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RICHARDSON Wealth

Market Ethos

The latest market insights from Richardson Wealth

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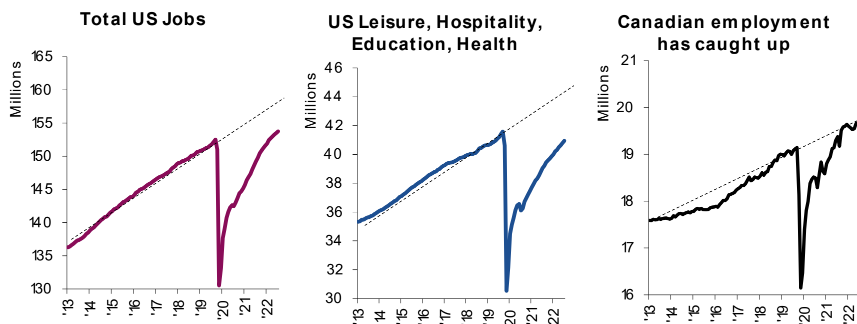
The labour curveball

Our team absorbs a lot of different economic/market views and opinions from a lot of different sources. We also do a ton of our own analysis. To put it bluntly, 2023 is lining up to be one confusing year. Inflation, the path of central banks, the economy and, of course, how the bond and equity markets react all have very divergent views. For a more fulsome synopsis of our views, we suggest looking at our 2023 outlook (*Bear market end game*). In this report, we narrow our focus to examine how so many can be calling for a recession while companies keep hiring.

Last year's jobs report and the final December reading that came out recently show that the U.S. economy added 223k jobs, unemployment dropped to a multi-decade low of 3.5% (lowest since 'the 60s), and even the participation rate ticked up a little. In other words, 4.5 million jobs added during 2022. For comparison, the average from 2010-2019 was around 2.2 million jobs. Of course, the economies of the world are still recouping jobs in a number of categories as we all move back to 'normal.' The first two charts below show total U.S. employment with a 'really simple' dashed line that one could argue would hold if the pandemic hadn't happened. The biggest gap is in Leisure & Hospitality and Education & Health, which are still missing jobs. The final chart is Canadian employment, which appears to have recovered better, back to trend.



Source: Bloomberg, Purpose Investments

This is all throwing in a bit of a curveball. **Because the economy is still recouping jobs from the pandemic in certain categories, labour is likely going to be a super-lagging indicator of the economy this cycle.** If you exclude the most pandemic-impacted industries from the employment data, it paints a much different picture. Job gains have been decelerating very quickly as 2022 progressed.

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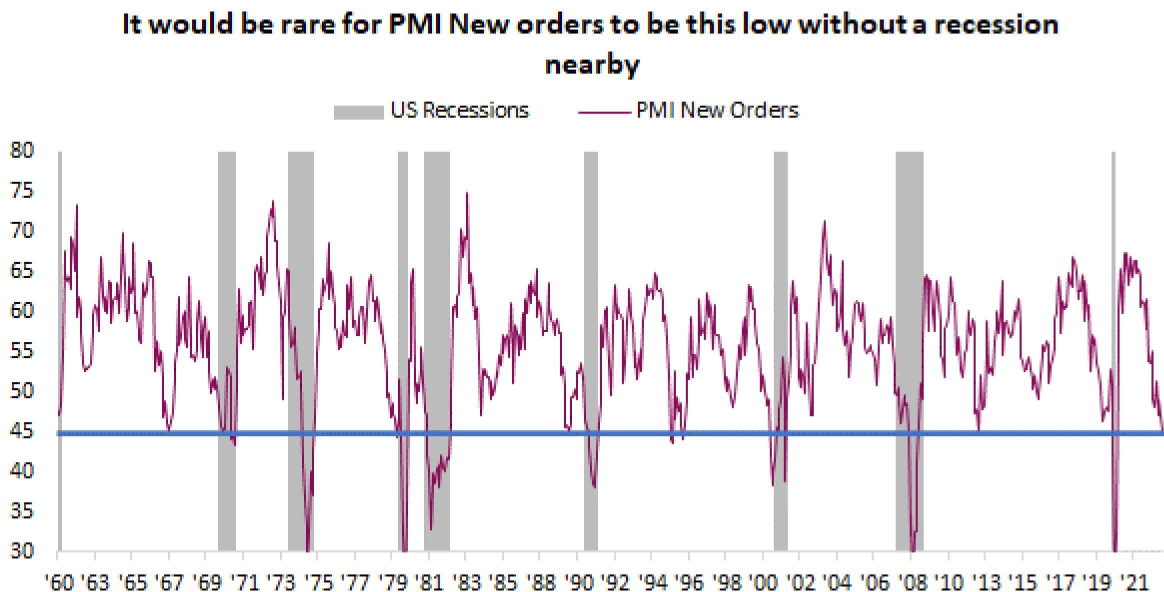
Let's take employment data with a grain of salt in 2023, then. Or at least don't suffer from lazy headline reading and dig a little deeper. We may need a little more salt in the opposite direction when looking at manufacturing. Currently, the five Market Cycle indicators we monitor for the health of manufacturing are all negative. These include purchasing managers, manufacturing & new order surveys, energy demand, trucking demand and rail volumes.

Purchasing managers surveys (PMI) are a diffusion index where purchasing managers are asked if they expect to be busier or less busy next month. A score of over 50 means over half said they would be busier, and a score under 50 more said less busy. Among the 16 biggest economies in the world, **ALL 16 WERE ABOVE 50 IN JUNE**. That is party time on the assembly line. A mere six months later, only 4 are above 50, and those 4 are smaller in the developing economy subset. The U.S., China, Japan, Europe, and Canada are all below 50 now. We could do a chart, but it's just a bunch of lines going down and to the right.

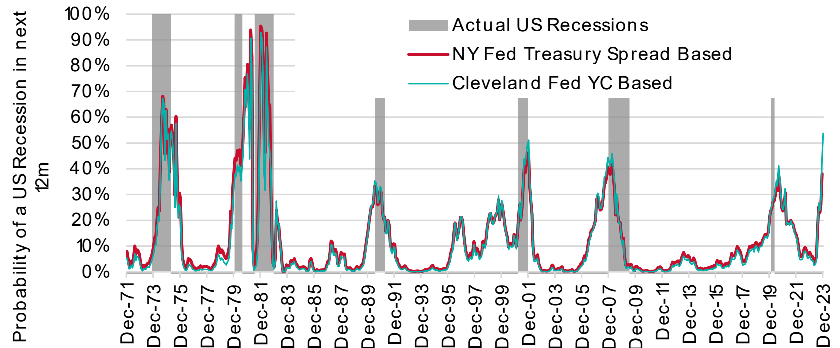
So why the grain of salt, you may ask? Well, if you recall, we had a bunch of bottlenecks, shortages, yadda yadda yadda in the past couple of years. No doubt manufacturing activity was ramped up to catch up with demand. So, is the clear slowing of global manufacturing activity a precursor of a recession or simply coming down from temporary high activity levels that were playing catchup. Chances are, it is somewhere in between. On a sobering note for the U.S., New Orders have fallen so far that it would be very strange if a recession was not nearby.



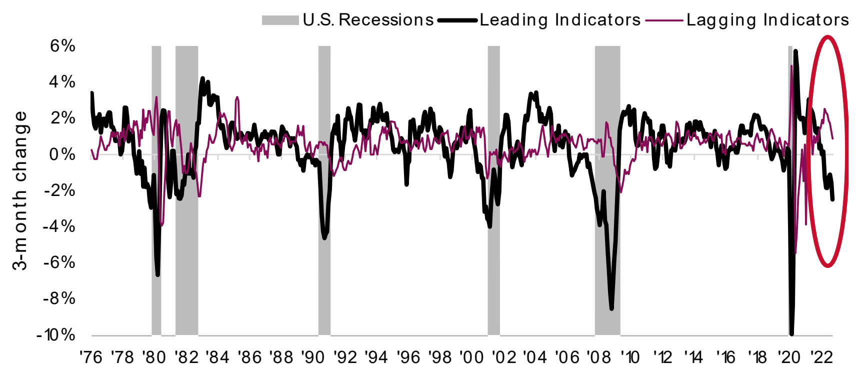
Recession warning bells

Still, the warnings are growing louder. Interest rate hikes started 10-12 months ago, depending on which country you look at. Some estimates have rate hikes taking nine months to broadly impact the economy, which means the pain is just starting. And don't forget, markets are down, and inflation sapped buying power, making us all poorer/less rich. That wealth effect also has an economic lag, which is probably coming.

The NY Fed and Cleveland Fed's recession probability models have certainly rung the alarm bell. In the past few months, they have spiked from 'all clear' to 'oh oh.' (Those annotation labels are ours, not the bank's.)



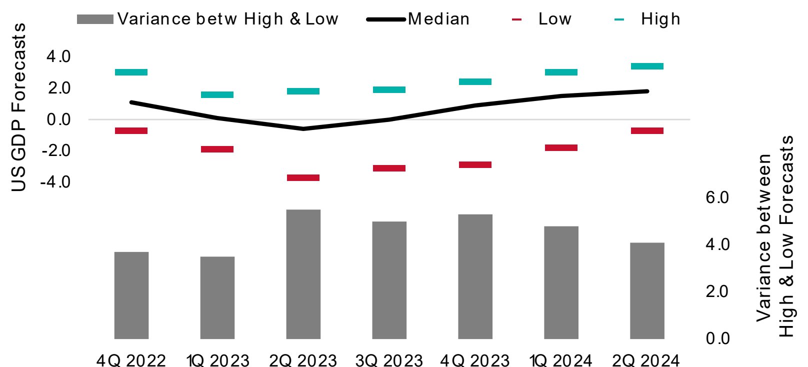
Leading indicators are troubling as well. In the chart below, we included the lagging economic indicator index, which continues to show positive growth. If you look at past recessions, the pattern is pretty clear. The leading indicators drop first, and the lagging often doesn't drop until the recession has started.



Source: Bloomberg, Purpose Investments

To be clear, there is no recession today. U.S. GDP is positive and could even surprise when we see the print for Q4. We nitpick the jobs data, but a job is a job, another consumer who will likely be a more robust spender. Perhaps this helps soften the slowdown. Perhaps China's removal of covid restrictions helps global growth. Would a Fed pause create a market with more certainty, encouraging housing activity and business spending? And many of these warning signs could prove to be early.

There are strong points on both sides, and this can also be seen in the divergence in economic forecasts. The chart to the right is based on economists' forecasts for U.S. economic growth. The green and red bars are the high and low estimates, with the line as the median. The bars are the difference between the high and low, which becomes pretty wide in mid-2023. For instance, in Q2, the high forecast is 1.7% growth, with the low at -3.7%.



Source: Bloomberg, Purpose Investments

Portfolio considerations

We continue to believe a slowdown will materialize in 2023, which very well could manifest itself into a recession. We are leaning more towards the recession camp. The signs are clearly there. This has us tilted more towards defense and holding extra cash. The follow-on question becomes, at what point will the equity and bond markets begin looking through the recession out the other side? We believe that point will come sometime this year, but it is not today. You can't look across the valley until you get closer to the edge.

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Source: Charts are sourced to Bloomberg L.P., Purpose Investments Inc., and Richardson Wealth unless otherwise noted.

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