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Investment Strategy Insights

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Labor Slack or Labor Squeeze?

- Conflicting Job Market Signals
  - Labor market tightness may lead to wage inflation, but both may ultimately prove transitory as the pandemic subsides
- No New News From the Fed
  - The Fed will likely follow a 3-phase plan of guidance, tapering and rate hikes so as not to disrupt the ongoing recovery
- "Hot" Earnings Season
  - Expect the recovery-driven earnings rebound to continue into late 2021, supporting equity markets

Conflicting Job Market Signals

- **Slack vs. Squeeze**. The unemployment rate in the U.S. sits at 6.0%, notably higher than its pre-pandemic level of 3.5%, suggesting that significant slack remains in the labor market. However, the NFIB's* survey of small businesses paints a bit of a different picture of labor dynamics, noting that 42% of small businesses reported job openings they could not fill, an all-time high. NFIB's Chief Economist Dunkelberg noted that "where small businesses do have open positions, labor quality remains a significant problem for owners nationwide."

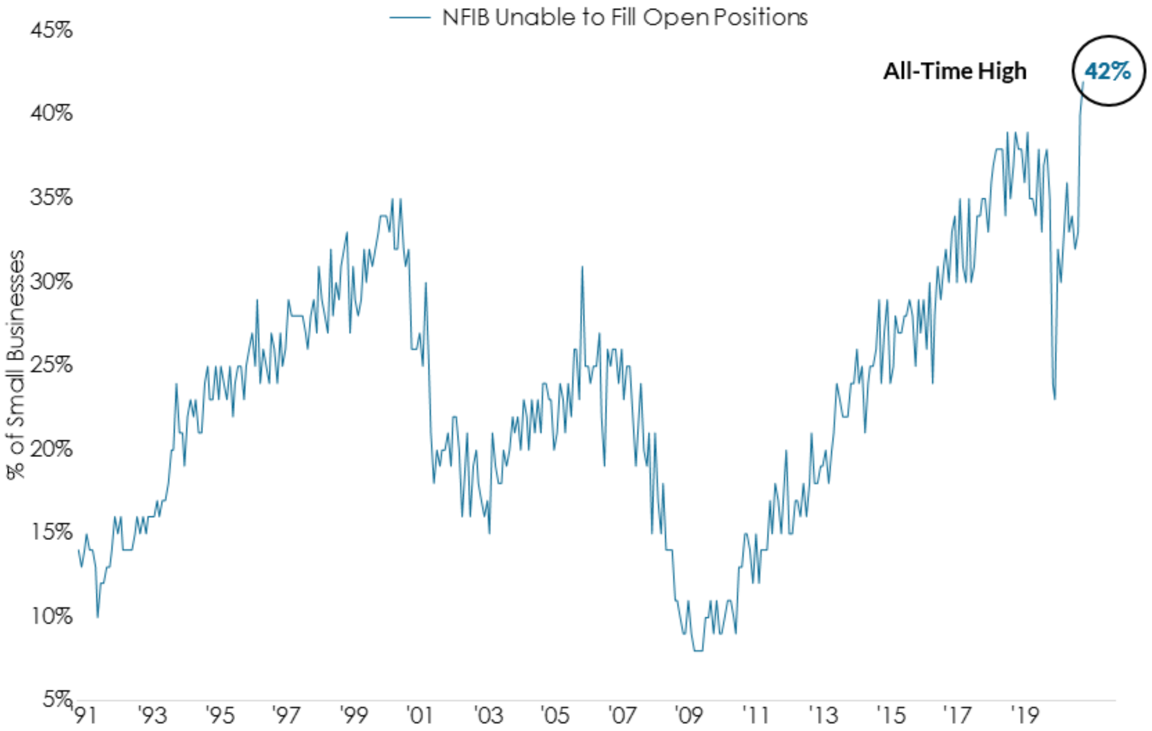
- **Labor Tightness → Wage Inflation.** When demand for labor is high and unemployment low, employers can be expected to bid wages up in order to attract the needed workers. Rising wages can both drive higher inflation and negatively impact corporate profit margins. So ingrained are these expectations that economists often cite the Phillips Curve, a graphical representation of this relationship between labor market tightness, represented by unemployment and inflation.

- **Transitory Tightness?** A deeper look into the main reasons for not working conducted by the U.S. Census Bureau** found that 4.1 million Americans were "concerned about getting or spreading the coronavirus," 2.6 million were sick with or taking care of someone with COVID symptoms and 6.3 million were caring for children not in school, making seeking employment difficult. If even a portion of those workers not working for COVID-related reasons returns to the workforce, labor market dynamics may change materially, easing the labor squeeze.

Labor market tightness may lead to wage inflation, but both may ultimately prove transitory as the pandemic subsides

Chart of the Week:

Small Businesses Are Struggling To Find Qualified Labor



Source: Glenmede, FactSet, National Federation of Independent Business (NFIB) *Data through 04/29/2021*
The NFIB Research Foundation has collected Small Business Economic Trends data with monthly surveys since 1986. Survey respondents are drawn from NFIB's membership. The survey was conducted in March 2021 and reflects a random sample of 10,000 small-business owners/members. The data shown is the percentage of small business owners in the NFIB's monthly jobs report, reporting job openings they could not fill in the current period, on a seasonally-adjusted basis.

*National Federation of Independent Business
**The U.S. Census Bureau's Household Pulse Survey collected the main reasons for adults not working at time of survey conducted; respondents could select more than one answer.*

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No New News From the Fed

- **No Changes from the Fed.** The Federal Open Market Committee (FOMC) met last week, and as expected, the Fed stuck to its game plan of keeping U.S. monetary policy on its ultra-accommodative trajectory. While the statement noted ongoing improvements in the economy and hinted at initial signs of inflation, the recovery is not quite far enough along to warrant a dramatic change in monetary policy at this time.

- **The Fed's Feeling Toward Inflation.** Of particular note was the Fed's recognition of rising inflation, with the statement characterizing price trends as "largely reflecting transitory factors." Investors should expect inflation to continue to rise through the summer, likely peaking later this year as the base effects from last year's pandemic-related price weakness rolls off. Chair Powell has indicated a willingness to tolerate inflation above 2% for some period of time and see through any short-term volatility in price levels.

- **Monetary Policy Roadmap.** If the U.S. economic recovery continues as expected, the Federal Reserve will likely follow a roadmap that begins with emphasizing forward guidance on monetary policy likely later this year. The next step may be a gradual tapering of its bond purchases sometime in 2022 when the dust is (hopefully) settled on the pandemic. This trajectory likely sets the Fed up to begin raising rates again in 2023 to normalize monetary policy. Investors should watch trends in employment and inflation for signs the Fed may need to take a detour from this path.

The Fed will likely follow a 3-phase plan of guidance, tapering and rate hikes so as not to disrupt the ongoing recovery

"Hot" Earnings Season

- **Stellar Earnings Results.** Earnings season is now in full swing, as ~60% of companies have already reported. Q1 has exhibited extremely strong results, with the blended year-over-year earnings growth estimate for the S&P 500, which combines actual results with consensus estimates for firms that have yet to report, currently sitting at ~46%. On top of that, the percentage of firms are beating consensus EPS estimates sits at an all-time high. Overall, Q1's earnings performance is shaping up to be one of the largest gains in corporate profits since the tailwind from the Tax Cuts & Jobs Act of 2017.

- **A Reopening Economy.** This promising earnings growth can be attributed, at least partly, to the progress the U.S. economy is making in breaking out of the pandemic's shadow. Many companies are experiencing exploding demand, as a result of the prior COVID-driven shortages in raw materials. Furthermore, firms have become increasingly savvy with adhering to the COVID way of life, making it easier for consumers to spend in an at-home, technology-driven environment.

- **Future Earnings Showing Promise.** The earnings figures seen in Q1 are likely swollen due to 2020's base effects of a bleeding economy, but they are still very encouraging. Going forward, pent-up demand has more companies citing shortages as an issue, compared to the concerns of supply chain disruptions that were prevalent during the pandemic. All in all, positive earnings growth is expected to continue into the later stages of 2021, as we trend toward a version of economic normalcy.

Expect the recovery-driven earnings rebound to continue into late 2021, supporting equity markets

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