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Ellumination Newsletter

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Recency Bias: Overlooked Risks in the Labor Market

September 17, 2025

The recent stream of economic data has us wondering if the investment world might be suffering from recency bias. Recency bias refers to the human tendency to overemphasize recent events. It's a basic survival instinct. If you live through a threat, you take steps to protect yourself against that threat. However, we often overprotect against the last known threat and discount threats in the past. Here is an example of how this can play out in real life. When I moved to Napa in 2015, the topic of earthquakes was discussed every time I saw a new house. Why? Napa suffered material damage in 2014 from an earthquake. Real estate agents would point out any damage and discuss earthquake risk. We have not had a major earthquake since, but we have had multiple fires over the last 10 years. When you tour houses today, fire risk is very top of mind. Real estate agents will point out potential danger and discuss ways the property has been remediated to reduce potential fire risk. You want to guess what no one is talking about now? Earthquake risk!

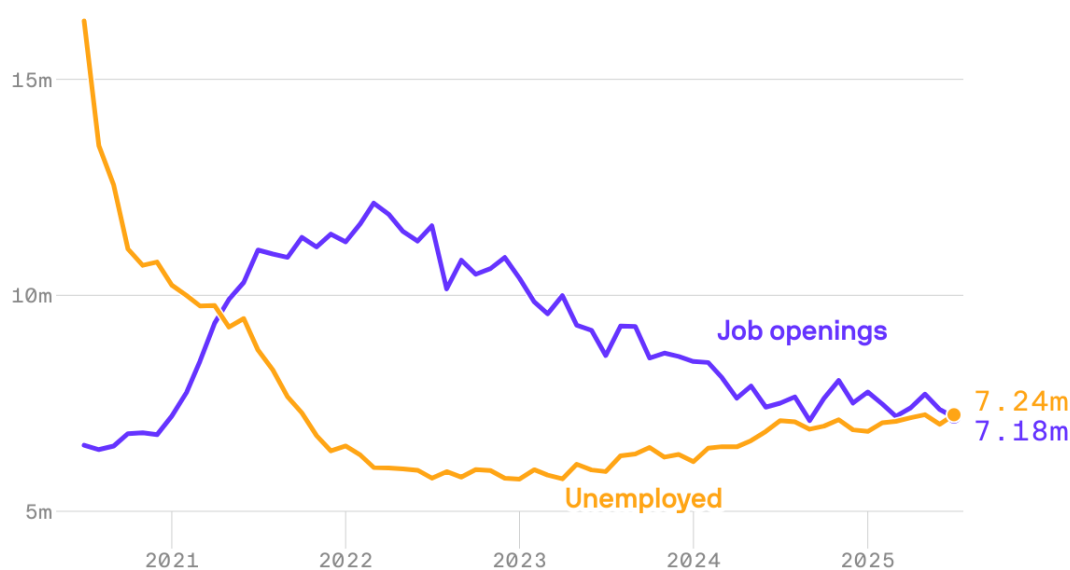
This dynamic plays out in the investment world too. Investors tend to prepare for the last disaster. After the Dot-Com crash, investors focused heavily on valuations and growth rates. After the Great Financial Crisis, investors focused heavily on leverage in the system. I am sure we don't have to tell anyone that the last disaster, the bear market of 2022, was driven by the Fed rapidly increasing interest rates to fight runaway inflation. Hence, it's natural that people

are watching inflation closely now. We are certainly guilty of this. We've communicated with our clients about the dangers of inflation creeping back up, especially as President Trump launched a massive global tariff war. We, like all of you, do not want to be caught in another bear market driven by to the Fed's response to high inflation.

However, trouble seems to be brewing elsewhere this time and, so far, it's being largely overlooked by investors. We're talking about the weakening jobs market. The news on the labor market is being reported widely, but the stock market has barely reacted. Last week we got more bad news, including a troubling update where job openings dropped below the number of unemployed. That hasn't happened since COVID.

Job openings and number of unemployed Americans

Monthly; July 2020 to July 2025



Data: Bureau of Labor Statistics. Chart: Axios Visuals

This is further evidence that the labor market is weakening quickly. The popular narrative so far has been that the labor market is holding up well because unemployment is still relatively low. That story is getting harder and harder to tell. Unemployment is rising, job openings are vanishing, and prior job growth estimates are being revised down at historic levels.

So why is the market still near all-time highs if the labor market is falling apart? As investors digested the job openings number, the general feeling was that it was good news because it gave the Fed an easier path to cut rates. In other words, we are firmly back in “bad news is good news” territory. Talking heads glossed over the bad jobs numbers and excitedly talked about how the Fed is now projecting three 25 basis point rate cuts in 2025, including one that happened today. The expectation is that the Fed can rescue the bull market once again. They are probably right to assume so. Certainly, expected stimulus in a variety of forms is part of the reason we are not rushing out of the market.

However, we do not take it for certainty that the Fed can get us out of the mess alone. The issue is that it's not entirely clear to us why job openings are down so much. While there are a lot of theories, no one really knows what is happening. Some people have blamed the issue on tariffs. However, the decline in job openings clearly started in 2022 which seems to refute this theory, at least in part. Some people have pointed to President Trump's deportation efforts. That theory states that companies are pulling job openings because they can't find applicants. It could be that companies over-hired coming out of COVID and are now growing into their headcounts.

At 5T, we think the most likely theory is that this is the beginning of AI's impact on jobs. We've heard too many examples of how AI can replace headcount to discount this theory. Companies may simply be doing more with the people they have and not have as much need for new employees. If that is true, then the Fed's rate cuts may not easily translate into new hires.

Hence, in the short term, we understand why the market is excited. Lower rates should stimulate the stagnant economy. Rate cuts will surely help reprice many assets, especially higher risk assets and real estate. We don't want to lose sight of the fact that rates cuts are needed because the economy is weakening. If the cuts stimulate job growth, then optimism will be warranted. However, if the rate cuts fail to bring a turnaround in the labor market, we could be in a lot of trouble and the rate cuts could add fuel to inflation at the worst time. See, there we go worrying about inflation again!

All the best,



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