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Market Update

June 2025

The economic trajectory remains heavily influenced by what Treasury Secretary Bessent has characterized as the "three-legged stool" of trade policy, tax policy, and deregulation, with trade policy uncertainty currently dominating near-term economic dynamics.

The near-term landscape has been shaped by tariff-related policy shifts and cascading effects on consumer behavior as well as sentiment/survey data. April data reflected a deceleration in consumer spending, with retail sales rising merely 0.1% (MoM) following March's 1.7% surge. This dramatic slowdown reflects the unwinding of front-loading behavior, as consumers had accelerated purchases to avoid anticipated tariff impacts.

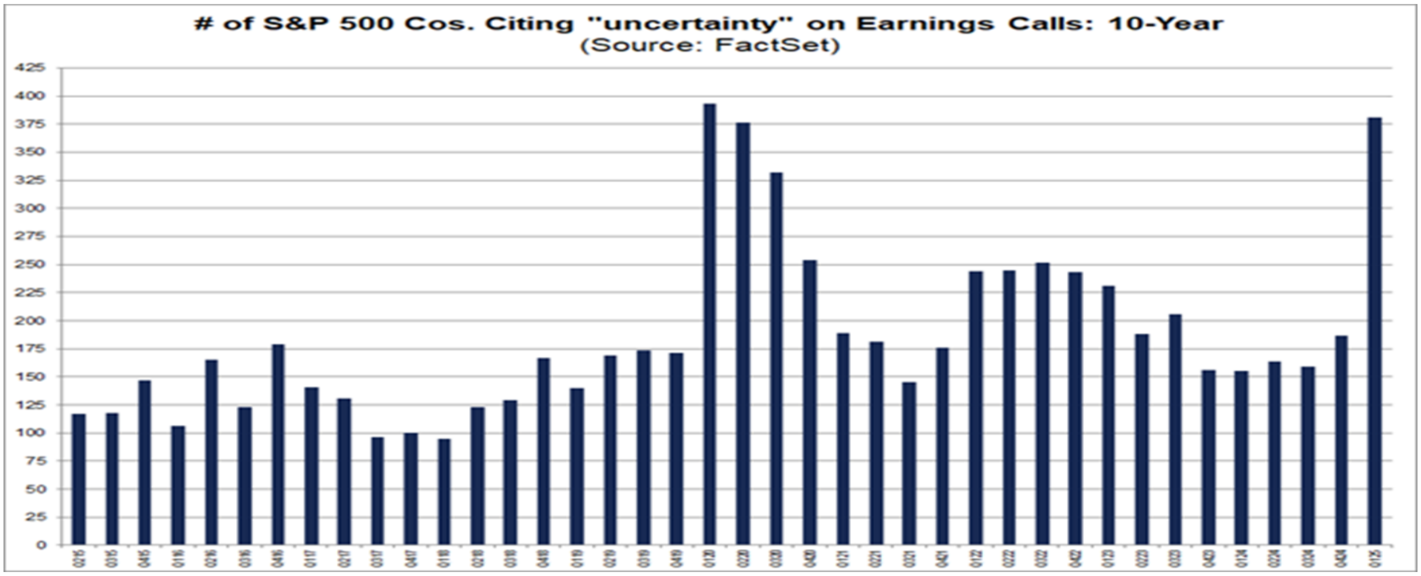
Consumer spending deceleration coincides with heightened business uncertainty that Federal Reserve Chairman Jerome Powell identified as creating "risks of higher unemployment and higher inflation". The uncertainty surrounding tariff policies is acting as a drag on economic growth, with businesses increasingly hesitant to hire, expand production, or make capital investments. This cautious business sentiment is being reflected in corporate earnings calls, where management teams are expressing concerns about the unpredictable policy environment.

Consumer sentiment data reinforces these concerns, with the University of Michigan's index falling to 52.2 in May, representing a 24% year-over-year decline. While sentiment stabilized after four consecutive months of declines, this occurred only after a temporary pause on some China tariffs was announced mid-month.

April's Personal Consumption Expenditures (PCE) data showed progress towards the Fed's goal, with the headline index rising just 0.1% monthly and 2.1% annually. Core PCE increased 2.5% year-over-year, approaching the Federal Reserve's 2% target. However, this softness appears driven largely by idiosyncratic factors suggesting the underlying trend may not be sustainable. Inflation expectations present a mixed picture.

The labor market showed few signs of cooling, with job openings rising from 7.2 million to 7.4 million in April. Friday's payroll report reflected an increase in non-farm payrolls of 139k versus the 126k forecast, while the unemployment rate remained steady at 4.2%. Average hourly earnings rose 3.9% year-over-year.

Given this economic backdrop, the Federal Reserve appears likely to maintain its current policy stance until there is greater clarity around the inflationary impact of tariffs. As inflation continues to run above the Fed's 2% target, expectations for rate cuts are being pushed further out, pending resolution of trade policy uncertainty or more definitive progress on inflation. We are centering around the first Fed easing to occur in October.



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Product Views

Rates: The 2 year Treasury recently closed above 4%, offering attractive value at current levels amid ongoing policy uncertainty. We are less constructive on the longer end of the curve and debates around the appropriate term premium given rising budget deficits. With the 10 year hovering around 4.50% the 2s/10s curve has stabilized just under 50 basis points, somewhat reversing the steeping seen in early April. We continue to recommend adding duration in the short- to intermediate-end of the curve, especially given the relative value in the front end. One other way to assess value is by comparing Treasury yields to market expectations for Fed Funds over the same term, as expressed through OIS. That spread, particularly in the 2 and 3-year tenors, has widened to levels last seen before COVID.

Credit: Credit markets have rebounded, with investment-grade spreads tightening to 85 basis points, erasing much of the widening seen earlier in the year and returning to levels last observed in late 2024 and early 2025. This tightening reflects improved risk sentiment and continued confidence in corporate fundamentals following the tariff delay. Given our view that tariff uncertainty will ebb and flow, we will look to add exposure as spreads widen above the current bottom-quartile levels.

Securitized: Securitized products have lagged the rally in credit. Nominal agency MBS spreads tightened by 4 basis points over the past month, but the move was modest compared to broader credit markets. The MBS option-adjusted spread (OAS) remained flat. Securitized assets have not fully participated in the spread tightening, and we maintain a constructive view on the sector. Despite interest rate volatility weighing on this space, we believe regulatory relief for banks could bring them back in as buyers.