

Jobs Data, Fed Patience & AI's Next Market Shock

KATHY JONES: I'm Kathy Jones.

LIZ ANN SONERS: And I'm Liz Ann Sonders.

KATHY: And this is *On Investing*, an original podcast from Charles Schwab. Each week we analyze what's happening in the markets and discuss how it might affect your investments.

KATHY: Well, hi, Liz Ann. This week we got the revisions to the jobs numbers and the latest unemployment report. Overall, it looked pretty good. The unemployment rate was down a little bit. The non-farm payrolls were a little bit higher than the market consensus had expected.

Do you think this means labor market is shaking off some of the recent stagnation that we've discussed in the past or the downward revisions to the previous year so severe that this is kind of a non-event?

LIZ ANN: Yeah, and Kathy, I'm glad you brought up the downward revisions. So there's a quarterly census survey and every year, actually twice throughout the course of the year, there's a major benchmark revision to the jobs report. And each year it's done for the year ending in March of the prior year. So it was close to a million payrolls that were revised out of the prior year's numbers. And it was a big number such that it took the total number of payrolls created for that period to only 181,000. So that is pretty anemic. But you're right, the jobs report that we just got for the prior month was stronger than expected on pretty much every metric.

Couple of caveats to that, though. Not only do we get annual benchmark revisions, but as probably anybody that has ever looked at a jobs report knows, when you get each month's report, you get revisions to the prior two months. Now those were mild revisions this past time, but we can't assume that the stronger-than-expected payroll numbers will not be subject to downward revisions. In addition, the unemployment rate is actually calculated from a different survey, the establishment

survey. Establishment survey is the survey that the Bureau of Labor Statistics does to generate the payrolls number, and the household survey is where the unemployment rate comes from. And there was a very low response rate relative to the norm.

So, I just think, yes, on the surface, relatively strong. But you could certainly find things to point to that suggest that we may continue to see some weakening. What do you think it says about... Maybe actually most importantly not necessarily about the direction of the economy, I think we're still in kind of this low-hiring low-firing kind of backdrop, but what are your thoughts on Fed policy? I looked quickly this morning. I think expectations for a March rate cut are down in the kind of mid-single digit based on the Fed funds future market, but what do you think? Does this move the needle, in your mind, in terms of Fed policy?

KATHY: No, I don't think it does. And keep in mind, we don't get a new Fed chair until May. So this is a meeting, you know, kind of like the last meeting with the same players, the same number of people there. Stephen Miran is still there, who's recently appointed by the administration. But all in all, you still have kind of the same group of people. And I have to assume that they're going to have the same reaction that they had the last time around, that the economy is growing at what we would consider above potential rate. When you look at GDP, the unemployment rate is low. Despite all of the caveats about the quality of the jobs, the number of the jobs, and the potential changes, they only have the data that they have to go on. And the unemployment rate is relatively low at 4.3%. And they did cut three times last year in response to a softening job market.

So, I would think that the majority would continue to think, "OK, we did that, the labor market looks like it's stabilizing, and therefore, there's supply-side reasons why we're getting this low job-growth numbers. And so there's nothing to do here because the inflation rate is still too high." And that's stuck at about 2.7, 2.8%, they're aiming for 2%. Financial conditions are still very easy.

There's not a motivating factor right now to move unless your forecast is for a much weaker economy or some people are making the case for much greater productivity will allow the economy to grow faster without inflation. But keep in mind, higher real growth requires higher real interest rates.

So it doesn't necessarily just open the door to much lower interest rates. So I think they sit on their hands for a while longer and maybe all the way until May when we get a transition from Jay Powell to presumably Kevin Warsh. We'll see what the policies are and what the data say.

One thing I'll say is there's a lot of parsing of data. And I do this all the time, break it down into little, tiny pieces and evaluate it. But at the end of the day, you do kind of have to look at the economy in aggregate, because Fed policy affects the economy in various ways, but they have to look at it broadly for the entire country. And so you can parse the data and say, "Well, this component's up, but that component's down, and da, da, da, da, da." But they can't fine tune policy to help this particular slice of the economy. So I think at the end of the day, the numbers don't move the needle. That's the long version of "nothing's going to happen right away."

Speaking of productivity, the other big news for the market is,

LIZ ANN: I know where you're going with this.

KATHY: ...yeah, this news about the disruptive AI in our industry, in the financial services industry. And it really had a big impact on financials, which have been doing quite well. So I'd want to get your thoughts on this move and what you think about it both short term and long term.

LIZ ANN: I think this is part and parcel of this latest phase in AI. We've talked about this before. I've been thinking about AI as three phases, sort of three Cs of the AI phases, and I actually just made an adjustment to my third C.

So that you had the create phase which was the origination of what we know as is AI and the hyperscalers, a very concentrated sort of play on AI that was part of why we had such a concentrated market. Then you went into the catalyze phase which is basically the build out, data centers and expanding the power grid and that's when you started to see the broadening out into the industrials and the materials, just a broader way to look at who's really developing this sort of broad ecosystem we think of as AI. And now I think... I had been saying we were in the cultivate phase, but that really only brought up who are the potential beneficiaries, who's cultivating AI in a way that's beneficial to their own business, but I think I changed it to the cascade phase because that's got a broader meaning and I think it encompasses not just who are the beneficiaries across industries and sectors, but who are the disruptors and who's being disrupted.

So we had a couple of weeks there where it was the SaaS stocks, you know, Software as a Service and many of them got just completely hammered. And then to your point, Kathy, more recently it hit some of the financial services companies with an announcement out of a company called Altruist about some AI-related planning around taxes. And, you know, our CEO Rick Wurster went on Bloomberg the other day and talked about the fact that this industry, let me just not speak in Schwab terms, should ostensibly be beneficiaries of a lot of these new AI tools and that there

have been times in the past when you've gotten some sort of new option or new technology. You know, Rick used robo-advice as an example of that and concerns that that would completely disrupt and upend the business and it ended up being able to be integrated as a very important part of the business.

So I think what we're experiencing now in this environment of not just rapid-fire rotations that literally can turn on a dime based on a headline that comes out or a quick narrative change, but it's also a function of who some of the dominant players are in the market. And I think it's that shorter-term... not just the retail traders, they get a lot of attention, rightly so, but some of the shorter-term speculators, even on the institutional side of things. And it's kind of a sell-first, ask questions, do real research later, kind of backdrop and I would caution investors not to either get overly excited when you have, say, a you know a subsegment of an industry or a sector all of a sudden doing well.

But I'd also say, you know, panic in the face of these rapid-fire shifts and rotations doesn't make a lot of sense, either. And that continues to be one of the reasons why we've had more of a factor emphasis than a sector emphasis, because these sector rotations are just happening fast and furiously. And if you sort of go down to the basics, in fact, our research is investing based on characteristics. And we've been saying, take kind of a GARP approach, old school Growth at a Reasonable Price, focus on balance-sheet health, and navigate that way as opposed to, "OK, which is the next industry? What's the next group of stocks?" It's either going to surge or get hit because of some AI-related headline. But it's the nature of the beast right now and that's the world in which we're living.

KATHY: Yeah, I, you know, I'm no, in no way am I expert on AI or any of this, but I will say that the robo-advisor example came to mind when, when I saw this happening because the initial impression was, "Well, everyone's just going to go to the robo-advisor, right?" And that, of course, didn't happen. And, you know, most companies now have incorporated some sort of robo-advisor into their offering.

But mine is more basic, just having, you know, having experience in the business. A, people still like to talk to a person before they push the button on a decision. And I think that hasn't gone away and won't go away because there are a lot of things to consider. But B, I don't think that people consider what happens to your data. You know, there's so much to talk about with securing your data. And it's something that a startup, I guess, I don't know what their plan is for that or how they deal with it, but I think there's a hesitancy to just turn over all your data before you actually know how secure it is or how it's going to be handled or what's going to happen.

So yeah, there'll be some early adapters, I'm sure, but I do think when I think back about even the introduction of TurboTax, remember how long it took for that to actually accumulate a lot of clients because they're with all these questions of "How's it going to handle all my information?" So I guess the bottom line is we tend to overestimate the impact in the short run, maybe underestimate it in the long run, and that's what it feels like to me is going on right now.

So I think it's time for us to look ahead to next week. What do you think investors should be paying attention to?

LIZ ANN: Yeah, well, it's not just next week, as you and I are taping this. We have Consumer Price Index, CPI, coming up. So as you and I taping this, we don't have the results of that. So expectations are for, I think, about three tenths on both headline and core. And you know, in this environment of sensitivity around Fed policy, any outliers could be somewhat market moving. We get some housing data next week. I don't expect anything significant. It's been calm in your world of longer-term Treasury yields, so you're not getting big swings that might impact either the actual housing numbers or sentiment around housing.

We get the Leading Economic Index, which a lot of people, including myself, used to look at very carefully every month. It's just not been a great indicator. This unique cycle of manufacturing, having been in the doldrums for quite some time until recently, but offset by much stronger services, that kind of stuff doesn't get picked up in the LEI. So I know I just mentioned it and said I don't look at it as carefully anymore, but that's just kind of a PSA to everybody out there that might still think that there's a tremendous amount of value.

And there we get trade data next week, always of interest in this tariff regime. And then we get, I think the next week we get PCE too, right, Kathy? So that's the Personal Consumption Expenditures Price Index, which is the Fed's preferred measure for inflation. How about you?

KATHY: Yeah, all... you know, obviously all those numbers, PCE in particular, CPI and PCE, the inflation data because that's clearly important for Fed policy and for the bond market in general. Those also get some minutes of the last Fed meeting. Those are always interesting to look through and see what they really focused on and what they chose to record in the minutes. It'll all change because we'll have some new people pretty soon. But for right now it provides a little insight into what the Fed is thinking, what they're watching, and what may be coming up later in the year.

LIZ ANN: So that's it for us this week. Thanks as always for listening. And as a reminder, you can keep up with us in real time on social media, I'm @LizAnnSonders on X and LinkedIn. Make sure you're following the real me, not one of my imitators.

KATHY: And I'm @KathyJones on X and LinkedIn, that's Kathy with a K. And you can always read our written reports, including lots of charts and graphs at schwab.com/learn. All of our episodes are also on YouTube. Just search for "On Investing podcast." And we'll be back next week with a new episode.

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