Capital Markets Group

Points to Ponder

November 19, 2021

The First Tee...

Job Jeopardy…the "Great Resignation" slack employment environment has been much more impactful on smaller firms compared to large corporations ***(at least so far)*****:**

- **Worker Watts**…the Department of Labor's JOLTS (Job Openings and Labor Turnover Survey) has hit a new record high:
  - The survey found the number of quits in a month (as a percent of total employment) were concentrated in companies employing less than 5000 workers…less impacted is a majority of S&P 500 firms whose total employment is over 5k:
    - The number of quits rose to an all-time high of 4.4 million in September…**while there were 10.4 million job openings**.
      - Quit rates have increased to a series high of 3%...and have been especially high in healthcare, arts & entertainment, and retail.
  - Companies were hopeful the end of pandemic supplemental unemployment benefits would increase the number of individuals returning to the workforce…but the COVID infection spike this summer derailed some of this staffing impact:
    - The pandemic, combined with rising stock values, also accelerated the rate of retirements by the Baby Boomers.
- **War for Workers**…companies are upping the ante to attract workers (especially those with specific skills and experience):
  - Hiring and retaining workers becomes a vicious circle where businesses offer sign-on bonuses and other incentives to attract and keep workers, creating a cycle of self-feeding turnover churning:
    - Job applicants are typically getting multiple offers at the same time, allowing them to cherry-pick opportunities:
      - Many new hires are often leaving jobs only after a few days to take a position elsewhere…called "ghosting coasting":
        - Companies are also reporting many new hires do not even show-up for the first day of work…or giving notice when they leave if they do start.
  - Retaining workers is also becoming more challenging as staffing shortages are creating extra work and extended hours for employees, causing increased stress, fatigue, and burnout…leading to more turnover:
    - The pandemic has played a major role in hiring and retaining workers…creating issues such as vaccine mandates, staying home to care for children, fears of infection, and a desire to no longer travel to the office or plant.
  - The number of job cuts announced by U.S. companies have fallen to the lowest level in 24 years.
- **Widgets, Wages and Worth**…higher employment costs are impacting business profit margins:
  - Companies are having to make tough decisions regarding passing-on rising labor costs to clients, or eating the increases…reducing revenues and possibly negatively impacting stock values (persistent wage increases typically erode equity value):
    - To insulate themselves from labor cost shocks, companies are looking more towards technology and automation:
      - S&P 500 companies are 70% less labor intensive now than they were in the 1980's (according to Bank of America data):
        - **Thirty-five years ago, it took about eight workers to generate $1 million in sales…today it takes only two.**
- **Win for Workers**…a positive aspect of the current work environment for laborers is the opportunity to realize higher pay and elevate their level of employment and work status (especially for blue collar jobs):
  - The Great Resignation is less about quitting and more about finding a better job (pay and job duties):
    - This is also positive news for the economy, as households will have larger amounts of expendable income to spend:
      - Front-line and low low-wage workers are leaving jobs at rates higher than historical norms…higher paid office workers are not.
- **Wage Push Inflation**…the tug-o-war between wages and the rising price of goods and services can evolve into an inflation spiral effect…creating a vortex that can be damaging to consumers, businesses, and the economy *(hello 70's & 80's)*
  - Wage increases surged nearly 5% last year, rising at a rate almost double that of pre-pandemic:
    - Despite the large salary gain, when accounting for the impact of inflation, real wages have actually declined:
      - Real Average Hourly Earnings decreased by 1.2% during the past twelve months from October *(one step forward, two backward)*.
    - Consumer prices are rising at their fastest rate in thirty years…beside wage pressure, rising material costs and supply-chain issues are also pressuring prices (the cost of oil alone is up 141% from its low in 2020…reducing consumer expendable income)
  - The supply chain issues should ease as we move into the new year, helping reduce material costs:
    - The cost of labor is a different situation, wage increases have historically had staying power (barring a strong recession):
      - Given the widespread shortage of labor, wage pressures are poised to persist…even when worker shortages ease:
        - It is unlikely workers will be willing to start taking wage cuts (currently, the concern is finding workers and worry about the costs later!)

At the turn...

The Back Nine…

Animal Farm…the shape of the yield curve is historically a precursor of what is to come for the economy, the bull and bear moves are clues analysts watch in forecasting:

- As inflation has risen from the dead during the pandemic, yield curves around the world are starting to flatten (short- and long-term rates are converging as central banks start to pullback on stimulus):
  - To grasp the impact of yield curve moves, it is always good to remember that when interest rates are rising, the price (value) on bonds is falling…and the visa-versa occurs when rates are falling:
    - Bull and bear bond markets are identified by price movement, not rates…a bull market occurs when investors are buying (driving the price of the bond higher), while a bear market is exemplified by falling prices (investors are selling):
      - There are occasions when the short-dated bonds can be in a bull market, while longer maturity issues are in a bear market…and visa-versa (it can even get crazier when the intermediate maturities are in a bear market, while the short and long issues are bullish.
  - It is also useful to remember that the Fed can only control short-term interest rates through the Federal Funds benchmark rate…longer-term interest rates are normally market driven, but the practice of quantitative easing bond buying programs have been designed to add liquidity to the economy and keep longer rates low.
- **Welcome to the Zoo**…there are four basic yield-curve price trends, here is some basic analysis:
  - **Bear Flattener**…this phenomenon occurs when the price of bonds are moving lower regardless of their maturity date:
    - As discussed above, this results in interest rates rising…this is where the "bear" connotation is applied to the move:
      - The flattening occurs when the prices of short securities weaken the most, increasing their rates faster than the longer bonds:
        - A bear flattening move is typically predicated when the Fed is tightening monetary policy, or traders are anticipating the Fed will be raising rates in the future…the action is usually influenced by inflation growth exceeding the Fed's target rate.
  - **Bear Steepener**…this move occurs when short interest rates are already low, and the Fed pushes them even lower:
    - This action typically occurs during a crisis (financial or as we have seen lately, a pandemic)…both can wreak on the economy:
      - The Central Bank and government stimulus actions flood the market with liquidity, raising the specter of future inflation:
        - To satiate the financial markets and business community, the Fed typically promises to keep rates low for an extended period to allow for sufficient time to recover from the damage caused by the crisis (this strategy can change if inflation rises to high, forcing the Fed to tighten).
  - **Bull Flattener**…this event occurs when both short and long bond prices are rising, which is a bull move in the market:
    - A flattening of the curve happens as longer dated security prices move higher by larger amounts, pushing their rates down farther than those of shorter issues (it takes a larger price move to make a basis point yield change for a 30-year bond than a 2-year issue):
      - A bull flattening curve is historically associated with periods when forces such as geopolitical tension are prevalent or times when the rate of inflation is below Fed growth target for an extended period (inflation growth reduces the value of fixed rate bonds)
  - **Bull Steepener**…occurs when bond prices are rising, but short-dated rates are falling faster than the longer-term:
    - The Fed lowering its benchmark target rate faster than anticipated typically creates this movement in the curve.
- **Upside-Down World**…an inverted yield-curve occurs when short-rates are higher than longer levels:
  - Though rare, rate inversion occurs when dire economic circumstances are predicted…typically, a coming recession.

19th Hole...

Ability will never catch-up with the demand for it. Malcomb Forbes

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