Why Wall Street Sees Bad News in Good News

The August payrolls report in the U.S. showed the economy adding new jobs at a solid clip, with 315,000 new positions added for the month. This strong showing in the labor market was an extension of several months of impressive job gains, with an average of 381,000 new jobs added in each of the last six months. Monthly wage growth eased a bit in August, with hourly earnings for private-sector workers rising 0.3% month-over-month, and 5.2% from a year earlier. But this modest wage growth was coming off an acceleration in Q2 when wages grew at 1.6% versus the 1.3% growth posted in Q1.

Businesses are hiring, workers are earning better wages, and the labor force participation rate – which measures the number of people in the workforce – is on the rise. Any economist would tell you this data is good news for the economy and is a sign that growth fundamentals are holding up in spite of inflationary forces. Wall Street would disagree.[1]
The reason is that the Federal Reserve is paying close attention to trends in the labor market, particularly when it comes to wage growth, because of the belief that higher labor costs can make inflation 'sticky.' At worst, a tight labor market and rising wages can result in what is known as a wage-price spiral, a feedback loop of rising labor costs resulting in businesses raising prices for goods and services. Higher wages equal more inflation.

This setup has created an environment where good news in some parts of the economy is being viewed as bad news for investors and traders. The stronger the labor market and wage growth, for instance, the higher the likelihood that the Federal Reserve is going to raise the fed funds rate by 0.75 percentage points at their September meeting and perhaps again in November. In this vein, good news for the economy is bad news for Fed monetary policy decisions, which is also apparently bad news for markets.

But I don't buy into this narrative. For one, it makes the assumption that the Federal Reserve's policy decisions are the single force driving the equity markets, which I strongly disagree with. I do believe there is a point where rising interest rates can be very prohibitive to growth, but I do not think we are very close to those levels with fed funds at 2.25% - 2.5%. The 10- and 30-year U.S. Treasury bond yields are also just above

3%, which historically remain at very low levels.

It is also true that rising rates have historically not resulted in falling stocks. In fact, the opposite has been true:

Fed Raising Rates	Change in Fed Funds Rate over the period	S&P 500 Index Price Change over the period
July 1954 to October 1957	2.7%	+33%
May 1958 to November 1959	3.4%	+32%
July 1961 to November 1966	4.6%	+21%
May 1967 to September 1969	5.2%	+5%
March 1971 to September 1971	1.8%	-2%
February 1972 to July 1974	9.6%	-26%
January 1977 to July 1981	14.4%	+28%
February 1983 to August 1984	3.0%	+13%
March 1988 to March 1989	3.3%	+14%
December 1993 to April 1995	3.1%	+10%
January 1999 to June 2000	1.9%	+14%
June 2004 to July 2006	4.2%	+12%
November 2015 to January 2019	2.3%	+30%

Source: Federal Reserve; Bloomberg[2]

Looking closely at the table above, readers will see that the Federal Reserve has carried out 13 monetary tightening campaigns, featuring several rate hikes in each. The S&P 500 went up in all but two of them, delivering a median gain of +14% (price return) while the Fed was actively raising rates. Rising rates do not necessarily mean falling stocks – in fact, they rarely do.

The two exceptions in the table above were 1971 during which the market declined by -2%, and 1972 to 1974 when the decline was much bigger. In those years, however, the U.S. economy was mired in recession due to the oil embargo, so the reason for the S&P 500's decline arguably was because of more than just higher interest rates.

Nevertheless, there seems to be a pervasive feeling that strong economic data reports are bad for the stock market since they could influence the Federal Reserve to remain maximally hawkish. I encourage readers not to embrace this view – just let good news be good news.

Bottom Line for Investors

There is one area where just about everyone can agree that good news is good news – inflation readings. July's personal consumption expenditures (PCE) price index, which is the Federal Reserve's preferred measure of inflation, fell by -0.1% month-over-month and landed at +6.3% year-over-year, both marking a deceleration from June. Relief at the pump has been a big contributor to falling price pressures, which I think we should see continuing in August. That report is due out on September 13, along with other economic data. For investors, look for softer inflation figures and don't fear strong economic readings – embrace them.

ABOUT MITCH ZACKS

Mitch is the CEO & Senior Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.

[1] Wall Street Journal. September 2, 2022. https://www.wsj.com/articles/steady-labor-market-keeps-fed-on-track-for-another-rate-rise-11662130400

[2] The Washington Post. January 26, 2022. https://www.washingtonpost.com/business/stocks-dont-rise-or-fall-because-of-interest-rates/2022/01/25/25d23e7c-7dd7-11ec-8cc8-b696564ba796_story.html

Weekly Market Update

Important Market News We Think Worth Considering

IN FOCUS THIS WEEK

- **Expensive air travel**
- **Who are 'quiet quitters?'**
- **Update on the U.S. services sector**

Air Travel is More Expensive, But U.S. Consumers are Doing it Anyway

Airline tickets experienced a price surge earlier in the spring, on the heels of rising oil and jet fuel prices. That saw ticket prices jump by 25% from the beginning of the year through May, far outpacing broad inflation. But then came June and July, with airline prices falling back just as consumers were eager to travel for the summer season. Ticket prices are still elevated, but that did not stop U.S. consumers from going forward with travel plans. This Labor Day, travel volume for a holiday weekend exceeded pre-pandemic levels for the first time, with the TSA reporting that 8.76 million travelers went through checkpoints over the holiday weekend. For Labor Day 2019, there were 8.62 million travelers. Consumers' enthusiasm for travel comes even amidst increasing stories of flight delays, cancellations, and lost luggage. Fortunately, airlines had a smoother weekend – data showed that only 0.6% of flights over the weekend were cancelled, and just 16.6% were delayed.[1]

A New Buzzword in U.S. Labor Markets: "Quiet Quitters"

The U.S. jobs market is historically strong, with about two open jobs for every unemployed American and wages steadily on the rise. But that doesn't mean U.S. workers are happy about it. Research by Gallup shows that a historically high number of U.S. workers are either actively disengaged from work or doing the minimum amount required to stay employed, a trend referred to as "quiet quitting." According to Gallup's research, about 50% of the U.S. workforce is made up of quiet quitters, with people who are "psychologically detached" from their work and simply collecting paychecks and perhaps pondering a different career. Only about one-third of respondents in Gallup's poll said they were engaged in their work and enjoyed what they do, which should alert bosses around America – especially those desperate to keep workers.[2]

Is the U.S. Services Sector Expanding or Contracting? Depends on Who You Ask

The services sector in the U.S. makes up a lion's share of the economy, far more so than manufacturing. It follows that activity in the services sector is key to monitor, as it often determines whether the broad economy is in expansion or contraction mode. That's why the conflicting readings for the U.S. services sector in August has not only been a head-scratcher, it's also emblematic of how difficult it is to get a clear read on the U.S. economy. According to the Institute for Supply Management, the services sector grew at a faster pace in August compared to July, with a reading of 56.9 versus 56.7, respectively. The data firm S&P Global offered a different take, stating that the services sector actually contracted in August due to falling demand. Their Services PMI Business Activity Index showed a 43.7 print for August, down from 47.3 in July and marking the fastest deceleration since May 2020. The two surveys use different methodologies and survey different businesses, so there is not necessarily one print that should be emphasized over the other. The takeaway here may ultimately be that the U.S. economy is stalling, not necessarily fully in contraction or expansion mode.[3]

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[1] Wall Street Journal. September 6, 2022. https://www.wsj.com/articles/labor-day-is-first-holiday-to-top-pre-pandemic-travel-levels-11662491960?mod=newsviewer_click

[2] Wall Street Journal. September 7, 2022. https://www.wsj.com/articles/quiet-quitters-make-up-half-the-u-s-workforce-gallup-says-11662517806?mod=djemRTE_h

[3] Wall Street Journal. September 6, 2022. https://www.wsj.com/articles/conflicting-surveys-paint-mixed-picture-of-services-providers-11662487652?mod=djemRTE_h

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