KKR

Flash Macro Update

U.S. Jobs Report | January 2024

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What You Need to Know

1 How are we thinking about the December U.S. jobs report?

The December nonfarm payrolls report showed what continues to be a distinctly robust trend in U.S. job and wage growth. Headline employment came in at +216k, above consensus of +175k, up from +173k in November (downwardly revised). Maybe even more important, average hourly earnings increased by +4.1% y/y, well above consensus of 3.9%, marking the first monthly increase in this metric in six months. Beneath the surface, other details in the report were less universally strong/hawkish in their implications, but were not enough to offset the strong signal from headline data, as well as other, "real-time", metrics of U.S. labor market health (e.g., initial unemployment claims remain subdued). See below for full details.

Bigger picture, we enter 2024 with a more optimistic view on growth versus the consensus (we see GDP at +1.5% this year, versus consensus of +1.3%). Key to our thinking is that the most cyclical areas of the economy have already bottomed, while fiscal policy remains a powerful offset to monetary tightening. We think too many people are locked into the paradigm that valuations are lofty, and the U.S. economy is topping out and headed for a hard landing. We do not see it this way.

Where are we focused? We see a constructive backdrop for markets in the year ahead but think this is still the time to maintain discipline on leverage, duration, margins, and creditworthiness. Against that backdrop, we like investments linked to operational improvement (including corporate carve-outs), our major investment themes (including Energy Transition, Security of Everything, and Productivity), and non-control positions with inherent downside protection (i.e., staying higher in the capital structure and owning some collateral).

WHAT DOES THE U.S. JOBS REPORT MEAN FOR OUR OUTLOOK, AND FOR MARKETS?

1. **The report goes against the disinflation thesis and is more in-line with our longer-term Regime Change thesis:** 1) the labor force participation rate fell back to 62.5% from 62.8%; 2) wage growth was 4.1% year-over-year compared to expectations of 3.9%; and 3) a lot of job growth is still coming from sectors that are stickier when it comes to inflation because they are not really interest rate sensitive.
2. **Concentrated market for job growth remains in force:** fully 77% of the job growth came from three sectors: government (52,000), education/healthcare (74,000), and leisure/hospitality (40,000). The good news is that these segments of the economy are still below pre-pandemic trend levels, so we do not expect this narrative to change as much as some of the dis-inflationist bulls.
3. **Meanwhile, the goods sector: It is hard to hurt yourself falling out of the basement window**. The ISM Manufacturing Index, which we use as a proxy for the short-cycle industrial economy, has been in contraction territory for 14 consecutive months – the longest stretch dating back to the post-Tech Bubble and 9/11 period. Jobs in this area have been weak too, with manufacturing jobs reaching just 6,000 this month (after shedding a net -12,000 jobs in October and November).
4. **Where are we struggling with the data**? Prior month revisions continue to get marked down. The reality is that ADP reports have been more right than the BLS in many instances. Second, the household survey is much weaker than the employment survey (fully minus 683,000 jobs this month!), so we need to make sure that small businesses and the gig economy are not tanking (which the data suggest, but that is not our view).
5. **What does this mean for markets?** First, the market is offsides to think that there are six rate cuts coming, so we like our position of three cuts in 2024. We also think that this adjustment by the market should put a near-term bid in the USD. Second, we stick to our duration call that 4.0% is an appropriate level for 10-year yields. For risk assets like Equities and Credit, we still need to work through more of an overbought condition relative to the year-end rally. That said, with central banks ending their tightening campaign and inflation coming down, we still see upward markets for risk assets in 2024. Longer-term, we continue to think the cycle continues, given 1) services has ongoing structural momentum and 2) the manufacturing economy is already in a recession. Bigger picture, our mega themes remain intact: automation, security of everything, experiences over things, collateral-based cash flows, and intra-Asia trade.

KEY TRENDS IN THE DATA

- Headline job growth reaccelerated in December, and the unemployment rate held steady at 3.7%. Overall, today's report aligns with our view that the labor market is not close to experiencing a 'hard landing', which means Fed policymakers will not be as worried about addressing their full employment mandate.
- Participation fell to 62.5% from 62.8% last month and remains about 90 basis points below pre-COVID levels. A combination of poor demographics and low participation is limiting the supply of workers in the U.S.
- Service-providing payroll (+142k, up from +106k in November) drove the bulk of private payroll gains this month, thanks to less-cyclical categories like Education/Healthcare (+74k) and, to a lesser extent, Leisure and Hospitality (+40k). On the public side, government also provided an outsize share of payroll gains (+52k). Meanwhile, Business Services employment stagnated (and is down -32k over the last three months).
- Goods producing payrolls added 22k jobs, with job gains across construction (+17k) and manufacturing (+6k). Overall, we think that the direction of travel for Goods sector employment may be starting to improve, as manufacturing PMIs have been negative for a very long time and mortgage rates have now peaked.
- By sector, employment across finance, tech, professional services, construction, manufacturing, transport/warehouse, education/healthcare,

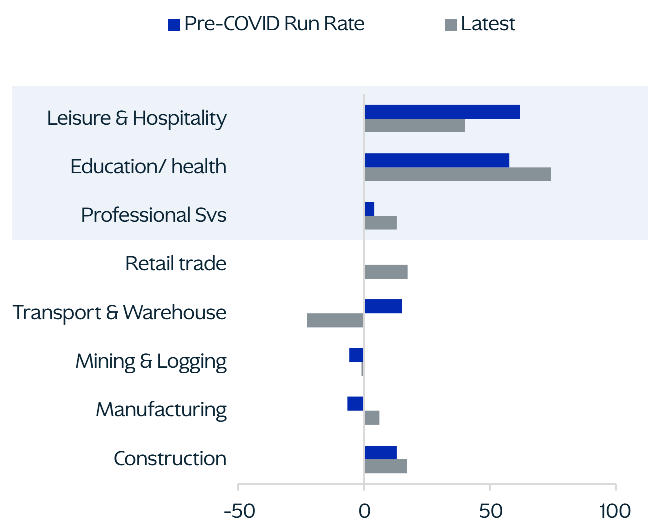
and retail and wholesale trade is back above pre-pandemic levels. By comparison, leisure and hospitality employment remains about 1% below its pre-COVID peak, although hiring in the sector has slowed following a period of extensive backfilling in the last two years.

- Month-over-month wage growth remained at +0.4%, with the year-over-year measure remained ticking up to +4.1% (about 20 basis points above consensus). Elevated wage growth will make the Fed more patient in its approach to rate cuts, we think, which is why we continue to see three Fed rate cuts this year versus market pricing for five or more cuts.

We continue to think that the U.S. economy will avoid a hard landing this year, as non-cyclical sectors like government and education/healthcare are providing a ballast to overall labor demand at a time when more cyclical Goods sectors are starting to bottom. Against that backdrop, we think unemployment will remain fairly low this cycle, and expect the Fed to cut rates only gradually.

Exhibit 1: The Pace of Job Gains Has Moderated, But Non-Cyclical Sectors Like Education and Healthcare Are Driving Job Growth

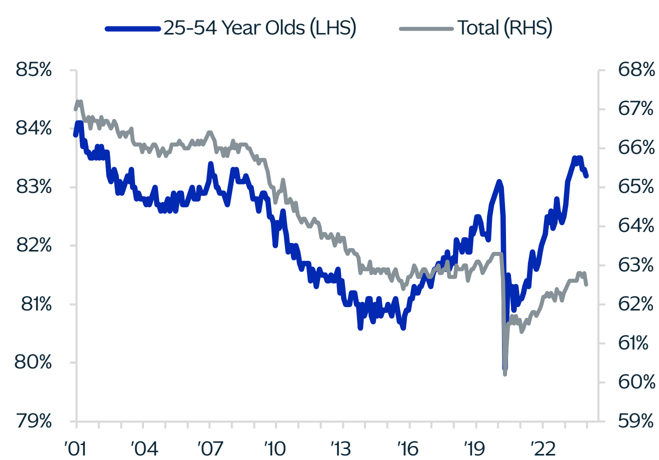
Payroll Growth: Major Services & Goods Sectors, Change '000



Data as at December 31, 2023. Source: U.S. Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

Exhibit 2: Prime-Age Labor Force Participation Ticked Down 10 Basis Points to 82.2%, While Overall Labor Force Participation Fell 30 Basis Points to 62.5%

Labor Force Participation Rate, %



Data as at December 31, 2023. Source: U.S. Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

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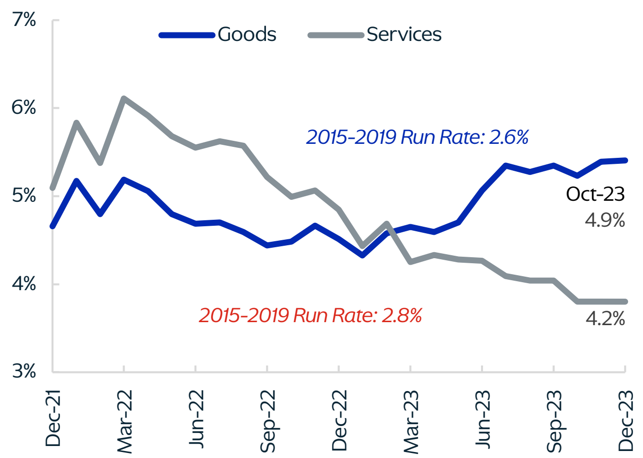
Exhibit 3: Wage Growth Remains Elevated, Despite Slower Price Growth

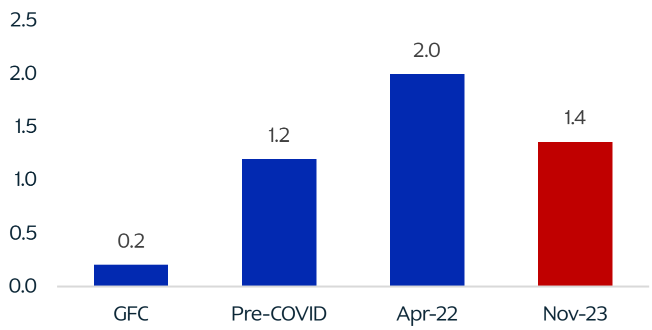
Y/Y AHE Growth, %



Data as at December 31, 2023. Source: U.S. Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

Exhibit 4: The Overall Labor Market Backdrop Is Less Inflationary Than It Was in 2022

Open Jobs per Unemployed Worker



Data as at November 30, 2023. Source: U.S. Bureau of Labor Statistics, KKR Global Macro & Asset Allocation analysis.

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