BESPOKE Investment Group
B.I.G. Tips

April 3, 2015

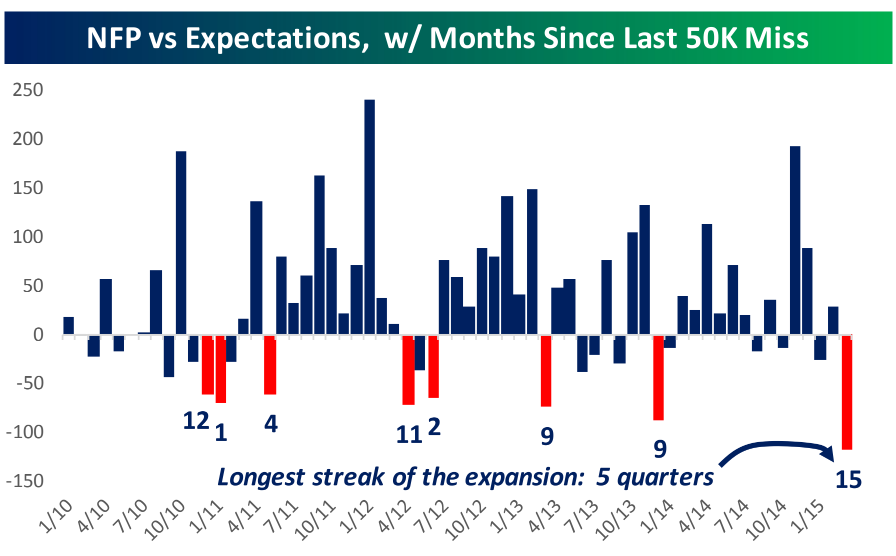
March Employment Report Reaction

With no *Bespoke Report* or *The Closer* today due to the Good Friday holiday, we wanted to send subscribers a quick note summarizing this month's Employment Situation Report from the BLS. At right we show expected versus actual readings for the report.

Headline Indicators

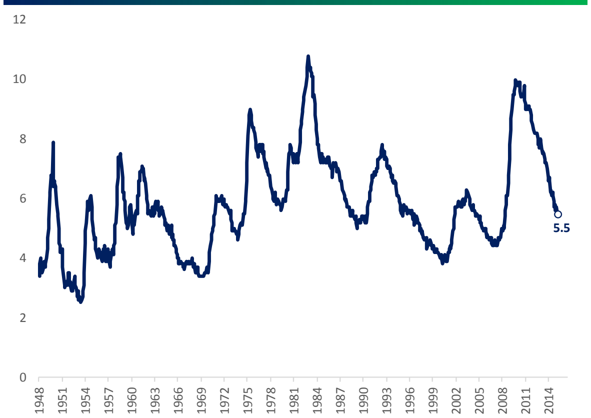
Indicator	Expected	Actual	Prev.	Revised
Change in Nonfarm Payrolls	245K	**126K**	295K	**264K**
Unemployment Rate	5.5%	**5.5%**	5.5%	--
Avg Hourly Earnings MoM	0.2%	**0.3%**	0.1%	--
Avg Hourly Earnings YoY	2.0%	**2.1%**	2.0%	--
Avg Weekly Hours All Empl.	34.6	**34.5**	34.6	--
Underemployment Rate	--	**10.9%**	11.0%	--
Labor Force Particip. Rate	62.8%	**62.7%**	62.8%	--

As shown, this was an undeniably weak report. The miss versus expectations for NFP was the largest since January 2014 (although payrolls shrunk by 696,000 that month). We had been concerned about a slowdown in hiring (as discussed in *The Closer* dated 4/1/15 and yesterday's monthly Employment Report Preview) based on very weak leading indicators for payrolls. The broad-based slowdown in economic activity we've seen so far in 2015 has now moved into the employment sector. As far as the headline print and wider economy goes, we'd make two key observations. First: in other parts of the economy it appears that first quarter weakness was primarily driven by special factors. We haven't been convinced otherwise based on the data we have seen, but remain open to the idea that the strong growth in the last three quarters of 2015 was an aberration if we don't see a strong bounce in Q2. Second, as shown below, we were due for a large miss versus expectations, having gone 5 quarters or 15 months without a large downside surprise. NFP is an extremely volatile data series, and we were, simply put, due for a big disappointment after months of consistent, steady gains. Whether that weakness continues remains to be seen.

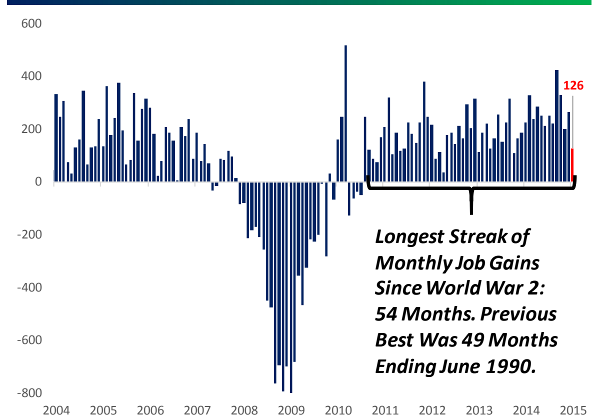


On the next page, we update monthly charts typically sent with *The Bespoke Report* on jobs Friday. On page 3, we provide some interesting tidbits gleaned from the guts of the report. Finally, on page 4, we update our *Countdown to Liftoff* indicator, and provide a snapshot of market reactions to the report.

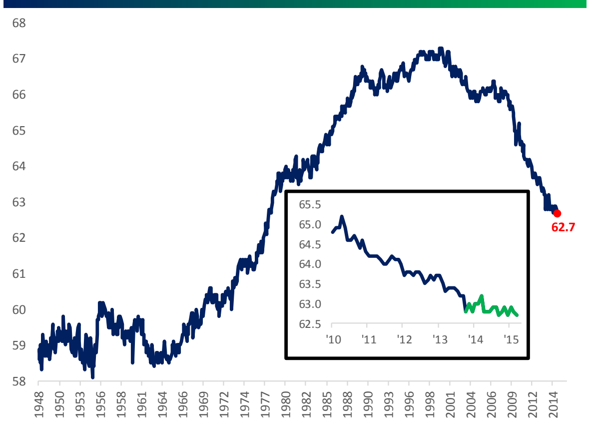
Unemployment Rate (%)



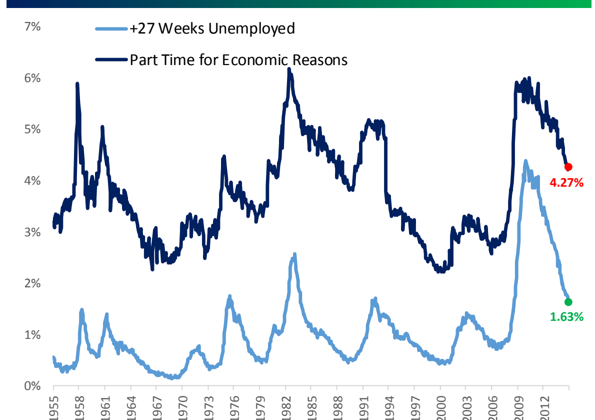
Change in Nonfarm Payrolls ('000s)



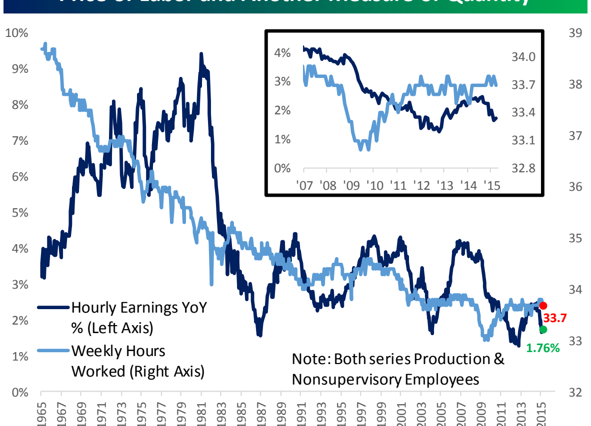
Labor Force Participation Rate



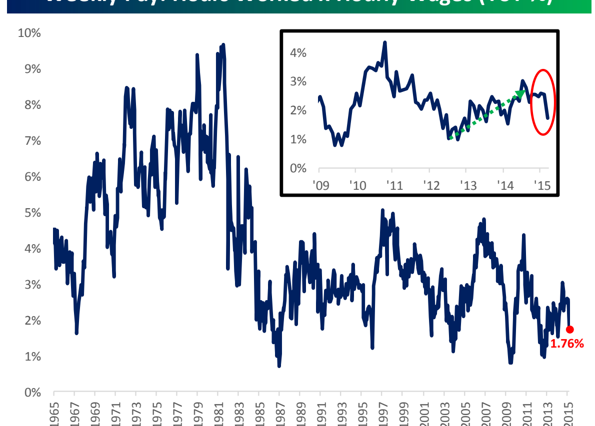
Marginal Worker Inventory: % of Labor Force



Price of Labor and Another Measure of Quantity



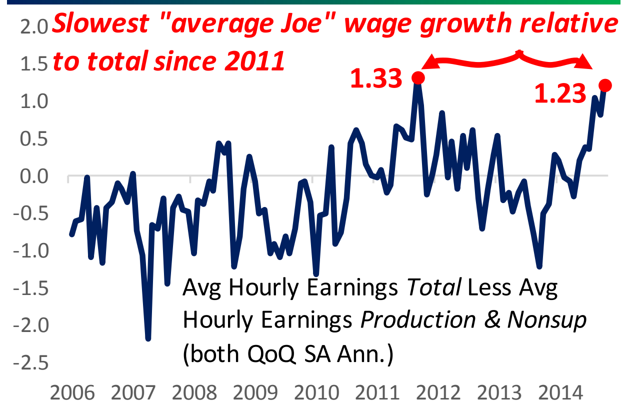
Weekly Pay: Hours Worked x Hourly Wages (YoY %)



The Labor Force Participation Rate fell, but long-term unemployment declined. Wages bounced month-over-month, but lower hours worked contributed to a big hit in year-over-year growth in total wage disbursals. The weak headline number isn't as concerning to us as a decline in the labor force participation rate, which signals weak demand. It also stands in contrast to strong wages the last two months (see page 3); strong wages and weaker hiring indicates a tighter labor market as businesses run out of candidates.

AHE Suggest Tight Labor Market...

...But It's Top-Heavy

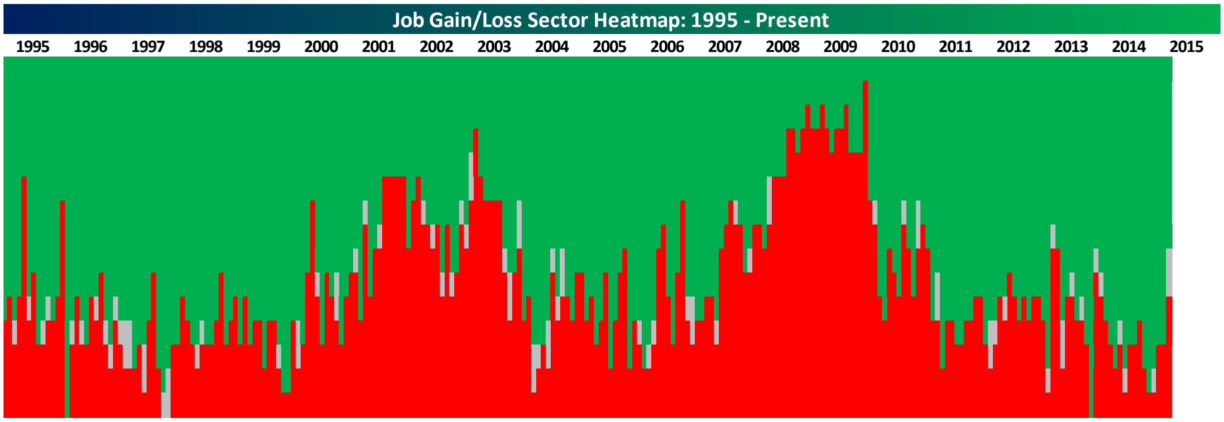


While positive wage growth is welcome and signals higher total employment costs (chart, upper left; all figures seasonally adjusted, QoQ and annualized), it mostly came from managerial employees. Production and nonsupervisory employees are seeing much slower wage growth over the past year. As of March (upper right chart) production and nonsupervisory employees saw wage growth 1.23% below their bosses; that's on a seasonally adjusted, QoQ basis, annualized. This is also visible in the unemployment rate. As shown at right, college grads have an unemployment rate of 2.5%, 3 percentage points lower than total. High-skill and managerial workers are in high demand, but their wage and hiring gains aren't being felt as broadly as we hoped.

Education Nation

Finally, below we have assembled a heatmap of employment gains for 12 private and three government sectors. As shown, this month's report showed the breadth of gains falling, although that's somewhat normal in expansions. Overall, this was a very weak report, despite some positives.

Job Gain/Loss Sector Heatmap: 1995 - Present



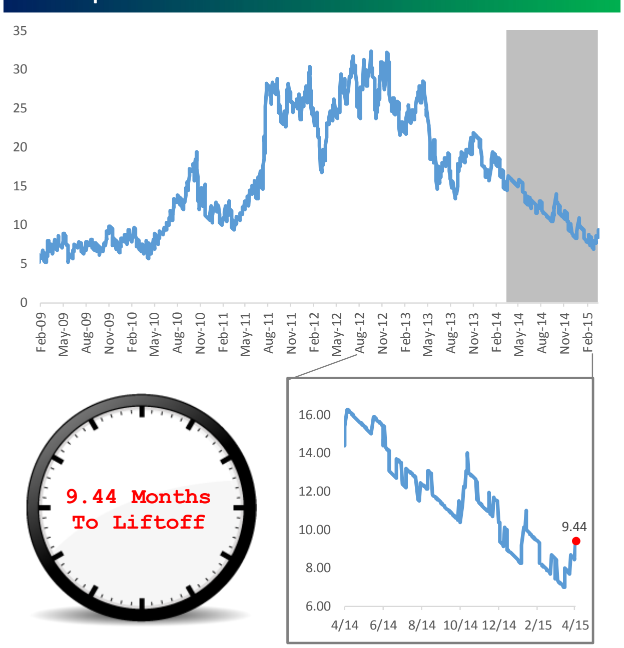
Positives: strong AHE, lower long-term unemployment.

Negatives: weak NFP, production & nonsupervisory earnings, breadth by industry; lower labor force participation, hours worked. Higher AHE and lower NFP *could* mean tighter labor markets but lower LFPR/breadth suggests weak demand.

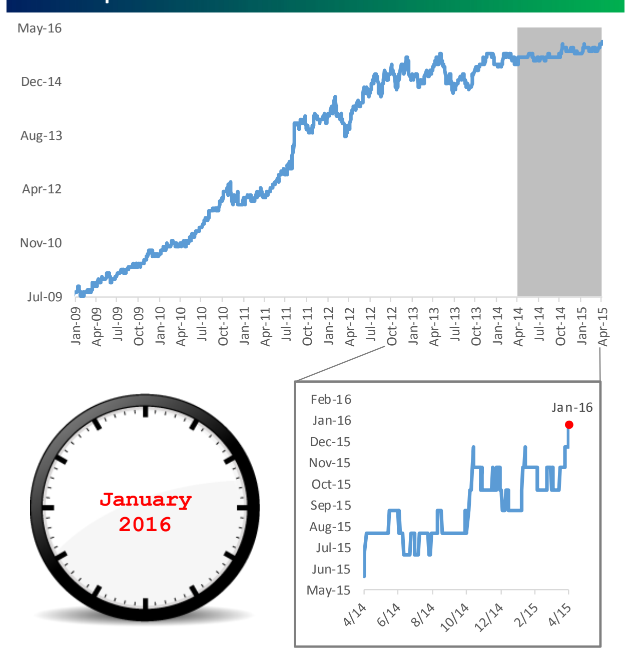
The market reaction to the Employment Situation Report was swift and aggressive. Had we seen a moderately below expectations report, we would have expected a dollar decline, rate rally, and risk rally: lower USD, lower Treasury yields, higher stocks and credit. Instead, the huge miss catalyzed the first two (Bloomberg USD Index down as much as 1.05%, -76 bps last; ten year yield down 11.1 bps immediately following the report, -7.3 bps to 1.839% last) but big selling of risk. S&P 500 futures closed at 9:15 AM and in the 45 minutes following the employment release they went from unchanged on the day (2059.50) to down 96 bps (2039.75; translates to roughly 2046 on the S&P 500 cash index). Credit also widened with the CDX HY index of CDS widening 4.1 bps before closing 1.75 bps wider; there was a similar move in IG credit. EM currencies also soared, with MXN, ZAR, HUF, and PLN all gaining 1% or more versus the USD. EUR was up 85 bps versus the greenback. Overall, we would characterize the market reaction has terrified: some weakness would have meant easier policy and therefore higher prices for risk assets. The massive miss in headline NFP and weak internals catalyzed some panicked selling in a very illiquid trading environment for all asset classes. The futures open on Sunday will be an interesting one, and we suspect will set the tone for the rest of the week even more than today's spotty trading did.

With the big rally in fixed income, Fed Funds futures were heavily bid, and the result was a move further out in the market expectation of a rate hike. Below we update our *Countdown to Liftoff* indicator, showing that the pricing of hikes further out we've seen since the March 17th FOMC statement got a big boost. Fed Funds futures now price no hike in 2015, a drastic move and the sharpest one we have seen since October. If weak economic data turns around sometime after Q1 GDP is released on April 29th, a hike in September or December is still very possible. For now, we are confident that there will be no hike in June under any plausible economic scenario, and a hike later in 2015 will require some improvement in the tone of economic data.

Bespoke "Countdown To Liftoff": Months To Fed Hike



Bespoke "Countdown To Liftoff": Month of Fed Hike



The Bespoke "Countdown to Liftoff" is our estimate of the time (in months) until a Fed policy rate hike. The calculation uses Fed Funds futures prices and constant assumptions about the size of the hike to calculate the hike date.