



Why We Worry – Part II

Dear Investors

In Part I of this series, we outlined why we believe the economics underpinning the AI boom may be far less sustainable than consensus assumes. In this instalment, we turn to a second, equally important fault line: the US labour market.

Beneath the surface of resilient headline data, a meaningful shift is taking place. Hiring has stalled, layoffs are broadening, and early signals from private datasets are beginning to resemble the early stages of past downturns. At the same time, the adoption of AI-driven automation is accelerating, introducing new pressures on employment that did not exist in previous cycles.

Whether these developments fade as they did in 2023, or whether they evolve into a layoff-induced recession, will be one of the defining questions for markets in the year ahead. In Part II, we unpack the evidence and explore what it may mean for both the economy and our investment stance.

Early Signs of a Slow-Fire Labour Market

One potential catalyst for the AI bubble to unwind is a layoff-induced recession. If job losses accelerate and economic activity weakens, growth in AI usage could fall sharply. A meaningful slowdown in AI capex would almost certainly reinforce economic weakness. In the hierarchy of what drives the business cycle, consumer spending (~\$20 trillion annually) matters far more than AI investment (~\$500 billion annually).

Conventional wisdom currently suggests that we're in a "low-hire, low-fire" environment. Increasingly, however, we're beginning to see data suggesting something closer to a "slow-fire" environment. While we laid out early signs of this in our recent [monthly update](#), the evidence has strengthened.

Multiple labour-market indicators have deteriorated:

- ADP, which tracks roughly a quarter of the private workforce, recorded 32,000 layoffs in November.
- Revelio Labs, covering around 35% of workers, also reported a decline in total nonfarm employment in October.
- Indeed's job postings now sit just 4% above pre-COVID levels, indicating a material softening in labour demand.
- Indeed's wage growth measure has fallen back to 2019 levels.
- While the government-produced headline payrolls number was solid for September, underneath the hood measures that typically lead a recession were also present – a rise in the unemployment rate and a drop in wage growth.
- Our own labour market data we track suggests that a sizeable number of layoffs occurred again in November.

For the purposes of enquiry, will this continue? Or will it be one-off like in 2023? What are the odds of a layoff-induced recession? The answer will likely meaningfully shape the fate of both the macroeconomy and the AI investment cycle.

AI Adoption as a Growing Driver of Layoffs

As a starting point, we are now seeing a clear rise in companies explicitly using AI to reduce headcount. A few recent examples illustrate the breadth of this trend:



- **McKinsey**, the consultancy, recently cut 200 jobs in a shift to join rivals in using AI to automate some positions. Management noted that “we will upskill folks more, we will probably have fewer folks in the non-client deployed areas, but they will be leveraged by today’s technology and AI.”
- **Allianz**, the insurer, announced plans to cut up to 1,800 jobs due to advances in AI automation. The job losses will mainly affect call centres and claims – departments where Allianz has a lot of employees currently.
- **Hewlett-Packard**, more commonly known as HP, will cut around 6,000 jobs by 2028 as the company leans into AI adoption. The layoffs will primarily affect those in product development, internal operations and customer support.
- **Clifford Chance**, a UK law firm, announced that it will reduce 10% of its back-office staff, directly attributing the cuts to AI-driven efficiencies.
- **ASN Bank** and **ING Bank**, both of Dutch origin, said that they will each cut up to 1,000 jobs due to digitalisation, AI and evolving customer needs.

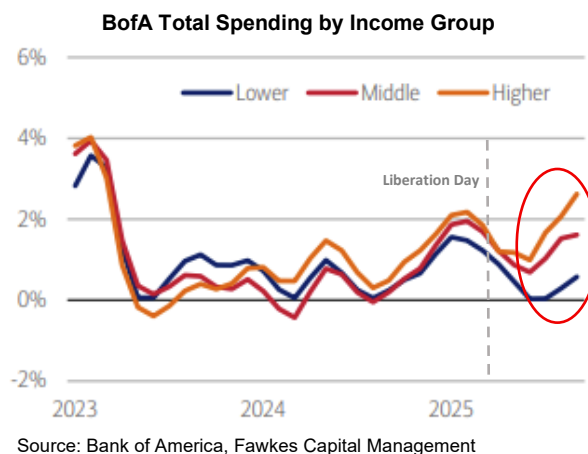
These are only a selection of the announcements made in just the last couple of weeks. In many cases, companies do not cite AI explicitly, yet the scale and concentration of the cuts strongly imply AI-driven restructuring. The common thread is that large portions of the workforce are being targeted for retrenchment, particularly in functions where LLM agents, automation tools, or AI-assisted workflows can meaningfully reduce human labour.

We think this trend is likely to intensify. Companies that would traditionally be late adopters – including insurers, banks, law firms, industrials and consumer-facing businesses – are now openly embracing AI to drive efficiency. The industries experimenting with and deploying AI are increasingly broad-based, and the cost incentives are compelling.

An interesting point of difference between the current AI bubble and the dotcom bubble is that the labour market was extremely strong just before the 2000 tech crash. The internet buildout was a net positive for job creation during its early adoption. The same cannot be said about AI.

The Divide in Consumer Spending Power

Under the surface, signs of macroeconomic strain are becoming harder to ignore. Following the imposition of Trump’s tariffs, a clear bifurcation has emerged between the spending behaviour of higher-income and lower-income consumers:



This macro data has been corroborated by commentary from consumer-facing companies throughout earnings season. Why does this bifurcation matter if aggregate spending growth still appears resilient? First, economic growth is determined at the margin: when the most financially constrained consumers begin to retrench, the slowdown can spread quickly.

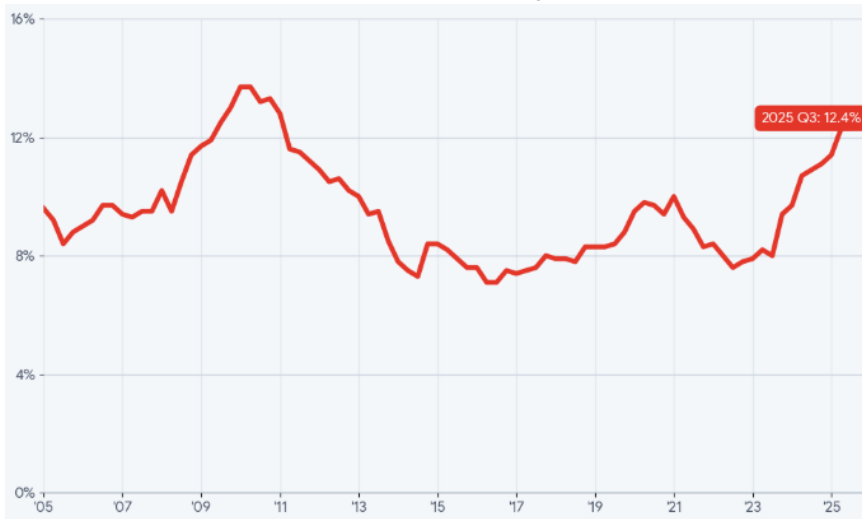
Second, the cost-of-living crisis weighing on real wages for lower-income Americans shows no signs of abating. With wages softening and inflation sticky, this cohort appears to be running out of spending capacity. By Bank of



America's estimates, lower-income households are seeing their post-tax wages rise by around 1.5% but inflation continues to remain elevated at around 3%. Real spending growth is very likely to decline from here. We therefore expect overall consumption growth to slow meaningfully over the next six months, increasing recession risk.

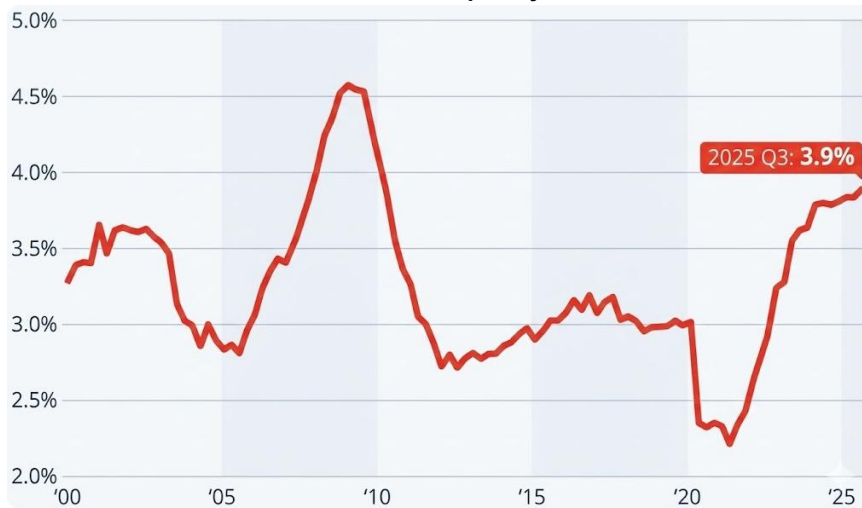
When rates rose in 2022 and the downturn came, low-income households cushioned rising living costs by drawing down Covid-era savings. Today's data, however, suggests that buffer has largely evaporated. Many of these consumers are now either unwilling or unable to reduce savings further, and their capacity to borrow has diminished. Instead, they are cutting back and shifting more of their spending to discount retailers. Consumer delinquency rates, meanwhile, have climbed back towards levels last seen during the GFC:

Credit Card Delinquency Rate



Source: Statista

Auto Loan Delinquency Rate



Source: Bankrate

Net private savings rates, as a share of the overall economy, have now fallen to very low levels – particularly among lower-income households. As Bill Gross observed in *The Bond King's Greatest Hits*, this dynamic echoes the vulnerabilities seen in past bubbles. In his November 1999 investment letter, he warned:

"[a]n economy that feeds on capital gains must cool off if those capital gains do the same. Our prosperity, to return to the same phrase, depends on prosperity itself, and at least some of our prosperity depends upon a booming stock market. History shows that the current state of affairs cannot continue indefinitely."



We are not yet at the same magnitude or duration of dissaving that characterised the late-1990s cycle. But given today's weakened labour market, the parallels are uncomfortable. Any further deterioration in spending power now poses a real threat to the broader economy.

When concerns aren't well-founded, they simply lead to missed opportunities. But in our view, the balance of risks has shifted. The reward for taking equity risk no longer appears compelling, and the downside feels increasingly asymmetric. At present, remaining fully long equities feels more like a gamble than a prudent investment stance.

Kind Regards,
Fawkes Capital Management

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