November 2012

A Pinch of Salt

Seasoned insights into the global markets

Issue 2

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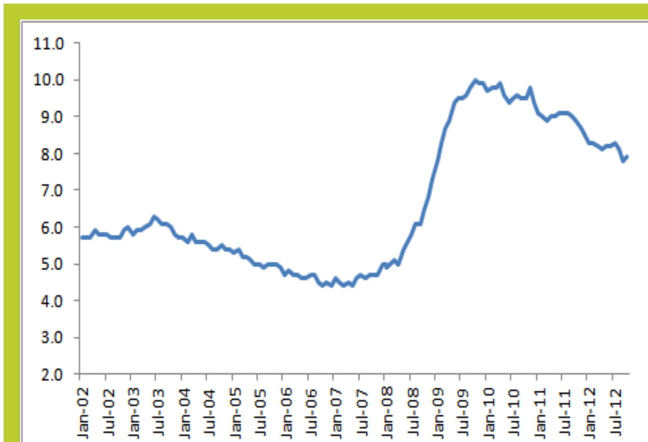

Unemployment Rate, % (Source: BLS)

Unemployed? Possibly, maybe, hmm, what was the question?

As promised in the last newsletter, this month I'm going to take a quick look at some of the unemployment figures in the US in order to examine some of the trends over the last few years. We'll try to dig a bit deeper to understand why the current unemployment trend (downwards) is unlikely to continue even as the economy continues to grow.

First things first. We need to define how we calculate unemployment. The equation itself is pretty straightforward:

$$\frac{\text{Number of Unemployed}}{\text{Number in Labor Force}}$$

Where it gets more complicated, as we shall see, is how you define who counts as being "unemployed".

But, taken at face value, if you look at the graph on the left hand side, you can see how unemployment has trended (in the US) over the last 10 years or so. Unemployment, as we know, spiked to 10% as a result of the recession in 2008, and has since been trending slowly downwards to where it now currently sits at a smidgen under 8%.

So, all clear up to here. Now let's think who counts as being unemployed, for the purposes of the published unemployment rate.

The Bureau of Labor Statistics rather helpfully (and perhaps counter-intuitively) tell us that the "unemployment insurance program has no bearing on whether a person is classified as unemployed". Rather, the US definition of someone who is unemployed is someone that does "…not have a job [and who has] actively looked for work in the prior 4 weeks".

So what the unemployed figure does not include or tell us about are the number of people who would work if they could find a job but have been discouraged enough that they have not looked in the last four weeks, or perhaps they have stopped looking altogether. As we shall see, there are a (very) large amount of people who are not working who would like to work – but are not counted as unemployed.

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Where did all the workers go?

So how many of these people are there that have dropped out of the labor force, at least for now. The simple answer is - an awful lot.

How do we know this? Well, some simple evidence is borne out by looking at the participation rate – this is simply the Labor Force (total employed and unemployed people) as a percentage of the total population.

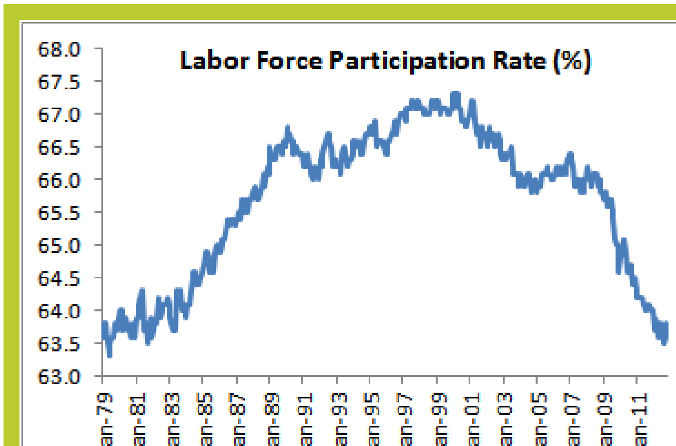
Have a look at the graph at the bottom of this column to see what this trend looks like.

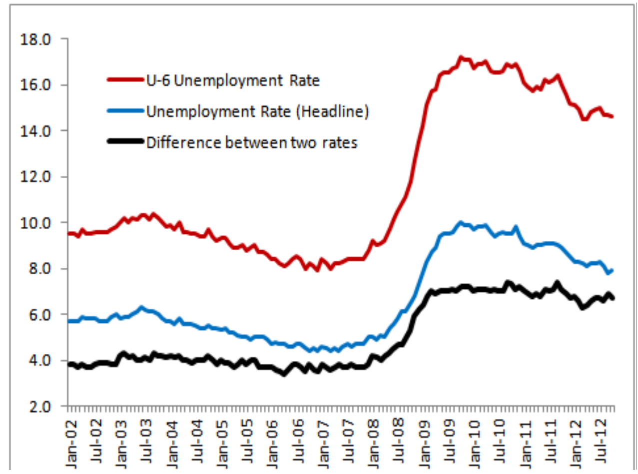
Scary, huh? Looks like a bad stock pick!

The fact is that there are, by my calculation, almost 8 million American 'workers' out there who used to be part of the Labor Force (based on participation rates from 2000) and have dropped out thereby making the unemployment figure lower than it 'should' be.

If even half of these workers rejoined the Labor Force, instead of the current 7.9% unemployment rate, we would be looking at a not-so-impressive unemployment rate of 10.4%.

It's fairly reasonable to expect that as the economy (hopefully) continues to generate semi-respectable growth, then people who had dropped out of the labor force will return and unemployment won't come down nearly as quickly as some commentators are expecting.





Marginally working

This is why some commentators do not pay so much attention to the monthly headline unemployment figure, but look instead at what is known as the U-6 series. This includes people 'marginally attached' i.e. those who would be likely to rejoin the labor force if the opportunities arose – including, for example, discouraged workers who want and are available for work but who have not looked in the previous four weeks (and therefore, as we wrote earlier, are not counted as unemployed).

The graph above shows both the U-6 unemployment rate (red line) and the headline unemployment rate (blue line).

But the key line to look at here is the black line which shows the difference between the headline unemployment rate and the U-6 rate, i.e. the people who are not classified as unemployed but would work if they could. Look at how it jumped after 2008 and is still stuck almost 3% above its pre-2008 rate. This is important!

Historically, about 4% of the population have not been classified as unemployed but would work if they could. That figure is now almost 7% - but likely to come back down as the economy improves. Which could mean that come the next Presidential election in four years time we may well still be talking about whether the unemployment rate is above or below 8% on election day.

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Ryanair case study: Customer Service and Investment returns

An interesting article in a recent publication from the CFA institute reported on investment approaches that took into account the "happiness" of customers, after several studies which showed how customer satisfaction with a company can be related to lower risk in that company's equity returns.

It made me think of Michael O'Leary, the very outspoken boss of Ryanair.

As is well known on the Irish side of the pond, customer satisfaction is not top of Ryanair's priority list, yet their success has been remarkable. Testament to their concern (or lack of) for customer satisfaction are comments by O'Leary, of which two of my favourite (there are many more that I would be happy to send on) are:

- On customer service: "People say the customer is always right, but you know what - they're not. Sometimes they are wrong and they need to be told so."
- On the in-flight experience: "Anyone who thinks Ryanair flights are some sort of bastion of sanctity … is wrong. We already bombard you with as many in-flight announcements and trolleys as we can. Anyone who looks like sleeping, we wake them up to sell them things."

Still, for the $18 I once paid to fly from London to Venice, I'm not complaining.

Final thought

The quote below is a wonderfully open and self-deprecating quote from a speech made in September by Richard Fisher, President of the Federal Reserve Bank of Dallas and former member of the FOMC. Well worth digesting.

"We are blessed at the Fed with sophisticated econometric models and superb analysts. We can easily conjure up plausible theories as to what we will do when it comes to our next tack or eventually reversing course. The truth, however, is that nobody on the committee, nor on our staffs at the Board of Governors and the 12 Banks, really knows what is holding back the economy. Nobody really knows what will work to get the economy back on course. And nobody – in fact, no central bank anywhere on the planet – has the experience of successfully navigating a return home from the place in which we now find ourselves. No central bank – not, at least, the Federal Reserve – has ever been on this cruise before."

Makes you wonder how we're going to get out of this economic mess, doesn't it?

Enjoy the cruise!

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