Is a September Rate Cut Now in Play?

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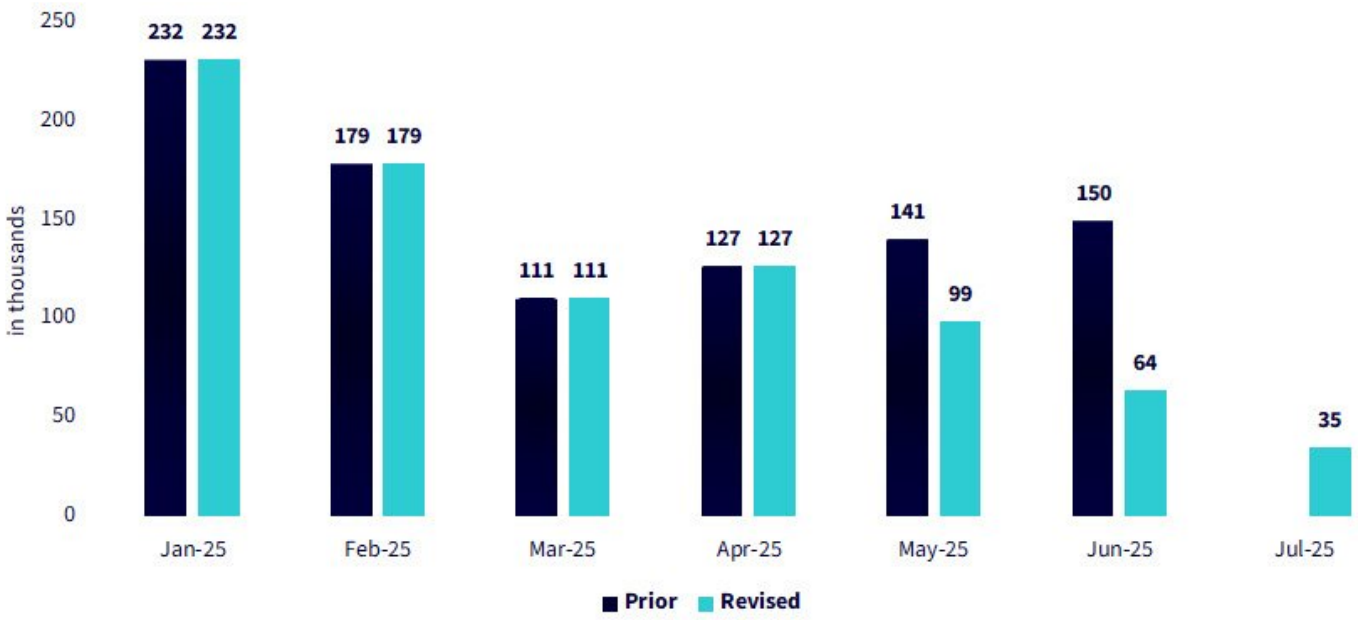
Kevin Flanagan
Head of Investment and Fixed Income Strategy

Key Takeaways

- July's sharply revised jobs report, with payrolls averaging just +35k over three months, has significantly softened the labor market backdrop and opened the door for a potential September Fed rate cut.
- Despite Powell's recent hawkish tone, Treasury yields dropped notably as markets quickly repriced expectations, highlighting the heightened sensitivity to labor and inflation data ahead of Jackson Hole.
- Fixed income investors may benefit from positioning in short-duration strategies like SHAG or USSH, which are likely to outperform if the Fed pivots to rate cuts later this year.

The busy week for the markets last week culminated in the July Employment Situation report. With the jobs data coming after the July FOMC meeting, investors were greeted with a dynamic that is somewhat unusual. With the July jobs data now in, the markets are faced with a visibly different labor market backdrop than what existed at 8:29 Friday morning prior to the release, i.e., much softer than previously thought over the last three months (see below).

Figure 1: U.S. Total Nonfarm Payrolls—Three-Month Moving Average



Source: Bureau of Labor Statistics, as of 8/1/25.

Here are some takeaways:

- Total nonfarm payrolls rose by +73k, visibly below the consensus estimate of +104k
- However, the bigger news is the fact that the prior two months were revised down by a combined -258k, the largest non-Covid related downward revision since 1979. As a result, the three-month moving average for payrolls plummeted to only +35,000 in July
- Powell's new favorite indicator, the unemployment rate, ticked up by +0.1 pp to a still low 4.2%, in line with expectations
- While we still have another employment report and two more months' worth of inflation data before the September FOMC meeting, today's jobs report changes the labor market backdrop Powell has been basing his policy decisions on. Jackson Hole, later this month, provides the opportunity to change forward guidance for Powell
- On its own, this jobs report puts a September rate cut in play
- What happens if upcoming inflation reports are elevated and show more tariff pass-through effects? That's the potential conundrum
- Needless to say, the Treasury market rallied, with the 2-Year & 10-Year yields falling more than -20 basis points (bps) and -10 bps, respectively on 'Fed re-pricing' following Powell's 'somewhat hawkish' FOMC presser last week
- However, a further rally, especially for the 10-Year, is dependent upon upcoming inflation data, such as the CPI report on August 12

Conclusion

Against this shifting labor market, and potential Fed monetary policy backdrop, how should fixed income investors position their bond portfolio? If the Fed does shift into “rate-cut” mode, the front-end of the yield curve, or short-duration strategies, would be expected to outperform. I suggest investors consider either the WisdomTree Yield Enhanced U.S. Short-Term Aggregate Bond Fund (SHAG) or, for a Treasuries-only solution, the WisdomTree 1-3 Year Laddered Treasury Fund (USSH) from our fixed income suite.

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