First Trust Portfolios Canada
Monday Morning OUTLOOK

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The Game Isn't Over

At the beginning of the season, not many predicted that the Philadelphia Eagles would be in the Super Bowl this year. But, they had a fantastic season and are favored over the Kansas City Chiefs. Predicting this economy is equally hard. Anyone who thinks they know exactly how things will turn out is fooling themselves. COVID policies – lockdowns, massive borrowing, and money printing to pay people not to work – have never been tried before. So, what happens is still up in the air.

It seems like just yesterday that ZeroHedge – with help from the Philadelphia Fed – was trying to convince people that job growth was non-existent in the second quarter of 2022. Never mind the fact that they purposefully conflated two different measures of jobs…it just wasn't true.

So, it must have come as a shock to those who believed that nonsense that in January, after the equivalent of 17 quarter-point Fed rate hikes, jobs data and hours worked exploded to the upside. Nonfarm payrolls rose 517,000 jobs, while revisions to prior months added an additional 71,000.

Not one economics group came even remotely close to getting this number right. And the print was especially surprising after seeing retail sales fall 4.3% and industrial production fall 5.2%, at three-month annualized rates, through December.

The difficulty of forecasting in this environment is absolutely astounding. On the one hand, the M2 measure of money has contracted in the most recent twelve months (the first time in more than sixty years), after growing over 40% in a two-year timespan. On the other hand, even with the Federal Reserve's sharp rate hikes, the federal funds rate is still below inflation.

Using M2 growth, alone, and Milton Friedman's lag of 6-9 months, we should be seeing the economy begin to slow, which is what retail sales, industrial production, housing, and retail auto sales have been pointing to. And so far with 256 out of the S&P 500 companies having reported, profits are down 3.1% from a year ago.

But it's not just M2…the rebound from COVID lockdowns is over. Stores are back open, airplanes packed, and hotels filled. Now that we are back to "normal", how much further can things go? We aren't going to have two packed-stadium Super Bowls this year, just one. And pandemic unemployment checks and PPP loans have run their course. Yes, some state and local governments, and school districts, have money left, but not much. To our way of thinking, we should see a slump now that the drugs of all the borrowing wear off.

So, how then did jobs provide such a large upside surprise!?! Do employers really know what they are doing? Do they see something that is not showing up in the data? Or is this a delayed reaction (after all, employment is a lagging indicator) to issues with hiring during and after the pandemic.

If you couldn't hire workers, but now they want to work, and you expect a soft landing (or even no recession at all) then you grab all the workers you can, when you can. But if there is a "hard landing" profits could be squeezed even more.

Taking all this into consideration, we don't think the boom in nonfarm payrolls is a signal worth following. Many companies…Peloton, Bed, Bath & Beyond, Hasbro, and lots of tech stalwarts were winners when services were locked down and people with fresh stimulus funds needed tech. But now they are all in either financial trouble or are laying off workers. The losers during the lockdowns (services) have all reopened, but people aren't going to double their use of services, especially with interest rates up and money supply down.

So, while one number from one month seemed to change a lot of people's minds about the economy, we think we're far from the final whistle of the game. This one isn't over yet.

Unprecedented actions on the scale that we experienced in 2020-2022 will bring unexpected results in 2023. So, while we never want to ignore a number like the January jobs report, we have to question how much is signal and how much is noise.

The economy is still absorbing the money printed during the pandemic. Inflation has not been eradicated, the Fed is highly unlikely to loosen policy anytime soon, and earnings are likely to fall as all the stimulus wears off. That's not a recipe for a simple forecast or a soft landing. Like the Super Bowl, until the game is played no one knows exactly what will happen. Count us less bullish than conventional wisdom.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
2-7 / 7:30 am	Int'l Trade Balance – Dec	-$68.5 Bil	**-$68.4 Bil**		-$61.5 Bil
2:00 pm	Consumer Credit– Dec	$25.0 Bil	**$25.0 Bil**		$28.0 Bil
2-9 / 7:30 am	Initial Claims – Feb 5	190K	**190K**		183K
2-10 / 9:00 am	U. Mich Consumer Sentiment- Feb	65.0	**65.0**		64.9