EPIC INVESTMENT MANAGEMENT

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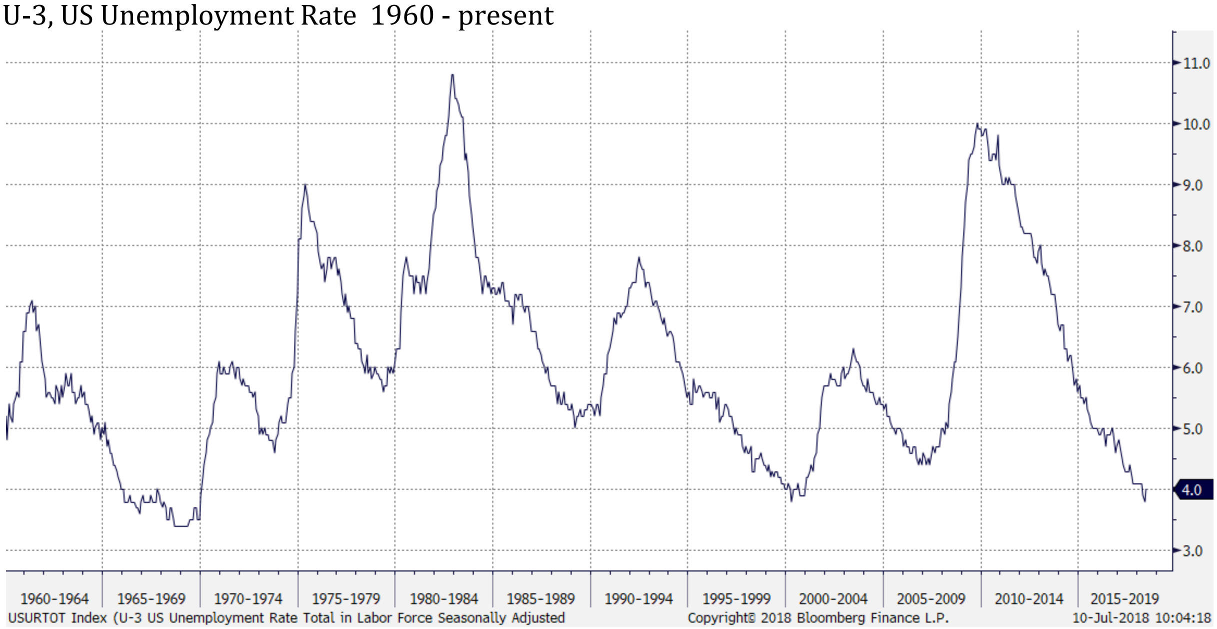
The Jobs Machine

Even an economic expansion still going strong after nine years leaves something to be desired. For instance, overall growth of Gross Domestic Product has been among the most tepid in modern history; the wage gap and wealth gap continue to widen; our twin deficits -- budget and trade -- seem to be permanent; and the middle class is justified in feeling left behind by the latest wave of prosperity.

One thing we cannot say is that this expansion is short on job creation. The unemployment rate in the US recently dropped to 3.8 percent before its slight rise to four percent. As shown below, this ranks near the lowest levels of unemployment in six decades.

U-3, US Unemployment Rate 1960 - present



One common complaint is that this rate is flattered by Americans leaving the labor force in the long aftershock of the Great Recession, often for early retirement. As the unemployment rate considers a ratio of job seekers to the total labor pool, the fewer people actively looking for work, the better the numbers appear. While this insight holds some sway, it no longer carries the day in assessing the state of the labor market.

Since 2001, the Bureau of Labor Statistics has deepened its understanding of labor markets by measuring not just the supply of workers seeking employment, but also the demand for labor from businesses and government entities seeking new workers. As described by the Bureau, “the availability of unfilled jobs -- the job openings rate -- is an important measure of the tightness of job markets, parallel to existing measures of unemployment”.

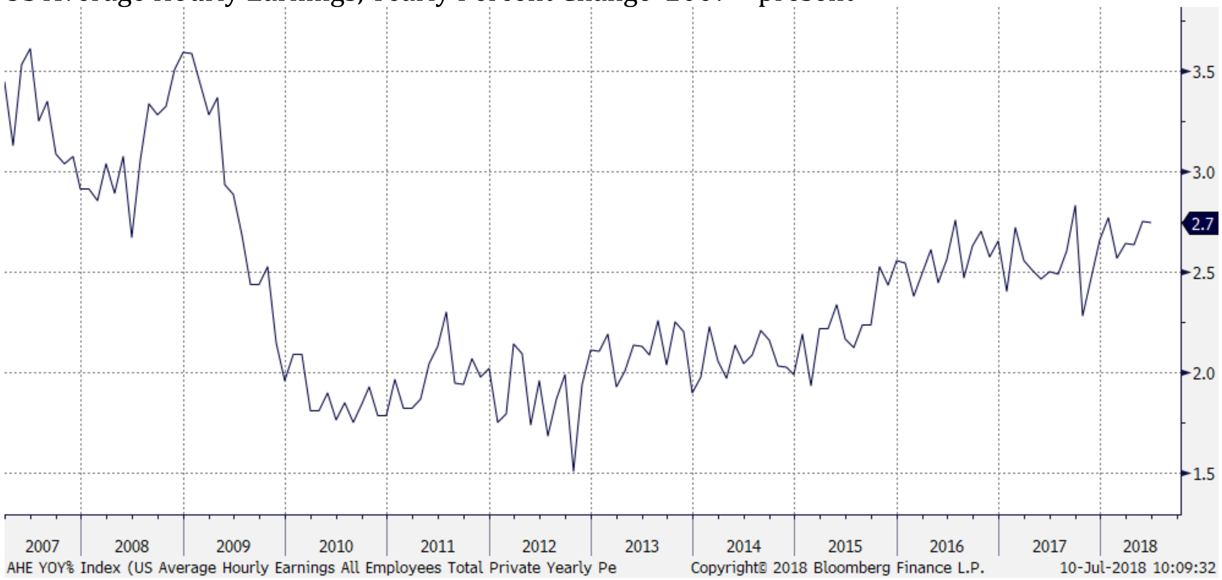
‘JOLTS’ Job Openings and Labor Turnover Survey 2001 – present

As shown above, recent ‘JOLTS’ readings indicate a record level of job openings, at over six million, three times as many unfilled jobs as at the recession’s trough in 2009.

Today there is a job opening for every unemployed adult in the US. Sure, there is still a mismatch of job skills to employer needs, and not everyone is willing to relocate to become gainfully employed. Nevertheless, the record demand for workers speaks to the current strength of our job market.

Alas, there is one more complaint about labor markets: wages are still weak.

US Average Hourly Earnings, Yearly Percent Change 2007 – present



The Phillips Curve expresses a long-held held economic principle that, as unemployment declines, wages will rise. It's a simple application of supply and demand, focused on the labor markets; and for the most part, few people have doubted its basic premise.

In this expansion, the validity of the Phillips Curve has increasingly come into question. The reason is straight forward: wages have not accelerated as expected. As shown above, year over year wage growth fell to 1.5 percent in 2012, well beyond the recession's trough. Today, with unemployment near multi-decade lows, wage growth is only measuring 2.7 percent per annum.

Perhaps this is another form of a Goldilocks economy -- not too hot, not too cold. Curiously, the phenomenon is not confined to the US. Japan boasts a 2.2 percent unemployment level and an overall inflation rate under one percent. Germany is down to 5.2 percent unemployment, low by European standards, and yet inflation sits just above two percent.

Theories abound on this conundrum, from the Federal Reserve to Wall Street economists…

1. The Phillips Curve is obsolete
2. Our government is lying about inflation, even fooling the bond market, the world's greatest collective wisdom
3. Baby boomers are retiring from high-paying jobs, being replaced by millennials at low pay
4. A sluggish banking system equals low loan growth, equals slow money supply growth, which means no inflation; and if there is no inflation in the system, employers will not pay up for labor
5. It's just a time lag, and in the coming months wage inflation will re-appear

Let's dismiss the first two explanations out of hand. It seems doubtful that the Phillips Curve has become irrelevant. Economics has always been a pliable science, but the basic laws of supply and demand must still exist. Likewise, while it is prudent to question government reports on overall inflation, the data on wages should be pretty tidy.

That leaves us with a combination of baby boomers retiring from high paying jobs, slow money growth keeping a lid on all forms of inflation, and a lag in the effects of low unemployment. That's probably as close an explanation as we will find. And if you know some friends living on the public dole, tell them to get a job… there are plenty to be had.

Bitcoin: Disease, Bubbles, and other Maladies

If Bitcoin's historic 2017 ascent reflected too many people counting on the greater fool theory, it seems to be losing support just as quickly, especially among thoughtful observers.

Bitcoin price in US Dollars 2015 – present

Let's start with the most complicated theory and work toward simplicity. According to one Wall Street report, the cryptocurrency has spread like a disease whose peak intensity has already passed.

As described by Barclays in a recent note:

> As more of the population become asset holders, the share of the population available to become new buyers -- the potential 'host' population -- falls, while the share of the population that are potential sellers ('recoveries') increases. Eventually, this leads to a plateauing of prices, and progressively, as random shocks to the larger supply population push up the ratio of sellers to buyers, prices begin to fall. That induces speculative selling pressure as price declines are projected forward exponentially. Analogously, this occurs with infectious diseases when the immunity threshold is reached; ie, the point at which a sufficient portion of the population becomes immune such that there are no more secondary infections.

How do we know Bitcoin has reached this stage? Barclays believes this is supported by surveys in developed economies, which suggest:

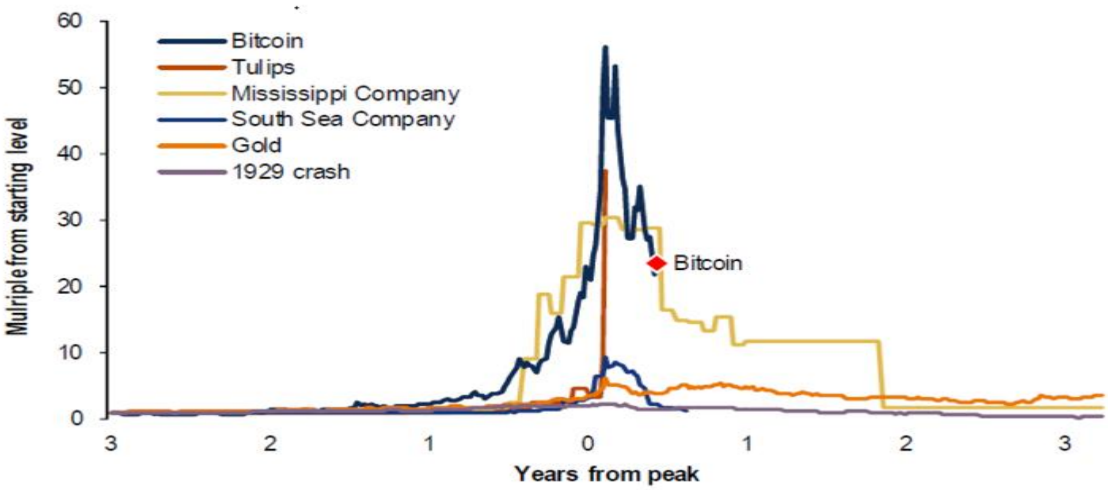
1. most potential Bitcoin investors ('hosts') in developed economies already are aware of Bitcoin (have been exposed to the 'virus')
2. only a small share of developed populations are susceptible to speculation ('infection'); and
3. the falling ratio of current to prior holders suggests a rising 'recovered' share of the population.

As a result, Barclays believes the speculative froth phase of cryptocurrency investment -- and perhaps peak prices -- may have passed.

A second Wall Street firm, Bank of America Merrill Lynch, states it more succinctly: Bitcoin is the greatest bubble in history, and the bubble is bursting. As evidence, the bank provides the chart shown below, which compares Bitcoin's rise and initial fall to that of the Dutch tulip mania and other famous asset-price collapses.

Note that while these assets might exist for extended periods of time, the bubble phase is brief -- typically within one year. For Bitcoin, that year seems to have been 2017.

Chart 2: The greatest asset price bubbles in history



Source: BofA Merrill Lynch Global Investment Strategy, Global Financial Data, Garber (2000), Frehen (2012), Bloomberg

Offering a third take on the matter, at Berkshire Hathaway's annual meeting, Chairman Warren Buffett and Vice Chairman Charlie Munger provided this exchange:

"Cryptocurrencies will come to bad endings," said Buffett, with unusual brevity.

"I like cryptocurrencies a lot less than you do," replied Munger, "To me, it's just dementia. It's like somebody else is trading turds and you decide you can't be left out."

Simple enough?

Tidbits...

Trade skirmishes break out, with tariff tit-for-tat between US, China, Europe, Canada.
Administration pulls out of Iran nuclear agreement, re-imposes economic sanctions on Iran.

California passes law banning local tax on sugary drinks.
California mandates that new homes be built with solar power systems, beginning 2020.
California surpasses UK, ranks as fifth largest economy in the world.

And the worst quality of life in the US.

Nestle to pay seven billion dollars to market Starbucks coffee and tea beyond Starbucks restaurants.

Seven billion dollars for coffee nobody likes.

Supreme Court decision opens door to state-sanctioned sports betting.
Supreme Court rules state and local governments can begin collecting taxes on e-commerce sales, regardless of companies' brick and mortar footprint.

Seattle approves, then repeals, "head tax" on firms employing large workforces, such as Amazon and Starbucks, blaming them for housing shortage. Silicon Valley cities consider similar taxes.

Wait, now they want to punish job-creators?

Congress rolls back Dodd-Frank banking regulation, eases burden on small and mid-sized banks.
US banking industry books record profits, highest return-on-equity since 2007.

Obamacare health premiums are projected to rise 15 percent in 2019, then settle into seven percent annual rate hikes for the next decade, says Congressional Budget Office.

Europe's General Data Protection Regulation becomes effective, aims to increase personal privacy.
Amazon Echo accidentally records family conversation, sends audio clip to friend on contact list.

Someone is watching or listening, always.

Social Security to tap into trust fund three years early, as revenues fail to support ongoing benefits.

KFC reportedly is developing fake-meat chicken, to comply with British mandate for lower calories.

Try formulating that marketing campaign.

US household net worth reaches milestone, 100 trillion dollars.

AT&T mega-merger with Time Warner is approved by US court, handing defeat to Justice Department, possibly opening floodgate for media consolidation.

Theranos founder Elizabeth Holmes, purveyor of phony blood testing systems, is indicted.

General Electric, original member of Dow Jones Industrial Average dating back to 1896, is dropped from the index.

Source:
Bank of America Merrill Lynch
Barclays
Bloomberg
Bureau of Labor Statistics
Patriot Post
The Wall Street Journal