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# AOR Update: Two Steps Forward, One Step Back

3 September 2024

## Key Takeaways

- ▶ U.S. equities largely recouped their midsummer losses following a string of favourable data releases that helped allay fears of a budding layoff cycle.
- ▶ The Jobless Claims indicator — our economic canary in the coal mine on the ClearBridge Recession Risk Dashboard — has improved to green, a development inconsistent with substantial deterioration in the labour market.
- ▶ Two additional signal changes this month saw Commodities improve to green while ISM New Orders slipped back into red territory. The overall signal remains a shallow green.

## Improving Economic Data Sparks Equity Rebound

U.S. equity markets ended August higher after largely erasing the S&P 500 Index's 8.5% selloff that [began in late July](#) and crested in early August. The turbulence was ignited as a growth scare emerged following a soft jobs report and fears of contagion emanating from an unwind of the Japanese yen carry trade. A rebound began following a favourable initial jobless claims release on August 8 that showed the labour market was likely not deteriorating as rapidly as had been feared, bolstering the prospects of a soft landing.

The second half of August saw a continuation of largely favourable data releases, including additional jobless claims reports that helped markets advance despite a few hiccups. The action of the last few months could be broadly described as "two steps forward, one step back" for both financial markets and the economy. This notion is mirrored by the ClearBridge Recession Risk Dashboard, which saw three indicator changes last month, two positive and one negative. Specifically, Jobless Claims and Commodities both improved to green from yellow, while ISM New Orders worsened from yellow to red. On balance, the overall signal remains in slightly improved but still shallow green territory (Exhibit 1).

In recent years, we have referred to initial jobless claims as our economic "[canary in the coal mine](#)" as it gives us a weekly real-time look into the health of the labour market that is not materially revised historically. Initial jobless claims measure the number of people filing for unemployment benefits in any given week, and the number of first-time filers (initial claims) provides insight into the number of layoffs occurring. An increasing number of layoffs bodes poorly for future consumer spending as labour income is the primary source of spending power for the typical American. Consumption can also suffer as a layoff cycle builds even among those who do not lose their jobs, which typically shows up as a dent to consumer confidence and general consumer retrenchment.

Exhibit 1: ClearBridge Recession Risk Dashboard

	August 31, 2024	June 30, 2024	March 31, 2024	
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	✘	✘	✘
<b>Overall Signal</b>	↑	↑	●	

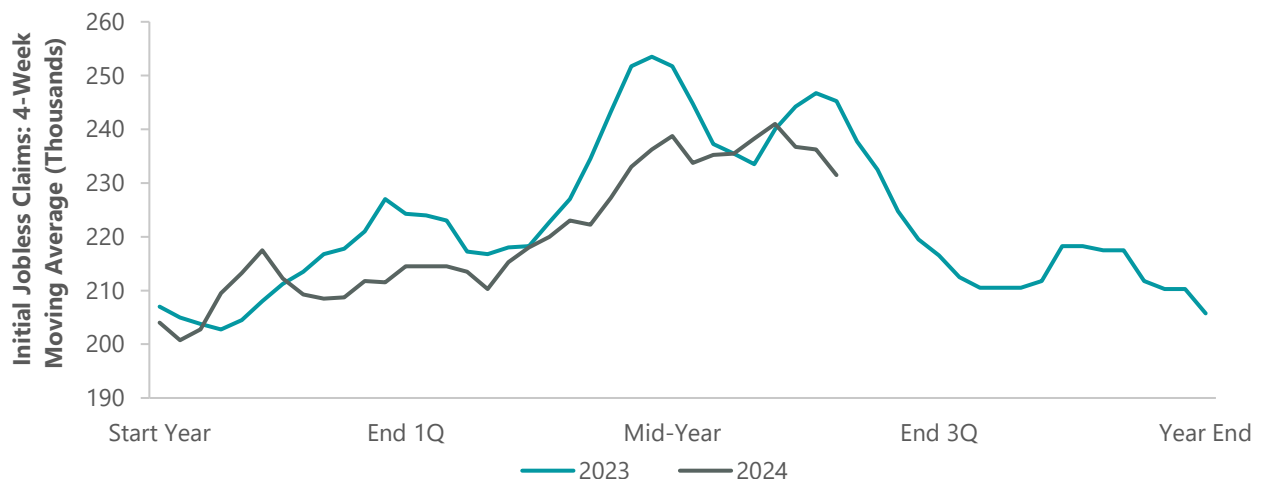
↑ Expansion     ● Caution     ✘ Recession

Source: ClearBridge Investments.

All of this is part of the reason why initial claims are one of the heaviest-weighted indicators in our dashboard. Specifically, we focus on the change in claims relative to recent trends to try and identify inflection points. This approach resulted in claims worsening to a cautionary yellow reading last summer when they appeared to be breaking out to the upside, although the indicator never turned red. With the benefit of hindsight and additional data, seasonal noise seems to have been a major contributor to the summer 2023 deterioration in claims. Claims recovered (decreased) last fall and were showing healthy readings by the spring of 2024 when we erred on the side of caution in maintaining a yellow signal coming into summer given the prospects of another seasonal pickup in claims.

By May, claims began to rise again as suspected; however, the data was loosely following the 2023 pattern until early August when they surged just as the aforementioned growth scare was emerging. In retrospect, this bounce was likely the result of Hurricane Beryl, which led to an outsize pickup in filings for unemployment benefits in Texas, and in tandem with normal auto plant shutdowns in Michigan as factories retooled to produce next year's models. We dug into both of these dynamics (and more) in greater detail in a recent [labour-focused white paper](#). With the effects from Hurricane Beryl fading and auto plants now back online, claims are once again tracking below 2023 levels, a positive sign for the continuation of the economic expansion.

Exhibit 2: Largest Stocks Distorting Valuations



Data as of 31 August 2024. Source: Department of Labor, Bloomberg.

The signal from initial jobless claims is consistent with an array of labour data that shows [normalisation rather than cooling](#). Although July's 114,000 nonfarm payrolls figure was soft, the average over the last three months has been 170,000, which is in-line with the 178,000 average seen in 2018-19, a period generally seen as consistent with the notion of maximum employment. Combined with the improved Commodities signal and the deterioration in ISM New Orders, the prospects of a soft landing look a bit brighter than just a month ago.

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