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June Jobs reverses May's Losses; Earnings Key to Stock Rally

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As bad a last month's employment report, this morning's report was as good. We saw a strong bounce back in employment, with payroll increasing at 287k, 101ky above expectations. More good news: the participation rate increased by one tenth, bringing unemployment back to the 4.9%, a comfort zone of the Fed. Hourly earnings were quiescent, rising only .1%, lower than expected, which puts the year over year wage gains a 2.6% rate. All these numbers alleviate fears of an excessive tightening in the labor market. This must mollify the Fed hawks, allowing Yellen to keep rates stable for longer. This labor market report also quiets fears of a sharp economic slowdown and corroborates the high frequency indicators such as jobless claims, that didn't indicate a slowdown. This is a positive report for the economy and the "risk-on" markets.

Despite the sharp increase in jobs, productivity has bounced back in Q2; Private sector jobs increased by 420k in Q2. With 122.1 million private workers, that represents a 0.34% increase, or 1.4% at an annualized basis. Average hours worked remained the same as May, but declined at a 0.8% annualized rate from Q4. Summing the two gives us a six tenths percentage points increase in total hours worked. With Q2 GDP estimated to increase at 2.3%, this gives us a 1.5% increase in productivity an annualized rates in Q2, a sharp jump from -1.7% rate in Q4 last year and -0.6% in the first quarter.

However, the productivity collapse since the financial crisis is far from over. In fact, we had a very similar jump in productivity in Q2 last year, rising to a much higher 3.1% in Q2 over -0.8% in Q1. And productivity growth was minus 1.7% in Q4 in both 2014 and 2015. Recall the long run productivity growth is 2.2%, so we have only reached the average in Q2.

Stocks increased on the announcement but I do not think will move much higher unless we get a strong indication that the second half of 2016 will represent a bounce back in earnings. That is why Q2 earnings are so important. Current estimates of 2016 earnings (S&P operating) is $114.31, which at yesterday's closing levels of S&P, makes for a P-E of 18.36. Given yields, this is not unreasonable, but they are not numbers needed for a sustained stock rally. Technically the market is still vulnerable; although S&P 500 is near its high. The Russell 2000, which I regard as a leading indicator, is still more than 10% below its high. This is still not an environment for a strong stock market rally.

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