JL Asset Management

TOP OF MIND

Q1 2024 FINANCIAL ANALYSIS & INSIGHTS

Economic Strength on the Surface: Good News for Labor market and Context for Rate Cuts

- **Employment Data:** For the week ended January 13th, initial jobless claims decreased by 16,000 to 187,000. Below all estimates in Bloomberg survey of economists
    - Reached the lowest level in more than a year, underscoring the resilience of the US labor market
    - Continuing claims decreased for a 3rd straight week and the four-week moving average of initial applications bolstered the strong job narrative and dropped to the lowest level in 11 months
    - While we typically see volatility in labor numbers around the beginning of the year, it appears that layoffs remain muted and are not trending significantly
- **Retail Sales**
    - With the backdrop of a strong labor market, US retails sales rose at the strongest pace in three months in December, capping a solid holiday season

- Rose by 0.6% during the month, a larger gain than the 0.4% increase expected in a survey compiled by Bloomberg and following a November gain of 0.3%
- Excluding a 1.1% increase in motor vehicle sales, retail sales were still up 0.4% compared to an expected 0.2% increase
- Department store sales jumped by 3% in December, while non-store retail sales were up 1.5%

- **Consumer Price Index**

  - December core CPI, which excludes food and energy prices, was up 0.3% MoM and 3.9% YoY – economists had projected a 3.8% annual gain
    - Including food and energy, the gauge increased 3.4% YoY

A Big HOWEVER

- **Producer Price Index**

  - Led by falling prices of fuel, US producer prices unexpectedly fell 0.1% in December on a monthly basis, a third straight month-over-month decline
    - Economists expected a 0.2% increase during the month
    - Excluding food and energy, PPI increased 0.2%
    - Prices for services were unchanged for a third straight month

  - Overall, it appears the lag effect of policies the Fed has put in place to combat inflation are beginning to flow through the system

- **The Consumer Remains Stretched**

  - Credit card delinquency rates have exceeded pre-pandemic levels, while the share of borrowers making only the minimum payments climbed above 10% for the first time since 2019, according to the Federal Reserve Bank of Philadelphia

  - Almost 3.2% of card balances were at least 30 days past due as of the end of September (the highest figure in more than a decade); additionally, the share of debts that are 60 to 90 days late also jumped

Putting it all Together – Rate Cuts

- Strong employment has continued to bolster the economy with retail sales holding up well through December, but cracks are beginning to show

- As of January 19th, futures contracts reflected about a 47% chance of an interest rate cut in March
  - Just a week prior, the probability of March cut was seen at nearly 80%, reflecting faster-than-expected declines in inflation

- Fed policy will be data dependent.Absent a slowdown in the economy or stronger signals of a significant inflation slowdown, the Fed is likely to wait to cut rates
  - According to Mohamed El-Erian, he "wouldn't be surprised if we start later, probably the beginning of the summer, and I wouldn't be surprised if we end up the year with cuts that are closer to what the Fed has signaled, which is 75 basis points as opposed to what the market has priced in."

What Does This Mean for Deal Flow and Human Capital Requirements?

- When the Fed does begin cutting rates, we should expect a significant tick up in deal flow

- However, in the interim, activity does seem to be picking up marginally
  - Pressure from LPs to return capital equates to pressure to do deals
  - According to Bloomberg, "Sovereign wealth funds and state pension provider are among investors telling money managers they'll only commit in their upcoming fund raises if their capital tied up in old funds is released"
  - Credit markets have suddenly improved, with bond yields falling during the late 2023 rally, allowing acquirers easier and more affordable access to capital

- Wall Street chiefs are finally calling the bottom on the dealmaking drought that has plagued their earnings for the past two years
  - Executives at the biggest banks are expecting a pickup in the coming months, tied to the Fed's apparent pivot away from two years of interest rate hikes

Firms Should be Gearing up for Increased Deal Activity Today

- Key areas to identify talent, include: originators, "deal captains" (who can execute transactions) and talent to make up the teams to help process the deals

- Additionally, many economists expect to see weak job growth in the most cyclical sectors (manufacturing, retail, transportation and warehousing) while Technology continues to add talent across the board

- The focus for 2024 on hiring restructuring and workout talent has already started to trend upwards given the potential slowdown in 2024