Take this job and love it: Mobility and skills define a changing labor market

By Michael A. Tyler, CFA
Chief Investment Officer,
Eastern Bank Wealth Management

When economists and politicians talk about the labor market, they seem to be describing two completely different worlds. The economists tell us that the labor market is operating at full employment, and they have the numbers to back up that assertion: The unemployment rate is at a two-decade low; incomes are rising faster than inflation; and the labor force participation rate is rising for the first time since the mid-1990s.

The economists are correct. The chart nearby shows the number of unemployed people in comparison to the number of job openings in this country over the past decade. At the bottom of the recession, 16 million unemployed Americans were chasing only 2 million job openings, a nearly 8:1 ratio of workers to jobs. Today, that ratio is just about 1:1, with 6 million unemployed workers and the same number of job openings. Total per-capita compensation (as measured by tax filings) has been rising at about 5% per year.

On the other hand, the politicians tell us that the labor market is troubled, and they have the stories to back up their assertion: Factories have closed as companies sent jobs and entire industries offshore. Laid-off workers can't find new jobs. Wages have been stagnant for decades.

The politicians are correct, too. Blue-collar jobs continue to disappear; only 5% of Americans are employed in manufacturing jobs today. On average, an unemployed person today needs about 10 weeks to find a new job, longer than it took at the bottom of some prior recessions. Average hourly wages are growing at only 2.5%, barely ahead of inflation.

How can it be that two diametrically opposed narratives can both be true? Is our country's labor force doing well or doing poorly? The answer is both, for two main reasons.

The first is that America's labor force has changed in ways that make it more difficult to match people to jobs. In bygone days, millions of single-earner families from the rural South moved to the industrial North, following the plentiful factory jobs that had opened up. Housing was available and inexpensive, so it was comparatively easy to decide to migrate across the country.

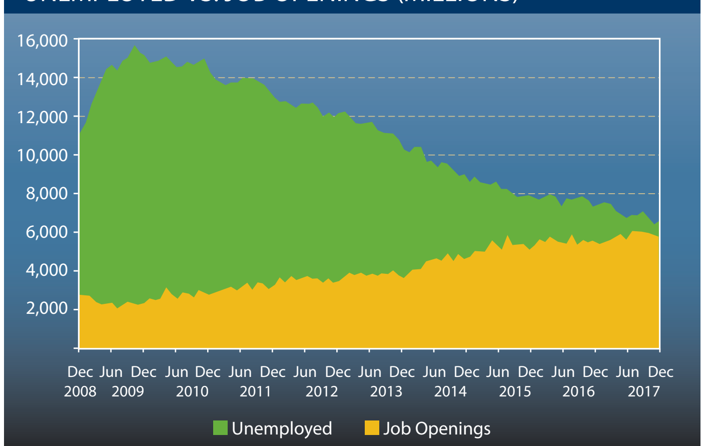
Today, when one worker in a two-income family is laid off, the spouse likely still has a job and may not be willing to risk giving up the family's remaining income to move elsewhere — especially because that family would likely be moving from a low-cost area to a more expensive urban center. It's a much harder option, and so we are today a much less mobile society.

The second problem is what economists have called a skills gap. We have millions of high-skill jobs begging for workers, and millions of low-skill workers looking for jobs; but the low-skill workers can't fill the high-skill jobs. Unemployment rates in areas with many high-skill industries are well below the national average, while the rates in rural and blue-collar areas are much higher.

The gap in incomes is particularly noteworthy. The 2.5% hourly wage gains include only wages and salaries, while the tax data (showing 5% annual growth) also includes bonuses and other forms of compensation. The price of labor is rising much more quickly where there are labor shortages — in the high-skill jobs that frequently use bonuses, commissions, stock options, and other financial lures. Workers with high skills are getting paid more, while workers with low skills are barely keeping up.

This two-tiered labor market poses an important political challenge: What can our state and federal governments do to help educate and train low-skill workers so that they can participate in the high-skill economy? As the midterm election campaigns begin to gear up, it's a question we should be asking the candidates.

UNEMPLOYED VS. JOB OPENINGS (MILLIONS)



There are almost as many job openings as there are unemployed workers, but the workers don't have the skills to fill the jobs.

>> FOCUS ON EQUITIES

Will equity markets continue their bull run?

By Rose Grant-Brooks
Equity Strategist,
Eastern Bank Wealth Management

It's often said that the most dangerous four words in the investment world are "it's different this time." And yet American large-cap stocks really did do something last year that they had never done before: For the first time in the history of the index, dating back 90 years, the S&P 500 posted positive returns for all 12 months of the calendar year. It really was different this time. What was almost as unusual was the market's relentless steadiness: In gaining nearly 22% through the year, it never dipped even as much as 3%. Volatility across most major asset classes was the lowest in a decade, as virtually everything increased steadily in value. The current bull market is now the second longest in modern history; it reached 105 months through year-end 2017. Can it continue?

Two factors underlay the outstanding 2017 equity market performance: synchronous global economic growth and rising corporate earnings. Both trends remain in place in early 2018, supported by a robust global economy. Consumer confidence and spending are favorable, labor markets remain steady, investment spending has picked up, and tax cuts for corporations will benefit earnings.

Outside the U.S., economic growth globally is also expected to build on its 2017 momentum. The OECD (Organization for Economic Cooperation & Development), a group of the most advanced market economies, reported that all 35 country members experienced economic growth for 2017, an unusual occurrence; in fact, it's the first time that this has happened since the formation of the group. Global earnings trends have improved, valuations are cheaper abroad, and dividend yields are slightly better outside the U.S.

Trepidation regarding the potential return of volatility and market corrections is understandable. Geopolitical threats and terrorism are ever-present but equity markets have learned to live with them. In the U.S., the Federal Reserve is expected to continue increasing the federal funds rate as economic growth continues to improve; will the central bank go too far? Will newly installed Fed chair Jerome Powell surprise investors with overly hawkish policy or tighter regulations? If any of these events cause an equity market correction, we would likely consider it a buying opportunity within the ongoing long-term bull advance.

>> PERSPECTIVES ON THE ECONOMY

All eyes are on the yield curve

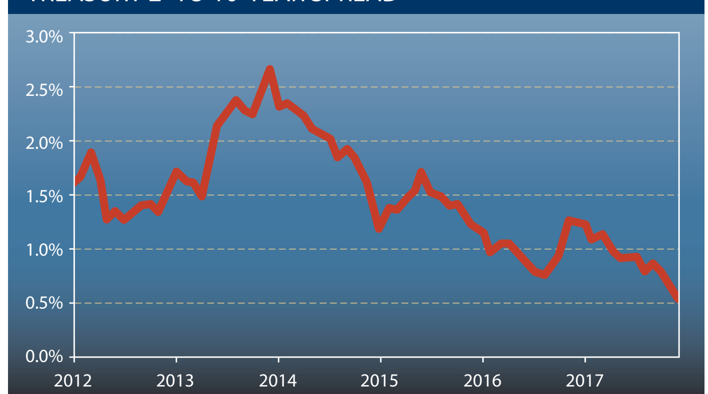
By Tom Bussone
Fixed Income Strategist,
Eastern Bank Wealth Management

For several years now, investors have obsessed about the Federal Reserve's path of raising the federal funds rate; this short-term interest rate still stands well below historical norms even after three hikes last year. In recent months, however, attention has been turning instead to the U.S. Treasury yield curve, which shows the relationship among interest rates of varying maturity dates.

Typically, longer maturities have higher interest rates, but the difference (or spread) has been shrinking for three years. The spread between the 2-year and 10-year Treasury notes has plunged from 231 basis points at year-end 2014 to 52 basis points at year-end 2017, and is now the narrowest since 2007; this spread may even invert, if the 2-year yield rises above the 10-year yield; an inverted yield curve has preceded the past seven recessions, most recently in 2000 and 2006. When the yield curve is flat or inverted, investors are committing money for longer periods but getting less return, as they fear slower economic growth. It is a "risk-off" trade.

We think longer-term interest rates will remain low. Inflation is quiet, central banks are still buying long-term bonds, and investors are beginning to worry about a potential slowdown in 2019. So if the Fed raises the federal funds rate three more times this year and long-term yields are steady, the yield curve would likely invert. If so, investors need to be cautious; in such circumstances, it has historically been wise to trim equity exposure and buy long-dated Treasury maturities.

TREASURY 2- TO 10-YEAR SPREAD



The difference in interest rates between the 2-year and 10-year Treasury notes has shrunk sharply in the past three years.