

Weekly CIO Letter

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The Labor Market Is Cooling – But Inflation Has Not Cleared the Way for Easier Money

The U.S. employment data have weakened materially at the margin. The investment question is whether this is the beginning of a broader slowdown or simply a normalization of an economy that remains structurally resilient.

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Editorial assessment

The most important development of the past week was not the headline unemployment rate. It was the combination of negative payroll growth, large downward revisions and a declining labor-force participation rate.

The evidence points to a labor market that is losing momentum, but not yet breaking.

The complication for investors is that inflation has not disappeared. China's producer prices remain elevated, while the U.S. July CPI and PPI

are still ahead this week. The Federal Reserve therefore faces a less comfortable combination: weaker employment alongside inflation that may remain too high for an immediate policy response.

One employment report cannot establish a trend. The BLS itself is scheduled to publish a preliminary benchmark revision to payroll data on August 28, meaning the current employment picture may change again.

Executive Summary

U.S. nonfarm payroll employment fell by 23,000 in July, while the unemployment rate remained at 4.1%. More importantly, May and June payroll gains were revised down by a combined 103,000 jobs.

The deterioration was concentrated in several areas rather than spread uniformly across the economy. Local-government education lost 50,000 jobs, retail lost 19,000 and financial activities lost 14,000. Healthcare continued to add jobs, although at a slower pace than its recent average.

The labor market is also showing less worker mobility. June JOLTS data showed 7.4 million job openings, 5.3 million hires, 3.2 million quits and 1.8 million layoffs and discharges.

At the same time, China's producer-price inflation remained positive at 3.5% year over year in July, although it fell 0.7% from June on a monthly basis. The composition is important: prices for means of production rose 4.8% year over year, while consumer-goods producer prices fell 0.8%.

The global macro picture is becoming more asymmetric. Growth is showing signs of cooling, but the inflation problem has not been fully resolved.

For investors, this argues against positioning portfolios around a single assumption of either rapid monetary easing or renewed inflation.

1. The U.S. Labor Market Has Lost Its Cushion

The July employment report is significant because the weakness extends beyond one disappointing monthly number.

Payroll employment fell by 23,000 in July. More consequentially, previously reported gains were revised sharply lower:

- May: +63,000, revised from +129,000;
- June: +20,000, revised from +57,000;
- July: -23,000.

The combined May–June revision removed 103,000 jobs from previously reported employment growth.

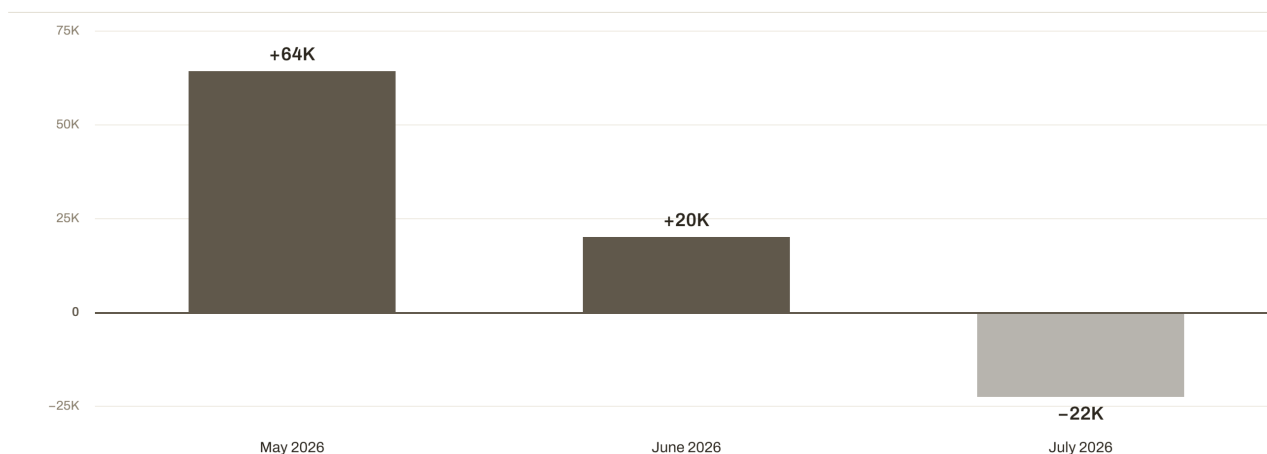
The twelve-month average monthly payroll gain has now fallen to only 34,000.

That is a material change from the labor market investors had become accustomed to.

ESTADOS UNIDOS

U.S. payroll growth has stalled

Monthly change in nonfarm payroll employment, latest reported data.



Source: U.S. Bureau of Labor Statistics, Employment Situation — July 2026.

The more important signal is therefore not that July happened to produce a negative number. It is that the underlying pace of employment creation has been revised down and has moved materially lower.

This matters for monetary policy

because employment is a lagging indicator, but payroll trends can reveal whether demand for labor is still expanding fast enough to absorb new workers.

The answer is becoming less clear.

2. The Unemployment Rate Is Not Telling the Whole Story

The unemployment rate remained at 4.1%, which would normally suggest a relatively healthy labor market.

There is an important qualification.

The labor-force participation rate fell to 61.4%, while the employment-population ratio was 58.9%. Since January, labor-force participation has declined by 0.7 percentage point.

A lower unemployment rate can therefore coexist with weaker employment conditions if fewer people are participating in the labor market.

This distinction matters for investors because a labor market can deteriorate

without producing an immediate jump in the headline unemployment rate.

The July report is better described as labor-market cooling than as an unemployment shock.

The deterioration is visible in participation and payroll growth before it is clearly visible in the unemployment rate.

The composition is also important

July employment changes were highly uneven.

Major changes:

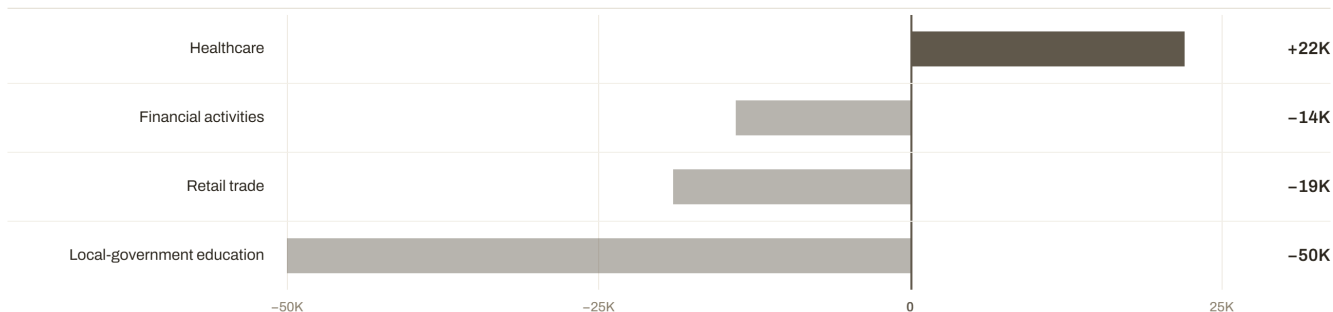
- Local-government education: -50,000
- Retail trade: -19,000
- Financial activities: -14,000
- Healthcare: +22,000

Financial-activities employment is now 121,000 below its May 2025 peak, according to the BLS.

Healthcare remains a major source of job creation, but its July increase of 22,000 was considerably below its previous twelve-month average of 36,000.

July job losses were concentrated in selected sectors

Monthly employment change in selected U.S. industries, July 2026.



Source: U.S. Bureau of Labor Statistics, Employment Situation — July 2026.

This is not yet the pattern of a broad private-sector recession. Construction, manufacturing, transportation and warehousing, information, professional services, leisure and hospitality and several other sectors

showed little change in July.

The more defensible interpretation is that the labor market has become much less forgiving.

3. JOLTS Confirms That Hiring Has Become More Cautious

The June Job Openings and Labor Turnover Survey provides a useful cross-check.

There were approximately:

- 7.4 million job openings
- 5.3 million hires
- 3.2 million quits
- 1.8 million layoffs and discharges

The number of openings remained high, but hiring did not accelerate alongside them.

This creates a subtle but important distinction.

A company may still advertise positions while taking longer to fill them,

reassessing budgets or becoming more selective about new employees.

This is consistent with a labor market moving from an environment of abundant hiring opportunities toward one in which employers and

workers are both becoming more cautious.

It is also consistent with the Federal Reserve's July assessment that labor demand and supply had broadly stabilized before the latest employ-

ment report.

The July payroll data suggest that this assessment may now need to be updated.

4. China Provides a Different Inflation Signal

The global inflation picture is not moving in one direction.

China's producer price index increased 3.5% year over year in July, down from 4.1% in June. On a monthly basis, producer prices declined 0.7%.

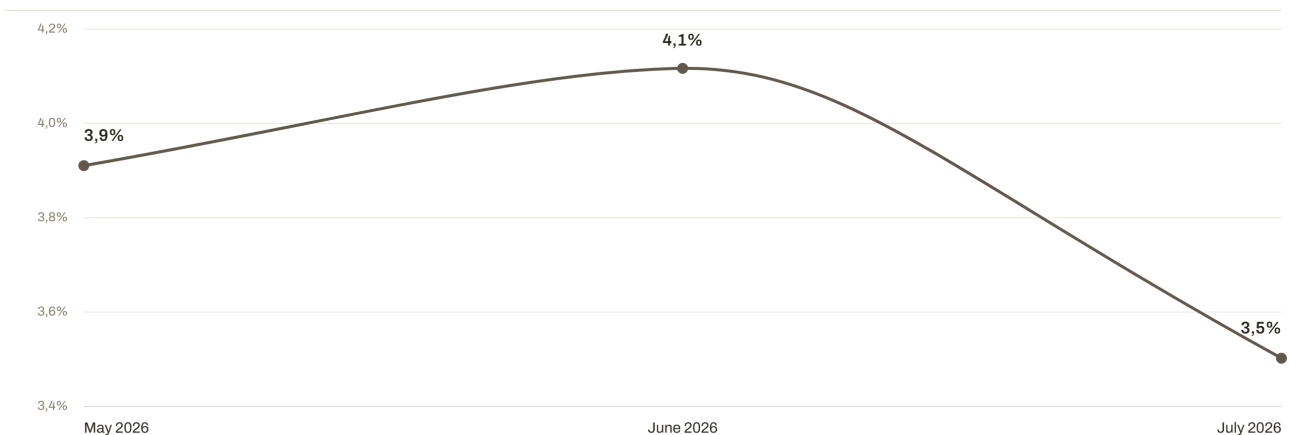
The composition is revealing.

Prices for means of production rose 4.8% year over year, while producer prices for consumer goods declined 0.8%. Non-ferrous metals and cables were up 19%, while fuel and power input prices increased 9.3%.

CHINA

China's producer inflation is easing, but remains elevated

Year-over-year change in China's industrial producer price index.



Source: National Bureau of Statistics of China. July 2026.

China's data suggest that some of the earlier commodity and supply-chain inflation pressure is easing at the margin.

But the level remains elevated, particularly for industrial inputs.

This matters globally because China's producer prices feed into manu-

factured goods, intermediate inputs and global supply chains.

It also provides an important counterweight to the U.S. labor-market story.

Weakening employment does not automatically mean rapidly falling inflation.

5. The Fed's Dilemma Is Becoming More Balanced

The Federal Reserve currently has two competing signals.

On one side:

Employment growth has weakened sharply, and the latest revisions suggest the deterioration began before July.

On the other:

Inflation remains above the Federal Reserve's 2% objective, and the central bank's July Monetary Policy Report described inflation as elevated partly because of energy and supply shocks.

The next test arrives this week.

The July U.S. CPI is scheduled for 12 August, followed by July PPI on 13

August. These reports will help determine whether the labor-market slowdown is occurring alongside sufficiently benign inflation for monetary easing.

If inflation data remain contained, the employment report materially increases the probability that the Fed can shift toward a less restrictive stance.

If inflation remains stubborn, the Fed may have to tolerate weaker employment for longer.

That is the more difficult scenario for markets.

Implications for Markets and Portfolios

Government Bonds

The employment report strengthens the case for maintaining exposure to high-quality duration, but it does not justify positioning for an aggressive rate-cut cycle before inflation data confirm the thesis.

will depend on how inflation evolves.

The mistake would be to treat one weak employment report as confirmation that the entire monetary-policy cycle has changed.

The most attractive part of the curve

Investment-Grade Credit

Slower employment growth is generally less damaging to investment-grade credit than to lower-quality borrowers.

Companies with:

- strong interest coverage;
- long debt maturities;
- recurring cash flow;
- limited refinancing requirements

Should have greater resilience if economic growth slows.

The distinction between credit quality becomes more important as the economic cycle matures.

High Yield and Private Credit

The employment data increase the importance of underwriting rather than simply harvesting yield.

A slowing labor market can affect:

- consumer demand;
- small-business cash flow;
- commercial real estate occupancy;
- refinancing capacity;
- default rates.

This does not imply an imminent credit event.

It means that the margin for underwriting mistakes is becoming smaller.

Equities

The labor report is not necessarily bearish for equities.

A softer labor market can reduce inflationary pressure and increase the probability of monetary easing.

The problem arises if weaker employment reflects a broader deterioration in corporate revenue.

The most resilient equity exposure should therefore come from companies whose earnings depend less on aggressive economic expansion and more on structural demand, productivity and strong balance sheets.

U.S. Dollar

A sustained deterioration in U.S. employment combined with lower inflation could weaken the dollar by increasing expectations for monetary easing.

But the dollar remains a global reserve currency, and risk-off episodes can generate demand for dollar liquidity even when U.S. domestic fundamentals weaken.

For Brazilian investors, this distinction is particularly important.

International diversification should not be reduced to a simple bet that the dollar will rise against the real.

Its primary function is to diversify currency, jurisdiction, economic exposure and sources of return.

Emerging Markets

Emerging-market assets could benefit if weaker U.S. employment translates into lower Treasury yields and a softer dollar.

The transmission is not automatic.

Countries with high inflation, weak

fiscal positions or significant external financing needs may not benefit equally.

This favors differentiation rather than a broad allocation to emerging markets as a single asset class.

Risks to the Central Thesis

1. The July employment report may be noisy

The BLS explicitly warns that employment estimates are revised as additional reports arrive. A preliminary benchmark revision will be published on August 28, followed by a final benchmark revision in early 2027.

2. Inflation could remain too high

A weak labor market does not guarantee lower inflation.

Energy prices, tariffs, supply constraints and commodity prices can keep inflation elevated even as employment slows.

3. Participation can distort the unemployment rate

A falling participation rate can temporarily prevent the unemployment rate from rising even as underlying labor-market conditions deteriorate.

4. The economy may remain structurally resilient

The Federal Reserve's July assessment highlighted strong productivity and capital investment, while the IMF expects global growth to remain positive despite significant geopolitical and trade-related headwinds.

The most likely scenario is therefore not a sudden recession, but a period in which growth, employment and inflation become less synchronized.

That is usually a more difficult environment for macro investors than a clean expansion or recession.

CIO Perspective

The labor market has changed.

The question is no longer whether U.S. employment is cooling. The data now provide reasonable evidence that it is.

The more difficult question is how far the cooling will go.

A few months of weak hiring would represent normalization.

A persistent decline in payrolls, accompanied by falling vacancies and rising unemployment, would represent something more serious.

We are not yet at the second stage.

The evidence currently supports a

cooling-but-not-breaking interpretation.

For portfolios, that distinction matters.

A slowing economy creates opportunities for duration and high-quality assets if inflation falls alongside growth. But if inflation remains elevated, the same slowdown can produce a much less favorable combination: weaker earnings without enough monetary relief.

This is why the next two inflation releases matter almost as much as the employment report itself.

Conclusion

The U.S. labor market has lost momentum faster than the headline unemployment rate suggests.

Payroll growth has slowed.

Previous gains have been revised lower.

Participation has declined.

Hiring remains cautious.

Yet inflation has not disappeared.

China's producer inflation has eased from its June peak but remains elevated, particularly across industrial inputs.

The global economy is therefore entering a period in which the direction of interest rates will depend

increasingly on the interaction between weaker labor demand and persistent price pressures.

We do not believe the current data justify a recessionary positioning.

We also do not believe they justify assuming that the current cycle of restrictive monetary policy can unwind quickly.

The appropriate response is selective:

quality over leverage, duration with discipline, liquidity over forced positioning, and genuine geographic diversification over dependence on a single macro outcome.

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