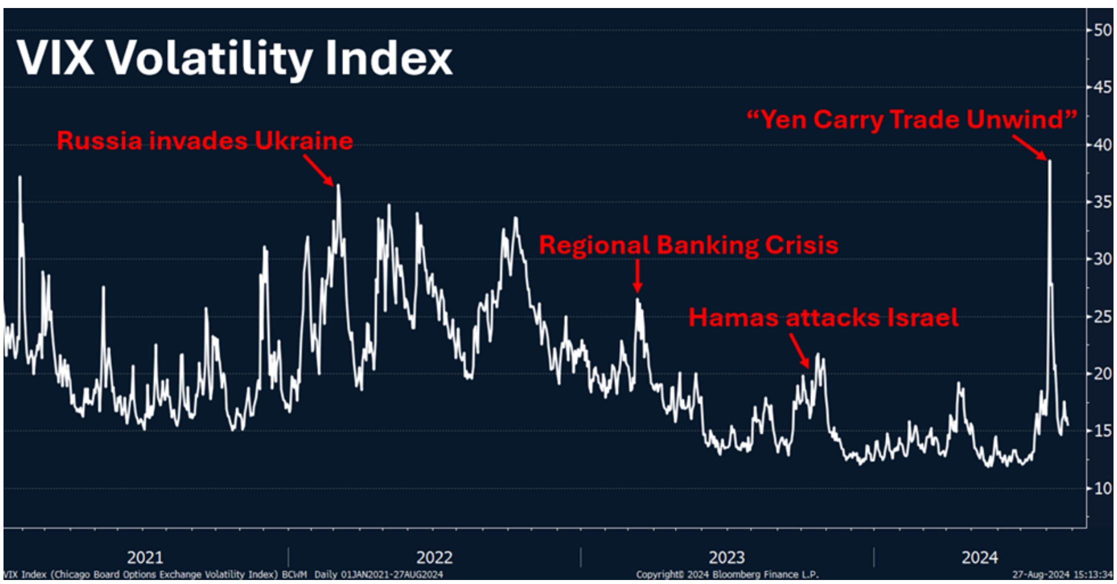
Market Mayhem, Monopoly, and Missing Jobs

During the first three trading days of this month, the stock market made a lot of noise. Weeks of lackluster economic data culminated in a pair of worrisome job reports that sparked a two-day selloff. On the third day, gasoline was poured onto the fire. Something called the "unwinding of the yen carry trade" (the details of which we will NOT get into in this commentary) caused a 12% drop in the Japanese stock market and brought further pain to U.S. stocks. All told, the U.S. stock market fell over 6% during the first three days of the month (tech stocks a little worse).

The VIX Volatility Index, aka the stock market's fear gauge, registered higher readings than it did during wars, a banking crisis, and decades-high inflation.



And, as we expected, once investors began to panic in the stock market, they quickly parked a lot of their cash in "safe havens" like U.S. Treasury Bonds. So, while stock prices were getting blistered, bond prices enjoyed a healthy rally. And if you happened to own stocks AND bonds that day (you know, that "diversification" thing), you might not have noticed a large change in the value of your investments.

During this time, we were busy at work, selling what was up (bonds) and buying what was down (stocks). But if you were an at-home DIY investor, there is a good chance you were locked out of your account, unable to trade. Many of the large "retail" brokerages could not handle the surge of people trying to log into their accounts.

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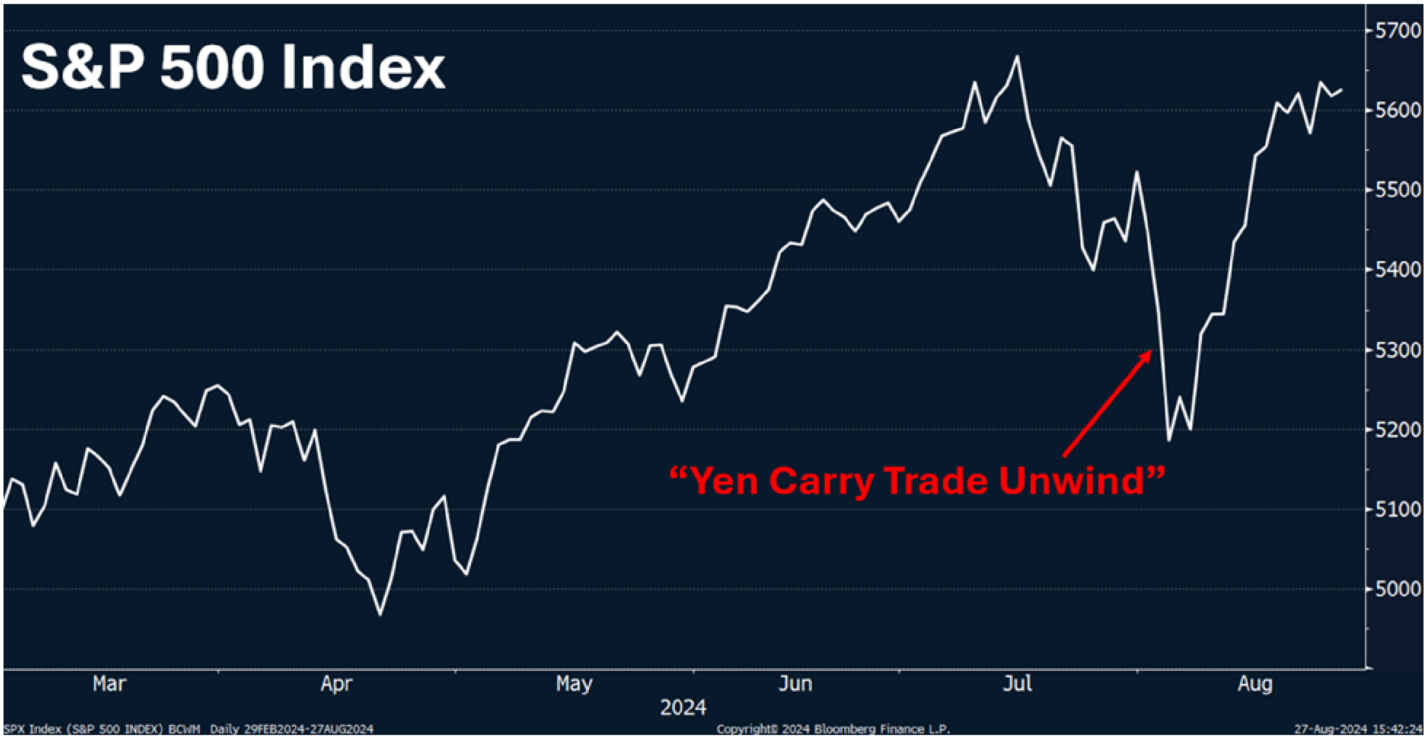
Over the next couple of weeks, the stock market recovered. A lot of the disappointing economic data that had set the stage for the selloff improved, but most importantly, the effects of the yen carry trade unwind had worn off. The early-month selloff wasn't the result of a rapid onset recession, it was more about the inner-workings of the market: a bunch of people were forced to sell (unwind) at the same time. The stock-price declines were overdone, and those investors who were able to take advantage of it were rewarded.



Today, the story in the stock market is the same as it was a month ago: a lot of big tech stocks look very over-valued and primed for bad returns if a recession hits, but we don't expect value stocks to suffer as much. The bull market didn't die in August, but it gave investors a reminder that taking risk works both ways.

The bond market, however, is NOT back to where it was a month ago, it's doing much better. Interest rates dropped about 0.20% in August, a significant movement. And they are down over 1% from their peak last year. In other words, bond *prices* have gone up. In fact, while the stock market has performed well this month, the bond market has performed even better.

With inflation waning and signs of a decelerating economy, the Federal Reserve has finally signaled that it's ready to cut short-term interest rates. Get ready for this to dominate the financial media airwaves.

The same day the market was having a meltdown, a judge in a U.S. District Court ruled that Google has a monopoly over the online search market. It's kind of hard for Google to defend itself. Think about it. When's the last time you "searched" anything on the internet? Google's domination of the market is profound, with 91% of the world "googling" things. And most people don't even go to Google.com to do so, because Google is often the default setting for most browsers, a competitive advantage for which the company pays billions of dollars.

Google's next biggest competitor in search is Bing. It owns 4% of the market. (Our guess is it's the 4% of people who don't know how to install Google's Chrome as their primary web browser.)

Lawyers argue that Google essentially controls access to the internet much like, at the turn of the 20th century, the railroads controlled access to goods and Standard Oil controlled access to petroleum.

But instead of oil, Google is trafficking in a different commodity: the specialized information it knows about each and every one of us. It uses that information to sell ads. Lots of ads. Just last year, $175 billion worth. Google can target 55-year-old fitness buffs in Rochester, NY, who work in accounting and drink wine. It's hard for other companies to compete with that level of focused advertising.

The last time there was this big of an antitrust case against a tech company was over two decades ago, when Microsoft was ruled to be monopolizing the web browser market. The government tried unsuccessfully to break up Microsoft, but key findings were upheld, creating room for young companies – like Google – to thrive.

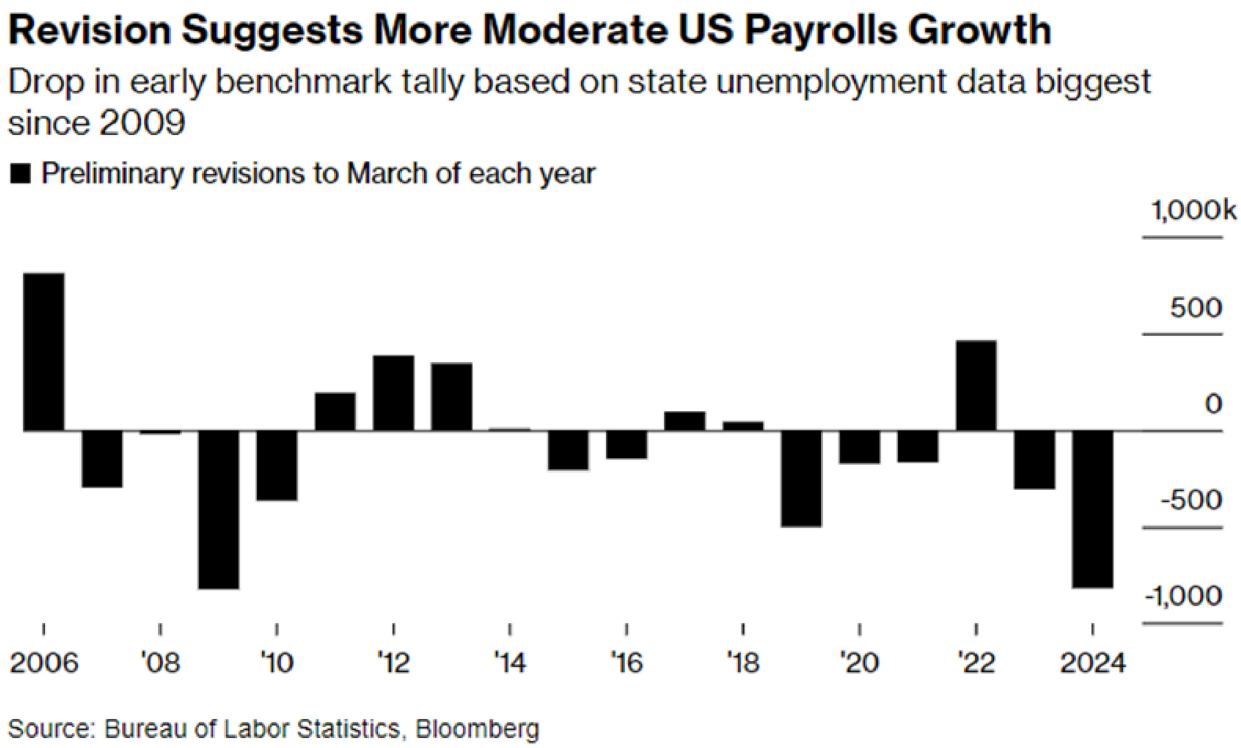
Now, the DOJ is considering the breakup of Google, which would be a huge outcome (much like the "Baby Bell" breakup of AT&T in 1984).

Google is way more than just the search engine it started out as. It re-named itself Alphabet in 2015 and owns companies such as YouTube and Android. It has a fast-growing Cloud business, and it owns the autonomous-vehicle company Waymo, among many others.

Whether or not a breakup of Google will happen remains to be seen. More will be known in early September. What is clear, however, is that there is bipartisan support for action to be taken against big tech companies that hold so much sway over our lives . . . and have dominated the stock market for the last several years.

At BCWM, we have been pessimistic about this country's economic future for a long time. And occasionally even *we* wondered if our pessimism was unwarranted, as economic data kept coming in better than we had anticipated.

It turns out that some of the data from the Bureau of Labor Statistics (BLS) was a tad bit rosier than it should have been. The BLS recently reported that for the 12 months ending in March, it overstated how many new jobs were created, thus making things seem better than they really were. It announced this week that it would be revising downward previously reported new jobs by 818,000, the largest such revision since 2009.



Before you put on your conspiracy-theory hat (These jobs numbers were cooked!), consider that, if this was politically motivated, the numbers wouldn't have been revised down until at least after November.

The more likely explanation has to do with something we talked about two months ago: immigration.

This particular monthly jobs number comes from surveys of employers who are supposed to represent the broader economy. Because these numbers can't ever be exact, the BLS performs an annual adjustment of the data based upon state unemployment insurance filings, which should be more accurate.

Our guess is that employers in the monthly survey perhaps included illegal immigrants (who frequently work for cash) and would not be eligible for unemployment benefits, and these workers dropped out in the revision. Another thing to consider is that a separate jobs number compiled by the BLS that tends to ignore illegal immigrants has not had major revisions.

Nevertheless, the major jobs number revision suggests that the labor market started moderating sooner than originally thought (but not sooner than *we* thought). At BCWM, we continue to see a moderating economy and more headwinds than tailwinds in the near future. We continue to be positioned for slower growth, lower inflation, and lower interest rates.