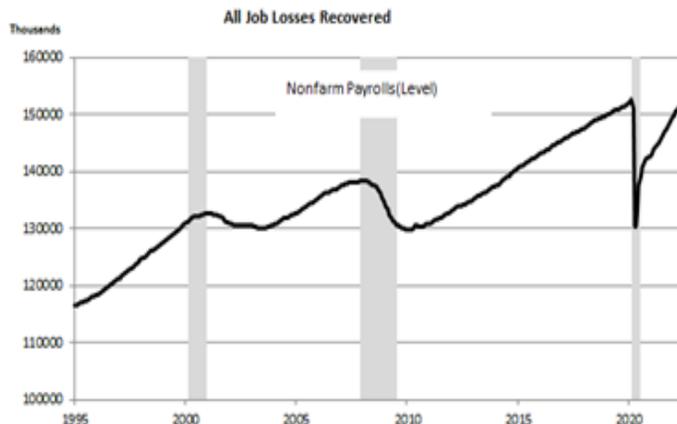


WEEKLY ECONOMIC COMMENTARY

If the U.S. economy is in a recession, the HR departments of Corporate America didn't get the memo. Employers added a blockbuster 528 thousand workers to payrolls in July, more than double expectations, while revisions to May and June added 28 thousand to the already heady increases for those months. So far this year, job growth averaged 471 thousand a month, while the unemployment rate fell to 3.5 percent, matching the lowest level in more than 50 years. During the final seven months prior to the brutal – but brief – 2020 recession, job growth averaged 221 thousand a month. Following the July increase, all of the pandemic recession job losses – more than 20 million -- have been recovered, a feat accomplished in a remarkably short time given the deep hole the labor market had to climb out of.

Not only did the payroll gain in July defy expectations of a slowdown to 250 thousand, it also defies recession-headlines generated by the two quarterly declines in GDP this year. Although it is common for companies to continue hiring during the initial stage of a recession, it is unusual for the pace of job growth to accelerate, as is currently the case. The 528 thousand increase in payrolls followed increases of 398 in June and 386 in May and was the strongest monthly gain since February. If there is one cautionary sign, it is that the number of workers in part-time jobs for economic reasons -- i.e. because their hours were cut due to slack economic conditions -- jumped by 303 thousand last month. But this metric is highly volatile and followed a 707 thousand plunge in June, so not much should be read into a one-month spike. Even with the latest increase, there are about half-million fewer workers in part-time jobs than in February 2020, the peak of the pre-Covid expansion.



Last month's stellar employment gain reflected ongoing changes in consumer buying patterns as the economy continues to reopen from pandemic lockdowns. Simply put, households are spending more on services and less on goods, which means they are traveling and going to restaurants and concerts while spending less time at home riding Pelotons and sprucing up their surroundings with furnishings. Hence service providers continue to drive the hiring spree, accounting for 402 thousand of the payroll increase last month. Leisure and hospitality companies led the way, which added 94 thousand workers, reflecting the still abundant discretionary funds in household bank accounts. Within that sector, restaurants and bars had the biggest appetite for labor, bulking up their payrolls by 74 thousand. Even so, employment in leisure and hospitality has still not recovered all of the recession losses, as it remains 1.2 million below the pre-pandemic level.



workers. The slowdown in wage gains is more an affordability than a demand issue, as companies in this sector, particularly restaurants and bars, simply do not have the budgetary clout to pay workers a competitive wage.

Notably, the robust demand for workers amidst a stagnant labor pool continues to put upward pressure on wages. Just as expectations for a slowdown in jobs growth last month were thwarted, so too were expectations that wage increases would slow. They didn't. Average hourly earnings for all private-sector workers advanced by a hefty 0.5 percent in July, up from 0.4 percent in each of the previous two months, keeping the increase over the past year at the same elevated 5.2 percent pace as in June. The

The shortfall of workers in leisure and hospitality is not surprising, given the wide pay disparity with most other occupations and the ample job openings available elsewhere. Leisure and hospitality workers are getting an average hourly wage of \$20.22 compared to \$26.61 for all non-management workers in the private sector. And while their wage increases have been more substantial over the past year – 8.1 percent compared to 5.2 percent for all workers -- the gap is narrowing. At the start of the year, average hourly earnings increased at a 13.3 percent annual rate in leisure and hospitality versus less than 5 percent for all private sector

pressure on wages is coming from both the demand and supply sides. While employer staffing needs remain strong, the labor pool is not keeping up. The labor force shrank by 63 thousand last month, and the labor force participation rate slipped 0.1 percent to 62.1 percent, falling further behind the 63.4 percent level just before the onset of the pandemic.

The shrinkage of the labor pool is somewhat puzzling, given the incentive of workers to come off the sidelines. Wages are increasing at the fastest pace in 40 years, and inflation is rising even faster, squeezing household budgets that presumably would encourage people to take a job. Interestingly, the slippage in labor force participation last month did not include prime-age workers – those in the 25-54 bracket – or older workers – those over 55 – as both of those age cohorts did increase their participation rates. The decline was concentrated among the younger population, those under 24 years old, which may reflect mobility constraints that prevent them from going where the jobs are. Specifically, high housing prices and surging rents may be locking younger people in place.



The gangbuster jobs report had a predictable effect on the financial markets. With imminent recession fears downgraded and inflation concerns flaring up, bond yields staged a significant leap, with the 10-year Treasury yield increasing from 2.70 percent to 2.85 percent on Friday. The yield is still well below the mid-June high of 3.48 percent but well off its nearby low of 2.57 percent, appropriately straddling the lines between recession and inflation. Significantly, the narrative regarding what the Fed will do next changed markedly following the jobs report. In recent weeks, a raft of softer economic data and nascent signs of easing inflation, highlighted by 50 consecutive days of lower gas prices, prompted forecasters to think the Fed would ease up on its rate-hiking campaign, throttling back the next increase to 50 basis points at the September policy meeting from the 75 basis point increase taken last month.

That narrative is no longer credible in our view. Given the powerful inflation tailwinds indicated by the still overheated job market and sturdy wage gains, it is hard to fathom policymakers taking a more lenient stance in the inflation fight. Indeed, Fed officials have spent the past several weeks – even before the July jobs report -- jawboning against the growing market perception that it would lower its rate-hiking sights. The reason: that perception was bringing on lower yields and spurring higher stock prices, resulting in easier financial conditions that, in effect, counteracted what the Fed was trying to achieve.

Keep in mind too, that Fed Chair Powell had previously maintained that the strong job market provided the economy with a formidable bulwark to withstand higher interest rates, lessening the potential damage from a more restrictive policy. With Friday's jobs report, his case has become even stronger, further bolstering the odds of a 75 basis point rate hike at the September meeting. Significantly, the odds of a soft landing may be improving, as price gains are slowing on a broad swath of commodities, not only gasoline, and a growing number of retailers are stuck with excess inventories that will be heavily discounted in coming months. The Fed's steadfast commitment to demand-curbing rate hikes should reinforce this trend and keep inflation expectations in check, even as the strong job market cushions the blow from its inflation-fighting campaign.

FINANCIAL INDICATORS				
INTEREST RATES	August 5	Week Ago	Month Ago	Year Ago
3-month Treasury bill	2.50%	2.37%	1.88%	0.06%
6-month Treasury bill	2.87	2.87	2.57	0.06
3-month LIBOR	2.86	2.78	2.43	0.13
2-year Treasury note	3.22	2.88	3.12	0.22
5-year Treasury note	2.77	2.68	3.13	0.77
10-year Treasury note	2.84	2.65	3.08	1.31
30-year Treasury bond	3.07	3.09	3.25	1.95
30-year fixed mortgage rate	4.99	5.30	5.30	2.77
15-year fixed mortgage rate	4.26	4.58	4.45	2.1
5/1-year adjustable rate	4.25	4.29	4.19	2.40
STOCK MARKET				
Dow Jones Industrial Index	32803.47	32845.13	31338.15	35208.51
S&P 500	4145.19	4130.29	3899.38	4436.52
NASDAQ	12657.55	1239.69	11635.31	14835.76
Commodities				
Gold (\$ per troy ounce)	1792.40	1782.70	1740.30	1762
Oil (\$ per barrel) - Crude Futures (WTI)	88.53	98.30	104.36	68.08
ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
ISM Manufacturing Index (July)	52.8	53.0	56.1	55.5
ISM Services Index (July)	56.7	55.3	55.9	56.6
Nonfarm Payrolls (July) - 000s	528	398	386	465
Unemployment Rate (July) - Percent	3.5	3.6	3.6	3.6
Average Hourly Earnings (July) - % change	0.5	0.4	0.4	0.4

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