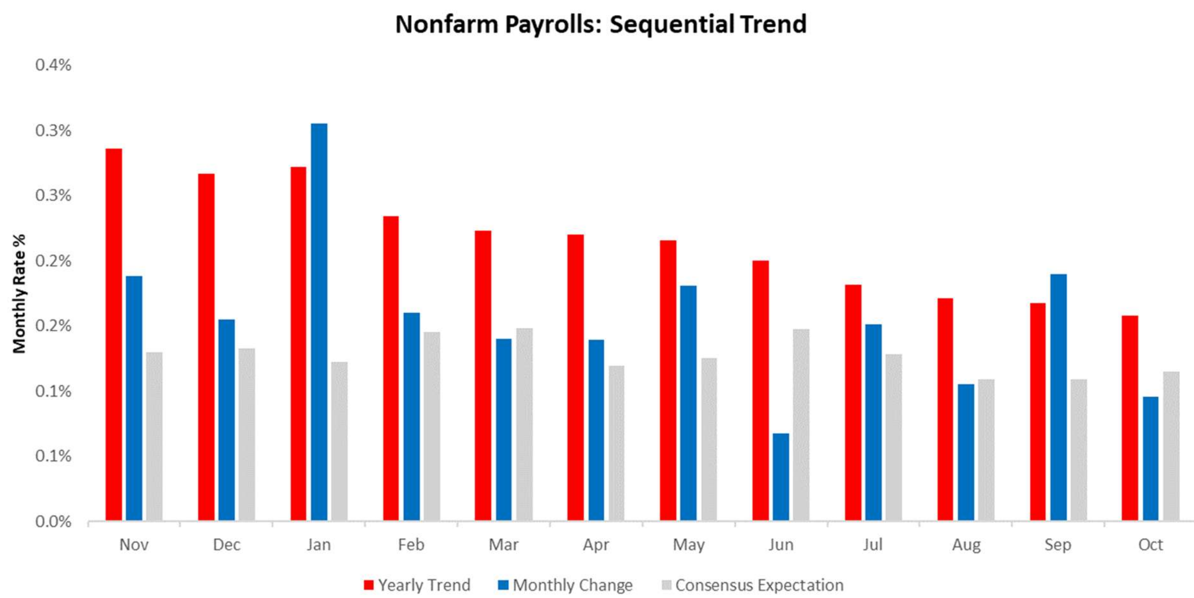
A Note From Prometheus Bespoke

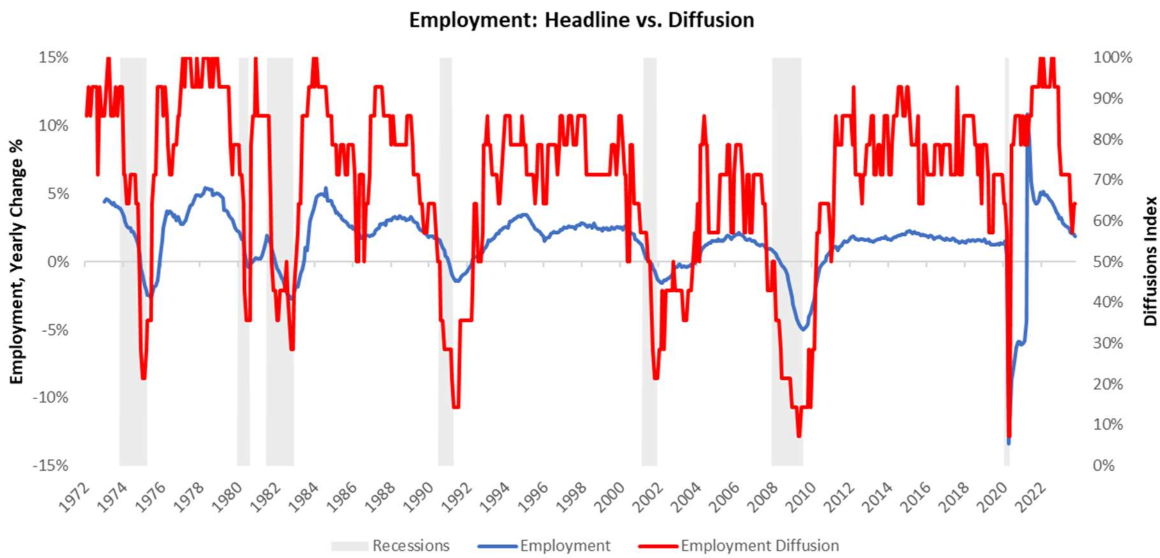
This note shares an excerpt from our Month in Macro report that was sent to all of our Bespoke clients last month. These reports aim to provide our clients with the most rigorous evaluation of macroeconomic conditions and their implications for major asset classes. We offer hundreds of pages of written research to our Bespoke clients every month. For more information about the Bespoke offering, email us at info@prometheus-research.com.

Cyclical Spotlight: Is Employment Turning?

A development that has significantly impacted markets has been the recent weakness in employment data. Archetypically, short rates rise, nominal spending falls relative to interest burdens, profits get squeezed, and only then do significant lay-offs occur. We dissect the drivers to understand better if this downtrend is durable. To begin, we visualize the recent weakness in nonfarm payrolls below:



Nonfarm payrolls increased 0.1% in October, disappointing consensus expectations of 0.11%. This print contributed to a sequential deceleration in the quarterly trend relative to the yearly trend. While this print wasn't a contractionary one, breadth has begun to weaken meaningfully:

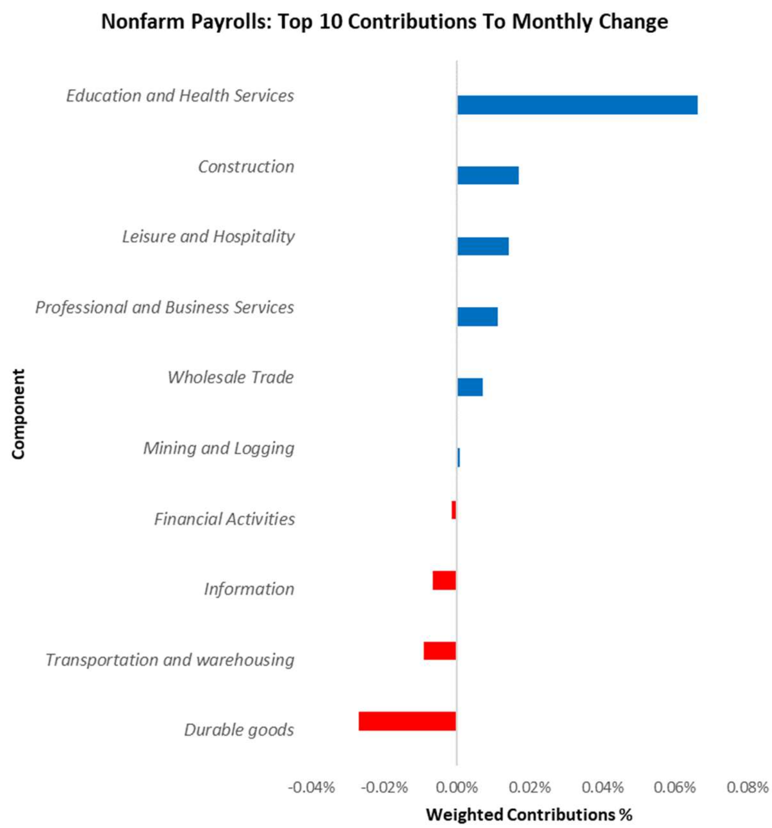


This weakness in employment has come alongside weakness in hours and nominal wages, resulting in weak nominal income data for October. We show the decomposition of our estimates below:

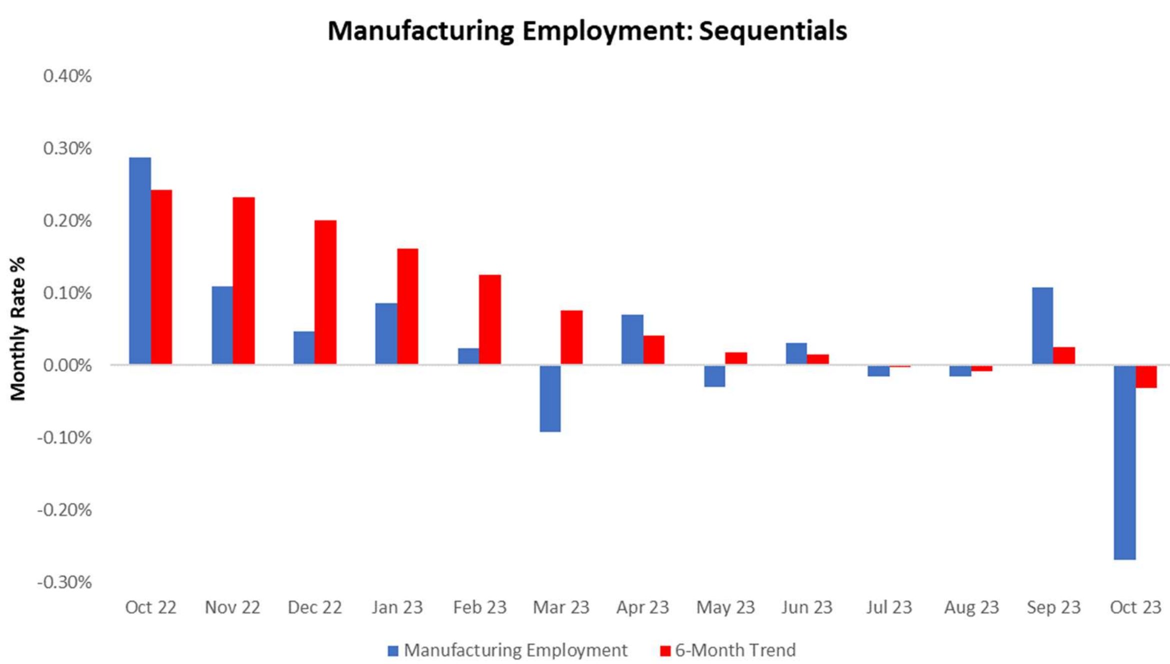
Nominal Employee Income: Composition, Most Recent Month

	Nominal Income	Employment	Real Wages	Hours	Wage Inflation
Durable goods	-0.05%	-0.03%	0.00%	-0.04%	0.02%
Wholesale Trade	-0.04%	0.01%	-0.01%	-0.03%	-0.01%
Professional and Business Services	-0.03%	0.01%	-0.01%	-0.12%	0.08%
Retail Trade	-0.03%	0.00%	-0.01%	-0.02%	0.01%
Financial Activities	-0.01%	0.00%	0.02%	-0.03%	-0.01%
Mining and Logging	-0.01%	0.00%	0.00%	0.00%	-0.01%
Transportation and warehousing	0.00%	-0.01%	0.00%	-0.01%	0.02%
Information	0.00%	-0.01%	-0.01%	0.01%	0.01%
Utilities	0.00%	0.00%	0.00%	0.00%	0.00%
Nondurable goods	0.01%	0.00%	0.00%	0.01%	0.00%
Other Services	0.01%	0.00%	0.00%	-0.01%	0.02%
Leisure and Hospitality	0.03%	0.01%	-0.02%	0.00%	0.04%
Education and Health Services	0.05%	0.06%	-0.02%	-0.05%	0.07%
Construction	0.06%	0.02%	0.00%	0.00%	0.03%
Total	**-0.01%**	**0.07%**	**-0.10%**	**-0.29%**	**0.31%**

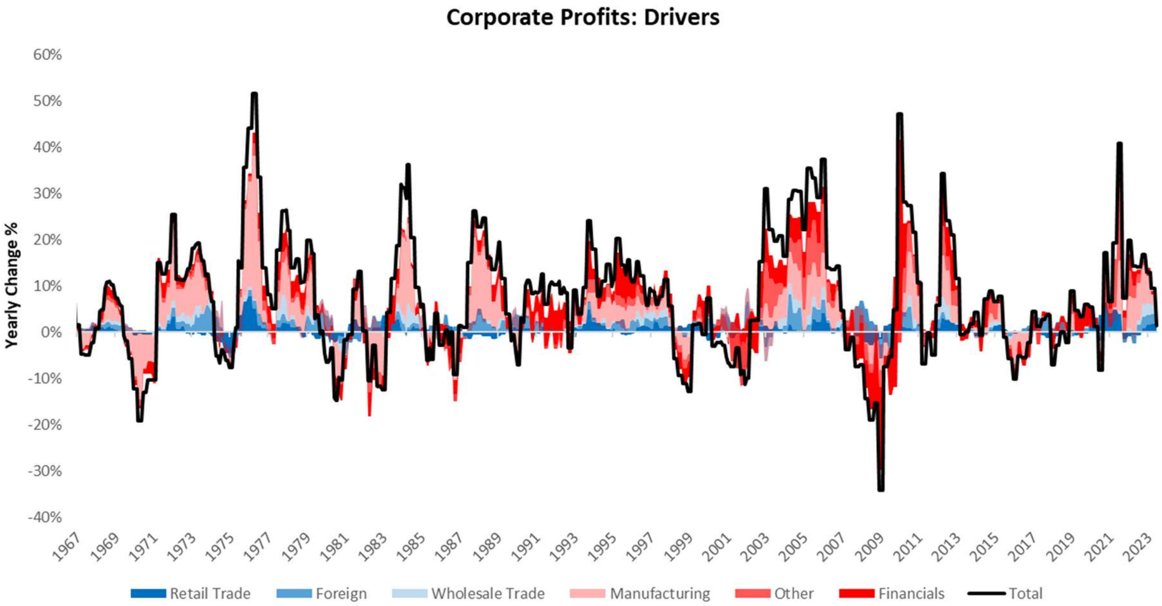
As we can see above, over October, we have seen a broad-based contraction in employment. Zooming in, the primary drivers of this print were construction (0.02%), Durable goods (-0.03%), and education and health Services (0.07%). Below, we show the top 10 drivers of the monthly change:



As we can see above, this weakest area of employment was durable goods manufacturing, continuing a recent trend of weak manufacturing employment. We highlight weaknesses by showcasing the sequential data in manufacturing employment:

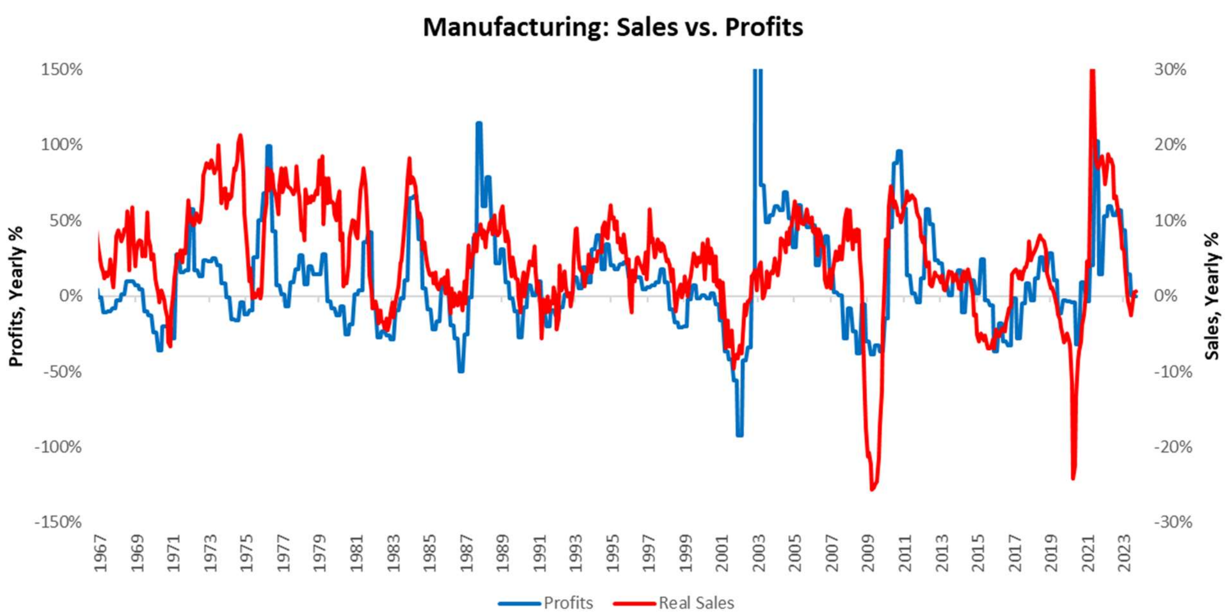


Manufacturing activity is of significant importance during this economic cycle and over time. This significance is because the manufacturing sector accounts for a large share of corporate profits. Most recently, manufacturing profits have declined:

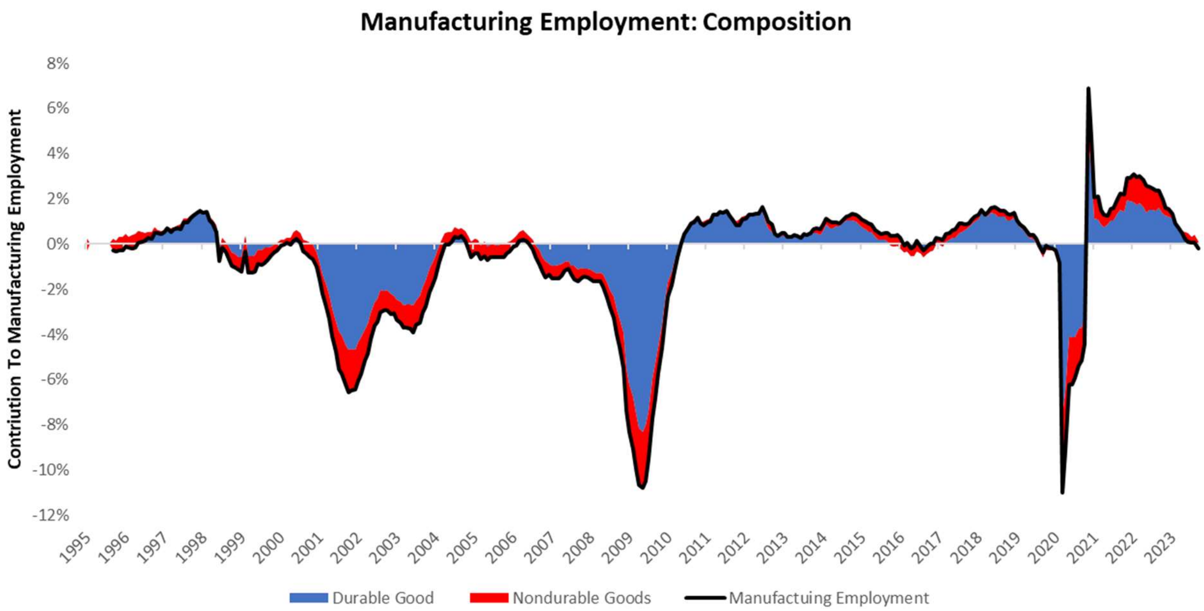


As we can see above, manufacturing has joined financials as a drag on corporate profits. This change is consistent with the pressures we have seen from nominal sales.

Below, we visualize the relationship between nominal sales and profits for the manufacturing industry. As we can see below, recent profit declines are consistent with contracting nominal sales:

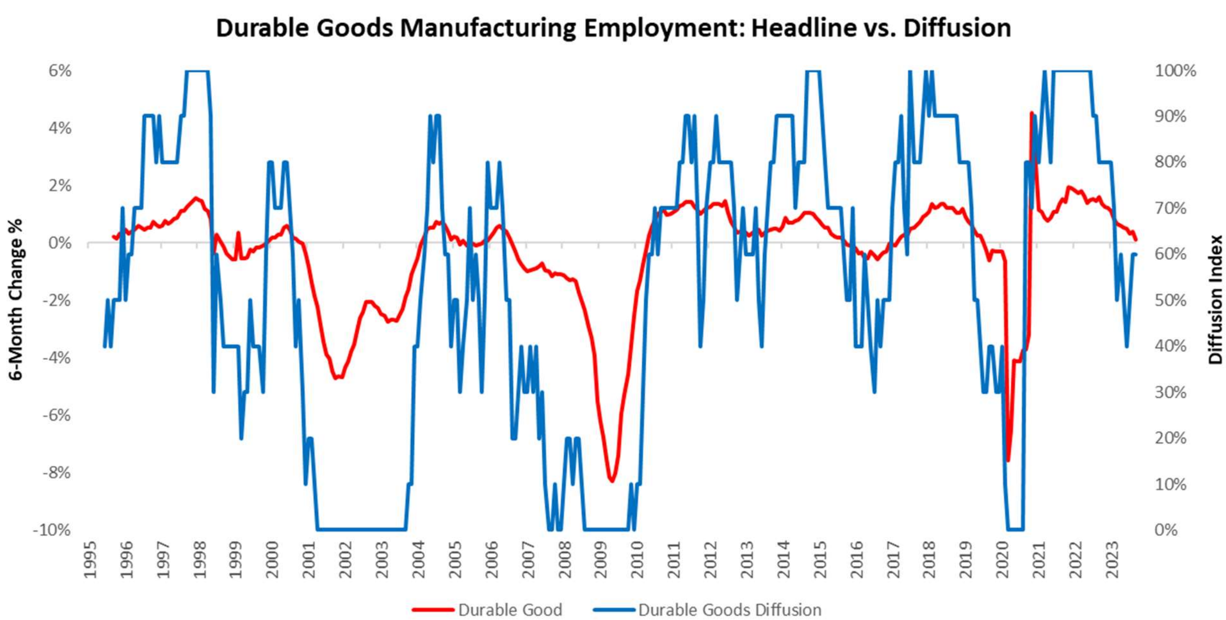


As such, barring a significant upturn in manufacturing activity, manufacturing employment will likely remain under pressure. To better understand the distribution of pressures, we zoom into manufacturing employment. There are largely two areas, durable and nondurable employment:

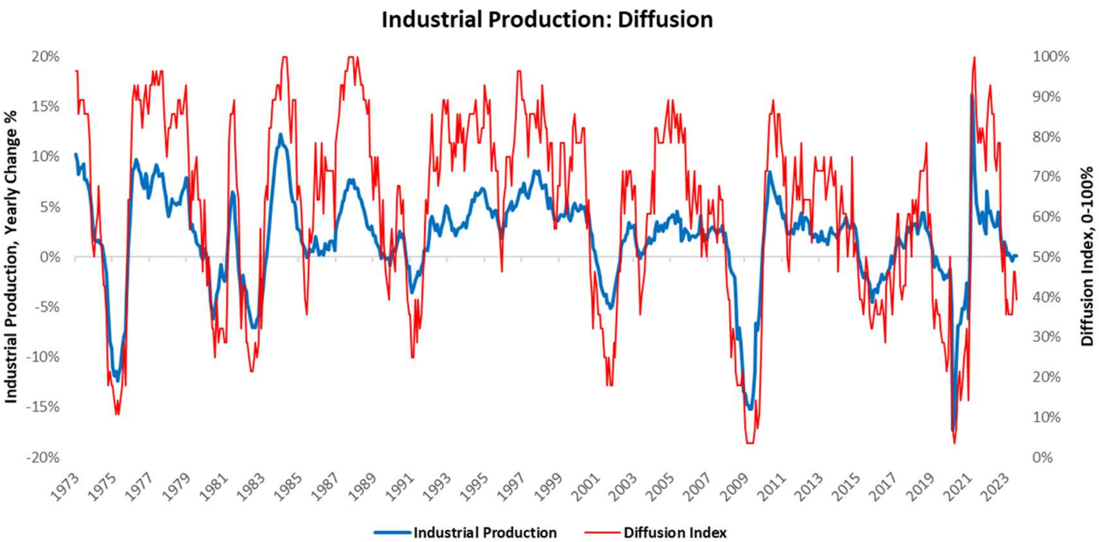


As we can see above, durable goods employment accounts for the majority of manufacturing employment. Furthermore, it has been the primary driver of recent weakness. We drill down deeper.

To assess the breadth of weakness in durable goods manufacturing, we look at the headline numbers relative to the diffusion of the subcomponents. We show this below:

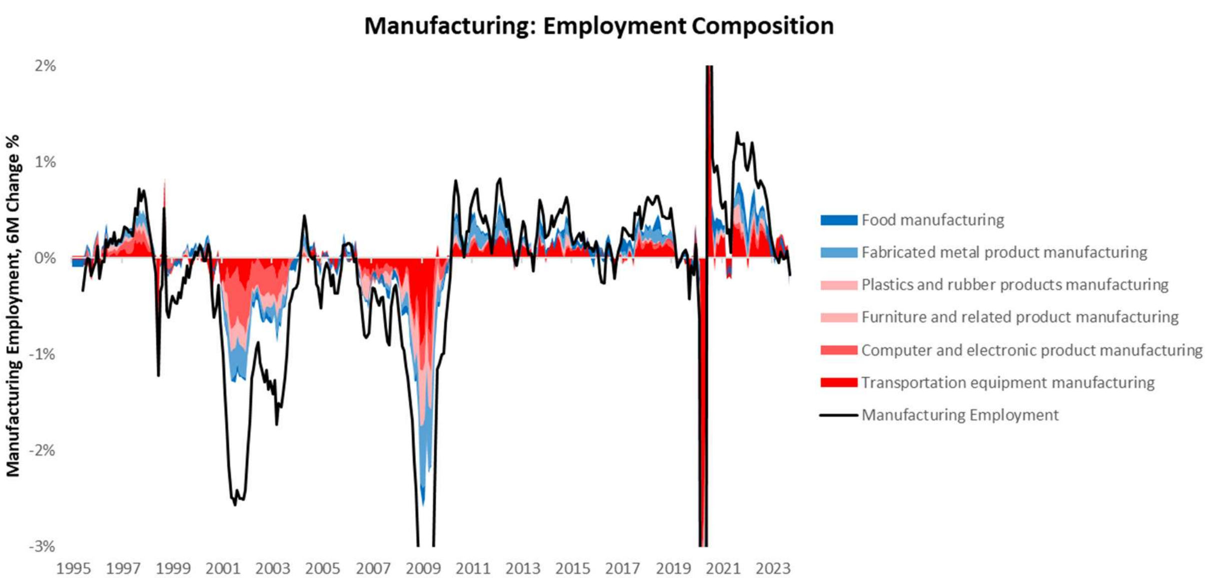


As shown above, approximately 40% of subindustries have laid off workers over the last six months. These conditions are consistent with what we see from industrial production data:

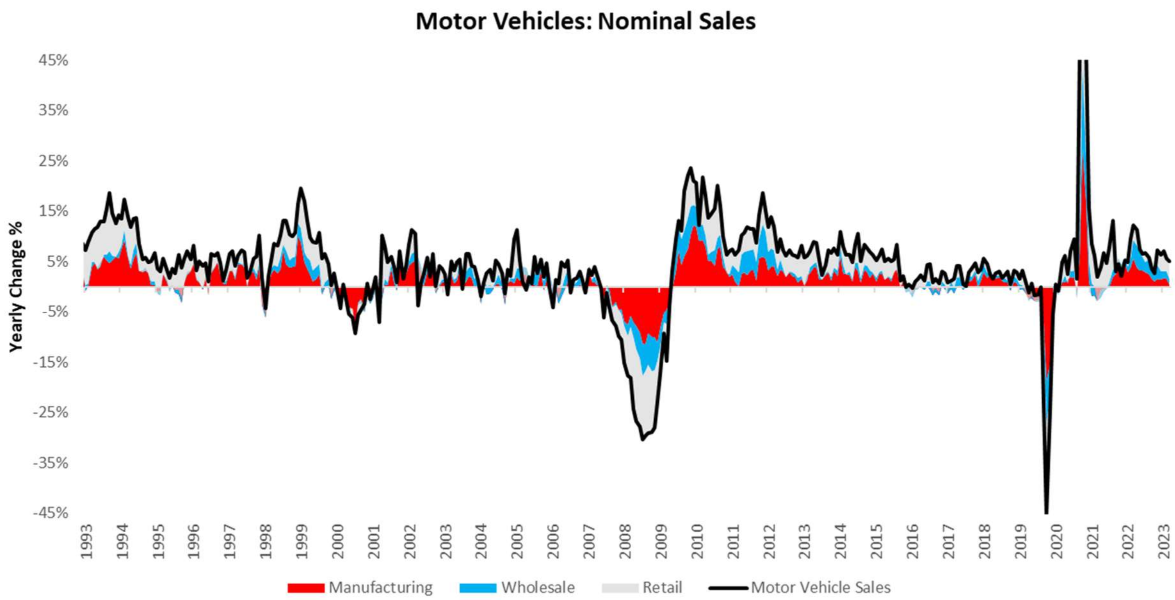


As we can see above, consistent with manufacturing sales and profits data, industrial production shows significant weaknesses in output, both in level and diffusion.

Thus, the weakness in manufacturing looks broad-based and expanding. However, while we think it makes sense for this weakness to continue to spread, we think it is important to highlight that it is unlikely to continue to spread at the current pace. This expectation comes from our understanding of transportation income dynamics, which remain robust relative to their employment. Transportation manufacturing was the largest contributor to the slowdown in durable odds employment last month and has contributed significantly to recent weakness:

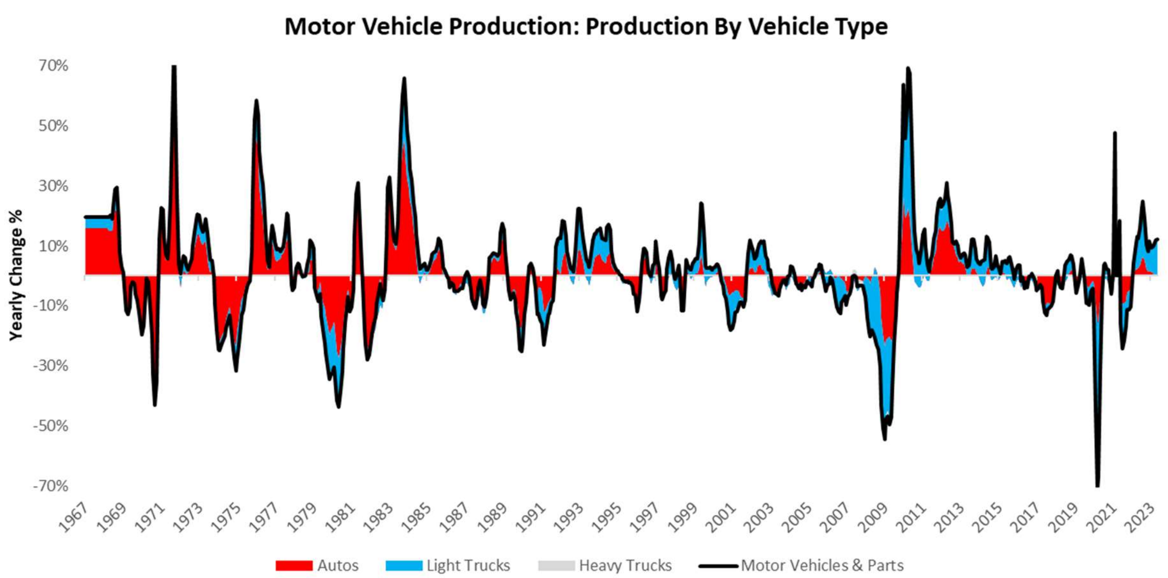


While this is consistent with broad manufacturing weakness, it is inconsistent with transportation dynamics. Below, we show nominal sales across the motor vehicle complex:

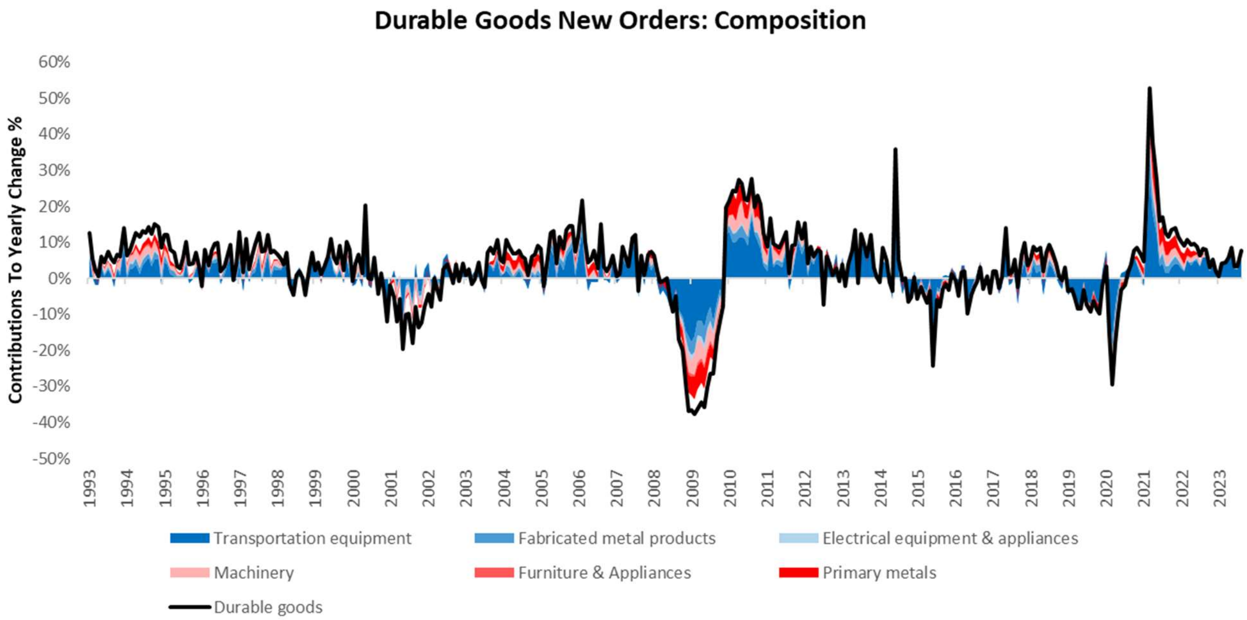


As we can see above, nominal sales remain strong for motor vehicles.

Furthermore, motor vehicle product remains strong as well. We show production by type:

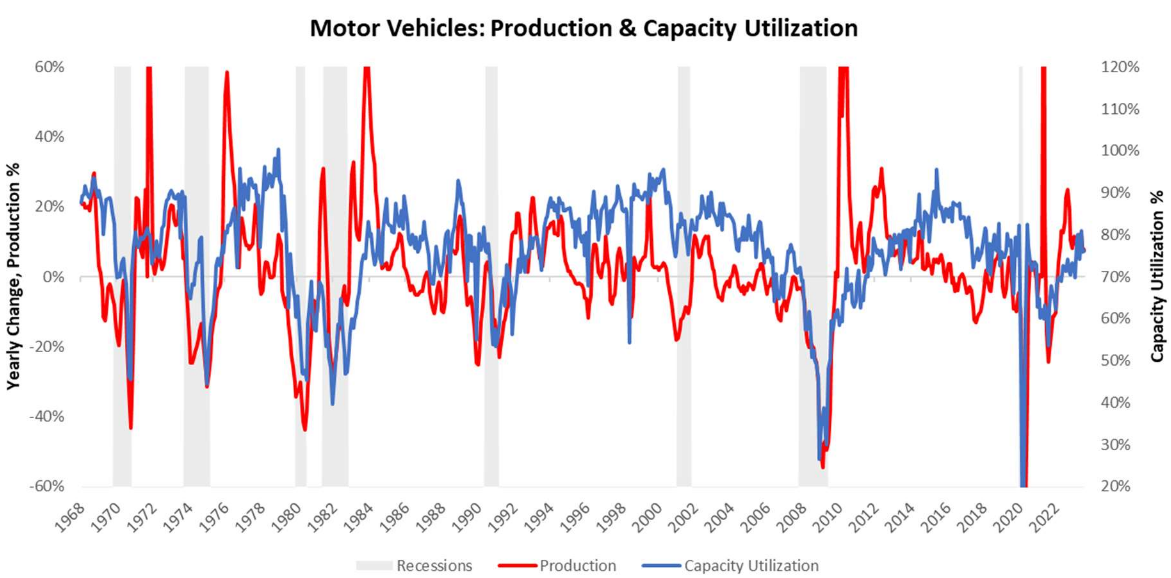


Additionally, orders for new transportation remains the strongest part of manufacturing durable new orders in the economy.



As we can see above, new transportation equipment orders have almost single-handedly kept orders for the manufacturing sector in expansionary territory. This strength is not just in nominal activity but also in real activity.

Motor vehicle production and capacity utilization have typically been good indicators of cyclical conditions. Currently, motor vehicle production relative to capacity is inconsistent with a recession. According to our estimates, readings between 65% and 43% are consistent with recessionary activity.



Therefore, through triangulation, our assessment of the weakness in transportation manufacturing employment stems from the UAW automobile workers' strike rather than from underlying weakness in the sector. As such, upon completing a deal between union workers and automobile companies, transportation employment will likely bounce. This bounce will likely temper the magnitude of ongoing manufacturing weakness's impact on employment. To be clear, we assess that manufacturing will weigh on employment; it just won't continue at the same pace, given transportation dynamics. The weakness in the manufacturing sector is another step forward in the archetypical cycle template, but significantly more softening is required for a broader impact.

DISCLAIMER: *All information, views, and opinions provided herein are for informational purposes only and should not be construed or relied upon as investment advice, an offer to sell, or a solicitation for any form of investment. The information contained in this website is the most recent information available to us (except otherwise noted); however, all of the information herein is subject to change without notice. Certain information included in this website is based on data obtained from sources considered to be reliable; however, no representation is made concerning the accuracy or completeness of such data. All opinions, estimates, and forward-looking statements, including any market forecasts or projections, involve several assumptions that may not prove to be valid. Past performance does not guarantee future results. The value of investments will fluctuate, and a loss of principal may occur. Any mention of an investment decision is intended only to illustrate our investment approach. Prometheus Investments Research LLC will not be held liable for any decisions made using its information content.*