INVESTMENT STRATEGY INSIGHTS

Labor Day Data Dump

September 6th, 2022

Labor Market Look-In

- Last Friday's jobs report may not be enough to back the Fed off from another 50 - 75bps hike later this month

Fed's Raise and Hold Gameplan

- Investors should not underestimate the Fed's resolve for material tightening via rate hikes and balance sheet runoff

Wall Street Wake-Up Call

- There may be further downside to the ongoing bear market, justifying an underweight to risk assets

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Labor Market Look-In

- **Latest Jobs Report.** Last Friday's jobs report for August brought with it the latest insights on the health of the U.S. labor market. Nonfarm payrolls were roughly in-line with consensus expectations, adding 315k jobs. However, this was offset by downward revisions of 107k for the months of June and July. On the other hand, the unemployment rate ticked up to 3.7%. Ordinarily, a rising jobless rate might be a signal of pain starting to seep into the labor market, but the 0.3% increase in the labor force participation rate suggests that the growing pool of willing labor may be a notable contributor.
- **Demographic Headwinds.** Workers reentering the job market is a welcome development – increasing the supply of available labor could help further aid in tamping down wage inflation and avoid the possibility of a dreaded wage-price spiral. With that said, each incremental step higher in labor force participation may prove difficult as the U.S. deals with demographic headwinds. For example, the Bureau of Labor Statistics projects that as the Baby Boomer generation reaches retirement age, the natural rate of participation in the labor force is likely to decline through the end of the decade.
- **It All Comes Back to Inflation.** On the margin, Friday's jobs report is likely a welcome sign for the Fed, which is trying to thread the needle for this economy by getting people back into the workforce to drive total growth in compensation while also taking some pressure off inflation through slower wage gains. There were some initial steps in the right direction here, with average hourly earnings falling to a 0.3% month-over-month growth rate in August, down from July's 0.5% pace.

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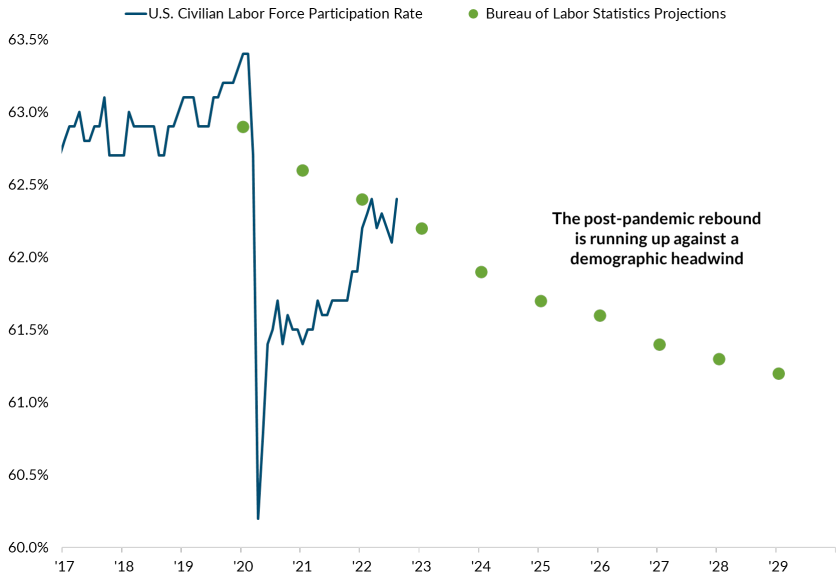
Chart of the Week:

Participation has jumped higher, but may start to hit a demographic ceiling



Source: Glenmede, FactSet, U.S. Bureau of Labor Statistics Data through 9/6/2022
The blue line represents the U.S. civilian labor force participation rate. The green dots represent projections from the U.S. Bureau of Labor Statistics for the path of the labor force participation rate. Actual results may differ materially from projections.

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Fed's Raise and Hold Gameplan

- **Latest From the Fed.** Echoing recent commentary from Fed Chair Powell, several regional Fed presidents continued to caution strongly against prematurely loosening policy. In his speech last Tuesday, New York Fed's Williams agreed interest rates would likely need to advance above 3.5% at some point to achieve their goal, while also reiterating the need to hold restrictive policy for some time. Walking the line, Cleveland Fed's Mester further backed the raise-and-hold messaging in an interview last week, suggesting the Fed may need to push rates "above 4% and probably hold them there next year."
- **To Neutral and Beyond.** In the wake of an accelerated pace of rate increases, monetary policy is approaching neutral quickly, the level above which should restrain the economy. While the Fed has not yet crossed the neutral Rubicon, it is expected to do so later this year as it remains laser-focused on the price stability half of its dual mandate. This reflects an expectation that the Fed will follow through in order to contain inflation, despite the impact on economic growth/markets.
- **Another Headwind: QT.** Though having taken the backseat to its rapid rate hikes in recent months, the Fed's quantitative tightening (QT) program is also gaining momentum. Heading into September, the Fed plans to ramp up its balance sheet reduction to a maximum of $95 billion per month, which should return the balance sheet to its pre-pandemic size as a share of GDP by year-end 2025. Such actions should withdraw liquidity from the financial system, adding a hard-to-measure tightening impact on top of their already aggressive rate-hiking campaign.

Investors should not underestimate the Fed's resolve for material tightening via rate hikes and balance sheet runoff

Wall Street Wake-Up Call

- **Markets Unwind.** Markets ended last week with the S&P 500 down 3.3%, as it continues to reverse course on its summer rally. After hitting a four-month high in August, the S&P 500 finished the month on a weaker note. The recent sell-off accelerated following Fed Chair Powell's speech at Jackson Hole, as it became clear that the recent run of weaker economic data would not prompt a pivot from the Fed on its ongoing monetary tightening campaign.
- **Don't Fight the Fed.** After weighing the latest spur of commentary, investors may be beginning to recognize the Fed's resolve in fighting inflation. Expectations for a third straight 0.75% rate hike continue to rise, with fed funds futures pointing to a roughly 68% chance of such an increase. Notably, markets are now pricing in a path that closely aligns with the Fed's last projections via its dot plot from the June FOMC meeting, with rates forecasted to end the year at 3.8% and peak at 3.9% in March of next year.
- **Valuations Dip Lower.** After rebounding from the June lows, markets have returned to levels at which they command significant premiums to fair value. However, with the recent decline, large cap stocks still do not appear to reflect the growing difficulty in the economic environment. According to Glenmede's Global Expected Returns model, large cap stocks experienced a considerable decline last week, though remain near their 75th percentile. All else equal, expectations of persistent tightening from the Fed and the associated economic fallout should weigh on those premium valuations, suggesting the ongoing bear market may have further room to fall.

There may be further downside to the ongoing bear market, justifying an underweight to risk assets

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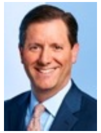

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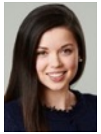

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