Asset Management

JUNE'S PAYROLL REPORT: A SWING AND A ...FOUL BALL

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After May's payroll report coming in as a weak "at bat," June's report had the expectations of a major league slugger during the home run derby. While June's total nonfarm payroll report rose by 224,000 and exceeded expectations, the June numbers ended up just outside the foul line. How can that be said given the Treasury market's sell-off following the release of the June jobs report? Luckily we aren't at a full count just yet; the July print will be the more important one (i.e., the 'payoff pitch') as June has merely balanced out a paltry nonfarm payroll gains in May.

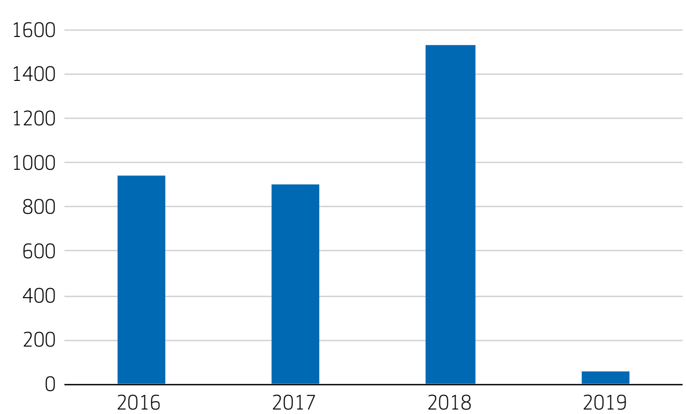
As we try to take a step back and observe the whole forest, not just the one-month tree, the following observations emerge:

1. **Monthly prints can be volatile, look for broader trends:** This June report follows May results which, when netting against sizable April net revisions, essentially amounting to no gains in payrolls for May. Thus, averaging out June's reported number over the past two months produces roughly 107,000 per month for May and June.

2. **The labor market is slowing:** The current three-, six- and 12-month moving averages for payrolls are all under 200,000, a drop from recent years when they were all somewhere in the mid-200,000 range. The six-month average (172,000) will drop again in July unless payroll gains match or exceed 312,000.

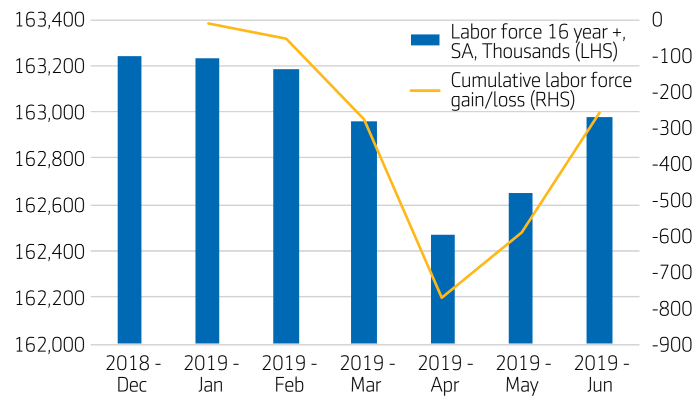
3. **Unemployment math can be deceiving:** The unemployment rate increased by 10 basis points to 3.7%. This illustrates a concerning trend in the internals of the Household survey, wherein a paltry number of jobs were gained year-to-date (60,000) as illustrated in exhibit 1. While individual monthly readings can be volatile or misleading, essentially no job gains for six months is an emerging trend that is hard to ignore. Fortunately for the unemployment numbers, the reduction in the labor force year-to-date (by 259,000), as shown in exhibit 2, is flatternng the unemployment rate. Note, however, that as we progress through the year the last stretch of annual reductions in the labor force was observed during and immediately following the financial crisis, from 2009 to 2011.

Exhibit 1: First half gains in civilian employment (SA, thousands)



Sources: BLS, Haver as of June 2019

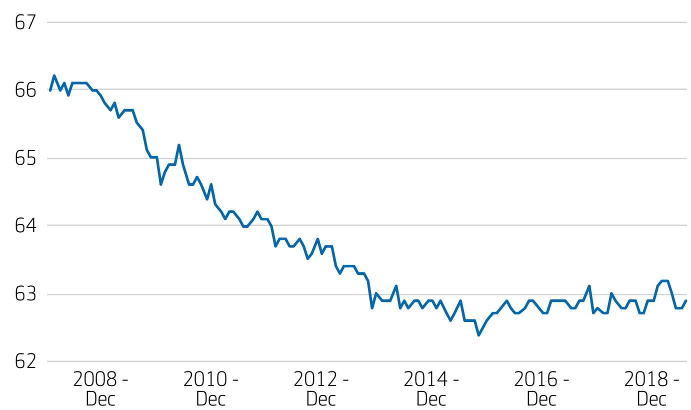
Exhibit 2: The Labor Force Shrank YTD



Sources: BLS, Haver as of June 2019

4. **Demographics are a powerful force:** The labor force participation rate (LFPR) is not showing much cyclical strength in a tug-of-war between secular downtrends (namely from demographics) and cyclical upticks. While the aging demographic story weighs on LFPR, a strong jobs market should exhibit upward cyclical force on the participation rate. However, this is not occurring as the LFPR has basically oscillated around the current rate of 62.9% since 2014 (exhibit 3).

Exhibit 3: LFPR (%) in a narrow range



Sources: BLS, Haver as of June 2019

The current trend in job gains and the labor force point to either: (1) a sinister near-term future for payrolls, or (2) a solid catch up performance in the second half of the year. Something has to give. This has implications for labor market slack/tightness and inflation.

In the end, the recent jobs report shouldn't sway the easing bias of the Fed. From a market perspective, the reaction to this number shows that more speculative Treasury holders got ahead of themselves as they were overcommitted to multiple anticipated Fed rate cuts. Still, with slowing global PMIs and aggregate hours, for instance, loading up on the cyclical trade at this juncture may be a challenging prospect.