the percentage of undocumented immigrants in the United States is moving toward 25% in 2024.

The Number of Immigrants Has Risen



Enforcement	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24YTD
Office of Field Operations (OFO)	216,370	281,881	288,523	241,786	294,352	551,930	1,137,452	1,255,279
U.S. Border Patrol (USBP)	310,531	404,142	859,501	405,036	1,662,167	2,214,652	2,063,692	1,501,367
Total Enforcement Encounters	526,901	683,178	1,148,024	646,822	1,956,519	2,766,582	3,201,144	2,756,646

ISS EVA, Center for Immigration Studies, U.S. Customs and Border Protection; graph through 2/24 and table is current, numbers in graph in millions

How does this impact claims? 12 million additional people * 75% working * 25% = 2.25 million "extra" illegal immigrants who are working now versus in 2010. Many work in agriculture, where the unemployment rate was 5.8% in August 2023 and is up to 11.3% in August 2024, but agriculture still makes up less than 5% of illegal employment. They primarily work in construction, business services, and leisure and hospitality. Even assuming a 7.5% unemployment rate (higher than the industries's weighted rate), the rise in illegal immigrants would drive weekly claims down only 3,200 (7.5% unemployment * 2.25 mil. more illegal immigrants/52 weeks). The Center for Immigration Studies suggests there was a 3.2 million swing in the annual change in the immigrant population from March 2020 and September 2021. The Center also suggests that 3.7 million of the immigrant surge since January 2021 is undocumented, so maybe 3,200 is a little low and the real impact on claims is 5,000 per week.

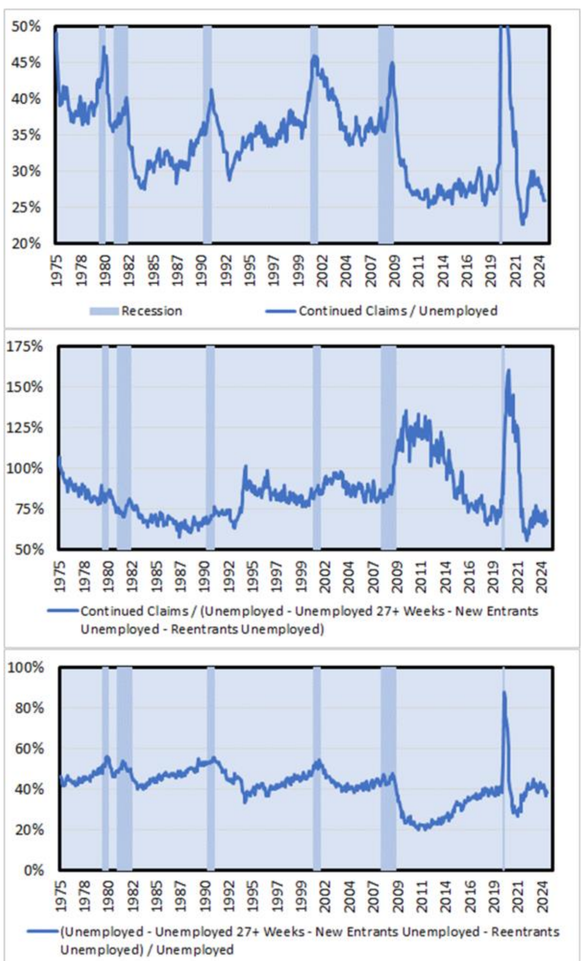
1. Claims Appear Low

Bad News: The Rise in Gig and Related Workers' Depressing Claims Numbers

The proportion of gig and related workers may be more than 1 out of every 3 or even higher, up from perhaps 11% in 2005 (click here for timeline), and these workers are generally not eligible for unemployment benefits. Still, a McKinsey study suggests these people are more optimistic about economic opportunity. Gig work includes vacation rentals, package delivery, ridesharing, etc., and workers go by titles such as freelancer, consultant, independent worker, etc.

Giving credit where it is due, the charts below are similar to what Peter Bernstein, Chief Global Strategist at BCA, recently published (mine are adjusted to include reentrants). It's clear (top chart) that continuing claims have declined relative to unemployment. Beyond gig and related workers, others are also not eligible for unemployment pay. Insurance generally runs out at 26 weeks, and new entrants (first-time job seekers) and reentrants cannot collect unemployment compensation. The middle graph shows the decline in continuing claims relative to the number of unemployed less those not eligible based on length of unemployment and new or reentrant status. Is the decline to 68% today from 90% in 12/95 due to the rise of gig and related workers?

Declining Claims to Unemployed



ISS EVA, FactSet, DOL, NBER

About 34% of Employment is Non-Permanent and Non-Temporary and Therefore Not Eligible for Unemployment Benefits

ISS EVA, FactSet, BLS, McKinsey (April 2022)

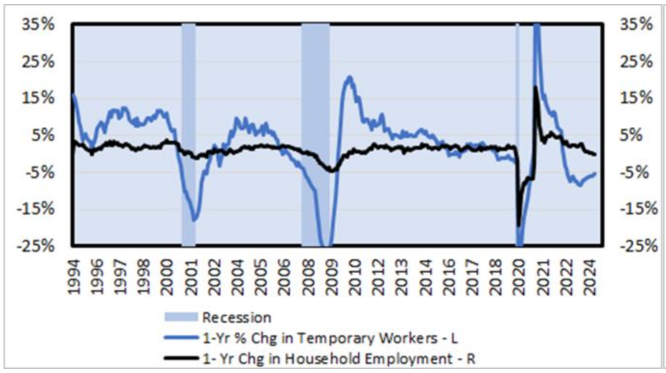
Let's assume that the percentage of gig and related workers – without unemployment insurance – has risen 15%. This means that weekly claims are understated by about 78,000 (34% of 230,000 weekly initial claims), or about 35,000 (15% of 230,000) if comparing low claim numbers relative to those about 20 years ago. The relative understatement is probably higher (50,000+) as the number of temporary workers is declining (see graph on next page). It's easy to let these people – and other gig and related workers – go as, after-all, they're on contract. The household survey (see graph on next page), which measures the number of people who have jobs instead of the number of jobs, shows that hiring has stalled (zero growth). Furthermore, if a gig worker loses one of his or her gigs, the person is still counted as employed by the household survey, so it may mask deterioration. If we add the impact of immigration and gig and related workers to the data, we get an initial claims number approaching 300,000 (see graph on page 1), or the economy's stall speed according to Ed Hyman, head of economic research at Evercore ISI.

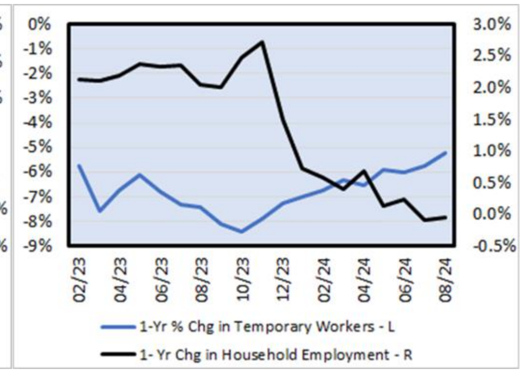
1. Claims Appear Low

***Good* or *Bad News*: Claims Temporarily Lower Because of Surging Productivity**

Do higher claims (fewer work hours) drive up productivity, or does lower productivity lead to firing and thus higher claims?

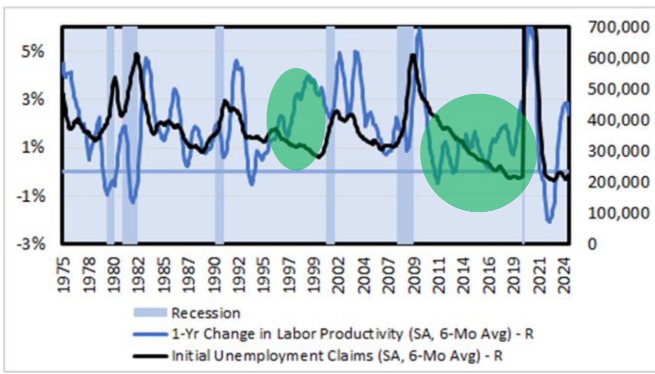
Declining Number of Temporary Workers as Household Employment Stalls





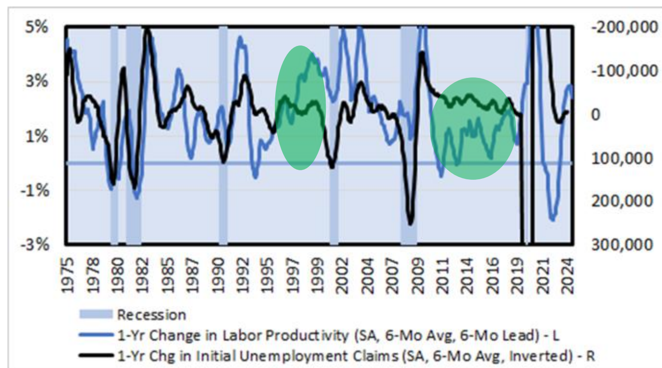
ISS EVA, FactSet, DOL, NBER

Productivity Typically Surges During or Just After Recessions When Claims are High (Positive Relationship), but an Increase in Productivity without a Recession Drives Claims Down (Negative Relationship)



Left graph shows productivity growth and level of claims

Right graph shows change in productivity leading change in claims (inverted)

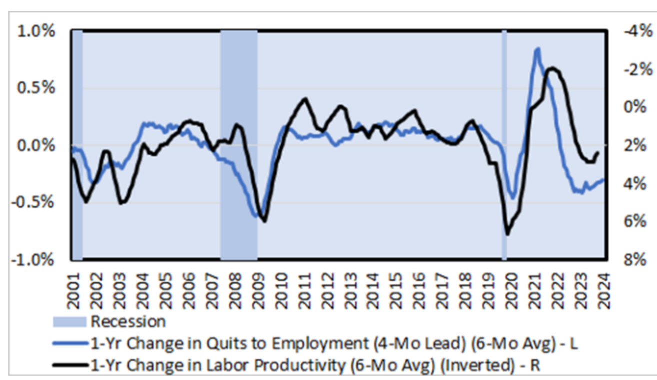


ISS EVA, FactSet, DOL, NBER

During a recession, workers may focus on their jobs instead of texting their family and friends, and productivity rises. Poorer workers may be, at least on average, those who lose jobs. Since employment lags the economy, as the economy improves (units rise) firms are slow to hire, so productivity surges higher.

However, if productivity rises mid-cycle (see 1995-99 and 2011-19), this could drive down claims. It doesn't make sense to let workers go if their productivity (units per labor hour) is rising, either because of high demand (unit growth) and/or more efficient employees.

Quits Rates Lead Productivity



ISS EVA, FactSet, DOL, NBER

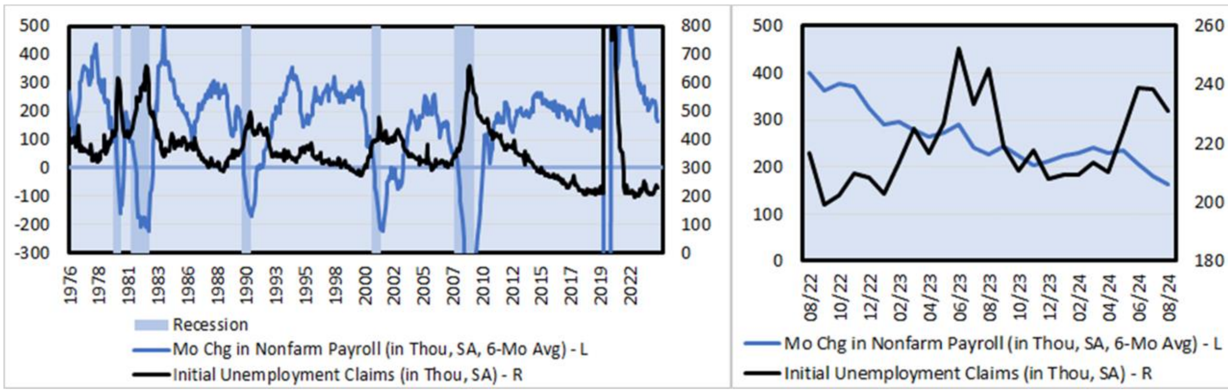
Currently, productivity is surging (up 2.7% in 2Q 2024 vs 2Q 2023), which is unusual at this phase of the cycle (assuming it is late). Is the boost because of AI? Perhaps modestly, but it's too soon to have this large of an impact. Plus, AI may first be used for cutting costs, and since wages make up the majority of costs, AI would not explain the low claims data. The surge could be due to the great resignation or high growth in capital expenditures 2-3 years ago. After one takes a new job, it takes time to learn the role before productivity rises and new capital may lead to efficiencies. Are we in the **sweat spot of productivity gains (and inflation, as productivity is negatively correlated with inflation)**, **and could this roll over and drive up claims?**

2. Employment Growth Positive but Shaky

Good News: **Modest Payroll Gains**

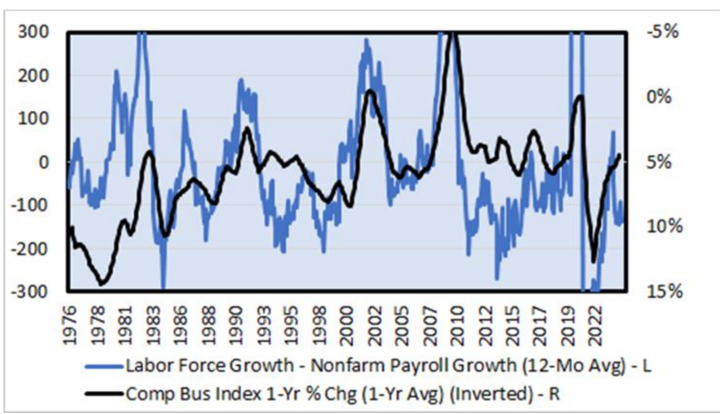
The job market is slowing, but it's still growing. August job growth came in at 142,000, following downward revised 89,000 in July.

Monthly Nonfarm Payroll Gains Slowing but Still Positive



ISS EVA, FactSet, DOL, NBER

Balance of Labor Impacts Wages



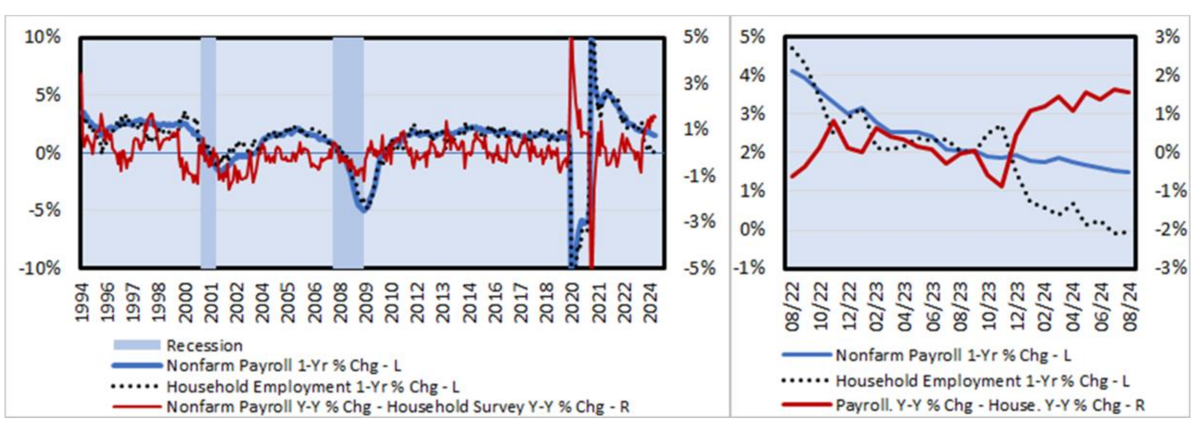
ISS EVA, FactSet, DOL, NBER; the left axis units is thousands

While the change in the labor force is a very volatile number, right now it appears the job market is balanced, as the six-month average gain in jobs is 164,000, which is about the same as the gain in the labor force (187,000 for all ages). This is good for for lowering wage growth. Well, that's assuming it remains balanced, as the 12-month average difference between the labor force growth and jobs indicates wage growth should be accelerating (see graph on left).

Bad News: **Household Employment Growth Has Screeched to a Halt**

The one-year change in non-farm payrolls and the number of people with jobs (household survey) are normally highly correlated, but currently payrolls are expanding 1-2%, while the number of people with jobs is declining over 2%. Looking back, we can see that this divergence also occurred during or just before the last three

Household Survey and Payrolls Diverging



ISS EVA, FactSet, DOL, NBER

2. Employment Growth Positive but Shaky

recessions. However, these two series also diverged this much in 1995 (soft landing) and 1997-98 (Asian and Russian financial crises) without U.S. recessions.

Bad News: People Don't Want Their Second Jobs

The positive difference between payroll and the household survey tells us that while people are gaining jobs, it's due to second jobs. Is this because the job market is so good that they can gain a second part-time job, or is it because they need the second job due to deteriorating financial situations or because they cannot find a full-time job? It appears that they would prefer full-time work.

The unemployment rate definitions are on the right. The U-3 is what gets space in the press, but there's a lot of useful information in the other rates. Of importance here is the difference between the U-6 and U-5, which is the percentage of people who are employed part-time for economic reasons (meaning, they can't find full-time work). You can see (bottom right graph) that it has risen by about 0.4% since December 2023.

A 0.4% rise on a labor force of 161.4 million (August) is about 646,000 workers. How many jobs and people with jobs were gained since December? 1,475,000 and 219,000, respectively. So, about 44% of the new job gains and all the worker gains are part-time by people who wish they could work full-time. It's not atypical for the U6-U5 to take off during recessions.

Sorry about that bad news, and, I apologize, but there's more to the story.

Unemployment Rate Definitions (www.bls.gov/lau/stalt.htm)

U-1, persons unemployed 15 weeks or longer, as a percentage of the civilian labor force;

U-2, job losers and persons who completed temporary jobs, as a percentage of the civilian labor force;

U-3, total unemployed, as a percentage of the civilian labor force (this is the definition used for the official unemployment rate);

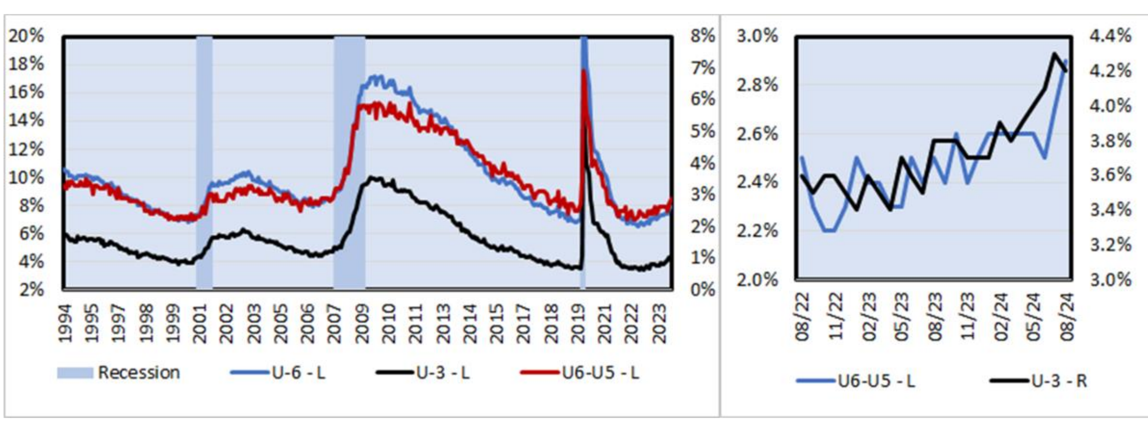
U-4, total unemployed plus discouraged workers, as a percentage of the civilian labor force plus discouraged workers;

U-5, total unemployed, plus discouraged workers, plus all other marginally attached workers, as a percentage of the civilian labor force plus all marginally attached workers; and

U-6, total unemployed, plus all marginally attached workers, plus total employed part time for economic reasons, as a percentage of the civilian labor force plus all marginally attached workers.

Definitions for the economic characteristics underlying the three broader measures of labor underutilization are worth mentioning here. **Discouraged workers** (U-4, U-5, and U-6 measures) are persons who are not in the labor force, want and are available for work, and had looked for a job sometime in the prior 12 months. They are not counted as unemployed because they had not searched for work in the prior 4 weeks, for the specific reason that they believed no jobs were available for them. The marginally attached (U-5 and U-6 measures) are a group that includes discouraged workers. The criteria for the **marginally attached** are the same as for discouraged workers, with the exception that any reason could have been cited for the lack of job search in the prior 4 weeks. **Persons employed part time for economic reasons** (U-6 measure) are those working less than 35 hours per who want to work full time, are available to do so, and gave an economic reason (their hours had been cut back or they were unable to find a full-time job) for working part time. These individuals are sometimes referred to as involuntary part-time workers.

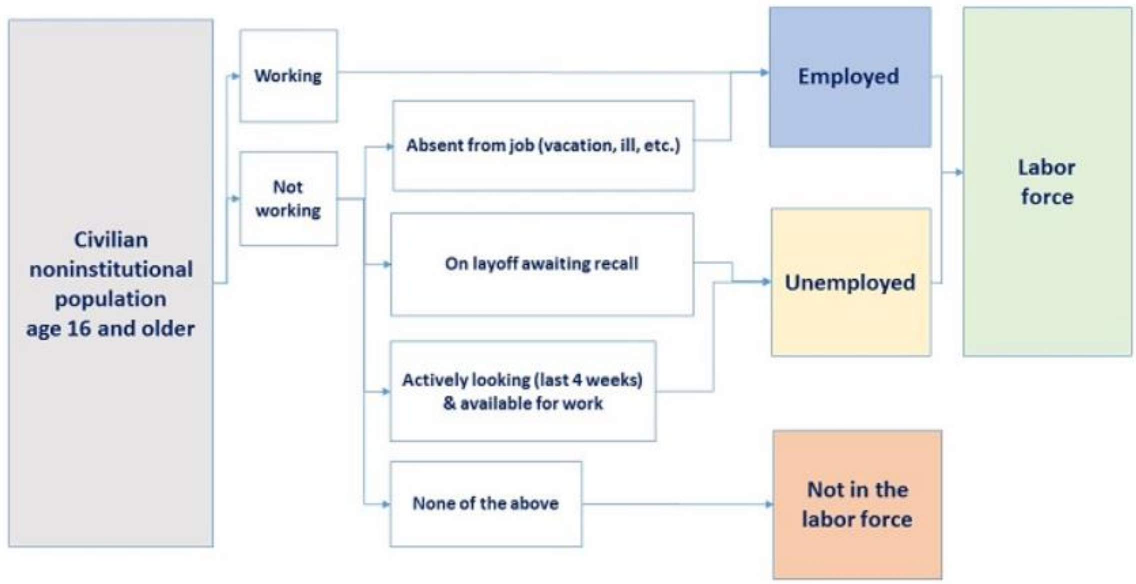
People are Working Part-Time but Not by Choice



ISS EVA, FactSet, DOL, NBER

2. Employment Growth Positive but Shaky

Bureau of Labor Statistics (BLS) Definitions



***Bad News:* Full-Time Jobs are Declining**

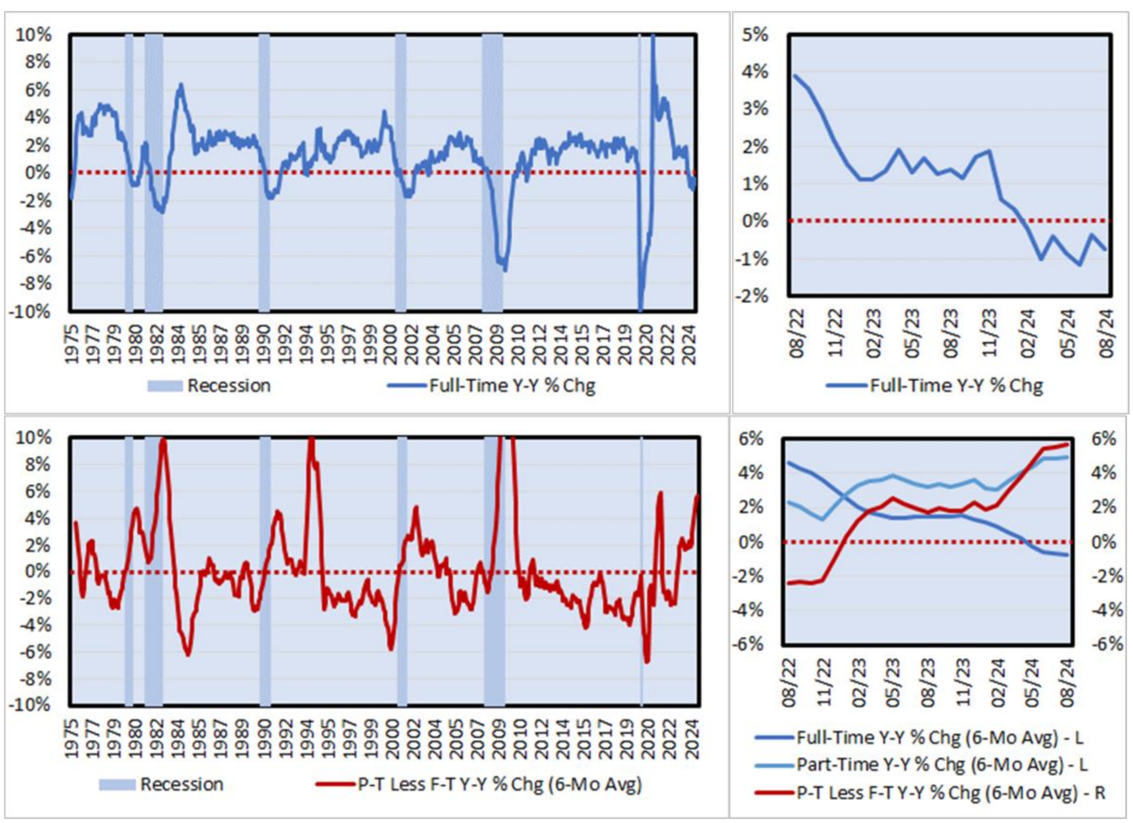
The number of full-time jobs begain its decent earlier this year. It's declining about 1% on an annual basis. A decline in full-time employment is a bad sign, as this has occurred during the last six recessions.

As shown, many new jobs are by people working part-time but not by choice. The remaining job gains are also for part-time workers. Part-time employent tends to grow quicker than full-time in every recession, perhaps because firms are reluctant to pay benefits when conditions are shaky. The one exception when part-time grew significantly relative to full-time and we did not have a recession is during the 1994-5 soft landing.

***Bad News:* Jobs-to-Unemployed Ratio Falling to 1.0**

Previously, I discussed that one reason the economy has not succumbed to a recession is because the number of job openings to the number

Full-Time Employment is DECLINING

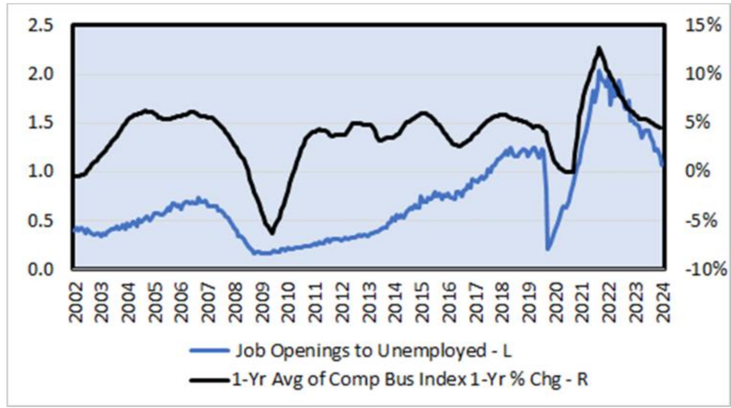


ISS EVA, FactSet, DOL, NBER

2. Employment Growth Positive but Shaky

unemployed has been greater than 1. I've counted down the number of months to 1.0, which should be when the unemployment rate and claims really take off. In February, in "[Employment Isn't As Good As the Headline Implies]," I noted we were at 1.4 to 1 and I estimated that we would be at 1.0 in 10 months. In May, in "[What's the Marketing Thinking]," I estimated 5 months when the ratio was 1.31 to 1 and assuming the participation rate stayed constant (it's risen). Now, we are at 1.07 to 1, so the day of reckoning is nearing. Positively, if the labor force has fewer job openings, then this will depress wage growth and help tame inflation. However, that also eats into the ability of consumers to spend and sustain economic growth.

Jobs to Unemployed Ratio Nearing 1.0



ISS EVA, FactSet, Conference Board, DOL, NBER

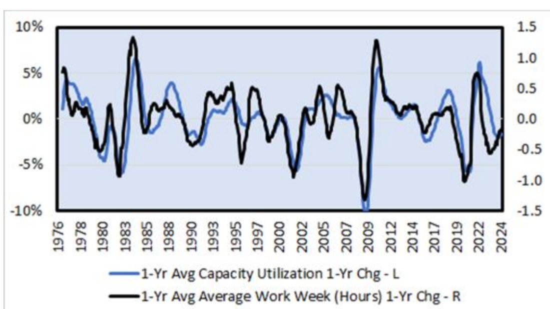
How about a bit of good news?

Good News: Capacity Utilization Stopped Declining

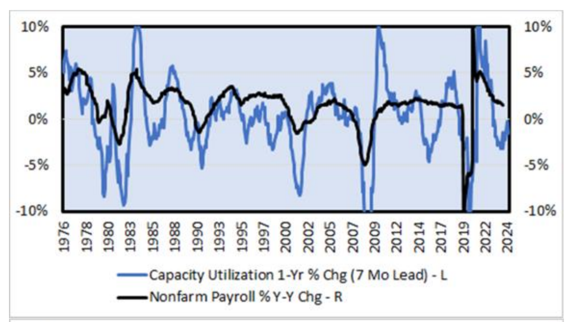
(1) Firms tend to add workers following gains in capacity utilization, which has stopped its descent. They need more worker hours to run the machines; and
(2) Eventually more workers.
(3) More hours lead to a lower duration of unemployment; and
(4) Lower continued claims.

Capacity Utilization Matters

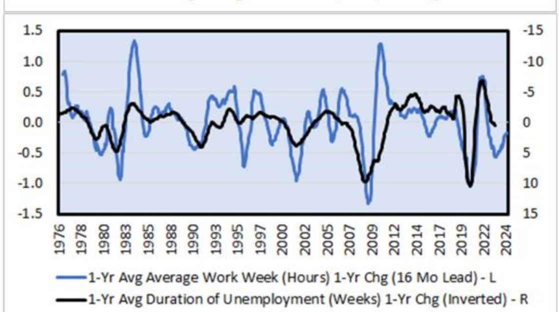
Capacity utilization correlated with work week, and both hooking up



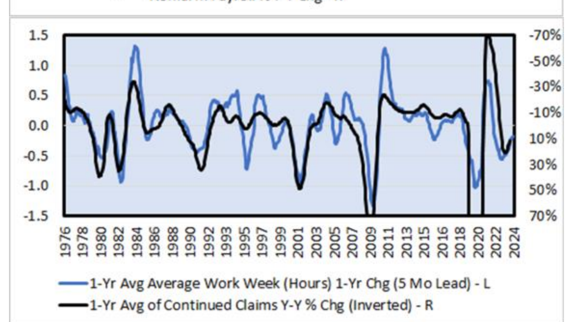
Eventually firms need more workers



Longer workweek lowers duration of unemploy-ment



Leading to lower continued claims



ISS EVA, FactSet, Conference Board, DOL, Federal Reserve, NBER

3. Rising Unemployment Due to Participation → Is That So Bad?

The BLS defines the participation rate as "the number of people in the labor force [those 16 or older who are either employed or unemployed (actively looking for work)] as a percentage of the civilian noninstitutional population. In other words, the participation rate is the percentage of the population that is either working or actively looking for work."

Good News: Participation Rate Rising Is a Reason for Higher Unemployment Rate

Earlier this year, the market cheered the participation rate rising as that meant there was more labor, which would thereby lower wage growth, and then lower the inflation rate. Now, they claim that the rising participation rate is contributing to higher unemployment rate, which is not something to worry about. I think the saying, "You can't have your cake and eat it (too)," applies here.

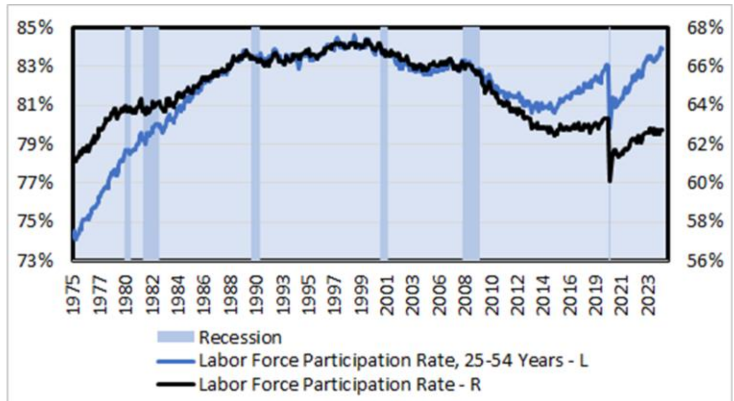
The 25–54-year-old participation rate has risen (top chart), so this has raised the supply of workers and put upward pressure on the unemployment rate. On the other hand, the overall participation rate is flat to slightly down.

The middle chart shows that reentrants and new entrants to the job market are a significant part of the reason the unemployment rate has risen.

Bad News: Participation Normally Rises before Recessions

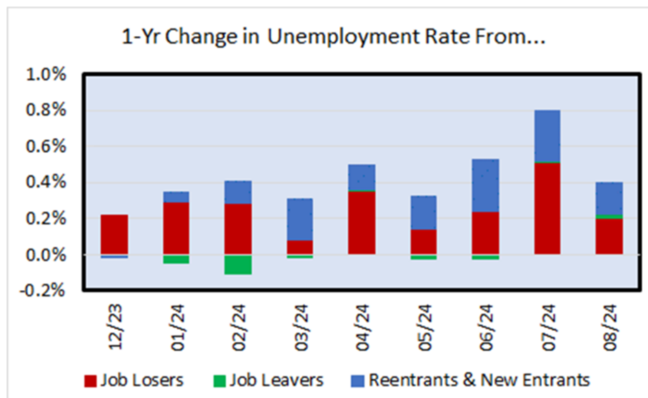
Again, given you can't have your cake and eat it too, please note that the participation rate tends to rise before recessions. Of course, higher participation didn't lead to recession in 1995 and the mid-1980s.

25-54-Year-Olds' Participation Rate Rising



ISS EVA, FactSet, DOL, NBER

New and Reentrants Boosting Unemployment Rate



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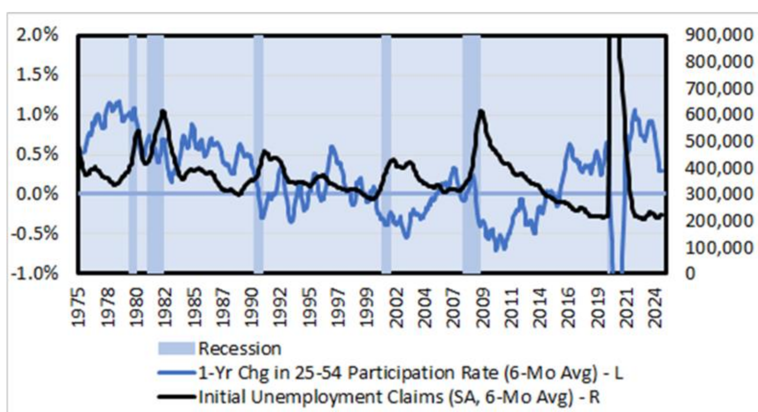
Participation Rate Rises before Recessions



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Investment Takeaways

Be careful looking at the headline claims, job growth, and unemployment rate data. There is much insight to be had by thinking deeper. Claims are low, but they may be artificially low compared to the past because of gig and related workers who cannot claim unemployment. Or claims may be low because productivity is temporarily high. Job growth is positive, which is good news, but all the net job gains are part-time and many of these workers would prefer to work full-time. While higher participation probably has added to the unemployment rate, more people may participate when at the latter end of a cycle, possibly before a recession.

Does it make sense that the Federal Reserve lowered rates last week? Based on employment, absolutely. The weak employment numbers may be why the Federal Reserve went for an initial 50 bp cut instead of 25. Maybe the Federal Reserve has looked deeper. However, given low credit spreads, high equity market multiples, and high 2025 earnings growth estimates, the financial market either has not looked deeper or believes the Fed is a savior that won't let it down.

Interesting times!

Coach

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