November 7th, 2016

That was a deceiving jobs report…
The catchy headline over the weekend was to accentuate and dramatize the fact that the S&P 500 declined for the ninth straight day as of the end of Friday's trading – something that has not happened since 1980! While true, it grossly over exaggerates the degree of the decline which was rather pedestrian at -3.1%. For context, throughout the history of the stock market there have been 298 instances where the S&P 500 lost more than -3% in one day. So, keep calm and carry on because this is one headline where the bark is much bigger than the bite.

This isn't to imply that their hasn't been some material technical damage done to the major averages because there has been, but for now most of the key indices (with the exception of the NYSE Composite) after breaking below their 50 and 100 day moving averages in this sell-off are still trading above their 200dma. Peeling back the onion a little further reveals that as of Friday's close 69% of the stocks in the broad S&P 1500 Index were at least -10% below their 2015-2016 highs (nearly 40% were at least -20% below).

While I'm not big on technicals, they do matter and it will be an important near-term signal for markets to hold above Friday's lows. Little did anyone know going into the weekend that FBI Director Comey was going to come out and announce that the reopening of the investigation into Hillary Clinton's emails is once again a non-event as far as they're concerned. Futures markets reacted dramatically to the news sparking all the risk-on trades that had been pared back over the last two weeks when the probability of a Clinton victory was losing some steam.

It's looking like by the time this missive goes to print most of the major averages will have recouped a nice chunk of the losses from the passive-aggressive sell-off over the prior nine days.

At last check, betting parlors and other polling aggregation forecasts are pushing up near an 80% probability of Clinton winning the election. While the set-up is eerily similar to what transpired in the lead up to the Brexit surprise, I don't believe we're likely to see a similar surprise outcome. However, like we're seeing with the buyer's remorse move out of the U.K. where last week Parliament won a key decision to have a say in how and when Article 50 is invoked to begin the process of exiting the U.K., I do expect there to be a fair degree of acrimony following tomorrow's vote from whichever party loses the election.

By 8pm EST on Tuesday night the exit polls in the critical swing states of Florida, North Carolina, and Ohio will be rolling in and how these states fall will dictate the importance of the next round of swing states of Pennsylvania, Michigan, and Wisconsin (which should be released between 8 and 9pm). It's likely that by 10 or 11pm EST American's will have a good idea of who will be the next U.S. President.

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In many circles the down ballot results are as important, if not more important than what happens with the Presidential race. It's Congress that holds the key check and balance responsibility over the Executive Office and let's not forget that what is said during a Presidential campaign and what is ultimately legislated over a four or eight year term can be quite different. Electronic markets suggest the House is very likely to remain in Republican control but the Senate has the potential to flip to a Democratic majority. What makes the Senate race so important is the fact that they have the sole power to confirm Presidential appointments that require consent, including Federal Reserve officials and Supreme Court justices. Fed Chair Yellen will be up for reappointment in February 2018 and Vice Chair Fischer will be up in June 2018. There are also currently two vacancies on the Board of Governors for the Federal Reserve and one vacancy for the Supreme Court. All prominent positions for key officials that have the potential to shape the framework for key policy decisions on the economy and social issues.

While there may be some more room to the upside for this stock market rally that got kicked off in the futures market on Sunday, investors should keep in mind that if the results ultimately come out according to the polls and betting markets then more policy gridlock awaits. This means continued friction on upcoming debt ceiling debates, tax policies that favor populist's sentiment (anti-Wall St. and pro-Main St.), and divisiveness around foreign policy, trade, and immigration. These issues are not going away and can only be addressed through a concerted effort for compromise from all sides to reach a collective common ground that benefits the masses to the detriment of the few.

One last thought pertaining to market pricing and investor psychology as it relates to this market rally in advance of tomorrows election. A Clinton victory has been the expected outcome by the markets for some time. Yes, markets always respond to the marginal change which is what occurred following both of the Comey announcements over the last couple weeks. But, the balance of risks and the biggest market pricing adjustment would come on the non-trivial odds of a Trump victory.

The disclaimer here is that the polling numbers tend to undercount the white working class voters – which are the ones that rallied behind Obama back in 2008 where he was running on a very similar theme to the one Trump is running today. Without question Obama did it in a much more eloquent and professional fashion, but he represented himself as the agent of hope and change, an outsider of sorts to go against the establishment, and a willing surrogate to take on the Washington elites and special interests.

This was a powerful message then which garnered a lot of traction and it remains a powerful message today, with the biggest difference between then and now being the personality, character, and track record of the messenger.

Lost in the shuffle of the upcoming election was a litany of economic data which showed some parts of the economy are gaining momentum as we head into year-end while other parts lead further credence to Larry Summers' secular stagnation view. The jobs report released on Friday was more in line with the latter (in my opinion). On the surface, the results looked pretty good with +161k new jobs created in October (a bit below consensus expectations for +173k), the unemployment rate fell to 4.9% from 5.0% the prior month, and average hourly earnings spiked by +0.4% month-over-month while rising to +2.8% year-over-year (its fastest growth rate of the expansion). In addition to that we saw upward revisions totaling +44k to August and September and the U6 rate of underemployment fell to 9.5% from 9.7%.

All good, right? So where's the "but"? Well let's take a little deeper dive and overlay some analysis. The +161k jobs created in October was the weakest print since May and is below the 3-month average (+176k), the 2016 average (+181k), and 2015 average (+229k). Year-over-year employment growth has slowed to 1.65% which is a marked deceleration from the February 2015 peak of 2.3%. Also striking in this report is the marked deterioration in job growth in the cyclically sensitive sectors of the economy (resources, durable

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goods manufacturing, transportation services, and construction) which added 15k jobs in October, but this is down from 50k in September and just half of the average of the past year.

Meanwhile the Household Survey showed a net loss of -43k jobs in October (the first decline since April) with the mix of jobs very weak as +90k in part-time jobs were added in Oct. while full-time employment fell -103k. And this wasn't just a one-time event as the September jobs report showed +430k part-time jobs were added while full-time jobs declined by -5k.

There was all sorts of excitement over the 2.8% year-over-year acceleration in wage growth to a new cycle high (best since June 2009). Don't get me wrong, as higher wages for the 70% of the economy we call the consumer is one of the most important ingredients to a sustainable economic expansion, but once again as was the case with the mix of jobs, the mix of where the wage gains are coming from is important. This is where the 2.8% wage growth metric didn't quite pass the smell test.

When you break this metric down into its respective pieces you'll find that the headline figure is a gauge of all workers which encompasses roughly 123 million private workers. The BLS then breaks these workers down into two categories: production and nonsupervisory private workers which make up the lion's share at 101 million or just over 82% of the entire private workforce. This category saw their wages increase by a meagre 0.18% month-over-month and 2.4% YoY which actually decelerated from 2.65% in September.

The majority of the steep climb in the wage gains came from the 18% of private workers which the BLS categorizes as supervisory, managerial private workers where average wage growth rose 4.7% YoY to an all-time high in October. So much for the income inequality theme that was front and center during the Democratic primaries.

Getting down to brass tacks, this employment report is an indication that the employment backdrop is hanging in there on solid ground, but it continues to lose momentum as one would expect this deep into an expansion. The biggest question going forward hinges on the pace of the slowdown in job creation, not the direction as that is no longer in question.

If you want a real-time market indicator for what's going on in the broader jobs market and the economy, have a look at the performance of Robert Half's stock (the largest staffing company in the country) compared to the S&P 500 (see chart below). Looking back over the last two cycles you can see that the stock price of Robert Half has been a fairly decent leading indicator for the economic cycle and the general stock market – this rather large gap that has opened up between the two since 2015 is either a break in the relationship or a precursor for a material price adjustment in one of these securities.

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This is what the CEO had to say on the labor market during their earnings call:

> "Now, on the pace of deceleration, I'd say that July, we actually ended July stronger than we began it, we were encouraged by that. August wasn't bad. But then September, where we usually start getting a sequential lift in September, we didn't see the lift we typically get, instead, it was sequentially about flat. And then again, traditionally we get even more lift yet again in October and we didn't see that lift either. So it's essentially sequential flattening starting in July, rather than the lift we typically see in September and early October."

What is showing a solid build-in for growth going into the fourth quarter is the manufacturing sector, as was seen by the rise in the JP Morgan Global PMI Composite Output Index increasing to an 11-month high of 53.3 in October from 51.7 in September. The improvement points to annual GDP growth accelerating from the malaise that had been evident during the second and third quarters.

All of this of course brings the Federal Reserve back to the forefront where the odds of a December rate hike have risen to better than a 75% probability. Don't be surprised when a month from now all you're hearing about is comparisons to what happened after the Fed hiked rates last December and it set off the worst start to a year for stocks in U.S. history. While there are plenty of parallels to a year ago – growth remains sluggish, inflation continues to run below target (but is firming), stocks are near their highs, credit spreads are tame, and financial conditions are loose – I don't suspect the hang-over from this hike will be nearly as severe. Although I do remain in the camp that the Fed is hiking more for credibility reasons and in the interest of building up some ammunition for the next recession than they are for fundamental purposes. It's no longer a debate – we are past the peak rate of growth for this cycle and as a result any Fed hike from here will be in the face of a slowdown.

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