

GROWTH HOLDS. THE RATE DEBATE RETURNS.

What August employment, rising Treasury yields and the next inflation reports mean for September markets.

A Stronger Economy Complicates the Rate Path

CENTRAL THESIS

The August employment report reduced immediate concern about a labor-market downturn, but it also removed an obstacle to tighter monetary policy. The result is a constructive growth signal paired with a more demanding valuation environment.

+162K

AUGUST PAYROLLS

Versus +56K consensus.

4.1%

UNEMPLOYMENT

Unchanged in August.

3.1%

WAGE GROWTH

Year over year.

4.37%

2-YEAR YIELD

Friday close area.

FIVE CONCLUSIONS

- Payroll growth materially exceeded expectations and both June and July were revised higher, strengthening the near-term growth signal.
- The headline was stronger than the underlying trend: the prior 12-month average payroll gain was only 31,000 before August.
- Labor conditions remain uneven. Participation improved to 61.6%, but remains 0.5 percentage point below January.
- Rates, not recession, are the immediate market constraint. The two-year Treasury yield rose as traders increased the probability of a September rate hike.
- Producer and consumer inflation data on September 10 and 11 now represent the decisive bridge to the September 15-16 Federal Reserve meeting.

BOTTOM LINE

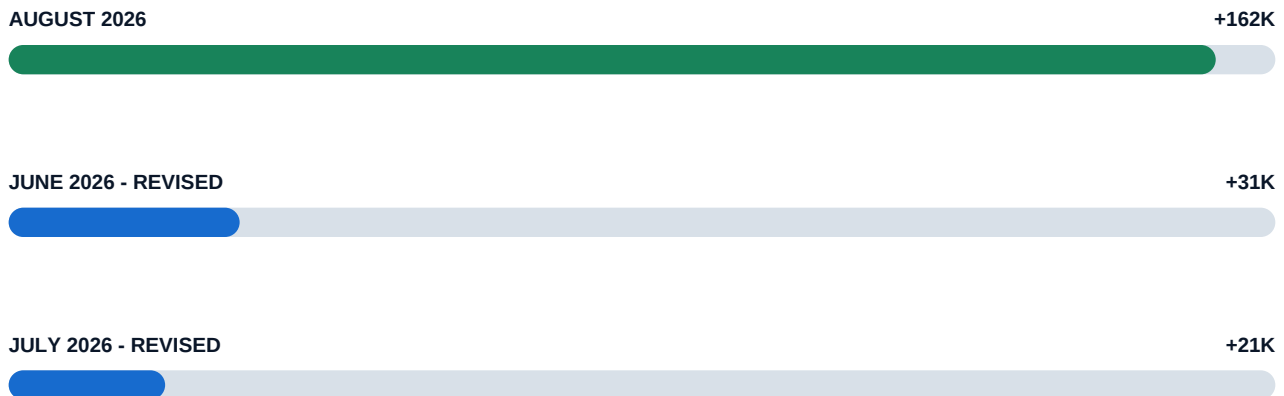
The growth case improved. The valuation hurdle rose. September should reward companies that can deliver near-term cash flows without relying on multiple expansion.

Sources: U.S. Bureau of Labor Statistics; Reuters, Sept. 4, 2026.

The Headline Rebounded Sharply

Nonfarm payrolls increased by 162,000 in August, nearly three times the Reuters consensus estimate of 56,000. June and July were revised higher by a combined 55,000 jobs, reversing part of the summer slowdown narrative.

MONTHLY PAYROLL GAINS AFTER REVISION



REVISION SIGNAL

June was revised from +20,000 to +31,000. July was revised from -23,000 to +21,000. Combined employment for the two months is now 55,000 higher than previously reported.

WHAT THE HEADLINE DOES AND DOES NOT PROVE

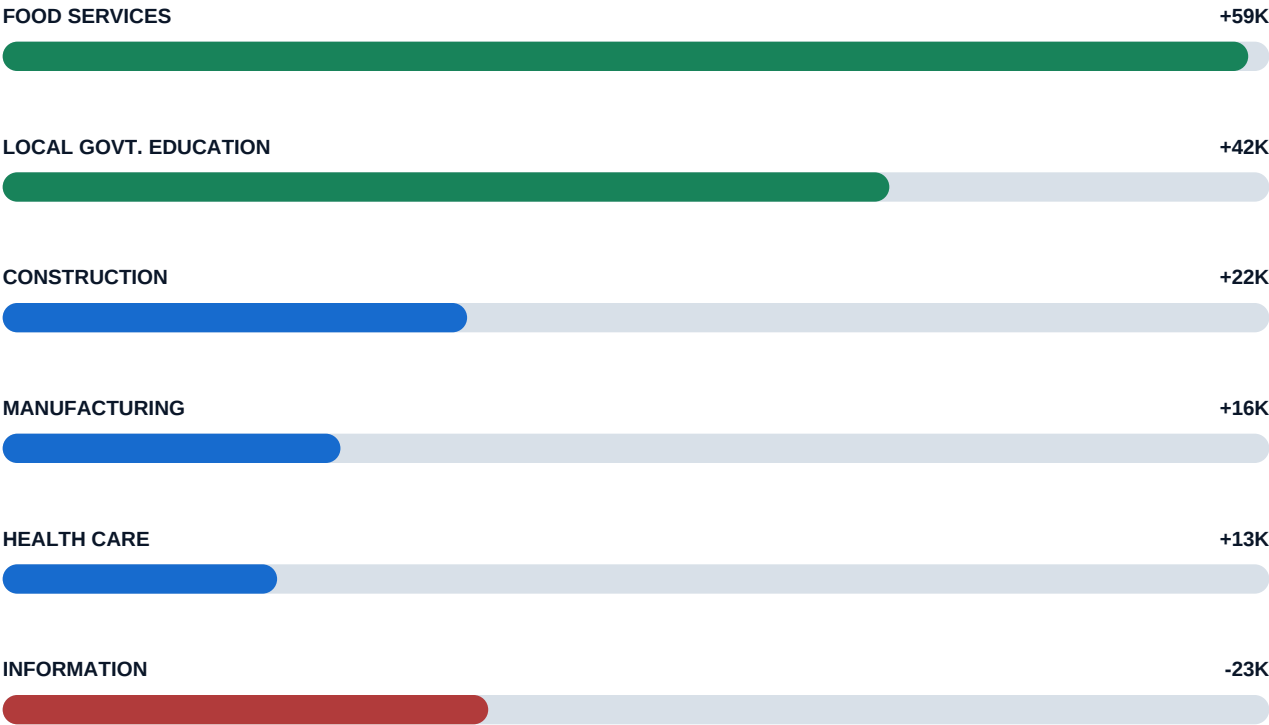
- It reduces the probability that the economy is entering an abrupt employment contraction.
- It supports household income and near-term consumption capacity.
- It does not establish a broad hiring boom; job creation was concentrated and the trailing trend remains subdued.
- It gives the Federal Reserve more room to prioritize inflation risk.

Source: U.S. Bureau of Labor Statistics, Employment Situation - August 2026.

Stronger, but Not Uniformly Strong

The composition of August hiring argues for selectivity. Restaurants and local government education supplied most of the net gain, while information-sector employment contracted.

SELECTED INDUSTRY EMPLOYMENT CHANGES



HOUSEHOLD INDICATORS

61.6%

PARTICIPATION RATE

Up 0.2 point in August.

1.9M

LONG-TERM UNEMPLOYED

27.0% of all unemployed.

4.4M

PART TIME FOR ECON. REASONS

Down 414,000 in August.

Investment implication: aggregate strength can coexist with meaningful sector divergence. Employment composition matters for consumer demand, margins and earnings sensitivity.

Source: U.S. Bureau of Labor Statistics, Employment Situation - August 2026.

Good News Met a Higher Discount Rate

Markets treated the employment report as good economic news but difficult valuation news. Short-term yields rose, the dollar strengthened and major equity indexes declined on Friday.

TREASURY MARKET AFTER THE REPORT

4.37%**2-YEAR TREASURY**

Policy-sensitive yield.

4.78%**10-YEAR TREASURY**

Long-duration hurdle.

57%**SEPT. HIKE ODDS**

Approximate late-Friday pricing.

FRIDAY MARKET RESPONSE

-0.51%**DOW****-0.38%****S&P 500****-0.29%****NASDAQ****+0.25%****RUSSELL 2000**

WEEKLY PERFORMANCE

+0.1%**S&P 500****-0.3%****DOW****+0.4%****NASDAQ****+0.1%****RUSSELL 2000**

CROSS-ASSET WARNING

Brent crude rose 7.6% for the week and U.S. crude gained nearly 10%, according to Reuters. Higher energy costs can reinforce inflation pressure just as the labor market gives policymakers more room to respond.

Sources: Reuters global markets coverage, Sept. 4, 2026; Associated Press index recap, Sept. 4, 2026.

Inflation Is Now the Decisive Gate

The employment report keeps a September rate increase in play, but the next inflation releases should determine whether the Federal Reserve has sufficient evidence to tighten policy at its September 15-16 meeting.

SEPTEMBER CATALYST SEQUENCE

SEP. 10	PRODUCER PRICE INDEX Pipeline inflation and margin pressure
SEP. 11	CONSUMER PRICE INDEX The central policy test
SEP. 15-16	FEDERAL RESERVE Rate decision and forward guidance

SCENARIO MATRIX

COOLER INFLATION	IN-LINE INFLATION	HOTTER INFLATION
POLICY Rate pressure eases MARKET READ Growth equities gain breathing room	POLICY Policy uncertainty persists MARKET READ Earnings quality drives dispersion	POLICY Hike probability rises MARKET READ Multiples and duration face pressure

Sources: U.S. Bureau of Labor Statistics release calendar; Reuters, Sept. 4, 2026.

What the Market Must Prove Next

The strongest labor report in months does not settle the September outlook. It changes the burden of proof. Markets must now absorb inflation data, elevated yields and a potentially tighter policy path while sustaining earnings momentum.

FOUR TESTS FOR RISK ASSETS

01 EARNINGS DURABILITY

Can revenue and cash flow grow fast enough to offset a higher discount rate?

02 MARKET BREADTH

Can performance expand beyond the largest technology companies?

03 INFLATION CONTROL

Can price pressure cool without sacrificing labor-market stability?

04 FINANCIAL CONDITIONS

Can credit, liquidity and funding costs remain supportive?

GENERAL FACTOR SENSITIVITY

EXPOSURE	POTENTIAL SUPPORT	PRIMARY PRESSURE
HIGH-DURATION GROWTH	Strong earnings	Rising real yields
FINANCIALS	Firm activity and curve steepening	Credit deterioration
SMALL CAPS	Broader growth and easier funding	Higher refinancing costs
ENERGY	Higher commodity prices	Demand destruction and policy risk

Watson Capital analytical framework. Factor relationships are directional, not forecasts or recommendations.

Growth Holds. Selectivity Matters More.

WATSON CAPITAL VIEW

The August employment report strengthened the case for continued economic expansion. It also increased the probability that restrictive monetary policy persists. This is not an inherently bearish combination, but it is one that raises the standard for security selection.

1

FOLLOW CASH FLOWS

Prioritize operating evidence over narrative momentum.

2

RESPECT DURATION

Higher yields place greater pressure on distant earnings.

3

MEASURE BREADTH

A healthier advance requires participation beyond index leaders.

4

WATCH THE SEQUENCE

PPI, CPI and the Fed decision form one connected catalyst chain.

5

UPDATE THE THESIS

Conviction should change when the evidence changes.

FINAL INVESTMENT CONCLUSION

September is no longer a referendum on recession risk. It is a test of whether earnings can outrun inflation, yields and a higher required return.

SELECTED SOURCES

U.S. Bureau of Labor Statistics, "The Employment Situation - August 2026," Sept. 4, 2026. Reuters, "Yields, dollar rise, stocks ease after solid U.S. jobs report," Sept. 4, 2026. Associated Press, "How major U.S. stock indexes fared Friday," Sept. 4, 2026. U.S. Department of the Treasury, Interest Rate Statistics.

IMPORTANT INFORMATION

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