July employment report: Satisfactory, but trade escalation overshadows

The nonfarm payrolls came in over consensus at 164k in July. Setting the three-month average at 140k. Average hourly earnings for all employees firmed slightly, supporting the consumer without spooking the Fed. However, trade uncertainty remains the wildcard that overshadows this employment report. The 12-month BCI recession forecast sits at 28.5% slightly under the warning threshold for potentially leaning out of risky assets.

Implications for Fed: The employment report is roughly in line with the Fed's assessment on the labor market—that job gains are solid and unemployment is low. Based on recent developments policy developments resulting in trade escalation on August 1st, we are more convicted in an additional rate cut in September. However, a deep and sustained easing cycle would require a full-blown recession scare which given at the moment is not supported but the employment data.

Implications for growth: The employment report suggests strong income fundamentals for consumers. However, an additional 10% tariff on the remaining $300 billion of Chinese imports will disproportionally impact consumer goods. Given the US consumer is the bright spot in recent GDP reports, trade escalation is especially worrisome and will be something to keep an eye on going forward.

EXHIBIT 1: BUSINESS CYCLE INDEX (BCI)
EXHIBIT 2: EMPLOYMENT FORECAST

Forecasts of nonfarm payroll employment changes as of July 2019

Source: Actual employment data from St. Louis FRED database. Out of sample forecasts were calculated by simulating the time-series model into the future. The value shown is the median of the simulated value for the month.

FREQUENTLY ASKED QUESTIONS

What is the Business Cycle Index?
- The Business Cycle Index (BCI) forecasts the strength of economic expansion or recession in the coming months, along with forecasts for other prominent economic measures.
- The two outputs featured here are the Business Cycle Index and the Employment Forecast.
- Inputs to the model include non-farm payroll, core inflation (without food and energy), the slope of the yield curve, and the yield spreads between Aaa and Baa corporate bonds and between commercial paper and Treasury bills. A different choice of financial and macroeconomic data would affect the resulting business cycle index and forecasts.

Why is it important?
- The BCI forecasts the future direction of the business cycle.
- Historically, the stock market responds to investor perceptions of the future direction of the business cycle.
Can I use the BCI as a market-timing tool?

- No. The BCI is not meant to serve as a direct prediction regarding the future performance of any financial market. It is not intended to predict or guarantee future investment performance of any sort.

How do we interpret it?

- An increase in the BCI indicates that the business cycle conditions are improving — either moving closer to exiting a recession or to stronger expansion.
- A decrease in the BCI indicates that business cycle conditions are worsening — either moving closer to entering a recession or to a deeper recession.

How often is it updated?

- The Business Cycle Index is updated monthly after payroll employment numbers are released and will be published around the 15th calendar day of the month.
These macroeconomic forecasts do not constitute a projection of the stock market or of any specific investment. 

Historical employment data displayed in the Business Cycle Index are reflective of current data as provided by the data sources including any revisions to previous data. These revisions may change historic data points and historic ranges for some or all indicators. These changes are usually due to seasonal adjustments to previously supplied data.

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Standard Deviation is a statistical measure of the degree to which an individual value in a probability distribution tends to vary from the mean of the distribution.

No investment strategy can guarantee a profit or protect against a loss in a declining market.

Please remember that all investments carry some level of risk, including the potential loss of principal invested. They do not typically grow at an even rate of return and may experience negative growth. As with any type of portfolio structuring, attempting to reduce risk and increase return could, at certain times, unintentionally reduce returns.

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RIFIS-21912