

**September 8, 2025**

## Economic Update

In a year replete with economic and policy surprises, probably most notable were the early August downward revisions to the Labor Department's non-farm payroll gains for the months of May and June, which showed far fewer jobs had been gained in those months than previously reported. May's payroll gain of 144,000 was reduced by 119,000 to 19,000, and June's 147,000 increase was slashed by 133,000 to 14,000. These shocking revisions totaling 252,000, which led to the removal of the BLS head, left the average number of jobs gained in the two months at about 16,000, sharply below the 174,750 average monthly non-farm payrolls gain from January through April, and well-short of the 50,000 to 75,000 workers who leave their jobs each month requiring replacement. US payroll growth rebounded a bit in July to a revised total of 79,000 but showed further weakness in August when just 22,000 new jobs were added. Other revisions showed the economy lost a net 13,000 jobs in June, the first such decline since December 2020 during the COVID era.

Nearly all of the jobs added last month were in social assistance and healthcare, which are heavily dependent upon government spending and largely escape the direct impact of the new tariffs. That's been the case all year where 453,000 of the 511,000 total net new jobs were in those sectors. Industries with high tariff exposure shed workers, including manufacturing (-12,000), wholesale trade (-11,700) and transportation equipment manufacturing (-14,500). Overall, manufacturing jobs have declined by 38,000 this year as the uncertainty and additional costs associated with the Trump tariffs have impacted hiring decisions. For example, Caterpillar estimates that tariffs could cost the company up to \$1.8 billion this year. Deere expects a tariff hit of \$600 million, mainly from higher steel and aluminum costs. Ford projects a \$2 billion impact from tariffs this year. And jobs in mining (-6,000) as well as oil and gas production (-2,100) declined as tariffs are said to have increased prices for materials causing a pullback in drilling. Construction job growth has stalled since January, falling 7,000 in August, likely due to the immigration crackdown and higher building costs from tariffs. In short, nearly all industries covered by the ISM Manufacturing survey last month reported a slowdown from tariff uncertainties.

A separate monthly survey of households showed unemployment ticked-up slightly to 4.3% last month from 4.2% in July, still a relatively low rate, suggesting that immigration restrictions are crimping the supply of available workers.

***The US has added just 511,000 net new jobs so far in 2025. Aside from 2020, when the pandemic hit, year-to-date job gains have been the fewest for the first eight months of a year since 2009, when the economy was in the grip of the great financial crisis. The August jobs report points to a stagnant job market since mid-year that has raised recession fears, has lengthened job searches and shut many young people out of employment.***

## **The Fed**

The sharp deterioration in job growth over the past four months, a generally reliable indicator of decelerating economic conditions, is driving the Fed to pivot monetary policy, setting aside its inflation risk bias to focus on propping up the labor market. Fed Chair Powell's Jackson Hole speech in late August reinforces the view that the July employment report represented a stall speed alert, when he noted that "downside risks to employment are rising. And if those risks materialize, they can do so quickly in the form of sharply higher layoffs and rising unemployment."

While Fed accommodation is without doubt on its way, Powell's comments notably tempered expectations for an aggressive string of rate cuts by pointing to lingering concerns around inflation, which has exceeded the Fed's target for more than four years. He also suggested that a so-called neutral setting for interest rates, where rates neither spur nor slow economic activity, which is thought to be around 3.25%, might be higher than it was during the last decade.

***The US central bank is clearly on its way to easing its benchmark rate, currently around 4.3%, toward the neutral rate, implying cuts of about 100 basis points. Now, the debate will quickly shift to how far and how rapidly officials will ease following the coming reduction this month. The surprising slowdown in job growth this summer has shifted expectations for further cuts throughout the rest of this year. Rather than cutting a quarter percentage point at every other meeting as previously anticipated, FOMC members are likely to weigh consecutive cuts of a quarter percentage point through their remaining meetings this year in reaction to the dismal August payroll numbers. Financial markets have raised their bets on rate cuts following the release of the August payroll data: Yields on the two-year US Treasury note, which closely tracks expected rate cuts, settled at 3.5%, its lowest level in three years. Data from the CBOE Group now shows there is roughly a 75% chance the Fed will make the equivalent of a quarter-point rate cut at each of its three remaining policy meetings this year.***

## Tariffs

While the US economy continues to expand, albeit at a slower, close-to-trend pace, on-again, off-again tariffs have added a layer of complexity to business planning as they reshape the global trading system affecting prices, supply chains, and expectations in ways that are hard to model. Many businesses have had to scramble to make changes to their supply chain arrangements, reminiscent of the pandemic era. Tighter immigration policies, resulting in the estimated loss of about 1.2 million workers this year, have led to an abrupt slowdown in labor force growth, in part accounting for the stable unemployment rate. And changes in tax policy, spending, and regulatory regimes will undoubtedly have important implications for economic growth and productivity. So, there remains much uncertainty about where these policies will eventually settle and what their lasting effects on the economy will be.

***A reasonable case can be made that the effects of the Trump tariffs will be relatively short lived, representing a one-time shift in the price level that will play out over time. However, it is also possible that the upward pressure on prices from tariffs could spur a more lasting inflation dynamic.***

Meanwhile, the status of the President's trade policy remains uncertain as a federal appeals court ruled last week that most of his tariffs were illegal, affirming a lower court's finding that the President did not have unlimited authority to impose taxes on nearly all US imports. Adding to the uncertainties, the appellate judges delayed the enforcement of their order until mid-October, allowing the administration time to appeal the case to the Supreme Court. While Trump's tariffs remain in force, for now, the adverse ruling casts serious doubt over the centerpiece of Trump's trade strategy.

## Forward-Looking Economic Indicators Remain Mixed

**ISM Manufacturing Index.** Activity in the manufacturing sector rose slightly to 48.7 in August, lagging the consensus expected 49.0, but remained in contraction for the sixth consecutive month. (Readings above 50 signal expansion; readings below 50 signal contraction.) The August reading continues a pattern that has spanned all of 2023 and 2024. Only seven of the eighteen major industries reported growth last month. The good news is the new orders index broke above 50 for the first time since January at 51.4. Order books were weak heading into this year, and survey comments suggest the added uncertainty from on-again, off-again tariffs had caused many customers' orders to be put on hold until stability returns. In response, manufacturing companies have scaled back, as both production and employment indices contracted in August. Perhaps the most disappointing part of the report showed inflation pressures remain elevated while manufacturing stagnates.

**ISM Non-Manufacturing Index.** The Institute for Supply Management's services index rose to a reading of 52.0 in August, exceeding expectations. (Readings above 50 signal expansion; readings below 50 signal contraction.) The August reading was the highest in six months, representing a turnaround from its recent downward trend. Growth was broad-based with twelve of the eighteen industries reporting growth. The index for new orders led the overall index to higher, as it rose to a ten-month high at 56.0. Business activity rose to a five-month high at 55.0. Despite the jump in new orders and the rise in activity, services companies remained defensive with their hiring at 46.5, marking the fifth time in six months when employment was below 50.0. The highest reading of the report was the prices paid index, which stood at 69.2, down from readings above 80 but still elevated.

**M2 Measure of Money Supply.** Though inflation pressures remain, the M2 measure of money supply, while now increasing at about 3%+ annual rate, is barely higher than it was three years ago, implying lower inflation and growth in the year ahead.

**Initial Jobless Claims.** Initial jobless claims rose to the highest level since June, adding to signals that the labor market is cooling, marked by fewer job openings as shown in the July JOLTS report, and softer wage gains. Initial claims increased by 8,000 to 237,000 in the week ended August 30. Claims remain well within their recent range, showing no spike.

**Front Barnett Economic Model.** The August reading of our firm's proprietary [Economic Model](#), using publicly available economic data and designed to signal a change in the direction of the overall US economy six to nine months ahead of an inflection point, remained above trend signaling expansion ahead.

## Current Conditions and Outlook

The US economy continues to experience the rolling recession we described in our July [Economic Outlook](#). So far, the labor market appears to be roughly in balance, absorbing a marked slowing in both the supply and demand for workers this summer without a meaningful uptick in unemployment. At the same time, GDP growth slowed notably in the first half of this year to a below-trend pace of 1.2%, roughly half the 2.5% rate in 2024. The decline in overall economic growth has largely reflected a slowdown in consumer spending which accounts for about 70% of GDP. High interest rates, elevated inflation, and fears of job losses have soured consumer sentiment resulting in more cautious purchasing, particularly among the lowest wage earners. Manufacturing, which amounts to about 13% of GDP, remains in contraction. Interest rate sensitive sectors including real estate, housing, autos and small companies without access to corporate financing, remain depressed. Higher tariffs have begun to push up prices in some goods categories. The latest available data indicate that total Personal Consumption Expenditure prices (PCE), the Fed's preferred inflation gauge, rose 2.6% over

the 12 months ending in July. Excluding the volatile food and energy components, core PCE rose 2.9%, higher than its level a year ago and well above the Fed's 2% target.

While US consumers have turned cautious, several factors, including this summer's pullback in hiring and slower labor demand, likely overstate the underlying behavioral shift, as spending gains this quarter are likely to have rebounded, aligning with income gains, which are rising at about a 2% annual rate. A bright spot in the revised 2nd quarter GDP data shows the surge in capital spending continues, driven by AI related outlays and changes in depreciation regulations. Business investment grew at a 15.3% annual rate in the first half. These developments suggest that softening labor demand is not placing a significant drag on current-quarter GDP growth which the consensus of forecasts now expects to be above-trend, near 2.5%.

***In short, despite pockets of weakness in the US economy, particularly in manufacturing, we fail to see the spike in job losses and/or signs of a sharp contraction in consumer spending which invariably lead to an economy-wide contraction. The economy remains resilient in the face of many headwinds. Consumer spending this quarter appears to be growing in line with incomes at a satisfactory 2% rate. Nevertheless, the current balance in US economic performance is delicate and at risk from the unpredictable, still-building drag from rising tariffs. It would not surprise us to see a temporary spike in core PCE inflation in the coming quarter before receding.***

## **Equity Investment Policy**

Buoyed by sound fundamentals, lower than feared tariffs, the all-but-certain Fed pivot, and rising Wall Street earnings estimates, the S&P500 has now rebounded over 30% from its April correction lows. The dominance of the mega cap, AI-driven, magnificent seven, which spanned almost two years, has recently shown signs of giving way to a more healthy, broader stock market leadership which now includes previously lagging financials, consumer discretionary stocks and industrials. Small cap and mid cap stocks, as well as emerging market shares which had trailed, reacting to the prospect of lower interest rates, have also rallied. Broadly diversified portfolios, which had underperformed their benchmarks in the first half, have gained traction since mid-year.

Despite the steepness of the market's rally and the rich 23x future earnings valuation of the cap-weight S&P500, the average stock, as measured by the S&P equal weight index, is more reasonably priced at about 18x forward earnings, not far above its average 16x multiple. So there is likely further room for the overall market to run from here as rising 2026 earnings estimates are discounted.

There has been no change in investment policy. Portfolios under our supervision remain fully invested within their guidelines, reflecting individual clients' risk tolerances. They remain well-diversified, balanced between *growth* and *value* investments, domestic small caps as well as holdings abroad in developed and emerging markets. Recall that by blending core *growth* and *value* equities in a single portfolio, a style unique to Front Barnett management, we seek to smooth portfolio returns over a market cycle.

We see earnings momentum, positive operating leverage and cash tax savings, as underappreciated tailwinds for equities. With earnings accelerating into next year and the Fed about to pivot, valuations can remain supported around current levels. However, sentiment-driven stock market corrections of 5% to 10%+ are inevitable, particularly during seasonally weak periods such as where we find ourselves currently.

### Fixed Income Investment Policy

With the approach of a pivot by the central bank, the yield curve has steepened. Shorter-term bond yields, reacting to likely Fed policy, have fallen while longer-term bond yields, reacting to expectations for future inflation and the sustainability of public finances, have drifted higher. Actively managed, high quality, laddered corporate bond portfolios under our supervision have a conservative target duration of 2.75 years, unchanged from earlier this year. We continue to reinvest the proceeds of bond maturities to fill out client's ladders, preferring to add to bonds maturing in less than 5 years. We believe it's timely for clients with substantial near-cash reserves positions who require liquidity, to selectively extend the maturity of those holdings.

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Indexes are unmanaged, do not include fees or expenses and are not available for direct investment. Definitions: **Personal Consumption Expenditures Index (PCE)**: A measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior. **Conference Board's Confidence Index**: The Consumer Confidence Survey® reflects prevailing business conditions and likely developments for the months ahead. **ISM Manufacturing Index**: The ISM manufacturing index or purchasing managers' index is considered a key indicator of the state of the US economy. It indicates the level of demand for products by measuring the amount of ordering activity at the nation's factories. **ISM Non-Manufacturing Index**: The Institute of Supply Management (ISM) Non-Manufacturing Index is an economic index based on surveys of more than 400 non-manufacturing (or services) firms' purchasing and supply executives. **S&P 500 Index**: The S&P 500 Index, or Standard & Poor's 500 Index, is a market-capitalization-weighted index of 500 leading publicly traded companies in the US. **S&P 500 Growth Index**: The S&P 500 Growth Index is a stock index administered by Standard & Poor's-Dow Jones Indices. As its name suggests, the purpose of the index is to serve as a proxy for growth companies included in the S&P 500. **S&P 500 Value Index**: The S&P 500 Pure Value Index refers to a score-weighted index developed by Standard and Poor's (S&P). The index uses what it calls a "style-attractiveness-weighting scheme" and only consists of stocks within the S&P 500 Index that exhibit strong value characteristics.

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