Market Update

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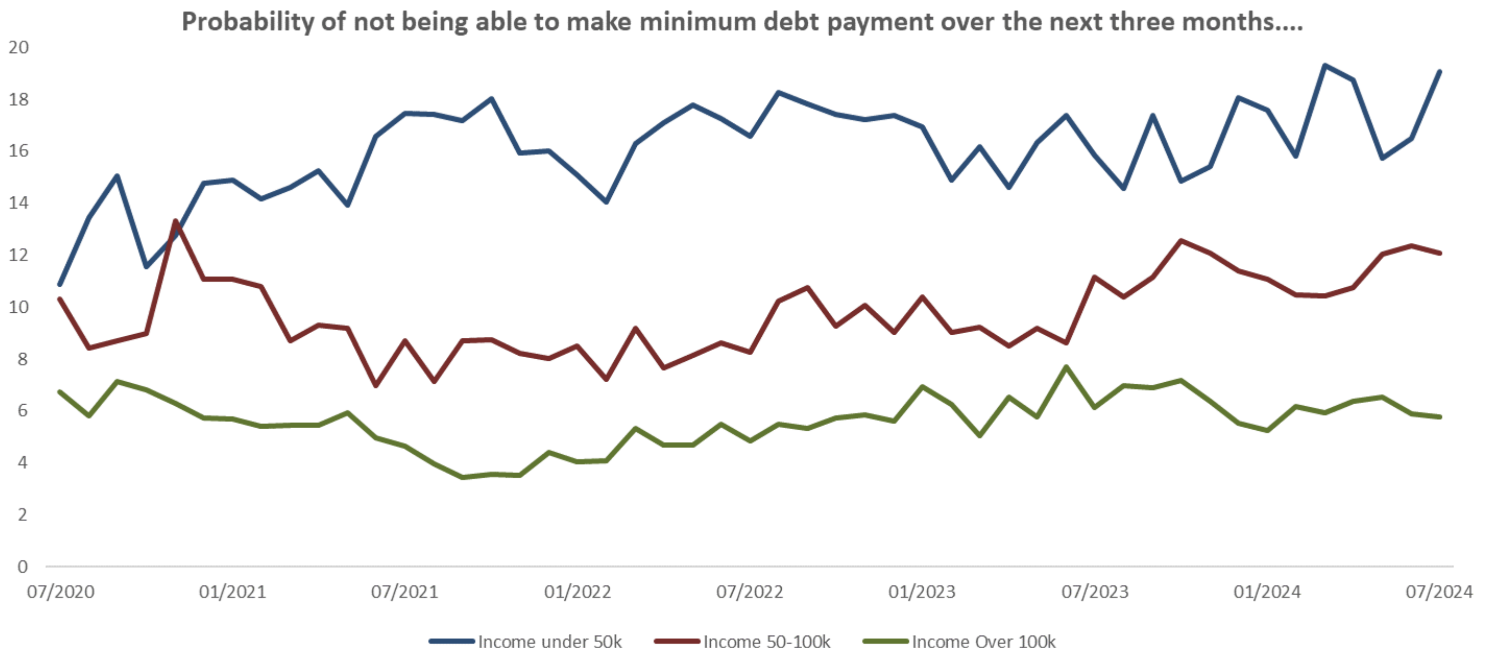
The U.S. economy has shown resilience, with second-quarter GDP growth revised upward from 2.8% to 3.0%. This robust performance has surprised some analysts who had expected a more pronounced slowdown. However, as the lags from the Federal Reserve's tightening policy actions loom, concerns persist about the sustainability of this expansion.

Inflation remains a central focus for both the Fed and market participants. Recent Consumer Price Index (CPI) data reported headline inflation at 2.9%, down from June's 3.0% reading. Core inflation, excluding volatile food and energy prices, held steady at 3.2% year-over-year. While progress has been made toward the Fed's 2% target, inflationary pressures persist, particularly for lower-income households. Over the past four years, average inflation has hovered around 5.0%, eroding purchasing power and raising concerns about potential credit deterioration.

The August jobs report sent mixed signals about the labor market. U.S. employers added 142,000 jobs, falling short of the expected 165,000. The unemployment rate dipped slightly to 4.2% from 4.3% in July, but this decline has raised concerns about labor market tightness and its potential impact on wage growth and inflation. These labor market dynamics have fueled discussions about the potential for more aggressive rate cuts by the Federal Reserve.

As the Federal Reserve prepares for its September meeting, all eyes are on its next steps. At the Jackson Hole Economic Symposium, Fed Chair Jerome Powell signaled a likely shift in monetary policy, sparking market expectations for interest rate cuts. Markets are pricing in a quarter-point cut at the September meeting, with a 30% chance of a half-point reduction. Friday's employment report has solidified expectations for a 25-basis-point cut, although the scale of the easing priced into markets may not align with a soft landing scenario. The Fed may temper these expectations in future communications.

Geopolitical tensions continue to influence financial markets. Ongoing global conflicts and trade disputes contribute to market volatility and shape investor sentiment. The interplay between growth, inflation, and employment will continue to dominate the economic narrative, as the Fed navigates a delicate balance between supporting growth and managing inflation.



Source: FRBNY

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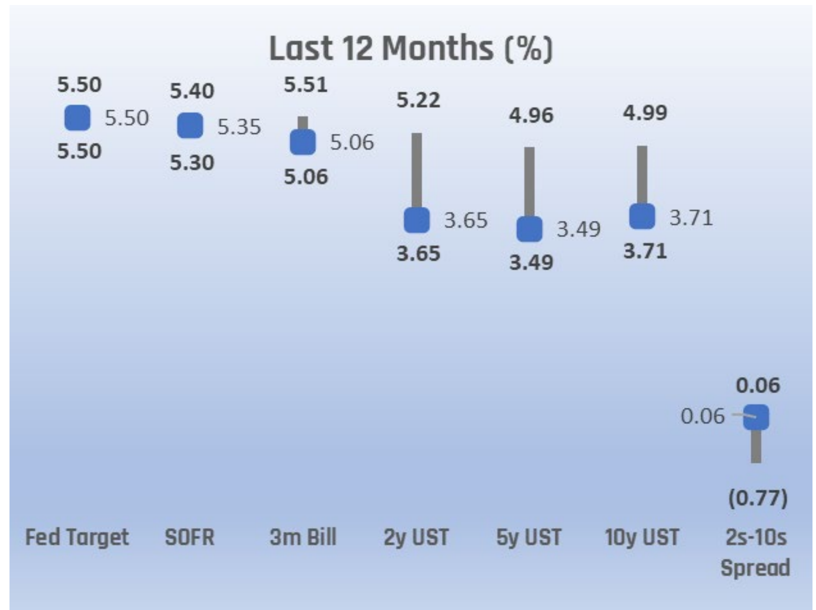
Product Views

Rates: Bond markets have responded to recent developments, with the 10-year Treasury yield falling to 3.71%, its lowest level in over a year. The 2s10s yield curve, a key recession indicator, has now disinverted, following historical patterns as the economy enters an easing cycle. As mentioned, the anticipated 250 basis points of cuts do not align with a soft landing scenario. While we're not entirely discounting the possibility of a hard or bumpy landing, we view it as less likely.

We maintain our neutral position on duration. This strategy provides flexibility to take advantage of more favorable conditions as the economic outlook and Federal Reserve policies become clearer.

Credit: Corporate credit spreads experienced volatility following the unwinding of the JGB carry trade in August. Although credit spreads widened from recent tights, we still view spreads as below fair value, especially given ongoing concerns about economic deterioration. While high-grade corporate fundamentals remain solid, corporate performance will largely depend on broader macroeconomic factors.

Securitized: While Agency MBS spreads have tightened to their narrowest levels in the past 12 months, we believe there is still room for further tightening when viewed over a longer time horizon. In a deteriorating economic environment, Agency MBS is likely to outperform credit. We remain focused on careful security selection to identify securities with the potential to outperform the broader market.



12 month high

Current

12 month low