

ECONOMIC OUTLOOK

Summary

The narrative surrounding the labor market has taken a decisive turn following the release of the July non-farm payroll report. Prior to this, signs of cooling were evident, though not yet alarming. Year-to-date monthly payroll gains had peaked at 158,000, which was notable since there were five months of 200,000+ job growth in 2024. As of June, the three-month average job growth decelerated to a modest 150,000.

However, the July payroll data dramatically altered this perspective. At 73,000 jobs gained, headline job growth missed an already low expectation by 32,000 jobs. While not ideal, the more significant revelation came from the substantial two-month net revision, which removed a staggering 258,000 previously reported jobs. This revision brought the three-month average job growth down to a mere 35,000, signaling a much weaker employment picture than previously understood. It is worth noting that monthly revisions have shown increased volatility since the COVID-19 pandemic, largely due to reduced response rates to government questionnaires, yet the sheer magnitude of this particular revision is profoundly impactful for both market participants and the Federal Reserve.

Just two days prior to this pivotal jobs report, the Federal Reserve concluded its July meeting, opting to keep interest rates unchanged. Intriguingly, for the first time since 1993, two Fed Governors (Bowman and Waller) dissented from the committee's decision, advocating for a 25 basis point rate cut. Both cited a weakening job market as a primary concern, underscoring the growing apprehension within the committee.

The Federal Reserve, tasked with its dual mandate of full employment and stable prices, adopted a hands-off approach

in the first half of the year. Despite inflation consistently coming in below expectations—even defying predictions of a surge from tariffs—policy uncertainty prompted the Fed to maintain its restrictive stance, delaying rate cuts. Even so, other economic indicators have signaled a cooling economy, such as first-half GDP growth slowing from the pace of the past few years, driven by the slowest personal consumption data since the pandemic. Additionally, cycle-high continuing jobless claims and weak ISM data suggest softer future economic prospects. The July payroll report will undoubtedly compel the Fed to move beyond mere observation and once again become truly data-dependent at their September meeting.

Positives

Second quarter GDP beat estimates (3.0% vs. 2.6% est.)

Core CPI (excluding food and energy) was lower than expectations for the fifth consecutive month

Retail sales showed growth for the first time in three months (0.6%)

Negatives

The unemployment rate moved higher by 0.1% to 4.2%

The labor force participation rate declined for the fourth straight month (62.2%)

Factory orders had their largest drop since the pandemic (-4.8%)

EQUITY OUTLOOK

Summary

U.S. equity markets reached an all-time high during the month of July before retreating slightly in the closing days of the month. Still, the S&P 500 rose 2.2% in July and now sits higher by 8.6% for the year. The Russell 1000 Growth Index climbed 3.4% outpacing the 0.9% rise in the Russell 1000 Value Index. International markets were mixed with the developed international MSCI EAFE Index falling 1.4% and the MSCI Emerging Markets Index adding 2.0%.

Despite lingering tariff uncertainties, equity markets responded positively to positive trade negotiations and developments, mostly resilient economic data and a solid start to Q2 earnings season. Looking forward, the outlook for the remainder of 2025 looks cautiously optimistic. Equity markets have seemingly become desensitized to the ever-changing tariff dynamics although that could change if inflation begins to flare up again.

The stock market's momentum is still very clearly positive although that can change rather abruptly. Equity markets look somewhat overbought in the near term and valuations are lofty from a historical standpoint. This sets the stage for some potential choppy markets as we move into the back half of the year. Global markets are poised for divergent performance given structural reform and uneven trade dynamics influenced by the Trump administration's tariff policies.

Positives

Recession risk continues to decline

Tech-driven productivity gains boost profitability

Negatives

Equity valuations are historically stretched

August and September are historically poor months

Unknowns

Federal Reserve bracing for more challenging decisions

Trade deals being negotiated but many road bumps lie ahead

FIXED INCOME OUTLOOK

Summary

For the third month in a row, the 10-year rate traded in a fairly narrow range. Except for a few days, the yield has been oscillating in a range of 4.20% to 4.50% since early May. Within the range, yields trended from the lower end to the highs in the first half of July following the passage of the “One Big Beautiful Bill” and June’s stronger-than-expected payroll growth. Rates then eased a bit lower as more mixed to soft data clouded the economic outlook. For the full month of July, interest rates rose across the entire curve with the 2-year rising 24 basis points (bps) and the 10-year advancing by 15 bps. Treasury bonds delivered a negative return.

At the July 30 meeting of the Federal Open Market Committee (FOMC) there were two dissents, which had not happened since 1993. The dissenters favored a rate cut and were concerned about a slowing economy, justifiably so. Even though the second quarter’s GDP surprised to the upside at 3%, the rate of growth for the first half of the year was just 1.2%, about half of last year’s pace. Additionally, personal consumption, which has driven the economy in recent years, declined to less than one-third of last year’s pace. The data available for the meeting indicated a resilient overall labor market, but growth in private company payrolls had begun to slow and new unemployment claims rise. Two days after the FOMC meeting the dissenters were vindicated as the July payroll report painted a completely different picture of the labor market. With a disappointing July and huge revisions, the three-month average growth in non-farm payrolls was now just 35k. Yields dropped to the low end of their trading range. Having previously removed expectations for a September rate cut, investors now fully anticipate one then and at least one additional by year’s end.

For the second month in a row, the size of the investment-grade corporate bond market shrunk as redemptions, maturities and coupons surpassed new issuance. At \$83 billion, July’s new issuance was the lightest of the year and 16% below the previous four-year average. After a record pace in the first half of the year (excluding the pandemic issuance of 2020), year-to-date issuance is now flat to last year’s pace while maturities

have accelerated. Credit spreads narrowed by about 7 bps during July and now offer only about 70% of their average spread of the past three years. The tightening spreads allowed investment-grade corporate bonds to outperform Treasury bonds and delivered a positive return for July. This shortage of supply should support the historically tight credit spreads as reinvestment of cash flows will become more and more challenging for bond fund managers.

We believe the early August decline in rates was justified by the weakening labor market and will be supported by the increasing likelihood of Fed rate cuts. But given the budget and tariff uncertainties we still recommend maintaining a neutral duration policy. With limited supply, we also continue to favor corporate bonds over Treasuries, although we are unlikely to materially increase our credit exposure at current levels.

Positives

Labor market has slowed increasing the likelihood of Fed rate cuts

So far, inflationary pressures have eased even in the face of new tariffs

Negatives

Some tariff inflation might just be delayed as producers work off inventories

Budget deficits requiring more Treasury issuance

Unknowns

Escalation of trade tensions

Resolutions of Russia/Ukraine war