ACADEMY
ASSET MANAGEMENT

Market Update

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The labor market has been a key driver of consumer strength, but this trend appears to be changing. The unemployment rate for June ticked up to 4.1%, and non-farm payrolls added 206k jobs, with notable changes in government (+50k) and professional and business services (-48k). Additionally, two-month net revisions were down 111k, and initial jobless claims have been trending higher since February stoking concerns of a slowdown in the labor market.

Growth appears to be moderating, with the Atlanta Fed's GDP forecast for Q2 at 1.5%. The lagged effects of Fed rate hikes continue to curb growth, with higher borrowing costs impacting levered consumers and corporations.

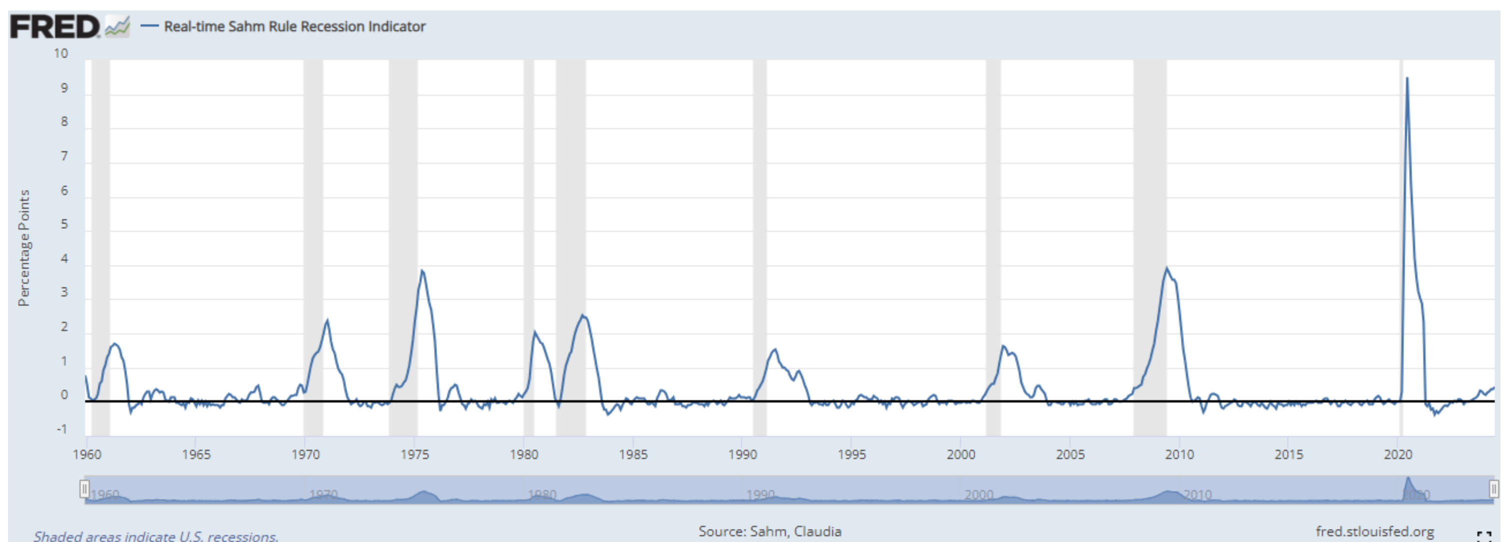
The Personal Consumption Expenditures (PCE) Price Index, the Federal Reserve's preferred inflation gauge, showed a year-over-year increase of 2.6% in its May reading, down from 2.8% in previous month, indicating a gradual easing of inflationary pressures.

Although consumers have been impacted by rising borrowing costs from Fed tightening, equity markets have rallied, with both the S&P 500 and Nasdaq setting new records, as investors price in a high likelihood of a soft landing. It is worth noting that excess savings are concentrated at the top of the income distribution. The top 20% of incomes account for about 40% of consumer spending and 80% of wealth. Consumer sentiment, as evidenced by the University of Michigan Sentiment Index, has been dropping over the last three survey periods.

Credit performance continues to deteriorate. Commercial real estate delinquencies among the largest banks have more than doubled since September 2023 and are now at their highest since the GFC cycle. Credit card balances and delinquencies are also rising. There is less transparency in emerging lending areas such as buy now, pay later (BNPL) which merits investigation.

Geopolitical risk remains a significant concern as the potential for worsening global conflicts cannot be ignored. Political drama associated with the upcoming U.S. elections could also elevate geopolitical risks. We remain focused on the deteriorating relationship between the United States and China which adds to increased uncertainty.

Easier financial conditions since Q4'23 have partly offset the effects of Fed hikes. The Fed is balancing the lagged effects of tightening with the risk of spurring inflation by easing too early. Fed officials remain cautiously optimistic about managing inflation but are committed to their 2% target and are closely monitoring economic data to inform future policy actions, including potential rate cuts. We continue to expect the Fed will cut one time later this year and will be forced to cut more aggressively next year.



The Sahm Recession Indicator 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 minimum of the three-month averages from the previous 12 months.

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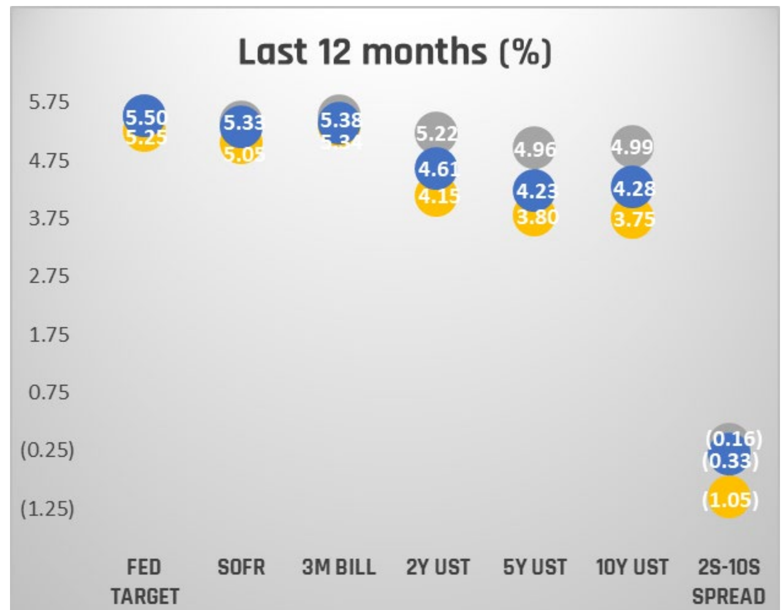
Product Views

Rates: Rates have modestly declined over the past month due to moderating growth and inflation, with markets anticipating a soft landing. The Treasury curve is inching towards disinversion, with the 2-year Treasury falling to 4.61% and the 10-year remaining relatively unchanged. We continue to favor adding duration in the front to intermediate parts of the curve in anticipation of Fed easing.

Credit: While corporate credit spreads have slightly widened over the last month; they are still in the bottom quartile historically, currently at 89 bps for the broader index. While high-grade corporate fundamentals remain solid, we maintain cautious due to minimal upside potential for significantly tighter spreads.

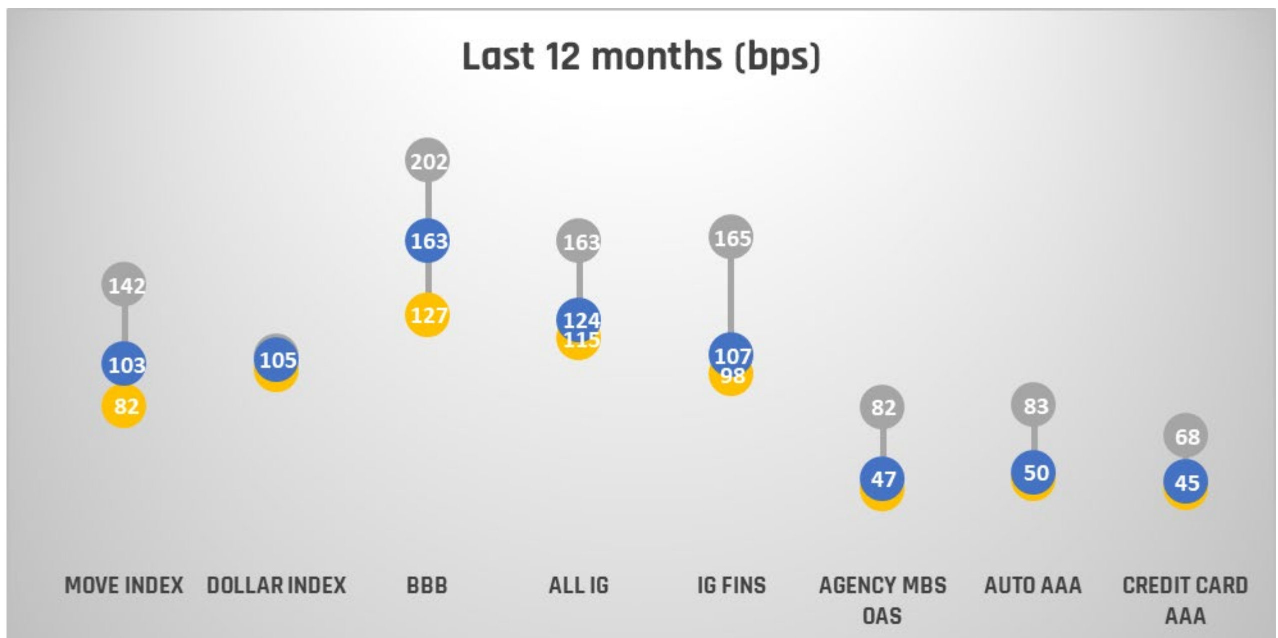
Securitized: We continue to prefer securitized assets, especially consumer ABS and Agency MBS. While spreads in Agency MBS have tightened, we anticipate further tightening. Consumer ABS indices have outperformed the Aggregate Index year to date, a trend we expect to continue throughout the year. Spreads in these asset classes remain in the top quartile based on 5- and 10-year historical data. Credit fundamentals in ABS are solid, and Agency MBS are well-positioned to act as a buffer during an economic downturn.



12 month high

Current

12 month low



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Investing in fixed income products is subject to certain risks, including interest rate, credit, inflation, call, prepayment, and reinvestment risk. Any fixed-income security sold or redeemed prior to maturity may be subject to substantial gain or loss.

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