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April 15, 2024

Eyes on the Market, Q2 2024

1. **The employment picture diverges while the GDP versus GDI picture converges;** The divergence between the expenditure and income based estimates of GDP has narrowed but remains historically wide. Adding to the mixed picture of economic activity, is the payrolls versus household survey estimates of employment gains. Payrolls have risen 2.9 million over the last year, whereas household employment is up only 642,000.

2. **NFIB (National Federation of Independent Business) Small Business Price Plans;** This has historically led to PCE (Personal Consumption Expenditures) price inflation. Recent data on NFIB Selling Prices is pointing to an upswing. This brings the focus back to inflation and the Fed's rate path ahead.

3. **High concentration in health care, leisure and hospitality employment;** These sectors, representing 29% of private employment, have contributed to 64% of gains over the last 12 months. Private payrolls have risen 2.2 million over the last year; health care & social assistance and leisure & hospitality are up 992,000 and 458,000 over that period.

4. **Real wage gains buoy consumer spending;** Thus far in 2024, consumer staples stocks have risen 3.6% and consumer discretionary stock prices are up 3.3%. The consumer continues to be supported by a strong labor market and rising real wages; however, the savings rate is historically low (i.e., consumers are spending an unusually high share of their current income).

5. **Treasury auctions back in focus;** The performance of Treasury auctions has been positive until now. The just auctioned 10-year bond recorded the worst results in five years, reversing the strong auctions YTD. Treasury supply ahead remains a concern as U.S. debt sustainability is driving up the term premia.

6. **Strong corporate margins;** This has been one of the most surprising developments in recent months. The fourth quarter profits data were strong. The contraction in profit margins that had occurred starting in the second quarter of 2021 is now reported to have almost completely reversed in the second half of 2023. Thus, even as price growth has slowed and labor costs have been sticky, margins are no longer reported to have been squeezed.

7. **M&A springs back;** Since the Fed's December pivot, M&A activity rebounded with easing financial conditions. Sectors leading span across technology, financials and energy.

8. **Technicals lift credit appetite;** Despite rising defaults and downgrades, technicals have dominated LevLoan and CLO performance. The LevLoan sector shrunk $9bn, witnessing the highest loan fund inflows in two years. Q1 CLO issuance recorded a new high at $50bn in BSL (bank syndicate loans). Reinvestment demand remains high.

9. **The BOJ lifts off;** The BOJ raised rates in March for the first time in 17 years, ending the negative policy rate regime. The BOJ said: "Based on recent data and other sources, it can be judged that it is now within sight that the price stability target will be achieved toward the end of the projection period of the January 2024 Outlook Report. In this situation, large-scale monetary easing measures, including the yield curve control framework and the negative interest rate policy, have likely fulfilled their roles."

10. **Broadening and intensifying political and geopolitical tensions;** Gold rising on China and Russia diversifying away from the US dollar. Oil is rising as China demand rises, while US supply drops and uncertainty develops around Saudi Arabia, Russia production. The war in the Middle East reshaping alliances.

The Rithm Take

Resilience has trumped recession YTD. A no landing scenario rather than a soft one is emerging; the risk is a transition to a hard landing. The market has shifted its focus back to inflation over growth. Real rates are testing 2023 highs while credit spreads are close to historical tights. Geopolitics are driving up gold, oil and exposing a demand hole for US debt.