

MONTHLY Portfolio Pulse

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Jobless Expansion?

The economy appears to be in a jobless expansion, with labor markets showing material weakness but many other economic growth indicators still flashing green (at worst with a tint of yellow). Purchasing manager indices (surveys sent to those in charge of buying goods and services) are mostly in expansionary territory while third-quarter GDP (economic output) is poised to show continued growth. The lack of job creation is giving the Federal Reserve room to resume rate cutting – starting with its upcoming meeting on September 16-17 – despite inflation remaining stubbornly above its 2% target. In this environment, we remain modestly overweight risk, preferring stocks over bonds and U.S. equities over their international counterparts.

The exit from the economic recession in the early-2000s is often viewed as a key example of a *jobless recovery* – in that jobs and wages failed to keep up with the pace of broader economic growth. This phenomenon was attributed to the rise of globalization (China joined the World Trade Organization in 2001) alongside the slow-but-sure integration of internet-related productivity. Today's ongoing expansion (which technically started post-Covid, but it could be argued really goes back to the recovery that started after the Global Financial Crisis) is turning into a *jobless expansion*. This time around, the primary culprit seems to be tech-enabled productivity (notably AI) – as globalization is, at best, slowing and possibly going in reverse with the new tariff policies in place. Putting numbers to this jobless expansion, job creation has fallen to a four-month average of only 27,000 jobs/month (vs. the previous year's average of 150,000) despite Q2 economic growth of 3.3% annualized and an expected 3.0% growth in Q3 (per the Atlanta Fed's "nowcast"). Meanwhile, core inflation – per the Fed-favorite Core PCE¹ index – remains stubbornly high at 2.9%.

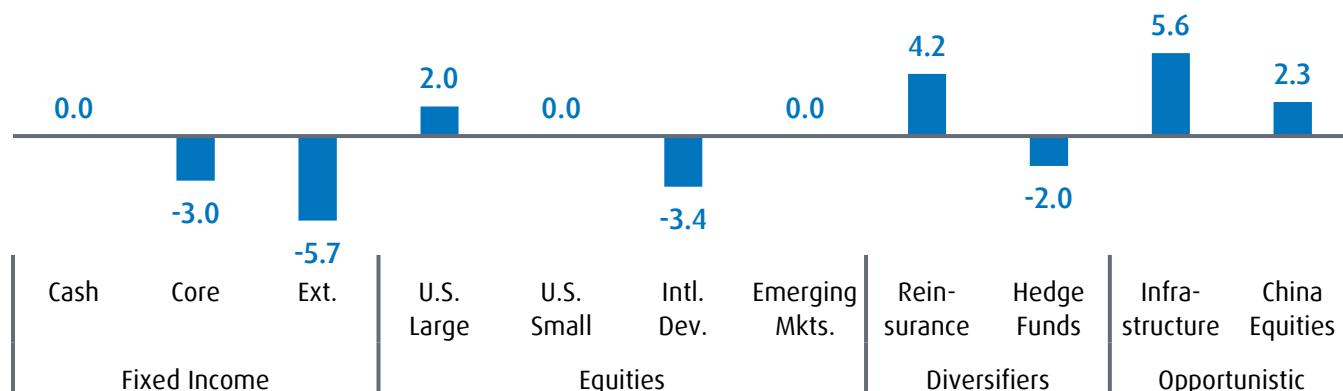
This is putting the Fed in a bit of a quandary – as their dual mandate requires them to seek both stable prices (with a self-imposed 2% inflation target) and maximum employment (unemployment near the

natural rate of unemployment – thought to be around 4%). Based on Fed Chair Jerome Powell's recent address at the Fed's annual retreat to Jackson Hole (August 22), the Fed is focusing on the latter – laying the groundwork to resume rate cuts at its September 16-17 meeting. The markets, of course, love this – as inflation is a problem for equities only if the Fed thinks it's a problem as well. And, currently, the Fed doesn't seem to mind that inflation has been stuck about 1% above their 2% target since April 2024. The combination of strong earnings and expected Fed rate cuts has pushed equity valuations to 24.1x last-twelve-month earnings (vs. a 10-year average of 21.8x).

In the context of the current environment, our asset allocation committee finds current valuations a bit rich but mostly justified. As such, we maintained our modest overweight to U.S. equities and our modest overweight to risk in general. Our base case (Exhibit 7) of Moderating Expansion – modestly slowing growth and a Fed on rate-cut patrol – leads us to expect an approximate 8% one-year return on U.S. equities (S&P 500), a ~4.5% premium to expected cash returns. We continue to like infrastructure as a way to play both the reshoring and AI (data center construction) themes while reinsurance remains a nice diversifier with a strong income component. Finally, we maintain our focused allocation to Chinese equities (detailed on page 3).

Maintaining a modest risk-on positioning

We made no changes in tactical asset allocation – preferring stocks over bonds and U.S. over international developed equity markets.



Allocations as of 9/15/2025. Ext. = Extended; Based on Balanced Portfolio.

¹PCE = Personal Consumption Expenditure

Macro Outlook

Growth

Much has been made of the recent labor market weakness, especially with the Bureau of Labor Statistics (BLS) downwardly revising job creation from April 2024 to March 2025 by a record 911,000 (~76,000 /month) as part of its annual benchmarking process (note: this was the preliminary report; a final report will be released in February 2026). But the disappointing jobs reports over the past two months do not jive with other economic data, which have remained solid. This includes the ISM new orders data, where both services and manufacturing are in expansionary territory (Exhibit 1). Q2 GDP was a strong 3.3% and Q3 GDP is also looking strong.

The positive spin here is that the economy has simply become more productive – generating more output with less labor. This may make for a constructive near-term economic environment (economic output strong, Fed cutting – what's not to like?). However, unless AI learns to eat and shop, economic growth will eventually suffer. Reestablishing labor demand is necessary for a sustained expansion.

Inflation

Inflation has struggled to take the last step towards the Fed's 2% target. Instead, the year-over-year yardstick has oscillated around 2.8% since the beginning of 2023 (Exhibit 2). This stands in stark contrast to the pre-pandemic inflation "equilibrium" of 1.6% (data from 9/2015 to 2/2020) – despite the fact that the pre-pandemic Fed funds rate capped out at 2.5% vs. the current 4.5%.

Today's higher inflation, even with a more restrictive monetary policy backdrop, speaks to the difficulty of getting the inflation genie fully back into the bottle. And the fact that the Fed is shifting focus to its full employment mandate only adds fuel to the speculative fire that the Fed is secretly (they'd never admit it) willing to tolerate above-2% inflation. After all, so long as inflation doesn't go higher – and there are reasons to think it won't (soft labor markets, technology) – the Fed is still fulfilling its price-stability mandate, just at a higher inflation level. Perhaps the best way to think about inflation moving forward is that while pre-pandemic 2% was the ceiling, now it's likely the floor.

Monetary Policy

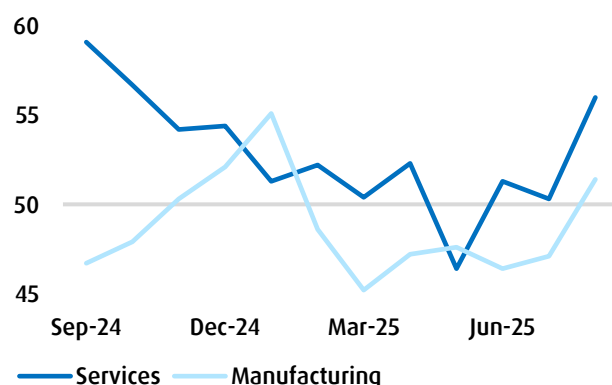
Now that a Fed rate cut has been fully priced in for the Fed's September meeting, the question turns to the pace of rate cuts after that. Currently, markets expect a cut per meeting through the end of the year but that the frequency will fade as we progress through 2026 (Exhibit 3). From now until the end of 2026, there will be 11 Fed meetings but only six expected 0.25% rate cuts, putting the Fed funds rate at 3%. Assuming the neutral rate – the policy rate that is neither restrictive nor stimulative to the economy – is also 3% (as is generally believed), the markets are implicitly saying they don't expect accommodative policy from the Fed over the next year-plus.

We believe the Fed is more willing to move into accommodative territory than the markets do. First, the Fed is more focused on reviving the labor market than forcing inflation to 2%. Second, the productivity potential of AI keeps the prospect of lower inflation on the table. Finally, we can't ignore the administration's desire for lower rates – and opportunity to nominate a Fed chair sharing that desire.

Exhibit 1: Economic bright spots

Outside of the labor market, the economy seems to be doing alright.

ISM New Orders

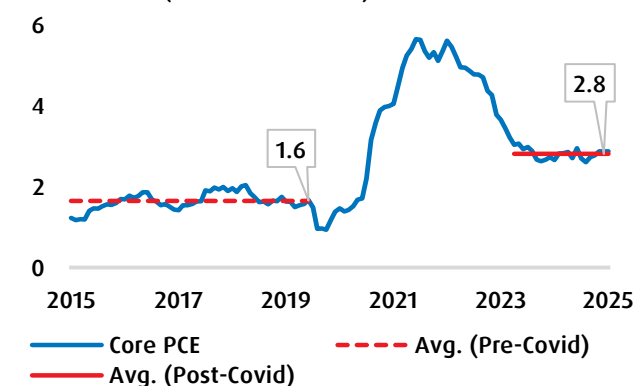


Source: Bloomberg L.P. Data through August 2025.
ISM = Institute for Supply Management.

Exhibit 2: The newest "new normal"

Post-pandemic, inflation has settled in at a higher level.

Core Inflation (Year-Over-Year %)

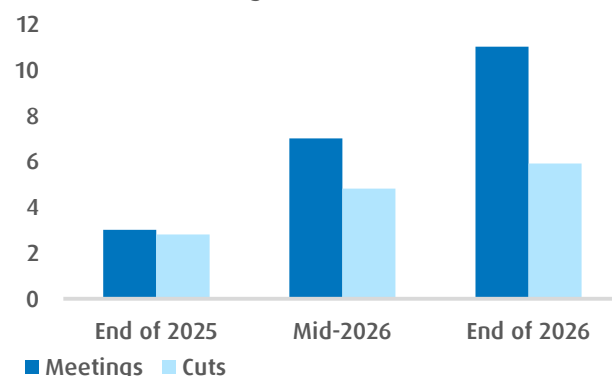


Source: Bloomberg L.P. Data through July 2025.
PCE = Personal Consumption Expenditure

Exhibit 3: Trouble keeping pace?

Markets don't expect a "rate-cut-a-meeting" to continue into 2026.

Number of Fed Meetings and Rate Cuts



Source: Bloomberg L.P. Data as of 9/10/2025.

Market Outlook

Fixed Income

Investors often look to Treasury yield spreads to understand what the fixed income markets think of the economic fundamentals and Fed policy. For instance, the “2s/10s” spread (the 10-year minus the 2-year yield) is often looked to for signs of recession. If the spread goes negative, the fixed income markets are expecting lower growth, inflation – and ultimately a lower Fed funds rate that brings down longer-dated yields. Today, that spread is at a healthy 0.5% – suggesting fundamentals are alright and the expansion is intact.

A bit more concerning is the recent increase in the “10s/30s” spread, which has gone from 0.2% to 0.65% over the course of the year. This spread speaks more to Fed credibility and its ability to (independently) maintain price stability. Now, before raising alarm bells, it’s important to know that the current spread is near the long-term average (going back to 1991) – and we’ve recently seen the 30-year yield come back below 5%. But should the fixed income markets believe the Fed is being overly politicized, this is where it may show up first.

Equities

Earlier in the year, international markets were beating U.S. equities on the fundamentals. DeepSeek – China’s seemingly more-efficient answer to U.S. AI (e.g., ChatGPT) – had spooked investors, pushing U.S. tech shares lower. Meanwhile, Europe (notably Germany) committed to more fiscal spending to modernize military and economic readiness in the face of ongoing Russian aggression and the Trump administration’s “America First” policies. But by the end of Q1, the narrative shifted from fundamentals to the weak dollar – as the world retaliated to Liberation Day tariffs by boycotting U.S. assets, notably U.S. Treasuries.

As we sit here today, the difference between international developed and U.S. equity returns is nearly all explained by currency. Meanwhile, the DeepSeek scare has not translated into lost enthusiasm for AI and AI capital expenditures. At the same time, some of Europe’s fiscal enthusiasm has faded (more than just looser purse strings, structural reform is likely needed). At this point, we’ll take U.S. fundamentals over those of international – with any dollar reversal an added bonus.

Opportunistic

Chinese equities (+29% year-to-date)² have been leading equity markets globally in 2025 – outperforming both their developed and emerging market counterparts. China’s investments in policy-favored sectors – such as advanced manufacturing, technology and infrastructure – have continued to spur GDP growth. Meanwhile, the PBoC (the Chinese central bank) continues its easing bias and has ensured ample liquidity in the system as seen in the year-over-year growth in money supply (M2, Exhibit 6). Further, market sentiment towards the U.S.-China relationship has improved following the trade truce in June. At the outset, President Donald Trump has been maintaining a cooperative stance, motivated by the desire to strike a deal. That said, the U.S. has continued to apply pressure via non-tariff tech barriers. Despite geopolitical headwinds, China’s tech story remains intact – as we believe any tariff-related developments are only likely to slow, not derail, China’s tech progress.

Elsewhere, our conviction in the Reinsurance space remains supported by elevated catastrophe bond issuance and attractive spreads.

Exhibit 4: Of fundamentals and credibility

The increase in the “10s/30s” suggests some lost faith in the Fed.

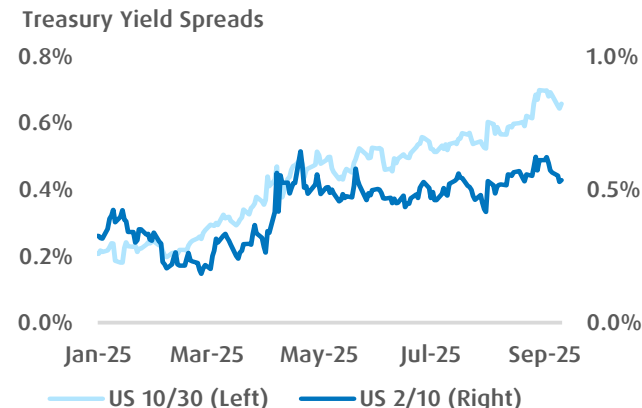


Exhibit 5: Blame the dollar

Most of international equity’s outperformance has been currency.

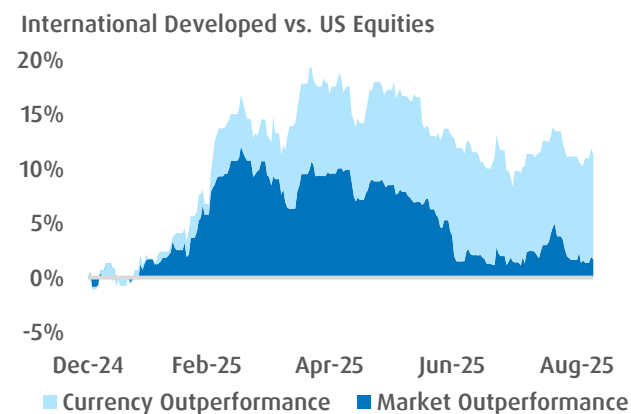


Exhibit 6: Increased liquidity

Central bank easing has pushed China’s money supply higher.



Exhibit 7: Scenarios

Downside Risk Case: Policy Disruptions	Base Case: Moderating Expansion	Upside Risk Case: Catalyst Convergence
<i>25% Probability</i>	<i>55% Probability</i>	<i>20% Probability</i>
Unpredictable policy disrupts economic functioning – both growth and inflation. Notably, immigration policy risks cutting the labor supply in key industries, just as labor participation rates are falling due to baby boomer retirements.	The economic expansion continues but growth starts to moderate as the softening labor market pressures consumer spending. The Fed focuses more on its full employment mandate (over stable prices) and begins a new rate cut cycle on 9/17.	A number of economic and financial market catalysts all converge to produce a strong and sustained US equity rally. These include: Fed rate cuts, midterm election growth boost, tax-bill provisions, deregulation and AI implementation.

Index Definitions

The **MSCI China Index** captures large and mid cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). The index covers about 85% of this China equity universe. **iShares Russell 3000 ETF (IWV)** is an exchange-traded fund incorporated in the USA. The ETF tracks the performance of the Russell 3000 Index holding equities of all market caps. **iShares Currency Hedged MSCI EAFE ETF (HEFA)** is an exchange-traded fund incorporated in the USA. The ETF seeks to track the investment results of an index composed of large- and mid-capitalization equities in Europe, Australasia, and the Far East while mitigating exposure to fluctuations between the value of the component currencies and the U.S. dollar. **iShares MSCI EAFE ETF (EFA)** is an exchange-traded fund incorporated in the USA. The ETF tracks the performance of the MSCI EAFE Index. The ETF holds large and mid-cap stocks. Its investments are focused on developed countries across the world excluding the U.S. and Canada. The ETF weights the holdings using a market capitalization methodology.

Data provided above is as of 9/10/2025 unless otherwise noted.

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