Improving Labor Numbers and Optimistic Purchasing Managers will Pressure Fed

Scott McIntyre, CFA
HilltopSecurities Asset Management
Senior Portfolio Manager
Managing Director
512.481.2009
scott.mcintyre@hilltopsecurities.com

Greg Warner, CTP
HilltopSecurities Asset Management
Senior Portfolio Manager
Director
512.481.2012
greg.warner@hilltopsecurities.com

This morning's stronger-than-expected labor market numbers suggest May non-farm payrolls (scheduled for release tomorrow) could surprise to the upside. The ADP employment report showed a gain of 978k jobs during the month of May. This was the biggest monthly increase in 11 months and well above the 650k Bloomberg median forecast. ADP report data indicated a significant majority (86%) of last month's payroll increase was concentrated in the rapidly-improving service sector where returning jobs are outpacing job seekers. In other labor news, initial jobless claims fell below 400k last week for the first time since the pandemic began, although at 385k the number of Americans filing for state unemployment benefits is still well above pre-pandemic levels.

The median forecast for tomorrow's payroll number is an increase of 661k, but many economists have cautioned that seasonal adjustment factors are out-of-whack, which suggests that the actual number could be well off the mark without rattling the markets. With a tremendous amount of noise and volatility in play, the data may not reflect reality. The reality is that employers across the nation are complaining of severe worker shortages as momentum builds entering the summer. Several Fed officials have recently spoke of labor market tightness, including Dallas Fed President Robert Kaplan and St. Louis Fed President James Bullard. The next FOMC meeting on June 15-16 will include an updated dot plot and a fresh set of growth and inflation forecasts. Since the Fed's primary objective seems to be a return to full employment, committee member rumblings about labor shortages are attention grabbers.

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On Monday, the ISM manufacturing index climbed from 60.7 to 61.2 in May. Readings above 50 indicate expansion, while levels above 60 are consistent with significant strength. The May report included several noteworthy sub-index readings. In particular, new orders jumped from 64.3 to 67, within a point of the 17-year high. At the same time, the orders backlog index rose above 70 for the first time in the 27-year history of the series, while the prices paid index slipped a bit, but remained extremely elevated at 88.0. Despite all indications that factory demand is strong, the current production index fell from 62.5 to 58.5 and the employment index slipped from 55.1 to 50.9. Factory managers continue to cite difficulty in filling orders and finding and retaining qualified workers. This is a very common theme.

Purchasing managers comments suggested imbalances aren't likely to correct in the near-term:

- "In 35 years of purchasing, I've never seen anything like these extended lead times and rising prices."
- "Steel prices are crazy high."
- "Market capacity in most areas is oversold, with no realistic improvement on the horizon. In fact, it appears that demand will continue to strengthen, leading to more significant disruptions."

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- "The current electronics/semiconductor shortage is having tremendous impacts on lead times and pricing. Additionally, there appears to be a general inflation of prices across most, if not all, supply lines."

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The ISM non-manufacturing index (released this morning) surprised to the upside yet again with all 18 industry sectors reporting growth. The May reading of 64 was the highest in the 24-year history of the series and indicates significant momentum in the service sector. Current production, new orders, order backlogs and supplier deliveries were all above 60 and at or near record highs. The employment index slipped from 58.8 to 55.3, reflecting difficulty in hiring service workers as the economy fully opens, while the prices paid Index climbed from 76.8 to 80.6, the highest reading in over 15 years.

The Atlanta Fed's GDPNow measure for the second quarter was +10.3% as of June 1st. Today's strong numbers suggest this measure may be too low.

Market Indications as of 11:02 A.M. Central Time

DOW	Up 34 to 34,634 (HIGH: 34,778)
NASDAQ	Down 122 to 13,634 (HIGH: 14,139)
S&P 500	Down 10 to 4,199 (HIGH: 4,233)
1-Yr T-bill	current yield 0.04%; opening yield 0.03%
2-Yr T-note	current yield 0.16%; opening yield 0.15%
3-Yr T-note	current yield 0.32%; opening yield 0.30%
5-Yr T-note	current yield 0.83%; opening yield 0.79%
10-Yr T-note	current yield 1.62%; opening yield 1.59%
30-Yr T-bond	current yield 2.29%; opening yield 2.27%