

Monthly Investment Insights

SEPTEMBER 2025

TOPIC 1:

Will the Federal Reserve (Fed) come to the rescue?

The weak July non-farm employment payroll report raised expectations of rate cuts by the Fed. However, we think the central bank will act cautiously with the pace and magnitude of easing.



What you can do

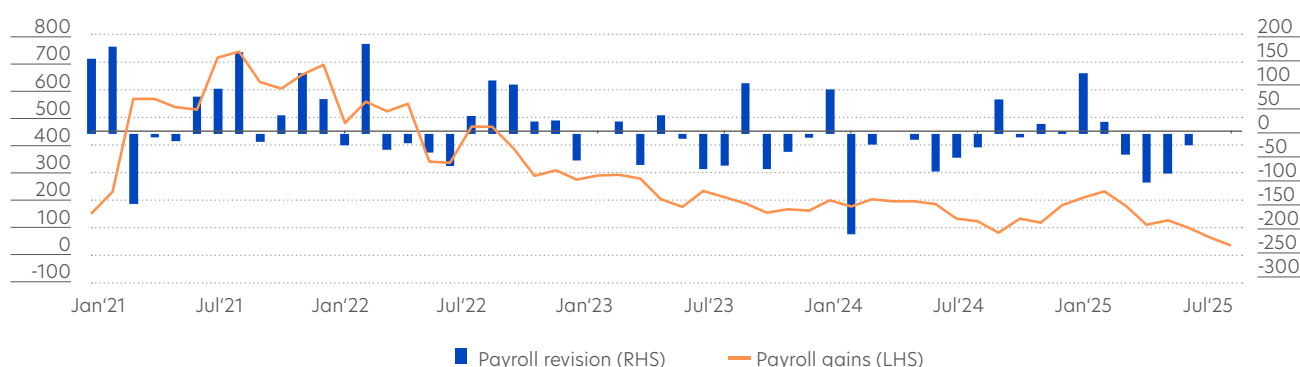
- With the Fed placing more emphasis on a cooling labour market over potentially higher inflation in the short term, investors should build income with investment grade bonds and quality dividend stocks.
- Our baseline view is the United States (US) economy will see slowing growth momentum in the second half of 2025 but avoid a recession. The July non-farm payrolls (NFP) report highlighted this growth slowdown.
- US non-farm payrolls, a key labour market indicator, increased by only 73,000 in July, falling short of expectations. More concerning were the significant downward revisions to May and June job gains. While revisions are common, the magnitude of the downward revisions and the declining trend of payroll gains over recent months (Figure 1) suggests the US labour market may not have been as resilient as previously expected.
- While other labour demand indicators, like job openings, appear more stable for now, slower economic growth and rising costs from tariffs could make businesses more cautious ahead, leading to reduced hiring plans in the second half of 2025.
- The latest July consumer price index (CPI) report indicates a slower-than-expected tariff passthrough to goods prices, and we retain the view that tariff-induced inflation is likely temporary. However, the combination of tariffs, a sharp decline in labour supply due to immigration rule changes, and a decreasing labour force participation rate could result in inflation staying persistent into 2026.
- The contrasting dynamics of weak labour demand and potentially higher inflation in the short term highlights the Fed's dilemma. At the recent Jackson Hole Symposium though, Fed Chair Jerome Powell signalled a greater emphasis on supporting labour market weakness by reiterating that tariff-driven inflation is expected to be short-lived.
- This reinforces our view that the Fed will reduce interest rates by 25 basis points (bps) in September unless there is a strong jump in payrolls or a clear upturn in price pressures.
- With the Fed likely to cut interest rates amid a softer growth environment, investors should diversify their portfolios by seeking income via investment grade bonds and quality dividend stocks, particularly in Asia.

Figure 1:

US non-farm payrolls gains and revisions

Month-over-month change (seasonally adjusted), in thousands

Third less first revision



Source: FactSet, J.P. Morgan Asset Management.



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TOPIC 2:

Large cap versus small cap stocks?

US large cap stocks have outperformed small cap peers thus far in 2025, and this trend may continue.



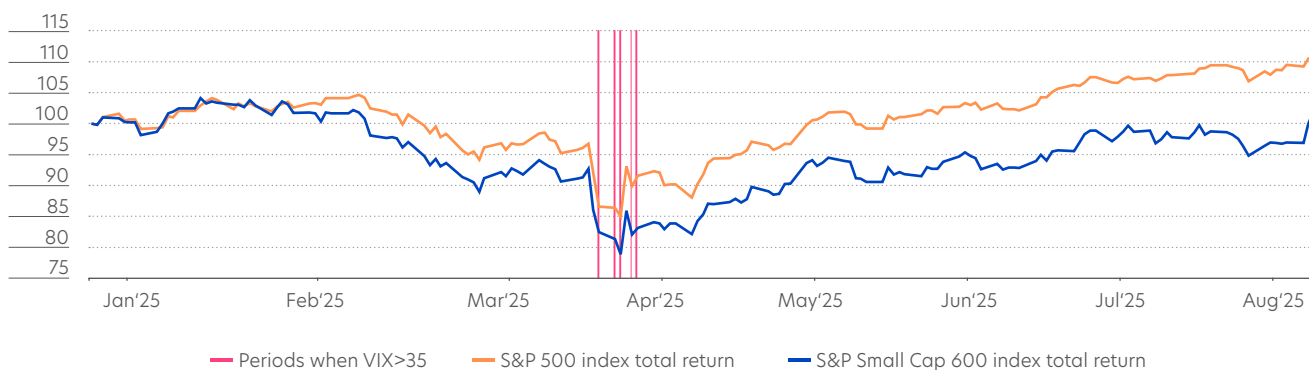
What you can do

- Given the potential slowdown in the US economy and ongoing policy uncertainty, investors should prioritise quality large cap stocks for their resilient corporate earnings and consistent performance.
- The S&P 500 index has continued to hit new highs throughout August despite some signs of a weaker growth environment and unpredictable policy announcements by the US.
- In this backdrop, weakness in small cap stocks has become even more apparent year-to-date. Comparing the total returns of US small caps (represented by the S&P 600 index) against US large caps (represented by the S&P 500 index), small caps have underperformed by 8 percentage points since the start of this year (Figure 2).
- During the most volatile period of this year, when the CBOE Volatility Index (VIX) spiked due to the April "Liberation Day" tariff announcements, there was a performance divergence between large and small cap stocks. Even with a calmer market environment recently due to heightened rate cut expectations, small cap stocks have yet to catch up.
- Small cap stocks face several headwinds that make them less attractive when compared to large caps.
- US tariffs remain much higher than end-2024 levels and increases import costs. Furthermore, small cap companies typically have higher leverage levels reflected by higher net debt to earnings before interest, taxes, depreciation, and amortisation (EBITDA) ratios and more concentrated supply chains.
- These combine to mean small cap companies have limited pricing power, reduced ability to absorb costs and less ability to easily switch or diversify supply chains to deal with unexpected tariff implications.
- As a result, small cap profit margins are reduced as they find it harder to pass on higher costs to consumers and have a higher trade exposure to countries like China, which previously supplied low-cost components that are now subjected to higher tariffs.
- In this backdrop, investors should prioritise quality large cap stocks over small cap peers, due to their comparatively better ability to navigate the tariff impact.

Figure 2:

U.S. large and small caps total return index

Indexed to 100 on 01/01/2025



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management. The CBOE Volatility Index (VIX) or volatility index is often referred to as the "fear gauge" of the stock market. It measures the market's expectation of volatility over the next 30 days. Shaded vertical region refers to periods considered very volatile (more than 35).



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TOPIC 3:

Investing in a declining US dollar (USD) environment

After the USD recorded a sizable depreciation in the first half of 2025, the pace of the currency's weakness may slow in the coming months. Investors should exercise flexibility in portfolio allocation as market conditions evolve.

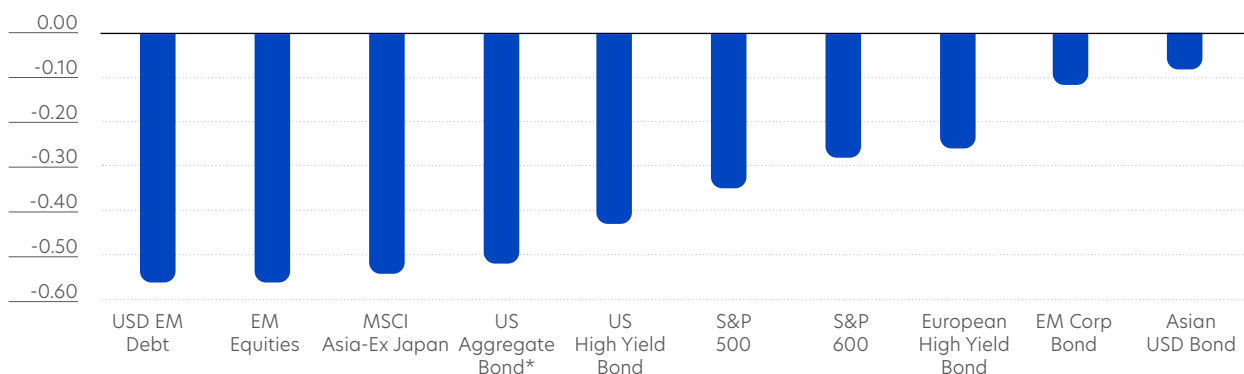


What you can do

- Diversify your portfolio beyond USD-denominated assets by seeking professionally managed fund strategies that hedges currency risks.
- The USD index (DXY) declined 10.7% in the first half of 2025, its worst half-year performance in 50 years. This sharp decline occurred even though the Fed held interest rates unchanged while other developed market central banks eased monetary policy. Factors contributing to the USD's weakness include slower US economic growth, rising fiscal deficits, and policy uncertainty.
- Although we anticipate further near-term weakening of the USD, the pace of depreciation is expected to moderate in the coming months. Nonetheless, it is important to note that the USD remains the dominant global reserve currency due to its critical role in global financial transactions, reflecting its underlying long-term trustworthiness.
- A scenario analysis can help you understand the potential drivers affecting the dollar:
 - **Strengthening factors:** 1) A global recession could trigger a risk-off scenario, reinforcing the USD's safe-haven status; 2) Sustained US growth momentum could signal a return of US asset outperformance.
 - **Weakening factors:** 1) A significant downgrade in US growth expectations compared to other major economies may lead to more Fed rate cuts; 2) US policy uncertainties such as tariffs, an erosion of Fed independence, and significantly higher fiscal deficits, could erode confidence in the USD's value.
- Investors should consider the long-term correlation between asset class and USD performance (Figure 3). A negative correlation implies that returns move in opposite directions. For instance, a decline in US Treasury bond prices often leads to a stronger USD. This occurs because higher Treasury bond yields attract investor inflows, strengthening the USD.
- If your portfolio is heavily tilted towards USD-denominated assets, you should consider professionally managed diversified fund strategies that hedges currency risk. For investors focused on generating income amid a weakening economy, you can consider a hedged global bond fund that reduces the impact of currency fluctuations.

Figure 3:

10-year correlation between asset class and USD performance



Source: FactSet, J.P. Morgan Asset Management. *US Aggregate Bond index is a benchmark that tracks a broad range of US investment grade bonds including Treasury bonds, corporate bonds, and mortgage-backed securities.



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