

# Webcast Summary



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## 2Q25 Market & Strategy Update

*Proposed trade and foreign policy changes from the new US administration have created uncertainty and volatility in financial markets during the first quarter of 2025, leading to a divergence in fixed-income returns—strong returns from US government bonds and many EM government bonds, contrasted with negative returns from Japanese government bonds and core eurozone government bonds. Spread sectors have provided positive returns but generally underperformed government bonds. The unpredictability of the proposed policy changes has driven a sharp correction in US stocks and the US dollar has weakened. We do see opportunities in this environment, with pockets of potential in DM rates in the eurozone, the UK and Australia. USTs and agency MBS provide important diversification to spread sectors. We also see opportunities in CMBS, and within select investment-grade and high-yield securities.*

### US Economic Outlook

- US growth is downshifting due to a myriad of factors: uncertainty over tariffs, waning benefits from immigration and reduced government spending, among others.
- We anticipate the US economy will see moderation in growth, as opposed to a recession. We see potential positive impacts on the horizon from the extension of tax cuts and a less strict regulatory environment.
- While jobs growth is slowing, unemployment remains low despite federal job cuts. Workers are seeing real incomes continue to grow, supporting consumption. Underlying price increases have recently been benign across both Consumer Price Index (CPI) and Personal Consumption Expenditures (PCE) indicators.
- We think that the impact from tariffs won't be fully passed through to CPI and is likely to have a one-off effect on price levels, rather than cause sustained inflation.
- While slowing, we expect US growth will continue to outpace that of most other developed market (DM) economies.

### Global Economic Outlook

- A significant fiscal boost from EU defense and German infrastructure spending will support eurozone growth and confidence. Negative effects from uncertain tariff measures will be an offset in the near term. The fragile Ukraine ceasefire agreement may lift confidence, and a plan leading to a lasting peace agreement should reduce energy costs further.
- Growth is stagnant in the UK. We expect the Bank of England (BoE) to cut rates by more than the market is discounting.

- In Japan, the economy is expected to grow at 1.5%-2.0% this year. The Bank of Japan (BoJ) will continue to tighten policy to normalize real interest rates due to high inflation.
- Chinese growth continues to decelerate, partly due to ongoing property market challenges. The government and People's Bank of China (PBoC) have signaled a shift in policy to support economic recovery, but deflationary pressure is likely to persist.
- Emerging market (EM) inflation has normalized, and real yields remain high. Political and trade concerns remain in focus as overall tariff uncertainty persists.
- While global growth is downshifting, it remains firmly in positive territory.

### Central Banks

- Overall, central banks should have room to continue cutting rates modestly in 2025.
- The Federal Reserve (Fed) remains well-positioned to provide support if the US economy falters. While the implementation of additional tariffs is likely to delay a return to the 2.0% inflation target, the stance of monetary policy remains restrictive and the trajectory of inflation is still expected to trend lower over the longer term, albeit at a slower pace.
- We expect the BoE to look through the near-term rise in inflation and cut rates more than the market currently expects this year.
- With inflation falling toward the European Central Bank's (ECB) 2% target, we expect two further rate cuts this year. The market is currently expecting rate hikes in the end of 2026 and into 2027, which we see as unlikely.
- The Bank of Japan (BoJ) is the only major central bank that is tightening policy. Japan's shortage of labor, poor demographics and low immigration are seeing wages rise. Higher inflation is expected to lead the BoJ to continue tightening monetary policy to normalize real interest rates, but hikes may occur at a slower pace of once every six months.

### Investment Themes

- **Credit Sectors:** Spreads generally remain tighter than historical averages despite recent widening. We continue to find opportunities within select credit sectors and securities while remaining tactical and cognizant of spread volatility.
- **Investment-Grade Credit:** We are focusing on new-issue opportunities and higher-quality issues with strong fundamentals. We will look to augment existing positions at more attractive levels. We remain positive on banks, specifically European banks.
- **High-Quality, High-Yield Credit:** We believe this cohort provides ample potential given strong fundamentals.
- **Structured Products:** We believe commercial mortgage-backed securities (CMBS) present compelling relative value, considering their improving fundamentals and reasonably attractive valuations.
- **EM Debt:** While the overall uncertain market environment necessitates caution, we do see some longer-term value opportunities in EM local currency debt.

### Q&A Highlights

- Despite the increase in monetary policy uncertainty, market volatility and spreads still trading through historical averages, we are not taking a strong defensive posture. We remain diligent in our fundamental credit research and have taken measures to improve quality to increase our defensive posture and get closer to home. We believe that we're in a good position to take advantage of volatility.

- Although we take potential default risk in CMBS very seriously, significant capital has been raised to compete with multiple bids on stressed offerings. As a result, we believe that the sheer volume of capital that has been raised to take advantage of these types of opportunities will stave off potential default risk.
- As government deficits have risen, so too have concerns about a supply and demand mismatch for the US Treasury (UST) market. So far, households (including hedge funds), mutual funds and pension funds have increased their total share of outstanding USTs, while the Fed, foreign public institutions and US banks have decreased their holdings.
- Eurozone semi-core and peripheral country spreads have remained stable despite the announced increase in defense spending. The proposed 1.5% of GDP increase is an aspiration, not a target, and many countries are likely to fund this spending through EU loans or by repurposing existing cohesion funds to avoid increasing national debt issuance.

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