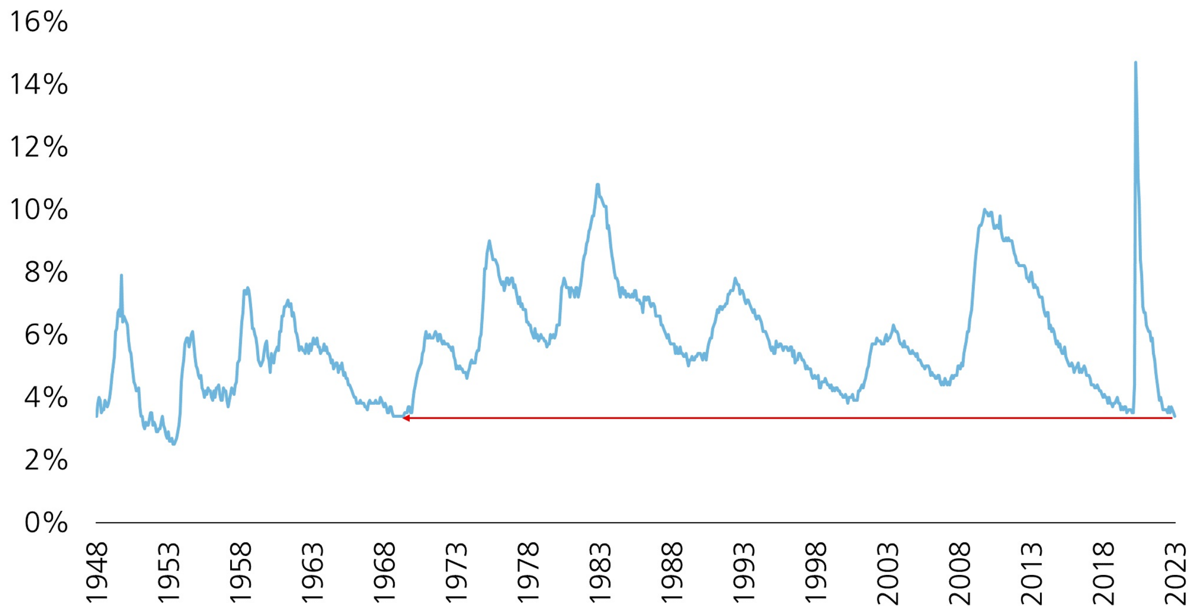

“U-3 US Unemployment Rate Total in Labor Force, Seasonally Adjusted. Source: Bloomberg, 8 February 2023.”

Chart of the week: Back to 1969

08 February 2023, 5:47 pm CET, written by UBS Editorial Team

Markets have repriced rate expectations after last week's strong jobs report. The environment remains one of high inflation, still-rising rates, and slow growth. We advise including defensive assets and being selective to position for upside as inflections in the economy materialize.

Those who can’t remember the last time the US unemployment rate was at the current level of 3.4% can be forgiven. You need to go back to May 1969, two months before Neil Armstrong landed on the moon, to find such a low level of unemployment.

And those who did not expect such a blockbuster jobs report in the US last week can be forgiven too. The US economy added 517,000 jobs in January, more than twice the number for December (223,000) and far more than the consensus expectation for just 189,000.

The payrolls release came after the Fed hiked by only 25bps for the first time since its first hike in March 2022, bringing the benchmark rate's upper bound to 4.75%. Clearly, this wasn't the data the Fed was hoping to see.

And Mr. Market understood. After the jobs report came out, markets repriced rate expectations by raising the implied rate for fed funds futures. On 6 February, the peak rate stood at 5.2% in July, close to the 5.1% interest-rate peak forecast by FOMC officials in December.

Speaking at a Washington event this week, Fed Chair Powell described the labor market as "extraordinarily strong,” saying that if the job situation remains very hot, “it may well be the case that we have to do more.”

A string of positive developments on inflation had fanned optimism that the Fed was winning the fight against inflation, but Powell highlighted that the persistent part of inflation that the Fed focuses on—which is driven by a tight labor market—has not shown signs of slowing, adding that there's a bigger risk in under-tightening than in over-tightening.

So for now, uncertainty remains on whether inflation will continue declining and how fast, as well as on the timing of a Fed pivot.

The near-term backdrop remains one of high inflation, rising rates, and slowing growth. At the same time, some positive developments, in particular declining inflation, China's reopening, and relatively resilient growth data, cannot be ignored.

A few months after Armstrong landed on the moon, the US entered a recession, and the unemployment rate started rising fast. Today, a US recession remains a risk. But if one materializes, we wouldn't expect a deep downturn given the underlying strength in the economy.

So we advise adding downside protection to portfolios by gaining exposure to defensive assets such as consumer staples and healthcare stocks. However, we also like strategies that offer exposure to equity market upside to anticipate inflections in the economy. We prefer cyclical assets that should perform well when the market starts anticipating those inflection points.

We hold a most preferred view on emerging market equities, which should benefit from China's reopening and a weaker dollar.

Commodities are also most preferred. The asset class is supported by secular drivers including the global shift toward net-zero carbon emissions, and it should benefit from a cyclical upswing in demand as economic growth improves.

We also like emerging market bonds, as we think spreads should tighten further with declining US inflation, China's reopening progressing, and increased support for China's property sector.

Main contributor: Linda Mazziotta

Also see: Jobs data calls dovish US pivot into question, 8 February 2023.

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