



# Charts and Smarts<sup>®</sup>

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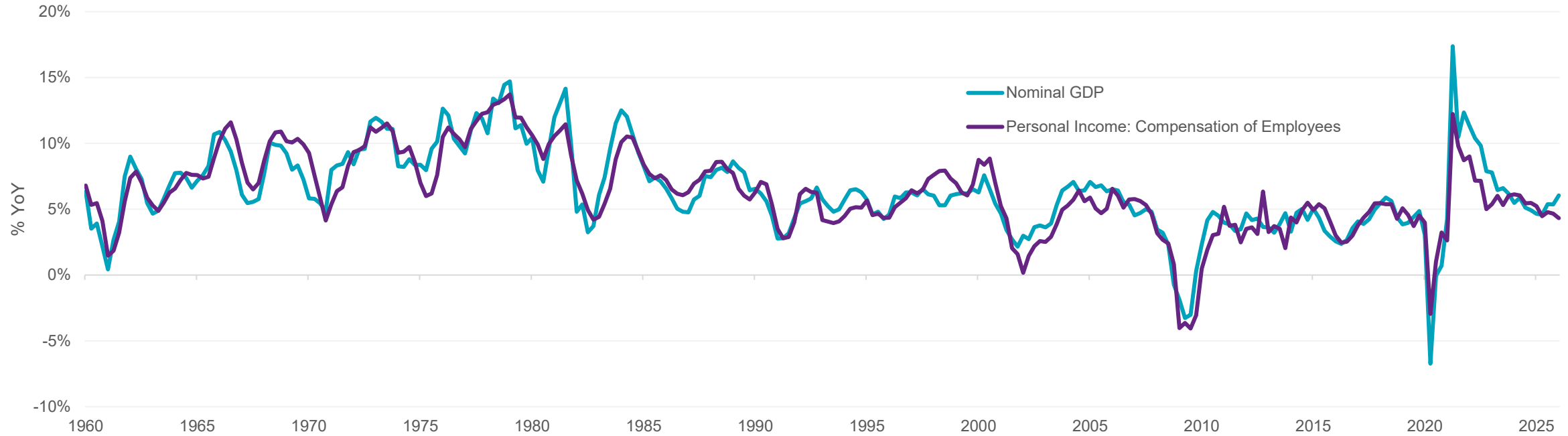
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Portfolio Strategist

# I Can't Tell You Why

## Compensation vs. Nominal GDP (3/31/60–3/31/26)

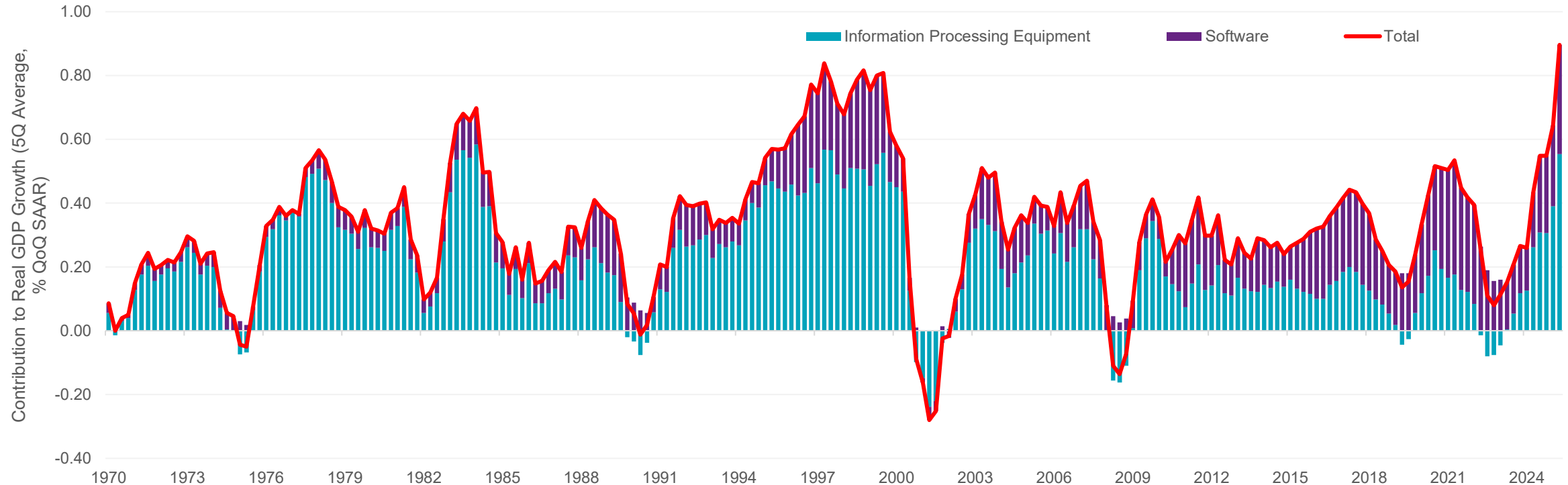


Over time income drives spending. Yes, credit plays an important role in spending, consumption, and broader economic activity, but a defining characteristic of the post-pandemic era has been the declining share of lending as a percent of GDP, which has seen core commercial bank lending plummet from about 37% of GDP entering the pandemic to just over 30%, matching levels last seen in the early 2000's. In other words, we've been in an income driven cycle, not a credit fueled one. But in recent quarters we've started to see nominal GDP diverge notably from underlying labor income as year-over-year nominal GDP has accelerated 6% while employee compensation has grown 4.3% over the past year. We've poked plenty of holes in the labor market reacceleration narrative in recent months as the data remains far more suggestive of a stabilization in conditions as opposed to an outright firming. The most convincing evidence of that remains the continued cooling in labor income growth. While the AI capex boom is likely playing a large role in the growing divergence between spending and income, both directly through nonresidential investment and the resulting wealth effects via rising asset prices, divergences like this tend not to last. The key question moving forward: How does that divergence resolve? With nominal aggregate income continuing to cool in the face of a real income shock, it's hard to see why nominal spending continues to accelerate, which ultimately feeds back into labor demand. And while labor market data has certainly looked more encouraging of late, the impulse to labor demand from the AI infrastructure buildout remains tepid at best, suggesting the greater risk is growth catching down to the continued cooling trend in incomes.

Source: Portfolio Analysis & Consulting. Bloomberg. Gross domestic product (GDP) is the value of all final goods and services produced within an economy and is used to measure the economic activity of a country or region.

# Hotel California

## Tech Capex Contribution to Real GDP Growth (12/31/70–3/31/26)

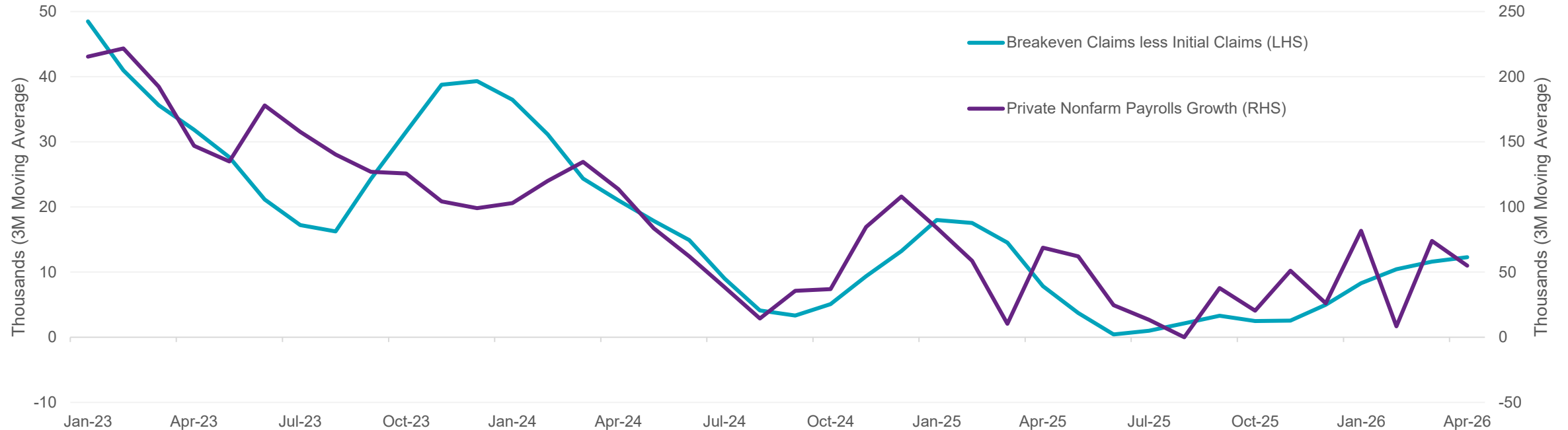


Speaking of AI, the AI trade is certainly back with a vengeance. The market narrative has been stuck between a closed Strait and an AI boom, but it's abundantly clear which one of those is winning at the moment, as markets continue to notch new all-time highs on the back of a stunning AI and tech-fueled ramp in equity markets. While the narrative around AI may have soured over the past few quarters, the data certainly hasn't shown any let up in the investment surge. Over the past five quarters, AI-related investment, defined as information processing equipment and software, has contributed nearly 90 basis points to headline real GDP growth each quarter, eclipsing the highs established during the late 1990's. While it is true that a considerable portion of these dollars leak abroad as these products are imported, they continue to support robust domestic demand and earnings growth. And the strength in that earnings growth has fueled yet another dramatic narrative shift with respect to the AI complex. Gone are the days of concerns over unknown ROIs, declining free cash flow, and wasted capital. As long as more investment and compute lead to better models and wider use cases, the more that investment is validated in the eyes of investors. Given the latest batch of headlines around model advancements it's no wonder markets are moving up and to the right on the back of tech.

Source: Portfolio Analysis & Consulting. Bloomberg. Gross domestic product (GDP) is the value of all final goods and services produced within an economy and is used to measure the economic activity of a country or region. QoQ SAAR represents quarter-over-quarter seasonally adjusted annualized rate.

# Take It Easy

## Initial Claims vs. Employment Growth Breakeven Threshold of Initial Claims (1/31/23–4/30/26)

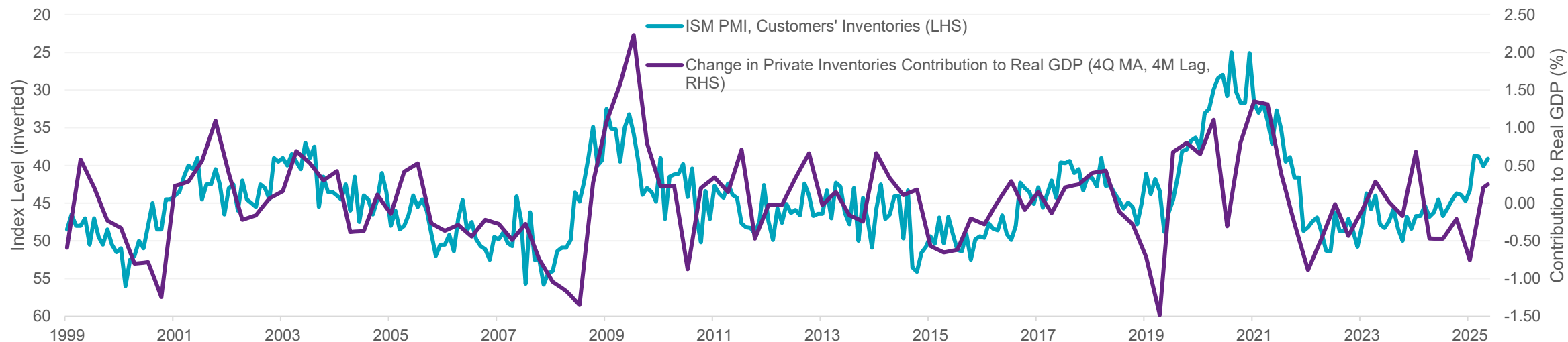


A fascinating convergence of sorts has been playing out with respect to the prevailing macro narrative. The growth bulls that entered the year calling for 3% real growth have been forced to reckon with an underwhelming fiscal impulse which is set to morph into a modest fiscal drag as we push further into the year as the energy shock erodes real incomes. Meanwhile, the doves appear to be growing increasingly less concerned with downside risks to growth and labor markets. The narrative is converging towards the Ho-Hum economy we envisioned to begin the year. But embedded within that emerging narrative is an expectation that the stabilization we've witnessed in labor market data over the past few months is the beginning of an outright reacceleration, as evidenced by a renewed uptrend in private payrolls growth and remarkably benign jobless claims. Claims in particular have garnered considerable attention as they have not only remained well behaved, but have continued to grind lower. Indeed, that is an encouraging sign, but just as labor supply dynamics have moved the goalposts with respect to what constitutes a strong payrolls report, so too has declining supply pressured lower the level of initial claims consistent with payrolls growth. Claims are moving lower, but so too is that breakeven level, and while the spread between initial claims and the estimated breakeven rate has been widening over the past few quarters, confirming the bounce we've seen in private payrolls growth, nominal wage growth continues to cool while hiring intensity remains anemic. When the facts change, we change our minds, but for now, the burden of proof remains on those arguing the nascent stabilization in payrolls growth is in fact the beginning of true reacceleration.

Source: Portfolio Analysis & Consulting. Bloomberg.

# Lyin' Eyes

## Inventories vs Real GDP (12/31/99–4/30/26)

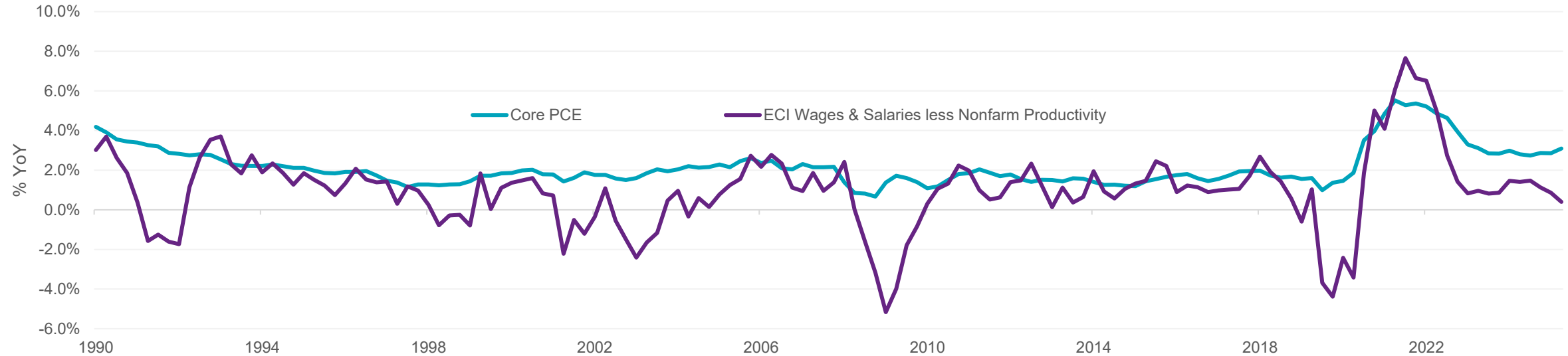


Another reason to be somewhat skeptical that the stabilization is destined to evolve into an outright reacceleration is that it is coming partially on the back of an inventory restocking cycle. One of the bright spots within the recent labor market stabilization has been the expanding breadth of job creation as more industries are now seeing job growth than job loss. Job creation is no longer exclusively a function of education and health services which drove the entirety of job creation in 2025. In particular, the reacceleration-istas have pointed out the rebound in cyclical employment, which has grown 67k over the past six months after shedding 188k jobs over the prior two years. Nonresidential construction related to the AI data center buildout has certainly been a key source of labor demand supporting both headline jobs growth and expanding breadth. Put that together with a manufacturing PMI that has bounced back into expansion territory and it's no surprise that the reacceleration thesis gained such a following early in the year. But while the manufacturing sector has added 16k jobs so far in 2026, that comes on the back of a massive reduction in capacity and headcount to the tune of almost 300k over the prior two years. To be clear, there is reason to be somewhat optimistic with respect to both the growth impulse and employment gains coming from the manufacturing sector, but that's a function of businesses restocking depleted inventories. With demand softening and tariff uncertainty continuing to loom over the past year it's no wonder that businesses have focused on moving existing inventory. But inventories can only be drawn down for so long until businesses need to begin restocking to keep pace with demand. That increased production looks set to provide a modest tailwind to growth and cyclical employment over the coming quarters, but don't conflate an inventory restocking cycle with a cyclical reacceleration. Real economic growth drives labor demand, and to the extent that real consumption is likely to moderate under the weight of declining real wages in the months to come, that portends a softening backdrop for labor demand in cyclical sectors on the other side of what may prove to be a fairly short-lived inventory restocking cycle.

Source: Portfolio Analysis & Consulting. Bloomberg. The Institute for Supply Management Manufacturing Purchasing Managers' Index (ISM PMI) is a monthly indicator of economic activity based on a survey of purchasing managers at manufacturing firms. Gross domestic product (GDP) is the value of all final goods and services produced within an economy and is used to measure the economic activity of a country or region. MA represents moving average.

# Already Gone

## Inflation = Compensation – Productivity (12/31/90–3/31/26)



While it may be too early to declare that labor markets are truly reaccelerating, what is clear is that conditions have stabilized. In the eyes of both the market and the Fed that means risks to the labor market are now more two sided while near term risks to the price side of the dual mandate move decisively to the upside. It's beginning to feel a whole lot like 2022 with market participants and FOMC members all scrambling to outhawk one another. And while the economy is in a profoundly different position than it was in 2022, particularly with respect to labor market tightness and nominal wage growth, that will do little to prevent the Fed from writing off the easing bias in the near term as the committee's patience wears thin with respect to looking through yet another negative supply shock with inflation already stubbornly above target. As long as labor markets continue to show some semblance of stability the Fed will continue to focus on the inflation side of the dual mandate. That said, the path from an easing bias to an outright tightening of policy is not linear. It's fairly easy to remove an easing bias and embrace a more balanced, or even modestly hawkish assessment of the balance of risks and the market has already priced in exactly that shift. But the bar for a tightening bias, let alone outright hikes, remains much higher. And that's particularly true given acyclical and supply side pressures that monetary policy is ill-suited to combat are driving the bulk of the renewed inflationary impulse. Meanwhile, underlying demand driven inflation pressures remain fairly benign as softening wage growth points to continued slack in labor markets and resilient productivity growth provides a further buffer to upside inflation risks. Against that backdrop the greater risk isn't runaway inflation but rather tightening in response to a short-lived supply shock amidst a declining nominal growth backdrop only to exacerbate downside risks to growth. Don't forget, hawkish talk is cheap. And while the incoming Fed Chair may have a vision to remove forward guidance, hawkish jawboning through forward guidance may very well be the best tool to manage those upside risks to inflation while not exacerbating still present downside risks to growth and labor markets.

Source: Portfolio Analysis & Consulting. Bloomberg. PCE represents personal consumption expenditures price index. ECI represents employment cost index.

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