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Good Labor Report; Rate Hike in December; Pound Sterling Wobbles

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A good employment report and one that fully vindicates Yellen's contention that the Fed did not need to be pressured into an early rate hike last month. Although the total payroll number was a little soft (+156k vs +167k expected), private payrolls were very strong. Even better, the participation rate continued on its upward course, rising to 62.9%, so that even though the household survey recorded a strong 354k increase (it had been running weaker than the payroll in recent months), the unemployment rate ticked up to 5.0%, the same as last December. Yellen had said after the September FOMC meeting that the rise in the participation rate gave the FOMC "breathing room," and September's labor report confirmed that. Wages rose only 0.2% month over month (one tenth less than expectations), and hours worked made a welcome recovery from August's low.

This report in no way changes my call for a December rate boost, barring a strong negative shock to the markets. In fact, during the week, the bond market was clearly coming to grips with the rate increase, as the ten year firmed to 1.74%, the highest since last May. I am not surprised to see yield-oriented stocks pressured by this rate rise, but if the economy and earnings do accelerate, as I expect, investors will return to these stocks as the best investment to provide current income, along with growth and inflation protection. On the economic front, the call for GDP growth in the current quarter is in the high 2s and slightly less for the fourth quarter. More important for stocks, the market is now entering "earning season," where firms' year-end guidance will be important.

The other notable development this week was the "flash crash" in the British pound sterling on Thursday afternoon, where it suddenly traded off 6.15% in a matter of minutes before recovering most of its loss. We have seen a number of these "flash crashes" in recent year, occurring in the equity and US Treasury markets. They have been caused by glitches in the shift of trading from designated market makers to computers. In the equity market, new procedures have been put into effect that I believe will greatly reduce, if not eliminate, these sudden downdrafts. I am not sure whether effective counter-measures have been introduced in the other markets.

Although flash crashes are upsetting to investors, one has to realize that only an infinitesimal amount of volume takes place at these abnormal levels and within minutes, prices normalize. Maybe investors would feel more positive if the exchanges put out an email: "Attention all traders and investors! For the next 60 seconds securities will be going for a 5% discount. But hurry, these opportunities won't last!"
