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Inflation Worries & Employment Data

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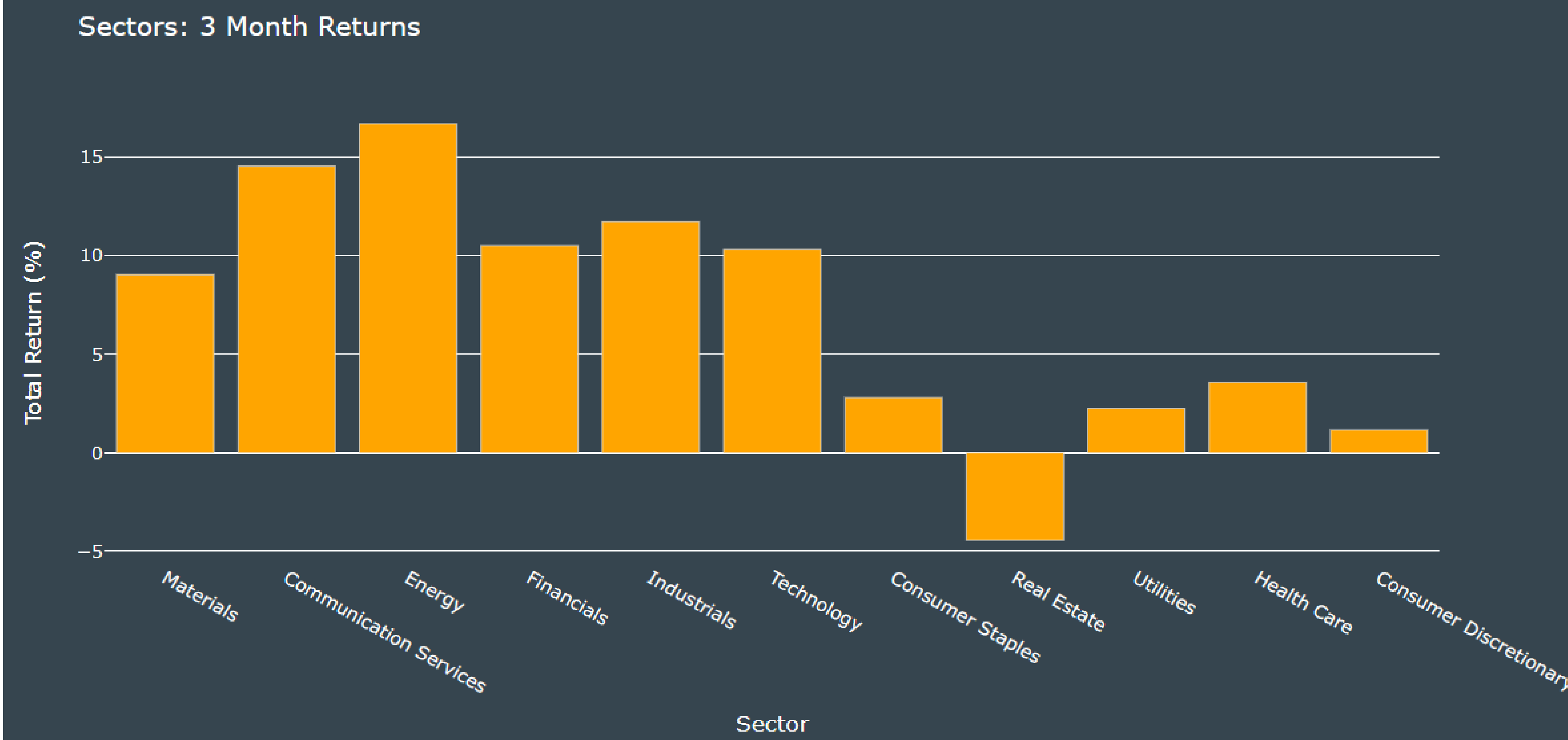
This week, the financial markets experienced a resurgence of volatility, which had been notably absent in recent months. Contributing factors included comments from Federal Reserve officials, growing concerns over inflation, escalating tensions in the Middle East, and the latest employment data. Federal Reserve officials Neel Kashkari and Lorie Logan highlighted inflationary pressures and their implications for monetary policy and interest rate adjustments, emphasizing that inflation metrics are currently taking precedence over employment figures. This discussion comes at a critical juncture, just before the release of the Consumer Price Index (CPI) data for March next week. Amid these developments, energy prices have surged due to increased tensions in the Middle East, particularly following an attack on an Iranian embassy by Israel. Iran, an oil producer with a daily output of nearly 4 million barrels predominantly sold to China, finds itself at the heart of these tensions. The potential for an escalating conflict in a region dense with major oil producers' spells uncertainty for oil prices. Consequently, energy stocks have emerged as the top performer over the last three months, benefiting from the uptrend in oil prices. The BLS also delivered some surprises with the Nonfarm Payrolls report indicating a robust addition of 303,000 jobs compared to the anticipated 200,000, marking the second consecutive month of job gains. However, a deeper analysis reveals underlying issues with the data. Notably, this growth was driven entirely by part-time employment, with full-time employment numbers declining by over 1.8 million in the past four months. This shift towards part-time continues to be understated by the media that just touts the headline number.

Oil prices bottomed out in December of 2023 at around $68 and have since been on a steady trend higher. Below is the price of USO which is a proxy for Oil Prices.

Prices are testing resistance from October 2023. Oil is only one of many commodities showing strength. A diverse range of commodities, including gold, silver, copper, steel, and cocoa, are experiencing significant uptrends. This resurgence across the commodity spectrum is reigniting debates on inflation and raising critical questions about the Federal Reserve's effectiveness in stabilizing inflationary pressures.

As technology stocks started to plateau, the rising oil prices spotlighted an attractive sector for investment rotation: energy. This upward trend in oil prices is bolstering the profits and margins of oil producers, making the energy sector a beacon for investors seeking returns. Over the past three months, the energy sector has emerged as the top performer.



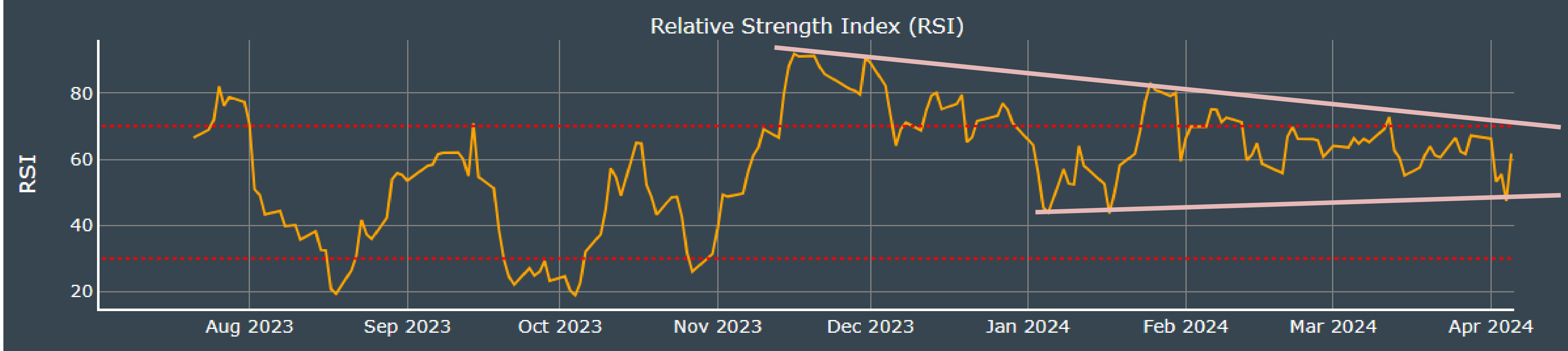
The Energy Sector ETF (XLE) is now on the cusp of surpassing its all-time high, set back in 2014, of approximately $99. A rejection at this level would signal momentum in this space is slowing and we could see consolidation but a confirmed break above it would mean the rally still has legs.

In recent years, Federal Reserve officials have been remarkably vocal about their perspectives on the economy and financial markets. Given the significant influence their opinions wield, it might be prudent to reconsider the frequency of their public addresses. Currently, their weekly speeches about potential future actions contribute to market confusion and unnecessary volatility. A case in point occurred last Thursday with Neel Kashkari's remarks.

"If we continue to see inflation moving sideways, then that would make me question whether we need to do those rate cuts at all,"

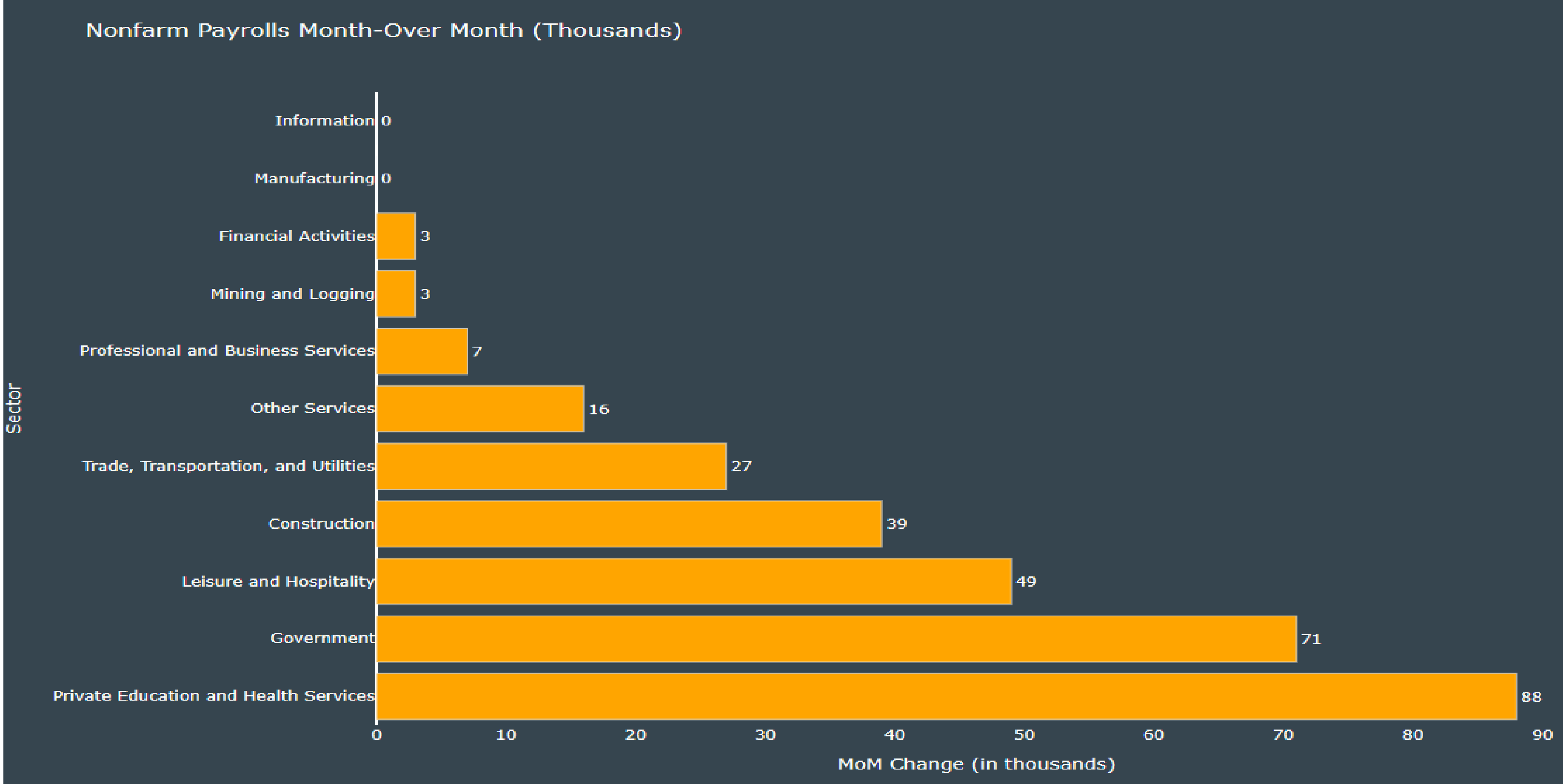
Kashkari added that if inflation continued to be stronger than hoped, he anticipates the Fed would hold its benchmark policy rate at the current 5.25%-5.50% range for a longer period of time. If that still did not work, further rate increases are "not off the table, but they are also not a likely scenario given what we know right now."

Although it appeared that the remarks were relatively subdued, the impact on the market was significant. Following the comments, the S&P 500 experienced a sharp 2% reversal, shifting from positive on the day to a decline of over 1%. This movement was largely driven by hearing reduced rate cuts or potential rate hike. Additionally, the index broke through the 20-day moving average (DMA), a crucial support level that has underpinned the recent rally. While there was a recovery on Friday, a confirmed breach of the 20 DMA could trigger the onset of an overdue correction in the range of 5-10%.

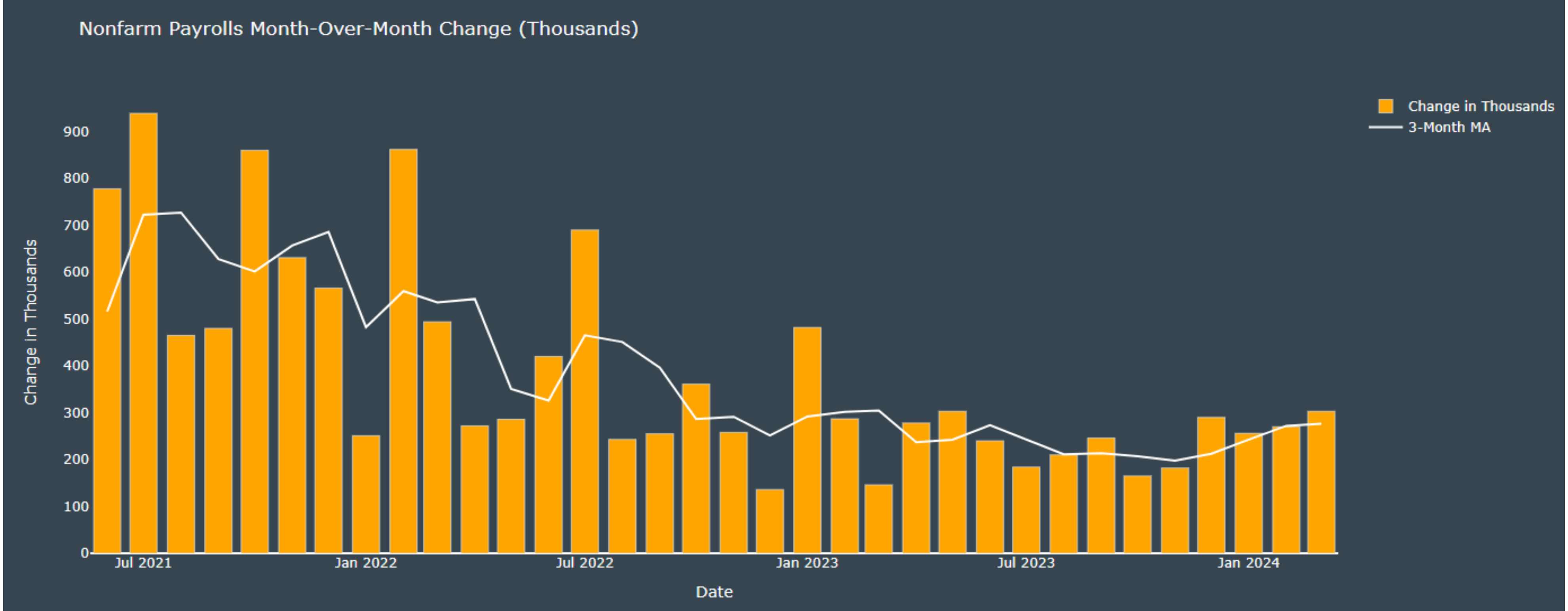


The Nonfarm Payrolls report exceeded expectations, posting a robust 303,000 jobs versus the anticipated 200,000, prompting a widespread rally in the market alongside rising yields—a market behavior that has become less common over the past year. Historically, rising yields and stock prices often moved in tandem, as investors typically shifted from bonds to equities. However, this dynamic has changed, with higher yields recently exerting downward pressure on stock prices. In contrast, the strong job report on Friday signaled to the market that the economy remains resilient, capable of withstanding higher yields. This interpretation led to an unusual but welcomed simultaneous increase in both yields and stock prices, encapsulating a sentiment that a robust economy can support higher yields and buoyant equities.

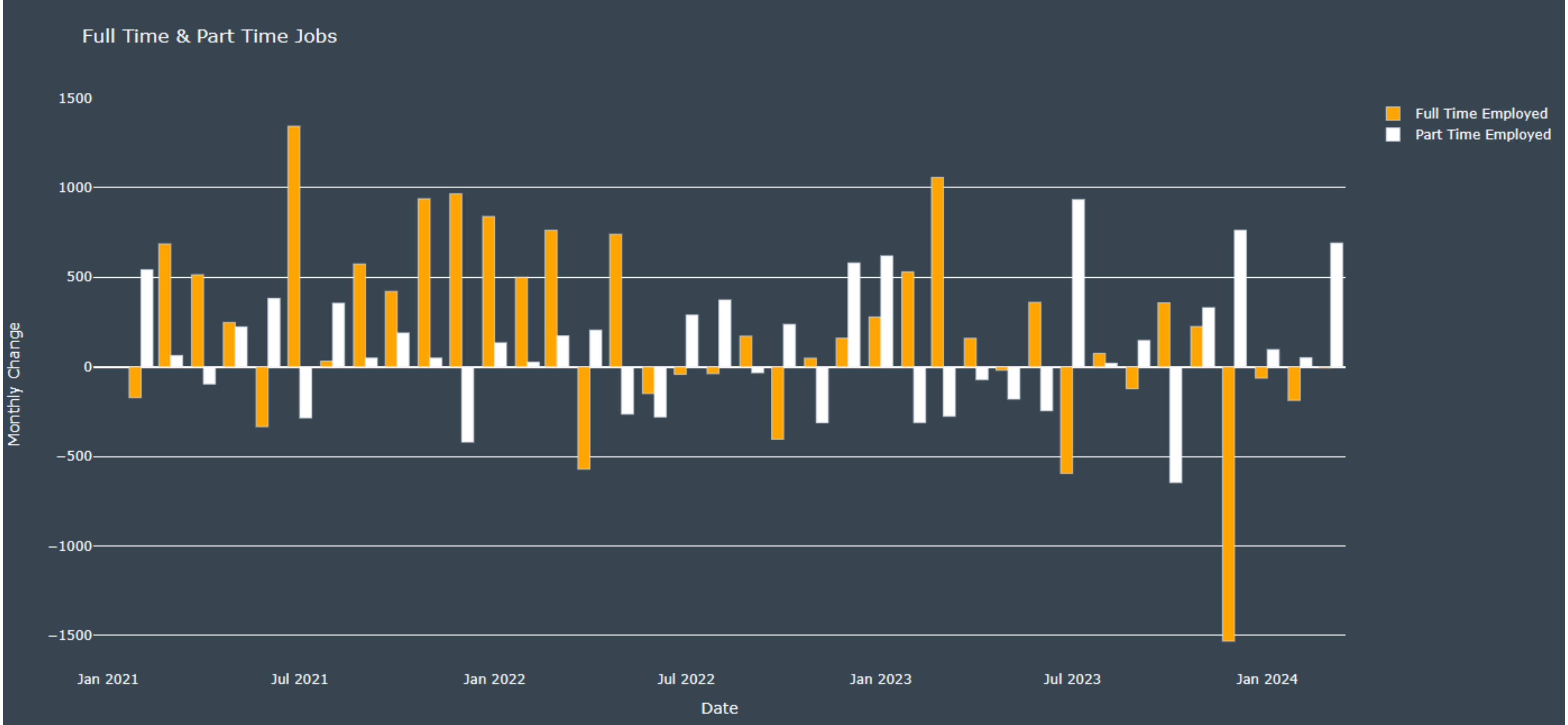
The sectors at the forefront of payroll increases were Private Education and Health Services, Government, and Leisure and Hospitality. Remarkably, for another consecutive month, over 50% of the job additions were in government-related positions. As previously noted, a heavy reliance on government sector job growth does not necessarily indicate a robust economy.



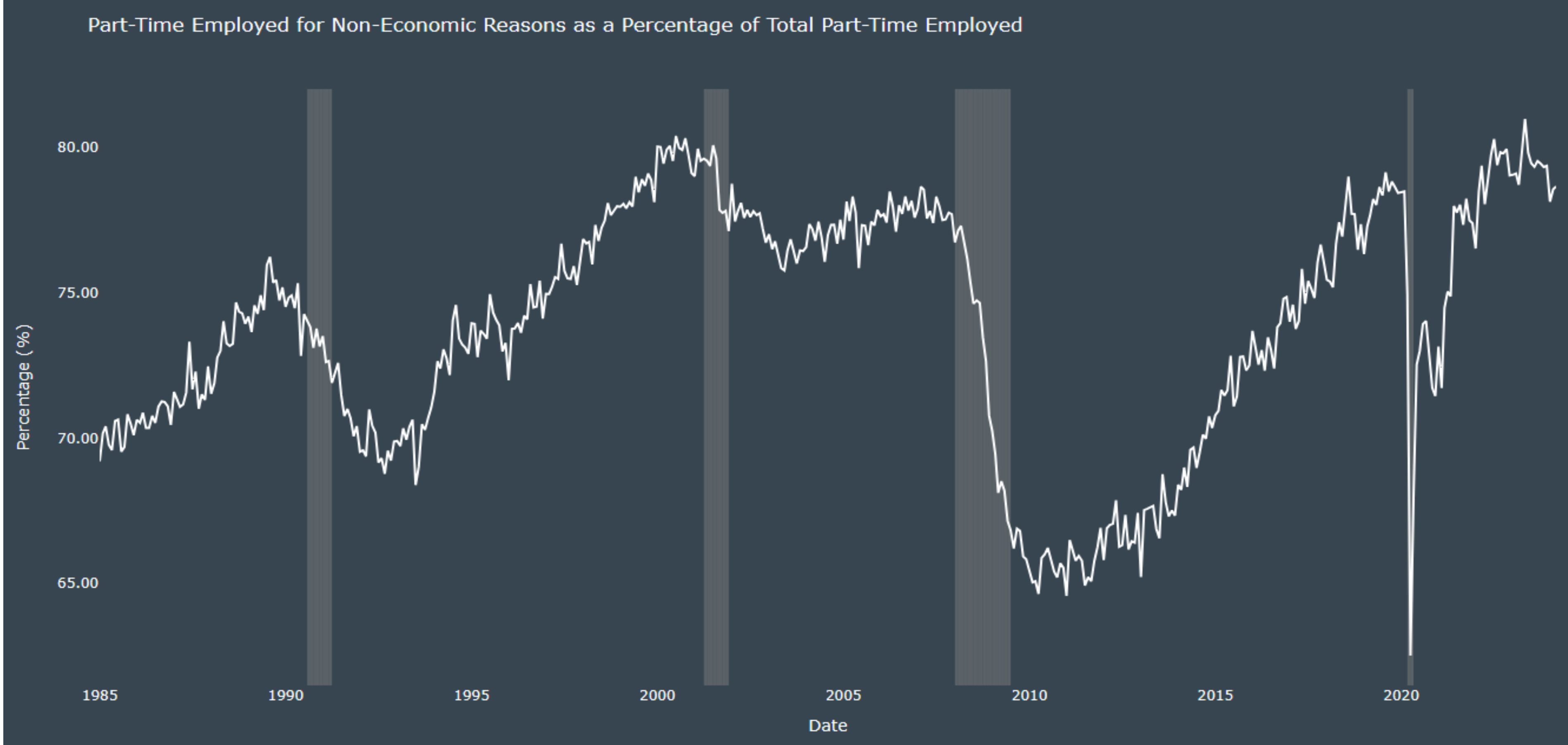
This month's headline job growth of 303,000 exceeded the three-month moving average and marks the second consecutive month of increases.



Moreover, this month's figures highlight a persisting trend in the job market: a lack of growth in full-time employment. Remarkably, the entirety of last month's job creation was in part-time positions. So, despite overall job growth, the quality and stability of part time positions does not represent a strong labor market.



The Bureau of Labor Statistics (BLS) offers a detailed breakdown of employment data, distinguishing between "Part-Time Employed for Economic Reasons" and "Part-Time Employed for Non-Economic Reasons." Over the last year, the latter category has accounted for more than 80% of the part-time jobs. An analysis by @NeelyTamminga on Twitter sheds light on the criteria used by the BLS to differentiate between these two types of employment. Economic reasons include factors like slack work, unfavorable economic conditions, challenges in securing full-time employment, and seasonal drops in demand. Non-economic reasons, on the other hand, encompass health issues, childcare or eldercare obligations, educational commitments, and retirement or limitations on earnings. Notably absent from these classifications are situations such as the need to meet household expenses, the loss of a spouse's job, or preparing for a new family member. This omission highlights a nuanced area within the BLS's categorization, potentially obscuring the real motivations behind individuals' pursuit of part-time work, whether out of financial necessity or for additional income.


Part-Time Employed for Non-Economic Reasons as a Percentage of Total Part-Time Employed
Percentage (%)
80.00
75.00
70.00
65.00
1985
1990
1995
2000
2005
2010
2015
2020
Date

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