

# Financial Markets This Week

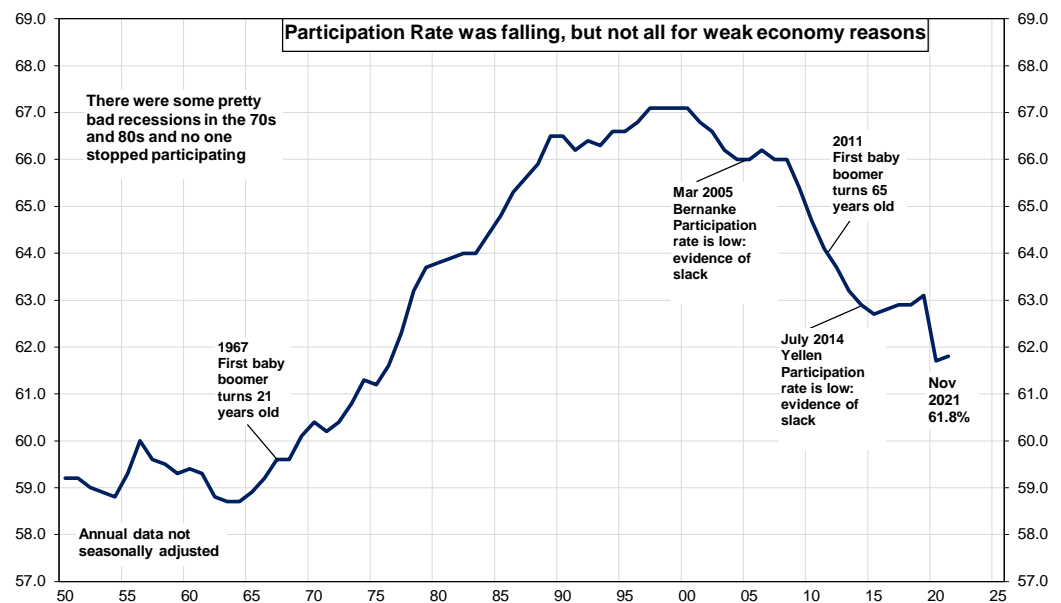
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## WHAT WALKS ON FOUR LEGS IN THE MORNING?

This week's newsletter is on the participation rate believe it or not. Participation rate as in are you in or are you out of the labor force. Are you participating in society or are you a drop out? There aren't that many topics in economics creating so much confusion. For a while we were worried Fed officials

might delay normalizing monetary policy waiting for the participation rate to rise back to pre-pandemic levels. No more of course after the Fed doubled the monthly pace of reducing their QE purchases to zero and forecast three rate hikes in 2022 at the December FOMC meeting.



If the participation rate is a leading indicator, it isn't a very good one. Bernanke pointed to the participation rate being low in March 2005 when he was a Fed governor, but the Greenspan Fed kept raising rates steadily to the 5.25% peak in June 2006 anyway. Fed Chair Yellen said the low participation rate was evidence of slack in the economy in July 2014, but then lifted rates the first time in seven years in December 2015 anyway even without seeing a higher participation rate.

There's politics involved. We first recall hearing about the participation rate in an interview on January 10, 2016 with House Speaker Paul Ryan right before the first presidential contest in Iowa. There could be some labor force dropouts who are discouraged and unable to find a job. The BLS does a survey on this and if drop outs are discouraged they aren't telling anyone. Basically there is a good reason when people are not in the labor force like they are in school, raising a family or over 65 years old and retired.

House Speaker Paul D. Ryan (R-WI)  
Look -- look, not to get into statistics, but our labor force participation rates are pretty awful. We haven't seen these since like the Carter years. What it means -- what that means is, able-bodied adults aren't working or aren't looking for work. They're marginalized. They're on the sidelines. We've got to get them back into the economy.

Backing up to define the participation rate using the November 2021 statistics, you take the number of employed, 155.175 million, add the 6.877 million unemployed, giving you the 162.052 million labor force and then divide it by the civilian noninstitutional population 16-years and over of 262.029 million and get the participation rate of 61.8%.

What walks on four legs in the morning, two legs in the afternoon, and three legs in the evening?  
The Classic Riddle of the Sphinx given to Oedipus Rex in Greek Mythology.

Labor force dropouts and the low participation rate shouldn't be a puzzle or a riddle. The participation rate has a very long-lived trend in the graph on the first page since the 1960s and the movement is primarily caused by the disruption brought about by the baby boom generation. There is a reason after all that people aren't working and that is, as they age, their participation in society, when it comes to formal work anyway, drops. Participation in the labor market, working or actively looking for work, is high when you are in your 30s, but it drops off dramatically as you hit your 60s. Unless you are a lawyer or an economist, you tend to stop working in your 60s.

Review and outlook: It's no mystery the participation rate is falling and will continue to fall as the baby boom generation has created a huge bulge in the population age brackets. After WWII, the huge jump in the annual birth rates from 1946-64 pushed the participation rate up, and as they age, the participation rate will come back down. There's a finality to life that cannot be changed. The first baby boomer turned 21 years old in 1967 pushing up participation, and the participation rate will continue to fall until the last baby boomer retires at age 65 in the year 2029.

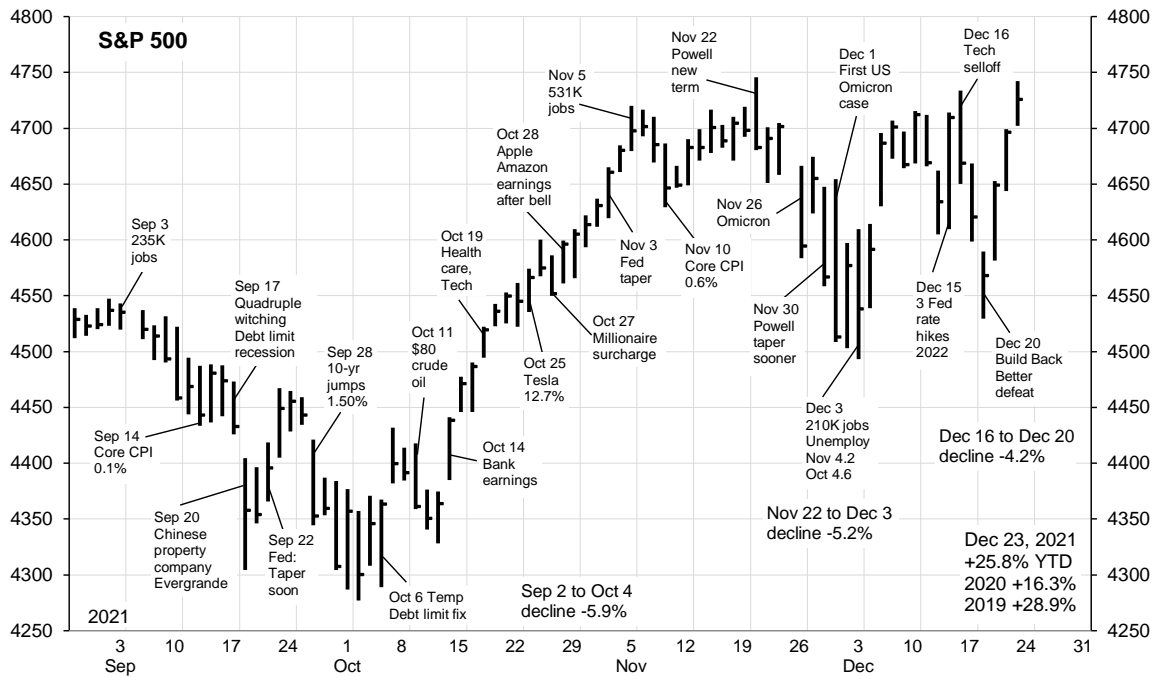
CIRCLE OF LIFE PARTICIPATION RATE	
36.4%	16-19 years old
72.1%	20-24 years old
82.6%	25-34 years old
82.0%	35-44 years old
80.8%	45-54 years old
72.3%	55-59 years old
57.1%	60-64 years old
33.1%	65-69 years old
18.9%	70-74 years old
8.6%	75-plus years
61.8	Total

Not everyone is aware of the permanent shift in the earth's seismic plates. What is written cannot be unwrit. The nation's demographic trend has known this day was coming for decades. One of the more liberal members of the FOMC, San Francisco Fed President Mary Daly said on Friday, December 17 (well, we read it in a tweet and didn't research it further) "Fed's Daly: Raising Rates Doesn't Mean We Are Declaring Victory On Full Employment; Still Expect More Workers To Come Back To Labour Force." Okay.

We don't know. Granted the measurement of who's up, who's down, who is in or out of the labor force looks to be a challenge in a nation of 332 million people. Counting votes is bad enough. Yet to our eye, the table below says that 70 percent of the dropouts since the pandemic are natural ones who are 65 years of age or older. It's the outsized baby boom generation. We can't imagine they are coming back to work from retirement in significant numbers regardless of the wages and benefits companies put up. The U.S. economy is closer to full employment or maximum employment than you think and it is appropriate for Fed officials to return rates to 2.5% normal.

Not in Labor Force Since Pandemic (not seasonally adjusted)					
Thousands	Total	65-plus	55-64	25-54	16-24
Change	4,537	3,194	188	1,256	-102
Nov 2021	99,930	45,928	14,744	22,584	16,673
Feb 2020	95,393	42,734	14,556	21,328	16,775

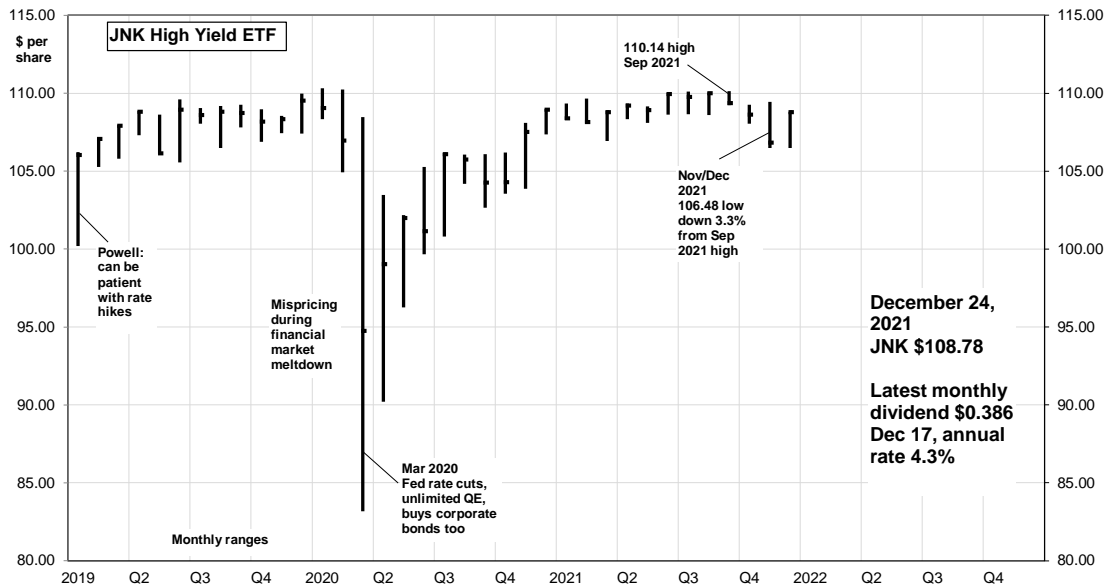
INTEREST RATES



Stocks bounced back from the latest sell-off: the December 16 to December 20 swift 4.2% drop. Tech selloff, Omicron, Build Back Better plan’s failure to advance were the reasons perhaps. Tech shares rethought the prior day’s news of three Fed rate hikes in 2022. The final day down on Monday was caused by the failure of the Biden Build Back Better plan to advance and the Omicron virus. All was forgotten by Friday’s record close with the S&P 500 up 25.8% year-to-date. November 22’s record high still stands however for the moment. Bonds hit the yield low for this week Monday around 2am ET and were back testing 1.50% again Tuesday and again Thursday, trying to get through.

JNK High Yield Bond ETF

We didn’t like the yield last week when looking at the AGG iShares Core US Aggregate Bond ETF, so we thought we would look at former Fed Chairman Volcker’s favorite asset class. High-yield couldn’t be better named for retiring baby boomers looking for places to stash the little cash they have before the tsunami wave of inflation washes it away. There are many ETFs. JNK has \$9.4 billion in assets. It paid \$4.63 in the 12 months of 2021, 4.3% off Friday’s \$108.78 close. Try to forget the pandemic loss.



OTHER ECONOMIC NEWS

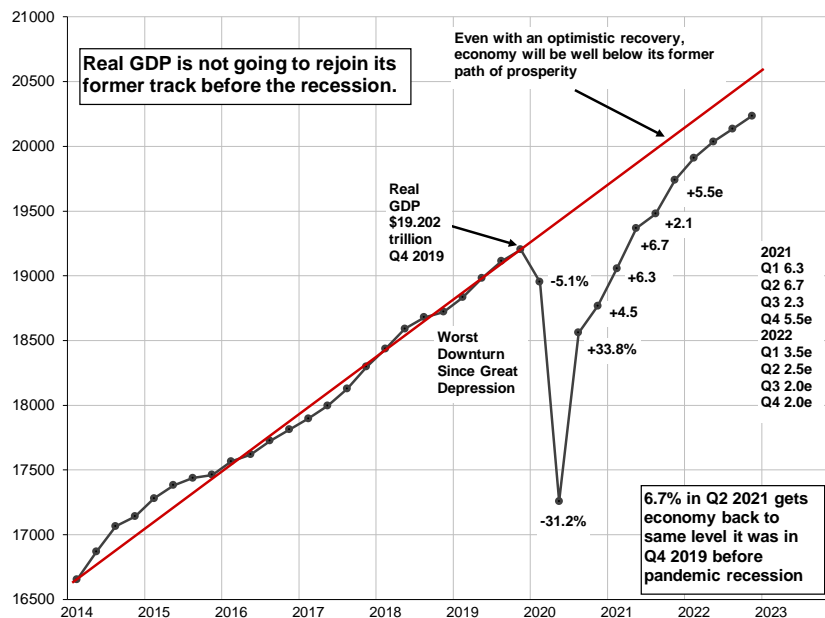
**Q3 2.3% GDP rebounding this quarter, but outlook clouds ahead for the 2022 skies (Wednesday)**

Breaking economy news. Third and final look back at the third quarter real GDP shows 2.3% with slight changes only from the 2.0% first estimate and 2.1% second estimate. While the third quarter was a dramatic slowdown from the first half of the year, keep in mind that the spread of the Delta variant weighed on growth as did the sharp decline in the Federal government stimulus programs. The Federal Reserve only thinks potential GDP is 1.8% for the longer run, so 2.3% looks okay given this measuring stick. Q3's 2.3% GDP is rebounding this quarter, but outlook clouds lie ahead for the 2022 skies.

Net, net, growth will be spectacular in the final quarter of the year stoked by white-hot consumer demand, but the economy's path going forward into 2022 will be a rockier one as Omicron puts up some formidable social distancing roadblocks to growth. We aren't returning to the dark days of the pandemic in March 2020 with outright shutdowns of factories and retail stores, but the way forward is not a clear one with professional sports seeing games being canceled, university students sent home, and many bars and restaurants shutting back down on their own even without the guidance from local government authorities. The latest outbreak of the virus is unwelcome certainly, but for the economic outlook next year it could be a good thing if it slows the unprecedented consumer demand surge that has fed the worst inflation seen since the 1980s.

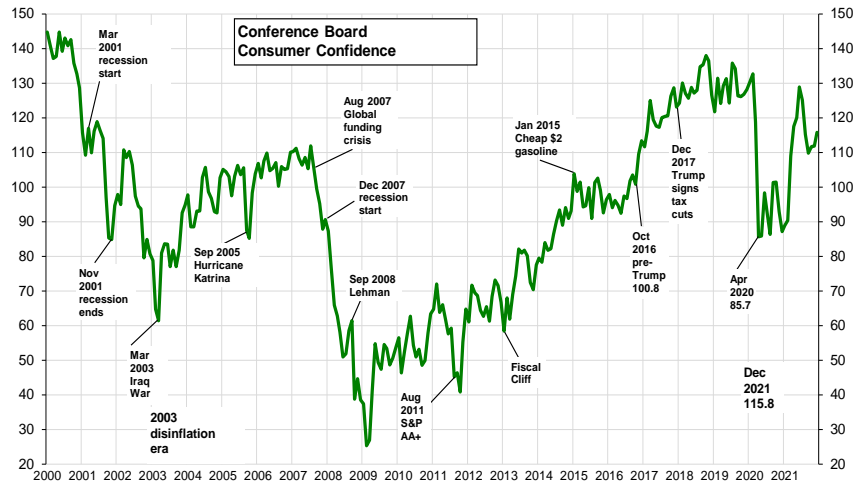
	Q1 20	Q2 20	Q3 20	Q4 20	Q1 21	Q2 21	Q3 21p	Q3 21r	Q3 21f
REAL GDP	-5.1	-31.2	33.8	4.5	6.3	6.7	2.0	2.1	2.3
REAL CONSUMPTION	-6.9	-33.4	41.4	3.4	11.4	12.0	1.6	1.7	2.0
CONSUMPTION	-4.8	-24.1	25.5	2.3	7.4	7.9	1.1	1.2	1.4
Durables	-0.9	0.0	5.5	0.1	3.5	1.0	-2.7	-2.5	-2.5
Nondurables	0.9	-1.9	4.4	-0.2	2.2	2.0	0.4	0.4	0.3
Services	-4.8	-22.2	15.6	2.3	1.8	4.9	3.4	3.3	3.6
INVESTMENT	-0.9	-9.6	11.7	4.0	-0.4	-0.7	1.9	1.9	2.1
Business Plant & Equipment	0.0	-1.8	-0.5	-0.2	0.1	-0.1	-0.2	-0.1	-0.1
Intellectual Property	-1.3	-2.0	2.7	1.3	0.8	0.7	-0.2	-0.1	-0.1
Homes	0.2	-0.5	0.5	0.5	0.8	0.6	0.6	0.5	0.5
Inventories	0.7	-1.4	2.2	1.3	0.6	-0.6	-0.4	-0.4	-0.4
Exports	-0.5	-4.0	6.8	1.1	-2.6	-1.3	2.1	2.1	2.2
EXPORTS	-2.0	-8.3	4.6	2.1	-0.3	0.8	-0.3	-0.3	-0.6
IMPORTS	1.9	9.9	-7.9	-3.7	-1.3	-1.0	-0.9	-0.8	-0.7
GOVERNMENT	0.6	1.0	-0.2	-0.1	0.8	-0.4	0.1	0.2	0.2
Federal defense	0.0	0.2	0.1	0.2	-0.3	0.0	-0.1	-0.1	-0.1
Fed nondefense	0.2	1.3	-0.4	-0.4	1.0	-0.3	-0.3	-0.3	-0.3
State and local	0.5	-0.5	0.1	0.1	0.0	0.0	0.5	0.5	0.5

Below line: Percentage point contributions to Q3 2021 2.3% real GDP  
 First estimate for Q4 is Thursday, January 27



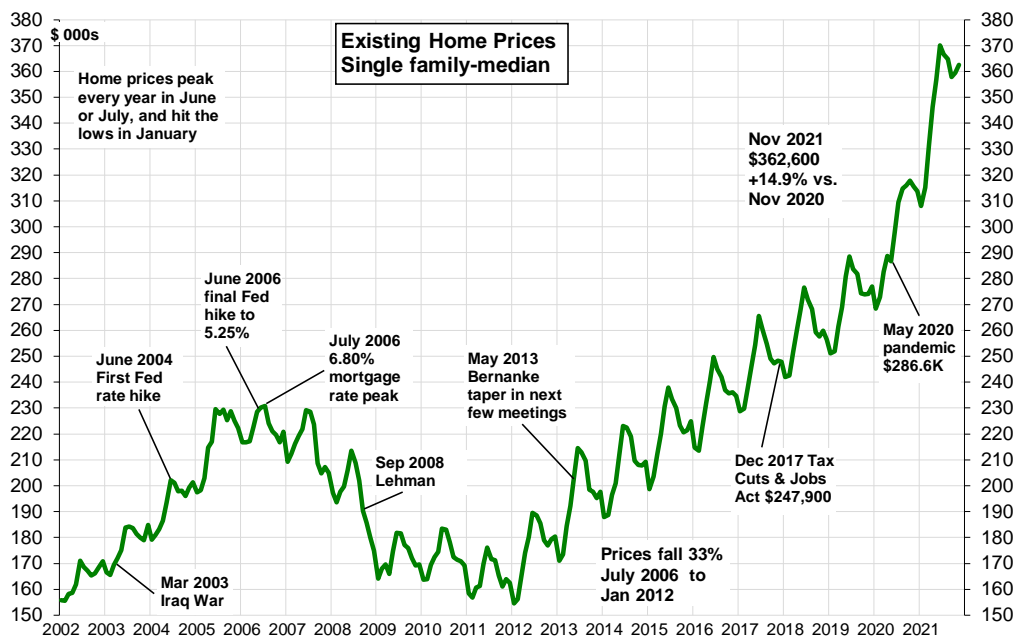
### Consumer confidence and home prices are okay for now, but... (Wednesday)

Breaking economy news. Consumer confidence is up, but for how long given this latest Covid outbreak? The cutoff date for the survey was December 16, but Omicron is the fastest spreading variant yet. The Conference Board consumer confidence index was 115.8 in December and November was revised to 111.9 from a 109.5 preliminary estimate. 12.5 percent said jobs were harder to get in December up from 10.8% in November which may mean the unemployment rate's plunge in recent months will slow.



Meanwhile, the nation's housing crisis continues with existing homes more costly than ever this month. Not quite perhaps, but median home prices nationwide did rise 0.9% in November to \$362.6 thousand which is close to the all-time high of \$370.1 thousand set in June this year during the peak of the summer selling season. Home prices are strongest in the biggest market in the South with prices up 18.7% over the last year where every other region saw single-digit gains.

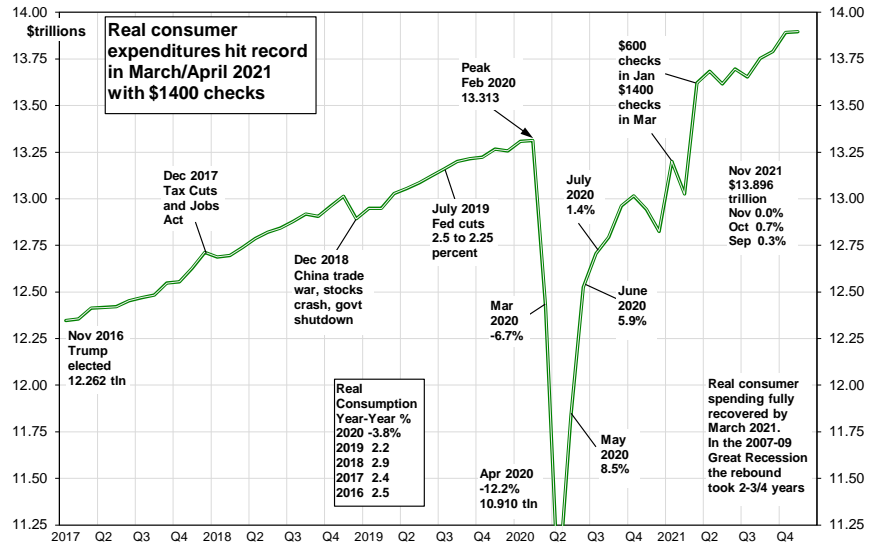
Net, net, the latest readings on the housing market and consumer confidence were solid, but for how long as the Omicron virus is spreading rapidly throughout the country. Economists have marked down their forecasts for economic growth in 2022 and the relative slowdown may get reflected in the confidence and home sales data in coming reports. Stay tuned. Story developing.



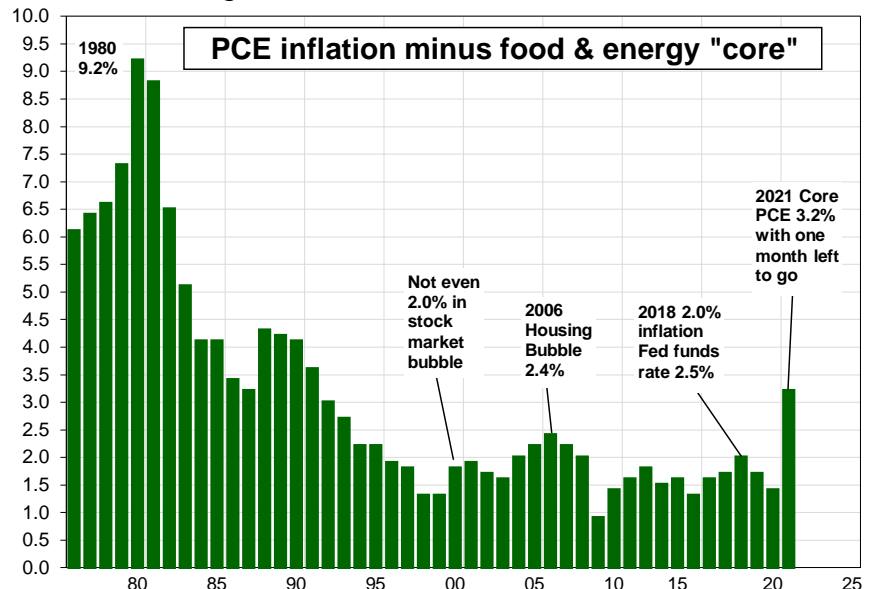
## Inflation up, consumer spending flat, and capital goods orders down (Thursday)

Breaking economy news. Three major reports today and no one to trade the news ahead of the Christmas holiday starting Friday. Unemployment claims remain at rock bottom lows of 205 thousand in the December 18 week showing there is an extreme shortage of workers available for companies to hire. The labor market is tight, tight, tight as a drum. No wonder inflation pressures are exploding with headline PCE inflation up 5.7% in November from year ago levels. Measured against PCE inflation on a full year basis, inflation is the worst since 9.0% in 1981 before cooling to 5.6% in 1982 after sky-high Federal Reserve interest rates and two back to back recessions curbed the consumer's appetite for goods and services.

Real consumer spending was flat in November at 0.0 percent, but spending in the fourth quarter is still running fast at 4.8% with December data left to go. Street estimates for Q4 real GDP should hold at around 5.5% given the strength in consumer purchases to date. The durable goods orders report rounds out today's economic news. Nondefense capital goods orders ex-aircraft that we monitor closely to see how business investment spending is doing each month fell 0.1% in November, but from record levels far above the best economy in fifty years before the pandemic; these orders rose 1.4% in September and 0.9% in October before cooling if that's the word.

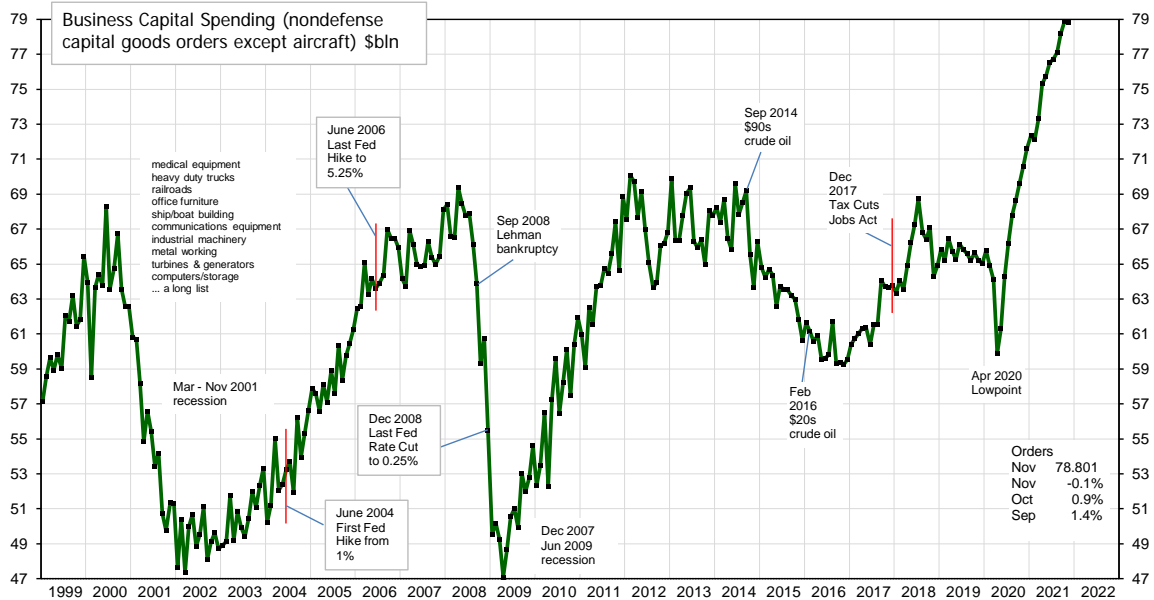


Inflation fires across the country continue to burn bright with November core consumer inflation jumping to 4.7% on a year-to-year basis. The outbreak of core inflation is the worst in decades and shows no sign of letting up. Today's figures argue strongly for Federal Reserve rate hikes sooner next year than later. There is likely to be disinflation at some point in 2022 as energy prices and commodities can't rise forever, but core inflation may well stick at a permanently higher level due to the unprecedented boom in consumer demand.



Net, net, business and consumer spending took a step back in November even before the first case of Omicron in the U.S. appeared at the start of December. For the consumer there may be some shortages out there of goods available to purchase as durable goods and nondurable goods purchases actually fell in November. Services rose 0.5% in November and continue to advance at the

same rate as they have been growing since August so it does not look like the flat overall consumer spending was due to new social distancing measures caused by the virus. For businesses the weakness in core capital goods orders showed a slight decline of 0.1% from record levels and may reflect over-ordering rather than any serious concerns that companies have about the sales outlook for their products and services in 2022. And now you're all caught up on the latest economic news. Happy Holidays to all.



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