MV CAPITAL MANAGEMENT

Weekly Market Flash

Hot Jobs, Cold Fed

January 10, 2025

What a difference a few months can make. Late last summer, markets were freaking out about what seemed to be a rapidly cooling labor market. Nonfarm payrolls for August increased by just 78,000, well below the 206,000 average for the twelve months prior to that. The Fed, too, was noticing the apparent tapering of conditions in the jobs environment. With inflation seemingly under control, the timing was right for an outsize interest rate cut, which duly arrived in September.

That was then. In November, nonfarm payrolls came in with a robust gain of 212,000. Today, we learned from the Bureau of Labor Statistics that the commensurate gains for December jumped to 256,000. Economists had been expecting to see just 136,500 additions to NFP, so financial markets were caught off guard by the BLS report (which also showed a slight decrease in the unemployment rate from 4.2 percent to 4.1 percent. The jobs market, it would appear, is sportingly healthy.

Too healthy, perhaps, for the Fed…and for the market. Following this morning's jobs report, the yield on the 10-year Treasury jumped to 4.8 percent, its highest level since November 2023. Further cuts to the Fed funds target rate would appear to be off the table for now, pushed back into the increasingly dense fog of mid-late 2025. Current expectations in futures markets have the Fed holding at current levels until possibly as late as September. Pretty much nobody expects a rate cut when the Federal Open Market Committee meets next on January 29.

All of this is happening, of course, before anyone is in possession of reliable data about the extent to which the incoming administration is going to turn up the volume with tariffs, tax cuts and anti-immigration policies. We will have a new baseline for inflation next week, when the December Consumer Price Index report comes out, with current economists' projections hovering around 3.3 percent year-on-year for core CPI. The problem being, of course, that 3.3 percent will likely be a baseline with considerable upside potential given the inflationary one-two punch of higher consumer prices (tariffs) and higher wages (immigration restrictions).

A worst-case scenario would have the combination of a hotter than expected jobs market and upward revisions to inflationary expectations forcing the Fed to return to raising rates. That, in turn, would likely exacerbate two other current areas of concern: a growing number of corporate bankruptcies and uncomfortably high delinquency levels in consumer credit. That would be a recipe for stagflation, the scourge of the late 1970s. To be clear, we do not believe this to be the likeliest outcome, but it is a scenario we have to bear in mind as we make portfolio decisions.

All things considered, more jobs is better than fewer jobs. Especially given our concerns about consumer spending in light of the credit card delinquency trend, the last thing we want to see any time soon is a spike in the number of people out of work. It may mean a few "good news is bad news" days like today in the market, but over time stocks and bonds will benefit from a healthy labor market. And perhaps this early January pullback will serve a purpose in nudging a few incoming policymakers away from some of the less desirable ideas being batted around. Guardrails, in other words.

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