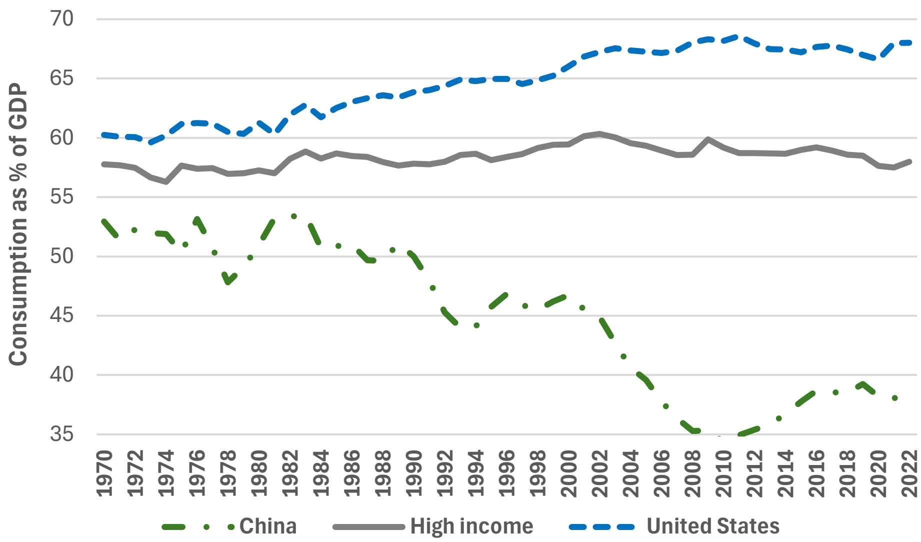
FOUNTAINHEAD
ASSET MANAGEMENT

Market Commentary: The Current and Future State of Our Job Market

August 2024

Our economy is heavily consumer driven. According to the World Bank, consumer expenditures account for 68% of our Gross Domestic Product (GDP), which is approximately 10% higher than similar high-income countries and double that of China![1]

Consumer Expenditures % of GDP[2]



A key factor driving consumer spending is employment. Without a paying job, consumers find it challenging to spend. Both the current state of one's job and the perceived future security of that job influence spending behavior. If consumers anticipate an economic downturn and potential job losses, they may reduce spending. Conversely, during periods of economic growth, consumers may feel more confident in borrowing and spending more. In summary, consumer spending is influenced by (1) current income and (2) perceptions of future job security and overall economic conditions.

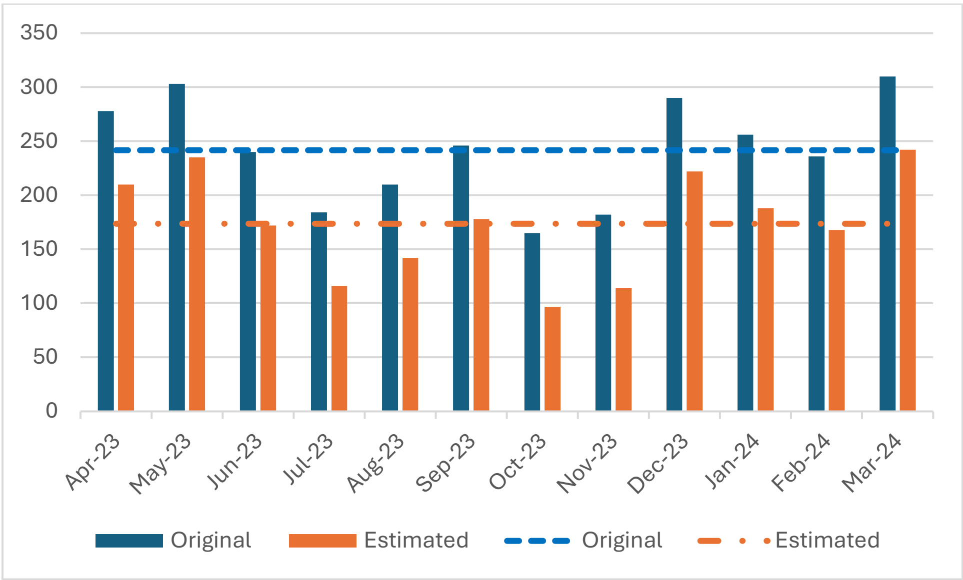
Let's examine the current job market and future job prospects:

[1] Economies do want a healthy mix of consumer and investment generated GDP, which the US has. China investments internally have attempted to create more consumer driven demand, which has run into some issues, such as the state of its local real estate market. Meanwhile, significant investment goes into exporting product which we in the US consume. The assumption is that China wishes they could create our consumer base locally. [No Quick Fixes: China's Long-Term Consumption Growth – Rhodium Group (rhg.com)]

[2] Source: [World Bank Group - International Development, Poverty, & Sustainability]

Economists estimate that the U.S. needs to add between 100,000 and 150,000 jobs per month to maintain a low unemployment rate and a healthy economy.[3] Our [recent podcast guest, Stephanie Aliaga of JP Morgan,][4] further refined this estimate to 50,000–100,000 jobs necessary based on U.S. demographics, with an additional 50,000+ jobs needed to account for immigration—both legal and illegal. Creating too many jobs in a month can lead to inflation as job seekers demand higher wages,[5] as seen in 2022 when job openings surged, largely due to an uneven economic recovery from Covid. Conversely, if too few jobs are created, consumer spending may decrease, leading to deflationary pressures.

Average Jobs decreased from 240,000 to 170,000[6]



In August, the Labor Department revised the number of jobs added over the 12-month period from March 2023 to March 2024 down by approximately 800,000. This adjustment lowered the average monthly gains from 240,000 to 170,000. The reduction was anticipated by the market, which had forecasted a 600,000 to 1 million decline, resulting in minimal reaction from financial markets.[7]

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[3] We have generally seen this range quoted. Statement by Acting Secretary of Labor Su on October jobs report | U.S. Department of Labor (dol.gov)

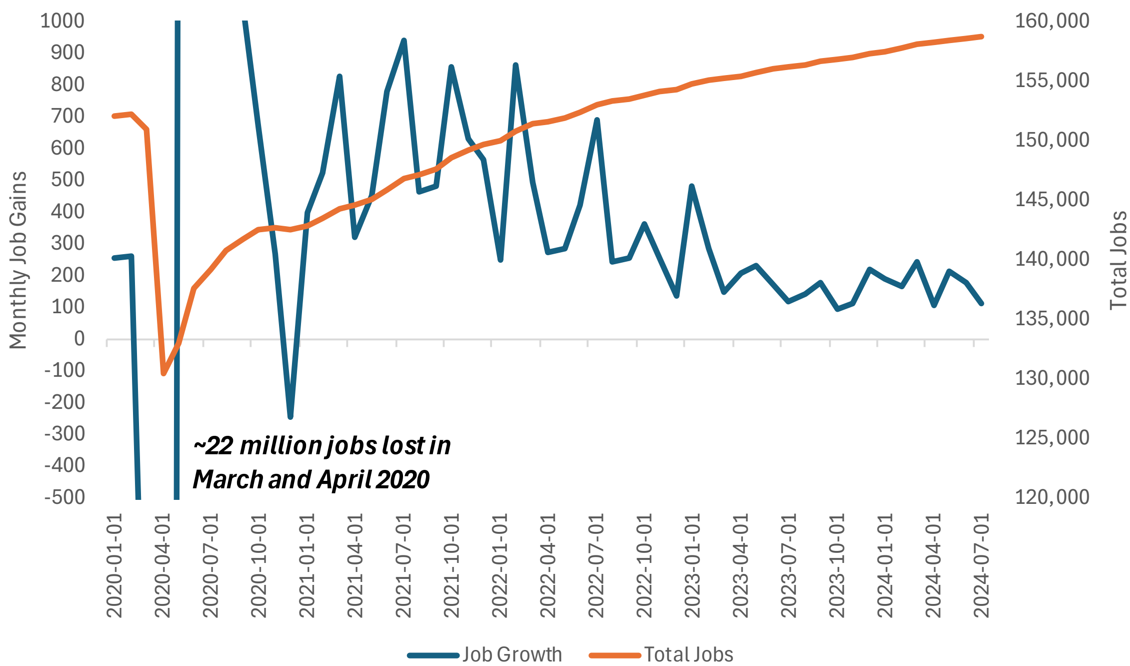
[4] 22. What Will Jobs Look Like i - Investment Wars - Apple Podcasts

[5] Which they would use to consume, driving up prices of everything.

[6] Source: Labor Department; chart created by Fountainhead

[7] How did this happen? Well initial job data comes from two surveys conducted by the Labor Department while the initial revision is based off of tax filings and updated demographic data – information not available on a monthly basis. It is actually how government transparency works in that a reasonable estimate is provided based on a rigorous methodology with further cleaning of data as it is captured.

Total Jobs + Job Growth – Note effects of Covid[8]



The Jobs report is likely to influence the Federal Reserve's decision to begin an easing cycle at their September meeting. The Fed will analyze expected job additions, among other indicators, to assess the potential softening of the economy.

Job security is closely linked to overall economic health. However, technology is significantly disrupting various sectors. For instance, the 3.5 million truck drivers in the U.S. may worry about being displaced by autonomous vehicles, while millions of warehouse workers and delivery personnel may fear job losses due to automation through robots and drones.

Artificial Intelligence (AI) has garnered significant attention recently and is increasingly integrated into daily practices. Will AI replace certain jobs? It's likely, but AI will also create new job opportunities. Historically, innovation has generally led to increased employment. While certain industries may face challenges, the broader adaptation of employee skill sets, and job requirements will evolve over time. A good example that was brought to our attention by Stephanie Aliaga is the evolution of bank tellers, who broadened their services as Automated Teller Machines (ATMs) replaced their original function.

[8] Source: Labor Department; chart created by Fountainhead

Deep Thought: The Case for Political Neutrality

[9]

"Silence is Not Violence: The Case for Political Neutrality"[10] by Dust to Dust is a thought-provoking article highlighting the dangers of allowing politics and every global cause to permeate all of our organizations and public spaces. The first part of the article highlights taking up causes without enough information – countering the argument of "silence is violence," while the second part highlights the prejudice and tribalism that arises by politicizing all of our organizations and public spaces[11]. The idea is that when organizations stick to their main causes or initiatives, and public spaces are more neutral, we allow people with different ideologies and backgrounds to mix, which ultimately lowers said prejudices and tribalism – after all, we are all human! Following is an excerpt:

Intergroup Contact Theory was "*first proposed by Gordan Allport in 1954 after studying the racial dynamics in the recently desegregated US military. In his seminal work, The Nature of Prejudice, Allport found that white soldiers in desegregated battalions displayed significantly lower levels of prejudice towards blacks than soldiers who remained in white-only battalions.... In a 2006 meta-analysis of 515 studies, psychologists Thomas Pettigrew and Linda Tropp found that intergroup contact typically reduces prejudice.* ***The mechanism is simple: the more we interact with outgroup members on a friendly, human-to-human level, the more we realize they are just like us.***"[12]

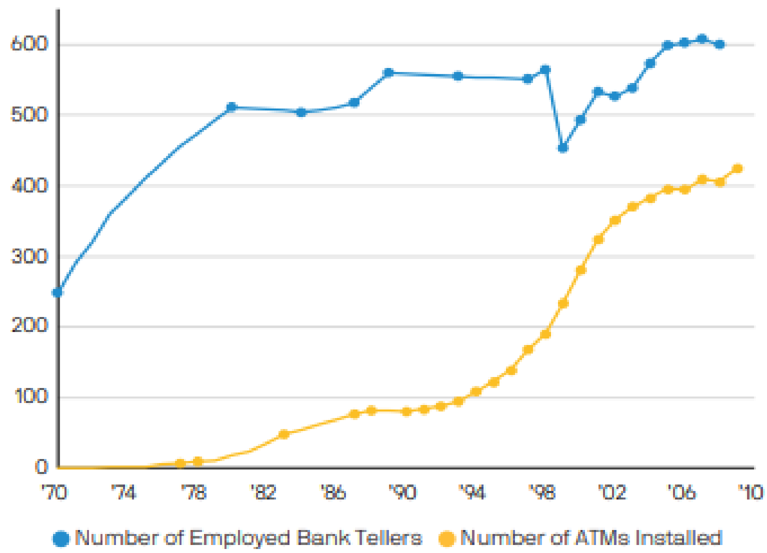
[9] Hands Across America is a great example of how 1980s culture uniquely sought to unite people for a cause.
[10] Silence is NOT Violence - Dust to Dust (substack.com)
[11] Intersectionality is a prime example of extraneous causes being incorporated within a focused charitable charter, alienating a subsection of those passionately believing in the actual charter but not the intersectional cause. A hypothetical example is of a local food bank taking a position on international climate change policy. The mission is to feed those in need locally, not address policy decisions on non-related causes.
[12] Silence is NOT Violence - Dust to Dust (substack.com)

The [World Economic Forum][13] publishes a biennial report titled "[Future of Jobs Report.][14]" This report explores future job market trends driven by technological innovations, highlighting both the loss of certain roles and the emergence of new ones. Key insights from the latest report include:

- **Income Inequality**: The report anticipates that income inequality will persist, particularly between high-income countries with tight labor markets and lower-income countries facing higher unemployment.[15]
- **Skill Disruption**: Employers estimate that 44% of workers' skills will be disrupted within the next five years. This raises questions about future job security and whether it will impact consumer confidence and spending.
- **Importance of Analytical and Creative Skills**: As machines increasingly take over routine tasks, analytical and creative thinking will become even more crucial for workers.

Exhibit 11: The expansion of bank automated teller machines (ATMs) coincided with growth in human bank teller employment

Total employment of bank tellers and ATMs, thousands



Source: Bank for International Settlements, Bessen (2016), Bureau of Labor Statistics, Occupational Employment Survey, J.P. Morgan Asset Management.

Despite concerns about technological disruptions, it's important to remember that these changes often take longer to materialize than expected. For instance, the report reveals that automation in operations increased by only 1% over the past three years, much slower than initially anticipated. Change is gradual.

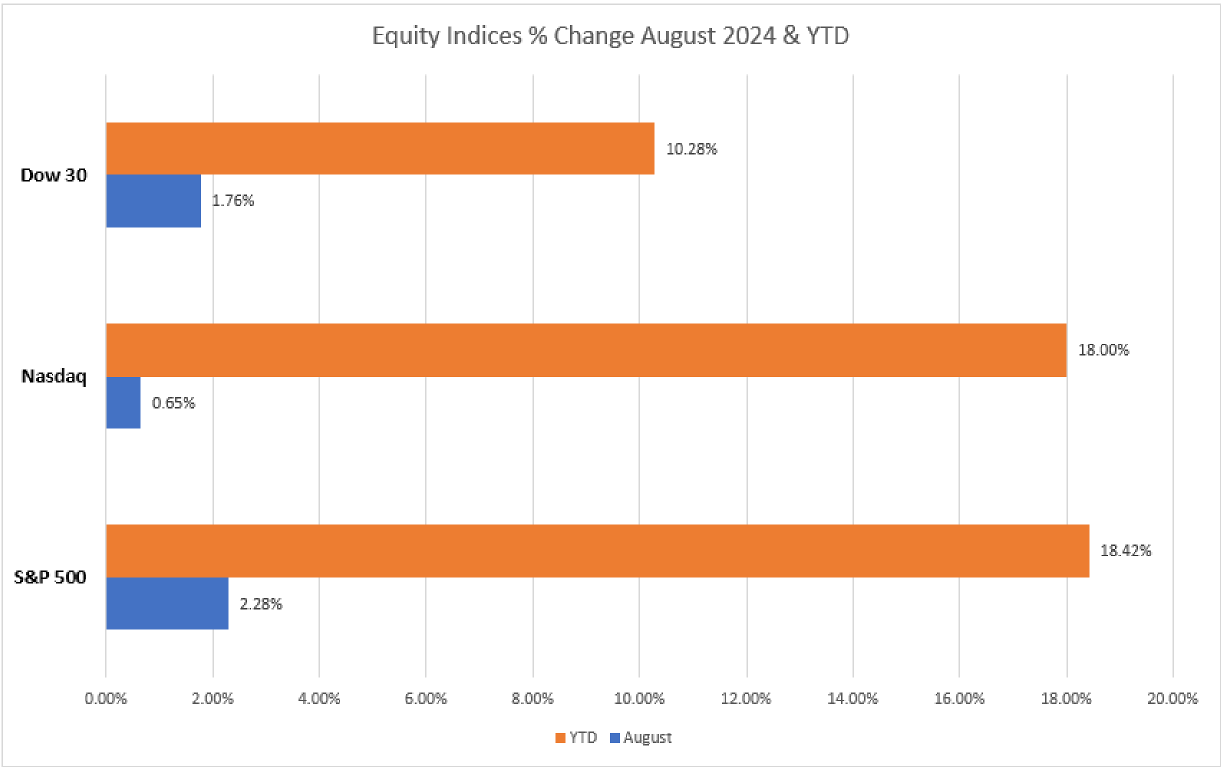
In summary, while we believe innovation will continue to drive positive disruption and increased productivity, it is likely to create new opportunities and generate further wealth and value globally.

[13] The World Economic Forum (weforum.org)
[14] WEF_Future_of_Jobs_2023.pdf (weforum.org)
[15] At some point, help desks will not be outsourced internationally – they will be outsourced to AI.

Talking Points: August 2024

Monthly Market Recap

After a rather volatile and negative start to August due to a massive unwind of a carry trade, coupled with anxiety around the economy given weak jobs data (note our market update on this event), markets managed to recover, resulting in mild positive returns in major US indices and further declines in yields.



Markets recovered on the back of positive inflation data and the belief that the Fed will begin to cut interest rates, which is generally viewed as a positive by Wall Street. Since the start of the Fed's hiking cycle back in March 2022 the hope has always been that the Fed would be able to "thread the needle" and not push the economy into a recession, while still managing to get inflation under control. This idea of a "soft landing" for the economy initially seemed unlikely, but as time went on it became the base case. This is due to the economy's general resilience (with the exception of small banks and areas within real estate) despite the Fed raising rates to 5.25% from 0% in less than a year and a half, resulting in a significant tightening of credit.

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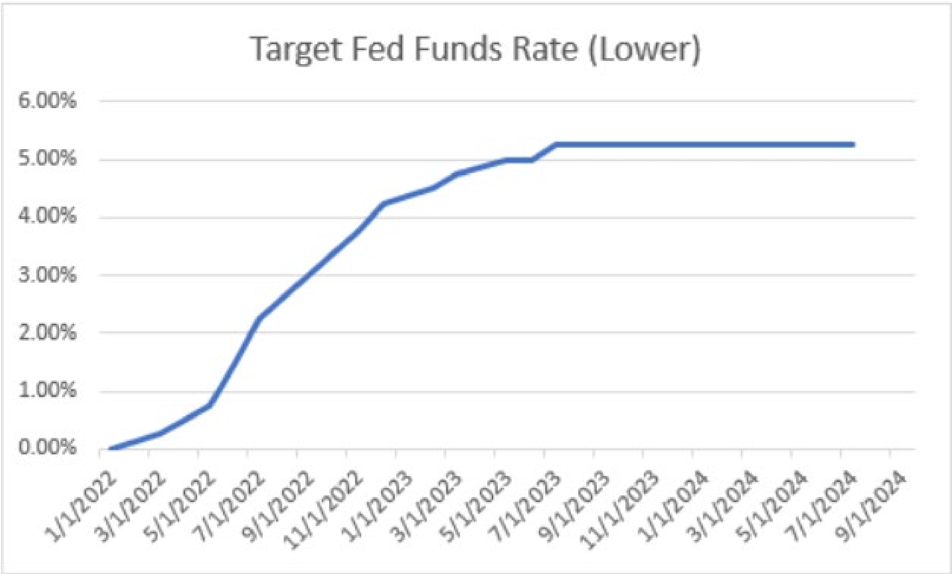

Recent economic data has set the table nicely for the Fed to cut and their commentary points to them being ready to do so. In fact, markets are pricing in a 100% chance of a rate cut to be announced at the upcoming Federal Reserve Open Market Committee (FOMC) meeting on September 17-18. Markets are pricing a ~70% probability of a 0.25% interest rate cut and a ~30% probability of a 0.50% interest rate cut.

Probability of Upcoming Fed Interest Rate Decisions							
8/30/2024	***Hike***	***Hold***	***Cut***	***Hike 25bps***	***Cut 25bps***	***Cut 50bps***	***Cut 75bps***
September	*0.00%*	**0.00%**	100.00%	0.00%	69.50%	30.50%	0.00%

Will the Fed be able to accomplish a soft landing? Data from this past month has certainly given them the breathing room to try. Note the bullish Inflation sentiment on the below FAM Sentiment Summary which counters the bearish Employment/Labor Market sentiment. A year ago, markets were very concerned that inflationary pressures would not allow the Fed to lower interest rates given softness in the economy – an important tool of the Fed (easing credit conditions to deal with market contractions). Now, inflation is allowing the Fed the room necessary to attempt to navigate to a soft landing or, perhaps as many analysts see it, a humming along of our economy!

FAM Sentiment Summary

2024	January	February	March	April	May	June	July	August
Fed	MILDLY BEARISH	MILDLY BEARISH	MILDLY BULLISH	BEARISH	MILDLY BEARISH	NEUTRAL	MILDLY BULLISH	MILDLY BULLISH
Interest Rate Decisions	NEUTRAL	n/a	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL
Commentary	BEARISH	MILDLY BEARISH	BULLISH	BEARISH	MILDLY BEARISH	MILDLY BEARISH	MILDLY BULLISH	BULLISH
Economic Data	NEUTRAL	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	NEUTRAL	MILDLY BULLISH	MILDLY BULLISH	NEUTRAL
Inflation	NEUTRAL	MILDLY BEARISH	BEARISH	BEARISH	NEUTRAL	BULLISH	BULLISH	BULLISH
Employment/Labor Market	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	BULLISH	NEUTRAL	MILDLY BULLISH	BEARISH
Housing/Real Estate	NEUTRAL	NEUTRAL	MILDLY BEARISH	MILDLY BULLISH	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	NEUTRAL
GDP	BULLISH	n/a	NEUTRAL	BEARISH	MILDLY BEARISH	NEUTRAL	NEUTRAL	NEUTRAL
Consumer Spending	MILDLY BEARISH	NEUTRAL	NEUTRAL	MILDLY BEARISH	MILDLY BULLISH	MILDLY BULLISH	NEUTRAL	MILDLY BULLISH
Consumer Sentiment	MILDLY BULLISH	NEUTRAL	MILDLY BEARISH	MILDLY BEARISH	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL
Global Events/News	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH
China	MILDLY BEARISH	NEUTRAL	NEUTRAL	NEUTRAL	MILDLY BULLISH	NEUTRAL	MILDLY BEARISH	NEUTRAL
Europe	NEUTRAL	NEUTRAL	MILDLY BULLISH	MILDLY BULLISH	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	MILDLY BULLISH
Russia Ukraine War	NEUTRAL	NEUTRAL	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	NEUTRAL	NEUTRAL
Israel Hamas War	NEUTRAL	NEUTRAL	NEUTRAL	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	BEARISH	BEARISH
US Politics	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL	MILDLY BEARISH	MILDLY BEARISH	NEUTRAL	NEUTRAL
2024 Election	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL	MILDLY BEARISH	MILDLY BEARISH	NEUTRAL	NEUTRAL
Budget Negotiations	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL	NEUTRAL
Earnings	NEUTRAL	MILDLY BULLISH	MILDLY BEARISH	NEUTRAL	BULLISH	MILDLY BULLISH	MILDLY BULLISH	NEUTRAL
Banking Turmoil	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	MILDLY BEARISH	NEUTRAL	MILDLY BEARISH	NEUTRAL	NEUTRAL
Crypto	BULLISH	BULLISH	BULLISH	NEUTRAL	MILDLY BULLISH	NEUTRAL	NEUTRAL	NEUTRAL

Notable Changes from Month Prior:

- Fed Commentary – Mildly Bullish to Bullish
  - This month Powell signaled to markets that a rate cut was likely rather than saying the decision would be data dependent
- Employment/Labor Market – Mildly Bullish to Bearish
  - Last month's labor market data showed "cracks" while this month's data pointed to material weakening
- Europe – Mildly Bearish to Mildly Bullish

- Markets had concerns that the ECB was a bit quick to cut rates given concerns that inflation could pick back up, but this month's inflation data came in lower than expected

Key Indicators:

- ***BEARISH***
  - Release of July's jobs report which showed that the US added fewer jobs than expected and that the overall unemployment rate moved higher
  - The yen rallying after the Bank of Japan raised rates last week – leading to unwinding of popular carry trade
  - Energy prices rising as a result of increased tensions in the Middle East (Israel sent around 100 jets to execute airstrikes in Lebanon and Hezbollah launched hundreds of missiles and drones at Israel)
- ***MILDLY BEARISH***
  - Manufacturing data which showed that manufacturing activity fell by much more than expected
  - Amazon's earnings highlighting how costly AI buildouts can be for companies
  - Disappointing earnings reports from Foot Locker and Abercrombie & Fitch
  - Super Micro Computer stock selling off after well know short seller Hindenburg Research accused company of having "glaring accounting red flags, evidence of undisclosed related party transactions, sanctions and export control failures, and customer issues"
  - Nvidia's earnings report disappointing for the first time in what seems like years
  - The US dollar having the worst month of year in August ahead of potential September rate cut
- ***NEUTRAL***
  - The Bank of England announcing that they would be cutting rates by 25bp
  - Bank of Japan announcing that it would not be raising rates again until the markets stabilize
  - Starbucks announcing that it would be hiring a well know Chipotle executive as its next CEO
  - Retail sales data from China coming in higher than expected
  - Employment data released by Bureau of Labor Statistics that revised total nonfarm employment by -818,000 for the 12 months ending March 2024

- Strong earnings results from Cava
- RFK Jr. officially suspended his presidential campaign and endorsing Donald Trump
- The Conference Board's Consumer Confidence Index rising by slightly more than expected for the month of August
- Housing data which showed that home prices grew at a slightly slower pace in June (vs. the month prior)

- ***MILDLY BULLISH***
  - Initial jobless claims coming in lower than expected after the prior week's jobs report release showed material weakening in labor market
  - PPI rising by less than expected for the month of July
  - Retail sales data from July coming in higher than expected
  - Inflation data from Europe which came in at lowest levels since 2021 (recall ECB cut rates even though there were some concerns over inflation picking back up)
- ***BULLISH***
  - July CPI and Core CPI data coming in lower than the month prior (CPI lower than expected, Core CPI in line with expected)
  - Comments from Powell made at Jackson Hole where he signaled to markets that a September rate cut should be expected
  - July PCE and Core PCE coming in lower than expected