Weekly Market Summary

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Brace for a Solid May NFPayroll Report! Unless Fed Powell Confirms Job Gains Are TRANSITORY!
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US Non-Farm Payrolls ("*NFP*") are usually reported by the Bureau of Labour Statistics ("*BLS*") on the first Friday of the following month, at 8:30 am Eastern Time (currently 3:30 pm Bahrain time). The data - which accounts for approximately 80% of the workers who produce the entire gross domestic product ("*GDP*") of the U.S. - is used to assist policymakers and economists with determining the current state of the economy and predicting future levels of economic activity. The major figure reported from the Non-Farm Payroll release is the number of additional jobs added from the previous month (based on the Establishment Survey - i.e. the assessment of some 400,000 business across the country), though the report also contains many valuable insights into the labour force and the overall health of the economy that have a direct impact on equity and bond prices, the value of the U.S. dollar and the price of commodities (gold and others). Those extra statistics include the overall unemployment rate and a youth unemployment rate (based on the Household Survey), the labour force participation rate (a key statistic used to determine the true employment situation in the country), the average workweek and the average hourly earnings and wage growth component (amongst the most crucial components currently, given the market's increased focus on early signs of rising wages and inflation). If the same number of people are employed but are earning more or less money for that work, this basically has the same effect as if people had been added or subtracted from the labour force. Each month's report may also include revisions to the previous two reports.

The US Federal Reserve, in turn, scrutinizes trends in the Non-Farm Payroll employment series. That analysis is reported and discussed at regular Federal Open market Committee ("*FOMC*") meetings. The NFP series is also one of the key economic statistics that the National Bureau of Economic Research ("*NBER*") studies to determine whether the economy is expanding (expansion) or contracting (recession). Expansions typically are periods of rising employment, whereas recessions are periods of falling jobs (mind you that such account can at best be characterized as too simplistic, given that employment is a well-known lagging economic indicator, and preliminary payroll releases are often subject to initial monthly updates and later annual benchmark revisions!).

As with all economic data, the estimate is a key part of the build-up! Economists around the globe look at their crystal balls or tweak their excel models and attempt to divine what the number will be. The reaction to the number can be magnified depending on whether it is close to, distant from, above, or below the estimated figure. Just to add in another element in past years, the private ADP payroll is released one or two days earlier, and while not a direct correlation, it is still an important part of the pre-release analysis for NFPs. Normally, economists and traders would often choose to sit back and wait for the digestion of the release in the broader market before expressing a view or taking a position.

And today is definitely going to be a big day on Wall Street! The May employment report will possibly be one of the most, if not the most, important piece of economic data due this month, with substantial implications for stocks and bonds (both have been mostly stuck in a tight range over the past four weeks). For this afternoon - and despite a resounding disappointment in April payrolls, released on May 7th, that showed a sharp slowdown in hiring during that month and stunned Fed officials and economists across the board - the Bloomberg consensus forecast for May NFP remains for a healthy increase of 675,000 new jobs, powered by growing demand for discretionary services and a boost in the goods sector. Such strong print, if it materializes, would mark a sharp rebound from April's 266K payroll increase and confirm that last month's deceleration was a one-month fluke (that can be simply explained by enhanced unemployment benefits that have led workers to live comfortably on Uncle Sam's dime and hold out for better terms, supply-chain bottlenecks

that are constraining production in some key industries and schools/day cares' closures that have kept many mothers from returning to the labour force). Economists also expect the unemployment rate to dip to 5.9% from 6.1%, a new pandemic-ear low, whilst average hourly earnings jump 0.2% month-on-month following a solid 0.7% gain in April.

Expectations of a rapid restoration of economic activity back in January was the trigger for the US 10-year benchmark rising from below 1.00% to a peak of 1.77% during the first three months of the year. After that rapid market shift, a period of consolidation has played out with the US 10-year yield idling in past weeks near 1.60%. The current tone of relief in bond land has not been challenged by recent evidence of hotter inflation readings, or hints from central bank officials that they are looking at a "*taper*" or reduction in their filled punch bowl of monetary liquidity. After all, the US central bank is still purchasing $120 billion of Treasury and mortgage debt each month and its balance sheet has doubled in size to $8 trillion since the start of 2020 (overall Fed holdings are seen reaching $9 trillion by 2023, or 39% of GDP according to estimates published this week by the Federal Reserve bank of New York! In line with Buzz Lightyear's famous "*To Infinity & Beyond*"!)

There is another powerful explanation (so powerful that I nearly fall off my chair every time I come across it 😊) for why bond market rates are steady and could well handle a gradual reduction in central bank buying. The current level of interest rates simply endorses the view of Fed officials that hotter consumer price pressure will prove transitory and is also in line with the Fed's stance that no pulling back on ultra-accommodative monetary policy will take place until it sees "*substantial further progress*" toward maximum employment and above-2% inflation. The latter condition is already being met, with price growth trending above average as the US reopens. Today's jobs report, then, is a "*critical data point*" for the Fed's next steps toward policy normalization, according to Bank of America economists. On one hand, a stronger-than-expected report could push the central bank further towards tapering its emergency asset purchases. Officials have been adamant they do not expect to shrink the purchases in the near-term, yet minutes from the Federal Open Market Committee's April meeting suggested they may soon discuss a plan for an eventual tapering (next FOMC meeting scheduled for June 16th, with economists unanimously projecting little change from the Fed). "*A strong rebound in employment could give the Fed more confidence in the recovery and the ability to start guiding markets toward a taper*," BofA said. Conversely, another disappointing report could push tapering further into the future, it added.

Irrespective of the near-term outcome, there is a sense that something doesn't seem right within markets and it is perhaps best explained by how a financial system that has enjoyed substantial support from central banks is inherently less robust. Both equities and housing are asset classes that have appreciated substantially in a climate of cheap borrowing costs. "*The paradox is that the more successful central banks are in driving up valuations of risky assets using stimulus, the harder it becomes for them to exit*," said Matt King, global markets strategist at Citigroup. Assessing the "*great unwind*" of monetary and fiscal support also features prominently in the latest edition of the annual Barclays Equity and Gilt study on long-term asset returns in the UK and the US. The bank wrote last week that the restoration of activity after the pandemic "*raises questions about the degree that support will be withdraw*." Among various scenarios, they noted, "*the risk of disorder seems meaningful in the US, where policy responses have been especially forceful*" and "*the prospect of a messy unwind could emerge for the Federal Reserve.*"

And then there is the usual insightful message from the Organisation for Economic Cooperation and Development ("*OECD*"), which warned this week that "*vigilance is needed*," (ah bon? 😊), but any attempt to raise interest rates should be "*state-dependent and guided by sustained improvements in labour markets, signs of durable inflation pressures and changes in the fiscal policy stance*" – so vague that every major central bank can say its policy meets the criteria. Earlier this week, BlackRock Inc. Chief Executive Officer Larry Fink said that investors may be underestimating the potential for a spike in inflation. "*Most people haven't had a forty-plus year career and they have only seen declining inflation over the last 30-plus years,*" Fink said at a virtual event hosted by Deutsche Bank AG on Wednesday. "*So, this is going to be a*

pretty big shock." Fink, who runs the world's biggest asset manager, added that central banks may have to reassess their policies if higher prices become a concern.

Overnight, bitcoin slid 5.4% after a cryptic tweet from Elon Musk apparently hinted at a potential split with the largest cryptocurrency. In his latest tweet, Musk wrote "#Bitcoin 💔"and a reference to a lyric from the popular song "*In the End*" by Linkin Park.

Could the Fed soon surprise markets and announce QE tapering via a similar broken heart emoji tweet? (😊)

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