Wages Are Growing: Should Investors Worry?

By SCHWAB NEWSROOM | SEPTEMBER 18, 2018

With the economy continuing to chug along nicely and unemployment remaining at record lows, it has been somewhat surprising that wages have remained relatively flat. But as August's jobs report indicated, that may be changing.

Bureau of Labor Statistics data showed that nonfarm payrolls were up 201,000 for the month, leaving the unemployment rate remained unchanged at 3.9%. The bigger news was that average hourly earnings were up 0.4% from the previous month and 2.9% from a year earlier (the latter is up from 2.5% on average last year).

While this is great for workers, the rise in wages could also have implications for the stock market. Namely, it's now almost certain that we'll see two more interest rate hikes from the Federal Reserve (Fed) this year. It may also be time to start looking out for a potential inflection point, or the moment when all the good news has been priced into the market and expectations for future performance start to sag. Let's take a closer look.

Goldilocks exits?

The combination of steady economic growth and falling unemployment has been a boon for workers, but it also created something of a mystery: Wages have grown only moderately and inflation has been low. On one hand, such conditions flew in the face of the idea that when unemployment falls below a certain level, consumer prices and wages will start to rise as businesses have to shell out more to hire increasingly scarce workers. On the other hand, the country was also benefiting from what market observers have called the Goldilocks economy—neither too hot, nor too cold.

The August report, however, raises the possibility that Goldilocks is leaving the building.

“The current pace of job gains, coupled with a multi-decade low in unemployment claims, is more than sufficient to keep the unemployment rate trending down—which means wage pressures should intensify,” says Schwab chief investment strategist Liz Ann Sonders.

Evidence of the upward pressure on wages can be found in the National Federation of Independent Business (NFIB) survey for August. It showed that a large chunk of small businesses are reporting higher worker compensation, and the share of small businesses planning to boost pay in the next three months is at a historically strong 21%. Finding qualified workers is now the most commonly cited problem facing small businesses, beating out taxes, weak sales and red tape in terms of business problems. More wage hikes may come in response.

“All this means two additional rate hikes—likely this month and again in December—are now almost assured,” says Liz Ann. “And these increasingly tight financial conditions could lead to more stock market volatility.”

Good for Main Street, implications for Wall Street

Another potential problem for markets is that eventually the pleasant surprises could start to give way to more disappointing data.

“When data becomes as historically strong as we’re seeing in a variety of employment statistics, it’s time to start looking for possible inflection points,” Liz Ann says. “When it comes to the relationship between economic fundamentals and the stock market, ‘better or worse’ tends to matter more than ‘good or bad,’ and at some point it’s going to get difficult for the data to continue delivering pleasant surprises.”

Unemployment reports look backward, at what happened a month ago, while the stock market generally looks forward. And when the job market is at its strongest, the stock market may already have moved on and started worrying about the party coming to an end. (The reverse can also be true—when things are at their most dire in the job market, the market might be looking for the spark that heralds the next recovery.)

Liz Ann says that statistics dating back to 1950 show that when the unemployment rate was below 4%, as it is now, stock market returns were quite low.[1] Conversely, when unemployment was at its highest, the stock market did very well—delivering returns that were nearly four times as high as when unemployment was plumbing the depths.

“That’s not to suggest that investors need to run for the hills now that the jobs market is so strong,” says Liz Ann. She believes there’s a “decent length of runway” before an inflection point in the stock market becomes evident.

She adds that productivity has improved, growth in average hourly earnings isn't excessive and top-line revenue growth for businesses remains strong. These factors should keep margins healthy for business and keep the Fed from moving too aggressively on interest rates going forward.

She warns investors to avoid complacency, however, and to be vigilant about increased volatility as we move into the later stages of the economic cycle.

What you can do next

- Want to talk about Schwab's outlook on the economy and its potential impact on your portfolio? Call our investment professionals at 800-355-2162.
- Watch Schwab experts discuss other market and economic topics in the Stock Market Report.

Important Disclosures

The information provided here is for general informational purposes only and should not be considered an individualized recommendation or personalized investment advice. The investment strategies mentioned here may not be suitable for everyone. Each investor needs to review an investment strategy for his or her own particular situation before making any investment decision.