Weekly Commentary with Professor Jeremy J. Siegel

Soft Payrolls, Strong Earnings Reinforce Bullish Outlook

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The market was jolted by a much weaker-than-expected employment report, sending Treasury yields sharply lower as investors quickly reduced the odds of another Federal Reserve rate hike. At first glance, the payroll number looked alarming, particularly when combined with sizable downward revisions to prior months and unexpectedly soft wage growth.

But I believe the headline overstated the weakness in the labor market. Much of the decline appears attributable to temporary factors—including weakness in leisure employment following the World Cup, seasonal distortions in state and local government hiring, and ongoing shifts in labor force demographics—rather than a sudden deterioration in underlying economic conditions. Most importantly, the unemployment rate actually fell to 4.1%, indicating that labor demand remains broadly consistent with today's slower labor force growth.

The labor market has entered a new equilibrium. With slower population growth, tighter immigration, and an aging workforce, monthly payroll gains of roughly 20,000 to 40,000 are increasingly sufficient to keep unemployment stable. The twelve-month average job gain has settled near that range, suggesting the economy is growing close to its sustainable trend rather than slipping into recession. The weaker employment data could ultimately prove constructive if GDP growth holds up. Fewer hours worked producing the same level of output would translate directly into stronger productivity growth—precisely the development investors have been waiting to see as artificial intelligence becomes more deeply embedded throughout the economy. While recent productivity reports have disappointed, the labor revisions raise the possibility data will start showing the long-awaited AI-driven acceleration.

For monetary policy, the employment report materially lowers the chance of a rate increase. Inflation data over the next week will remain critical, but oil prices continue to be the key variable. Gasoline prices have risen from their recent lows following renewed geopolitical tensions, yet futures markets currently imply modest declines over the coming months if Middle East tensions do not escalate further. Money supply trends also deserve close attention here. Since the onset of the recent conflict, M2 has expanded at roughly an 8% annualized pace, but that growth now appears to be moderating back toward the 5% to 6% range. That remains above pre-war levels but is far removed from the explosive monetary expansion experienced during the pandemic. Unless oil prices experience another significant spike, I believe it will be difficult for the Fed to justify raising rates at its September meeting.

Corporate America continues to deliver remarkably strong earnings, with profit margins reaching levels rarely seen outside of powerful post-recession recoveries. I believe much of this strength is structural rather than cyclical. Today's technology leaders expense enormous investments in research, software, and intellectual property rather than capitalizing them as traditional physical assets. That accounting treatment makes reported profit margins appear extraordinarily high even though companies are earning returns on massive investments that never appear on the balance sheet. Outside tech, profit margins remain relatively stable, suggesting the extraordinary profitability is concentrated among firms benefiting most from AI and intangible capital rather than reflecting excessive leverage or unsustainable pricing power.

The key question going forward is whether AI finally begins to show up in the productivity statistics. If businesses produce more with fewer workers while maintaining exceptionally strong earnings growth, the economy may be entering a more favorable long-term productivity cycle. That would support continued earnings expansion, ease inflation pressures, and ultimately allow monetary policy to become less restrictive. The labor report may have surprised investors, but beneath the headline, the broader story remains one of an economy that continues to adapt, innovate, and demonstrate remarkable resilience.

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