Seth D. Rosenthal, CFA
John Gilmore

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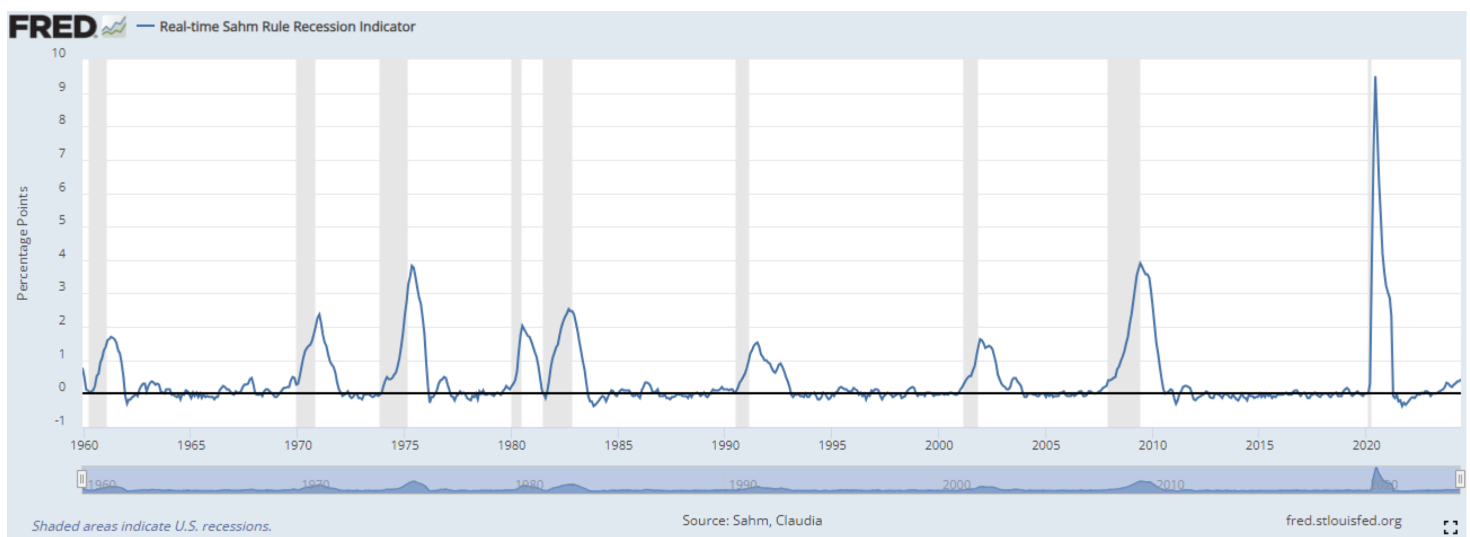
The U.S. labor market shows signs of weakness, with the latest report revealing a sharp slowdown. Nonfarm payrolls increased by only 114,000 in July, falling short of expectations, and the unemployment rate rose to 4.3% from 4.1% in June. The current unemployment rate is above the Fed's year end target. This uptick has triggered discussions around the Sahm Rule, a recession indicator we highlighted last month. This rule, which has accurately identified every recession since 1970, signals the start of a recession when the three-month moving average of the national unemployment rate (U3) rises by 0.50 percentage points or more relative to the lowest three-month average from the previous 12 months.

On the inflation front, the U.S. continues to see easing price pressures. The annual inflation rate fell for a third straight month to 3% in June 2024, the lowest since June 2023, while core inflation remained steady at 3.4% in May. Although these figures suggest progress toward the Federal Reserve's 2% target, they are still above the desired level.

Geopolitical tensions in the Middle East have notably impacted risk sentiment. While oil prices initially rose due to fears of a broadening conflict, they settled lower as global supply remained largely unaffected. However, the situation remains volatile, with crude oil prices rising in response to escalating Iran-Israel tensions. Simultaneously, the Shanghai Containerized Freight Index indicates a significant increase in freight rates, reflecting growing concerns about shipping disruptions and potential inflationary pressures.

Consumer sentiment has been mixed. The University of Michigan Index fell to 66.4 in July from 79.4 in March, indicating growing concerns among consumers about the economic outlook. Conversely, the Conference Board's consumer confidence index rose to 100.3 in July from 97.8 in June, driven by improved near-term expectations but weakened perceptions of current conditions. High-income consumers have benefited from strong risk asset performance. However, risk-off sentiment may pressure the Fed to cut rates further.

The Federal Reserve has maintained a cautious stance, keeping interest rates unchanged at 5.25%-5.50%. While signaling openness to future rate cuts, the Fed emphasizes the need for confidence inflation is moving sustainably towards its 2% target before easing. Market expectations for Fed policy shifted dramatically after the latest payroll report, with traders now pricing in a nearly 50 basis point cut in September and over 125 basis points of total cuts before the end of 2024. This reflects growing concerns about economic growth and potential recession. Beyond maximizing employment and stabilizing prices, the Fed must ensure financial stability. We remain vigilant to market volatility and the effects of contrasting central bank monetary policy (e.g., Yen carry trade). Without continued weak data or additional market instability, we anticipate Chair Powell will downplay the probability of a 50 basis point cut at Jackson Hole.



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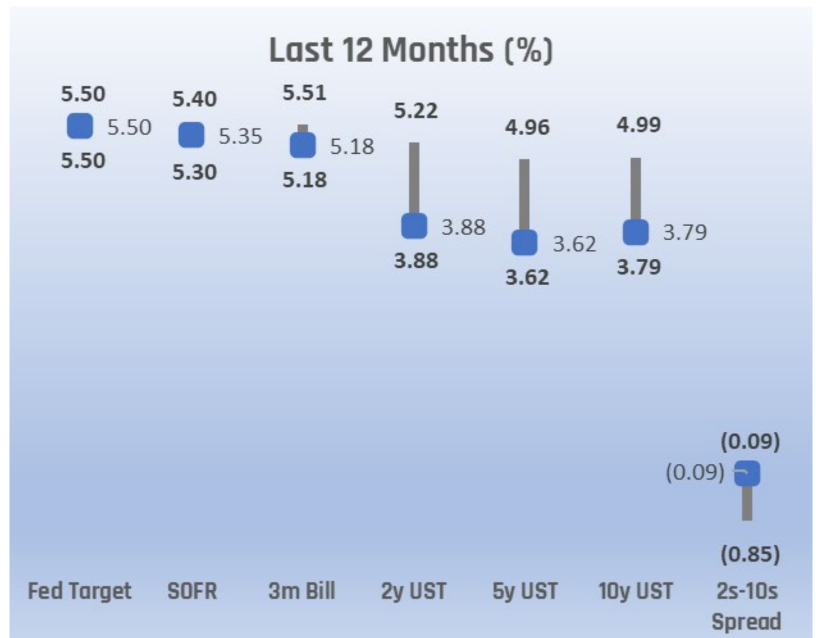
Product Views

Rates: Yields across the 2-year to 10-year Treasury curve have fallen below 4.00% following the recent payroll report. The 2s-10s curve is now -9bps, the least inverted since July 2022. Market expectations for Federal Reserve policy have turned increasingly dovish, with implied rates projected to decline nearly 250 basis points over the next two years. While this is not unreasonable, the front-loaded nature of these anticipated cuts (125 bps for the rest of the year) feels aggressive. We believe better entry points will emerge as markets rationalize these expectations.
Given these dynamics, we have adjusted our stance to a neutral duration. This approach allows for flexibility to capitalize on more favorable conditions as the economic outlook and Federal Reserve policies become clearer.

Credit: Corporate credit spreads have widened following Friday's payroll report. We still view spreads as below fair value, especially given concerns around economic deterioration. Although high-grade corporate fundamentals remain solid, corporate performance will be largely impacted by macroeconomic factors.

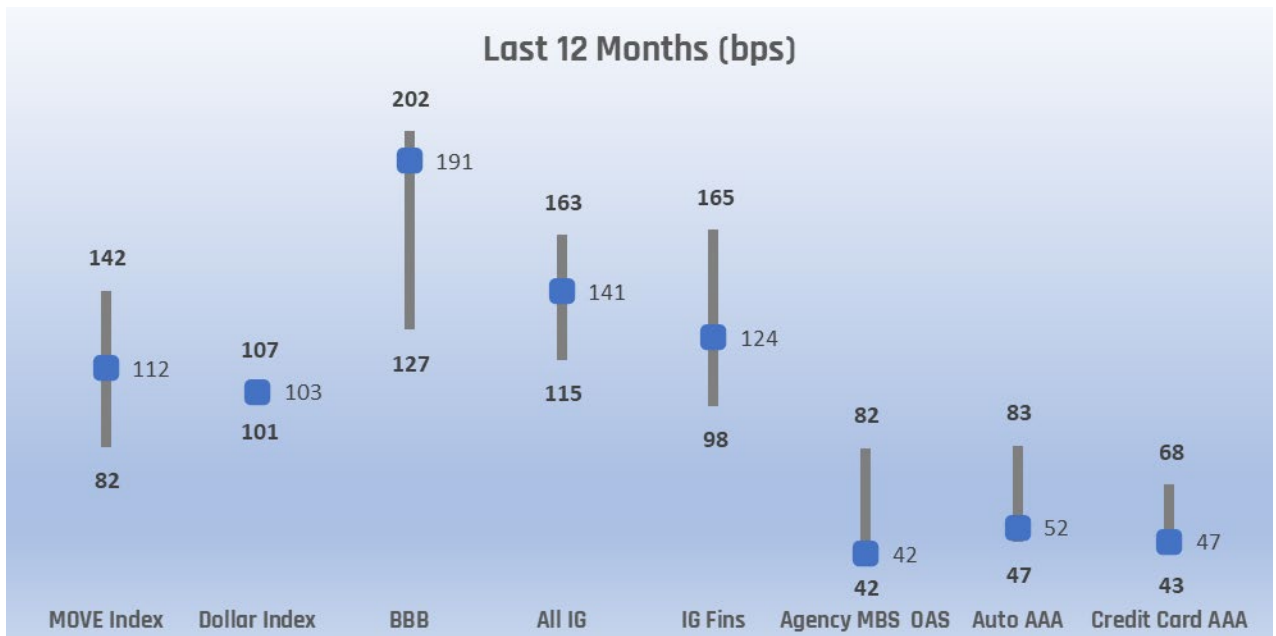
Securitized: We maintain a strong preference for securitized assets, particularly consumer ABS and Agency MBS. Despite the recent spread tightening in Agency MBS, we foresee additional narrowing. Consumer ABS indices have outperformed the Aggregate Index this year, a pattern likely to persist. Credit fundamentals of ABS are robust, and Agency MBS are positioned to provide stability in an economic downturn.



12 month high

Current

12 month low



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