



Ropes Wealth Breaks Down The Jobs Report and Addresses Recession Obsession

Today we learned the U.S. economy added 390,000 jobs in May, better than expected despite fears of an economic slowdown and with a roaring pace of inflation. At the same time, the unemployment rate held at 3.6%, just above the lowest level since December 1969. Job gains were broad-based. Leisure and hospitality led, adding 84,000 positions. Professional and business services rose by 75,000, transportation and warehousing contributed 47,000, and construction jobs increased by 36,000. Surprisingly, the retail sector lost -61,000 jobs in May, though the sector remains 159,000 jobs above its February 2020 pre-pandemic level.

Clearly the tight labor market is sticking around and shrugging off fears of a downturn. For this reason, the Federal Reserve will likely be undeterred from an expected 0.75% increase in the Fed Funds target rate at their upcoming July meeting. They have made a commitment to cool inflation and bring the jobs picture back into balance from the current high demand and low labor supply.

The challenge is that cooling the highest inflation in 50 years and bringing a labor market into balance without crashing it is no easy feat. For this reason, it was no surprise that a Fed report earlier this week showed businesses are expressing increasing concerns about future prospects – eight of the central bank's 12 districts reported slowing growth while four specifically cited recession fears.

What would a recession look like? Drawing comparisons to the 2007-2008 Great Financial Crisis and the 2000-2001 dot-com bust don't hit the mark, because those were recessions fueled by credit. The result was overbuilding in housing and internet infrastructure. Current cycle excesses are not credit-driven, as balance sheets of corporations, banks and households are the strongest in decades. Rather, current cycle excesses have been driven by liquidity, which fueled speculation in financial assets such as cryptocurrencies, venture capital, unprofitable technology companies and special purpose acquisition companies (SPACs). Unwinding those excesses has thus far not caused much damage to the real economy.

Of course, given the high level of inflation, it might be easy to compare this period to the 1970s, but recall any inclination by the Federal Reserve to fight inflation by raising interest rates met stiff political resistance back then, a stance which is not true today. At the time, President Lyndon Johnson, beleaguered by the costs of the unpopular Vietnam war, put intense pressure on the Fed Chairman William McChesney Martin to keep interest rates low. Nixon did the same to Fed Chair Arthur Burns. And even after Nixon resigned in 1974, Congress continued to pressure the Fed to avoid anti-inflation policies that might slow the economy.

In contrast, efforts by the current Fed Chair Jerome Powell and his colleagues to bring down inflation enjoy considerable support from both the White House and Congress, at least so far. The Fed today has the independence it needs to make policy decisions based solely on the economic data and in the longer-run interests of the economy, not on short-term political considerations.

But they are walking a tightrope because factors beyond the Fed's control can contribute to inflation. Like the OPEC oil embargo then, supply-side forces are important today — not only the increases in global energy and food prices due to the Russia-Ukraine war, but also pandemic-related constraints, like the disruption of global supply chains. Unfortunately, the Fed can do little about these supply-side problems.

But we have unique conditions in play today that might keep us from a 1970s style slowdown.

While higher interest rates will undoubtedly hurt demand for housing and autos, both sectors are in a strong position given low inventories and production rates. The resilience of high housing prices—up by double-digit rates over the past two years—reflects very low supply that will only worsen with higher rates and a construction slowdown. In autos, this cycle has yet to fully recover from COVID-related semiconductor shortages, and production remains below prior peaks. As supply chains clear, ample order backlogs may keep manufacturing utilization uncharacteristically high for a recession.

The second consideration is the labor market. Not only is it tight as defined by unemployment, but we are at an all-time high with new job openings to potential applicants. This suggests that, rather than initially resorting to layoffs going into a slowdown, companies may first reduce their postings of unfilled openings. Next, while consumer savings have run down and credit card debt growth has picked up, payments relative to disposable income are not stressed. At the same time, the catalysts for the corporate capital spending boom appear strong, with current needs around supply chains, energy infrastructure, service business automation, cybersecurity, and national defense.

The “recession obsession” that is driving daily headlines and market volatility does not reflect some of these mitigating factors that might keep a downturn short and shallow. We urge you to keep them in mind, and know we are carefully reviewing every piece of economic and market data for clues on the severity and risks to this outlook. For now, we maintain a commitment to your long-term investment plans and are employing a surgical focus on earnings quality and structural resiliency of the companies you own as the best way to navigate this environment.

On a final note, we join the people of Japan in mourning the tragic loss of their longest-serving Prime Minister, Shinzo Abe. He was a great leader, a strong ally to the U.S., and a dedicated public servant whose assassination this morning reminds us of the fragility of life and tragedy of violence that plagues our world.

Thank you for your interest in our investment commentary. If you would like to speak personally with a member of our team at any time, please click [here](#).

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