Fixed Income Outlook

| 3Q25

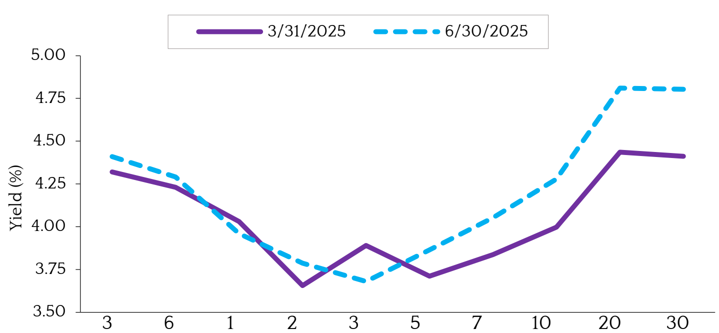
Key Takeaways:

1. **Despite heightened economic uncertainty in the second quarter, bond markets remained resilient. Investment grade bond returns were largely positive across maturities as falling credit spreads offset rate increases.**
2. **The yield curve retained its unusual "U" shape as long-term rates rose on inflation concerns while short-term rates remain anchored by Fed policy.**
3. **The Fed remained in a "wait and see" approach, as stable inflation and continued labor market strength is offset by the uncertain impact of several of the Trump administration's fiscal policies.**
4. **We continue to believe fixed income offers a compelling opportunity for investors, as bond yields remain attractive with ample liquidity in high-quality issues. We aim to build portfolios that offer liquidity, strong credit ratings, and principal protection.**

During the second quarter, the bond market faced uncertainty due to tariffs and widely diverging forecasts for economic results. However, investors were resilient, adopting a skeptical view of recently announced, though not yet enacted, fiscal policies that are expected to be inflationary. Bond returns were positive, and the investment grade market traded with ample liquidity. It was an excellent period for bondholders.

The yield curve retained its unusual "U" shape throughout the quarter, even as longer-dated yields increased. Long-term interest rates rose amid investors' fears that pending fiscal policy changes could induce higher levels of inflation. These concerns include not only tariff actions but forthcoming budget legislation as well. Meanwhile, short-term rates have been anchored by the Federal Reserve, who remains in a "wait and see" posture as these policies evolve.

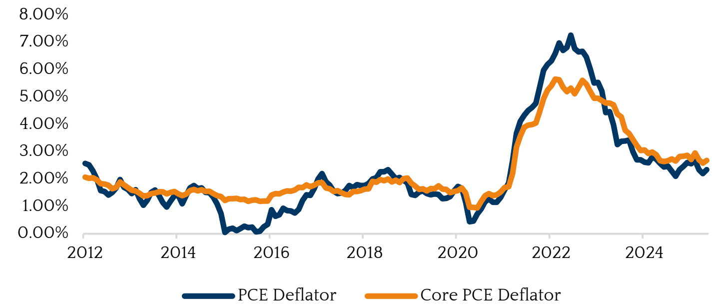
Figure 1 U.S. Treasury Yield Curve on March 31, 2025 & June 31,2025



Source: Bloomberg as of 6/30/2025

Overall, the Fed has been a neutral observer of recent macroeconomic trends. Board members noted that inflation continues to be above its long-term objective. Yet, the current level of inflation has not shown a strong upward or downward trend. Employment remained solid with an unemployment rate hovering near 4%, a solid level by many standards. Additionally, GDP growth has been positive and healthy, underscoring the strength of the current economy.

Figure 2 YoY Personal Consumption Expenditures Price Indices 2012-2025



Source: Bloomberg as of 6/30/2025

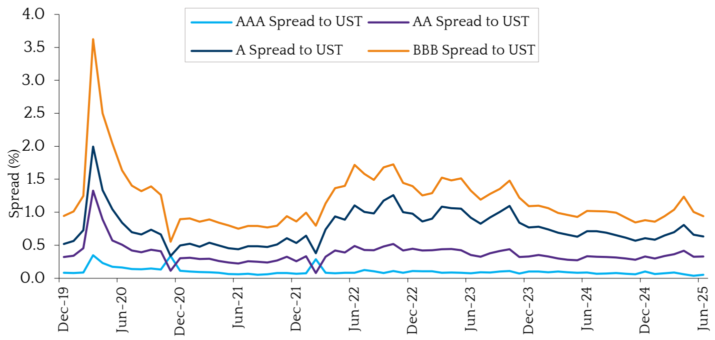
Given these factors, we find it unsurprising that the Fed has held rates steady. They have been unmoved by the myriad fiscal policies introduced by the Trump administration, perhaps due to wavering deadlines and frequent changes of direction. With all of this uncertainty, both the Fed and investors have found it challenging to discern trends and future developments. While some view their inaction as a political statement, their decisions were grounded in economic data rather than ulterior motives.

As we look ahead, we do not expect the Fed to adjust monetary policy unless economic data clearly indicate a need. Inflation figures, which have stayed benign so far, may respond more quickly to tariff policies and fiscal budget changes. Shifts in employment levels will take longer to materialize in official statistics. We anticipate that the Fed will be patient before implementing any policy changes.

Credit spreads, or the additional yield required by investors to compensate for default risk, remain very narrow. The ongoing search for yield has compressed spreads to historically rich levels. They have also shown less volatility than expected given the turmoil around tariffs, suggesting that current spread levels may persist. Overall, spreads are too narrow, and investors are not being adequately compensated for the risks they are shouldering.

Past performance is not indicative of future results. There is no guarantee the observations and trends described herein will continue.

Figure 3 Intermediate Investment Grade Credit Spreads (OAS) by Quality Rating Cohort December 2019 to June 2025



Source: Bloomberg as of 6/30/2025. UST = US Treasuries

Second quarter 2025 performance data show that corporate bonds outperformed government-guaranteed issues by a substantial margin. Even AAA-rated Corporate bonds surpassed U.S. government and agency securities. Within the Corporate bond sector, lower-quality issues prevailed over higher-quality issues as investors continue to chase yield. These dynamics also held true for the year-to-date performance period.

We continue to purchase high-quality, investment-grade bonds for our clients' portfolios. Despite the unusual yield curve, we believe yields remain attractive and high-quality bonds are liquid. We aim to strike a balanced allocation between Corporate bonds and U.S. Government-guaranteed issues. Our objective is to build portfolios that offer liquidity, strong credit ratings, and principal protection.

John Beaver, CFA© | Portfolio Manager

Important Disclosure