Weekly Market Flash

Jobs Numbers, Interest Rates and Tech Stocks

May 7, 2021

The main theme of the past several weeks has been the surging economy. A big GDP number last week (six percent growth in the first quarter of 2021), rebounding consumer confidence and the first signs of an uptick in inflation have all supported the narrative that the recovery is here and about to kick into high gear. This sunny take on things had some economists in a positively giddy frame of mind this week ahead of the monthly jobs report published by the Bureau of Labor Statistics this morning. The official consensus of analysts whose job is to forecast macroeconomic trends was for 975,000 gains in nonfarm payrolls. Some, though, were predicting as many as two million new jobs. Offices are reopening, businesses are getting…well, back to business, and they need workers!

Wait, what?

Or so we all thought. The BLS report came out as always at the precise time of 8:30 am today and it was, to use the technical term, a damp squib of the highest order. The actual number of payroll gains according to the report was 266,000, not anything bumping up on a million or more. The unemployment rate, which was supposed to decline by a couple ticks to 5.8 percent, instead notched up slightly to 6.1 percent (it was 6.0 percent the previous month). To add insult to injury, the payroll gains reported last month for March were revised down from 916,000 to 770,000. So much for a blowout labor market.

It is always important to remember that these economic reports always have some variability in them. The BLS report is essentially a survey of a statistical sample of households and businesses conducted over a period of several days sometime in the middle of each month. Over a period of time the reports can illustrate a broad-based trend, but any individual report can always be an outlier. The April report that came out today most likely is that kind of outlier. All indications, today's numbers notwithstanding, are that the labor market is fairly robust. If there is any problem, it would seem to be that in many sectors employers are finding it hard to fill positions. It may take several months for supply and demand to work themselves out. In the meantime we probably shouldn't get overly exercised about any single data point.

The Market Weighs In

Stock and bond markets have their own way of digesting this news. Let's start with the bond market. The big thing going on here, as we know from watching interest rates over the past several months, is inflation. Not the inflation we have today, which is still pretty contained, but the inflation bond investors think we are going to have. The inflation an overheated economy generates will force the Fed to step in sooner than it wants to tighten monetary policy – i.e. reducing its asset purchases and eventually increasing the short term interest rates over which it exerts influence. The hotter the economy runs, according to this logic, the greater the risk of Fed action and thus higher interest rates.

So when the jobs numbers came out today so far below expectations, bond investors jumped for joy. Okay, not literally, though maybe a few hypercaffeinated types really did cut a rug on the trading floor. But the hot take was "bad for jobs, good for rates" and the benchmark 10-year Treasury yield declined by a few points (when bond prices go up, bond yields decline).

This movement in the bond market, in turn, makes its presence felt in equity markets. When you see stock prices go up or down on any given day, the majority of the volume driving those moves comes from short term programmatic trading wired to automatically respond to trigger events. A macro event causing interest rates to go down, all else being equal, is likely to trigger a rise in those parts of the stock market deemed most sensitive to rates. This tends to consist of tech and other types of growth stocks. Sure enough, the tech-heavy Nasdaq Composite is up over one percent this morning on the back of those jobs numbers.

Why is this? It has to do with how these companies are valued. Growth stocks often derive their value from assumptions about the growth investors predict will happen years from now. The cash flows produced by that growth then need to be expressed in present value terms. You do that by applying an interest rate – the "discount rate" – to express a stream of future cash flows in present value terms. The lower the discount rate, the higher that present value number. Hence, interest rate changes have an outsize effect on companies with lots of growth assumptions built into their future performance.

All of this is short-term, of course. We will no doubt get some other number sometime in the coming days that carries a different message, and the algorithms powering the trading programs in the stock and bond markets will go the other way. And so it goes ad infinitum.

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