CHANDLER ASSET MANAGEMENT

Economic highlights from the week ending on October 8, 2021

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Job growth was weaker than expected in September, but the unemployment rate fell below 5% for the first time since March 2020. U.S. nonfarm payrolls increased by 194,000 in September, versus the consensus forecast of 500,000. However, July and August payrolls were revised up a total of 169,000. On a trailing 3-month and 6-month basis, payrolls increased at a solid pace, up an average of 550,000 and 582,000 per month, respectively. The U-3 unemployment rate declined to 4.8% in September from 5.2% in August, a bigger decline than expected. The labor participation rate declined slightly to 61.6% in September and remains lower than the pre-pandemic level of 63.4%. The employment-population ratio increased modestly to 58.7%, but also remains below the pre-pandemic level of 61.1%. 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 8.5% in September from 8.8% in August (versus 7.0% in February 2020). Annualized average hourly earnings were up by 4.6% in September versus 4.0% in August, reflecting strong wage growth driven in part by the ongoing imbalance in the supply and demand for labor. Although labor force participation has been slow to recover and more than 7.6 million people remain unemployed in the US, the labor market has made significant progress over the past year.

Today's employment report will be Fed policymakers' last read on payrolls and unemployment prior to the next Federal Open Market Committee (FOMC) meeting on November 2nd- 3rd. We believe today's report was sufficient for the Fed to announce their intent to start tapering asset purchases at the next FOMC meeting. If so, we will be closely scrutinizing the Fed's planned timeline for a signal on their concerns about inflation. The September FOMC meeting minutes will be released next Wednesday, which might provide some insight on the potential pace of tapering. According to the minutes from the last FOMC meeting, most Fed policymakers were in favor of reducing the pace of Treasury and agency mortgage-backed securities proportionally in order to end purchases of both asset classes at the same time. Fed Chair Powell has already signaled that the tapering process would likely be complete by mid-2022, which suggests that the tapering process will likely be somewhat more aggressive in terms of timeline and quantities, relative to the post-Global Financial Crisis tapering period in 2014. Arguably, the US labor market is stronger today than it was in December 2013 when the Fed announced the previous taper. At that time, the unemployment rate was 6.7% and more than 10.4 million people were unemployed, compared to a current unemployment rate of 4.8% with about 7.7 million unemployed. Wage growth and inflation are also currently running much hotter, due in large part to supply chain bottlenecks and labor shortages, which is certainly top of mind for Fed policymakers.

The Treasury yield curve has steepened meaningfully in recent weeks. Since the beginning of September, the 10-year Treasury yield has increased more than 30 basis points to about 1.61% (at the time of this report). The spread between the 2-year Treasury yield and the 10-year Treasury yield is roughly 129 basis points, which is generally in line with the longer-term average, as the mean spread since 2002 has been

133 basis points. Nevertheless, we believe the yield curve may be poised for further steepening. In our view, the Fed's relatively slow withdrawal of monetary policy accommodation, amid a backdrop of a strengthening labor market and economy that is growing at an above-trend pace, may drive longer-term yields higher over the near-term, all else being equal.

Last night, the Senate voted to extend the Federal debt ceiling through early December, avoiding possible government default later this month and alleviating near-term risks to the economy and financial markets. Lawmakers agreed is to raise the borrowing limit by $480 billion, enough to meet the country’s cash needs until December 3. That date corresponds with the deadline for averting a partial government shutdown. Congress now has another month or so to negotiate a longer-term solution.

Next Week

CPI, FOMC Minutes, PPI, Retail Sales, Empire State Manufacturing, Import and Export Prices, Consumer Sentiment

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