

Economic Outlook:

Waning Labor Market Momentum and Still-Elevated Inflation Complicate Rate Outlook,
amid Unknown Policy Impact

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STIFEL

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The consumer has been faring quite well given ongoing gains in the labor market, but more recently, the pace of consumer spending has moderated and job creation has stalled

Inflation has shown improvement from earlier peak levels – which is to say prices continue to rise, but at a slower pace – but more recently, the pace of improvement has slowed with some metrics showing upward momentum

For the Fed, already walking a delicate line between stable prices and full employment, lingering fiscal policy uncertainty has muddled the outlook

The Consumer

Inflation

Policy Decisions

Labor Market Conditions Cooling but Still Positive

Despite ample concerns and a decline in confidence, consumers remain resilient thanks to decent gains in the labor market

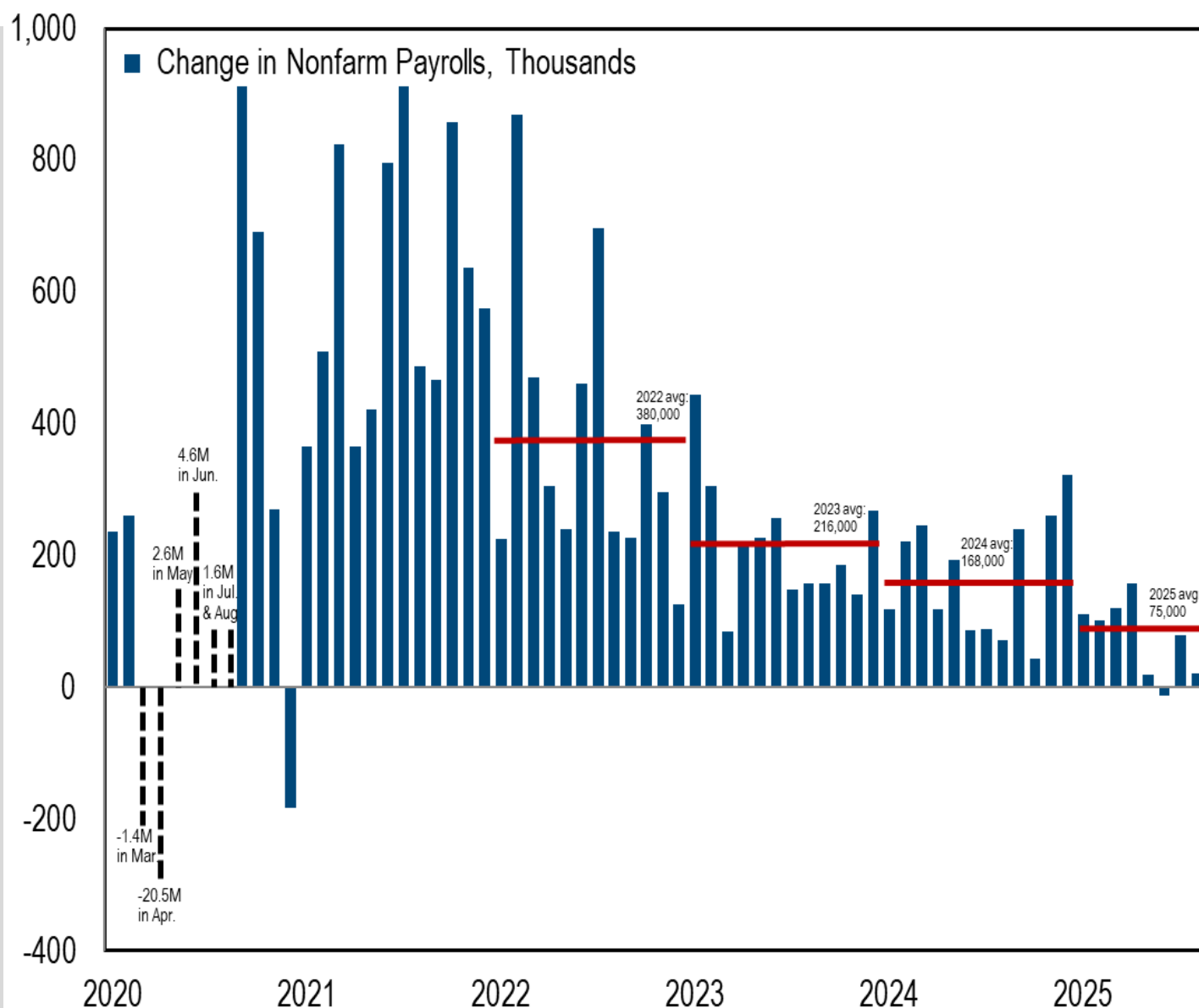
So far this year, job creation has averaged just **75k**, despite a drop in topline growth at the start of the year

Hiring momentum slowed from **216k** in 2023 to **168k** in 2024

Nonfarm payrolls rose by **22k** in August, less than expected and a two-month low; the three-month average, however, ticked up to **29k**, albeit near the weakest pace since June 2020

With earlier revisions to previous months, the overall change (August data + net revisions) was just **1k**

Despite benchmark revisions (-911k, U.S. employers still added **2M** jobs in 2024, a solid level of job creation, albeit down from the **2.6M** jobs added in 2023, the **4.6M** jobs added in 2022 and the **7.2M** jobs added in 2021 following the pandemic plunge of 9.2M in 2020, the largest decline on record, and more than the combined decline in 2008 and 2009



Source: Bureau of Labor Statistics/Haver Analytics

4.3% U.S. and 4.7% Kentucky Unemployment Rate, Still Below Full-Employment Range

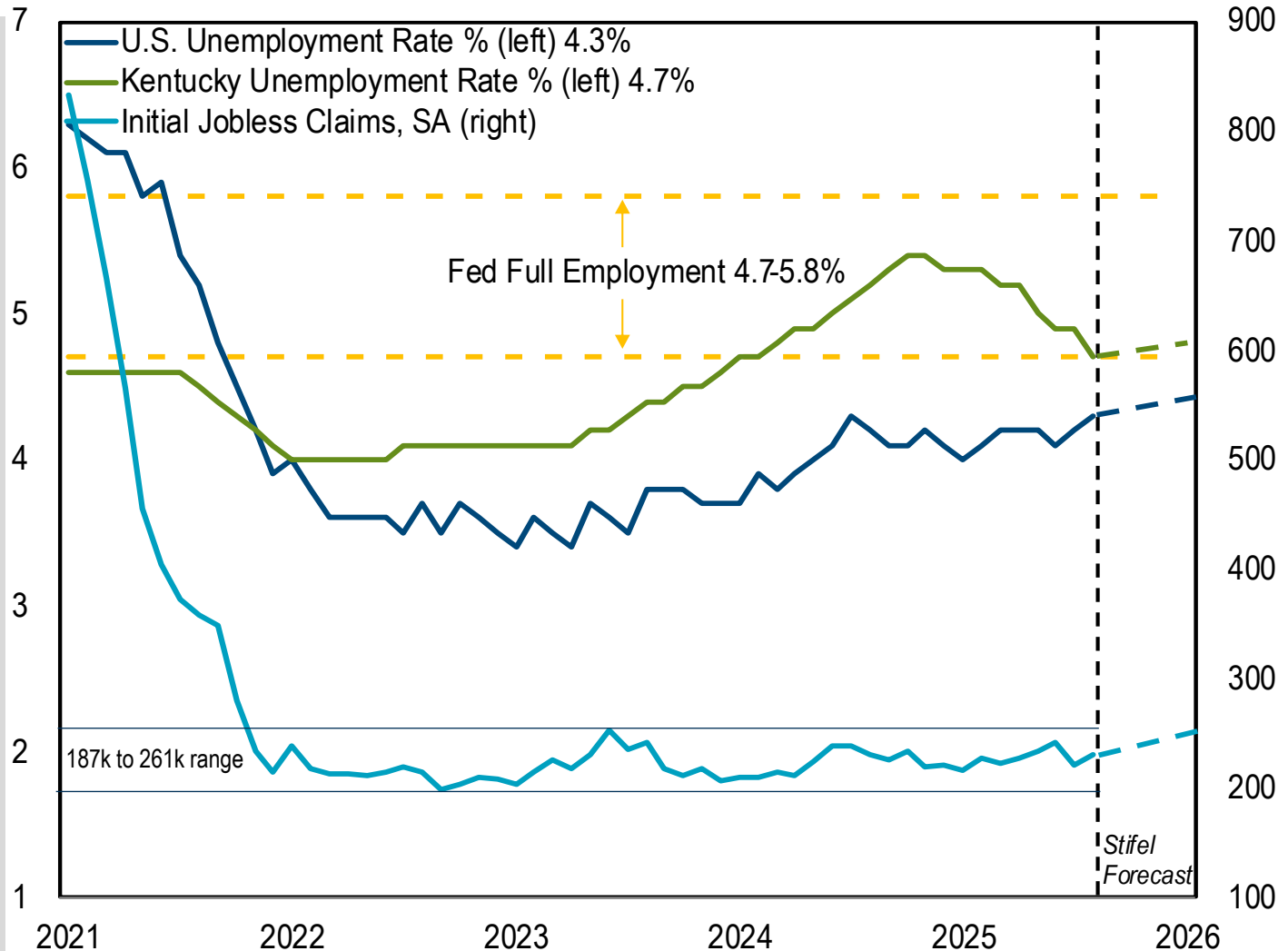
At the same time job creation has slowed, a natural function of an aged recovery, the U.S. unemployment remains low; rising somewhat at **4.3%** in August, the highest since October 2021, it is still well below the Fed's full employment range; in Kentucky, the unemployment rate fell to **4.7%** in August, the lowest since December 2023

The unemployment rate is likely to rise to 4.5% by year-end, reflecting reduced activity, an increased reliance on AI and tighter immigration policy which has led to an abrupt slowdown in labor force growth

While household employment has risen by just an average 15k over the past six months, the labor force has also increased by just 70k, keeping the unemployment rate artificially low

Conflicting metrics:

Jobless claims low but ticking up; continuing claims at a multi-year high; prolonged unemployment over 25% of unemployed; job vacancies down 5M from peak but above pre-pandemic level; recent grad unemployment 9.3% vs. 3%



Source: Bureau of Labor Statistics/Department of Labor

**The Sahm Rule is a recession indicator that uses unemployment data to signal the start of a recession. The rule is triggered when the three-month moving average of the unemployment rate increases by 0.5 percentage points or more; in August 2024, the 57bp increase in the three-month average of the unemployment rate from the cycle low triggered the Sahm Rule, yet, we are no longer in the trigger range and this rule has never been tested with 7.2M job vacancies

Average Hourly Earnings Still Positive

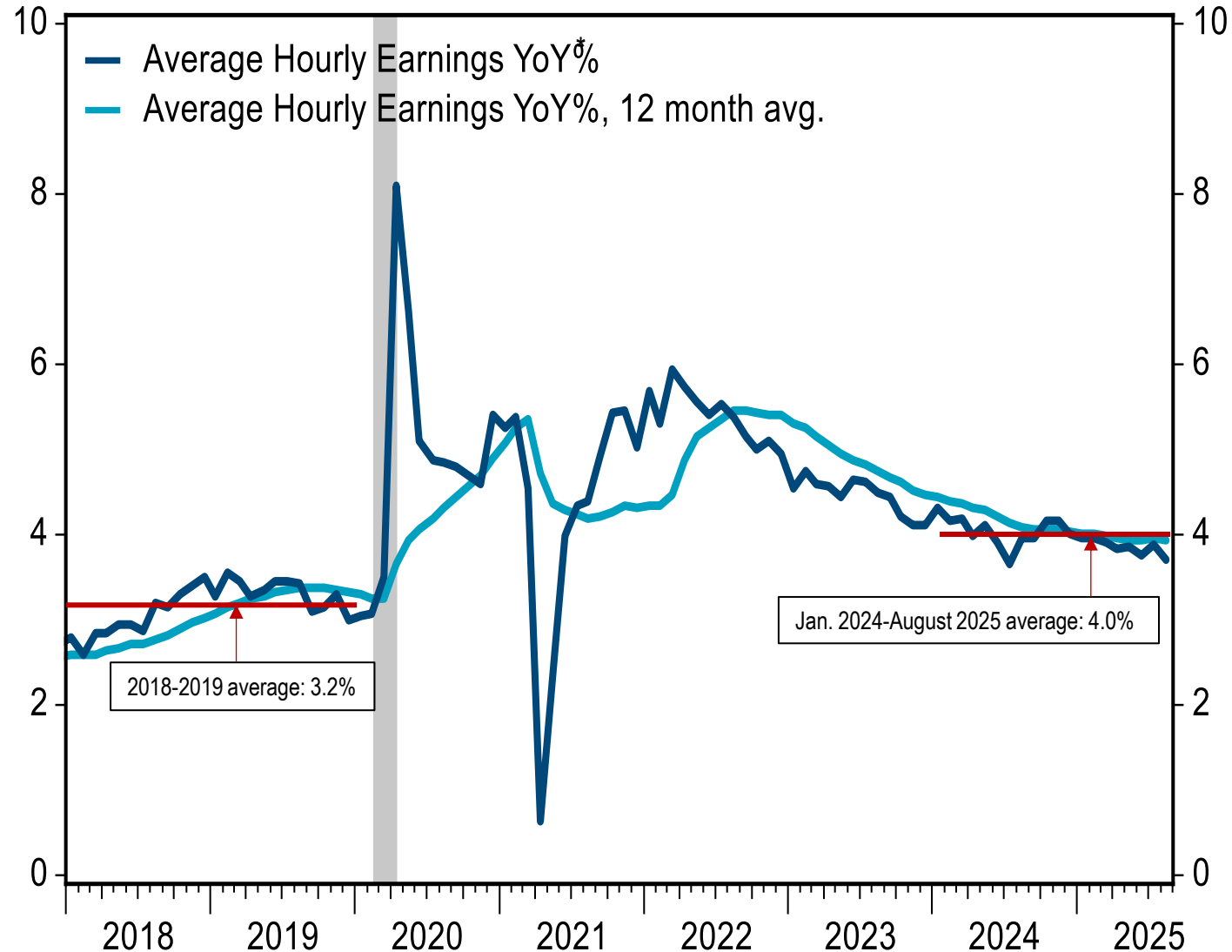
Solid wage growth continues to tilt the table towards a positive assessment of the labor market, highlighting the lingering disconnect between labor demand and supply

Down from an earlier peak of 5.9% in 2022, wages rose **3.7%** in August, the smallest annual gain since June, still offering welcome support for the consumer

Average hourly earnings rose **0.3%** in August, as expected, and following a similar rise in July

As businesses search for workers, compensation is elevated, although the trend appears to be moderating as businesses struggle to absorb costs

Longer-term, businesses may turn to technology or close doors; for now, costs are likely to remain elevated as long as labor remains scarce



Source: Bureau of Labor Statistics/Haver Analytics

*Does not include government assistance

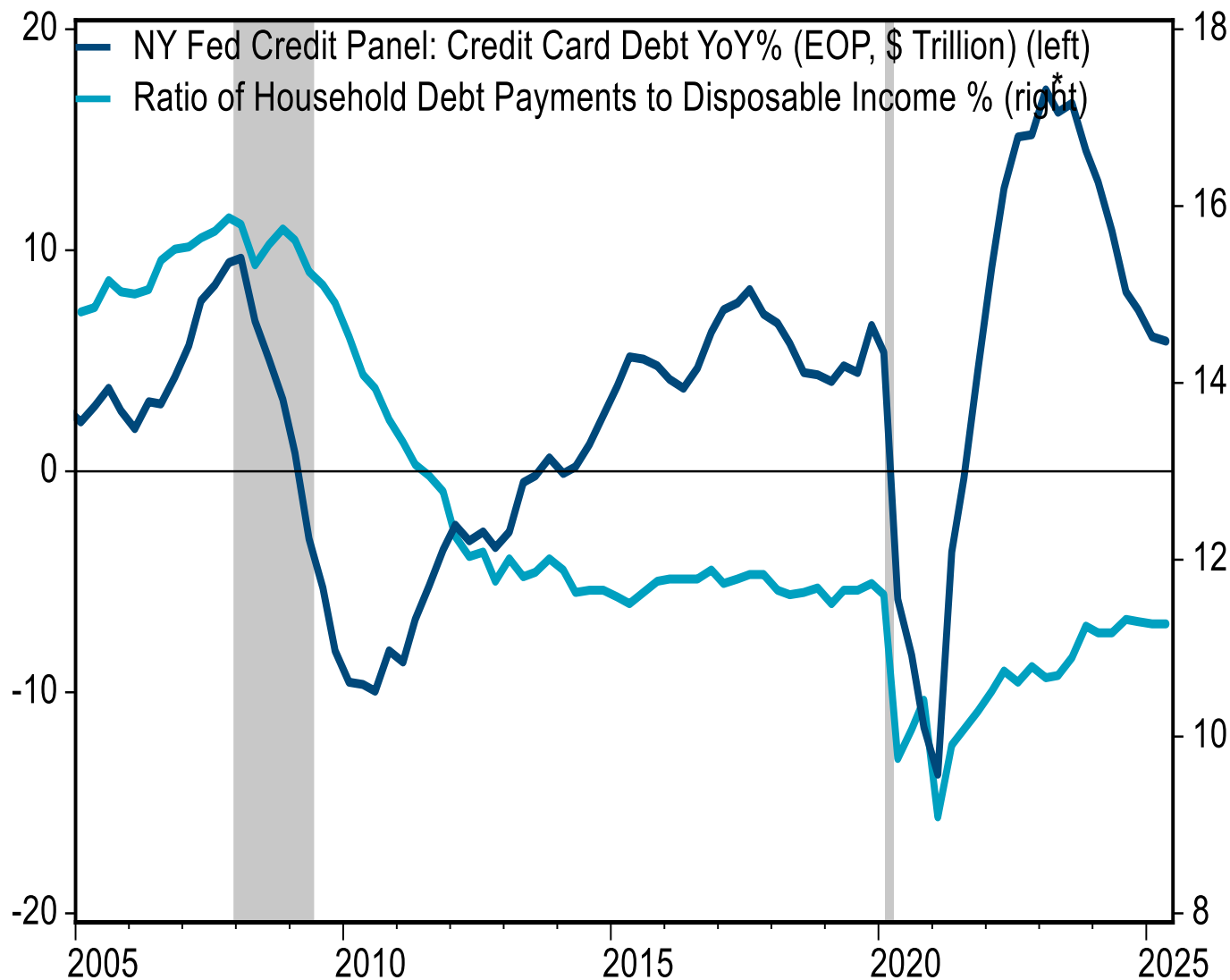
Debt as a Percent of Income Near Record Low

While steady, consumers are not on unshakable footing; consumers are feeling the pain of higher prices and borrowing costs

Aside from income support, consumers are turning to alternatives: (organic) savings, interest earnings, (inorganic) “*buy now pay later*” options, wealth transfers, 401ks, and credit cards (**\$1.2T**)

Historically, a flag of weakness – nominally – and with delinquencies on the rise; however, predominantly those with lower credit scores and debt as a percent of disposable income remained at **11.3%** in Q2, still near the lowest on record

Not advocating for credit card growth, but room to grow liabilities suggests further spending and borrowing power



Sources: FRBNY/Haver Analytics

*Debt payments consist of the estimated required payments on outstanding mortgage and consumer debt

** After 3 years of relief, student loan payments resumed in October 2023 for approximately 45M Americans

Retail Sales Volatile With Broader Momentum Modest but Positive

Even with organic and inorganic supports, a loss of momentum has resulted in fewer dollars spent, higher nominal debt, and rising delinquency rates

Consumers are still spending but doing so at a reduced pace, and inflation is complicating the picture (not cost adjusted)

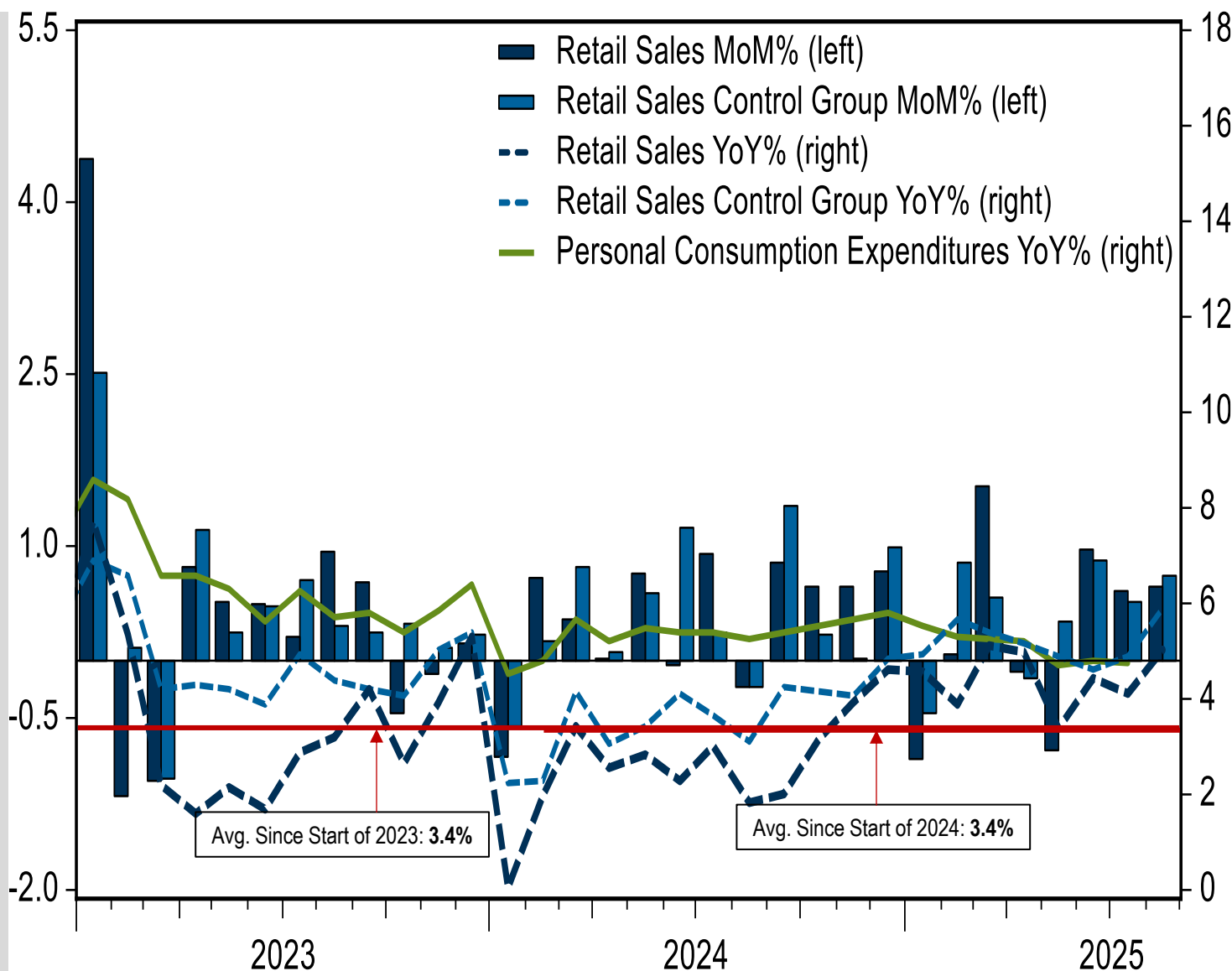
Year-over-year, retail sales rose **5.0%** in August, the strongest pace in four months, but **consumers are taking home less**

Sales rose **0.6%** in August following an upwardly revised 0.6% gain in July

Control group rose **0.7%** in August and increased **5.9%** year-over-year, the largest annual increase since February 2023

Large retailers report customers are cutting back as the balance sheet is becoming increasingly fragile amid rising costs and elevated

Personal consumption expenditures rose **0.5%** in July and **4.7%** YoY



A Rise in Household Net Worth (For Some)

A change in spending patterns is not symmetric across households

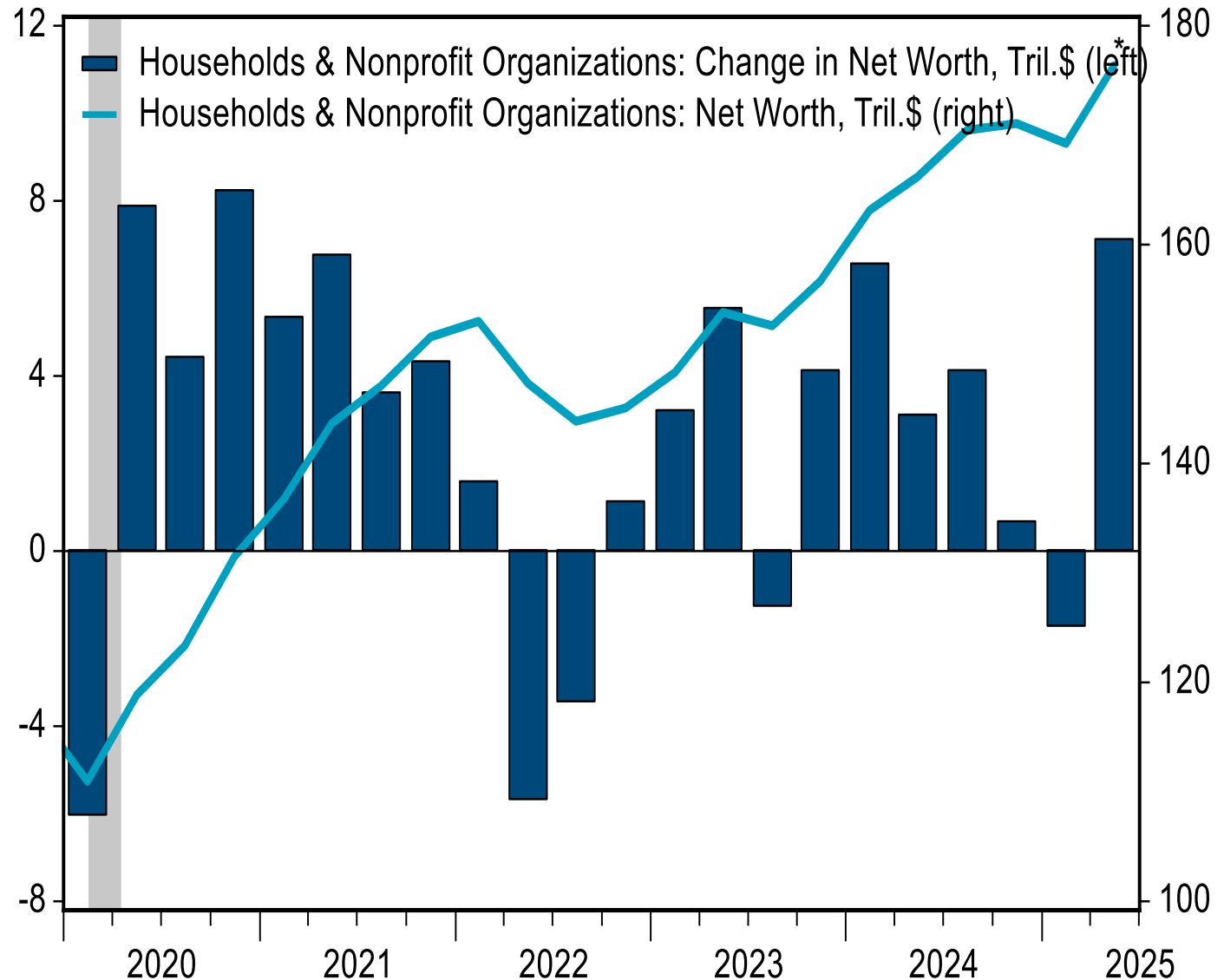
Household net worth has grown **\$31.4T** since the start of 2023 thanks to a surge in asset prices

Net worth jumped \$7.1T in Q2 to **\$176.3T, the highest level recorded**

Benefit limited to upper end of the income spectrum

Still, a net gain suggests there is still a significant amount of borrowing and spending power in the economy

As of September, home prices have risen 4.1% from the start of the year, or by \$2.0T, bringing the total value to \$51.7T, and the equity market has risen 14.7% to a total value of \$57.1T



Source: Bureau of Economic Analysis/Haver Analytics

*Household net worth represents the total value of assets (financial as well as non-financial) minus the total value of outstanding liabilities.

Waning Business Investment

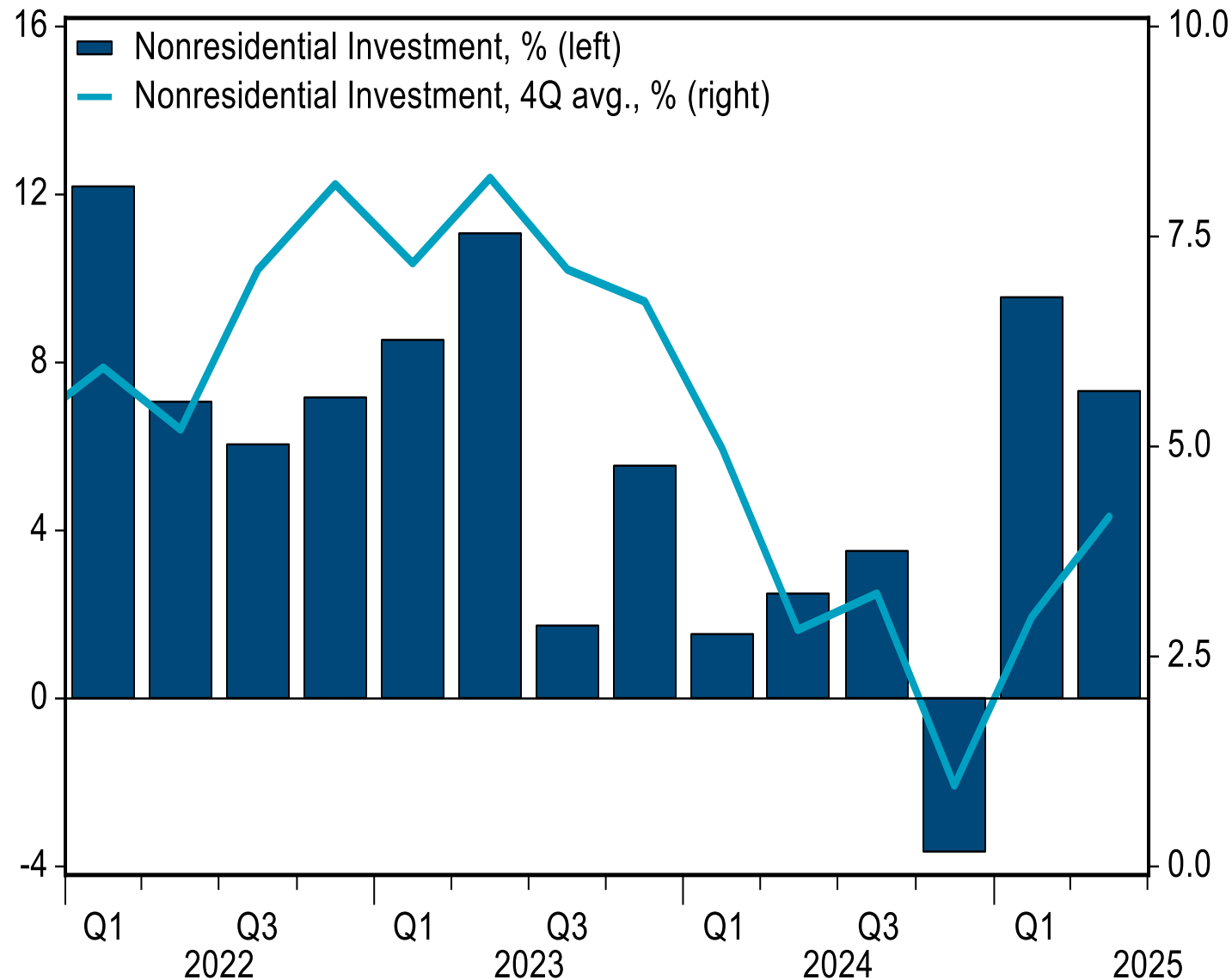
Businesses will continue to struggle under the weight of higher prices, elevated costs of parts, materials, rents, and labor, along with a limited ability to pass on rising costs without the risk of losing market share, reflecting:

- * A muted pass-through of tariff-driven inflation
- * And, a loss of investment momentum (down **3.7%** in Q4 '24)

Of course, in Q1, nonresidential investment rose **9.5%** as businesses front-loaded purchases of aircrafts and computers ahead of planned levies

By Q2, activity moderated somewhat, up **7.3%**, the weakest pace in two quarters

Averaging activity, the downward trend is likely to continue as reduced profit expectations lead to *some* credit quality problems



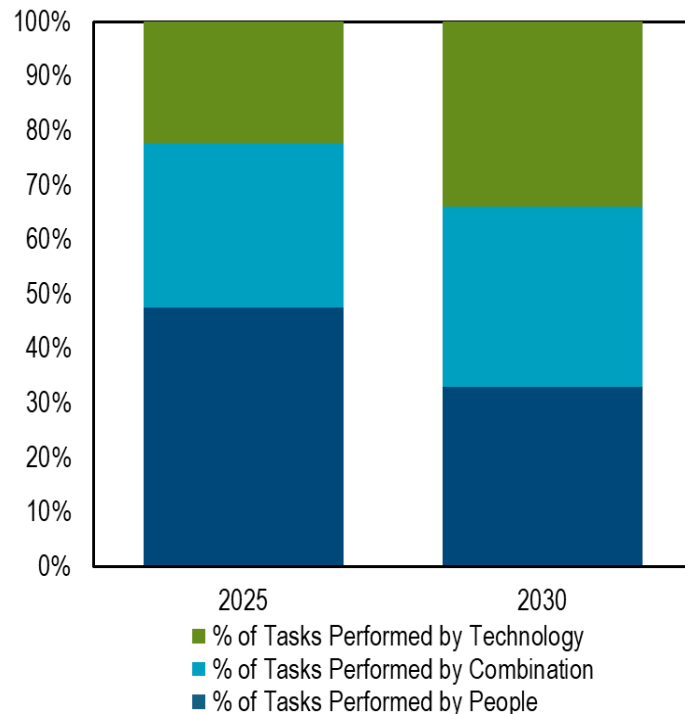
Source: Bureau of Economic Analysis/Haver Analytics

Impact of Artificial Intelligence (AI) on Labor Market

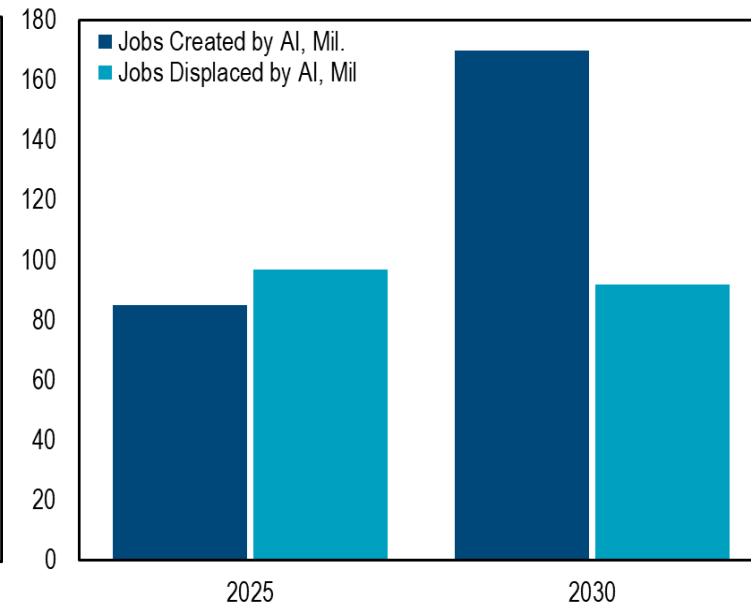
To offset rising costs, some corporations have already announced hiring freezes, cut down on investment or turned to AI for cost reductions (efficiency and productivity increases)

50% of businesses in the U.S. say they have already adjusted their staff based on the adoption of AI with **80%** reporting plans to over the coming 12-18 months

AI could also result in ample job destruction and/or displacements, potentially resulting in a net loss of **9M** jobs this year alone with potentially **34%** of the current tasks in the labor market becoming automated by 2030



Source: World Economic Forum



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Household Affordability Near Record Low as Mortgage Rates Remain Elevated

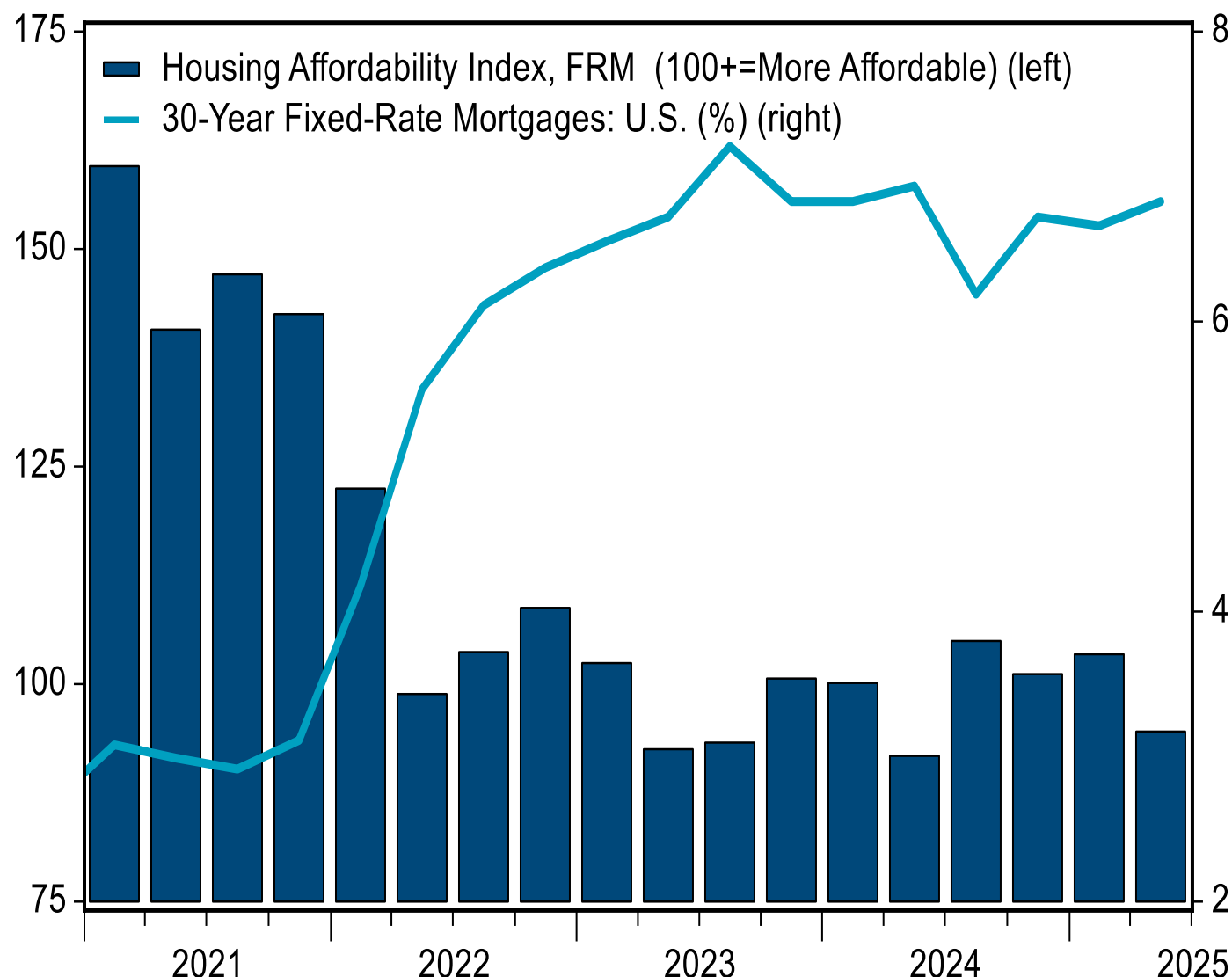
Higher rates undermine affordability (entrance) and create a lock-in effect (exit)

According to RedFin, more than 83% of homeowners have a mortgage rate below 6%, while 73% of homeowners have a rate below 5% and 55% have rate below 4%, resulting in a lock-in-effect

This lock-in effect is precluding would-be-sellers from offloading or replacing current property ownership at the risk of resetting one's mortgage from 3% to just shy of 7%

The 30-year mortgage rate rose from **4.50%** to a high of **7.90%** as the Fed initiated rate **hikes** in 2022

Amid the first round **cut** rates fell to **6.13%** in the week ending September 20, down 177bps from the earlier peak, although more recently, the 30-year mortgage rate has moved up to **6.37%**



Sources: NAR, FHLMC/Haver

Trillions in Commercial Loans Set to Reset at Higher LTVs

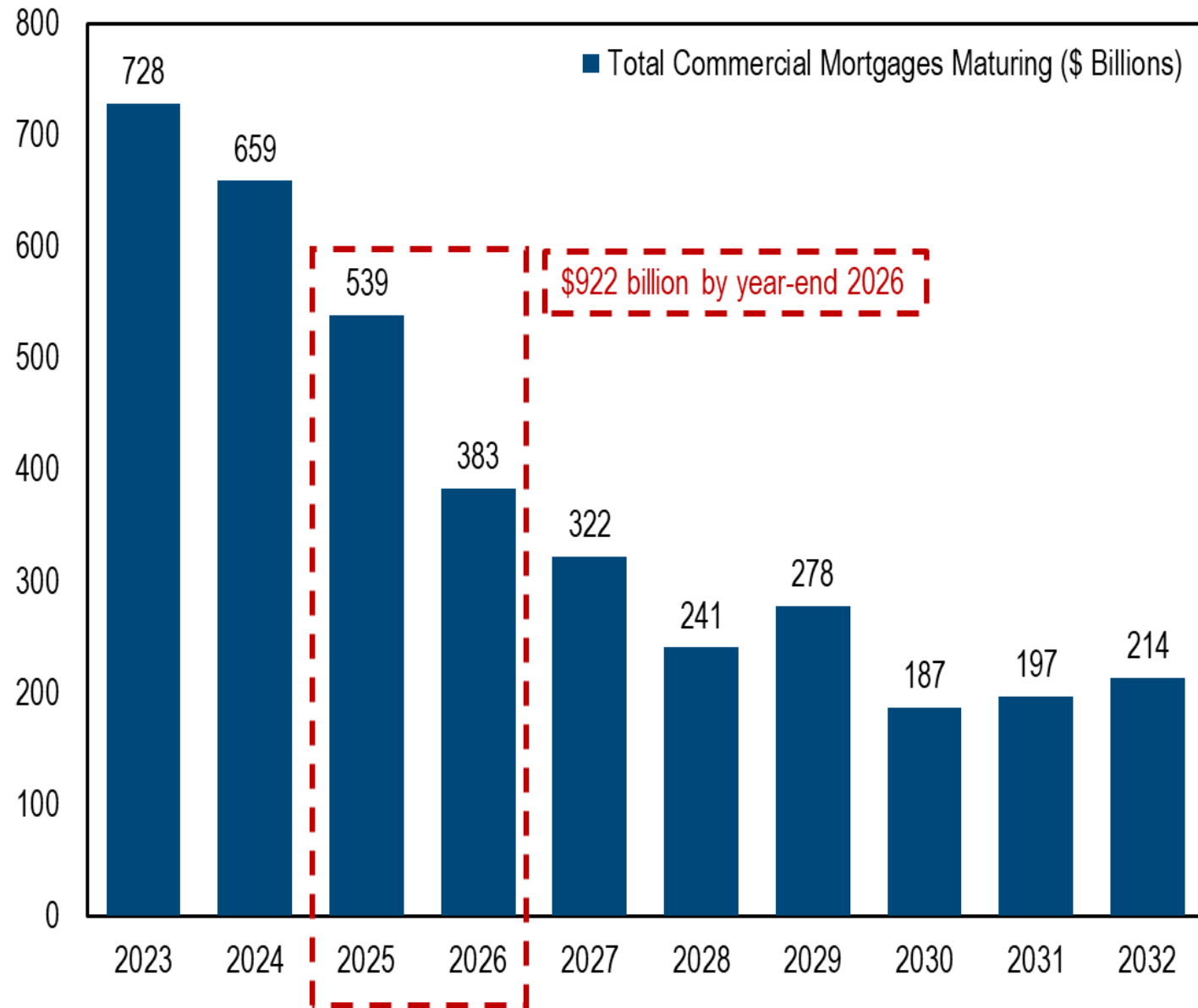
Even with little reprieve in home prices or prices with rates higher for longer, the biggest risk to the outlook stems from the commercial market, as elevated costs undermine affordability and valuations for investors

Trillions in commercial loans coming due in the next several years, resetting at significantly higher rates

The risk failed to materialize in 2024, pacified by the prospect of lower rates

Rates elevated and potential for easing stifled by inflation, risk for 2025 has compounded from the pressure of potential resets from 2023-2024, **driving higher LTVs**

By the end of 2026, nearly **\$1T** in commercial loans are slated to mature



Source: CRED iQ, MBA

Return to Office Rates Complicate Commercial Real Estate Market Outlook

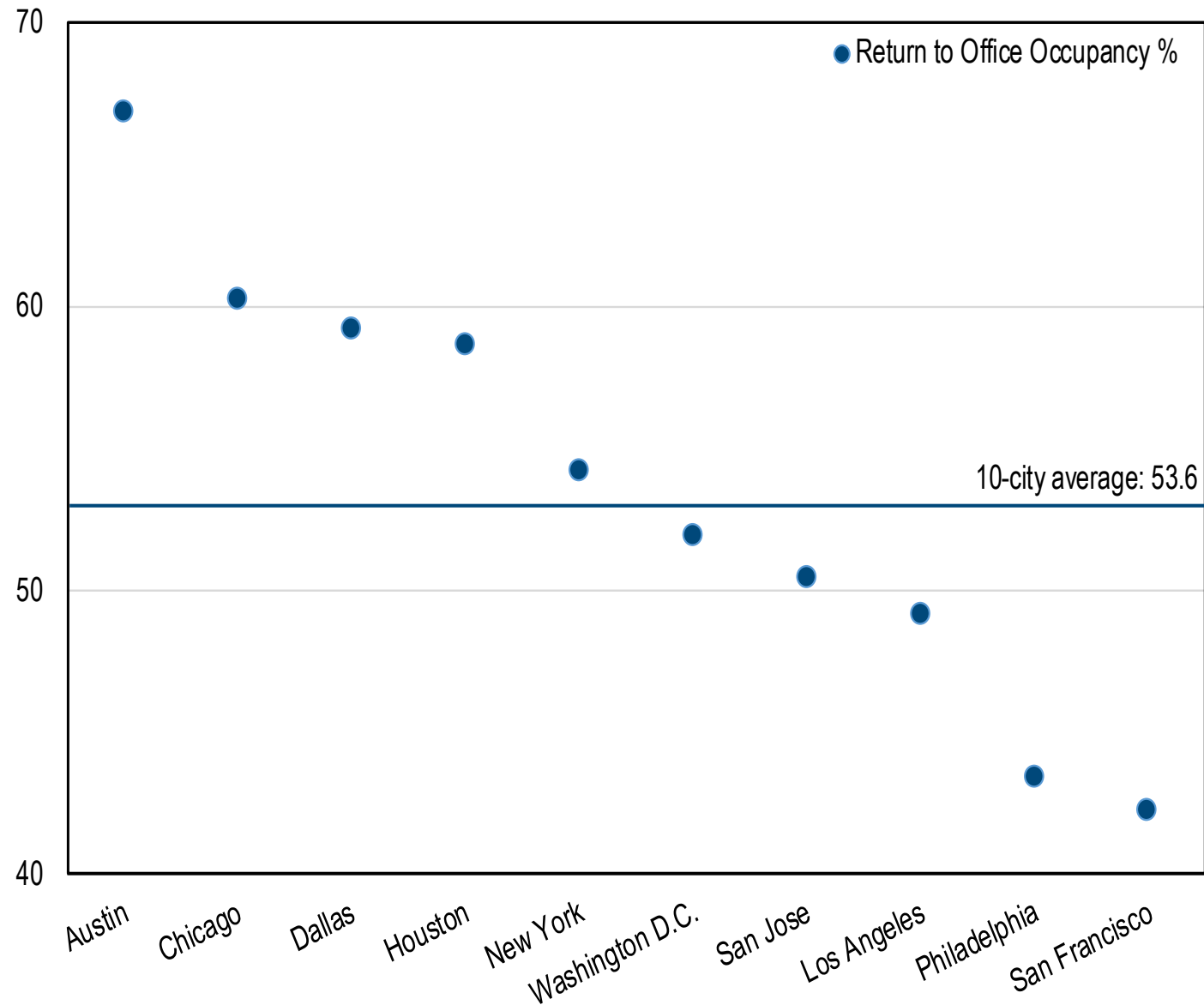
For the commercial market, as the work-from-anywhere environment has been wholly adopted, a change in structural preferences has resulted in a significant relocation of populations

Downtown urban centers are still experiencing a **54%** return to office rate on average

Contagion extends to secondary businesses and financial system (less than \$250bn)

According to real estate data firm Trepp, the U.S. office delinquency rate peaked at **11.01%** in December 2024, but has since fallen to **7.23%** as of July

Other areas, however, experiencing population booms will need further investment in commercial space to support the emerging growth and demand in everything from shopping centers to office spaces or alternative spaces for work, grocery stores and everything in between



Source: Kastle

Higher Rates Likely to Weigh on Nominal Growth (While Avoiding Recession?)

Significantly revised lower forecasts for first half growth reflecting policy impact on trade (exports rose 0.4%, imports 38% for a near 5% loss of topline activity/**-0.6% drop in Q1**)

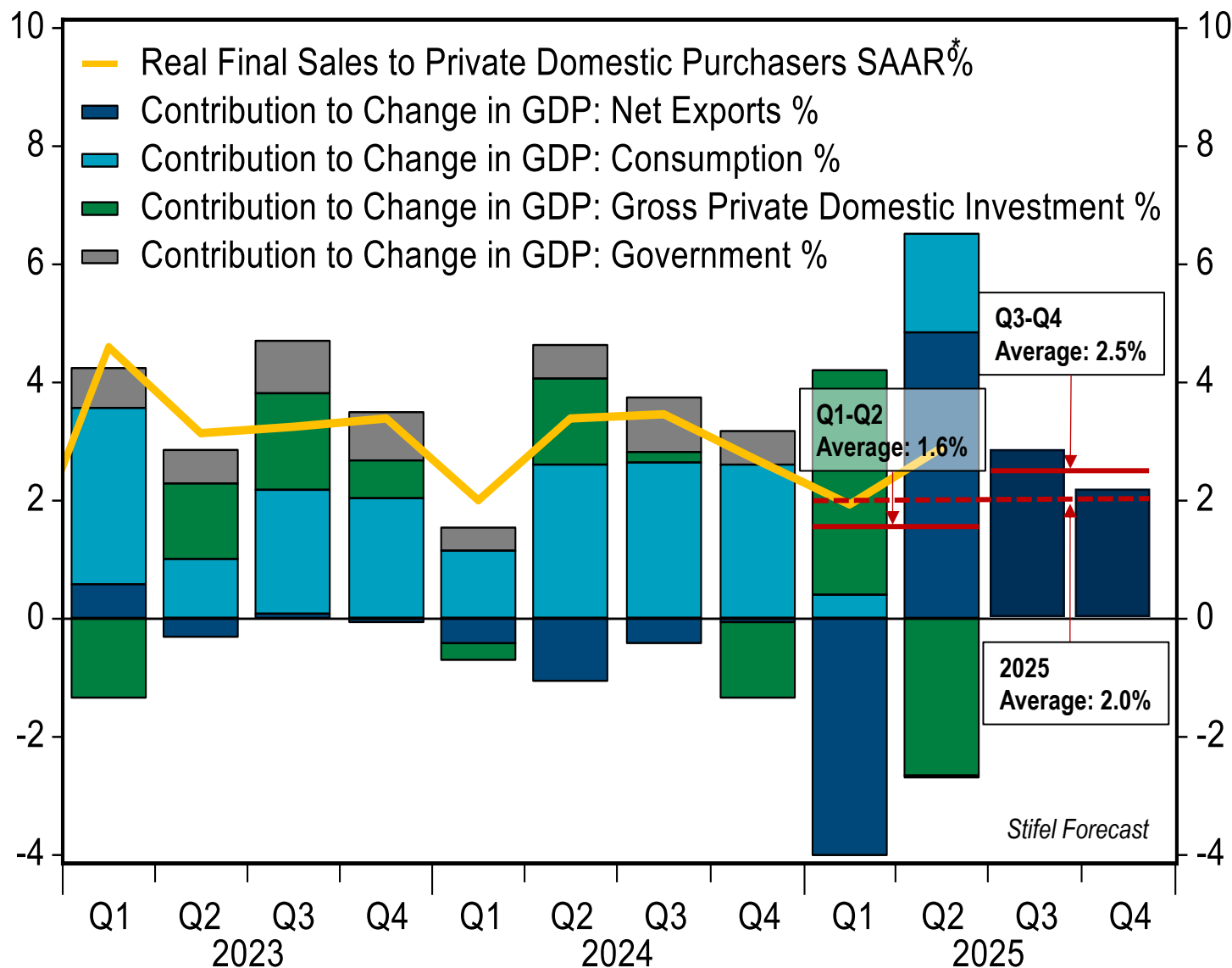
Inventories surged \$172B in Q1, a three-year high

Sizable offsets from consumption (2.5% in Q2) and investment (7.3% in Q2) carried into the second quarter

After all, businesses invest in inventory when relatively confident about consumer; knee-jerk reaction reversed with **GDP up 3.8% in Q2**

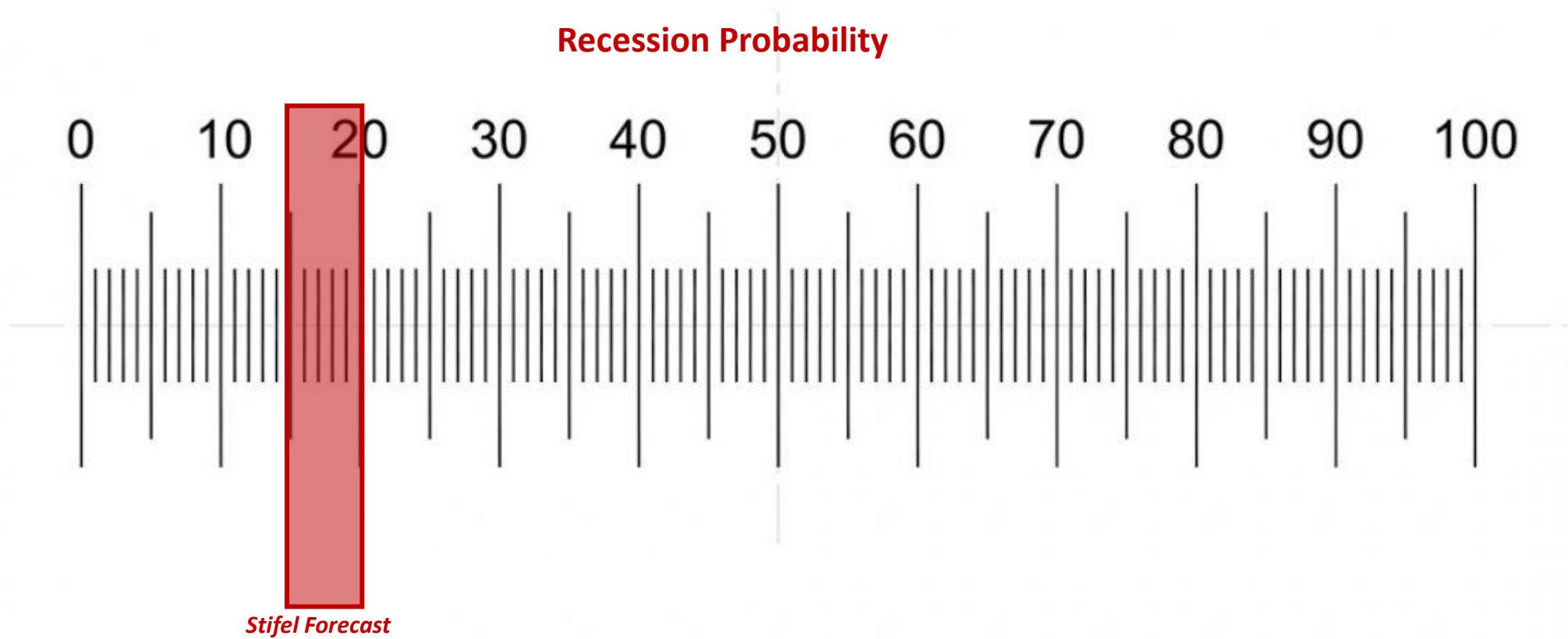
Going forward, uncertainty remains, but resilience of consumer and investment likely to result in 2% growth profile

The Fed revised its GDP forecast down from 1.4% to **1.6%** in 2025 to **1.8%** in 2026



Source: Bureau of Economic Analysis/Haver Analytics

*Note: Real final sales to domestic purchasers excludes net exports, change in private inventories, and government consumption



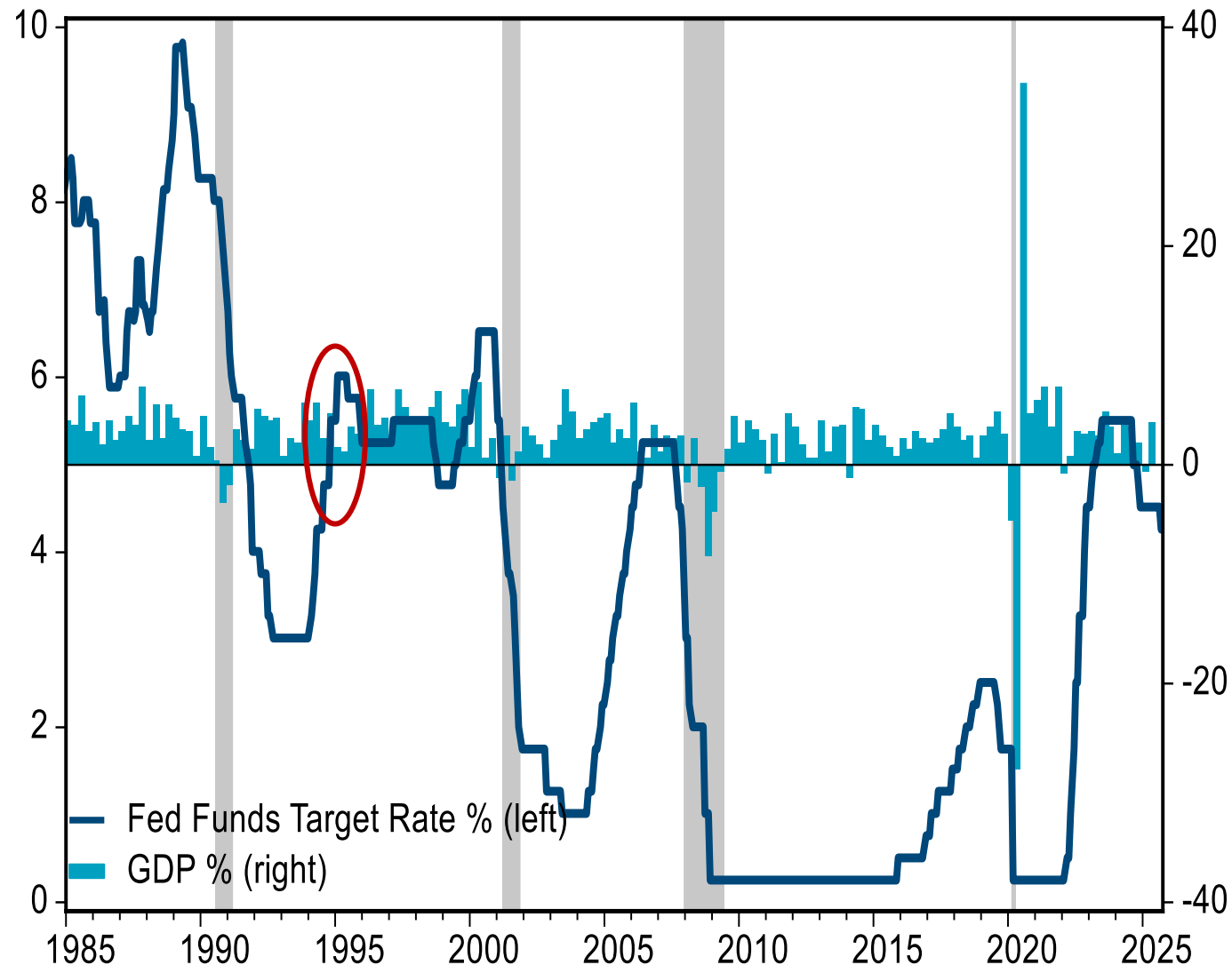
Soft Landing Only Achieved by the Fed Once in Last 60 Years

Over the last 60 years, the Fed has managed to achieve a soft landing only once in 1994-1995 under then Fed Chairman Alan Greenspan

Conditions more challenging this time; don't get partial credit for soft landing

The bigger concern and likelihood is not an outright downturn or outright recession, but a period stagflation as the economy slows to virtually a non-accelerating pace on average

	1995 Soft Landing	Current Cycle
Peak Unemployment Rate	7.8% (Jun '92)	14.8% (Apr '20)
Peak Core PCE YoY	4.4% (Sep '90)	5.6% (Sep '22)
Money Supply Growth	\$3.2T to 3.6T*	\$15.2T to \$22.1T**
Money Supply Growth, %	12.5%*	45.5%**
Source: Bloomberg		
	*1990-1995	**2020-Current Date



Sources: FRB, BEA/Haver

Counterparts Abroad Facing Conundrum of Slower Growth and High Inflation

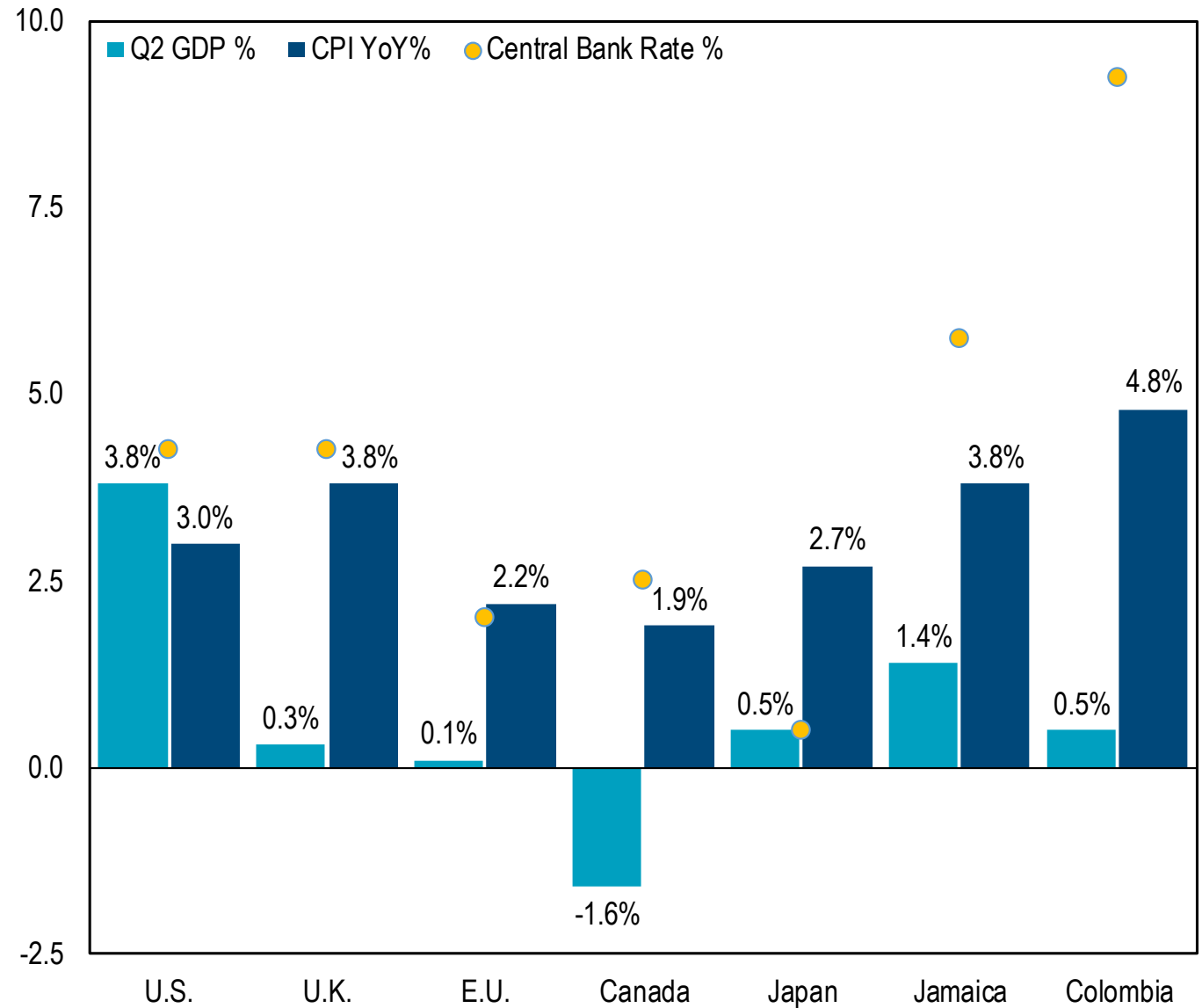
Global central banks face a conundrum of slower growth and still elevated inflation

The Bank of England (BOE) held rates steady at 4.00% in September, the lowest in two years, with growth rising 0.3% in Q2 and inflation up 3.8% in July on an annual basis

Meanwhile, the European Central Bank (ECB) held its deposit rate in September steady at 2.00% with growth rising 0.1% in Q2 and inflation up 2.2% in September on an annual basis

The Bank of Canada (BOC) cut rates 25bp to 2.50% in September with growth contracting 1.6% in Q2 and inflation up 1.9% annually in August

The Bank of Japan (BOJ) held rates steady at 0.50% in September with GDP rising 0.5% in Q2 and inflation rising 2.7% in August on an annual basis



Source: Bloomberg

U.S. Debt Continues to Increase, Risking Pressure on Inflation, Longer-Term Rates

The government balance sheet has grown to nearly **\$37T** as of late and includes both debt held by the public as well as debt held by federal trust funds and other government accounts

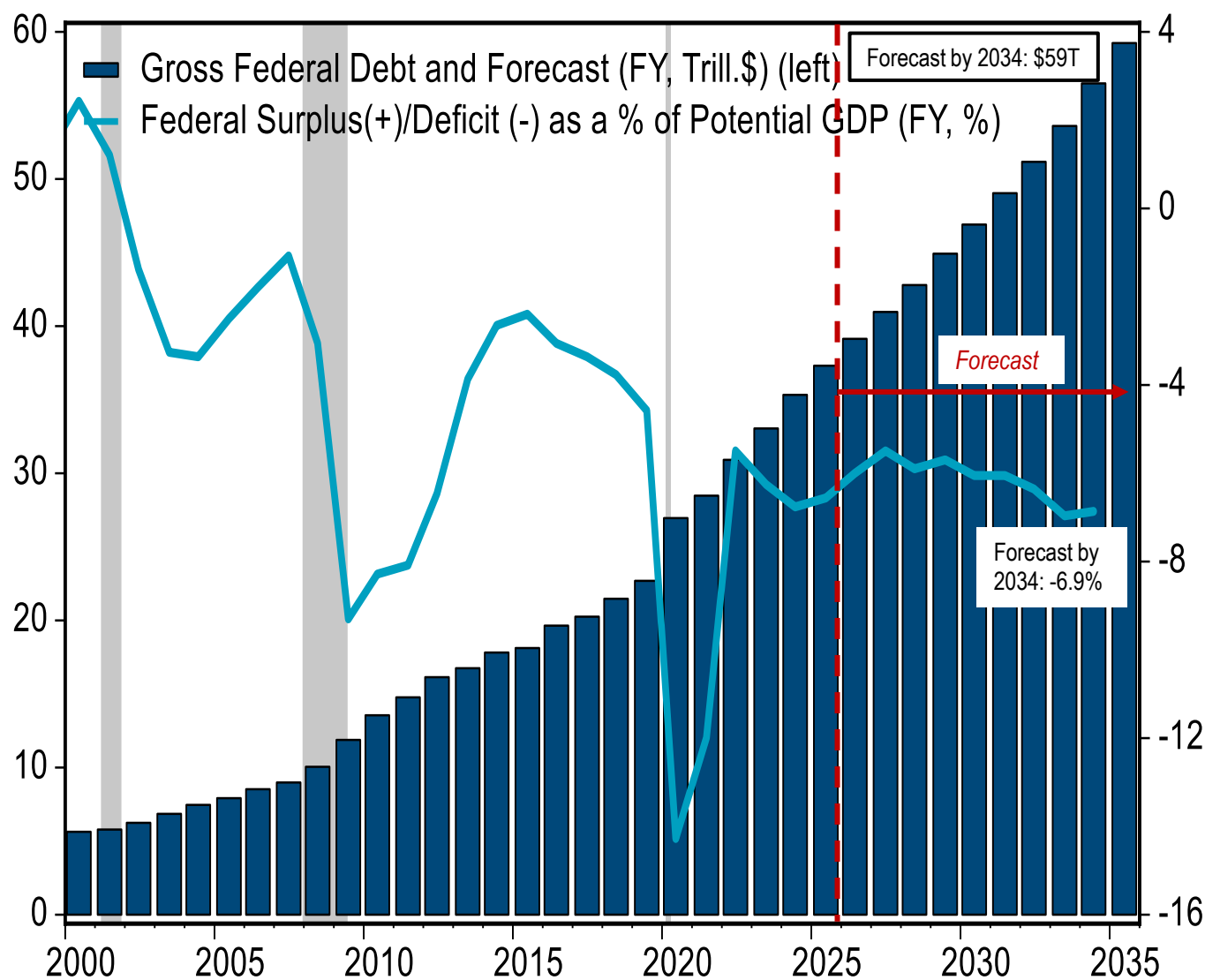
In FY 2024, the federal deficit was **\$1.8T**, and 6.4% of GDP

Meanwhile, in FY 2025, the deficit held steady at **\$1.8T**, approximately 6.0% of GDP

The deficit is expected to remain elevated at 6.9% of GDP, **more than two times the historical norm**

Rising federal deficits matter and will continue to reshape expectations for higher longer-term rates, complicate the Fed's pathway, and risk further inflation

Wake up call in Q4 2023 short-lived amid prospects of easing



Source: Congressional Budget Office/Haver Analytics

President Trump Signs Tax and Spending Package

The One Big Beautiful Bill Act (OBBBA) was signed by President Trump on July 4th

The bill combines \$4.5T in tax cuts – permanently extending the 2017 tax cuts, and including new tax breaks for tips, overtime (“windfall” relative)

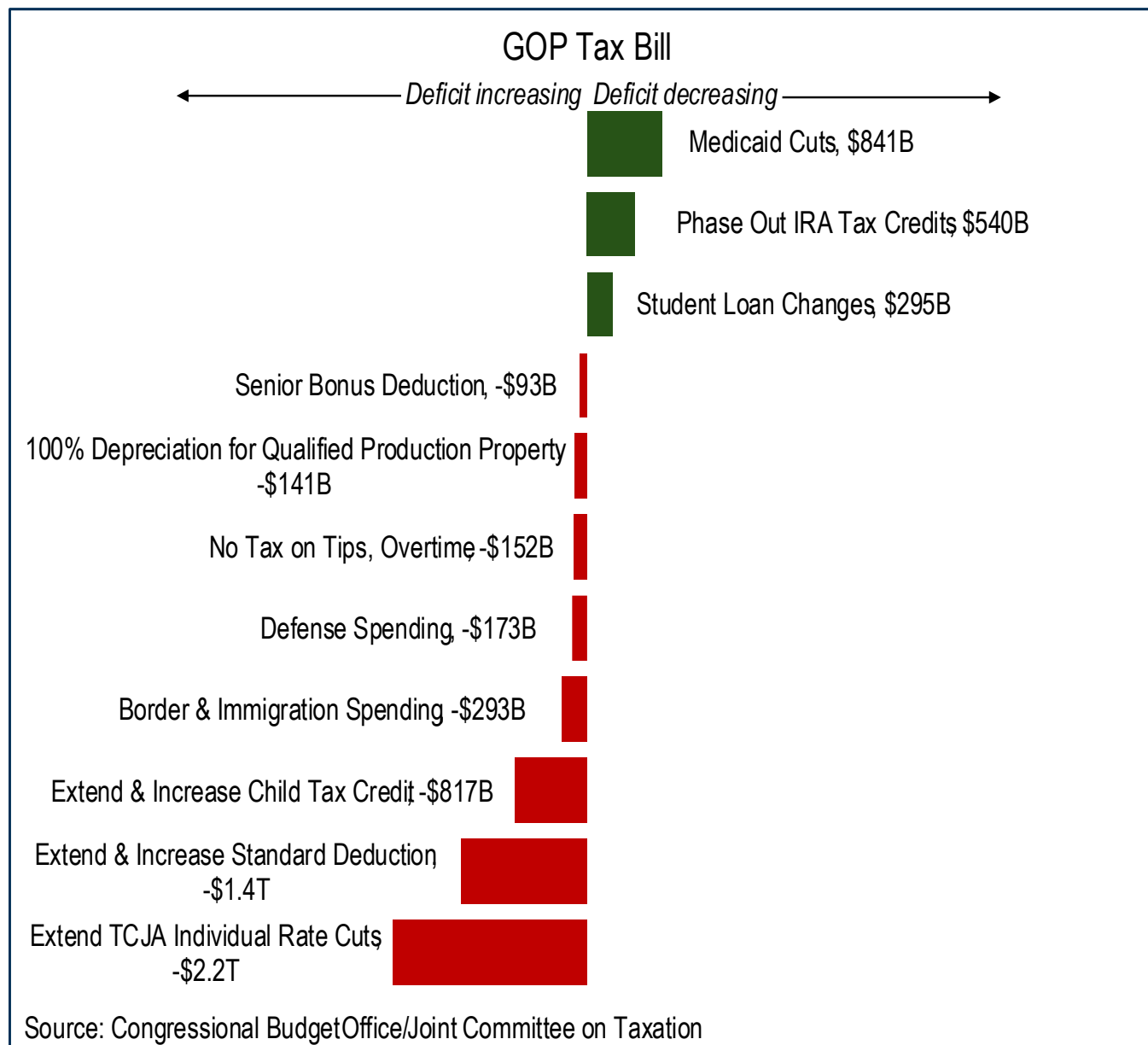
Permanent restoration of 100% bonus depreciation for qualified production property – along with \$1.2T in spending cuts on social programs such as Medicaid, renewable energy tax credits

Economic Impact? Jumpstart economy vs. CBO price tag of \$3.4T over the next 10 years (9% of debt)

Income brackets before the Tax Cuts and Jobs Act (TCJA) and after the One Big Beautiful Bill Act (OBBBA)

Prior law (2017)		Current law (2025)	
Not over \$19,050	10%	Not over \$23,850	10%
\$19,051-\$77,400	15%	\$23,851-\$96,950	12%
\$77,401-\$156,150	25%	\$96,951-\$206,700	22%
\$156,151-\$237,950	28%	\$206,701-\$394,600	24%
\$237,951-\$424,950	33%	\$394,601-\$501,050	32%
\$424,951-\$480,050	35%	\$501,051-\$751,600	35%
Over \$480,050	39.6%	Over \$751,601	37%

Source: IRS



Loss of Government Revenue from Tax Cuts Could be Offset by Potential Cuts

Not all spending; Trump administration has a focus on reducing waste and government inefficiencies

A reduction in waste could potentially offset a loss of revenues, soften the inflationary impact from the OBBBA or tariffs, and add to longer-run growth over the same period

DOGE has cut \$199B from the government budget, approximately 2.8% of the total federal budget (\$6.75T), and 3.4% of the budget without defense (\$5.87T)

Department	Amount Cut (Mil.\$)	Reported Firings	Total Department Size
Department of Defense	\$35,525.7	--	104,231
Department of Health and Human Services	\$32,558.4	12,900	80,199
USAID	\$30,735.4	2,000	10,000
Department of Energy	\$6,843.8	700	16,453
Department of the Interior	\$6,380.7	2,300	71,510
Department of Agriculture	\$4,968.0	--	96,340
Department of Treasury	\$4,215.0	--	109,145
Department of Education	\$3,179.0	6,500	4,273
Department of State	\$3,122.7	--	11,622
Environmental Protection Agency	\$2,836.4	380	18,448
Department of Homeland Security	\$2,828.6	400	186,136
National Science Foundation	\$2,622.4	85	1,504
Department of Veterans Affairs	\$2,407.4	2,400	300,002
Department of Commerce	\$2,084.0	--	50,846
Housing and Urban Development	\$1,695.0	4,000	9,685
General Services Administration	\$1,205.0	600	12,682
Office of Personnel Management	\$874.3	--	5,907
Department of Justice	\$828.5	75	113,694
Department of Labor	\$753.1	--	16,246
Securities and Exchange Commission	\$610.4	--	3,750
United States Agency for Global Media	\$419.7	1,300	3,500
Department of Transportation	\$294.5	400	57,816
Institute of Museum and Library Services	\$239.9	--	70
National Endowment for the Humanities	\$234.1	117	180
National Aeronautics and Space Administration	\$168.0	23	18,000
Government Accountability Office	\$162.1	--	2,877
Small Business Administration	\$137.7	45	3,877
Social Security Administration	\$104.8	--	67,486
Consumer Financial Protection Bureau	\$93.8	--	1,700
International Assistance Programs	\$79.9	--	--
Internal Revenue Service National Office	\$53.0	7,315	93,654
National Park Service	\$46.1	--	20,000
Other***	\$50,125.6	18060	1,455,267
Total Cuts	\$199,000*	59,800**	2,963,000

Source: Department of Government Efficiency (as of 7/27)/Office of Personnel Management

*\$199B in cuts is equivalent to 2.8% of total federal budget

**59,800 in reported firings is equivalent to 2.0% of total federal employees

***Other is a grouping of 147 federal agencies and departments

Focus Turns to Appropriations Amid Government Shutdown

The big fiscal gambit, however, is passing the appropriation bills with the September 30th deadline passed and the U.S. government now in the midst of a shutdown – now the 2nd longest in history

The immediate impact will largely be felt by government workers with hundreds of thousands potentially impacted by furloughs – or layoffs

Additionally, a shutdown – especially if prolonged – can have negative effects on the economy, eroding confidence and realized activity levels potentially reducing GDP, as well as impacting small business loans, and National Parks, again, at least temporarily

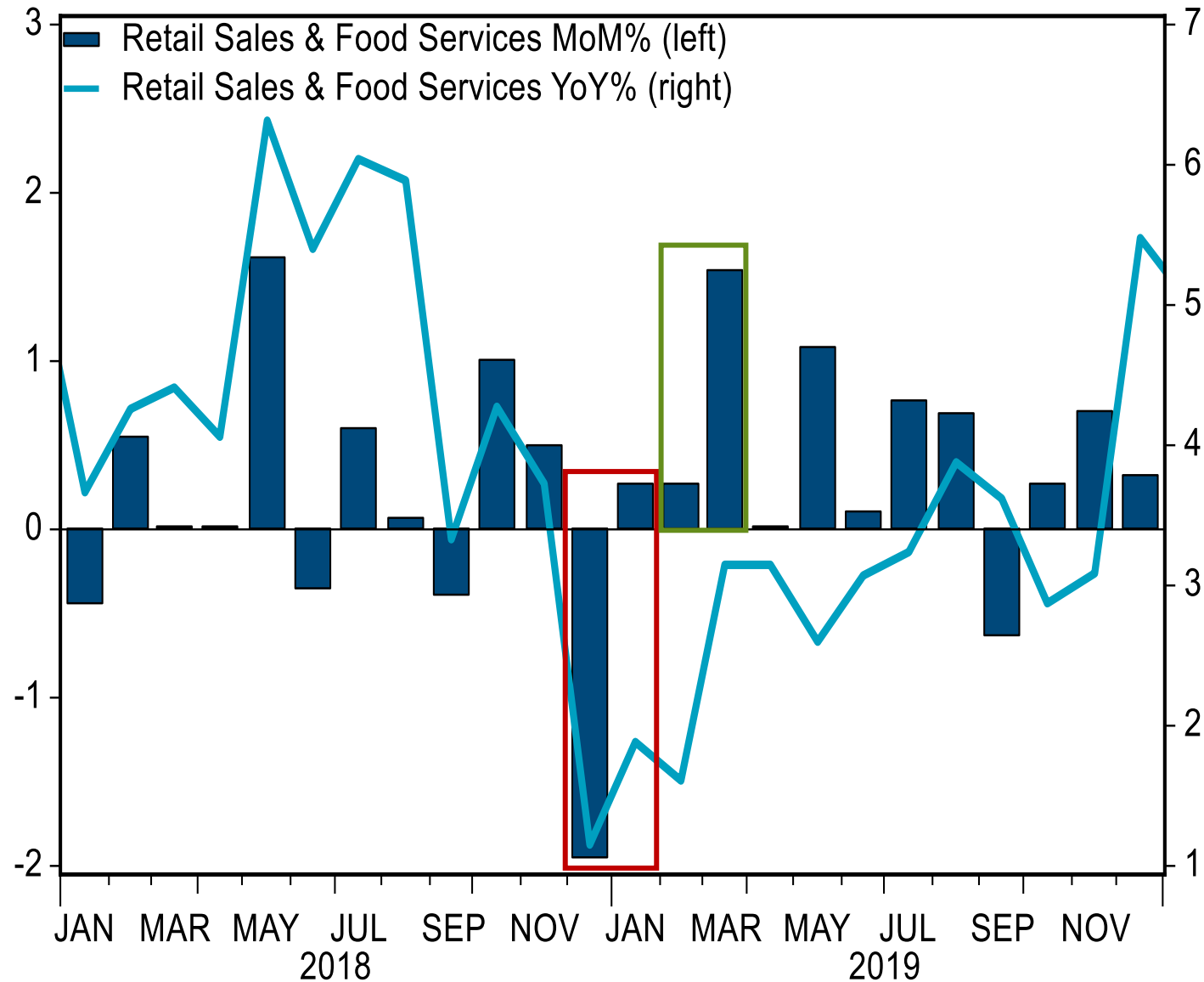
Funding Ended		President	House Majority	Senate Majority	Length of Shutdown, Days
Sept. 30, 1976	R	Gerald Ford	D	D	10
Sept. 30, 1977	D	Jimmy Carter	D	D	12
Oct. 31, 1977	D	Jimmy Carter	D	D	8
Nov. 30, 1977	D	Jimmy Carter	D	D	8
Sept. 30, 1978	D	Jimmy Carter	D	D	17
Sept. 30, 1979	D	Jimmy Carter	D	D	11
Nov. 20, 1981	R	Ronald Reagan	D	R	2
Sept. 30, 1982	R	Ronald Reagan	D	R	1
Dec. 17, 1982	R	Ronald Reagan	D	R	3
Nov. 10, 1983	R	Ronald Reagan	D	R	3
Sept. 30, 1984	R	Ronald Reagan	D	R	2
Oct. 3, 1984	R	Ronald Reagan	D	R	1
Oct. 16, 1986	R	Ronald Reagan	D	R	1
Dec. 18, 1987	R	Ronald Reagan	D	D	1
Oct. 5, 1990	R	George H.W. Bush	D	D	3
Nov. 13, 1995	D	Bill Clinton	R	R	5
Dec. 15, 1995	D	Bill Clinton	R	R	21
Sept. 30, 2013	D	Barack Obama	R	D	16
Jan. 19, 2018	R	Donald Trump	R	R	3
Dec. 22, 2018	R	Donald Trump	R	R	35
Oct. 1, 2025	R	Donald Trump	R	R	Ongoing

Source: House of Representatives/Senate/NBC

Impact of Shutdown Expected to be Muted

The lasting impact is likely to be very muted as furloughed workers entirely recapture lost or delayed compensation, which typically boosts spending in the immediate aftermath of the reopening more than enough to offset the temporary dip during the government closure

In 2018, a 35-day shutdown – the longest in history – caused an estimated loss of 0.3% in Q4 '18/Q1 '19



Source: Census Bureau/Haver Analytics

Delayed Economic Releases Due to Shutdown

The biggest and more lasting impact of the shutdown is the disruption to the flow and release of economic data including construction spending, jobless claims and the Nonfarm Payrolls report, particularly at this pivotal point in monetary policy

Without updated inflation and employment figures, in particular, the Committee, already fiercely divided between hawks and doves, is likely to face additional challenges determining the appropriate pathway for policy

Report	Source	Original Release Date	Rescheduled Release Date
Construction Spending - Aug	Census	Oct 1	TBA
Initial Jobless Claims - Sep 27	DOL	Oct 2	TBA
Factory Orders - Aug	Census	Oct 2	TBA
Nonfarm Payrolls - Sep	BLS	Oct 3	TBA
Trade Balance - Aug	BEA	Oct 7	TBA
Initial Jobless Claims - Oct 4	DOL	Oct 9	TBA
Wholesale Inventories - Aug	Census	Oct 9	TBA
Federal Budget Balance - Sep	Treasury	Oct 10	TBA
Consumer Price Index - Sep	BLS	Oct 15	Oct 24
Real Earnings - Sep	BLS	Oct 15	TBA
Retail Sales - Sep	Census	Oct 16	TBA
Producer Price Index - Sep	BLS	Oct 16	TBA
Initial Jobless Claims - Oct 11	Labor	Oct 16	TBA
Business Inventories - Aug	Census	Oct 16	TBA
Industrial Production/Cap. Util. - Sep	Fed	Oct 17	TBA
Import/Export Prices - Sep	BLS	Oct 17	TBA
Housing Starts/Building Permits - Sep	Census	Oct 17	TBA
Leading Indicators - Sep	Conf. Board	Oct 20	TBA
Chicago Fed NAI - Sep	Fed	Oct 23	TBA
New Home Sales - Sep	Census	Oct 24	TBA

Source: Bloomberg

Trade and Tariffs: The (Inflationary) Impact on the Economy Will Depend

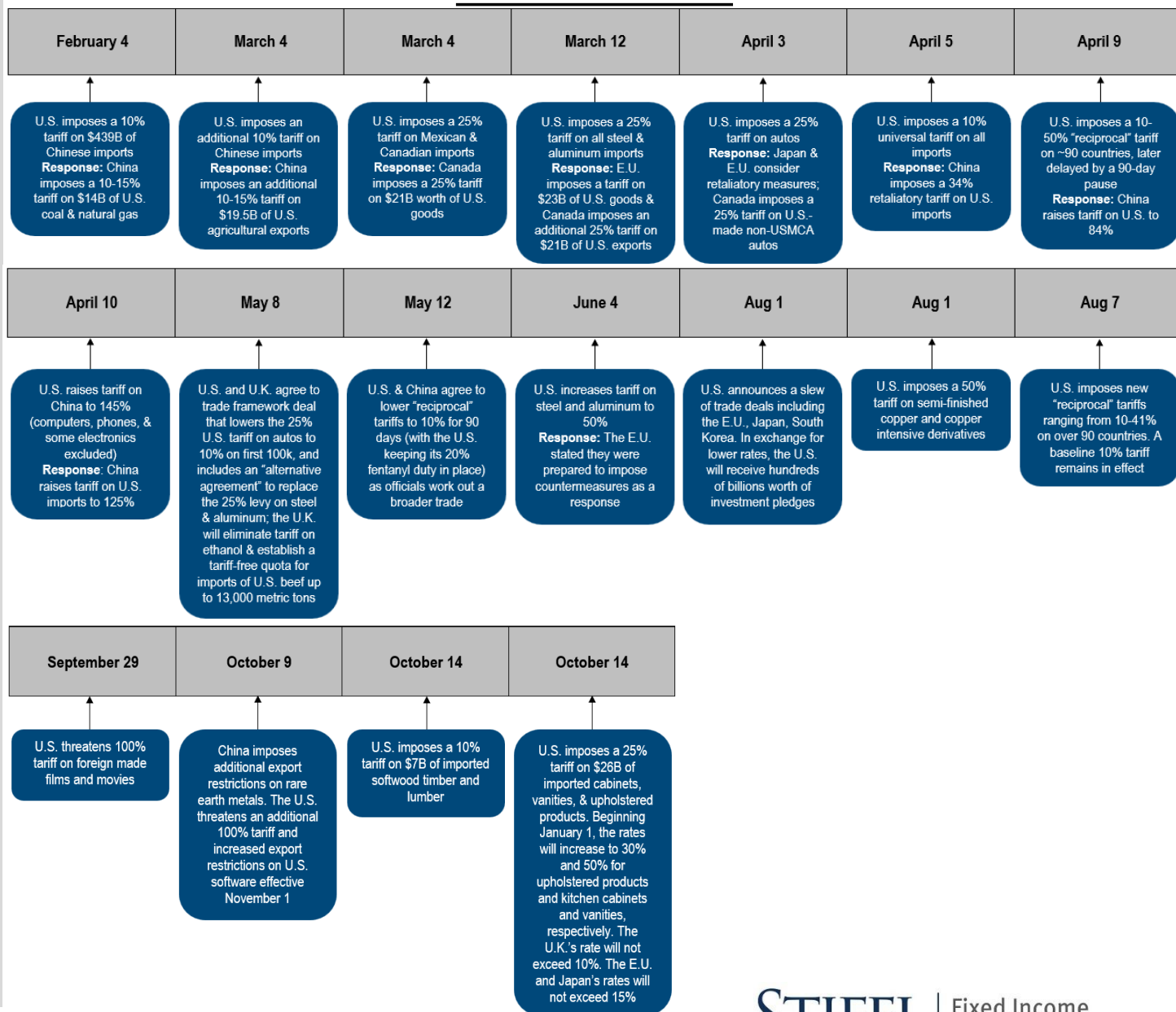
The biggest – fiscal policy - unknown stems from international policy, particularly tariffs with countless rounds of levies threatened, amended, delayed, and re-negotiated

President Trump implemented a 10% universal tariff on all imports, a 25% tariff on goods from Mexico and Canada (USMCA good exempted), a 50% tariff on all steel and aluminum imports, as well as a 25% tariff on foreign autos

On August 7, new levies on over 90 countries ranging from 10-41% went into effect

On October 9, China introduced new export controls on rare earths aimed at deterring use for defense purposes, and President Trump responded with a threatened 100% additional tariff and increased software export restrictions effective November 1

2025 Tariff Timeline



Progress in Trade Deals

The Trump administration has made progress, striking deals with several countries, while others are still underway – and most facing ongoing legal challenges (\$142bn in tariff revenue at risk)

While some trading partners have made deals with the U.S. and negotiated rates lower, such as the U.K. (10% tariff), Japan (15% tariff), and the EU (15% tariff), other countries such as Switzerland and Brazil were unsuccessful in reaching a trade deal with imports from these countries now facing a 39% and 50% levy, respectively

While additional tariffs went into effect on August 7, and as some deals are still being finalized, the exact impact on the economy still remains somewhat unknown, with higher levies continuing to compound concerns of inflationary pressures

Country with Trade Agreement	Date Announced	2024 Tariff Rate	Tariff Rate Before Trade Agreement	Tariff Rate After Trade Agreement
UK	May 8	3%	25%	10%
Vietnam	July 2	5%	46%	20%
Indonesia	July 15	8%	32%	19%
Philippines	July 22	6%	20%	19%
Japan	July 23	4%	25%	15%
EU	July 27	5%	30%	15%
South Korea	July 31	1%	25%	15%
Pakistan	July 31	10%	29%	19%
China	May 12	8%	145%	30%*

Source: CNBC/United States Trade Representative/The White House

*Note: The U.S. has threatened an additional 100% tariff on Chinese goods and export restrictions on U.S. software effective November 1 due to increased Chinese export restrictions on rare earth minerals

Consumers Still Reeling from Years of Higher Prices

How will these policies impact the economy? It depends

Clarity, details, directional momentum, and specifics of implementation and legality are needed

Tariffs have been particularly painful for consumers after years of price hikes on everything from medical care to groceries to housing and insurance costs

Tariffs themselves are not inflationary lacking the perpetual upward momentum; however, retaliatory trade action can result in price pressures

If businesses passed on the entirety of tariffs, prices could rise 1.5%; a 50% pass-through could result in 0.8%

Pass-through has been limited to 25/20% as businesses have worked to shield consumers

CPI Category Increase Since 2020



Clothing: **+8.5%**



Medical Care: **+14.3%**



Recreation Services: **+23.5%**



Transportation: **+28.5%**



Groceries: **+29.6%**



Housing: **+29.6%**



Household Energy: **+39.5%**



Roasted Coffee: **+46.3%**



Car Insurance: **+56.2%**

Impact on Consumers: Rise in Inflation Expectations, Decline in Confidence

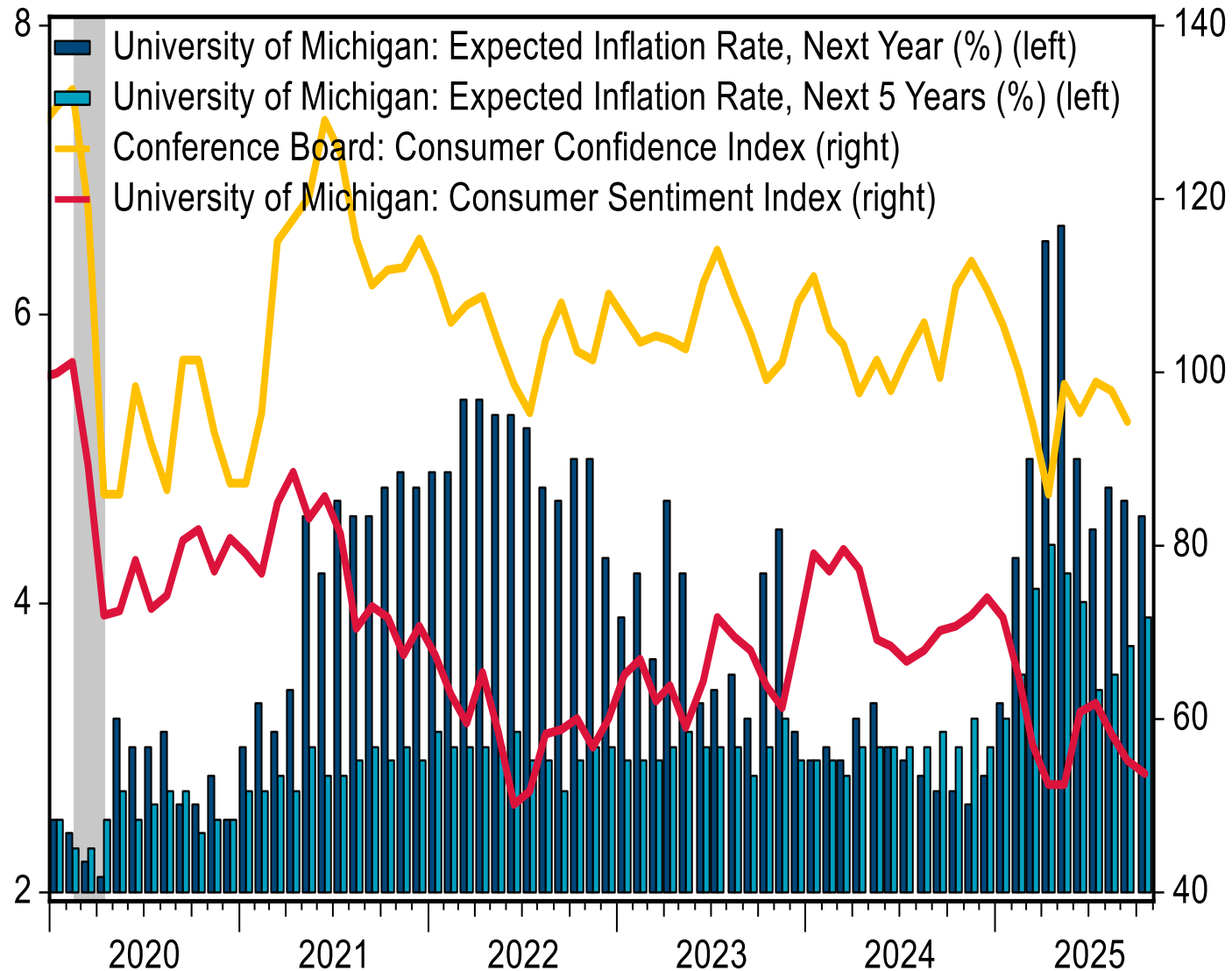
Even with the realized impact of tariffs muted, the anticipation of higher prices has eroded activity and confidence

Short-term inflation expectations fell to **4.6%** in the October report, while longer-term inflation expectations rose to **3.9%**

Short-term inflation expectations are still 130bps higher from the start of the year

The University of Michigan Consumer Sentiment Index fell from 55.1 to **53.6 in October, a five-month low**, while the Conference Board's Index slipped 3.6 points to **94.2** in September, a **five-month low**

Since the start of the year, the University of Michigan Consumer Sentiment Index is down over **eighteen** points, while the Conference Board's Consumer Confidence Index is **eleven** points lower (off roughly **20** points from earlier peak)



Sources: University of Michigan, The Conference Board/Haver Analytics

Impact on Businesses: Ramp Up in Inventories and Increased Uncertainty Ahead of Tariffs

Business optimism has taken a toll in this difficult environment of elevated costs and unknowns

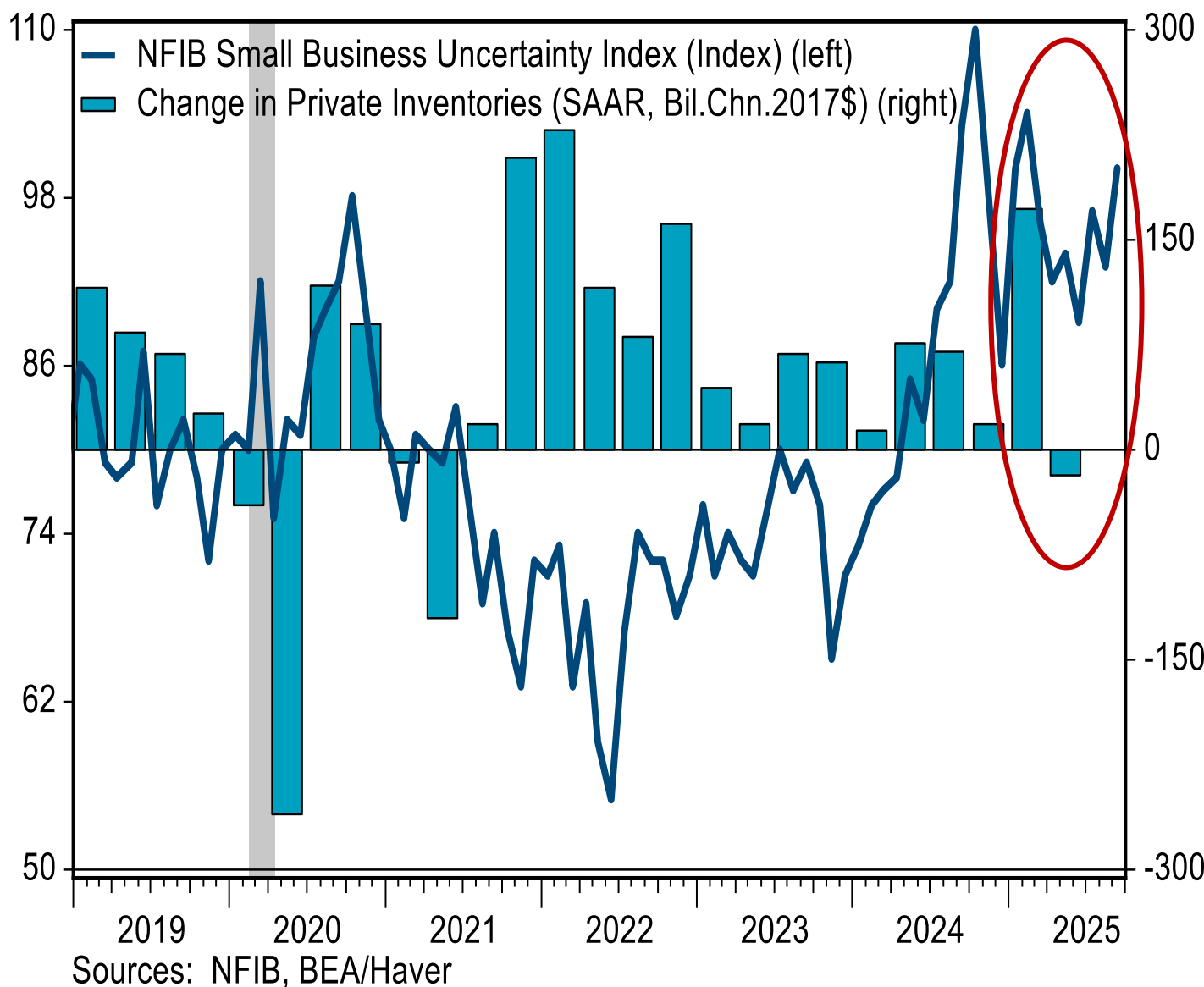
Small business optimism remains near a one-year low, off five points from a peak reached in December

The NFIB Uncertainty Index, meanwhile, rose seven points to a reading of **100** in September, the **fourth highest reading on record**

84% of firms report no plans to hire within the next three months, and **89%** reported that now is not a good time to expand their business

At the same time, inventories rose by **\$160.5B** in Q1 (later fell by **\$26.0B** in Q2) with new orders growth roughly **6%** YoY as businesses stockpiled goods, signaling confidence in a sustainable consumer and underscoring a divide between hard and soft data

According to the ISM Manufacturing Index, inventories rose 0.5 points to 49.4 in August, a four-month high after rising to a near-term peak of 53.4 in March



- Bloated and growing government balance sheet
- Rising equity market valuations; Increased volatility
- An uncertain but still “*spendy*” consumer
- International and geopolitics risks
- An aggressive fiscal policy agenda under the leadership in Washington

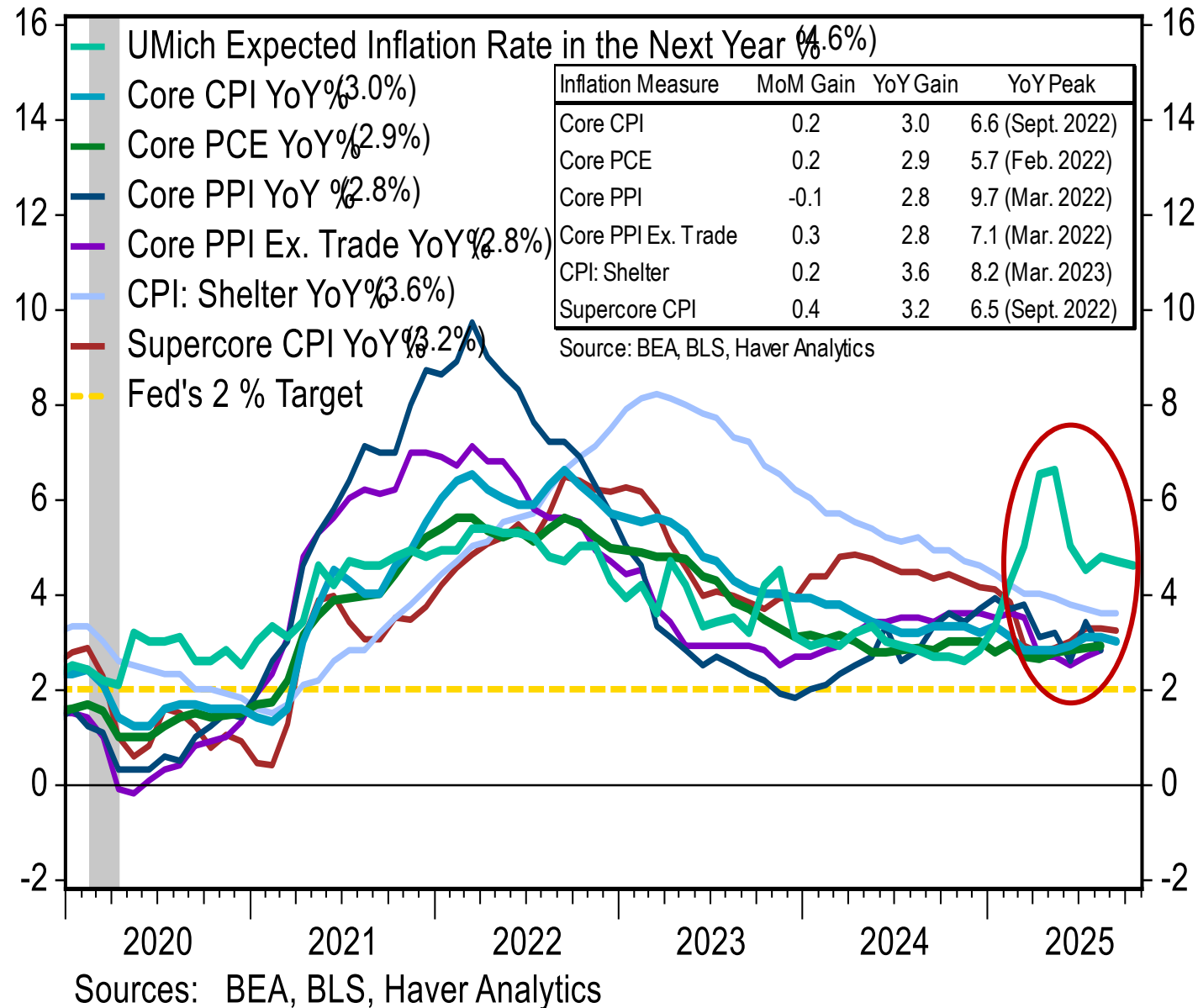
Inflation Remains Uneven, Uncertain, and Elevated

Its all about the data, inflation data!

Improvement at the start of the year reflecting a weaker growth profile; nominally prices remain elevated, shy of expected improvement and some upward momentum recently

With the Fed's preferred measure, the core PCE sub 3%, inflation remains below more dire predictions of 5%+

Acceleration in inflation reflects a rise in services costs along with evidence that tariffs are seeping into the economy (six of eight major CPI categories impacted)



Fed Projects Two Additional Cuts This Year, Sees One Cut Next Year

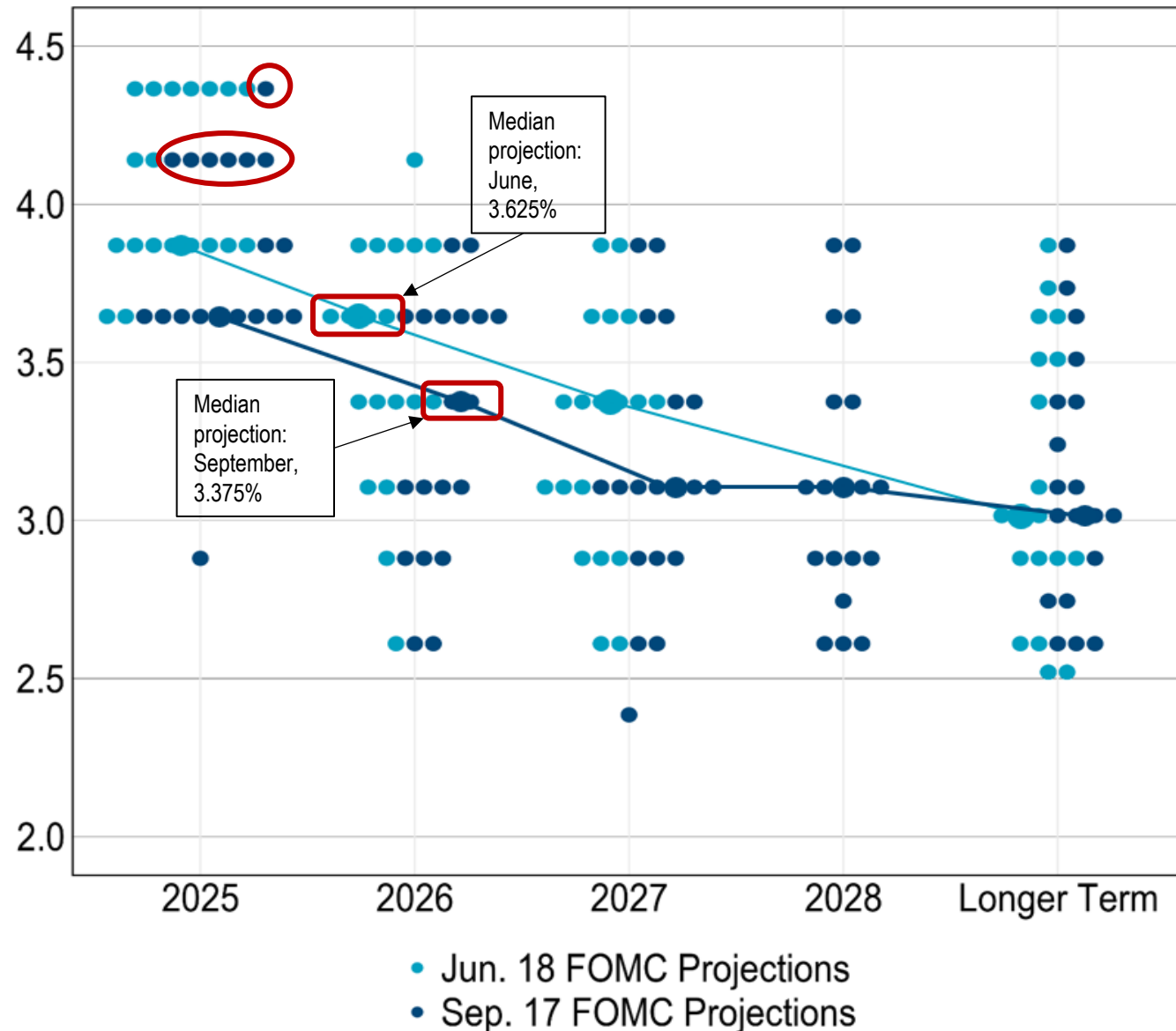
This *relative* improvement in inflation – coupled with labor market cooling – has boosted optimism for near-term policy relief

The majority of Fed officials now anticipate **two** additional rate cuts in October and December this year and **one** next year

With opposing forces on either side, there were still many officials who remain more hawkish than the median forecast suggests; in March, **four** officials anticipated no further cuts in 2025 vs. **seven** in June and again in September

This highlights the growing divide between Fed officials concerned about potential weakness in the labor market and still-elevated inflation

Recall, despite the lack of inflationary improvement, the Fed opted to move forward with a third-round rate cut in December '24, striking a more *"cautious"* tone in January



Source: Bloomberg

The Fed remains optimistic but cautious on the economy:

*“Recent indicators suggest that **growth of economic activity moderated in the first half of the year.**”*

“Job gains have slowed, and the unemployment rate has edged up but remains low.”

“Inflation has moved up and remains somewhat elevated.”

“Uncertainty about the economic outlook remains elevated.”

*“The Committee is attentive to the risks to both sides of its dual mandate and judges that **downside risks to employment have risen.**”*

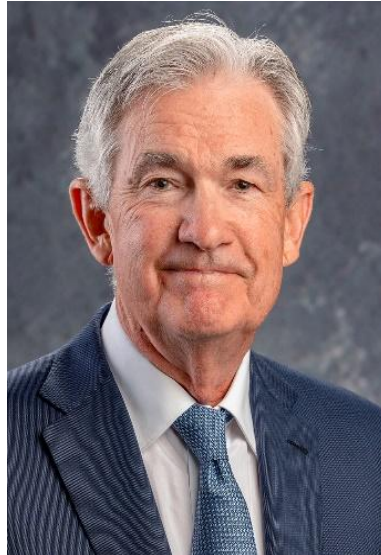
Powell Opens the Door to More Rate Cuts Due to Labor Market Concerns

The Fed is in no hurry to *significantly* alter policy, although the material downgrade in the Fed's assessment suggests a likelihood of a minimal adjustment near term

For now, policy is in a good place and 125bps closer to neutral than it was a year ago *BUT* policy still remains restrictive, with risks to both sides of the mandate (suggesting labor market weakness could warrant a rate cut just as easily as elevated inflation could warrant a continued pause or rate hike)

The case is building for another **cut** at this point; Powell opened door in Jackson Hole

While the **July** policy pause was fully priced into the market, for the first time in 30+ years, **two** Fed governors dissented
In **September**, cut was widely anticipated and one Fed Governor dissented in favor of 50bp cut



“The marked slowing in both the supply of and demand for workers is unusual in this less dynamic and somewhat softer labor market...The downside risks to employment appear to have risen.”

“Really since April, to me the risks of higher and more persistent inflation have probably become a little less. And that's partly because the labor market has softened, GDP growth has slowed. And so I would just say that the risks there has been less than what one might think.”

“If we move too quickly, then we may leave the inflation job unfinished and have to come back later and finish it. If we move too slowly, there may be unnecessary losses, painful losses, in the employment market. So we're in the difficult situation of balancing those two things...the labor market has actually softened pretty considerably, and puts us in a situation where the two risks are closer to being in balance.”

Federal Reserve Chairman Jerome Powell Speaking at the September FOMC Press Conference and at an Event in Rhode Island

September 17, 2025 and October 14, 2025

2026 Fed Composition Likely to Have a Dovish Tilt

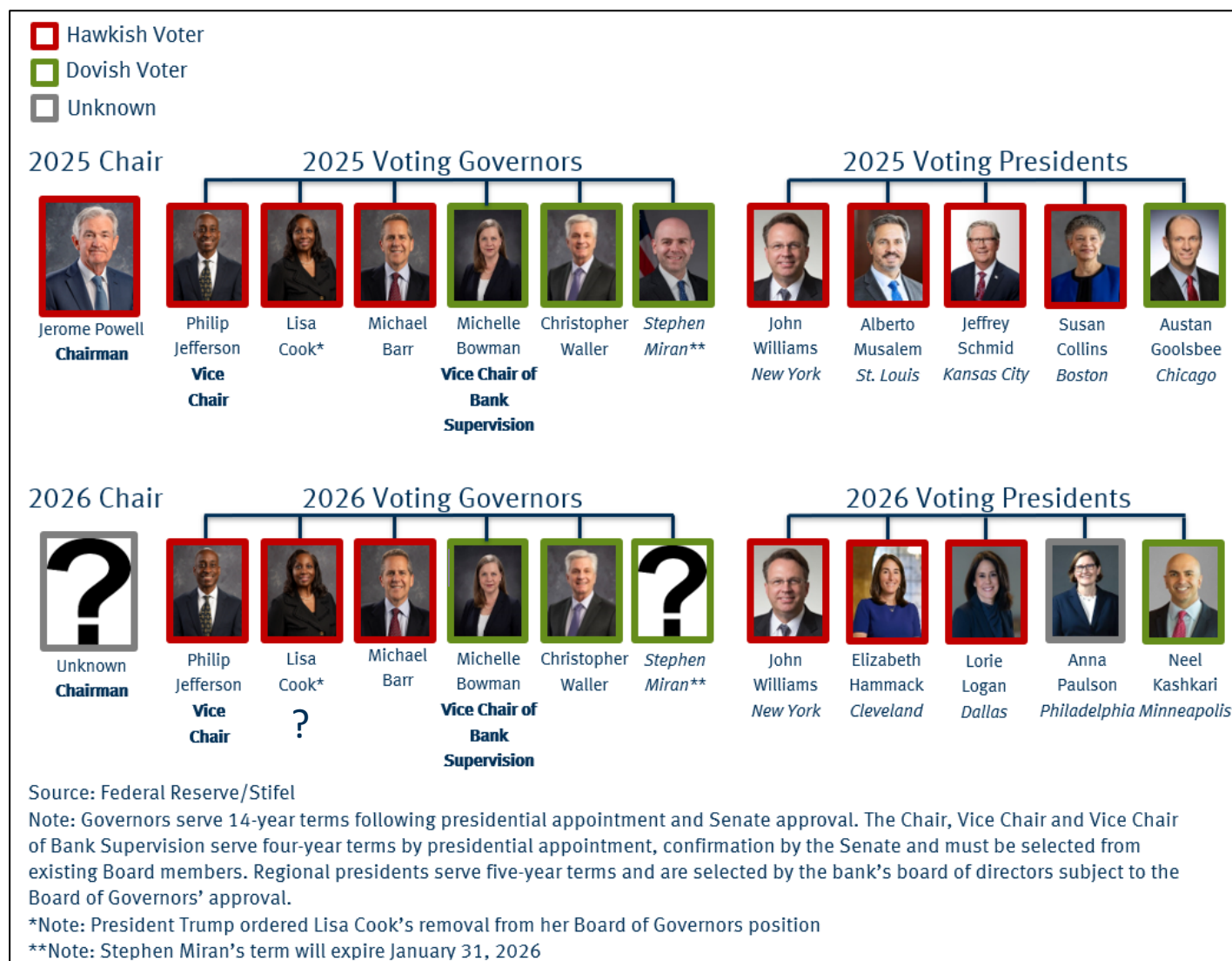
While elevated inflation will limit the downside potential for rate cuts, a Dovish leaning Fed could push rates closer/faster towards neutral

President Trump will have the opportunity to leave his mark on the Federal Reserve with his nomination of the next chair as Chair Powell's term ends on May 31, 2026

However, Powell's term as a board member does not expire until January 31, 2028

It is customary, but not required, for former chairs to leave the board after their term as chair concludes. The last person to remain on the board following term expiration as chair was Marriner S. Eccles in 1948

Council of Economic Advisers Chairman Stephen Miran has been confirmed to fill the vacant Federal Reserve Board seat left by Adriana Kugler. Miran will serve out Kugler's term which ends on January 31, 2026



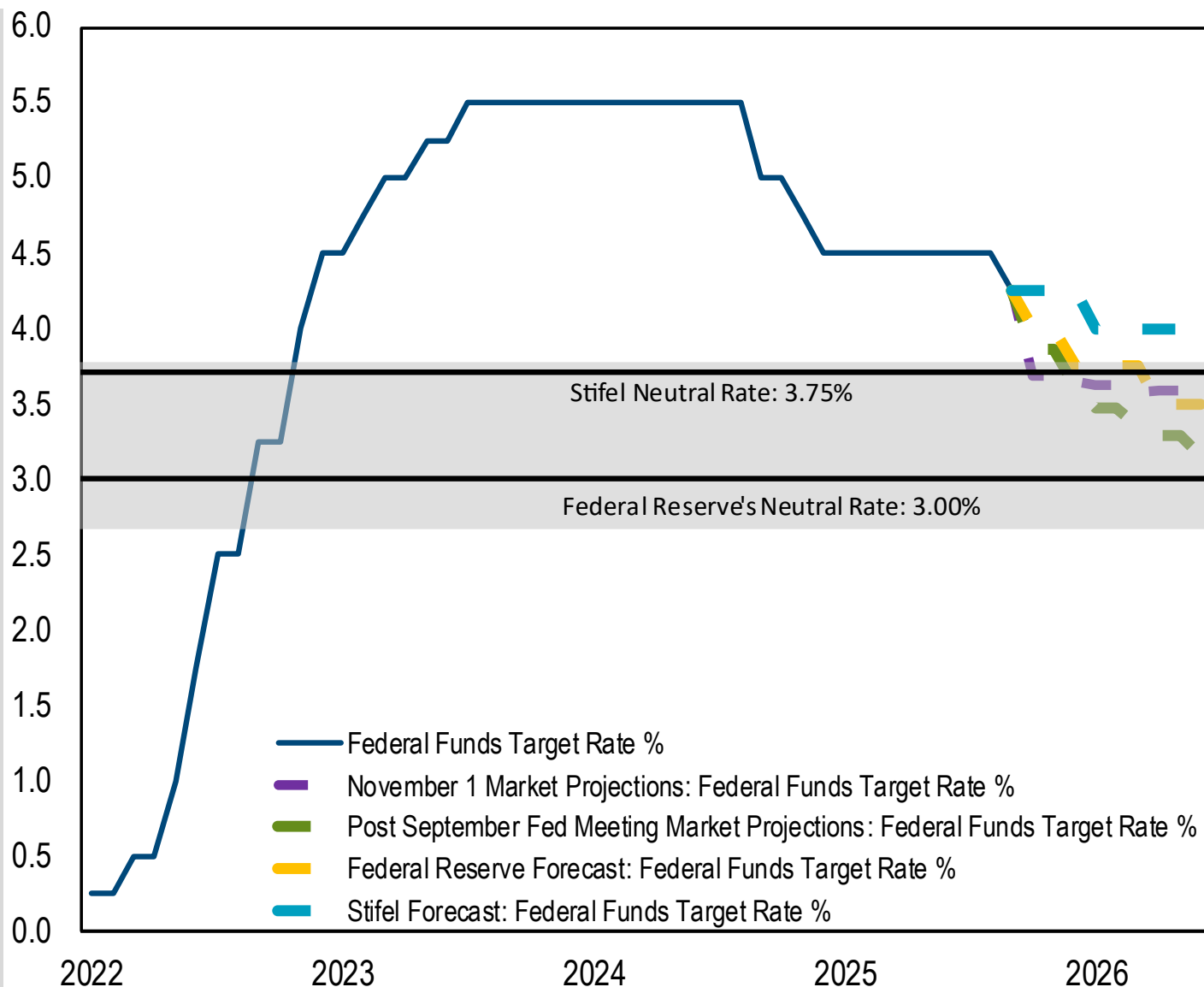
Potential for Near-Term Cut Propelled by Cooling Labor Market, Limited by Elevated Inflation

The notably weaker assessment of the economy suggests the Committee is potentially paving the way for at least *some more* easing in policy, but inflation will limit downside

A minimal number of rate cuts – two – in response to earlier weakness and waning momentum in the labor market but limited by inflation

Time is of the essence; price pressures could heat up into the holiday season and as businesses more aggressively pass on cost increases previously absorbed into the bottom line

Any decision to move beyond a minimal reduction towards neutral will depend on the impact of tariffs and the broader pathway of inflation



Source: Bureau of Economic Analysis/Federal Reserve/Stifel

Prior to the September 2024 employment report, investors anticipated **110bps** in cuts in 2025; following the September FOMC meeting and August employment report, investors anticipate **50bps** of cuts by year-end

Window of opportunity is closing given the opposing forces of potentially higher inflation to come coupled with still positive growth in the second half of the year, juxtaposed with a softening labor market and somewhat more moderate spending patterns

Higher for longer position on rates

A more normal, positively sloped yield curve

Potentially higher neutral level of policy

Thank you



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Additional Information Is Available Upon Request

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STIFEL | Fixed Income
Capital Markets

Immigration Reform

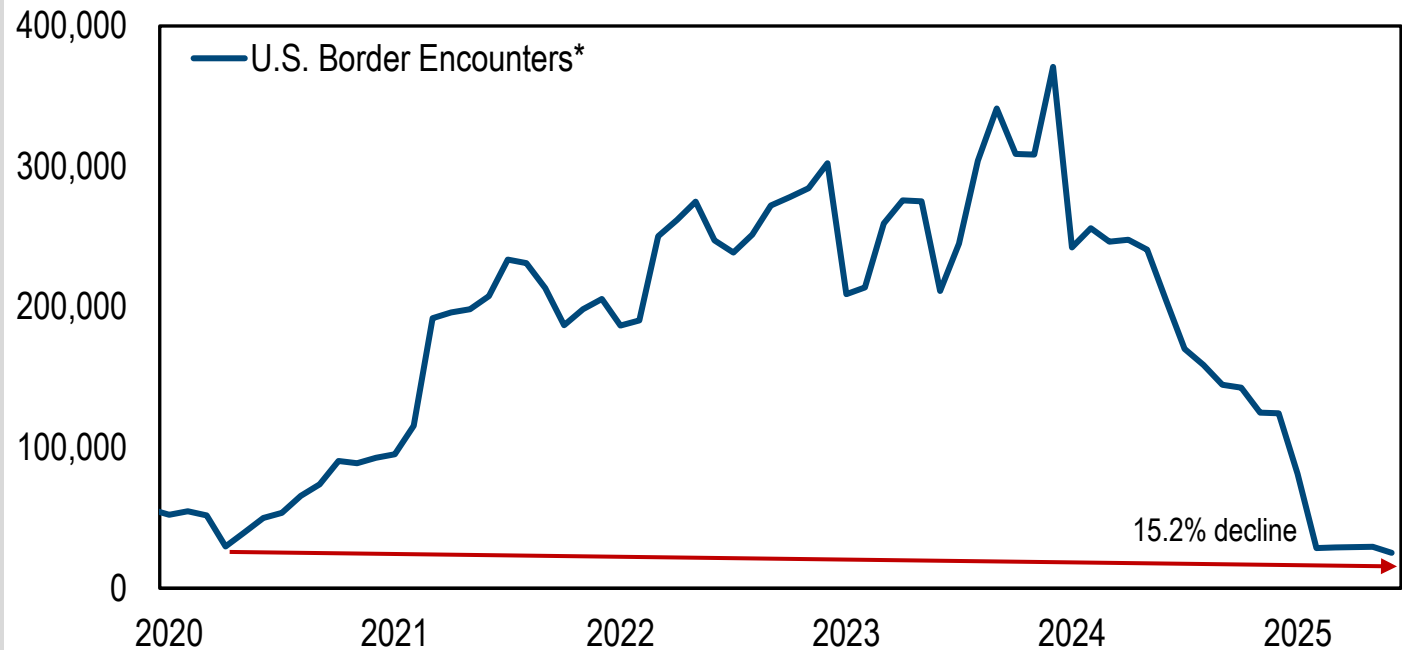
Additional immigration restrictions could exacerbate the already existing labor supply shortage, result in higher production costs and wage pressures, as well as reduce overall growth

At the same time, more stringent restrictions could reduce drains on certain government programs and alleviate pressure on certain state budgets

Deportations totaled nearly 150k in the first six months of President Trump's second term with the administration indicating a target of potentially 1M a year

*Source: Center for Immigration Studies/U.S. Customs & Border Patrol

Encounter: any interaction between a U.S. Customs and Border Protection officer and a noncitizen who is attempting to enter the United States without authorization



State	Cost of Illegal Immigrants* (Bil.\$)
California	30.9
Texas	13.4
New York	9.9
Florida	8.0
New Jersey	3.9
Illinois	3.9
Arizona	3.2
North Carolina	3.1
Georgia	3.0
Virginia	2.8

Source: Federation for American Immigration Reform

*Spending data from 2023