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Job Gains Good For Sales

Nonfarm payroll increased by 214,000 in October. This marks the ninth consecutive month that gains were more than 200,000 and a record 49 consecutive months without a decline. The payroll report, weekly initial jobless claims, and ISM employment indexes released last week all indicate ongoing job gains, which should sustain US economic and earnings growth. We think one of the best measures of total household income is aggregate payrolls (average hourly earnings multiplied by total private sector hours worked). This drives retail sales and consumer spending, which makes up the bulk of US GDP. Based on October's aggregate payrolls, household income rose 4.8% year over year, the highest growth rate in two years. With national average gasoline prices below $3 per gallon, the lowest since 2010, consumer purchasing power is even higher.

Household incomes rose 4.8% year over year, accelerating to the highest growth rate in two years.

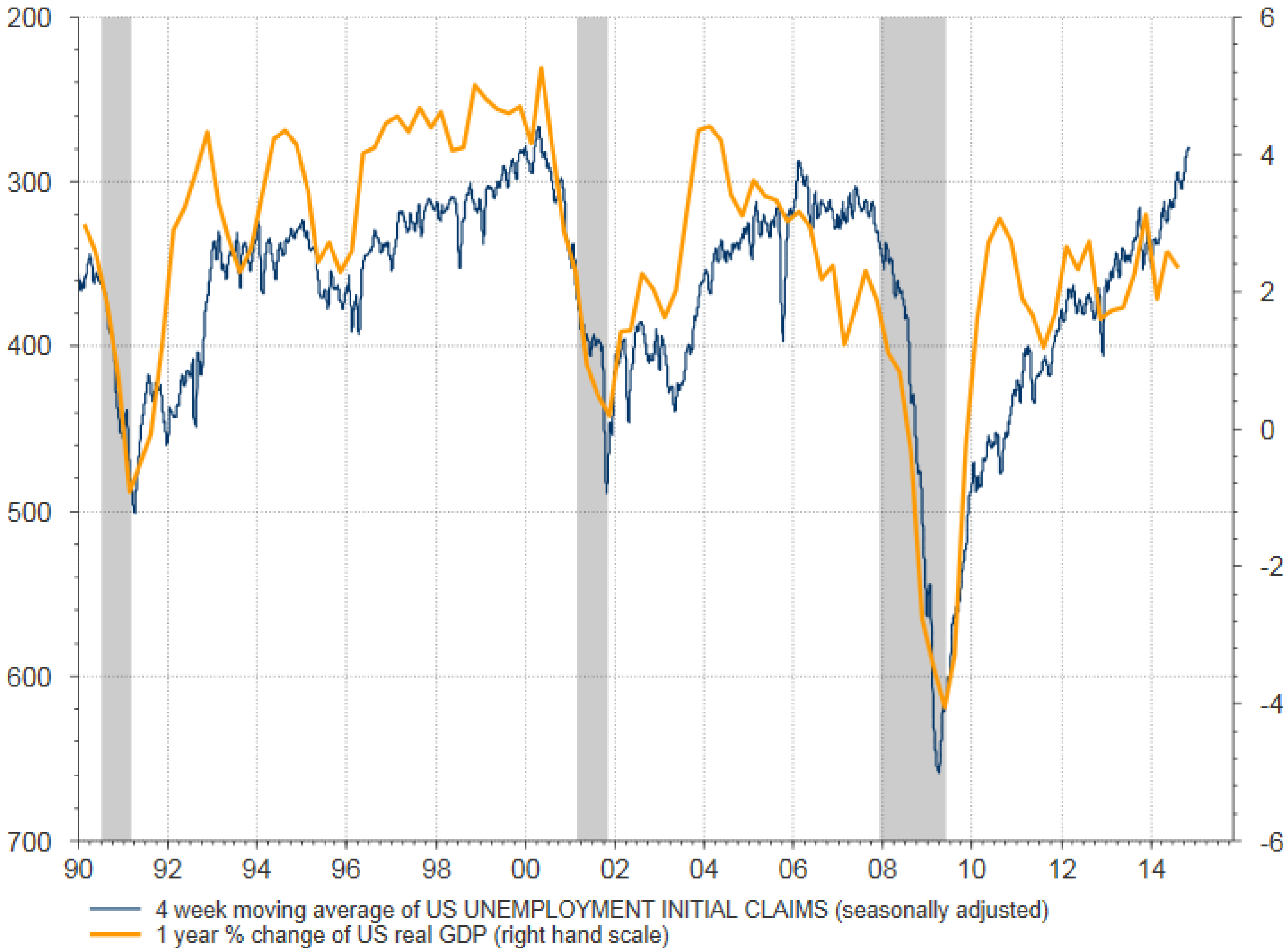
Weekly initial unemployment insurance claims are the lowest since 2000, currently averaging below 300,000 (see Weekly Chart). Claims provide a good indication of economic growth and currently suggest real GDP is accelerating to above 3% year over year in the fourth quarter from 2.3% in the third quarter. Meanwhile, the ISM employment indexes for both services and manufacturing increased in October, implying ongoing improvement in labor market conditions.

In this environment — with sales improving, profit margins still high and inflation low — we think investors should stay overweight equities.

We do not believe lower unemployment and faster wage growth will prompt the Federal Reserve to prematurely tighten monetary policy. October's 5.8% unemployment rate remains above the Fed's 5.3% long-run expected average. Average hourly earnings and total employment compensation both rose just 2% from a year ago and have been trending around that rate for the last five years. Moreover, labor costs, adjusted for productivity gains, remain low and are arguably still disinflationary. Indeed, inflation expectations implied by the bond market are below 2%. We think the Fed will eventually raise interest rates, but they are clearly data dependent and in no hurry. In this environment — with sales improving, profit margins still high, and inflation low — we think investors should stay overweight equities. Third-quarter corporate earnings grew approximately 7.6% year over year, with sales growth around 4% (based on the 90% of the S&P 500 companies reporting results so far). We expect earnings growth of about 7% next year, and we think US stocks should rise at about the same rate.

Last week's elections produced a wave of Republican victories, with the US senate reverting to GOP control. Although not enough to enact a full-scale conservative agenda with secure veto/filibuster-proof votes, we think the results increase the likelihood of more business-friendly legislation being sent to the president on immigration, trade, energy, and taxes. The Republican domination of state legislatures and gubernatorial wins are potentially more consequential. Democratic control of state governments has been reduced to 7 from 14, the lowest since the 1860s. We expect GOP-controlled state legislatures to enact pro-growth policies, which would likely be received favorably by financial markets, in our view.

THE WEEKLY CHART: JOBLESS CLAIMS POINT TO HIGHER GROWTH



Source: Thomson Reuters Datastream; Past performance is no guarantee of future results.

Weekly initial jobless claims for unemployment insurance generally correlate fairly well with real GDP. Because GDP is reported quarterly and nearly one month after the quarter's end, we look to more frequently reported indicators as a helpful way to gauge overall economic activity. Although jobless claims can be volatile week to week, the four-week average has been below 300,000 (thin blue line, inverted left scale), suggesting that real GDP growth (thick yellow line, right scale) in the fourth quarter could accelerate above 3%.

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