

4Q25 Market Outlook: Quarterly CIO Webcast

FEATURING



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US growth has slowed, but recession fears have faded. Inflation is trending toward central bank targets. The US labor market has softened, prompting the Fed to resume rate cuts, which has led to declining US Treasury yields. Global yield curves have steepened and spread sectors have outperformed. Our portfolio positioning reflects a more cautious approach, as valuations across asset classes are generally fully valued and opportunities are less abundant than a year ago. We continue to focus on disciplined, fundamental, relative value investing, seeking pockets of opportunity in fixed-income while remaining mindful of technical and macroeconomic risks. In this environment, we favor selective, research-driven bond picking—especially in CLOs, CMBS and local EM debt.

Global Economic Outlook

- Eurozone growth has recently been boosted by trade and the front-loading of tariffs, but these effects are seen as temporary, with risks remaining as unemployment rises in Germany, and France faces industrial threats.
- The UK is experiencing continued softening in the labor market and wage growth, which may create opportunities for investors in UK duration.
- Competition from Chinese imports is accelerating in the eurozone, adding further pressure to regional growth prospects.
- Emerging market (EM) economies are benefiting from attractive real yields and supportive technical inflows, especially in local currency debt, while exposure to hard currency sovereign and corporate spreads has been reduced.

US Economic Outlook

- US growth has slowed since the announcement of tariffs, but recession fears have dissipated.
- The labor market has softened, with the Federal Reserve (Fed) now more focused on employment risks than inflation.
- Wage growth, layoff rates, and job openings suggest normalization rather than outright contraction.
- Unemployment is notably rising among 20–24-year-olds, possibly due to AI or other factors, though the cause is still unclear.
- The income disparity is widening, with lower-income cohorts struggling more than others, even as sectors like travel and hospitality show persistent strength.

Inflation

- Global inflation has generally trended toward central bank targets, with the ultimate destination expected to be lower from current levels, despite recent disruptions from tariffs.
- The ultimate destination for US inflation is expected to be lower from current levels over the next several quarters.
- Tariffs have been a significant driver of recent US inflation trends, with companies now passing on higher costs to consumers and headline inflation potentially stalling or rising in the near term.
- Achieving the Fed's 2% inflation target may prove stubborn and take longer than anticipated, but the overall trajectory for inflation is still expected to be downward.

Central Banks

- The Fed and other major central banks have cut rates in response to slowing growth, softening labor markets and inflation trending lower.
- We expect central banks to lower policy rates further, with the Bank of Japan an outlier, continuing to hike and normalize rates.
- The Fed's focus has shifted from inflation to labor market risks, especially after recent payroll revisions and signs of employment weakness.
- Achieving further rate cuts may become more difficult and data-dependent as the gap between current policy rates and long-term neutral rates narrows, particularly heading into 2026.

Investment Themes

- Investment-Grade Credit: Fundamentals remain strong, but accelerating M&A activity presents mixed risks, including potential credit downgrades; close monitoring of covenants is essential.
- High-Yield Credit: Higher-quality issuance and a bias toward refinancing are positive trends; M&A activity generally benefits high-yield, which also features stronger protections.
- Private Credit: Stress signals are increasing, such as increased pay-in-kind interest payments and rising defaults; lower-quality issuance is migrating to private credit, warranting close monitoring.
- Structured Products: Collateralized loan obligations (CLOs) and commercial mortgage-backed securities (CMBS) offer relative value opportunities, supported by improving underlying quality.

Q&A Highlights

- Government shutdowns have historically had limited market impact, with most lasting fewer than five days. While the current shutdown could be longer, markets appear to be taking it in stride.
- There is risk both in the Fed delaying rate cuts and in cutting too quickly, and the Fed remains highly data-dependent.
- Fundamentals guide credit positioning, and spreads are consistent with supportive fundamentals. Significantly tighter spreads are possible but not likely, so the focus remains on incremental coupon and idiosyncratic opportunities.



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