We finally got the Nonfarm Payroll number we wanted: 271,000 new jobs in October, the highest of the year and the lowest unemployment rate since April 2008. The market now puts the probability of a December rate rise at 75%, which is where it was in August. The 10-Year Treasury note climbed 10bps to 2.32% and the 2-Year by 8bps to its highest level all year. Another sign was the fall in long-term unemployment, seen here:
All good, right? Not so fast. The labor force has grown 2% since late 2007 to 157 million but the “not in labor force” group has grown 18% to 94 million. Whether you subscribe to the demographic argument, the secular decline thesis or skills mismatch model, you are left with a spluttering version of the U.S. job engine.

Other items this week before we cheer:

1. **Productivity**: increased 1.6% but most of that was because of fewer hours worked.
2. **Personal Income**: rose 0.1% and at the per capita level by around 2.6% YOY. Better.
3. **Leading Economic Indicators**: down from August and July and loan demand falling.

Meanwhile, the market wants this earnings season over. Earnings and revenues are both down 2.2% and 2.9% respectively. But the market is up 12% from its August lows, so this means price/earnings valuations have stretched from the five-year average of 14.1 to 16.5. It also means that investors are looking for a rebound and do not want to be out of the market. We agree with that.

The market is also more discriminating, which we really like. Here is the S&P 500 compared to a basket of companies with high share buy-backs. Since August, the broad market has outperformed the Buyback Index by 6%. Why? Well, investors prefer real growth more than financially engineered earnings.

**Bottom Line**: Chances of a hike just increased. But is by no means certain. We are encouraged by the market’s resilience and see no reason why it should change this year.

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