

History Shows Unemployment Numbers can Be Misleading

By Rick Foytek, CFA

One of the most talked about effects of this current recession has been the growing number of people joining the ranks of the unemployed. To add insult to injury, the financial markets seem to take its cues from the monthly jobs report. Whether or not you have personally joined the ranks of the unemployed or simply know somebody who has, it is an important issue that will be with us for some time to come. While we can all easily put our hands on the current statistics--8.5% national unemployment, 12.6% for Michigan, and over 5 million jobs lost since the recession began--understanding what we can expect over the coming months is quite different.

For a little historical perspective, we should go back to the late 1990s, when technology stocks were in full rally mode. One of the reasons that this sector was doing so well is due to the promise of greater productivity. More specifically, the ability to manufacture the same amount of widgets with fewer employees or more widgets with the same number of employees was a driving force behind much of the spending on technology. Not only was this concept attractive to individual companies, it was also seen as a boost to the overall economy. In fact, productivity was often referred to as the "speed limit" of the economy. Said differently, the economy could grow faster, without the inflationary effects due to the lack of dependence on as many employees. More specifically, the lower risk of wage inflation raised the potential growth rate of the economy. This strategy worked well. Advancements in technology allowed profit margins to expand, product offerings to rise, and IT jobs to surge.

While these developments provided a nice tailwind for the economy during the late 1990s, the story was much different for much of the subsequent recession and recovery. In fact, we experienced what was called a jobless recovery as we clawed our way out of the recession of 2001. While a jobless recovery sounds about as logical as government intelligence or jumbo shrimp, we all watched it happen. Simply put, we did not see the typical improvement in the job market as the economy embarked on the road to recovery. This was in part due to the efficiencies that were created by the rise in productivity. Said differently, we didn't need to call back as many employees as were let go.

While each recession begins and ends differently, we would not be surprised to see this recession end with a jobless recovery. All we have to do is look to the automotive industry for an example. All of the auto manufacturers, both domestic and foreign are retooling to prepare for a materially different sales climate. As a result, we are watching plants being closed, brands being discontinued, and companies going through unprecedented restructuring. Because of this massive restructuring and the shift in demand, we will likely see a much more muted and delayed recovery for the automotive industry when compared to the broad economy. And once the auto industry does recover, the new model will be to do more with less, which means most of the job losses auto

personnel are experiencing today will be permanent. However, despite the changing automotive landscape, the broad economy and broad employment situation will once again improve.

While a jobless recovery is less than optimal, there are reasons to be optimistic. For starters, many opportunities are spawned during times of change. A perfect example of this is the current push into both green technology and green energy. These industries will demand thousands of employees at every level. Another example is health care. We have all been hearing about the “Graying of America” for some time. As the wealthiest generation begins to retire, they will demand more and more health-related products and services to afford them the lifestyles they wish to maintain.

We would also caution against reading too much into the unemployment data. The biggest reason for this advice is that the surveys and statistics exclude small companies. This exclusion means that people who take advantage of an opportunity and start a small business are never counted as employed. Just think about the e-Bay phenomenon. Some reports claim that over 1.25 Million people create income by selling on e-Bay. What is equally amazing is that e-Bay wasn't founded until the fall of 1995. While it is likely that not all of these people have replaced their previous income, it illustrates how someone can be “unemployed” yet still earning money. This has the potential to seriously underestimate the number of employed, as small businesses have long been responsible for growth in our economy. Excluding the small businesses also has the potential to invalidate forecasts for home sales, retail sales, and auto sales. Underestimating these sales forecasts may be appropriately conservative in the beginning, but it creates a scenario where companies may in fact need to play catch up with their hiring when demand rises more than was originally anticipated.

As we continue to experience the evolution of our economy, we will undoubtedly witness evolution in the job market. Over the past 10-20 years, we have watched as we have transitioned away from a primarily manufacturing-centric economy to a service based economy. While there may be some jobs to be regained in the manufacturing segment of this economy, the more sustainable growth will likely come from the service sector. However, small businesses have many more opportunities available to them in both the manufacturing and service sectors.

Hopefully you and those around you will remain insulated from the current weakness in the job market. Additionally, we would encourage you to take what you read and hear with a grain (or boulder) of salt. If you do become one of 8.5% that are unemployed, we would encourage you to look for opportunities in the growth sectors of this evolving economy.

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