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FIRST QUARTER, 2025 — *Investment Review*

FIXED INCOME OVERVIEW

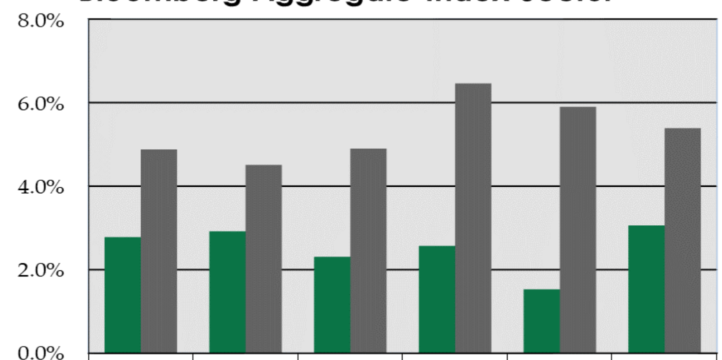
The U.S. bond market rallied as interest rates across the Treasury yield curve fell, driven by slowing inflation and concerns about future economic growth. A late-quarter tariff uncertainty-related selloff pushed the more sensitive areas of the bond market wider, while U.S. Treasuries and Agency debt held up quite well.

The Bloomberg Aggregate Index gained 2.78% in the quarter, primarily driven by the aforementioned Treasury and Agency Mortgage-Backed Securities (MBS) debt. Generally speaking, however, it was a decent quarter for most sectors within the investment-grade bond market. Corporate bonds failed to keep pace with the indices, as heavy new issue supply coupled with growing investor uncertainty led corporate bonds to finish up 2.31%. The Bloomberg Intermediate Govt./Credit Index finished up 2.42%, while the short duration Bloomberg 1-3yr. Govt./Credit Index returned 1.63%.

Article Highlights

- Tariff uncertainty hits risk assets
- Credit Spreads drifted wider but are still tight
- Resilient Labor Market
- Inflation is slowing

Bloomberg Aggregate Index Sector



	INDEX	Tsy	Corp	CMBS	ABS	Agency MBS
Q1 25'	2.78%	2.92%	2.31%	2.57%	1.53%	3.06%
Last 12 Months	4.88%	4.51%	4.90%	6.46%	5.90%	5.39%

Source: Bloomberg

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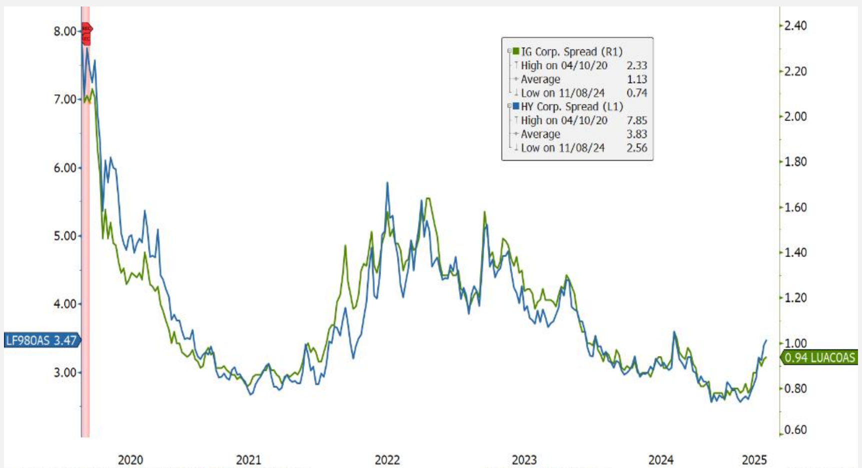
Credit Spreads

Investment-grade corporate credit spreads (green line) widened about 15 basis points as tariff-related economic uncertainty and rising delinquencies on cards and auto loans gave investors pause. IG spreads finished the quarter at 94bps after starting the year at compressed levels in the low 80s. High-Yield bonds also exhibited weakness as investors moved to calmer waters, as spreads widened 60bps to close at 347bps. The chart below shows that the markets are trading closer to longer-term levels, which is expected, given the uncertain backdrop. If anything, the late-quarter spike in high-yield spreads speaks volumes. In this case, the trend is not your friend, but perhaps, in time, there will be deals to be had.

Credit Spreads

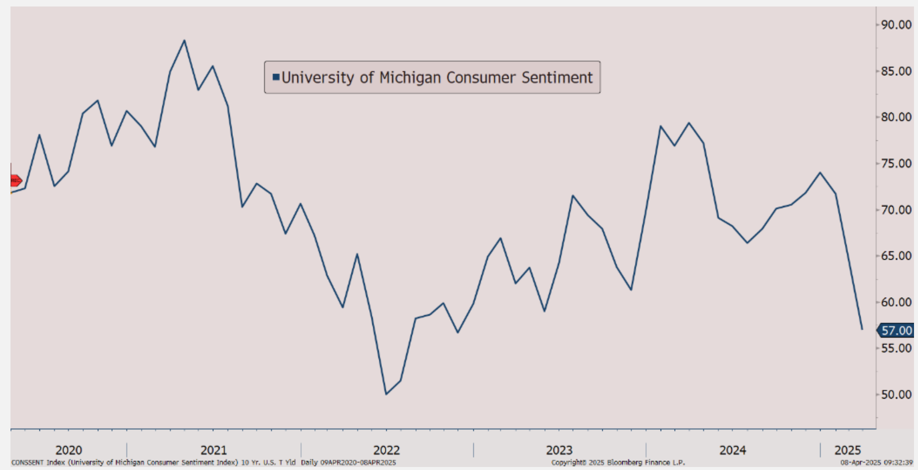


Source: Bloomberg

The Economy

Resilient but slowing continues to describe the current state of our domestic economy. Employment remains strong despite the numerous headlines from Washington, D.C., and the DOGE. The most recent Nonfarm Payrolls report exceeded expectations, adding 228,000 jobs, its most substantial number since December 24. The number of job openings vs. unemployed appears to moderate at just over one, indicating a market that has found equilibrium after a yo-yo-like post-pandemic run. Meanwhile, GDP growth continues decelerating, with December's 2.5% annualized growth throwing a few cautionary flags. We would be remiss not to point out that near the end of February, the Federal Reserve Bank of Atlanta revised its growth forecast to negative numbers, as weaker consumer sentiment and spending combined with what will likely be a bumpy rollout of trade and tariff policy. Consumers still appear concerned with inflation, which is justified by recent experience.

Consumer Sentiment

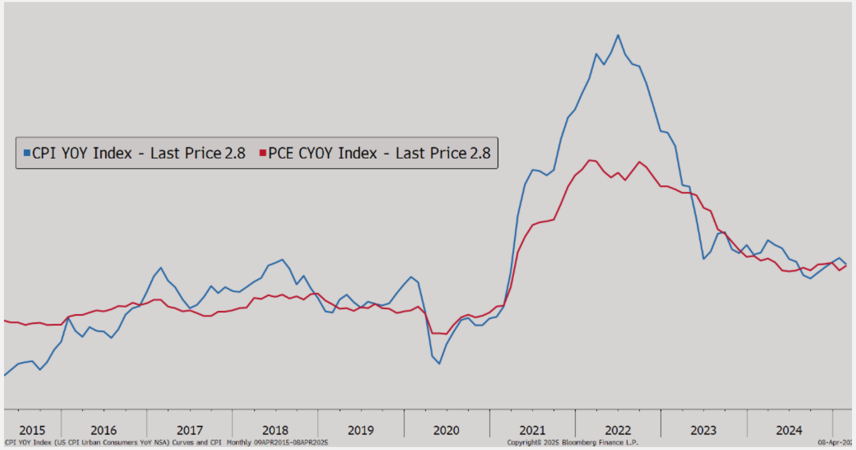


Source: University of Michigan, Bloomberg

Fiscal and Monetary Policy

Speaking of interest rates, the Fed Funds Futures market began the year expecting two cuts totaling 50 basis points in 2025, a status quo outlook if there was one, especially given market participants' prior optimistic view of Fed policy. The headline CPI (blue line) has remained between 2.4% and 3.5% during the last year, while income and expenditure levels have remained relatively stable.

PCE and CPI Converge



Source: Bureau of Economic Analysis, Bureau of Labor Statistics, Bloomberg

Core PCE (red line in the above chart), the Federal Reserve's preferred inflation gauge, registered a 2.8% reading, slightly higher than January's 2.7%. This reminder suggests that while readings are no longer in the 3% range, they are also not in the low 2% range. The Fed still finds itself in a tricky spot, as it seemingly does not want to remain hawkish, given that the economy is slowing while angst is on the rise. Barring a catastrophic policy error, the Fed will likely stay data-dependent and on the sidelines, even while acknowledging restrictive policy.

Second Quarter, 2025 STRATEGY

The impact of a new trade policy will take center stage throughout the second quarter. Predicting an exact timeline or magnitude of the detail is difficult at best and impossible at worst. Therefore, we look to maintain our somewhat cautious approach to fixed income risk. We will, however, remain slightly lower in duration than our respective indices as we feel inflation could take a leg up.

With investment-grade corporate spreads widening and an uptick in volatility, we do not feel the current environment suggests overly aggressive positioning. That said, we do feel like the valuation backdrop is improving. We will look for opportunities in credits we like with a history of good cash flow generation. The domestic utilities sector, a current overweight and outperformer for us, could be used to fund a move into other sectors and names that have previously underperformed. We will likely remain somewhat cautious in more cyclical sectors as tariff resolution and the ultimate effect on the economy still need to play out.

Within CMBS, we are sticking to bonds at the top of the stack. 2-5 year last cash flow deals appear interesting as they've traded flat to 10-year LCFs due to concerns about refinancing the underlying loans. Yet, the sharp decline in rates should mitigate this concern somewhat (although, admittedly, a slowdown in the economy would also reduce NOI for many properties). In ABS, we have seen very little selling, and dealers have held their offers. But, we look to add to hyperscale datacenter ABS on a significant widening. The sector has underperformed this year after outperforming in 2024, mainly due to negative headlines around AI demand. The workloads of hyperscale data centers in ABS are almost entirely devoted to non-AI applications, and data center demand is still running well ahead of supply; therefore, the fundamentals for data center ABS remain solid.

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