Good News/Bad News!
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There was a lot of economic news last week. It reminded me of when someone says to you – "I've got good news and bad news. Which do you want to hear first?" The week's bad news was the certainly the big tumble in the stock market. The irony was that it was sparked by the great news that the U.S. unemployment rate is falling faster than anyone expected.

What's the connection between these two news items?

First let's examine the good news. America's economy created 295,000 jobs in February, a pace of growth faster than for 2014 as a whole. Unemployment fell to 5.5%, a level that, back in 2013, the International Monetary Fund predicted would not be reached until 2018.

Reports show that America is now creating jobs faster than at any time since the year 2000, which is inline with the fast-paced economy of the late 1990s. Reports also indicate that there are 1.7 million more employed people than last year. More importantly, perhaps, there are 1.1 million fewer people in the "long-term unemployed" category, which is now down to 2.7 million overall.

How could such great news negatively affect the U.S. stock market?

There are three possible explanations. First, the labor markets may be creeping toward that place where businesses have to compete for talent and pay their workers higher wages. When payrolls go up, corporate profits go down. There is little direct evidence this is happening yet—overall, wages are up just 2% in the past year, roughly even with inflation. But there are reports that small business employers have more unfilled job openings than at any time since April 2006. Meanwhile, the average workweek is inching up, which suggests that companies need people at their desks longer than they did before.

If the unemployment rate hits 5.4%—which could happen this Spring—then our economy will have reached what Federal Reserve economists consider to be "full employment." This, of course, does not mean what those words actually say; it is a coded way of saying that the balance of negotiating power will have started to shift from employers to workers.

The second reason could be bond rates. As stocks were falling last week, bond yields were actually moving upward in what was described as the biggest one-day selloff since November 2013. In fact, the yields on 10-year Treasuries rose from 2.11% to 2.239% in a single day. This makes sense because as bonds become more competitive with stocks, demand for stocks goes down—as do stock prices. Surprisingly, stocks yielding the highest dividends tended not to fare as well in selloffs. This may suggest that investors who had been relying on stocks for income are now making a shift back to bonds.

The third and maybe the most significant reason for the last week's market turn down is the increased chances that the Federal Reserve will move up its timetable for raising interest rates. The news that unemployment rates are decreasing at a rate much quicker than expected, raises the likelihood that the Federal Reserve would raise interest rates sooner than expected. The Fed has held interest rates close to zero for more than six years to stimulate growth following the 2008 global crisis. But last week's announcement about employers adding nearly 300,000 jobs last month, which was far above expectations of about 235,000, fueled expectations unemployment would fall further and inflation might pick up.

So, how credible are these three concerns?

While it's important to monitor the activity in the market, it's equally important to remember not to overreact. After all, the federal government is certainly not going to raise interest rates from zero to 5 percent overnight. Further remember that if interest rates are going up, it's because the economy is getting stronger, and while rates are rising, they still remain low by historical standards.

Bottom line, while some may base their financial decisions on headlines and trumped up news media, smart investors know to pay attention but not panic. For those of us monitoring a carefully planned, long-term investment strategy we should be celebrating now another positive step in the U.S. economy's steady recovery.

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