



# REBALANCE AND REPLENISH AS U.S. ECONOMY SOFTENS

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*NEPC sits down with Phillip Nelson, Head of Asset Allocation, to address the elephants in the room... errr...markets: tariffs, the labor market, a weakening economy, and monetary policy. Read on for NEPC's current investment and economic outlook in an ever-shifting landscape.*

## **1. Tariffs have been at the forefront this year. Should investors be worried?**

Markets are increasingly agnostic to new announcements around tariffs amid expectations of trade deals and compromises. This indifference sets the stage for a more severe surprise in the instance of negative news.

While the U.S. has reached trade agreements with the European Union and Japan, the most important one we are waiting on is with China. Currently, the market is optimistic about a deal on the horizon with China and is pricing in a fairly benign environment. If we see a breakdown in talks or an outcome that looks more like an embargo than a trade deal, markets could react harshly.

That said, the fact that the S&P 500 is hitting record highs in spite of higher tariffs—currently above 18%—wasn't on anyone's bingo card.

## **2. Labor markets, the bulwark of the U.S. economy and the force behind U.S. consumer resilience, are showing signs of weakness. What is the significance of the jobs report in July?**

The July jobs' report, with the addition of 73,000 new non-farm payroll jobs, came in below expectations. Of greater importance, downward revisions to the May and June reports by 258,000 indicated growth of just 35,000 jobs in the three-month average payroll, underscoring the increasing vulnerability of the labor market; with the exception of the early months of the Covid pandemic, the scale of payroll revisions were the largest since the late 1970s, pointing to potential trouble in the labor market.

The weak jobs' report puts the labor market, tariff policies, and the Federal Reserve on a collision course for mid-September at the central bank's next meeting. In fact, markets may be receptive to a softening labor market as that could serve as a potential catalyst for a reset in monetary policy. As a result, we could see material shifts in the market's expectations for Fed rate cuts in 2025 over the course of the next 40 days.

## **3. What does this mean for the economy and for investors?**

The July jobs report has already set events in motion. When you look at the jobs number, you could argue we are already in a bit of a recession, but the resilience of the U.S. consumer is keeping the economy afloat, with household spending and consumption driving the country. But there are pockets—

particularly small businesses which have traditionally served as engines of economic growth—that are feeling some stress.

#### **4. Amid all the noise, what are the key data points NEPC is focused on?**

Without doubt and, at the cost of repeating myself, a key data point is the monthly jobs report and the scale of potential downward revisions to previous data. Markets are watchful of these reports and any shifts in Fed policy, especially as the Federal Open Market Committee members gather later this month at the annual economic policy symposium in Jackson Hole, Wyoming; the potential for a 50-basis points cut in September is very much on the table.

A vital data point that no one has the answer to as yet is the impact on consumers and businesses as tariffs start flowing through the system.

#### **5. What's the one piece of advice for investors in this environment?**

Bring down exposure to assets that have outperformed expectations and build up a liquidity buffer.

## **IMPORTANT DISCLOSURES**

As of 7/31/2025, Source: S&P, Russell, MSCI, JPM, Bloomberg, Factset

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