Weekly Commentary **January 6, 2017**

JEREMY SIEGEL .com

Strong Labor Report; Stocks Stall as traders wait for earnings

Friday 9:15 a.m. EST

Good, but not a terribly exciting labor market report. Although jobs fell 19k short of expectations (26k short on private payrolls), that shortfall was exactly offset by the 19k upward revision of the previous two months. The participation rate and unemployment rate both ticked up one tenth, the latter rising to 4.7%. Manufacturing employment, which will be watched closely by the Trump administration, was up a nice 17k. Hourly earnings were up 4 tenths, and year over year earnings rose to 2.9%, 4 tenths over the previous month and one tenth above expectations.

Stocks have stalled on the way to 20,000 as traders wait for Q4 earnings. Stocks are not cheap, and higher earnings must be a factor in for stocks to continue to rise. Perhaps the most surprising part of this week was not the labor market, but the sharp reversal in the Chinese yuan as the Chinese government bought the RMB to shake out the shorts and convince speculators that their currency is not a one way street. Long rates also sank as stocks pulled off their highs. The ten year, which had reached 2.60%, fell to 2.35% before the jobless report (now at 2.39%). End of year Fed Funds futures fell from 1.24% last week to 1.18%. Since the midpoint of the current Fed Funds range is 62.5 bps, futures predict about 2 quarter-point rate increases based on the raw data. However, since there is a hedge premium in these futures, these data are more realistically point to between 2 and 3 increases.

Last Tuesday I was privileged to interview Pat Harker, President of the Federal Reserve of Philadelphia and this year a voting member on the FOMC. His interview can be heard on the Wharton Radio (Sirius XM Channel 111) at 1:00p.m. today. Harker is a mild Hawk, believing that 3 rate increases will be necessary this year. He is flexible and will watch the market and the economy. His long-term projection of the funds rate is 3%, in line with the consensus. He does worry about tightening labor markets sparking wage increases and will react sensitively to higher wage gains.

The bottom line from today's report is that unless the participation rate rises significantly over the coming year, gains in the 150k-180k area are not sustainable and will cause labor pressures that will lead to higher inflation. The Fed will then tighten, slowing domestic demand and putting upward pressure on the dollar, further pressuring domestic demand. Rightly or wrongly, Trump will own the labor market data going forward.

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