Weak ISM Report Reverses Employment Report Selloff

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The bond market sold off in early trading following an unexpected rise in wages and a drop in the labor force participation rate, but reversed course and rallied big after the ISM service index showed U.S. purchasing managers had suddenly become less optimistic.

Nonfarm payrolls rose +216k in December, topping the +175k median forecast. However, revisions to the previous two months subtracted -71k, *so net payrolls were actually a bit weaker*. Employment gains moderated in the second half of 2023 with an average of +213k jobs added to company payrolls, down from +311k in the first half, but the labor market remains surprisingly solid despite the Fed's efforts to cool the economy.

Notable payroll increases were concentrated in leisure and hospitality (+40k), healthcare (+38k), local government (+37k), social assistance (+21k), retail (+17k) and construction (+17k). The sector shedding the most jobs last month was transportation and warehousing (-23k).

Household survey data showed a -683k drop in employment while -845k Americans exited the labor force, resulting in an *unchanged* unemployment rate of 3.7%. The unexpected decline in workers (and/or people looking for work) drove the participation rate down from 62.8% to 62.5%, *the lowest since February.*

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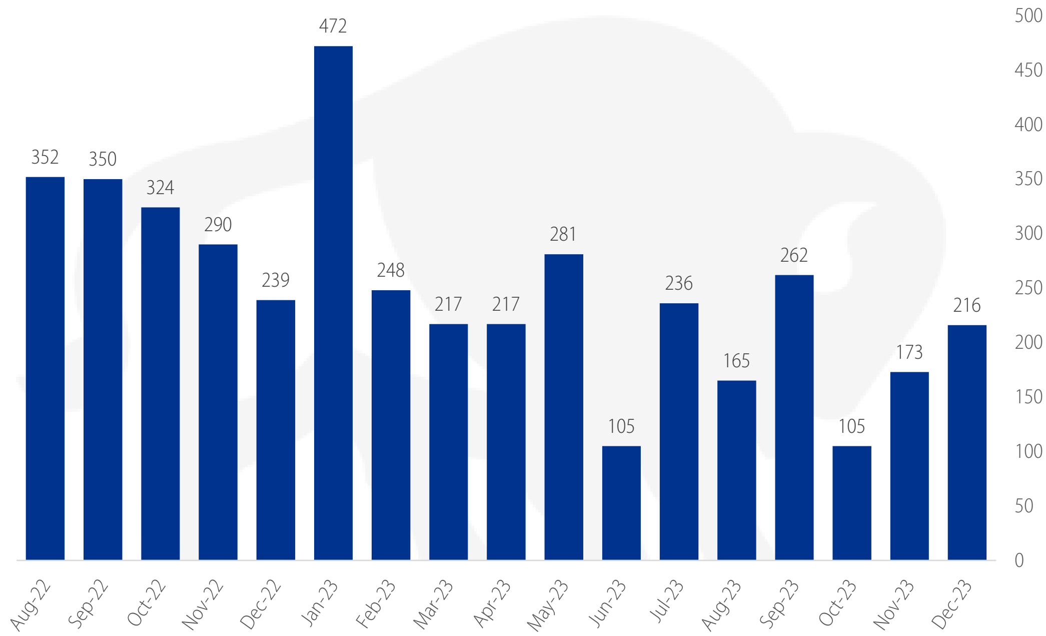
Non-Farm Payrolls Total Change (in thousands)



Source: Bureau of Labor Statistics

Average hourly earnings (which obviously impact inflation) exceeded the median forecast by a tenth, rising +0.4% for the month and +4.1% year-over-year. Fed officials will be particularly disappointed by the shrinking workforce and larger-than-expected wage increase.

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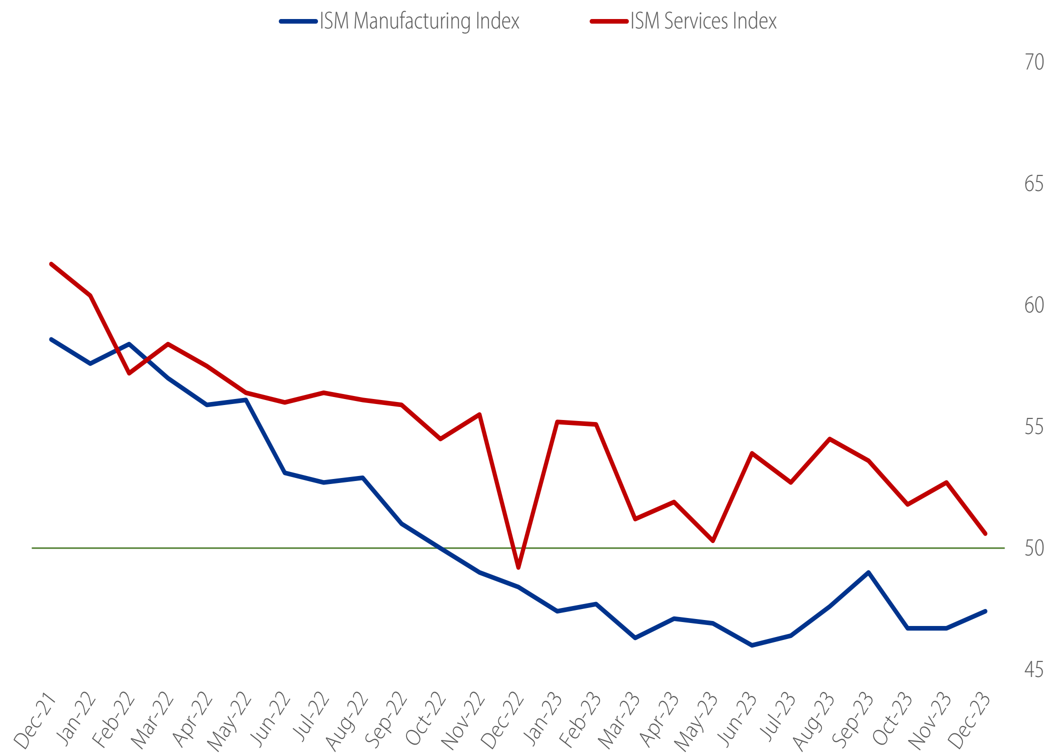
The bottom line to a head-scratching December employment report is that *the labor market is still much too tight*, and judging by the drop in the participation rate, seems to be getting tighter. That doesn't bode well for corralling wages, which suggests persistently stubborn inflation and *a more patient Fed*.

Yields rose in early trading as investors pushed out expectations for the initial rate cut.

ISM Purchasing Managers Index



Source: Institute for Supply Management

Since the service sector is the primary driver of GDP growth, the notion that it's taken a sudden turn points to a more significant decline in overall growth in early 2024, and increases the possibility that Fed officials could begin easing as soon as the March FOMC meeting.

Ninety-minutes later, unexpected weakness in the ISM service survey for December threw a wrench into the market sell-off. The composite service index fell from 52.7 to 50.6, just above the 50 mark which divides expansion from contraction. Since the service sector is the primary driver of GDP growth, the notion that it's taken a sudden turn points to a more significant decline in overall growth in early 2024 and increases the possibility that Fed officials could begin easing as soon as the March FOMC meeting.

The ISM *employment* sub-index, quite contrary to the message signal by this morning's report from the Bureau of Labor Statistics, fell 7.4 points to 43.3. This index is suddenly *well into contraction territory at its lowest point since July 2020*. Although the ISM survey is soft data, it indicates purchasing managers expect to hire significantly fewer workers in the coming months.

Earlier this week, the ISM *manufacturing* index for December came in 47.4, which doesn't really signal anything other than *continued contraction in the factory sector*. The composite index has now been below the 50 mark for 14 straight months, and given expectations for slower growth in 2024, it'll likely remain in contraction territory well into this year. Within the composite, the prices paid index fell from 49.9 to 45.2 as an increased number of factory managers experience lower prices.

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Market Indications as of 10:08 A.M. Central Time

DOW	Up 98 to 37,538 (HIGH 37,715)
NASDAQ	Up 100 to 14,610 (HIGH: 15,623)
S&P 500	Up 31 to 4,720 (HIGH: 4,794)
1-Yr T-bill	current yield 4.78%; opening yield 4.82%
2-Yr T-note	current yield 4.33%; opening yield 4.38%
3-Yr T-note	current yield 4.10%; opening yield 4.15%
5-Yr T-note	current yield 3.94%; opening yield 3.98%
10-Yr T-note	current yield 3.98%; opening yield 4.00%
30-Yr T-bond	current yield 4.15%; opening yield 4.15%