WILSONS ADVISORY

US Equities Defying a Slowing Economy

Our weekly view on asset allocation.

11 August 2025

Slowdown Evidence Accumulating

After an extended period of resilience, recent data releases suggest the US economy is losing momentum. Q2 GDP released earlier this month confirmed H1 growth of just 1.1% versus last year's run rate of 2.6%.

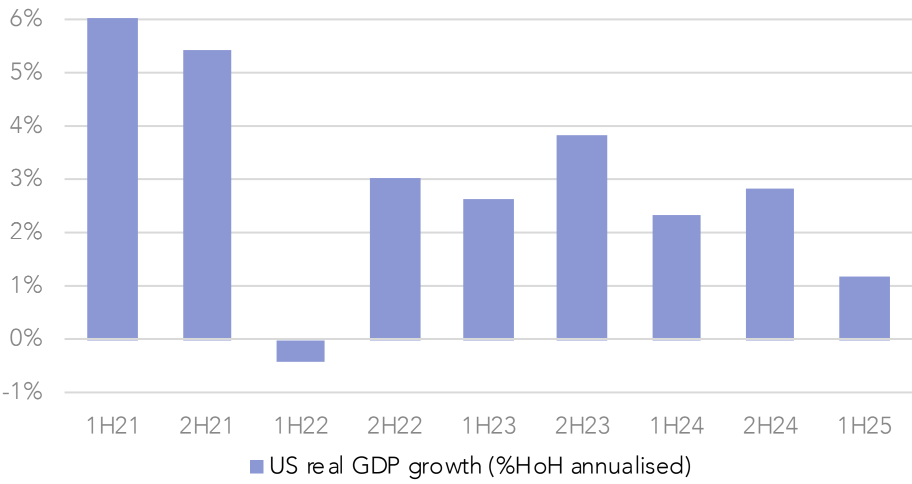
However, it was the recent (August 1) labour market report that produced the biggest surprise. July payrolls were on the soft side, at 73k new jobs versus expectations of 104k. More importantly, however, May and June saw large downward revisions of 125k and 133k respectively. While monthly revisions to recent months are quite normal, the magnitude of the July 2025 revision was exceptional, representing the largest such adjustment since 1978.

These downward revisions revealed a labour market generating less than 20k in monthly jobs growth in both May and June, taking the three-month moving average of jobs growth to an anaemic 35k per month. This compares to the "pre-release" three-month moving average of 150k, which was quite close to the long run pace of job creation.

Indeed, just two days before the payrolls release, Fed chairman Powell cited a robust labour market as a key reason that the Fed was in no hurry to cut interest rates.

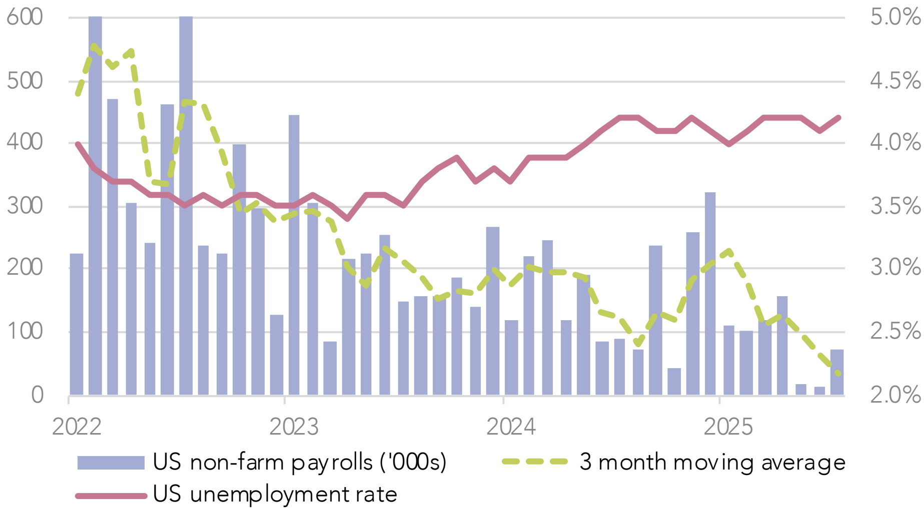
The reaction of the market to the weak labour market figures was dramatic, with 10-year bond yields falling 16 basis points and the two-year yield falling 27 basis points. Expectations for a Fed rate cut in September, which had dropped from a 65% probability to 45% post Powell's "hawkish" policy press conference two days earlier, spiked to over 90% post the downward revision of the labour market data. US equities fell 1.6% on the day, although stocks have subsequently recovered much of this fall.

Figure 1: US economic growth has slowed significantly this year



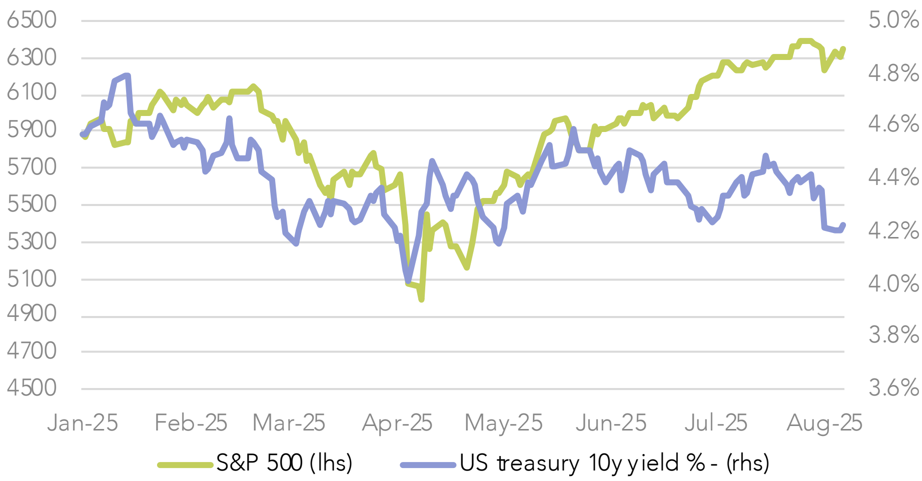
Source: Refinitiv, Wilsons Advisory.

Figure 2: The US labour market has lost momentum



Source: Refinitiv, Wilsons Advisory.

Figure 3: US bond yields fell last week while equities wobbled but recovered



Source: Refinitiv, Wilsons Advisory.

Trump Shoots the Slowdown Messenger

With such large revisions to the employment picture in recent months, the "credibility" of the data came under scrutiny and prompted President Trump to fire the head of the Bureau of Labor Statistics hours after its release. While Trump's "shoot the messenger" approach is quite disconcerting, the market seems to be becoming desensitized to such outlandish actions, with equities managing to stage a sharp rebound early last week.

Following on from last week's shock labour market print, the ISM service sector business conditions survey also reinforced the message of a slowing US economy, falling from 50.8 to 50.1. Indeed, the employment sub-index came in at a very weak 46.4 (i.e. a contracting labour market).

In terms of the official data, the unemployment rate, which the Fed is arguably more focused on than non-farm payrolls, ticked up to 4.25% from 4.12%. This is not a huge deterioration and still a very low level of unemployment, but the stalling in job creation is often a recessionary precursor and would likely worry the Fed.

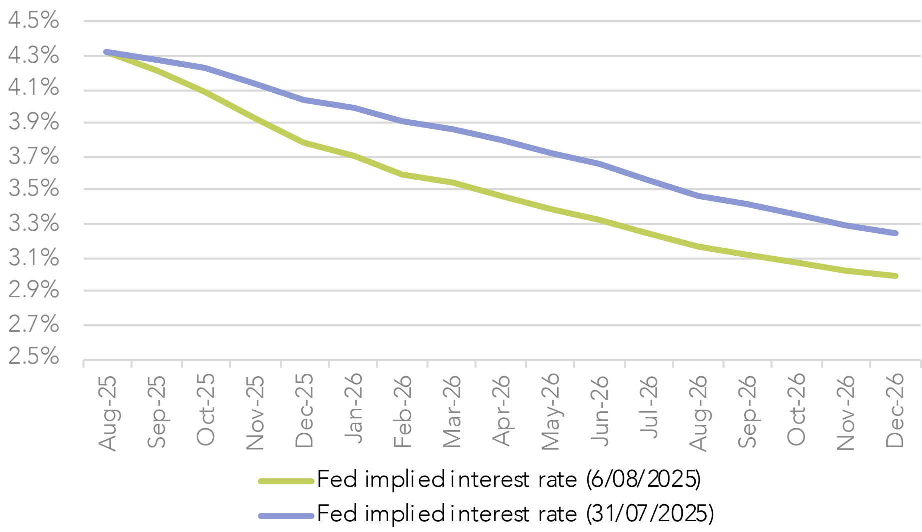
Why are equities remaining relatively resilient into what is seemingly an economy threatening to stall under the weight of uncertainty created by Trump's tariff policy and general policy unpredictability?

Equities taking their cue from a resilient earnings season

A key reason behind the resilience in equity markets is that in contrast to the economic data, the current Q2 earning season has been, once again, better than expected. In aggregate, US earnings continue to show resilience, although the tech sector is doing a lot of the heavy lifting.

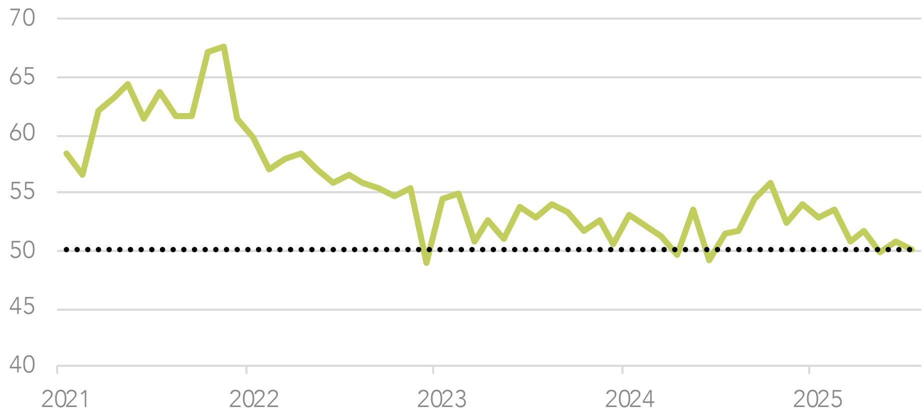
We are now ~80% of the way through the Q2 reporting season and over 80% of companies have reported a positive EPS surprise. Year-on-year earnings growth for the second quarter is now averaging ~10% compared to a 5% estimate at June 30. This is in line with the growth rate seen in recent quarters and very impressive in a longer-term historical context.

Figure 4: The market has increased the probability of more near term easing from the Fed



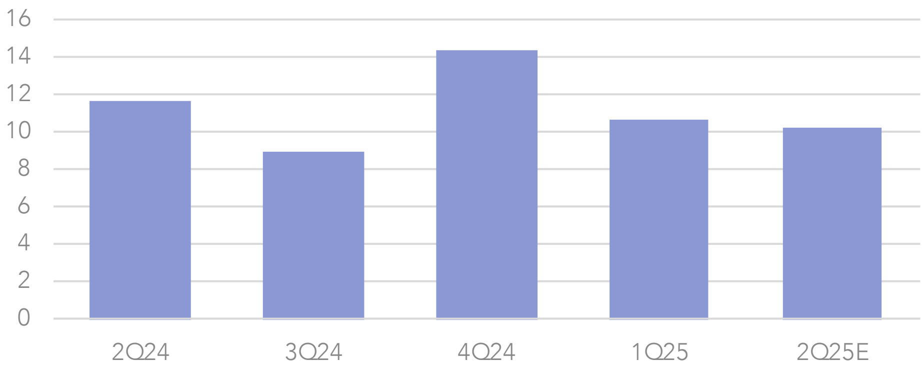
Source: Refinitiv, Wilsons Advisory.

Figure 5: Slowing is evident in the "tariff free" services sector



Source: Refinitiv, Wilsons Advisory.

Figure 6: US earnings growth continues to be resilient but tech driven



Source: Refinitiv, Wilsons Advisory.

Perhaps indicative of the evidence of slowdown within the economic data is that earnings results are showing something of a two-tiered market, with the tech sector mostly very strong (led by the mega caps) while other areas are less robust. This includes many areas linked to consumer spending. Indeed, while tech sector earnings growth is close to 20%, ex-tech growth is more mundane, averaging in the low single digits. So while the AI narrative appears on a firm footing, consumer and tariff exposed sectors appear more fragile.

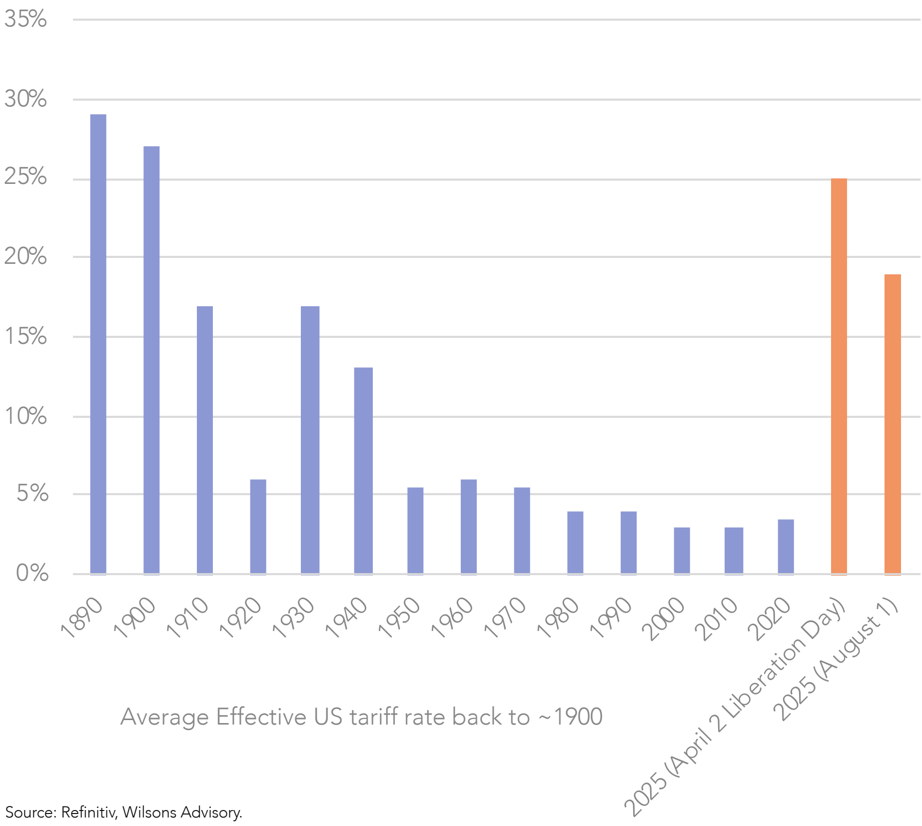
Given the size of the tech sector, its ongoing strength has been enough to keep the market buoyant - though the narrowing of performance is somewhat cautionary.

The Fed Put Back in Play?

Arguably another reason the US market is shaking off bad economic news is that the market sees a rising probability that the Fed will cut rates at its next meeting (September 17) before implementing several follow-up cuts. The complication for the Fed is that inflation is likely to be in the early stages of a multi-month pick up, off the back of tariff-induced goods price rises.

So far, the evidence of inflation pass-through has been very minor, but we would expect more evidence of accelerating prices in this week's August 12 CPI print. There are two CPI prints (and one labour market print) due between now and the next Fed meeting on 17 September. Tariff-driven inflation is likely to be a theme for CPI prints for several months.

Figure 7: The US Effective Tariff Rate is significant and likely to push up inflation near term



Source: Refinitiv, Wilsons Advisory.

We see US CPI annualising close to 4% through the second half of this year, up from the current ~2.5% level.

From a tariff perspective, last week President Trump announced an updated list of reciprocal tariffs, with the overall effective tariff rate now expected to land at a significant 19%. This is down from the 25% on Liberation Day, but up from only ~3% at the start of this year. The US equity market has largely shrugged off the recent "bad news" on tariffs. Powell himself noted that tariff effects on inflation might be seen as short-lived "one-time base effects". However, with worsening jobs data and signs of a spending slowdown, the potential impact of tariffs on both consumer spending and the CPI ultimately may prove hard to ignore.

We anticipate that the uptick in CPI from tariffs will not stop the Fed from easing policy, assuming the labour market continues to show softness. However a backdrop of stalling growth and rising inflation suggests an uncomfortable period for a currently buoyant equity market.

As a result, we see the near-term risk-return trade-off for stocks as not particularly favourable. Looking further ahead, the tariff-driven inflation spike should have run its course by year end and the prospect of multiple Fed rate cuts should help the US economy regain its footing in 2026. As a result, we see the 6-to-12-month outlook as decent. Longer term the US market should remain supported by significant structural technology sector tailwinds, so our caution is tactical rather than strategic.

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