The 10-year US Treasury yield closed 2 basis points lower at 3.49%—having jumped as much as 12bps earlier in the session—while the 2-year yield rose 5bps to 4.28%. (ddp)

Strong US jobs report prompts market swings

05 December 2022, 1:39 pm CET, written by UBS Editorial Team

A stronger-than-expected US jobs report sparked a sell-off in stocks and bonds at the start of Friday's trading session, amid concerns that the Federal Reserve may have to keep tightening policy for longer to cool the economy. But these moves largely reversed, and the S&P 500 closed just 0.1% lower on the day (+1.1% on the week).

The 10-year US Treasury yield closed 2 basis points lower at 3.49%—having jumped as much as 12bps earlier in the session—while the 2-year yield rose 5bps to 4.28%. Futures market pricing for the expected peak in fed funds next May increased by 6bps to 4.92%. The DXY dollar index, which had risen in the wake of the jobs data, closed 0.2% lower.

The US labor report showed that non-farm payrolls grew by 263,000 in November, the slowest job growth since April 2021 but well above expectations for an increase of 200,000. The unemployment rate was unchanged at 3.7%, slightly above a 50-year low. Average hourly earnings rose 0.6% month-over-month, the fastest pace since January, and October's figure was revised up from 0.4% to 0.5%.

What do we expect?

Friday's market swings capped a volatile week for the S&P 500, which had rallied more than 3% on Wednesday as Fed Chair Jerome Powell signaled a likely downshift in the pace of rate hikes after four consecutive 75-basis-point increases.

Several data releases during the week pointed to a weakening economy and an easing of inflation pressures. The ISM Manufacturing PMI fell into contraction territory at 49 in November, down from 50.2 in October and the lowest reading since May 2020. The prices paid component of the index declined for an eighth straight month. Meanwhile, the US core personal consumption expenditures (PCE) price index, the Fed's preferred measure of inflation, increased by 0.2% month-over-month in October, a moderation from September's 0.5%.

But we think Friday's jobs report indicated that the labor market remains tight. In particular, the 0.6% growth in average hourly earnings, after 0.5% in October and 0.4% in September, is too high for the Fed's liking and heading in the wrong direction. The declining labor force participation rate—which ticked down to 62.1%—is also discouraging, in our view.

As Powell said in his speech at the Brookings Institution, wage growth remains "well above the levels that would be consistent with 2% inflation over time." He noted the risk of this spilling over into core services inflation, making it harder to bring down.

We appear to be heading for a situation where inflation is slowing from its peak, but is not on track to hit the 2% target because of rapid wage growth. We think this could eventually end up forcing the Fed to raise rates beyond the 5% terminal rate currently priced into markets. However, we still expect the Fed to moderate the pace of hikes to 50bps at the FOMC meeting on 14 December.

Economic growth is likely to slow further next year as the cumulative impact of Fed rate hikes weighs on activity, in our view. This should take a toll on corporate earnings. We expect 2023 S&P 500 EPS to contract by 4%, and believe bottom-up consensus expectations for 5% growth may be too optimistic.

How do we invest?

Markets are likely to remain volatile, and we do not think the economic conditions for a sustained upturn are yet in place. But given the prospect of periodic rallies, we prefer strategies that add downside protection while retaining upside exposure.

We prefer the more defensive areas of the equity market—including consumer staples, healthcare, and quality-income stocks—which should be relatively resilient as economic growth deteriorates. We also favor value stocks, which have historically outperformed when inflation is above 3%. In fixed income, we prefer higher-quality and investment grade bonds versus high yield.

The US dollar has fallen by around 8% from its peak, but we expect renewed strength for the safe-haven greenback in the months ahead as the slowing global growth environment#particularly in Europe#comes back into focus. We also like the Swiss franc, and hold a least preferred view on the euro and sterling.

Meanwhile, high equity-bond correlations this year have underlined the importance of seeking alternative sources of return, for example in certain hedge fund strategies. Macro strategies have been particularly strong performers this year, and we expect them to continue to do well in volatile markets.

Main contributors - Mark Haefele, Brian Rose, Alison Parums, Vincent Heaney, Jon Gordon

Content is a product of the Chief Investment Office (CIO).

Original report - Strong US jobs report prompts market swings, 5 December 2022.

Important information
As a firm providing wealth management services to clients, UBS Financial Services, Inc is registered with the U.S. Securities and Exchange Commission (SEC) as an investment adviser and a broker-dealer, offering both investment advisory and brokerage services. Advisory services and brokerage services are separate and distinct, differ in material ways and are governed by different laws and separate contracts. It is important that you carefully read the agreements and disclosures UBS provides to you about the products or services offered. For more information, please visit our website at www.ubs.com/workingwithus.
© UBS 2021. All rights reserved. UBS Financial Services Inc. is a subsidiary of UBS AG. Member FINRA/SIPC.
There are two sources of UBS research. Reports from the first source, UBS CIO Global Wealth Management, are designed for individual investors and are produced by UBS Global Wealth Management (which includes UBS Financial Services Inc. and UBS International Inc.). The second research source is UBS Group Research, whose primary business focus is institutional investors. The two sources operate independently and may therefore have different recommendations. The various research content provided does not take into account the unique investment objectives, financial situation or particular needs of any specific individual investor. If you have any questions, please consult your Financial Advisor. UBS Financial Services Inc. is a subsidiary of UBS AG and an affiliate of UBS International Inc.