CHANDLER ASSET MANAGEMENT

Economic highlights from the week ending on January 7, 2022

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Job growth slowed in December, with US nonfarm payroll growth of just 199,000 in the month versus the consensus forecast of 450,000, but the unemployment rate still declined to 3.9%, the lowest level since February 2020. Nonfarm payrolls for the prior two months were revised higher by a total of 141,000. On a trailing 3-month and 6-month basis, payrolls increased an average of 365,000 and 508,000 per month, respectively, which still compares favorably to the average job gains in the five years leading up to the pandemic of about 196,000 per month. We believe a variety of factors are keeping some workers out of the labor force for now, which continues to hold back job growth despite strong demand from employers. We believe the resurgence of the virus in December has likely prolonged some workers from returning to the labor force. The labor participation rate was unchanged in December at 61.9% and remains lower than the pre-pandemic level of 63.4%. The employment-population ratio increased to 59.5% in December from 59.3% in November, but also remains below the pre-pandemic level of 61.2%. In our view, labor participation will likely improve gradually as the health situation improves. The U-6 underemployment rate, which includes those who are marginally attached to the labor force and employed part time for economic reasons, declined to 7.3% in December from 7.7% in November (versus 7.0% in February 2020). Annualized average hourly earnings rose 0.6% month-over-month and were up 4.7% year-over-year in December versus 5.1% in November. Although wage growth eased slightly on a year-over-year basis in December, we believe the month-over-month gain is indicative of an ongoing imbalance in the supply and demand for labor which may keep upward pressure on wages over the near- to intermediate-term.

Overall, the labor market has recovered significantly since the early stages of the pandemic. Although labor force participation remains lower than it was in early 2020, there are signs the economy may be near full employment within the context of the current health situation. Most Fed policymakers seem to be bifurcating their opinions of what constitutes maximum employment amid near-term dynamics versus potential long-term full employment in a post-pandemic environment. According to the minutes from the most recent Federal Open Market Committee (FOMC) meeting in December, several policymakers view current labor market conditions as largely consistent with maximum

employment. We do not believe the December employment report, albeit lackluster, will cause policymakers to meaningfully change their view.

The Fed has recently pivoted toward a more hawkish stance as inflation indices continue to run hot and the labor market appears relatively tight within the context of the current health situation. The Fed's recent meeting minutes indicate that policymakers are strategizing an approach to remove monetary policy accommodation. The Fed is currently tapering its asset purchases and we expect that process will be complete within the next few months. Should aggregate demand remain strong and economic activity remain robust, we believe the first rate hike may be announced in the first half of this year after the taper is complete. However, we do not believe monetary policy is on a pre-set course. We expect the Fed to adjust policy at a gradual pace and believe policymakers will adjust their views as necessary based on incoming economic and financial market data. We project a measured and cautious approach to policy normalization by the Fed will likely put upward pressure on Treasury yields across the curve this year.

Next Week

Empire State Manufacturing, Housing Market Index, Housing Starts & Permits, Philly Fed, Existing Home Sales, Leading Indicators

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