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MACRO MUSINGS

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Unusual Economic Data As Pandemic Conditions Subside

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SUMMARY

- While higher inflation was anticipated, the latest print came in even higher than expected. However, digging deeper into the numbers suggests unique conditions accounted for most of the increase.
- The April jobs report came in much weaker than expected, with only 266,000 jobs added compared to expectations for a million. Other employment figures did not confirm the weaker than expected report, suggesting job growth remains robust.
- More than six months have passed since the market's last 5% decline. While it may seem intuitive that this streak will exacerbate the next decline, this has not been the case historically. In the previous seventeen instances, not one led to a bear market (greater than 20% decline).

HIGHER INFLATION WAS EXPECTED, **BUT NOT THIS HIGH**

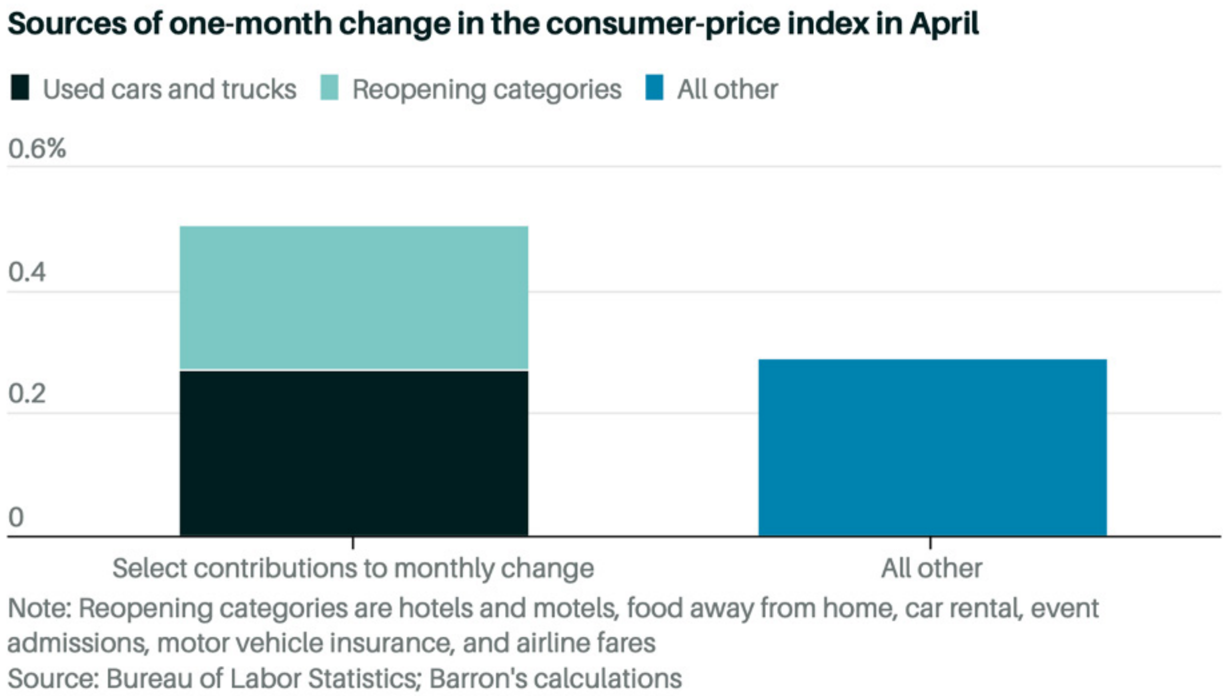
In April, the consumer price index (CPI) was up 4.2% vs. last year. Core CPI, which excludes volatile food and energy prices, rose 0.8% from March to April. While a rise in inflation was expected, this was well above expectations.

These figures are noteworthy. The annual rate is the highest since 2008, while the core figure is the largest month-to-month increase since 1981. Inflation worries have been rising over the past several months; could those fears finally be coming to light?

We do not believe so. When you dig deeper into the numbers, the recent data does not look nearly as alarming.

First, you have the base effect. In this case, the year-over-year comparison is unusually large because the prior year's number was weak. May 2020 represented the nadir of the Covid pandemic economic collapse. Prices have been steadily rising since.

The base effect doesn't explain the large month-over-month change in Core CPI, but where prices increased does matter. A substantial part of the increase came from specific areas related to reopening (like air travel) and constraints in the automobile industry. About half of the growth came from used cars and reopening categories (chart from Barron's):



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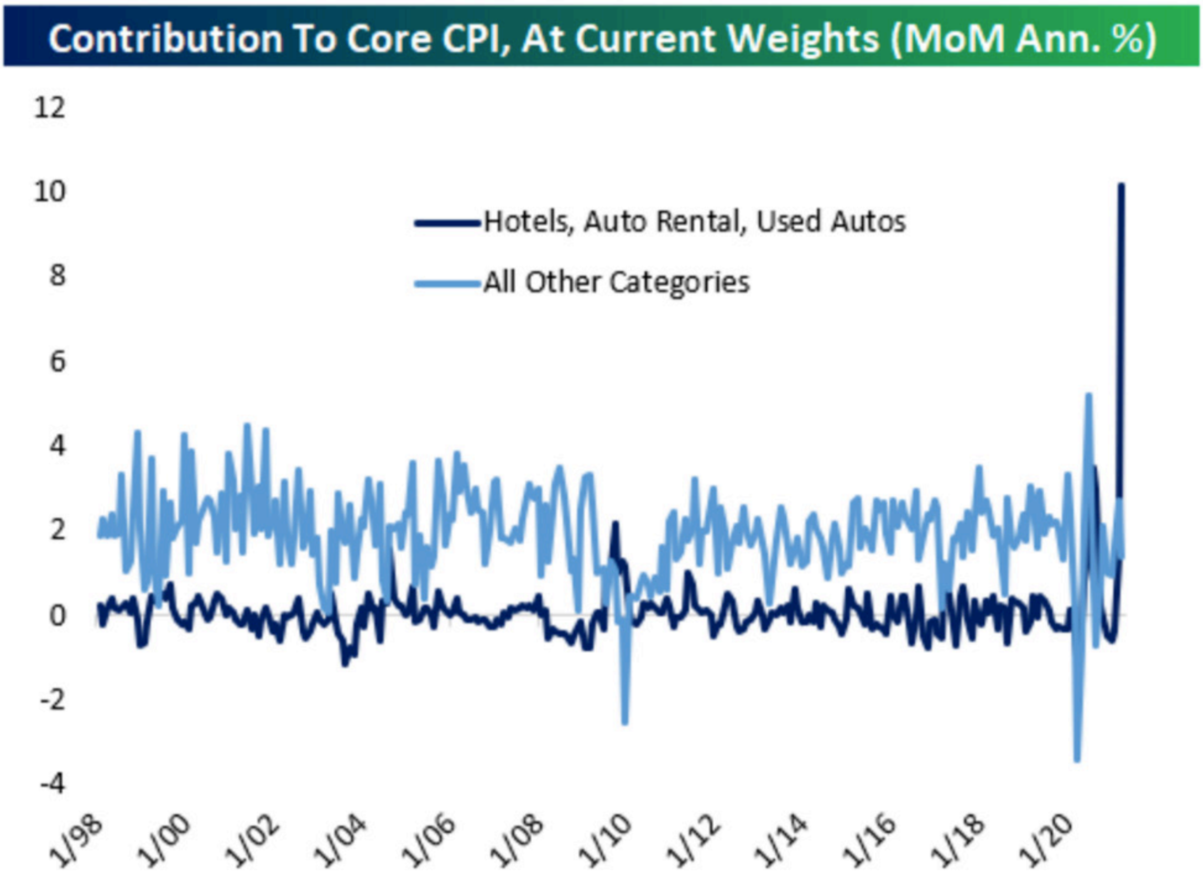
Used cars and the various reopening categories only make up about 5% of the overall price index. This chart from Bespoke shows how uncommon this sort of spike is and how it overwhelmed the rest of the index:



The quirks in the supply chain affecting the automobile industry should be resolved in the months ahead. Likewise, other "reopen" categories should see prices moderate as industries like airlines increase the number of flights to meet the rising demand for air travel.

Perhaps the biggest takeaway from the inflation data is that the Fed remains undeterred despite the record increase. In recent speeches, various Fed officials have continued to convey their belief that any inflation will be short-lived. The Fed still cares more about getting unemployment down to 4% than about inflation rising to 4%.

THE JOBS REPORT WAS **DISAPPOINTING**

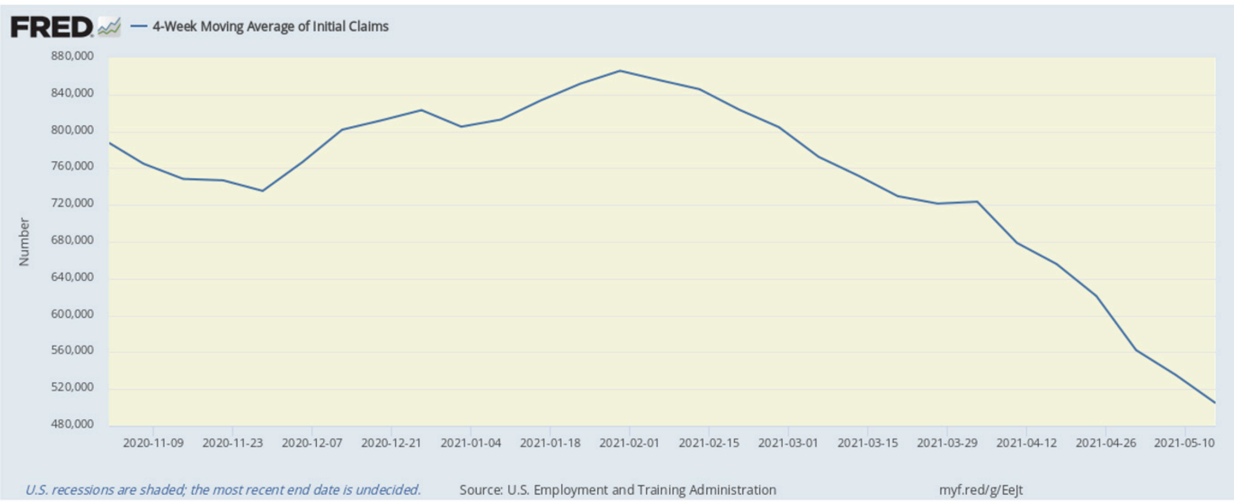
Economists expected over a million jobs to be created in April, but the actual figure was 266,000.

Several reasons have been cited for this huge discrepancy:

1. **Fear of Covid** – some people are slow to return to work out of fear of getting sick.
2. **Childcare issues** – people would work, but many schools and daycares are still not running at full capacity, and summer camps are limited.
3. **Extra unemployment benefits** – the unemployed are getting an additional $300 per week in insurance until September, thanks to the latest rescue package from Congress.
4. **Supply chain issues** – a shortage of semiconductor chips is limiting auto production, which in turn is limiting opportunities in manufacturing work.
5. **Skills mismatch** – jobs are available, but people lack the qualifications for them.

These explanations seem reasonable on the surface, but the monthly jobs report is one of the noisiest economic indicators and is subject to heavy revisions. It is impossible to dissect the exact reasons why the data came in this way. Combined with the fact that the economy is transitioning to a post-pandemic reality, it is no surprise that the estimates were way off.

In our view, the biggest concern for the economy would be if job growth were slowing due to a lack of demand from employers. That does not appear to be the case. Other employment indicators like initial claims—arguably the timeliest indicator for the job market since it is updated weekly—suggest the employment situation continues to improve:



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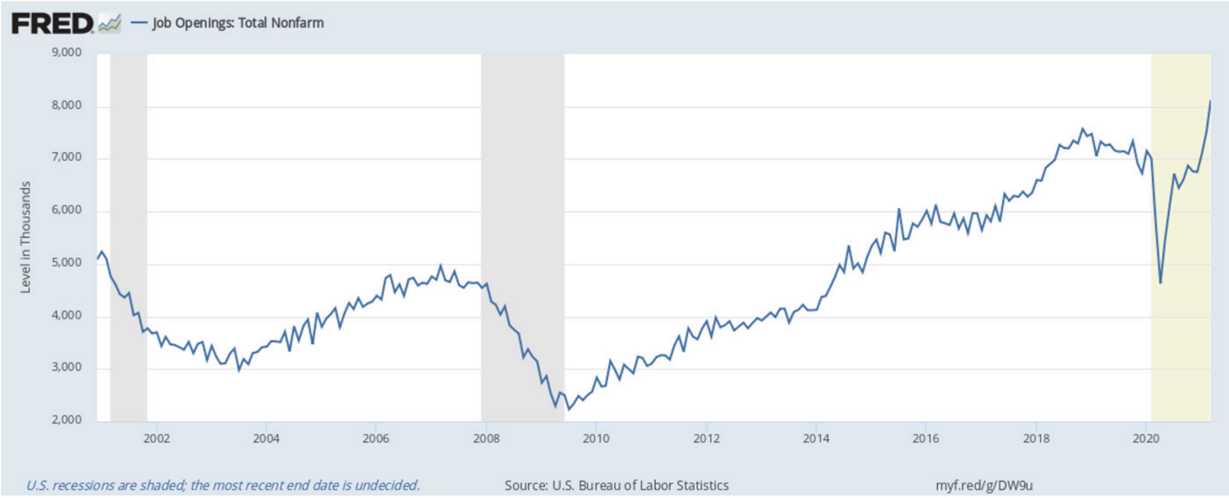
Likewise, job openings are at an all-time high. Not something you see at the start of a slowdown in the economy:



So, what caused job growth to miss expectations? Perhaps the simplest explanation is economists were just too optimistic. Generating a million jobs in one month is extremely rare. There have been only four months in the last thirty years that saw jobs grow at that pace, and they were the four months after the lockdowns of last spring, which left over twenty million people out of work. Before that, the only other month on record was September 1983.

Ultimately, it is the trend that matters much more than one month of data, and the trends in initial claims and job openings remain encouraging and bode well for continued economic growth.

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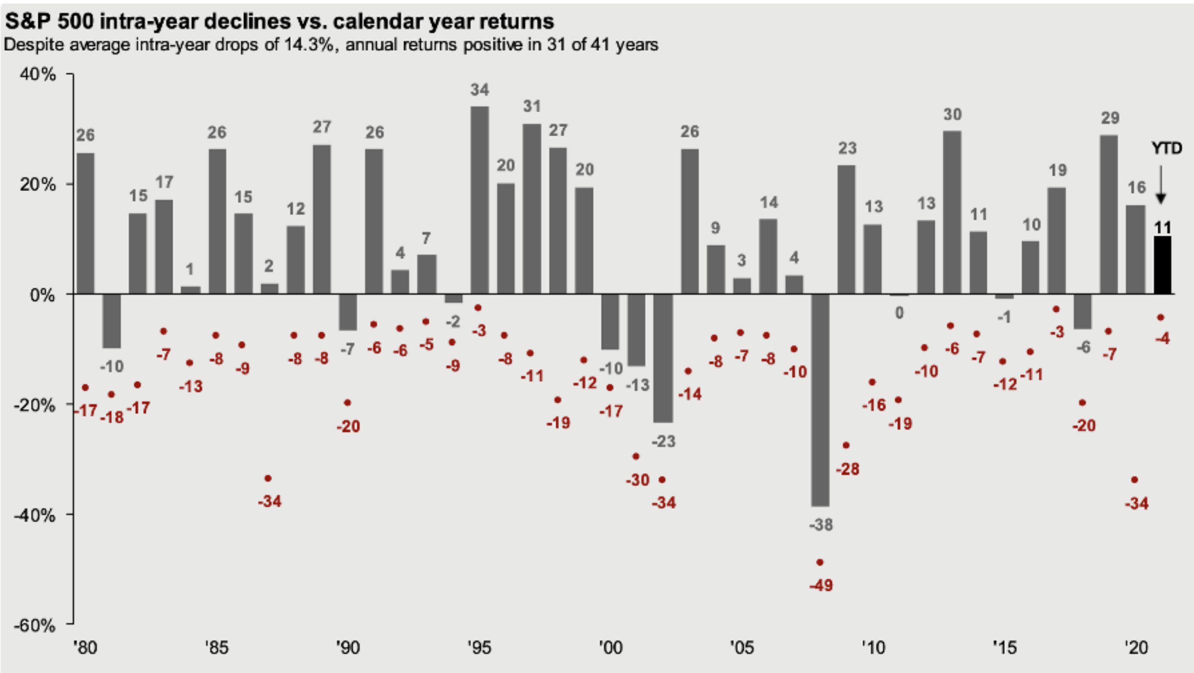
IT'S BEEN A WHILE SINCE
THE MARKET DECLINED 5%

The S&P 500 has not suffered a 5% decline since last October, one of the longest streaks in history. As a reminder, a 5% correction in a calendar year is the norm. Only in 1995 and 2017 did the market fail to correct at least 5% (chart from JPM):



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2020, over which time period the average annual return was 9.0%.

It is tempting to think that the longer we go without a 5% drop, the bigger the eventual fall. However, historically, this has not been the case. In previous instances when the market went at least six months (134 trading days) without a 5% decline, short-term returns were below average, but returns six months out were fine. More importantly, there were no bear markets during any period (data from Sentiment Trader):

S&P 500 after 134 days without a 5% drawdown from all-time high

Signals (17)	1 Week	2 Weeks	1 Month	2 Months	3 Months	6 Months	1 Year
Median	**0.1**	**0.5**	**-0.1**	**0.6**	**1.8**	**6.6**	**6.3**
% Positive	**59%**	**59%**	**41%**	**53%**	**71%**	**76%**	**65%**
Avg Risk	-0.4	-0.6	-1.3	-3.8	-3.8	-4.9	-6.1
Avg Reward	0.5	0.9	0.9	2.5	3.3	7.9	12.1
% Big Drop	12	12	18	12	18	12	12
% Big Rise	6	6	6	0	0	6	18
Z-Score	-0.1	0.3	-0.8	-0.7	-0.1	1.7	-0.5

© SENTIMENTRADER Numbers are % return after signal; Risk = avg max loss; Reward = avg max gain; Z-Score +/- 2 suggests significance.

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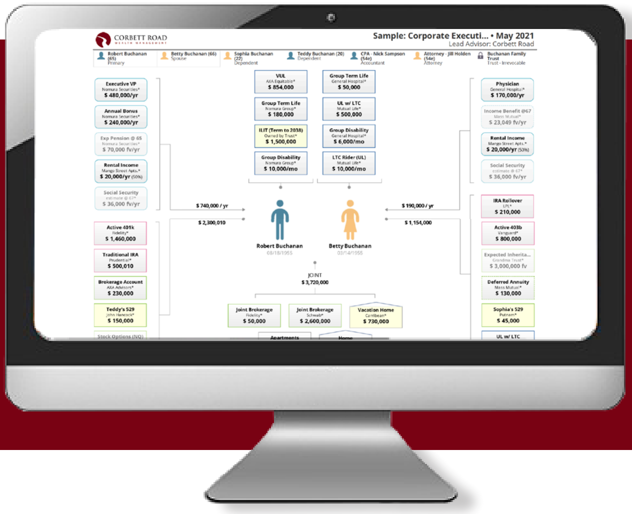
SUMMARY:
ONE MONTH DOES NOT MAKE A TREND

While recent inflation data came in higher than expected and the jobs report disappointed last month, we remain focused on the trend, which continues to be positive. As the economy recovers from an unprecedented series of events in 2020, it is not all that surprising to see some unusual economic data in the aftermath of the pandemic. The categories contributing to last month's higher inflation rate are unlikely to see sustained price increases of that magnitude, and the trend in employment data remains overwhelmingly positive. Recently, the market has shown exceptional resilience, and historically, new all-time highs and a lack of significant declines have been predominately bullish for the future. Synthesizing all of this, we have a positive **macro**cast™ score suggesting that bear market risk remains low.



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