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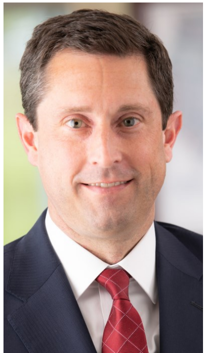

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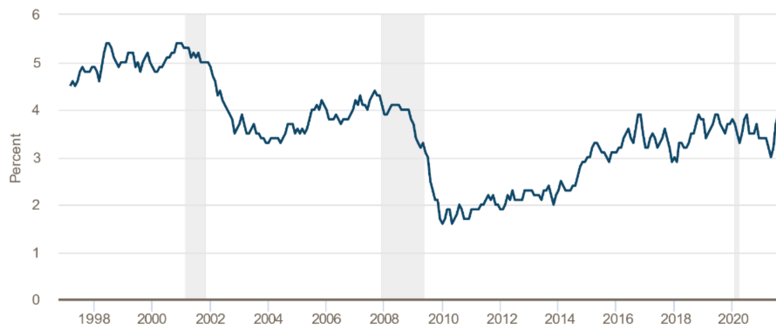
Where are all the workers?

"Business is great, I just can't find any help". These words have been repeated by many employers over the past year as the labor shortage continues to present real challenges for businesses and consumers. At this point, virtually all of us have been affected in some way by staffing issues. Hotels closing off floors, restaurants moving to carry-out only, or just simply waiting longer to receive items purchased on-line (we're not bitter though). Many businessowners are juggling the difficulties of finding new hires with trying to retain current staff being tempted away for higher paying jobs. According to the Bureau of Labor Statistics, there are over five million less workers today than just prior to the pandemic, while the labor participation rate (those working or actively looking for work) sits at a 50-year low. In order to lure people into open positions, employers have been raising wages while some are offering perks such as assistance with college tuition or sign-on bonuses. The competitive fast food restaurant industry has been pulling out all the stops, using promotions like offering $50 just to appear for an interview and daily pay intervals. Despite these attempts, the unfilled positions remain stubbornly high.

"Seat yourself. Grab a menu. Take any table. Hey, you know how to cook?"

So, where are all the workers? The list of concerns holding people back from working has been well publicized; fear of COVID, parents attending to at-home children, and the enhanced weekly unemployment benefit have all been noted contributors. It's hard to argue that these factors and disincentives to work aren't playing a role in the labor shortage. Now that schools are open and additional unemployment support has disappeared, the idea that some of the unemployed will find their way back into the labor force seems logical. To revisit the competitive fast-food industry, McDonald's recently stated on their quarterly earnings call that the staffing situation is still challenging but improving. Their corporate owned restaurants saw applications for open positions increase significantly during the quarter and cited that states that ended the extra unemployment benefit early saw even higher application rates[1]. Although this is just one example from a very large employer, these comments offer some support that there may be light at the end of the labor shortage tunnel.

[1] McDonald's Corp Q2 2021 Earnings Call Transcript



The hiring is coming at a cost. Officially, the Federal Reserve Bank of Atlanta's wage tracker is showing growth of 4% but reports of hourly rates in some industries increasing by 5-25% from a year ago are becoming common. In our previous newsletter we mentioned that the impact of government policies implemented during the pandemic would be better understood as the reopening took hold. The well-intentioned supplemental unemployment programs were designed to plug holes left in personal income, however one of the unintended consequences appears to be its influence in finding workers. This, in turn, is forcing businesses to raise wages for certain jobs in some places. While there are structural issues within the labor market which will be an ongoing challenge (finding workers in certain industries was a problem heading into the pandemic), we do expect workers will reappear and job openings will continue to diminish over the coming months. The side effect of this trend could be we all pay a little more at the cash register as the increased costs are passed down to the end user.

The debate carries on regarding the effects of rising wages and higher prices. On one hand, a one-time adjustment in wages or prices does not constitute the lasting "bad" inflation that is feared and could help boost the economy with more consumer spending. On the other hand, the risk remains that high inflation sticks around leading to higher interest rates and lower asset values. There are smart people on both sides of the debate. JP Morgan's CEO Jamie Dimon recently offered a reasonable take on the current situation, *"inflation to me, looks like there's a part that's transitory, and there's a part that's not. That's not a disaster."* This seems like a simple yet fair assessment. We don't entirely know what the outcome looks like, only that prices may remain elevated for some goods and services while others will return to more modest levels, but the situation as a whole appears manageable for now.

"History never repeats itself, but it does often rhyme"
-Mark Twain

The mostly calm, quiet summer became a bit noisier following the Labor Day holiday. The month of September saw several looming global issues converge which contributed to the increase in market volatility. Although not completely identical, the current concerns look eerily similar to obstacles investors endured in recent history.

- **DC political policies surrounding the infrastructure bill, tax reform, and looming debt ceiling**. The more significant near-term risk is tied to the debt ceiling, where a political impasse would result in a default on U.S. debt obligations—which has never occurred. Although we've "seen this movie before" and the likelihood of the debt ceiling being breached is minimal, the lead-up threat of it occurring may cause continued investor anxiety. Recall that the debt ceiling debate in 2011 resulted in Standard & Poor's downgrade of the U.S. credit rating, which caused temporary

market turbulence. The infrastructure and tax reform bills are two large, complicated pieces of legislation that could continue to hang over markets. Significant legislation like this can take time and restructuring to pass (or not). President Trump's tax cut and jobs act took 336 days to pass from inauguration, while President Obama's affordable care act took 1,807 days. One of the main concerns for investors is that higher corporate/individual tax rates will be impactful to profitability and spending. We won't speculate on the political "sausage making" process, only that there is a high level of uncertainty surrounding these bills in their current state.

- **China's slowing economic growth, increased regulation in some industries, and the country's largest real estate developer teetering on default.** Although most of these concerns appear to be a China problem for now, the risk remains that weakness could spill over to other areas. As China grapples with a number of these lingering issues, the negative ripple effects will be felt most notably with its regional trading partners and those investing/lending directly to Chinese companies. In August 2015, a bout of global market turbulence was linked to China's weak economy, sharp declines in their stock market, and a currency devaluation—which underscores the potential of increased market volatility as China works through the excesses that have built-up in their economy.
- **The Federal Reserve's comments on the upcoming "taper" or reducing the pace of bond purchases.** As the economy continues to recover and some pockets appear to be overheating the Fed will begin the initial steps in backing away from its emergency policies in the coming months. The modest tapering will likely be designed to have little impact to markets initially. However, it's easy to imagine we've started down a path that will ultimately lead to higher interest rates. It's important to note that tapering has been done before and is still relatively fresh in investors and central banker's minds. The last taper began in December 2013 and concluded in October 2014. The Fed then announced the first interest rate increase in December 2015, two years after the taper began. The course of action this time will likely play out over a shorter period. It will ultimately be the pace at which rates rise that will be more impactful to asset values than the actual threat of higher rates.

We view the market reaction to these concerns as ordinary turbulence for now, however there is always the risk that one or multiple factors turn into a big bang. As previously mentioned, markets have some experience in the listed items of concerns and generally don't react irrationally to a repeated or well publicized shock. Elevated stock valuations will also play into near term risks. Stocks priced for perfection are less able to absorb bad or unforeseen news relative to stocks priced cheaply. Even though worries and concerns continue to be widespread, fundamentally not much has changed. The past 12 months has produced a relentless rally in asset prices and a correction period or patch of weakness is not unusual. Although a volatile market environment may not be ideal for some investors, a pause in the upward trajectory of prices can offer us the opportunity to rebalance, reposition, and act on new investment ideas.

Third Quarter Recap

The month of September saw the first 5% decline for the S&P 500 this year while nearly 90% of the index's constituents have already experienced a correction of at least 10%. Despite the September weakness, U.S. stocks eked out a fractional gain during the third quarter and are up 16% this year. Gains continue to be concentrated in more cyclical areas of the markets. The surge in oil prices has benefited the energy sector which is up 42% this year while the anticipation of rising interest rates and healthy economic outlook has benefited the banking sector, + 29%. Stocks in developed international economies were down slightly for the quarter and are up 9% this year. Weakness in China contributed to a sharp decline in emerging market stocks, down 8% during the quarter and slipping into negative territory for year.

Bond returns continue to occupy negative return territory for the year, down 0.87% [2]. Bond yields started the quarter at 1.60%, declined to 1.17% in August, then rose again to 1.50% [3] levels. The nearly round trip for yields reflects a lot of the uncertainty surrounding U.S. economic growth and inflation while also calibrating for the Federal Reserve's upcoming plans to reduce its pace of bond purchases.

As always, we will continue to monitor market activity and make adjustments to portfolios as needed. Please do not hesitate to contact us with any comments or questions regarding this newsletter or other matters. Thank you for your continued confidence and trust.

Sincerely,

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[2] As measured by the Barclays Intermediate Govt/Corp bond index
[3] Yield on the 10-Year U.S. Treasury Note

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