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The Labor Market Is Weaker: Don't Shoot the Messenger

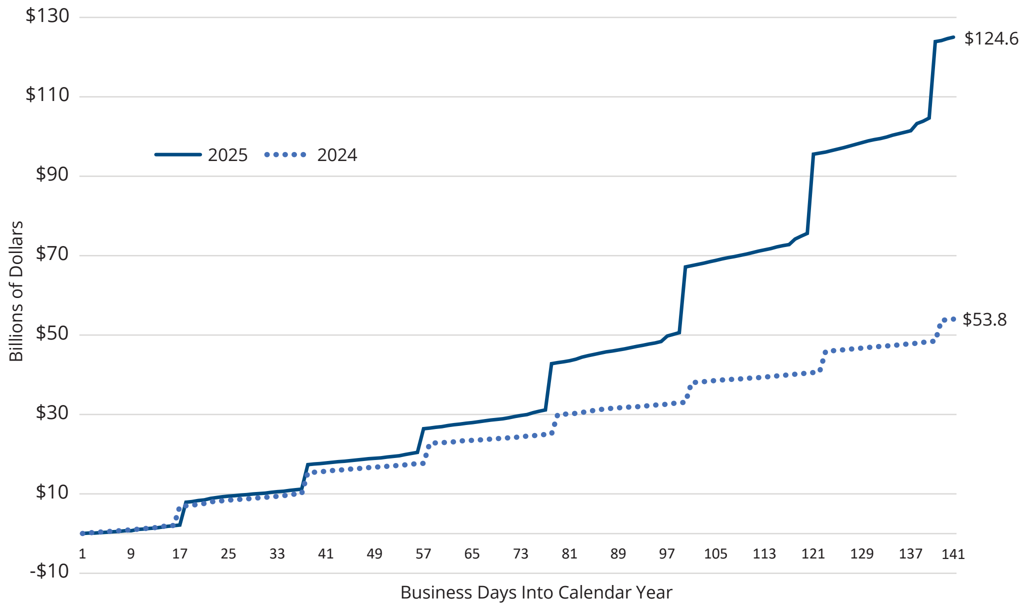
There are signs the US economy is cooling. Bonds have rallied as the Federal Reserve weighs a possible September rate cut.

What's Driving Markets...

1. **Trade deals:** The US struck several deals with trading partners during the weeks leading up to the administration's August 1 deadline for reciprocal tariffs to take effect. Discussions between the US and China remain ongoing after the world's two largest economies agreed to a truce that was set to expire on August 12. A deal between its two largest trading partners, Mexico and Canada, also remains elusive, though some goods will be covered under the United States-Mexico-Canada Agreement and, therefore, exempt from duties. Mexico was granted a 90-day reprieve to continue negotiations while Canada was hit with 35% tariffs. Other notable deals include the European Union (15%), Japan (15%), United Kingdom (10%), as well as Vietnam, Indonesia, Philippines, India, South Korea, Cambodia, and Thailand. The current effective tariff rate now stands at 18.3%[1], the highest in nearly 90 years.

   Year-to-date, US Customs and Border Protection has collected more than double the tariff revenue compared to last year (**FIGURE 1**). This revenue stream will serve as a partial offset to the tax cuts of the One, Big, Beautiful Bill Act (OBBBA). In the coming months, we'll continue to see data with regard to the distribution of costs across consumers and corporate margins—although those costs may already be showing up in inflation data.

FIGURE 1
Tariff Revenue Has More Than Doubled Since Last Year
US Gross Tariffs and Certain Other Excise Taxes (2024 vs. 2025)



As of 7/31/25. Data Sources: Department of Treasury Daily Treasury Statement, Wellington Management, and Hartford Funds, 8/25.

Insight from sub-adviser Wellington Management

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2. **Powell stands his ground:** The Federal Open Market Committee (FOMC)[2] once again held rates steady at 4.25%–4.50%, as expected. The statement slightly downgraded growth language, aligning with weak second-quarter real final-sales data. While most members appear comfortable holding beyond September, two dovish dissents (Bowman and Waller) favored a cut—unusual but not surprising given their recent public comments. Federal Reserve (Fed) Chair Jerome Powell acknowledged the dissents as being data-driven, and he praised the quality of debate. In the press conference, Powell leaned hawkish by:

   - Not ruling out a September cut but emphasizing the need for more data.
   - Noting the Fed may already be looking through tariff-induced inflation by not raising rates—his first such comment.
   - Highlighting labor-market balance, while acknowledging slowing payrolls alongside a constrained labor supply due to immigration policy.

   Fiscal easing, deregulation, and reduced trade uncertainty may support a cyclical upturn, lowering the odds of further labor-market deterioration and sustained easing, though that narrative could be questioned following the weak July payrolls report.

3. **Economic data giving conflicting signals:** US GDP expanded 3% in the second quarter following a contraction in the first quarter as imports fell sharply in the wake of tariff implementation. Consumer spending—the engine of US growth—advanced a relatively tepid 1.4%.

   Inflation pressures remained acute, with year-over-year measures of core CPI and core PCE[3] (the Fed's preferred gauge) accelerating to 2.9% and 2.8%, respectively, in June with the upside surprises primarily focused on goods inflation. These readings may make some Fed members uneasy about cutting policy rates, absent more material degradation of the labor market (although the recent payrolls number may be delivering exactly that degradation).

   Payroll growth in July came in below expectations, accompanied by a substantial downward revision of 258,000 to the prior two months' figures—providing dovish policymakers with compelling justification for a rate cut at the September FOMC meeting. The unemployment rate rose to 4.2%, even as labor supply contracted due to deportations, signaling a notable deterioration in labor demand.

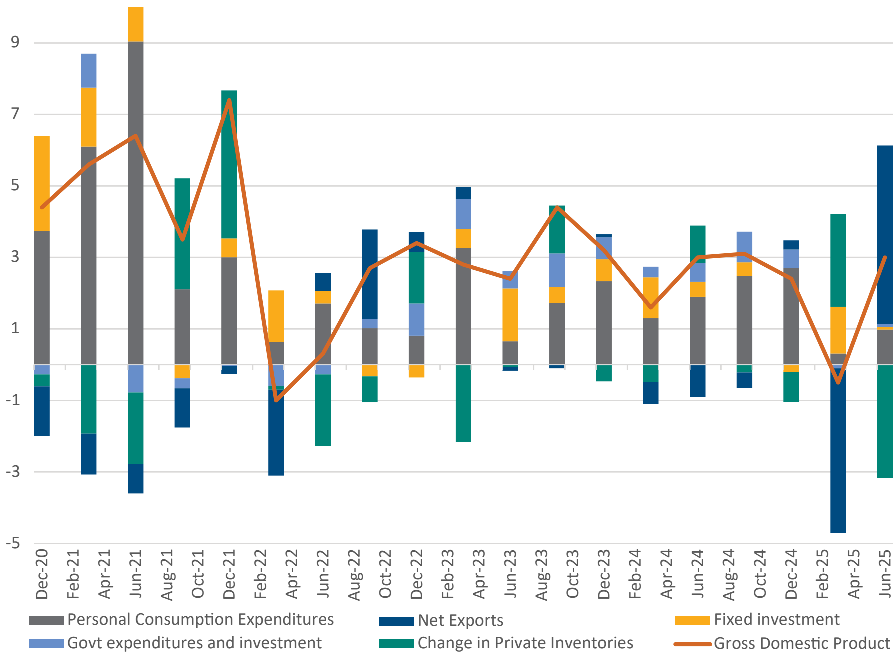
   This marks a pivotal shift in the data narrative: For months, market participants had anticipated signs of labor-market weakness but were confounded by its absence. That inflection point has now arrived, offering a clear signal that US employment conditions are rapidly cooling. While some seasonal distortions may be present, we also anticipate that federal layoffs and workforce reductions will begin to weigh on labor estimates in the coming months. Markets reacted decisively to the data, triggering a sharp rally in rates and lifting the probability of a September rate cut from roughly 45% to nearly 88%.

"For months, market participants had anticipated signs of labor-market weakness but were confounded by its absence. That inflection point has now arrived.

FIGURE 2

Inflation Pressures Remained Acute in June

Contributions to US GDP (%, Quarter-over-Quarter, Annualized)

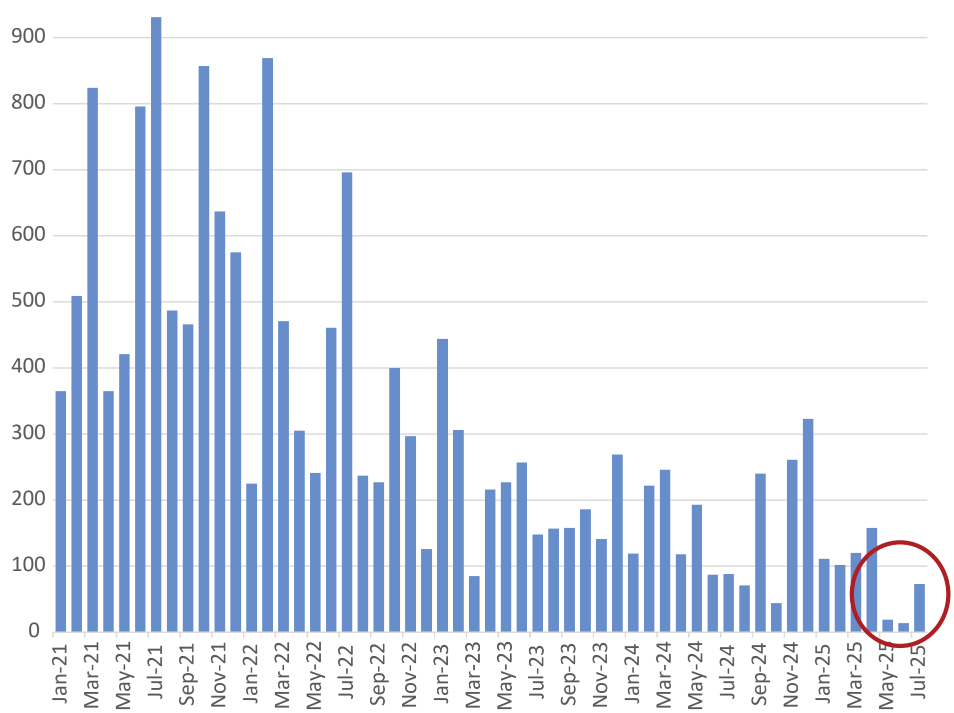


As of 6/30/25. Data Sources: Bureau of Economic Analysis, Bloomberg, Wellington Management and Hartford Funds, 8/25.

FIGURE 3

Weak July Payroll Growth and Large May-June Revisions Fueled Concerns

Changes in Nonfarm Payrolls (in thousands)



As of 7/31/25. Data Sources: Bureau of Labor Statistics, Bloomberg, Wellington Management and Hartford Funds, 8/25.

> "While some seasonal distortions may be present, we anticipate that federal layoffs and workforce reductions will begin to weigh on labor estimates in the coming months.

4. **Treasury refunding:** Treasury's quarterly-refunding announcement largely met expectations, with the department indicating that increased coupon issuance was not on the table in the near term, and with a notable increase in long-end[4] buybacks. Both of these factors contributed to a bull flattening[5] of the Treasury yield curve.[6] Additionally, Treasury will allow a limited number of non-primary dealers—likely hedge funds—to participate in buybacks, expanding the number of counterparties it interacts with in secondary markets.

What's Keeping Us Up at Night...

1. **Powell's successor:** President Trump may announce his nomination for the next Fed Chair in the coming weeks in an effort to undermine Powell's authority. There appears to be a three-horse race for the next Fed Chair: National Economic Council Director Kevin Hassett, former Fed Governor Kevin Warsh, and current Fed Governor Christopher Waller. A risk we're monitoring is whether market participants will question the Fed's independence going forward, which could lead to a steepening of the yield curve and an increased inflation risk premium.
2. **Fading US exceptionalism:** Implications include: (1) diversification away from US assets and (2) potential for continued US-dollar (USD) weakness. At the current stage, we think continued dollar weakness based on cyclical factors (such as impetus for Fed cuts and stickier inflation), combined with institutional concerns, will continue to play a role in strategic asset allocations.
3. **Institutional integrity:** President Trump fired the commissioner of the Bureau of Labor Statistics (BLS) following the publication of the most recent payroll numbers, which showed anemic US job growth. It's important to note that the BLS methodology is consistent with the gold standard of statistical data collection, and the firing has no merit from the perspective of quality of data and output. Revisions to this data series are the norm as the BLS receives and collects more data over time. The firing should be of grave concern to fixed-income market participants. It will degrade the credibility of US statistical outputs, which are considered among the most credible in the world. Undermining objective data collection could mean additional risk premia[7] in US capital markets and may accelerate the diversification trade away from USD-based assets by capital-market participants.

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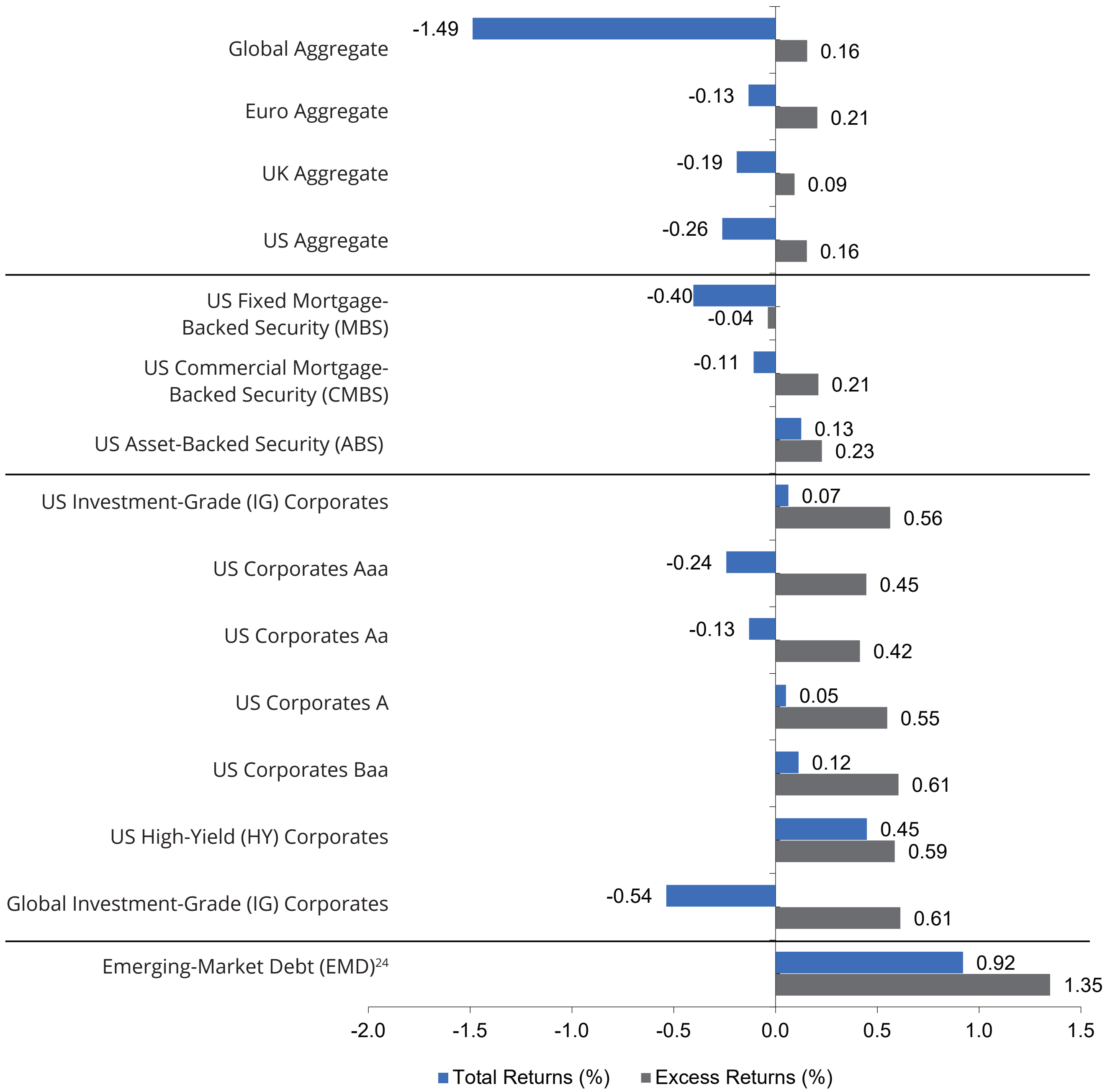
Investment Implications for Consideration

While the below positions have been static for some time, it's a reflection on how drawn out the current cycle has been due to the underlying strength of the economy.

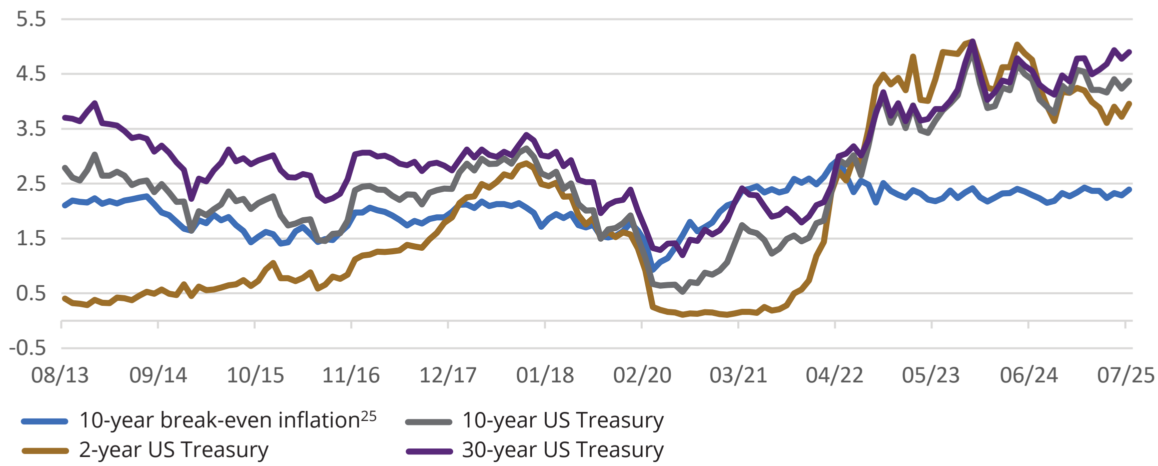
- The risks of a recession remain elevated, yet tariffs are also likely to add to the current inflationary impulse. Given these dual risks, we still favor higher-quality total-return strategies[8] that are less constrained by benchmarks. These could include:
  - Global sovereign and currency strategies that potentially shine during these periods by capitalizing on diverging growth and inflation dynamics, uncoordinated central-bank policies, and the trend toward deglobalization. Alternative assets to US Treasuries, such as European, Australian, and Japanese government debt (as well as select currencies), can serve to deliver the diversification benefit required for a broader portfolio.
  - "Go anywhere"[9] strategies that may be able to navigate the late cycle and potentially add value through sector rotation as dislocations emerge. We currently favor holding more duration[10] to counterbalance credit risk. We also find opportunities to lean into international markets (e.g., global convertibles, global high yield, and global convertible bonds[11]) to build a more potentially resilient return profile.
- Core Bond/Core Bond Plus/Intermediate Bond positions[12] may make sense with attractive pricing for all-in yields, and we think recession/growth risks will likely outweigh inflation risks over the medium term. Intermediate government/credit or short-duration strategies may be useful as a more risk-balanced way of adding high-quality ballast into asset allocations. Moreover, the recent slowing of economic data highlights a cooling of economic conditions.
  - Agency MBS[13] valuations appear attractive vs. investment-grade credit.[14] Improving supply-and-demand dynamics, primarily driven by deregulatory initiatives, remain a tailwind for MBS.
  - We are not yet ready to advocate a return to the long end of the yield curve given current valuations and curve shape.
- Securitized credit[15] could be a potential hedge against rate volatility since it generally offers attractive risk-adjusted spreads. Senior parts of the capital structure, in particular, can offer attractive carry[16] with substantial subordination[17] in case the cycle turns negative faster than expected. While these sectors may face headwinds from non-US buyers finding more attractive opportunities in home markets, we think the hedge against rate volatility that subordination can provide will remain important in volatile markets. For clients looking for higher expected returns, we favor select CLO equity,[18] which allows locked-in, non-recourse, term financing for an actively managed pool of bank loans.
  - We favor seasoned RMBS,[19] which embeds substantial home-price appreciation and can withstand price declines, in our view.
  - CMBS[19] faces structural challenges that affect lower-grade offices and regional malls, but we see opportunities in a few well-positioned areas, such as high-end New York office buildings and marquee hotels.
- Higher-yielding credit: US and global high yield[20] currently offer nearly a 7% yield-to-worst,[21] despite tight spreads.[22] We remain cautiously optimistic that higher-yielding credit (including leveraged loans[23]) may continue to perform well for 2025.
  - We advocate careful issuer selection and active management given uncertainty around tariffs and fiscal policy.
  - We believe more cyclical sectors and subordinated structures offer limited compensation for the increased risk.

FIGURE 4: Monthly Fixed-Income Sector Total and Excess Returns



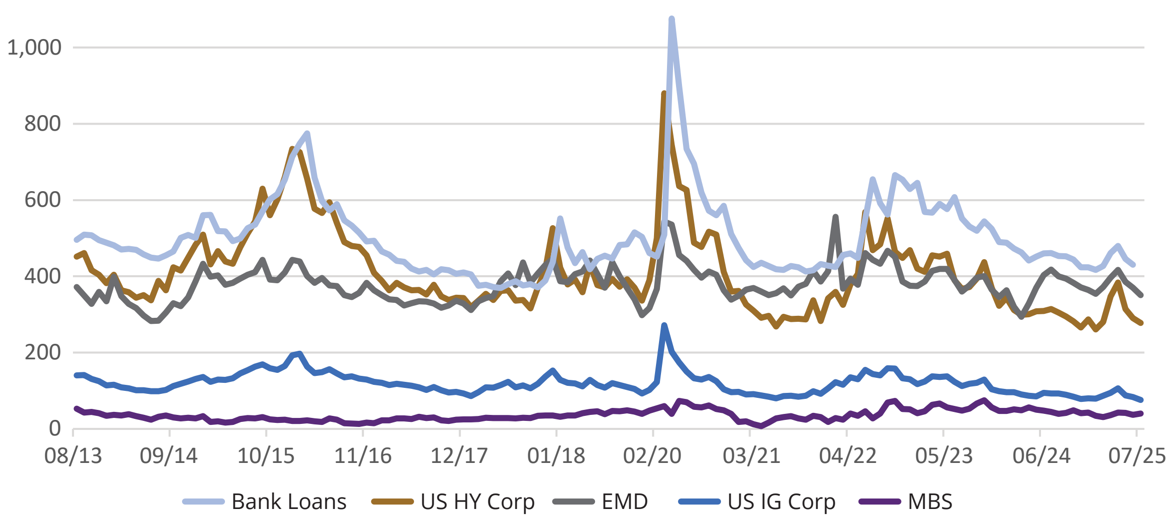
Monthly data as of 7/31/25. **Past performance does not guarantee future results.** Excess returns are defined as investment returns from a security or portfolio that exceed a benchmark or index with a similar level of risk. Indices are unmanaged and not available for direct investment. See last page for representative index definitions. Sources: Bloomberg and Wellington Management.

FIGURE 5: US Yields (%)



As of 7/31/25. Sources: Bloomberg, Wellington Management.

FIGURE 6: Fixed-Income Spreads (basis points)



As of 7/31/25. **Past performance does not guarantee future results.** US IG Corp is represented by the **Bloomberg US Corporate Bond Index**; US HY Corp is represented by the **Bloomberg US Corporate High Yield Bond Index**; EMD is represented by the **J.P. Morgan EMBI Global Diversified Index**; MBS is represented by the **Bloomberg US MBS Index**; Bank Loans are represented by the **Morningstar/LSTA US Leveraged Loan Index**. See last page for representative index definitions. Data Sources: Bloomberg, JP Morgan, Morningstar LSTA, and Wellington Management.

To learn more about opportunities in fixed income, please talk to your Hartford Funds representative.

[1] Source: Yale Budget Lab

[2] The Federal Open Market Committee (FOMC) is the monetary policymaking body of the Federal Reserve System. The FOMC is responsible for directing the nation's monetary policy by influencing the money supply and credit conditions to promote maximum employment, stable prices, and moderate long-term interest rates.

[3] The Consumer Price Index (CPI) in the United States is defined by the Bureau of Labor Statistics as "a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services." The Personal Consumption Expenditures (PCE) price index is a measure of the prices that people living in the US, 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.

[4] The "long end of the yield curve" refers to the segment of the yield curve that represents long-term bonds, typically those with maturities of 10 years or greater.

[5] A bull flattener occurs when long-term interest rates fall faster than short-term rates, leading to a flatter yield curve, while a bear flattener happens when short-term rates rise more quickly than long-term rates, also causing a flatter yield curve.

[6] The yield curve is a graphical representation that plots the interest rates (or yields) of bonds with equal credit quality but different maturity dates at a specific point in time.

[7] A "term premium" refers to the extra yield that investors demand for holding longer-term bonds compared to shorter-term ones, reflecting the compensation for bearing the risk that interest rates might change during the bond's lifespan.

[8] Total return includes interest, capital gains, dividends, and distributions realized over a period. Total return accounts for two categories of return: income (including interest paid by fixed-income investments, distributions, or dividends) and capital appreciation, representing the change in the market price of an asset.

[9] Go-anywhere strategies are typically benchmark-agnostic and not bound by limits on exposure by sector, quality, currency, or country. Whereas traditional core-bond-plus strategies generally have flexibility to invest across the fixed-income landscape, they generally have upper limits on the amount that can be invested in securities rated below-investment-grade, domiciled outside the US, non-US-dollar-denominated, or reside in a particular sector (e.g., emerging markets).

[10] Duration is a measure of the sensitivity of an investment's price to nominal interest-rate movement.

[11] With convertible debt, a business borrows money from a lender or investor where both parties enter the agreement with the intent (from the outset) to repay all (or part) of the loan by converting it into a certain number of its preferred or common shares at some point in the future. The agreement specifies the repayment and conversion terms which include the timeframe and the price per share for the conversion as well as the interest rate that will be paid until either conversion or maturity.

[12] Core/core plus strategies typically invest in a baseline of investment-grade bonds such as government, corporate, and securitized debt. Core-plus funds can take that baseline and add additional sectors such as corporate high-yield, emerging-market debt, or non-US currency exposures to enhance returns.

[13] Asset-backed securities (ABS) is a type of financial investment that is collateralized by an underlying pool of assets—usually assets that generate a cash flow from debt, such as loans, leases, credit card balances, or receivables.

[14] Investment-grade credit refers to bonds or other debt securities deemed to have a low risk of default by credit rating agencies like Moody's, S&P, and Fitch. In essence, these are considered high-quality bonds issued by entities (corporations, municipalities, governments, etc.) with a strong capacity to meet their financial commitments.

[15] Securitized credit involves pooling a large number of loans into an investable asset. Examples include mortgage-backed or asset-backed securities.

[16] "Carry" generally refers to the return or cost associated with holding an asset, often used in the context of currency or asset trades, where investors borrow in a low-interest currency and invest in a higher-yielding one.

[17] Subordination refers to a lower priority level of debt or securities. Subordinated debt ranks below senior debt in terms of claims on assets and earnings. This means that in the event of a default or liquidation, subordinated debt holders are paid after senior debt holders. Subordinated debt is often considered riskier because it has a lower claim on assets, but it typically offers higher interest rates to compensate for this increased risk.

[18] A collateralized loan obligation (CLO) is a type of security that allows investors to purchase an interest in a diversified portfolio of company loans. There are two types of CLO tranches: debt tranches and equity tranches. Debt tranches are treated like bonds and have credit ratings and coupon payments. These debt tranches come first in terms of repayment, and there is also a pecking order within the debt tranches. Equity tranches do not have credit ratings and are paid out after all debt tranches. Equity tranches are rarely paid a cash flow but do offer ownership in the CLO itself in the event of a sale. Because equity tranche investors usually face higher risks, they often receive higher returns than debt tranche investors.

[19] Commercial mortgage-backed securities (CMBS) are fixed-income investments backed by mortgages on commercial properties rather than residential real estate. Residential mortgage-backed securities (RMBS) are a type of mortgage-backed security backed by residential real estate mortgages.

[20] High-yield securities, or "junk bonds," are rated below-investment-grade because there is a greater possibility that the issuer may be unable to make interest and principal payments on those securities.

[21] Yield to worst is the minimum yield that can be received on a bond assuming the issuer doesn't default on any of its payments.

[22] Spreads are the difference in yields between two fixed-income securities with the same maturity but originating from different investment sectors.

[23] A leveraged loan is a type of loan provided to companies or individuals that already have a significant amount of debt or a low credit rating. These loans are considered high-risk by lenders due to the increased possibility of the borrower defaulting. To compensate for this higher risk, leveraged loans typically come with higher interest rates compared to traditional loans.

[24] Emerging-market debt (EMD) are debt instruments issued by developing countries. These bonds tend to offer higher yields than Treasuries or corporate bonds in the US. Emerging-market issues tend to carry higher risks than domestic debt instruments.

[25] The break-even inflation rate is a measurement that aims to predict the effects of inflation on certain investments, by analyzing known market inflation rates from recent years. It can be calculated by comparing the yield of an inflation-based bond (such as Treasury Inflation-Protected Securities, or TIPS) with a nominal bond of the same maturity period. The difference represents the break-even inflation rate, or the rate that inflation would have to be for an investor to "break even"—or earn the same return—between purchasing TIPS or nominal Treasuries.

Representative Indices from Figure 4:
Global Aggregate: Bloomberg Global Aggregate Bond Index; Euro Aggregate: Bloomberg Global Aggregate Bond Index - European Euro; UK Aggregate: Bloomberg Global Aggregate Bond Index - United Kingdom; US Aggregate: Bloomberg US Aggregate Bond Index; US Fixed MBS; Bloomberg US MBS Index; US CMBS: Bloomberg CMBS ERISA Eligible Bond Index; US ABS: Bloomberg Asset-Backed Securities Index; US IG Corporates: Bloomberg US Corporate Bond Index; US Corporates Aaa: Bloomberg Aaa Corporate Bond Index; US Corporates Aa: Bloomberg Aa Corporate Bond Index; US Corporates A: Bloomberg A Corporate Index; US Corporates Baa: Bloomberg Baa Corporate Bond Index; US High-Yield Corporates: Bloomberg US Corporate High Yield Bond Index; Global IG Corporates: Bloomberg Global Credit - Corporate Bond Index; Emerging-Markets Debt: Bloomberg Emerging Markets Hard Currency Bond Index.

Index Definitions:
Bloomberg Global Aggregate Bond Index is a broad-based measure of the global investment-grade fixed-rate debt markets.

Bloomberg Global Aggregate Bond Index - European Euro includes fixed-rate, investment-grade Euro denominated bonds.

Bloomberg Global Aggregate Bond Index - United Kingdom includes fixed-rate, investment-grade sterling-denominated bonds.

Bloomberg US Aggregate Bond Index is composed of securities from the Bloomberg Government/Credit Bond Index, Mortgage-Backed Securities Index, Asset-Backed Securities Index, and Commercial Mortgage-Backed Securities Index.

Bloomberg US MBS Index tracks fixed-rate agency mortgage backed passthrough securities guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

Bloomberg CMBS ERISA Eligible Bond Index measures the performance of investment-grade commercial mortgage-backed securities, which are classes of securities that represent interests in pools of commercial mortgages. The index includes only CMBS that are Employee Retirement Income Security Act of 1974.

Bloomberg Asset-Backed Securities Index, the ABS component of the Bloomberg US Aggregate Index, has three subsectors: credit and charge cards, autos, and utility.

Bloomberg US Corporate Bond Index covers all publicly issued, fixed rate, nonconvertible, investment-grade debt.

Bloomberg Aaa Corporate Bond Index is designed to measure the performance of investment-grade corporate bonds that have a credit rating of Aaa.

Bloomberg Aa Corporate Bond Index is designed to measure the performance of investment-grade corporate bonds that have a credit rating of Aa.

Bloomberg A Corporate Bond Index is designed to measure the performance of investment-grade corporate bonds that have a credit rating of A.

Bloomberg Baa Corporate Bond Index is designed to measure the performance of investment-grade corporate bonds that have a credit rating of Baa.

Bloomberg US Corporate High Yield Bond Index is an unmanaged broad-based market-value-weighted index that tracks the total return performance of non-investment grade, fixed-rate, publicly placed, dollar denominated and nonconvertible debt registered with the Securities and Exchange Commission.

Bloomberg Global Credit - Corporate Bond Index is an unmanaged index considered representative of fixed rate, non-investment grade debt of companies in the US, developed markets, and emerging markets.

Bloomberg Emerging Markets Hard Currency Bond Index includes USD-denominated debt from sovereign, quasi-sovereign, and corporate EM issuers.

Morningstar/LSTA Leveraged Loan Index is a market-value-weighted index that is designed to measure the performance of the US leveraged loan market based upon market weightings, spreads, and interest payments.

J.P. Morgan EMBI Global Diversified Index is a broad-based, unmanaged index which tracks liquid, US Dollar emerging-market fixed- and floating-rate debt instruments issued by sovereign and quasi-sovereign entities.

Important Risks: Investing involves risk, including the possible loss of principal. • Fixed income security risks include credit, liquidity, call, duration, and interest-rate risk. As interest rates rise, bond prices generally fall. • Investments in high-yield (“junk”) bonds involve greater risk of price volatility, illiquidity, and default than higher-rated debt securities. • Mortgage-related and asset-backed securities’ risks include credit, interest-rate, prepayment, and extension risk. The value of the underlying real estate of real estate related securities may go down due to various factors, including but not limited to strength of the economy, amount of new construction, laws and regulations, costs of real estate, availability of mortgages, and changes in interest rates. • Loans can be difficult to value and less liquid than other types of debt instruments; they are also subject to nonpayment, collateral, bankruptcy, default, extension, prepayment and insolvency risks. • Foreign investments may be more volatile and less liquid than US investments and are subject to the risk of currency fluctuations and adverse political, economic and regulatory developments. These risks may be greater, and include additional risks, for investments in emerging markets. • The risks associated with mortgage-related and asset-backed securities as well as collateralized loan obligations (CLOs) include credit, interest-rate, prepayment, liquidity, default, and extension risk. • Diversification does not ensure a profit or protect against a loss in declining markets.

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