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PORTFOLIO ANALYSIS & CONSULTING

Charts and Smarts®

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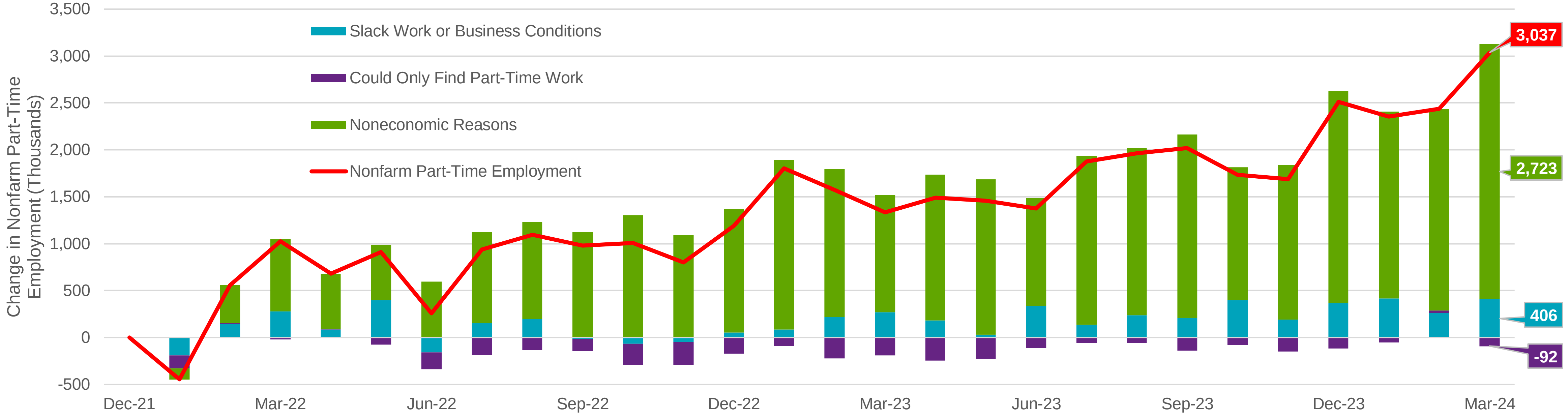
Breadline

Contribution to Change in Nonfarm Part-Time Employment (12/31/21–3/31/24)

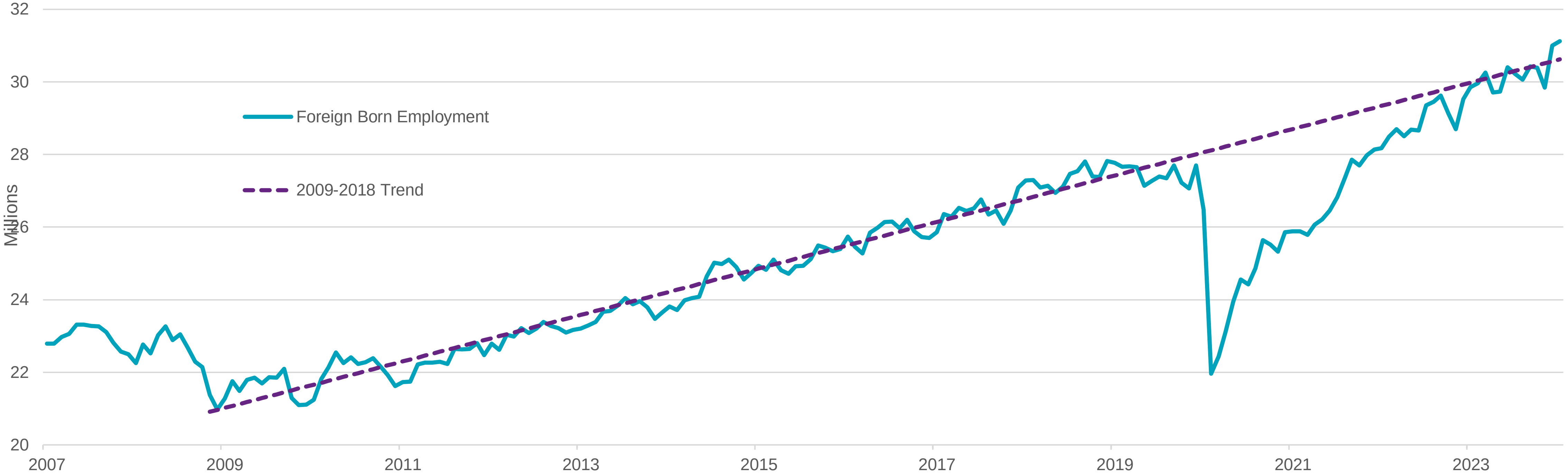


After a modest deceleration in late 2023, the labor market is off and running again with momentum picking up, as we've now strung together five consecutive beats on nonfarm payrolls growth, good for the second-best streak since 2000. Better yet, that strength has come even as wage growth continues to normalize. Despite this unequivocally good news, the bears continue to poke around for red flags that suggest impending doom. The latest narrative seems to have settled on the increase in part-time employment in a "pick your adventure"-type story. Either part-time employment is rising because workers can't find full-time employment, or budgets are getting squeezed, forcing consumers to pick up extra jobs to augment their incomes. Fortunately, the Bureau of Labor Statistics includes the reasons for part-time employment. The first of these paths is clearly refuted by the responses, which actually denote a decline in those working part-time due to their inability to find full-time work, and only a modest increase in those working part-time due to slack work or business conditions. That leaves 2.72M of the roughly 3M increase in part-time employment since December 2021 driven by noneconomic reasons. The tireless bears have tried to spin this yet again, but from our perch the increase is just another sign of a strong labor market. Instead of working part-time because of stretched budgets, perhaps potential workers who might otherwise not be able to work due to school or caregiving arrangements, are being drawn into part-time roles that provide sufficient flexibility from hours and location. Part-time employment is indeed on the rise, but similar to the rise we've witnessed in the unemployment rate, it's rising for good reasons, as a tight labor market draws workers off the sidelines and increases labor supply, helping to place downward pressure on wage growth. That's good news, not bad.

Source: Portfolio Analysis & Consulting, Bloomberg.

Hangar 18

Foreign Born Employment (1/31/07–3/31/24)

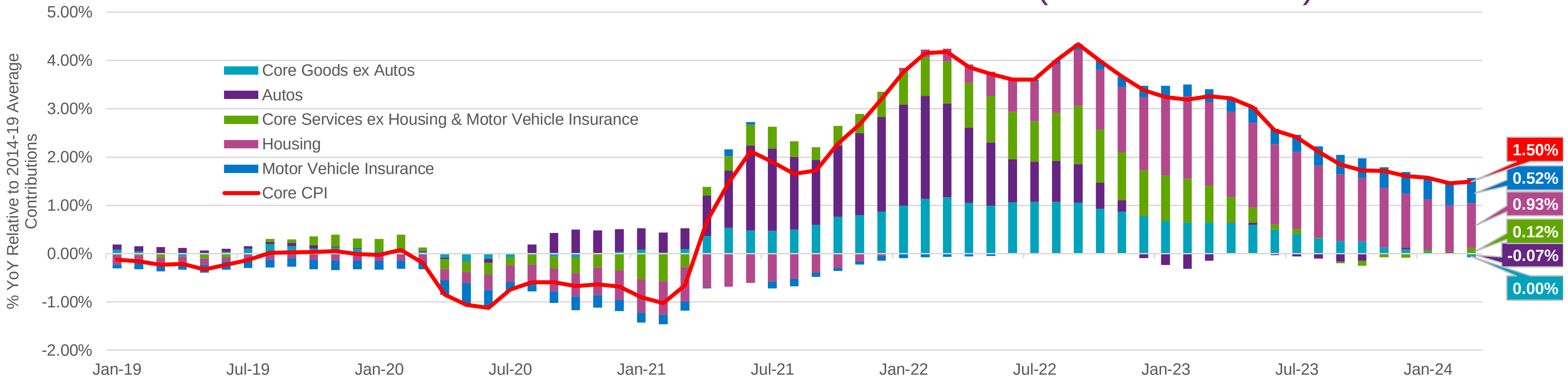


Two likely driving forces behind the increase in part-time employment have been the gains in participation rates for 16 to 24 year olds to near cycle highs as well as prime-age women to near all-time highs. While this has undoubtedly contributed to the increase in labor supply and resulting softening in wage growth, another driver has finally been receiving its due share of credit of late: immigration. Our readers will know we've long pointed to recovering immigration as a source of increasing labor supply, particularly for service industry jobs that have seen the most acute labor supply issues. Foreign born employment has added nearly 8.7M jobs since the pandemic lows and over 3.4M jobs from pre-pandemic levels, helping to reclaim the robust 2009-2018 trend despite no net growth in foreign born employment in all of 2019 due immigration curbs. With aging demographics and reduced labor force flows from older cohorts, particularly those 65+, increased inflows from immigration has been critical in helping alleviate the supply-demand imbalance in labor markets earlier in the pandemic recovery. That continues to pay dividends as strong labor supply from immigration, rising female and teen participation, and part-time employment, among others, have exerted downward pressure on wage growth, helping to remove any inflationary impulse from labor markets. The result: A resilient economy experiencing robust, disinflationary growth, which continues to show remarkable signs of strength and even reacceleration.

Source: Portfolio Analysis & Consulting, Bloomberg.

Chosen Ones

Contributions to Excess Core CPI Consistent with 2.3% Core CPI (1/31/19–3/31/24)

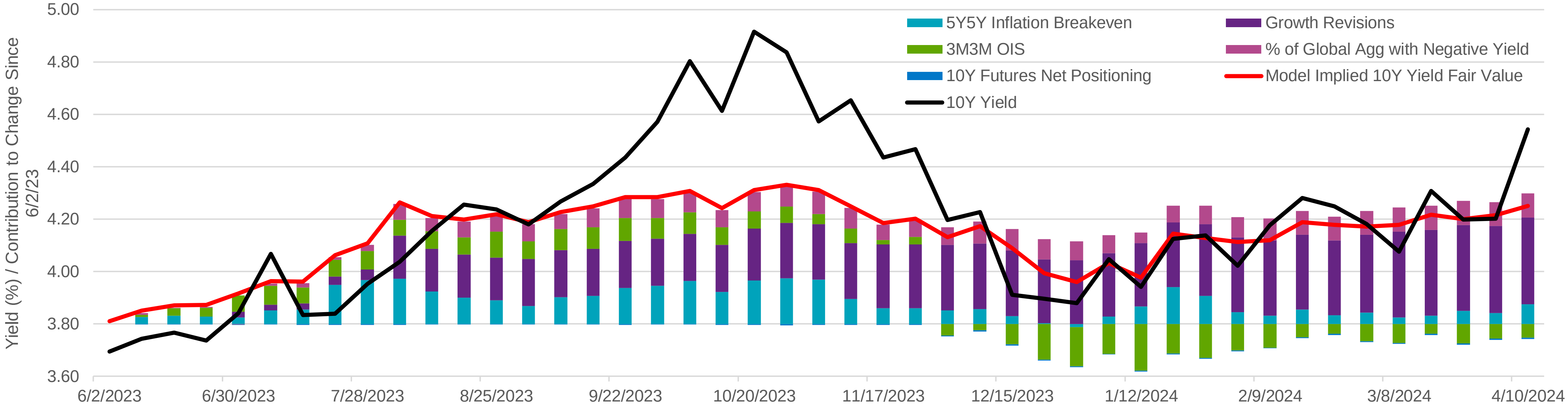


After a bumpy start to the year for inflation prints, which saw residual seasonality drive a notable uptick in the pace of monthly core CPI prints, the March CPI was one of the most anticipated inflation reports in some time, as the market looked to get the first clean read of the year. The print certainly delivered on drama as core CPI printed 0.359%, rounding up to the third consecutive 0.4% print and ahead of consensus estimates for 0.3%. It was certainly not the kind of drama the market was hoping for, and triggered a predictable selloff in both rates and equities and saw 2024 policy expectations trimmed to just 1.6 cuts. Beyond the headline figures, the reacceleration in supercore services CPI provided plenty of fodder for the bears and inflationistas to claim that inflation was, at the very least, remaining sticky above target and potentially reaccelerating. But below the surface, the story was no different than we've seen for months now. The print was driven almost entirely by moderating but still stubbornly high housing costs, elevated medical care services, and hot motor vehicle insurance. Though the print prompted some hysteria in markets, the details continue to point to an encouraging, albeit bumpy, disinflationary process. Looking at contributions to core CPI by the three components of Powell's Checklist, core goods, housing services, and supercore services all show cause for optimism. Core goods have normalized back to modest deflation, while supercore services excluding motor vehicle insurance have returned back to pre-pandemic contribution levels consistent with 2% core PCE. The last remaining culprits: Housing and motor vehicle insurance are inherently lagged, and each have a pipeline of disinflation yet to come, as multi-family supply continues to improve and new and used vehicle prices and vehicle repair costs, which drive insurance premiums, continue to cool. It's no longer about broad based and structurally sticky inflation, but rather a function of time, as the pipeline of disinflation works its way through the last bastions of inflation in housing and auto insurance. The song remains the same: the Fed's easing bias remains intact and policy recalibration is a matter of when, not if. That's all that matters for risk assets.

Source: Portfolio Analysis & Consulting, Bloomberg. Excess inflation defined as contributions to core CPI relative to 2014-2019 average contributions consistent with 2.3% core CPI and 2.0% core PCE.

One Thing

Contribution to Cumulative Change in 10Y Yield Fair Value Model (6/2/23–4/10/24)

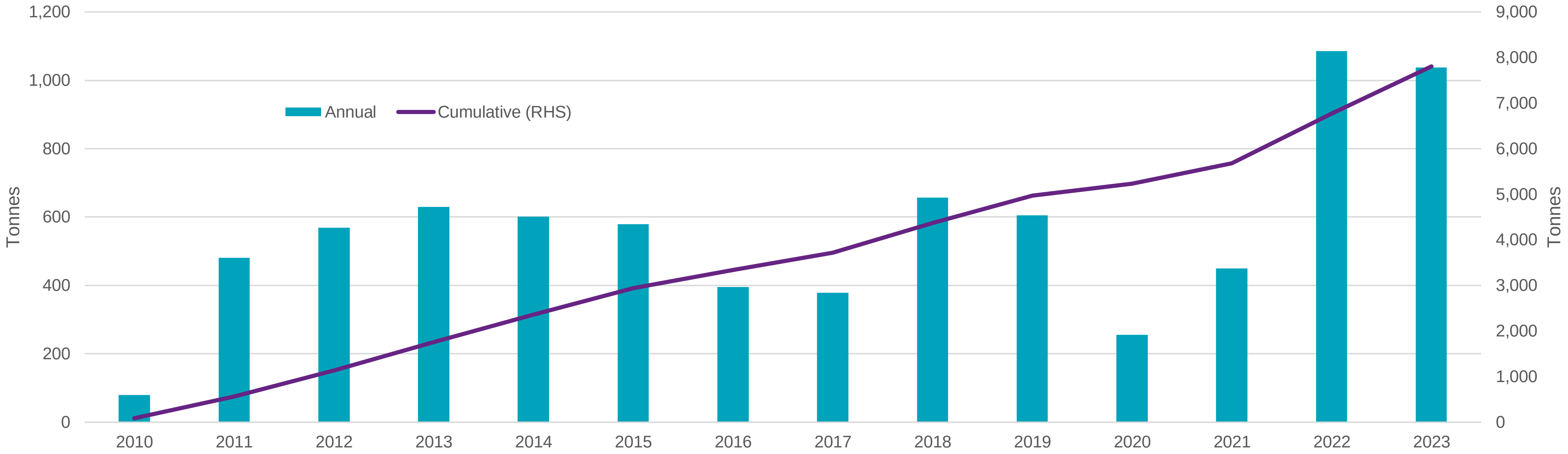


What a ride it's been in rates markets over the past year. The 10-Year yield swung wildly from 3.30% in April 2023 during the depths of the banking turmoil up to 5% in October on the back of strong growth, debt ceiling fears, deficit concerns, increasing coupon supply, and a technical air pocket, before finally retracing back below 3.80% by year end 2023 on soft landing optimism. Since the December lows, the 10-Year yield has been stair-stepping higher as the market unwound 2024 rate cut expectations before surging back up through 4.50% on the heels of the March CPI print. So as calls for a return to 5% or even higher begin to percolate yet again, where do the fundamentals pin fair value for 10-Year yields? A simple regression of inflation expectations, growth expectations, short rates, global rates, and futures positioning has a strong track record explaining the moves in yields with an R-squared of nearly 93%. Not too shabby. Today, that model places fair value for the 10-Year at about 4.25%, just a stone's throw away from the Q3 peak for the model of 4.33% as the 10Y marched up to 5%. What's notable, however, is the drivers of the moves are quite different. Whereas the move in Q3 was set off by stronger than expected growth, rising inflation expectations, then triggered a backup in global rates and an increase in short rates expectations. The recent backup, however, has been almost entirely driven by rising growth expectations as inflation expectations have remained largely in check. The model and its drivers suggest that the trading range for 10-Year yields may begin to compress as robust growth limits the scope of policy recalibration, lifting the floor closer to 4% as a continuation of the disinflationary process puts in a ceiling around 4.5%. But just as we saw last year, there's always scope for a technically driven overshoot and, as the market has priced out almost all traces of cuts in 2024 and calls of sticky inflation above target have grown in both number and volume, the pendulum may be close to swinging too far to the higher for longer camp once again.

Source: Portfolio Analysis & Consulting, Bloomberg. Model consists of 5Y5Y Forward Breakeven, JPMorgan US Forecast Revisions Index, 3m3m OIS, Percent of Global Debt with Negative Yield, and net 10Y Noncommercial futures positioning.

Symphony of Destruction

Net Gold Demand From Central Banks (2010–2023)



One of the most head scratching moves cross assets over the past few months has been the torrid run for gold, which has surged nearly 20% over the past two months and is up over 46% since the September 2022 lows. While common explanations for its surge fall back on looming recession risk and sticky inflation, these narratives miss the mark as consensus has finally capitulated on recession calls and inflation has cooled rapidly over that time. To be sure, recent inflation prints have reinvigorated calls for sticky inflation, but a look at flows and ETF holdings of gold show little retail interest in the precious metal, despite those percolating fears. So, what's truly behind the gold rock's move? Central bank purchases have soared over the past two years as foreign central banks look to diversify their reserve holdings away from the dollar. Now, before we go too far with the dollar's demise narrative, the dollar is not on a rapid freefall in its standing as the global reserve currency. That's a process that would take decades, not a handful of years, and there's yet to be a suitable alternative to the dollar, which gold and bitcoin, for that matter, certainly are not. But what has happened in recent years is a shift underway by some countries, particularly Russia and China, in addition to some other foreign actors, to reduce their reliance on dollar reserves in the wake of the weaponization of the dollar against Russia, as a result of its invasion of Ukraine. A massive price-insensitive source of demand seems to be the driving force behind the stunning move that has defied typical correlations and relationships. Just how far that move can run remains to be seen, as growth remains robust with elevated real yields and cooling inflation.

Source: Portfolio Analysis & Consulting, World Gold Council.

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