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Signs of a More Hawkish Fed and Labor Market Improvement Push Yields Higher

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Earlier this week, the December ISM manufacturing survey indicated factory improvement despite a decline in the headline composite, which fell from 61.1 to a still solid 58.7. In this diffusion index, any reading above 50 indicates expansion, while the 60 mark is considered *very strong*. Although the current production index (61.5 to 59.2) and new orders index (61.5 to 59.2) both slipped a notch, factory managers signaled significant improvement in delivery times and reduced inflationary pressure.

Supplier delivery times (the only ISM index in which a decline is good) dropped from 72.2 to 64.9, hinting that bottlenecks may be clearing earlier than expected. The prices paid index plunged from 82.4 to 68.2, the lowest level in over a year, as fewer purchasing managers reported rising prices. Although the monthly reports from the Institute for Supply Management are based on surveys, they have long track records of timely and relevant information.

This morning, the headline ISM *non-manufacturing index* for December fell from 69.1 to 62. Although the -7.1 point drop was the largest in 20 months, it followed the highest reading in the history of the series. The December story in the service sector was similar to the factory sector in that new orders (69.7 to 61.5) and business activity (74.6 to 67.6) both dropped, while the supplier delivery index (75.7 to 63.9) indicated *reduced delays*. The employment index slipped from 56.5 to 54.9, but given the well-documented hiring challenges faced by service managers, this is still an encouraging number. What isn't particularly encouraging is the prices paid index, which actually climbed from 82.3 to 82.5. This suggests that price pressures in the service sector aren't retreating, which probably reflects continued wage pressure.

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Yesterday, the ADP employment change report showed U.S. business's added +807k jobs to payrolls in December, nearly doubling the median forecast with the strongest ADP job count since May. Service-providers added +669k jobs, continuing a gradual rise in service sector hiring. Although the ADP report doesn't correlate particularly well with the BLS report in the short run, the December ADP strength suggests upside to tomorrow's BLS employment report.

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Yesterday afternoon, the minutes from the December FOMC meeting were released. There really weren't any big surprises, but the financial markets interpreted the minutes as being *more hawkish* than previously thought. According to the minutes, "participants generally noted that, given their individual outlooks for the economy, the labor market, and inflation, it may become warranted to increase the federal funds rate sooner or at a faster pace than participants had earlier anticipated." In addition, "*several* participants though it might be appropriate to begin reducing the size of the balance sheet relatively soon after beginning to raise the overnight funds target." On the surface, comments by Fed officials sound more *hawkish, but in reality the minutes reveal committee discussions, not decisions*.

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On Tuesday, the November JOLT survey continued to show job openings near historical highs, at the same time those who do have jobs feel secure enough to quit. Job postings slipped from 11.1 to 10.6 million, while a record 4.5 million Americans quit their jobs in November, representing a 3% quits rate. Typically, a high "quits rate" indicates labor market confidence, but in the COVID-tinted economy, the reasons for quitting may cut a little deeper.

Tomorrow's release of the December employment report is expected to indicate improvement in hiring as the median forecast for non-farm payroll is an increase of +440k, twice the disappointing +210k add in November.

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Market Indications as of 11:26 A.M. Central Time

DOW	Down -51 to 36,356 (HIGH: 36,800)
NASDAQ	Up 44 to 15,144 (HIGH: 16,057)
S&P 500	Up 11 to 4,712 (HIGH: 4,797)
1-Yr T-bill	current yield 0.42%; opening yield 0.32%
2-Yr T-note	current yield 0.88%; opening yield 0.82%
3-Yr T-note	current yield 1.14%; opening yield 1.08%
5-Yr T-note	current yield 1.47%; opening yield 1.42%
10-Yr T-note	current yield 1.73%; opening yield 1.70%
30-Yr T-bond	current yield 2.11%; opening yield 2.09%