Market Update

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Despite ongoing policy uncertainty from the executive branch, investors should look through near-term noise and focus on the broader economic landscape. Regulatory relief is emerging as a key tailwind: in June, deregulatory measures advanced for both the energy and banking sectors. Energy companies are benefiting from streamlined permitting and expanded federal leasing, while large banks are poised to see relief, which could boost Treasury demand and facilitate increased share repurchases.

However, the fiscal outlook has dimmed with the passage of the One Big Beautiful Bill (OBBB). The bill's expansionary spending and tax provisions reduce optimism for fiscal discipline in Washington, setting the stage for increased Treasury issuance. Over the long run, this trajectory raises concerns about the U.S. fiscal endgame, as rising debt and deficits put upward pressure on the term premium. We are looking to any stimulative short-term economic activity to enhance consumer and business spending.

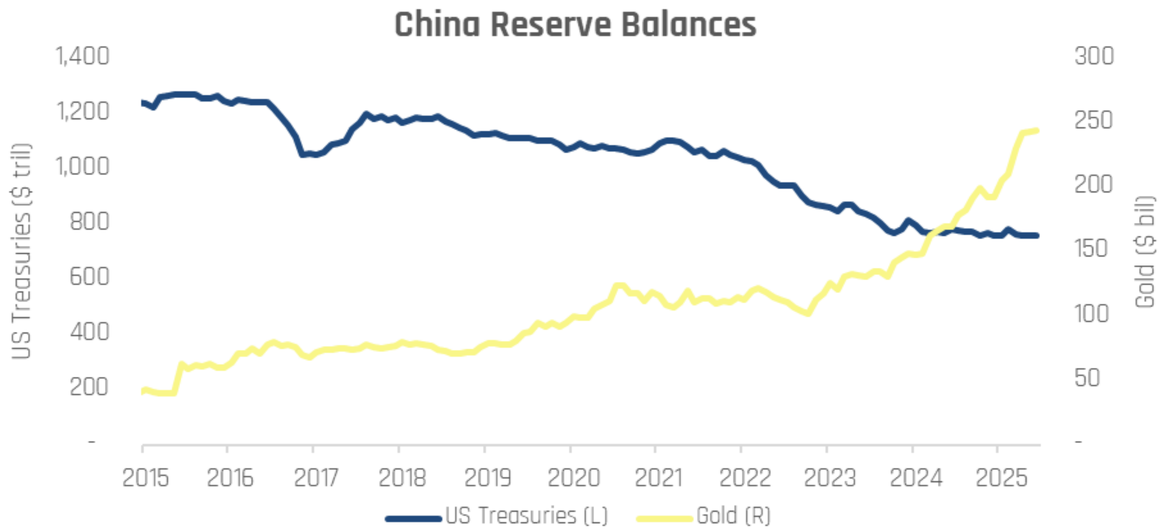
Trade policy remains a central theme. We expect the tariff negotiation to ultimately settle average of 15–20% range. Under this scenario, we see consumers bearing over half the cost burden, translating into higher prices at checkout. While this would further stoke inflation, it could also accelerate corporate investment in productivity, particularly artificial intelligence, as companies seek to offset higher input costs. Tariffs at these levels could generate $300 billion in annual revenue, offering some fiscal offset to rising deficits.

The tariff pass-through effect could push inflation higher even as economic data has broadly surprised to the downside. While the labor market is showing some signs of softening, evidenced by a modest rise in jobless claims, a higher Challenger job cut tally, and a cooling JOLTS report, there is no indication of a sharp deterioration at this stage.

Meanwhile, gold has surged over 25% year-to-date and could climb further as central banks diversify away from the U.S. dollar, reflecting global concerns about U.S. fiscal sustainability and geopolitical risks.

The potential for geopolitical flashpoints appears temporarily reduced. However, ongoing trade tensions and broader global uncertainties warrant continued vigilance.

Looking ahead, Fed Chair Powell's term ends in May 2026. We anticipate President Trump will nominate an uber-dovish successor. Until then, we expect Chair Powell to hold the line, with the next rate cut likely deferred until October as the Fed waits for clarity on inflation's trajectory and tariff impacts.



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Product Views

Rates: Last Friday's payroll report pushed short-term rates higher, as expectations for Fed rate cuts were delayed. We view this as an opportunity to selectively add duration in the front to intermediate part of the curve. However, we remain cautious on the long end, where rising term premiums reflect growing concerns over fiscal discipline in Washington. Additionally, we expect the curve to steepen if markets perceive that a new Fed Chair may pursue more aggressive easing than the dual mandate warrants.

Credit: Credit spreads have declined sharply since peaking in early April and are now at year-to-date lows. While credit bulls may highlight attractive absolute yield levels, we believe comparable (or better) yields can be found in other asset classes, such as taxable municipals and securitized assets.

Securitized: MBS spreads tightened in line with other spread assets but remain above long-run medians. We believe potential regulatory relief for banks could bring them back as active buyers, offering additional support to the sector. Consumer ABS spreads, however, did not compress to the same extent and continue to offer relative value. We also see selective opportunities in conduit CMBS, though careful credit analysis is critical, as not all deals are created equal.

Municipals: The spread between corporates and taxable munis has narrowed to under 10 basis points for similarly rated credits. In past cycles, this level of tightness has been temporary, and we see no reason for this time to be different.