Ropes Wealth Suggests Powell Needs Some Old-Fashioned Parenting Advice

Why won't they just listen!?!? Fed Chair Jay Powell must be feeling frustrated right now, like a parent with an intractable child, as markets just won't do what they are told. I remember reading parenting books after my first son was born, with all their tips for discipline to make your child behave and in turn make me mother of the year. State commands positively. Give age-appropriate instructions. Reward compliance. Like Jay, I had some bumps implementing those techniques. To be fair, he can't resort to "remove electronics" like I did.

A week ago, Powell admonished the markets on their speculation about the timing of rate cuts: *"It would be premature to conclude with confidence that we have achieved a sufficiently restrictive stance, or to speculate on when policy might ease."* Nevertheless, Fed funds futures contracts are implying more than 130 basis points of cuts in 2024. Treasury yields have moved sharply lower: the 2-year yield is now trading at 4.69%, the 5-year yield 4.23%, and the 10-year yield is as low as 4.22%. In the month of November, the 10-year yield plummeted 60 basis points, its biggest monthly drop since 2008, which played into why the S&P 500 rallied 8.9%, the best November since 1980, excluding 2020.

Even though interest rates are certainly not at high absolute levels at their current range of 5.50%, especially as compared to history when rates at times reached double-digits, the market is like a junkie wanting its fix. If a number defined the 2010s, it was 2 percent. Inflation, annual economic growth, and interest rates at their highest all hovered around that level — so persistently that economists, the Fed, and Wall Street began to bet that the era of low-everything would last. And we want, nay need, rates back at low levels to feel confident about the path forward.

Which is why this morning's strong jobs report, while certainly a positive by all rational accounts, is spooking markets that there is a risk to the narrative that rate increases are over and rate cuts are about to begin. Nonfarm payrolls increased 199,000 in November, an uptick from the 150,000 advance reported in October, due largely in part to the return of striking auto workers. But healthcare, leisure and hospitality, and government sectors all reported strong hiring. The odd man out was retail, which posted a decline in hiring despite the holiday season.

The unemployment rate fell to 3.7% which was impressive as the labor force participation rate—the share of the population that is working or looking for work—rose to 62.8%. Average hourly earnings advanced by 0.4%, matching the biggest monthly advance this year, and are now tracking 4% year-over-year which reflects the persistence of wage inflation.

In other employment news this week, there was the release of the so-called JOLTS reporting-- the Job Openings and Labor Turnover Survey – which declined from 9.4M to 8.7M in October, the lowest since March 2021. Highlighting the breadth of cooling, eight of the ten major sectors reported fewer openings for just the second time since April 2020. Health care and social assistance openings sank 236k, positions at financial firms fell 217k, and leisure and hospitality businesses reported 124k fewer openings. Perhaps this report, in combination with the payrolls advance reported this morning, means the economy is moving closer to employment equilibrium.

Turning to economic activity indices, the ISM Manufacturing Index unexpectedly remained at a reading of 46.7 in November, now marking the 13th consecutive month of contraction (a reading below 50). In contrast, the ISM Services index recovered in November after a couple of monthly declines, but the rate of expansion remained below the average pace for 2023.

What does this all mean for the outlook in 2024? You have heard me use the terminology "rolling recession" to describe this unique post-pandemic cycle and how strength and weakness have each persisted across various economic segments. The hits have been hardest and earliest on manufacturing, housing, and are now spreading to services and the consumer, though in a choppy way. However, there is enough disinflation in the pipeline that the July rate hike will likely be the last in this cycle. As a result, the outlook remains for shallow, and ongoing, rolling slowdowns that do not crescendo to the worst case.

If rate cuts are truly done, the knee-jerk expectation of investors, as evidenced in November's market action, is often one of relief and even euphoria. However, please note that looking back in history, six months after final rate hikes, the S&P was down as much as 18% and up as much as 20%. A year after, the range was even wider from down 28% to up 32%. In addition, the span of time between the final rate hike and subsequent first cut was also quite wide. There are no blueprints to follow. With that, we urge caution and prudence in considering the 2024 outlook, with equal parts enthusiasm for interest rate hike relief and a healthy respect for the more challenging operating environment companies face. Circling back to the notion of discipline that started this week's piece, it is important to employ long-term thinking, keep emotions at bay, and be consistent and current with your planning and allocation. For our part, we will focus on identifying and implementing the most appropriate arrangement of investments for you as we strive to ensure you are ready for anything and everything the economy and markets may throw our way next year.

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