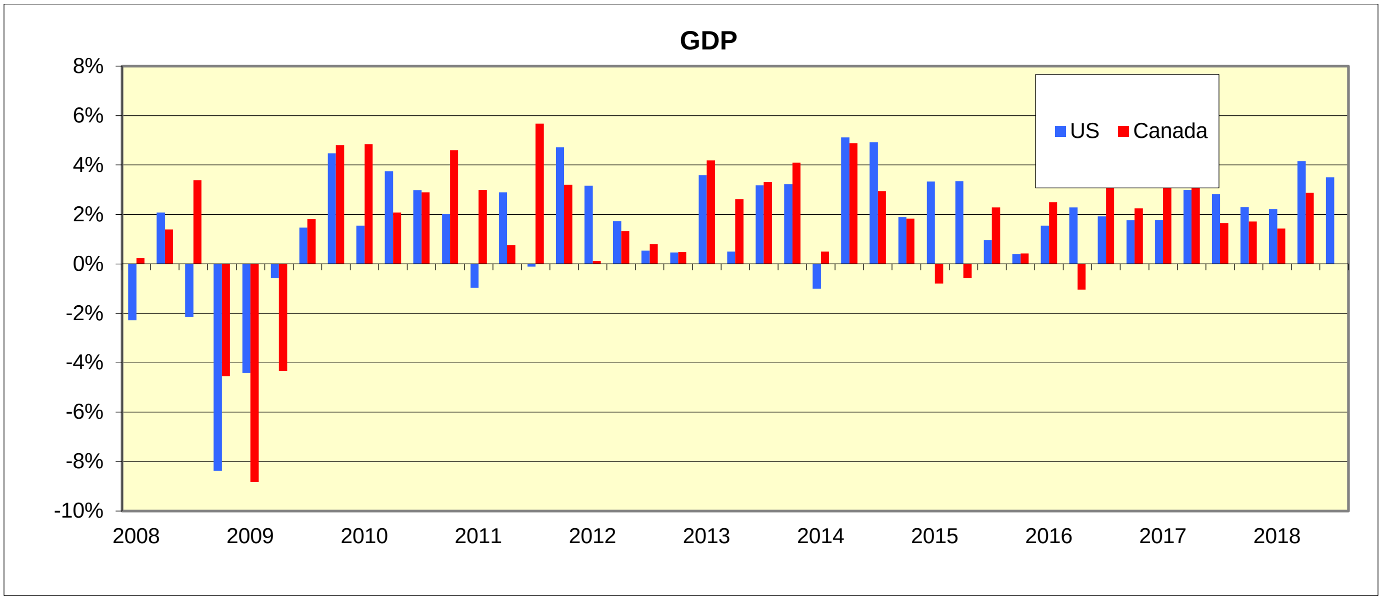
December 2018

# Late-cycle job market disparity

*By Richard J. Wylie, CFA*
*Vice-President, Investment Strategy*

Despite recent equity market volatility, headlines about new all-time highs in U.S. markets were seen over most of 2018. These headlines refocused attention on the disparity between equity market performance in the U.S. and Canada. Since the U.S. and Canadian markets bottomed simultaneously on March 9, 2009 at the height of the financial crisis, U.S. stocks climbed a cumulative 333% through September 2018. Canadian stocks, represented by the S&P/TSX Composite Index, accumulated a far more modest 114% over the same period. In fact, since the S&P/TSX Composite Index recorded its most recent high in mid-July, the index experienced another correction, falling a cumulative 11.1% to October 29, 2018[1]. Not surprisingly, some of the disparity between the two equity markets is reflected by differences in the respective economies generally and labour markets specifically. Interestingly, this current situation represents a material turnaround since the early days of the recovery from the Great Recession in 2008-09. The uncertainty surrounding the stability of the economy and the investing environment during the late business cycle can be unnerving. Working with a financial advisor to establish a long-term financial plan can alleviate some of the concerns that accompany these periods.

## Economic growth



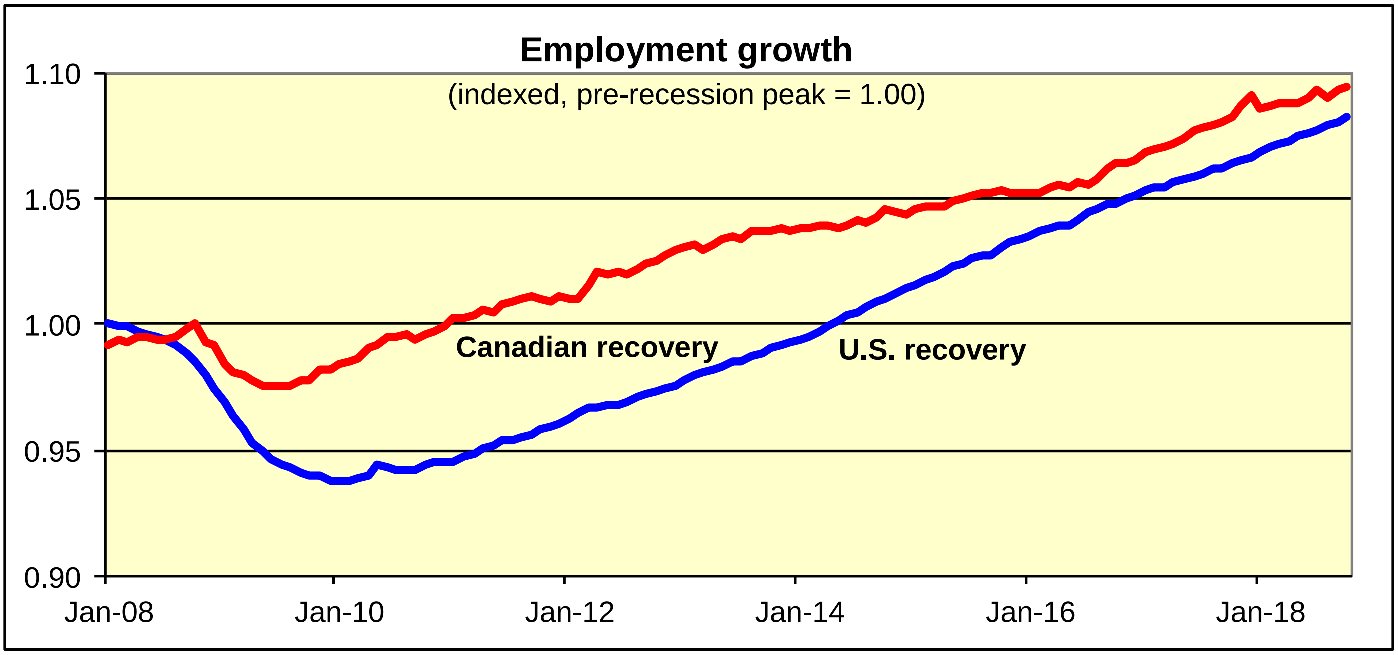

Source: U.S. Bureau of Labor Statistics; Statistics Canada

[1] The S&P/TSX Composite Index, the main Canadian equity index has experienced two corrections and two bear markets since the beginning of the broader recovery in 2009.

During the global financial crisis and its immediate aftermath, Canada's conservative financial system became the "model" for the rest of the world. Less aggressive lending practices helped limit the spread of contagion that was embodied by repackaged sub-prime mortgages. As can be seen in the preceding chart, during the recession and early recovery between 2008 and 2010, Canada recorded modest net economic growth, with GDP expanding an average 0.4% annually. Over the same period, broader economic growth in the U.S. was flat. However, since 2014 average growth in U.S. GDP has been 2.4% while in Canada the figure has been a less robust 2.0%.

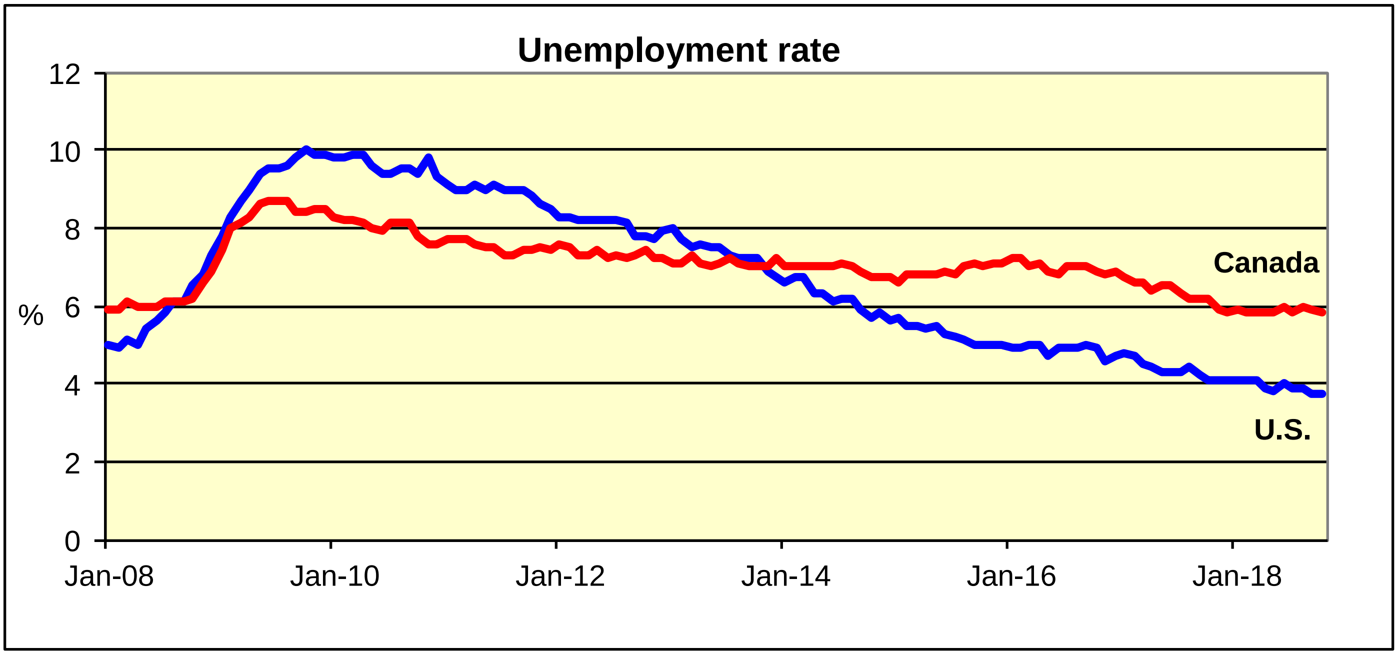
## Employment

Against this broader economic background, greater *relative* economic stability during the recession allowed the job market in Canada to recover faster in the early post-recession period. By July 2009, 426,500 jobs (2.5%) had been lost to the recession. However, a new peak in employment was achieved in January 2011, a scant 18 months later. As can be seen in the next chart, this contrasts dramatically with the U.S. experience over the same period. In the U.S., non-farm payrolls were cut by 8,693,000 (6.3%) from their peak in January 2008 to the trough in January 2010. This was the greatest cumulative job loss on record (dating back to 1939, but not including The Great Depression). The U.S. recovery took considerably longer than in Canada, with non-farm payrolls finally establishing a new high in May 2014, a full 51 months later.



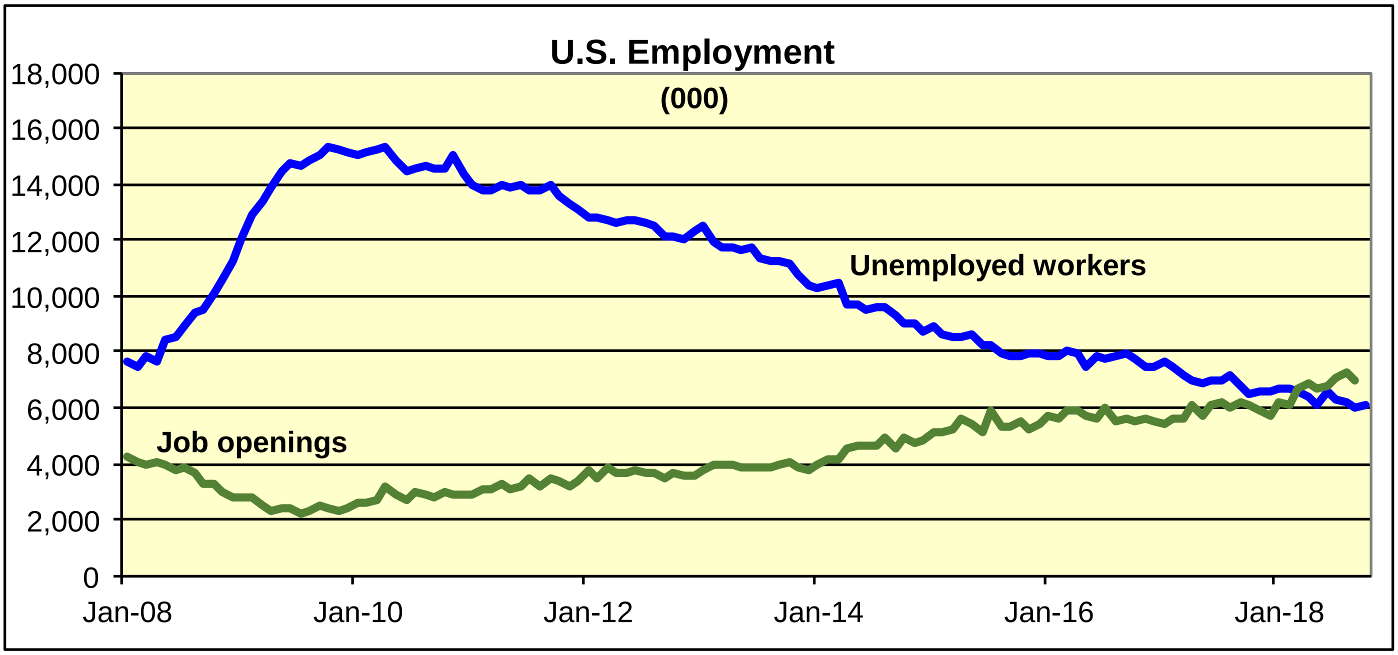

Source: US Bureau of Labor Statistics; Statistics Canada

Now, as the late stages of the current business cycle appear to be approaching, the U.S. job market has expanded well beyond Canada's. Consistent with this timing, U.S. employers are now facing a tightening labour market. As can be seen in the next chart, the U.S. unemployment rate now stands at 3.7%. The last time it was lower was January 1970.



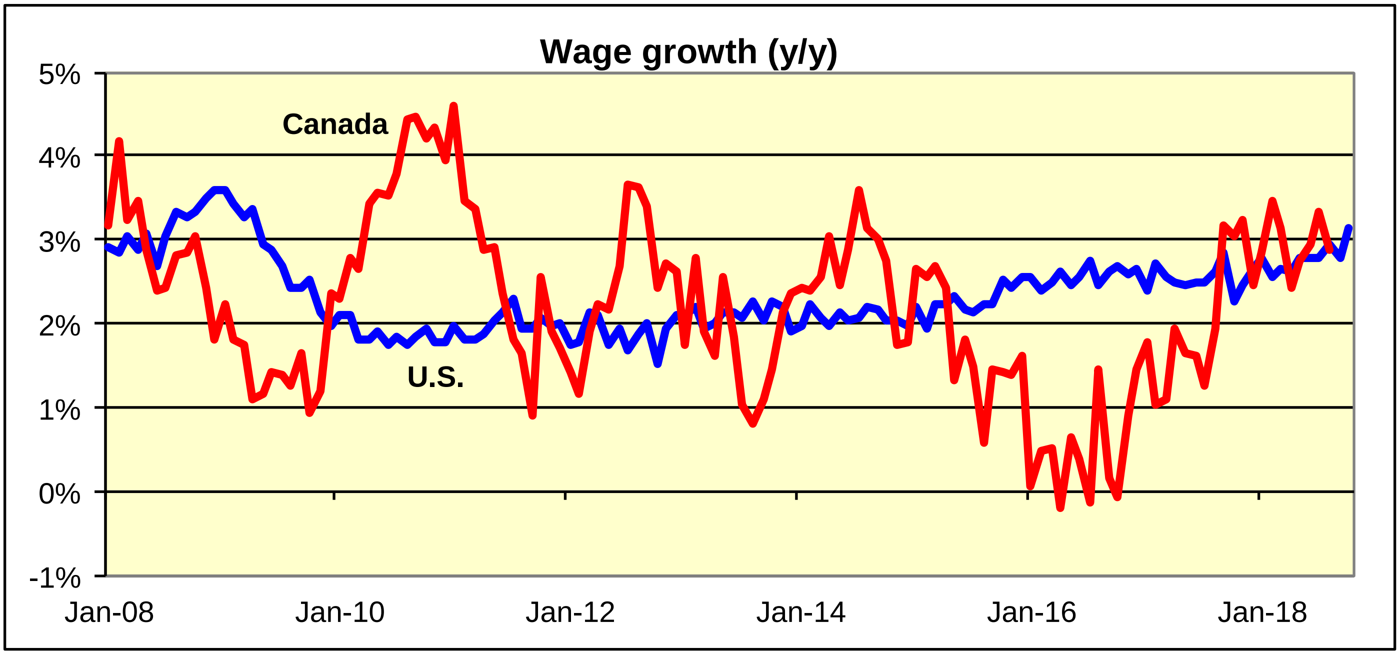

Source: US Bureau of Labor Statistics; Statistics Canada

U.S. initial jobless claims data are now also the strongest since 1969. As of October, non-farm payrolls had 97 consecutive monthly gains, the longest stretch since the data was first collected in 1939. In addition, the number of job openings hit a new series high of 7.3 million in August. This data series only goes back to December 2000. However, as can be seen from the chart below, March 2018 marked the first time that the number of job openings were greater than the actual number of unemployed Americans, a significant development.




Source: US Bureau of Labor Statistics

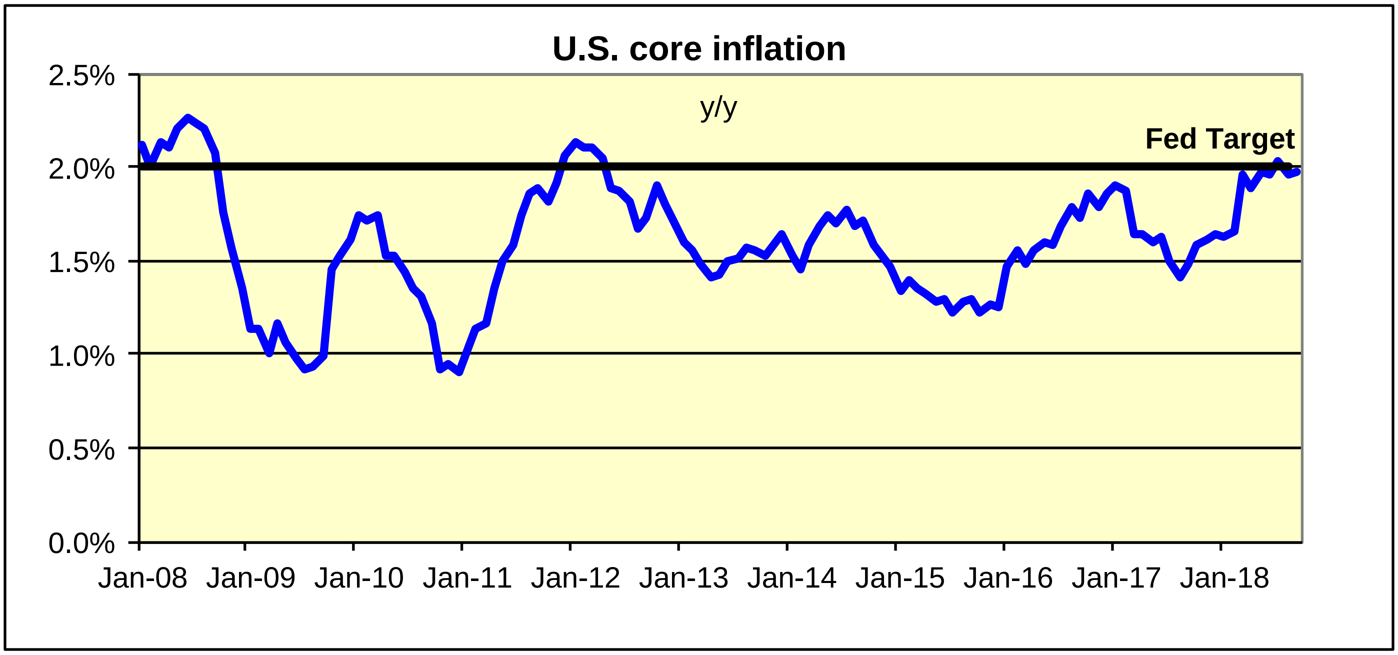
Canada's labour market has not been particularly weak, but it has not seen the same level of consistent growth as the U.S. Through October, there have been six monthly gains in employment and four months of declines during 2018. The unemployment rate was 5.8% in the latest report (also October), matching the cyclical low. This also happens to be the lowest rate recorded since consistent data was made available in 1976. Not surprisingly, the more consistent growth in U.S. employment is being reflected in wage growth, as average hourly earnings stood at a 3.1% (annual) growth rate in October. Canada's wage growth has been more volatile, as can be seen below. Annual growth in Statistics Canada's broadest wage measure, average weekly earnings, has ranged from 4.6% in January 2011 to -0.2% in April 2016.



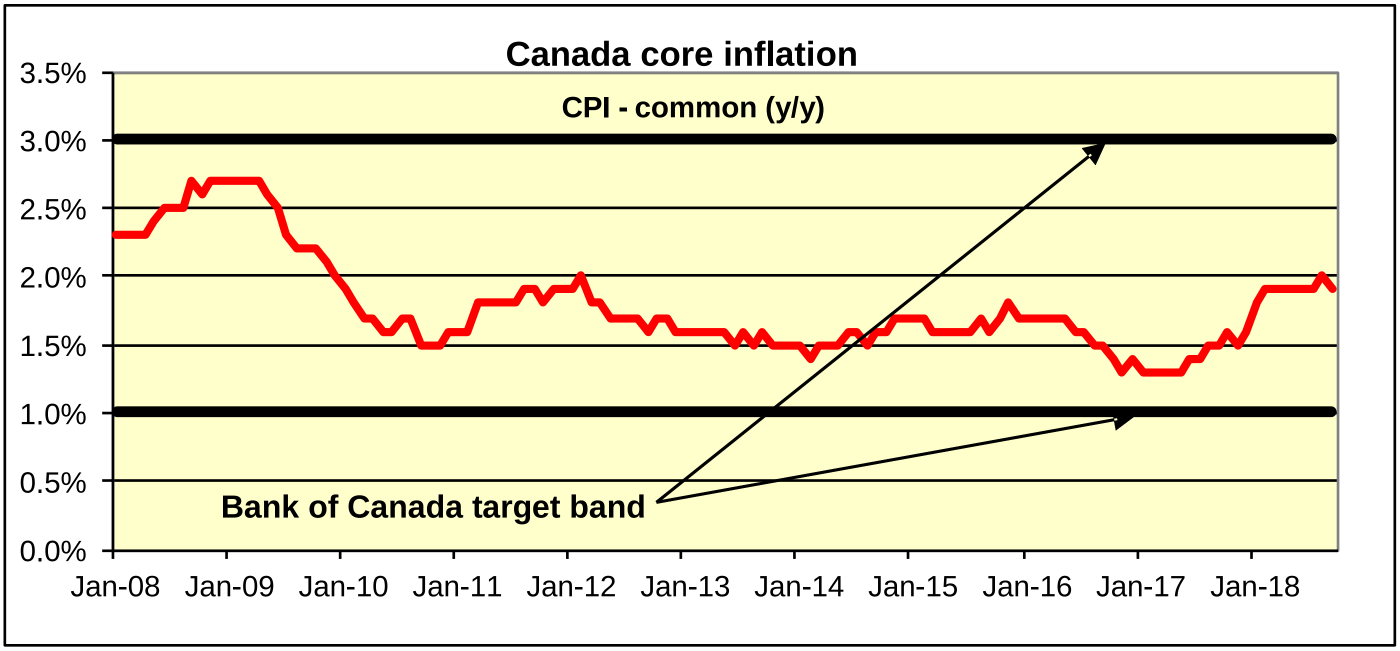

Source: US Bureau of Labor Statistics; Statistics Canada

## Inflation

In either case, the U.S. is facing actual capacity constraints with respect to its job market, and given Canada's lower productivity, we may not be too far away. Traditionally, investor concerns surrounding tight labour markets are focused on the potential for wage-driven inflation. As can be seen in the next two charts, both the U.S. Federal Reserve and the Bank of Canada find themselves close to their specific targets, using their respective inflation measures of choice. For the Fed, this measure is the price index for personal consumption expenditures less the volatile food and energy components. For the Bank of Canada, the preferred inflation measure is CPI-common, which also removes volatile components and uses specific statistical modelling techniques to further reduce overall volatility.



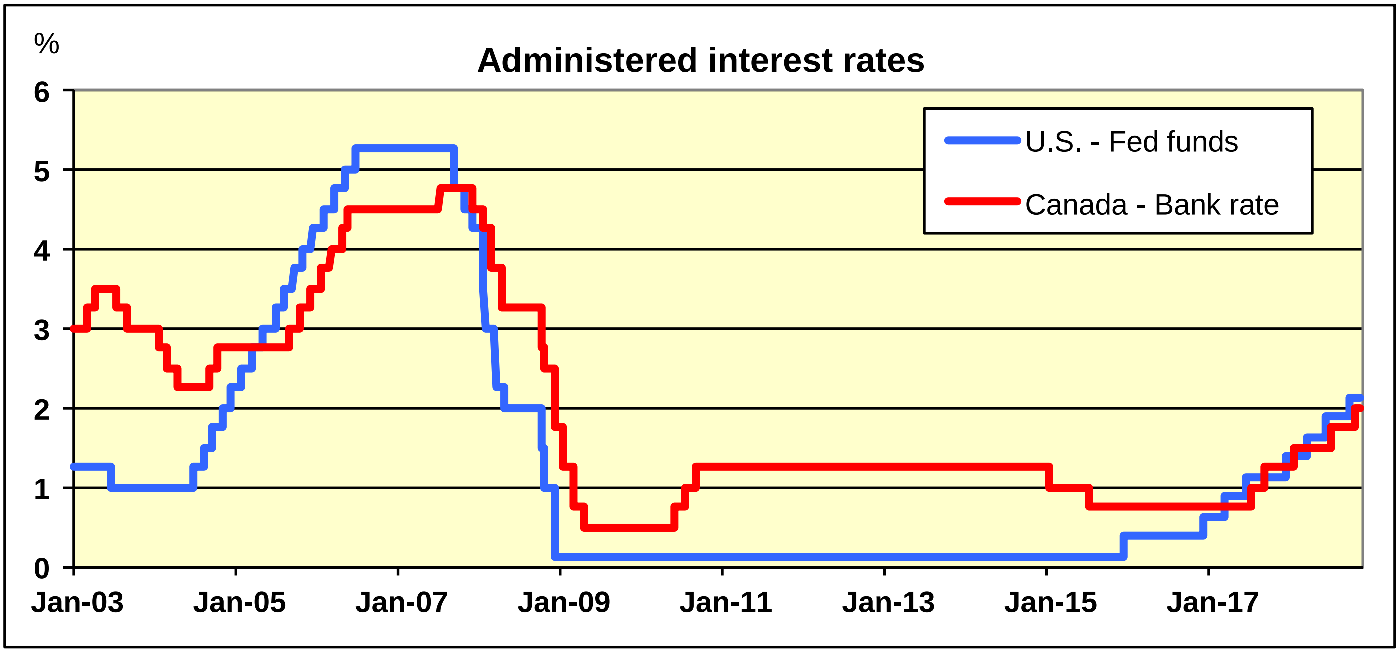

Source: U.S. Federal Reserve; US Bureau of Economic Analysis




Source: Bank of Canada; Statistics Canada

## Interest rates

Regardless of the prevailing inflation rates, both the Bank of Canada and the Fed are clearly in the midst of a tightening cycle for monetary policy. It appears that they, too, are anticipating higher rather than lower inflation. As can be seen below, the Fed has raised the range on Fed funds by 25 basis points (a basis point is 1/100th of one per cent) eight times since December 16, 2015. The mid-point of the target band is now the highest seen since April 30, 2008. On the domestic front, the Bank of Canada has increased its bank rate five times since July 12, 2017 and the prevailing 2.00% rate is the highest since December 9, 2008. In reality, material tightening of monetary policy by the North American central banks has not been seen since the 2004-2007 period.




Source: U.S. Federal Reserve; Bank of Canada

## Conclusions

- Now that the economies appear to be in the late stages of growth, the economic advantage that Canada experienced during the last recession and the early part of the recovery has shifted in favour of the U.S. This is particularly true in the U.S. labour market where material capacity constraints are appearing.
- Both the Bank of Canada and the U.S. Federal Reserve are in the midst of a tightening cycle for their respective monetary policies. Investors may have difficulty recalling the last broader tightening cycle that occurred between 2004 and 2007 and could be experiencing some unease as a result.
- For investors, expectations of steadily rising interest rates during the late stages of a business cycle can be cause for concern as bond prices come under pressure and future corporate profitability comes into question. Taking advantage of professional advice during periods of uncertainty can ensure that emotion does not prompt any departures from their financial plans.

The information contained herein consists of general economic information and/or information as to the historical performance of securities, is provided solely for informational and educational purposes and is not to be construed as advice in respect of securities or as to the investing in or the buying or selling of securities, whether expressed or implied. Stonegate Private Counsel is a division of CI Private Counsel LP which is an indirect wholly-owned subsidiary of CI Financial Corp. ("CI"). Stonegate Private Counsel is a registered trademark of CI Investments Inc. Neither CI Investments Inc. nor its affiliates or their respective officers, directors, employees or advisors are responsible in any way for damages or losses of any kind whatsoever in respect of the use of this report. This report may not be reproduced, in whole or in part, in any manner whatsoever, without prior written permission of CI Private Counsel LP. Copyright © 2018 All rights reserved.