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MARKET
PERSPECTIVE

Tight Jobs Market Means a Tough Job for the Fed

By James M. Walden, CFA

Headline inflation continues to moderate, with January's year-over-year change of 6.4%, down from June's peak of 9.1%. With inflation trends pointing in the right direction and stable market interest rates, the S&P 500 was up 11.6% through the end of January from the October low. Despite the progress on inflation, the Fed's challenge remains: making sure it tightens conditions enough to sustainably lower inflation closer to its 2% target while avoiding tightening so much that it causes unnecessary damage to the U.S. economy.

DASHBOARD

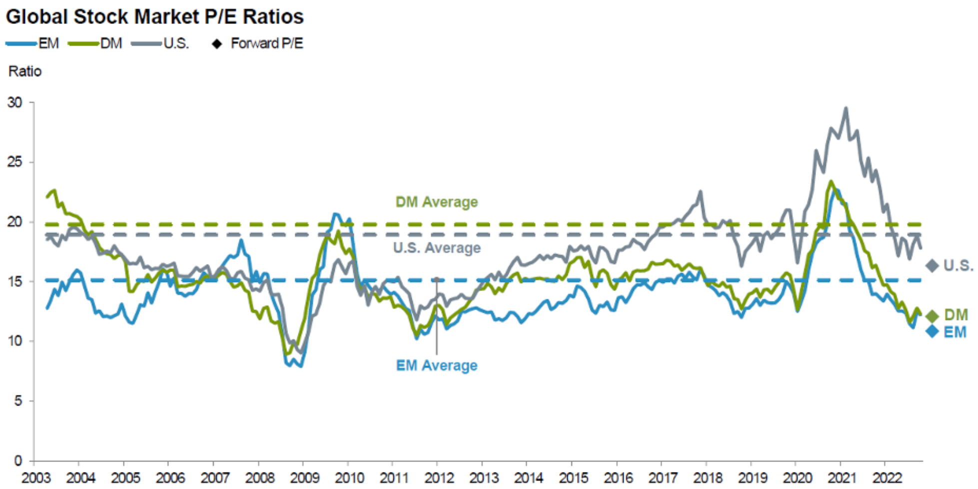
- Business Cycle
- Valuation
- Trend

The January jobs report, which came in white hot, didn't make things easier for the Fed. The U.S. economy added 517,000 jobs in January. Economists had been expecting just 187,000. That was enough to push the unemployment rate down to 3.4%, the lowest since 1969. The problem for the Fed is that such a strong jobs market can put upward pressure on wage growth, which can drive inflation higher, all else equal. It's doubtful the Fed will declare victory over inflation when it sees employment data like that, let alone move soon to cut rates, as some hope.

Despite the recent rally in the stock market, we still lean toward caution and continue to hold more cash than usual. We're still concerned that the market hasn't priced in a recession, which, given the evidence we see accumulating, seems more likely than not. And a recession would likely be accompanied by a decline in corporate profits, a reason for perhaps another leg down in stocks.

However, we do see better opportunities in other areas of the global financial markets and have put some cash to work in client portfolios. A mild winter in Europe removes the dire scenario of energy rationing to European homes and factories. The combination of China's sudden elimination of Covid restrictions and modest policy stimulus should help provide a near-term improvement in broadly diversified emerging economies. As the exhibit on Page 2 shows, valuations for international equities are significantly more attractive than those of U.S. equities. And with fixed income now offering higher yields, we've added exposure to bonds.

Exhibit: Global Stock-Market Valuations



Source: FactSet, Bloomberg, Fidelity, Clayton Wealth Partners, as of 12/31/22.

Bullish

- Significant pent-up consumer demand
- Reasonable equity valuations
- The most attractive yields for fixed income in years
- Fed progress toward reducing inflation
- China's lifting of Covid restrictions, which could provide a lift

Bearish

- Slowing global economic growth with recession pressures mounting
- High global inflation
- Ongoing deterioration in housing
- Tightening by the Fed and other global central banks
- Russia-Ukraine war and other geopolitical concerns

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As Partner & Chief Investment Officer, James Walden strives to maximize our clients' long-term, risk-adjusted portfolio returns. This includes determining strategic and tactical asset allocations, as well as specific investment analysis and prudent rebalancing. Jim is also a partner & management team member. His expertise includes advanced investment research and valuation, and he is passionate about his role in helping clients reach and exceed their financial goals.

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