



Market Commentary  
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English Version

# A Navigation Guide for Current Markets

Get guidance on investments, and the major  
structural factors behind your clients' portfolios.

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## A Navigation Guide for Current Markets

Fed rate cut expectations surged, following weak labor data and downward revisions, reinforcing dovish Fed sentiment and increasing market volatility. Moreover, economic data signals a slowdown, with manufacturing in contraction and consumer spending softening amid tariff pressures, prompting concerns over the Fed's next move.

The treasury curve steepened, driven by short-end yield gains after the July jobs report; meanwhile, the ten-year yields have remained volatile year-to-date, affected, among others, by auction results.

Equity markets remained volatile, led by outsized moves in mega-cap tech, while broader market earnings growth continued to lag.

What a turbulent last couple of weeks. U.S. markets were rattled during the previous trading sessions by both macroeconomic data and market players digesting the ever-changing slew of news. We deemed it fit to review the latest economic developments to

gauge how they affect equities and fixed income securities alike.

In a timeframe of about a week, the market's expected probabilities of rates changed drastically, time and time again. Going into the Fed's July meeting, markets were pricing in close to a 46% probability of a 25bps rate cut in September. After the meeting, Chairman Powell left traders pricing in much lower odds for a cut, close to 0%, amid uncertainty surrounding the real impacts of tariffs on inflation, as well as the economy's resilience. Two days later, the July jobs report painted a very different picture. Aside from the actual nonfarm payrolls figure being well below the market's expectations, what struck a nerve were the downward revisions to the previous data, which implied that the labor market was not as strong as previously expected, an argument that was partially confirmed by the increase in the unemployment rate. These developments have significantly increased the odds of a September rate cut, now standing at close to 91%, as of this writing. It should be noted that some of the more dovish FOMC members also share these market expectations, with Minneapolis Fed President Neel Kashkari affirming his view of two rate cuts by year-end.

Additional data on the softer side continued to point towards an economic deceleration, with the ISM manufacturing index sinking further into contractionary territory, while the ISM services index just inched away from signaling contraction. **According to market analysts, the current backdrop is one of an economy dealing with the aftermath of President Trump's tariffs, as well as consumers who are paring back their spending trends.** Sometime ago, we wrote a piece titled [“Balancing the Economy Between a Cold and a Heart attack”](#), where we argued that the Fed was eventually going to be faced with weaker employment data, and was going to have to make the choice between addressing a recurring cold, inflation, or focus on preventing a heart attack in the form of a weak job market. It seems that we may be at that point.

In addition to a weaker macroeconomic environment, the earnings season currently underway has painted a mixed picture, with some companies whose expectations were low surprising to the upside, whereas those that had higher expectations being unable to meet the bar. Additionally, some companies have continued to absorb most of the tariff-induced cost increases, but that situation isn't necessarily sustainable in the long run. Some companies are starting to evaluate price hikes.

**On the fixed income front, the Treasury curve has exhibited a steepening so far this year. Looking at the 2-10 spread, the rate differential has widened – mainly due to the gains displayed by the two-year note.** This steepening has been more pronounced since the release of the previously mentioned jobs report. Bear in mind that the short end of the curve tends to react to facts rather than expectations, and the pronounced move in the two-year seems to be aligned with a fully priced-in rate cut in the September meeting. In contrast, the ten-year Treasury has

had a volatile year, including a widening of its yield close to 4.8% and gains that drove the yield to 4%. Against this backdrop, it is relevant to highlight that the last 10-year note auction exhibited weak demand from investors, with some market participants questioning whether the previously seen gains are sustainable in the long run.

It is widely known by investors that one of the main goals of the current Treasury secretary is to have lower interest rates, both for shorter and longer-dated debt. This is no minor task. According to the last available monthly Treasury statement, the cumulative payments in net interest for FY 2025 stood at USD 749bn, equivalent to a 5% YoY increase, and a deficit of USD 1.337tn. **Considering the deficit is projected to continue growing in upcoming years, higher interest rates would bode ill for interest payments and would proportionately increase the already high deficit, painting a more dire fiscal outlook for the Trump administration.**

**Thus, amid this volatile and fluid environment, together with tight spreads on the corporate debt side of things, we continue to favor having exposure to the short-to-mid end portions of the curve. We side with the current market expectations that Fed cuts should materialize sooner rather than later, which should continue to bullishly steepen the Treasury curve.** On corporate debt, we continue to favor a bottom-up approach that favors strong fundamentals and solid balance sheets, while we would take advantage of potential spread widenings to lock in more attractive rates.

**On the equity front, volatility has been the name of the game.** Since the beginning of August, the S&P 500 dropped 3%, then clawed its way back up, all in a matter of a couple of days. The tech-heavy Nasdaq has behaved similarly. At the same time, the CBOE

Volatility Index jumped close to 44%, then dropped 25%, all in a matter of days. Under the surface, we have seen behemoths like Meta jump over 11% in one day, after posting better than expected earnings, while others have been severely punished after reported earnings that were good, but not great. Keep in mind that, although an 11% move may not seem like much, when we consider that Meta's market cap before the move was USD 1.7tn, a USD 200bn appreciation in one day is astounding. That being said, it should come as no surprise that the mega-cap technology names have driven much of the earnings growth experienced over the past year. **So far, the year-on-year earnings growth reported by the Magnificent Seven stocks, except for Nvidia, which is yet to report, has registered at 26%, while the rest of the S&P 500 posted growth closer to 4%.** This 22% differential in earnings growth between both subsets of companies was expected to narrow to under 15%, as leadership was expected to shift from a narrow group of companies to the broader market. However, the gap continues to remain wide, as the great rotation of market leadership is developing more slowly than expected.

What would action, or inaction, by the Fed mean for a market with such narrow leadership? The answer is that it depends on the Fed's motivation for cutting rates; there are good cuts and there are bad cuts. If the Fed cuts rates because it has the flexibility to do so and wants to stave off further deterioration in the labor market, within a backdrop of benign inflation, it would likely be positive for equity markets. A preemptive cut to stay ahead of the game would be a good cut. However, if the Fed cuts because it has no choice, forced by a rapidly deteriorating job market, regardless of what inflation numbers are showing, it could prove to be detrimental to equity markets. A reactionary move by the Fed to try to catch up with the economic backdrop would be a bad cut. So far,

we have seen inflation numbers that appear to be rather benign. However, several companies, such as Procter and Gamble, have announced that they will be raising prices across a wide range of staple products to pass on the effects of tariffs, a move that could push inflation higher. At the same time, employment numbers indicate that while initial jobless claims remain relatively low, continuing jobless claims remain at cycle highs. In other words, people may not be losing their jobs, but those who do are having a tough time finding new positions. These are just two data points that we are continuing to monitor; however, as we know, data points combine to make trends.

**What should investors do? Stay diversified and focused on the long term. Staying diversified across a global subset of assets would help defray some of the risk within U.S. equities.** It is important to note that despite the near-term volatility, we continue to maintain a neutral stance towards U.S. equities, meaning not too overexposed, but not too underexposed either. Sector diversification within U.S. equities is also important. A degree of exposure to the Technology and Communications sectors continues to make sense as the AI revolution continues to develop. At the same time, exposure to other sectors that will also benefit from the AI revolution, such as Industrials and Utilities, as well as undervalued sectors that could benefit from lower rates, such as Materials and Healthcare, also make sense. Again, diversification is key.

Lastly, it is critical to keep in mind that whether we are investing in equities or fixed income, keeping our focus on the long term is key. Volatility is an inherent part of the markets; in fact, it is what keeps markets going. As such, **although U.S. financial assets will likely be subject to increased volatility in the near term, we remain constructive on both U.S. equity and fixed income assets over time.** ■

# House Views Matrix

Global Asset Allocation	TACTICAL (UP TO 3 MONTHS)	CYCLICAL (UP TO 12 MONTHS)
	Equities	NEUTRAL
Fixed Income	OVERWEIGHT	NEUTRAL
Cash	NEUTRAL	NEUTRAL
US Equities <sup>1</sup>	OVERWEIGHT	NEUTRAL
European Equities	NEUTRAL	NEUTRAL
Japanese Equities	OVERWEIGHT	NEUTRAL
Emerging Market Equities	NEUTRAL	NEUTRAL
Chinese Equities	OVERWEIGHT	NEUTRAL
US Treasuries <sup>2</sup>	OVERWEIGHT	OVERWEIGHT
Investment Grade Fixed Income	UNDERWEIGHT	UNDERWEIGHT
High Yield Fixed Income	UNDERWEIGHT	UNDERWEIGHT
Emerging Market Sovereign	NEUTRAL	NEUTRAL
US Dollar	NEUTRAL	UNDERWEIGHT
Energy <sup>3</sup>	UNDERWEIGHT	UNDERWEIGHT
Precious Metals	OVERWEIGHT	OVERWEIGHT

<sup>1</sup>Relative to global equities in USD

<sup>2</sup>Relative to aggregate fixed income markets in USD

<sup>3</sup>Relative to an overall commodity allocation

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