DUCENTA SQUARED
ASSET MANAGEMENT

Monthly Fixed Income Insight

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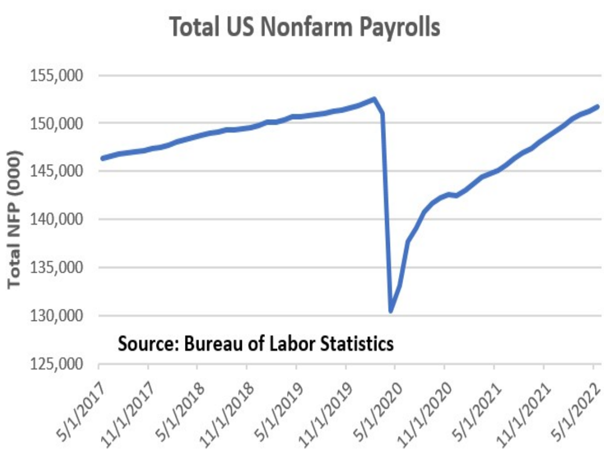
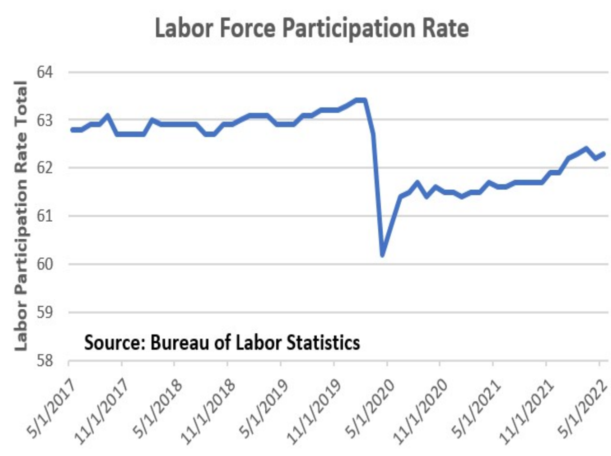
When Good News Is Bad News

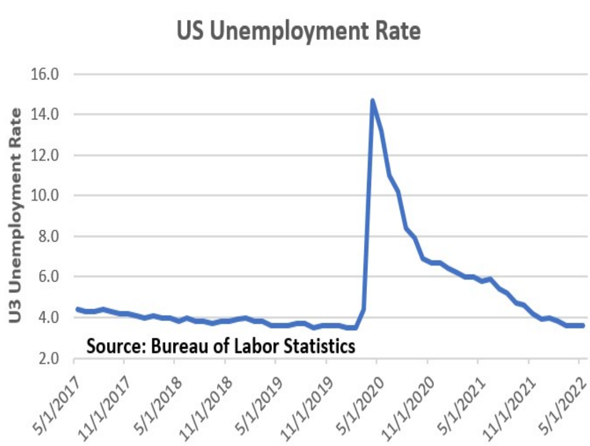
The May employment report showed the labor market continues to surge which would normally be a cause for celebration for the economy and the financial markets. Unfortunately, like many things since the pandemic, these are not normal times. As Federal Reserve Chairman Powell noted in his March press conference, "the labor markets are tight to an unhealthy level" with demand for labor outstripping supply. With inflation the singular focus for the Federal Reserve, the continued strength in the labor markets has become a big problem and good news in the jobs market has become bad news for inflation and the Federal Reserve.

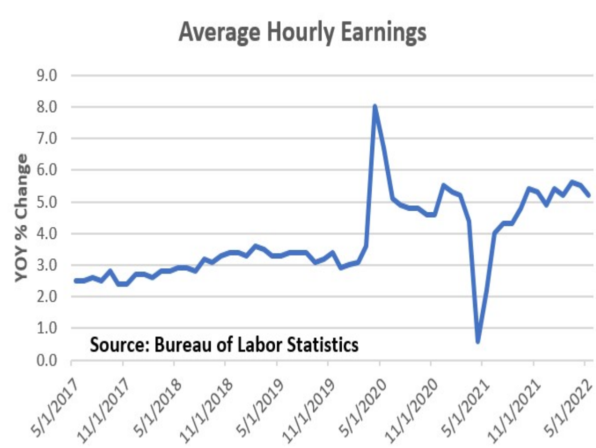
The May employment report showed a stronger-than-expected 390,000 jobs added for a three-month average of 408,000. Hiring is moderating somewhat from the six-month average of 505,000 and the one million plus monthly additions in the immediate post-pandemic period, but demand for labor is still far outpacing supply. There are currently 11.4 million job openings which is almost twice the number of people unemployed and looking for work.





With regard to the May jobs report, The Federal Reserve can take some consolation from the fact that the unemployment rate held steady at 3.6% for the third consecutive month, average hourly earnings decelerated from 5.5% to 5.2%, and the labor force participation rate ticked higher. However, the moderation in the overheating labor market is not coming fast enough, especially considering the recent very strong CPI inflation report, which showed continued broad based price pressures.





The Federal Reserve has a very challenging task in bringing down inflation, which is near a 40-year high, and at the same time, avoiding a recession in the economy. To achieve a soft landing, the primary goal for the Fed will be to cool the overheating labor markets. Wage growth will need to slow from the current 5.2% to between 3% and 4% to be more consistent with the Fed's 2% inflation target. To slow wage growth, monthly job gains will need to fall to below 200,000 or possibly 100,000. Unfortunately, history is not on the Fed's side when it comes to engineering a soft landing following a period of tight monetary policy. The soft landings of 1984 and 1994 both occurred during periods of slowing inflation and as the unemployment rate held above the natural rate, both of which are not the case today. We will be watching our market and economic recession indicators closely, but for now we expect the US economy to slip into a recession in the second quarter of 2023.