



Global Fixed Income Outlook & Strategy

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Market Recap & Outlook

The US government shutdown has left investors with a data gap, as the statisticians at the Bureau of Labor Statistics are classified as inessential workers. September payroll and unemployment data are unpublished. Total Federal layoffs may be about 700,000-750,000 employees, and the length of the disruption is unknowable. If the shutdown lasts a month or more, the unemployment rate could reach approximately 4.6%-4.7%, but there will be no one to tell us.

With public data unavailable, markets are expected to focus on private data. For the labor markets, these include ADP, Homebase, Revelio, and Indeed. These currently show a mixed picture, with ADP showing private employment down for the past two months. Indeed, which skews towards small business shows a stronger picture, but on net the view is of a low hire, low fire labor market going sideways. The Chicago Federal Reserve thinks the unemployment rate is about flat at 4.3% before the shutdown effect.

Private inflation data is equally mixed. Truflation is benign, running at about 2% year-over-year, though its sample may be skewed towards goods. Separately, ISM Services Prices Paid is trending higher and can be a leading indicator of broader inflation trends. We suspect that inflation is also more or less sideways: not breaking higher, as much of the tariff shock has been absorbed for the time being in margin compression but not decelerating much either. Two high profile price pressures are the price of beef, as prior drought has reduced herd size, and the cost of electricity, which is being pushed higher by soaring data center demand.

The Federal Reserve will have to make policy in a partial data vacuum. We suspect that if the shutdown is still in effect at the next Fed meeting the obvious economic and labor market damage from the shutdown will lead to another 25bp cut. Congress and the White House seem to have found a new and highly unpleasant way to get the Fed to cut rates.

We expect data centers, AI and machine learning capital expenditures to be the most powerful positive drivers

of economic growth in the next year or two. Bullish expectations for these industries also dominate equity values. In turn, wealth effects may be aiding high end consumer sentiment. Moody's Economics has claimed that 49% of US consumption is by the richest 10% of Americans. The US economy is now sometimes described as K-shaped, with the top half of the letter doing extremely well, but the bottom half experiencing a much more precarious reality. Q3 GDP was relatively strong according to the Atlanta Fed GDPNow estimate, but once more we may not know for a while.

Mexico's new import tariffs are the first pushback we have seen against the global export surge from Asian countries diverting manufacturing exports away from the US into other markets. This export diversion is large and extremely important for sustaining Asian, and notably Chinese GDP growth this year, as domestic consumption still looks feeble, in our view. We believe it also has the benefit of exporting disinflation to emerging markets destinations. This has encouraged us to hold duration in local markets expected to benefit.

Mexico's case may be unique, given its US-Mexico-Canada Agreement (USMCA) membership and the need to curry favor with the US, which does not wish to see Mexico become a Chinese re-export venue. But the broader issue of export saturation is systemic and will be a factor in many countries' trade policy decisions.

Our Strategy

With the US stock market and the US economy increasingly dominated by the AI investment theme, the case for non-US global fixed income seems particularly strong. If AI growth and earnings expectations do disappoint, i.e., if AI is a bubble, we would expect the resulting crash in values to be a deflationary shock, lowering US growth, equity returns, yields and the US dollar. For investors heavily invested in an AI accelerationist future, nondollar fixed income looks to be a compelling hedge.

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Important Disclosures

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