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Market Update

September 2025

Real GDP growth for Q3 2025 has decelerated sharply, with the Atlanta Fed GDPNow below 3% and the Philadelphia Fed's Survey of Professional Forecasters revising expectations to 1.3% annualized. This marks a sharp slowdown from Q2's 3.3%, suggesting the economy is stalling after the inventory-driven and post-tariff spending surge.

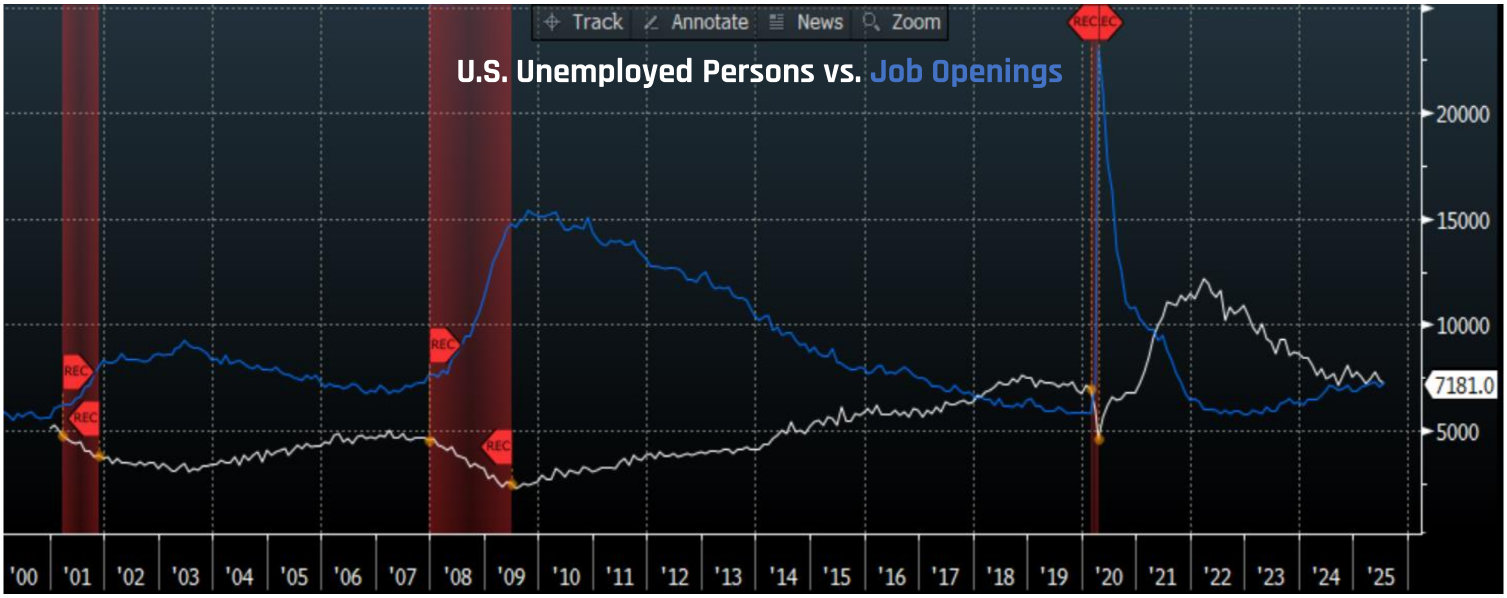
It is evident that the employment landscape is weakening. For the first time in over four years, there are now more unemployed Americans than available job openings (see chart below). The August jobs report reinforced this cooling trend, adding only 22k positions versus expectations of 75k. The unemployment rate ticked up to 4.3%, its highest level since 2021. Additionally, long-term unemployment has increased by 385k over the past year, with over a quarter of unemployed individuals now jobless for 27 weeks or more.

Tariffs continue to add cost pressures. Walmart's CEO Doug McMillon noted that "costs have been rising weekly," with expectations for further increases into Q4, though gradual enough that customer behavior remains steady. Annual tariff collections are estimated at $300 billion against $20 trillion in consumer spending. A full pass-through could add 1.5% to inflation, though firms vary—Target treats hikes as a "last resort," while others absorb costs. The August 29 Federal Circuit Court ruling against IEEPA-based tariffs adds policy uncertainty.

Despite declining mortgage rates, with 30-year fixed rates falling to approximately 6.50%, the refinancing universe remains constrained. We estimate that only around 10% of the mortgage market currently has sufficient incentive to refinance. Even if rates decline to 5.00%, less than 25% of homeowners would find refinancing economical, highlighting the limited boost to the consumer through lower mortgage rates this time around.

An underappreciated factor in the monetary policy outlook is the February 2026 reappointment of regional Fed presidents. Since these officials vote on the FOMC, shifts in their reappointments, especially if hawkish presidents are replaced, could tilt the committee more dovish.

Chair Powell's Jackson Hole address marked a shift in Federal Reserve communication, explicitly acknowledging that "the shifting balance of risks may warrant adjusting our policy stance." This dovish pivot reflects growing concern about labor market deterioration outweighing residual inflation pressures. We are aligned with market expectations of a September rate cut followed by two more 25 bps cuts in the final two meetings of 2025. Furthermore, we see 75-100 bps of rate cuts in 2026.



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Product Views

Rates: Treasuries have rallied following Chair Powell's pivot at Jackson Hole and a weakening labor market. Two-year yields are down more than 40 bps over the past month, while 10-year yields are 30 bps lower. The 2s10s curve has steepened, consistent with our view that the front end will adjust to anticipated FOMC policy. We continue to favor the front and intermediate segments of the curve, as markets often overprice the extent of Fed cuts. This leaves additional room for front-end yields to decline, with intermediate maturities likely to follow, though to a lesser degree, in sympathy with short-end price action. The rise on global bond yields may dampen demand for longer dated treasuries.

Credit: Credit spreads remain largely unchanged month-over-month and year-to-date, despite the typical post–Labor Day supply surge. We continue to stress that if the economy is slowing, spreads have meaningful room to widen, particularly given their current position in the bottom decile relative to long-term history—even amid strong corporate fundamentals. Conversely, if growth holds up, we see limited scope for further tightening. In this environment, we maintain an up-in-quality bias within credit for added resilience in the event of a downturn, alongside an underweight stance overall.

Securitized: We continue to favor securitized assets over corporate credit. We see incremental demand for MBS as bank regulatory relief takes hold, and we remain less concerned about prepayment risk given that much of the market remains 150–200 bps out of the money. For prepayment dynamics to shift meaningfully, one of two things must occur: either a substantially lower 10-year yield—which we view as unlikely, as previously discussed—or tighter spreads, which would be broadly supportive for MBS.

We also continue to see value in select non-agency and consumer securitized sectors, though we recommend disciplined underwriting and rigorous ongoing monitoring.