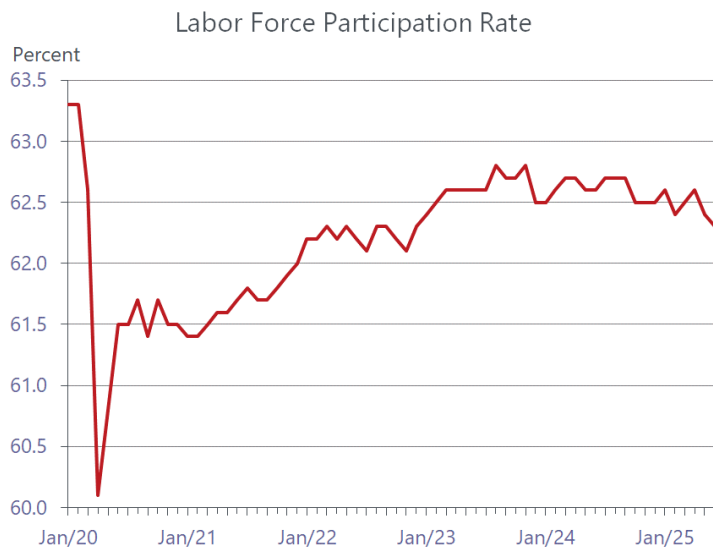




It's unclear why state and local governments took on 80 thousand workers last month. Most of the gain was for teachers and support staff in education, which probably reflects more statistical noise than reality. The Labor Department always has a difficult time trying to correct through seasonal adjustments the significant -- and variable -- numbers of educators who leave their jobs for the summer in June. That said, changes in the government workforce are far less sensitive to cyclical forces than is the case in the private sector, where employers fill staffing needs based on current and expected economic conditions.

On this score, conditions look far less bright. Jobs in the private sector grew by only 74 thousand in June, the smallest increase since last October. And most of that came from a sector that is least sensitive to business conditions -- health and social services -- where payrolls increased by 59 thousand workers. The demand for these workers is influenced more by long-term trends in demographics, notably an ageing population, than by short-term changes in economic activity. The decline in the diffusion index compiled by the Labor Department -- which measures the percentage of industries that are expanding or contracting their workforces -- to under 50 in June underscores the narrowing base of support propelling job growth.

Just as the headline growth in total payrolls overstates the strength in the job market, so too does the surprising 0.1 percent drop in the unemployment rate to 4.1 percent in June overstate



the tightness in labor conditions.

This rate, which is compiled from a companion survey of households, fell primarily because the labor supply shrank. The labor force participation rate fell to 62.3 percent in June, the lowest since December 2022. Given the government's clampdown in immigration and mass deportations, we expect future growth in the labor force to downshift markedly. Keep in mind that slower growth in the labor supply means that fewer workers need to be hired to keep the unemployment rate from rising. At least one respected study by the

Brookings Institution estimates that the breakeven rate of hiring to maintain a steady unemployment rate will be as low as 10 thousand later this year and 2026.

While the jobs report delivered enough strength to keep the Fed from cutting rates sooner rather than later -- as President Trump has urged it to do -- it also kept the door wide open for a rate cut later in the year. Simply put, there was nothing in the report that signals more inflation down the road. That's because wage gains remained subdued. Average hourly earnings increased by a tame 0.2 percent during the month and by 3.7 percent from a year ago, the slowest annual gain since last July. Before that, you would have to go back to May 2021 to find

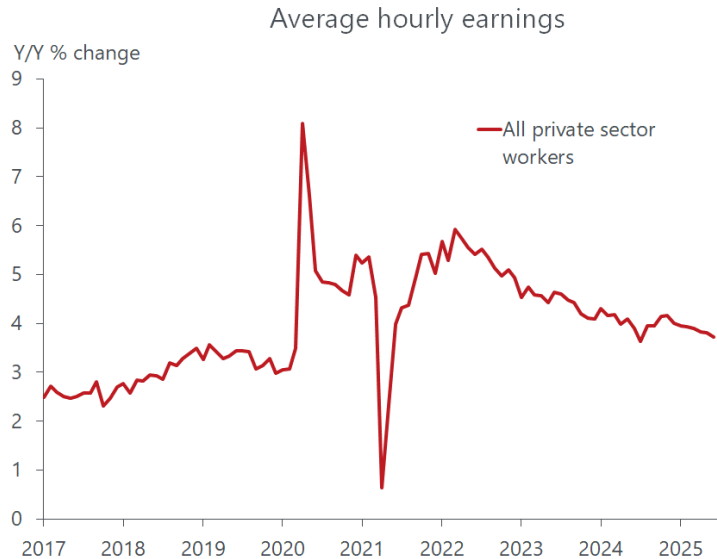
another time of slower wage growth. A 3.7 percent annual wage increase is fully compatible with a 2 percent inflation target after adjusting for productivity growth.

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At the same time, it is strong enough to keep workers ahead of inflation. We won't have the consumer price data for another few weeks, but it is likely to once again lag the gain in worker earnings. That means household purchasing power should remain intact and support consumer spending. The story could change

later in the year, as the lagged impact of tariffs seeps into prices and cuts into disposable income. But the passthrough to prices is still unknown as is the demand destruction that tariffs will cause. All the reason for the Fed to stay on the sidelines and stick to its wait-and-see approach.

Simply put, the June employment report doesn't change our outlook for Fed policy. While some of the underlying details were softer than the headlines, the report paints a picture of a labor market that's healthy enough to tolerate the Fed remaining on hold as it assesses the impact of changes in tariff and fiscal policy on inflation and growth. We expect the Fed to keep rates steady at least until September and more likely until December. By that time, we expect the hit to inflation from tariffs will be receding, allowing the central bank to focus more on the labor market side of its dual mandate. That said, the Fed will cut rates sooner if the next couple of job reports show a significant deterioration in labor market conditions. In that case, However, we think the Fed will not only pull the rate trigger, but it kicks off the next rate cutting cycle with a larger than the normal quarter point reduction, starting with a catch-up cut of half point.



## FINANCIAL INDICATORS

INTEREST RATES	July 3	Week Ago	Month Ago	Year Ago
3-month Treasury bill	4.35	4.30	4.34	5.37
6-month Treasury bill	4.30	4.24	4.30	5.29
2-year Treasury note	3.89	3.75	4.05	4.62
5-year Treasury note	3.94	3.84	4.13	4.23
10-year Treasury note	4.35	4.29	4.51	4.28
30-year Treasury bond	4.87	4.83	4.97	4.48
30-year fixed mortgage rate	5.67	6.77	6.85	6.95
15-year fixed mortgage rate	5.80	5.89	5.99	6.25

STOCK MARKET				
Dow Jones Industrial Index	44,828.50	43,819.27	42,762.87	39,375.87
S&P 500	6,279.40	6,173.07	6,000.36	5,567.19
NASDAQ	20,601.10	20,273.46	19,529.95	18,352.76

COMMODITIES				
Gold (\$ per troy ounce)	3,338.80	3,286.10	3,334.00	2,397.60
Oil (\$ per barrel) - Crude Futures (WTI)	67.11	65.08	64.78	83.28

ECONOMIC INDICATOR	Latest Month/Quarter	Previous Month/Quarter	Two-Months/ Qtrs Ago	Average-Past Six Months or Quarters
Nonfarm Payrolls (June) - 000s	147	144	158	130
Unemployment Rate (June) - Percent	4.1	4.2	4.2	4.1
Average Hourly Earnings (June) - % change	0.2	0.4	0.2	0.3
ISM Manufacturing Index (June)	49.0	48.5	48.7	49.1

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