ClearBridge Investments

Recession Indicators: Labour Measures Show Improvement

May 4, 2021

Key Takeaways

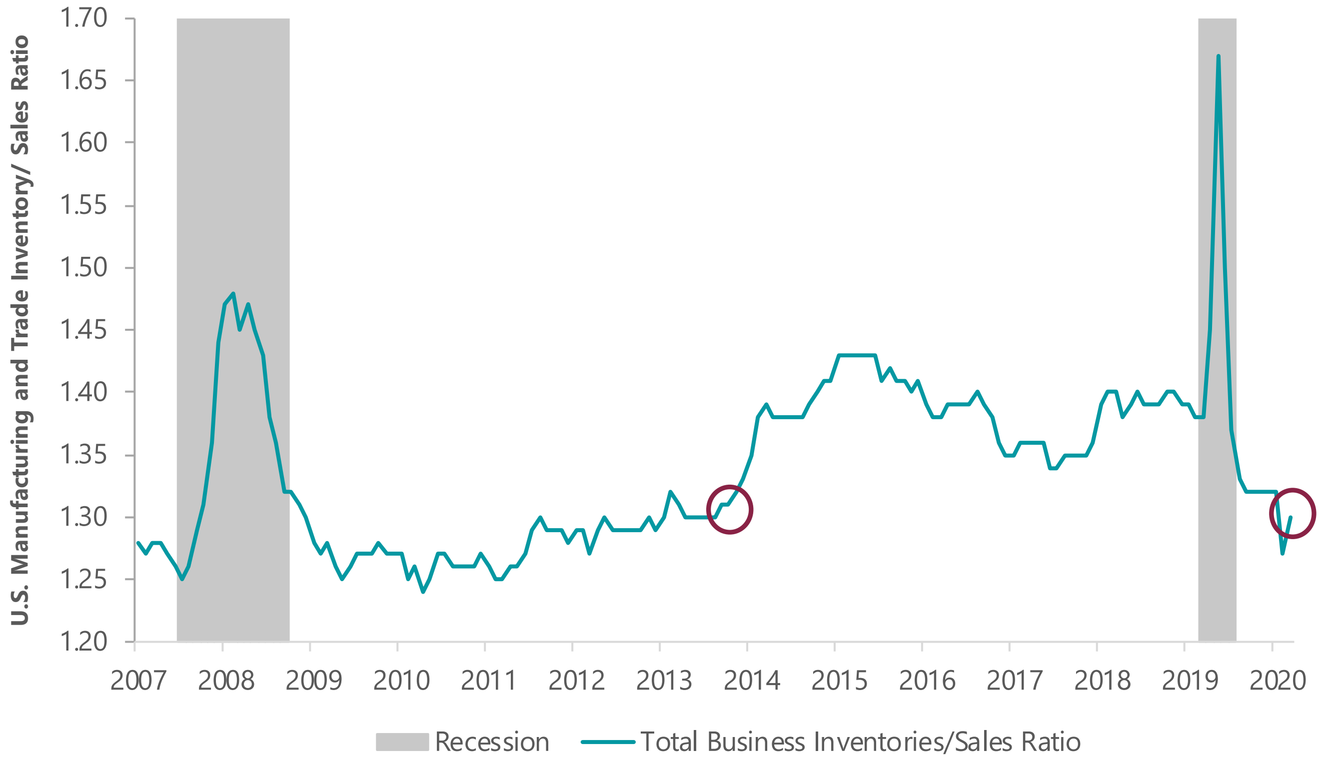
- The ClearBridge Recession Risk Dashboard improved in April and maintains an overall green signal with three positive underlying changes related to the labour market: Job Sentiment and Wage Growth improved to yellow while Jobless Claims advanced to green.
- An improving labour market should help drive further upside to consumption and GDP expectations as individual stimulus payments begin to wane, while wage growth trends suggest little risk to corporate margins and inflation at this time.
- Looking ahead, we remain optimistic that the recovery will continue to unfold and be the primary driver of further upside for risk assets.

Vaccine Progress, Stimulus Raising Growth Expectations

U.S. equities delivered another strong month of performance in April, with the S&P 500 Index rising 5.3% on the back of an improving COVID-19 situation and an accelerating economy. The vaccination campaign continues to show solid progress with 43% of all Americans having received at least one dose (and 82% of the 65+ population) according to the CDC. As vaccinations have ramped up, COVID-19 case counts rolled over in the second half of April, leading to an easing of social distancing guidelines in many parts of the country. So far, the U.S. appears to be following a path similar to that of Israel, where case counts plateaued when roughly 25% of the total population had received their first vaccine dose before collapsing when that figure rose beyond 40%.

The improving COVID-19 picture, along with the $1.9 trillion American Rescue Plan, has helped to drive 2021 GDP expectations up to 6.3% from 5.3% at the start of the month. Consensus expectations for corporate profits also moved higher by 5% for 2021 and 3% for 2022 on the back of a robust first-quarter earnings season so far. While first-quarter GDP missed consensus expectations slightly, the 6.4% print was held back by a -2.6% drag from inventory destocking. This should ultimately prove temporary and will likely provide a lift to GDP in the second quarter and beyond as inventories are back to 2014 levels and businesses are starting to restock as shown in Exhibit 1.

Exhibit 1: Inventory Rebuild, Economic Tailwind



Data as of Feb. 28, 2021. Source: U.S. Census Bureau, FactSet.

Within the GDP print, consumption was particularly strong, rising 10.7%. This is consistent with the very strong retail sales releases recently, with March's 9.8% growth the second-best reading in history. Although this indicator was already green on the ClearBridge Recession Risk Dashboard, it improved beneath the surface. The overall dashboard similarly remained green while continuing to show improvement, and is likely to register its strongest-ever readings in the coming months. The dashboard has three indicator changes this month, all related to the labour market: Job Sentiment and Wage Growth both improved to yellow from red, and Jobless Claims improved to green from yellow.

Exhibit 2: ClearBridge Recession Risk Dashboard

		April 30, 2021	March 31, 2021	February 28, 2021
Consumer	Housing Permits	⬆	⬆	⬆
	Job Sentiment	●	✖	✖
	Jobless Claims	⬆	●	●
	Retail Sales	⬆	⬆	⬆
	Wage Growth	●	✖	✖
Business Activity	Commodities	⬆	⬆	⬆
	ISM New Orders	⬆	⬆	⬆
	Profit Margins	⬆	⬆	●
	Truck Shipments	●	●	●
Financial	Credit Spreads	⬆	⬆	⬆
	Money Supply	⬆	⬆	⬆
	Yield Curve	⬆	⬆	⬆
	Overall Signal	⬆	⬆	⬆

⬆ Expansion ● Caution ✖ Recession

Source: ClearBridge Investments.

The first indicator to improve was Job Sentiment, which saw the largest monthly jump in "Jobs Plentiful" responses to the survey in its 54-year history. Similarly, "Jobs Hard to Get" responses posted their second consecutive monthly decline. With employers noting difficulty filling jobs in business surveys and posted Job Openings at 7.3 million — already above pre-COVID-19 levels and nearing their 2018 cycle peak — we expect further improvement in Job Sentiment as the reopening continues and facilitates further improvement in the labour market. Importantly, this should help support consumption as individual stimulus payments begin to wane.

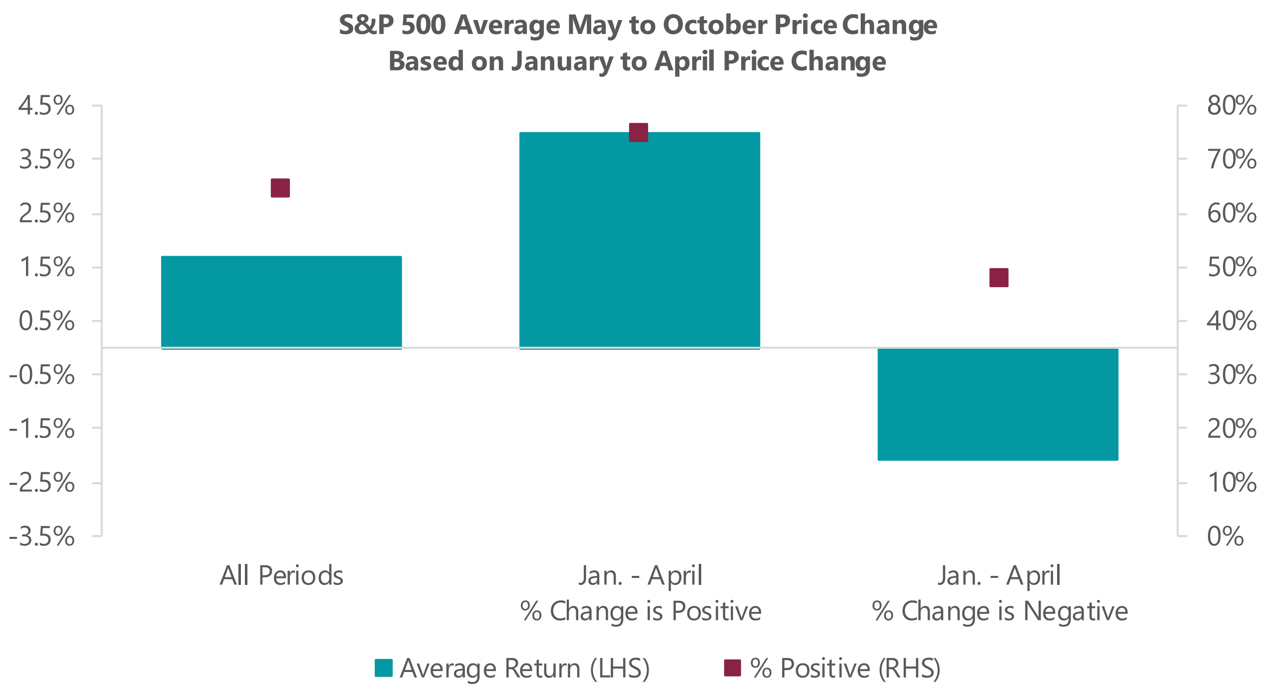
The second indicator to improve is Wage Growth, a further sign of labour market normalisation. Aggregate wage measures spiked during the early part of the pandemic due to mix-shift issues as a disproportionate number of lower-earning workers were laid off (many in leisure industries), driving the average up. As social distancing guidelines are eased and many of these workers are hired back, the average wage figure has started to revert to normal and will likely see further downward pressure in the coming months. Importantly, metrics that adjust for these issues such as the Atlanta Fed's median wage tracker remain steady and are not showing cause for concern. With underlying wage acceleration stable, the threat to corporate margins and, in turn, inflation, has not yet fully passed but is looking more favorable at present.

Jobless Claims Trending Toward More Normal Levels

The final indicator to improve is Jobless Claims, which have moved down substantially in recent weeks. During the initial wave of the pandemic, Jobless Claims soared to over 6 million, a figure that is nearly 9x the previous record. This was a 65-standard-deviation event, orders of magnitude less common than getting hit by lightning. According to the National Weather Service, an American has a one-in-15,300 chance of being hit by lightning, which is around 2x the statistical probability of a 4-standard-deviation incident (1 in 31,560). Given these dynamics, we believe a combination of art and science can deliver superior outcomes when assessing the health of the economy and gauging indicator changes. While we typically refrain from overriding the underlying model behind the dashboard, we believe incorporating human judgement and wisdom can be pivotal in unique circumstances. To that end, we have erred on the side of caution in upgrading the Jobless Claims indicator over the last few months and with initial claims now moving into the mid-500,000 range, we are well below levels associated with historically deep recessions.

Taken together, these three indicator changes paint a picture of an improving labour market, a component of the economy that initially saw a more sluggish recovery than consumption or corporate profits (and financial markets). As we look toward the coming months, we remain optimistic that the recovery should continue to unfold and be the primary driver of further upside for risk assets. While some follow the old adage "Sell in May and go away," we note that this has not held up as well over the subsequent six months in years when the S&P 500 was positive from January through April.

Exhibit 3: Sell in May and Go Away?



Source: S&P Global, Bloomberg.

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