GLOBAL FINANCIAL
Private Capital
COMPREHENSIVE WEALTH MANAGEMENT

Is It Time to Leave Your Job?

SYNOPSIS

- The job market is governed by the laws of supply and demand in the same manner as equities, bonds, and every other market where assets are bought and sold.
- Liquidity and price discovery are critical to the health of the job market and act as a precursor to wage growth.
- Recent economic data point to rising liquidity in the job market, which could help to wind down the Fed's war on seniors and savers.

ECON 101: SUPPLY VS. DEMAND

A government report on Tuesday showed that Americans are becoming more willing to quit their current jobs for new opportunities. The implications of such a trend could be highly beneficial to our economy, but before we discuss why, let's first explain how the labor market operates.

The job market is governed by the laws of supply and demand in the same manner as equity, fixed income, currency, and commodity markets. If a particular skill set is in high demand but faces a shortage of available talent, such as computer programming in Silicon Valley, salaries for these skills will rise quite high.

On the flip side, if a large talent pool exists for skills that are less in demand, such as oil rig workers during a cyclical downturn in energy prices, then the salaries and opportunities for these workers will fall. The constant battle between supply and demand creates an environment where there are times when employers have the upper hand and times when employees can exert leverage on their bosses. For example, the computer programmer will probably have far greater success demanding a raise today when compared to the worker on an oil rig.

Simply put, supply and demand not only create prices for skills in the various sectors within our economy, but these forces also swing the pendulum of power between employee and employer as we progress through an economic cycle.

MARKET LIQUIDITY

The ability to sell a stock immediately is one of the most attractive components to U.S. equity markets. At any given point during market hours, an investor can sell a large quantity of stock with the expectation that the order will execute within seconds.

This feature is referred to as "liquidity", and U.S. equity markets are some of the most liquid financial markets in the world. Investing in highly liquid markets allows investors to sell quickly if a crisis emerges and also lowers transaction costs because of the large number of buyers and sellers at any given time.

For example, DIAS portfolios invest in only the most liquid stocks as a precautionary measure. If these portfolios held stocks that were less liquid, we could run the risk of outsized losses if we needed to exit a position quickly.

A popular example of an "illiquid" market is the housing market. Unlike equities listed on U.S. stock exchanges, homes can take several months or even years to sell when conditions are harsh (think about the difficulty selling a home during the financial crisis in 2008).

The reason why some markets are more liquid than others goes back to the laws of supply and demand. When more active buyers and sellers exist in a market, liquidity rises, and when buyers and sellers leave a market, it dries up.

Generally speaking, the more liquidity in a market, the better it operates because of a concept called "price discovery," which simply states that the more buyers and sellers in a market, the better that market prices an asset.

Going back to the housing example, if an apartment for sale in New York City receives 20 offers, more support exists for the price because there are so many willing buyers. Furthermore, the several thousand transactions that occur each year in NYC for comparable apartments better informs the prospective buyers as to the true market price for the unit.

Conversely, if a house for sale in Anchorage receives only one offer after being on the market for a year, and only a handful of comparable properties recently sold in the area, there's little price support and may not reflect the true value of the house (perhaps the seller has to accept any offer on the table because he took a new job in Florida).

Liquidity and price discovery are critical to properly functioning markets, and the job market is no different. When the economy is hot, switching jobs is much easier than during a recession because there are so many more willing buyers (employers) in the market when economic prospects are strong.

Furthermore, the only two ways to really know the price of your skills is to (1) actively look for a new job in order to get "bids" from prospective employers, or (2) judge your skills against comparable "transactions." More liquidity in the job market makes it easier to accomplish these tasks.

JOB MARKET LIQUIDITY RISING

In job markets that are illiquid due to an economic recession, the process of price discovery becomes challenging because firms are not hiring. Here, employers have the upper hand and keep wage growth under control. We've seen this very situation unfold since the financial crisis in several sectors of the economy.

However, reports such as the one this week indicate that liquidity is returning to the broader job market as more people switch jobs. Said another way, the power is slowly shifting back to employees, which is a precursor for what we need more than anything in our economy at the moment, and that is wage growth.

***NOTE**: As the pendulum shifts back to employees, profit margins will likely come under pressure for employers. In most industries, employee compensation is one of the biggest expenses for a company. As investors, the trick here is to invest in companies who have pricing power on the goods and services they sell because these are the ones who will have more success passing along these costs to their customers in order to maintain profitability.*

There are two critical reasons why wage growth is so important for the U.S. economy right now:

1. **Consumer Confidence**: The more liquid the job market, the easier it is for someone to find a better and/or higher paying job. Less fear surrounding a job translates to higher consumer confidence and discretionary spending, which is extremely important given that consumer spending represents 70% of the U.S. economy.
2. **Inflation**: As consumers demand more goods and services because they can spend more money, prices will rise and boost inflation modestly. The Fed anxiously wants to see higher inflation so they can bring interest rates off the current zero level and end this war on seniors and savers.

The bottom line is that any reliable indication of liquidity returning to the job market will most likely result in wage growth down the line, which is needed right now to continue the slow and steady economic expansion in the U.S.

The data released this week are very encouraging and further support my view that although short-term volatility from rising interest rates may continue to spook markets from time to time, we remain in the early innings of a secular bull market that could span many years to come.

Sincerely,

Mike Sorrentino, CFA
Chief Strategist,
Aviance Capital Management