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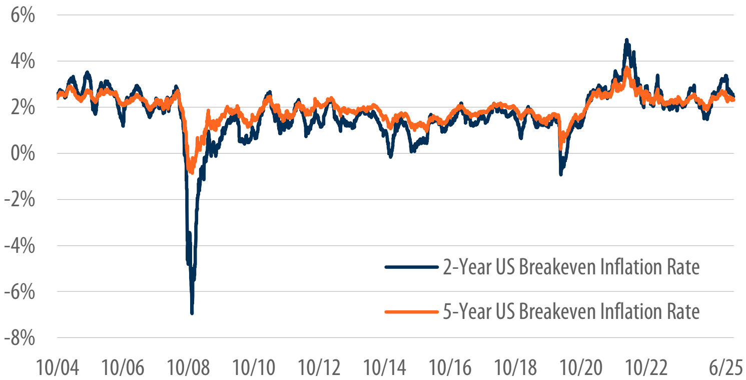
Chart 1: Inflation Breakevens

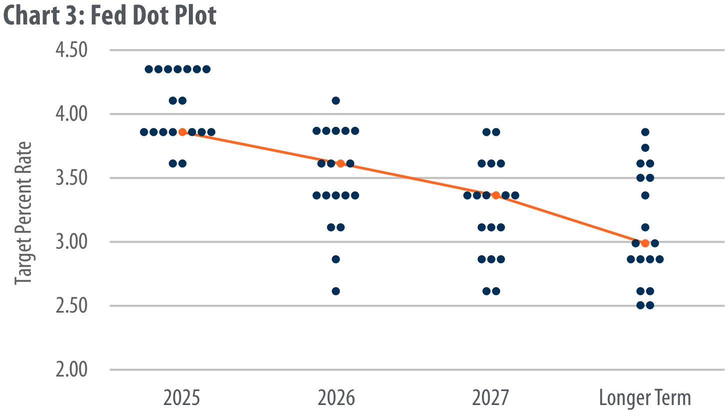


Source: Bloomberg. Data from 10/27/2004 to 6/30/2025. The breakeven rate is a market-based gauge for the expected annual inflation. Past performance is no guarantee of future results.

Chart 2: 10-Year U.S. Treasury Real Yield

Source: Bloomberg. Data from 8/3/1998 to 6/30/2025. **Past performance is no guarantee of future results.** Real Yield is an interest rate that has been adjusted to remove the effects of inflation. Real Yield is calculated as the difference in yields between U.S. Treasury bonds and Treasury Inflation-Protected Securities (TIPS).

Chart 3: Fed Dot Plot



Source: Bloomberg. Data as of 6/30/2025. Orange dots are the median of the Federal Open Market Committee Dots.

In the famous movie Groundhog Day, Bill Murray's character, Phil Connors, wakes up repeatedly to the same song, "I Got You Babe" by Sonny & Cher, trapped in an endless loop reliving the same day. Similarly, bond investors might feel they've experienced their own "Groundhog Day" in the second quarter of 2025. Despite the wild market swings in 2Q, we now wake up to a new quarter with credit spreads (valuations) basically back to where they started.

Over the quarter, inflation expectations have notably eased from their March and early April highs. Specifically, the bond market's inflation expectation for the next two years fell sharply from 3.28% at the end of the first quarter to 2.45%, while its expectation for the next five years declined from 2.63% to 2.31% (Chart 1). The elevated inflation expectations early in the quarter were influenced by President Trump's "Liberation Day" tariff policy. However, Trump's pausing of tariff increases (except on China), along with supportive inflation data, helped to lower the market's inflation expectations. Additionally, the price of West Texas Intermediate crude oil has since declined from $71.48 per barrel at the start of the quarter to $65.11 by June 30, 2025, further underpinning lower forward inflation projections.

The policy proposals in the "One Big Beautiful Bill Act" recently led to a steeper yield curve as the bond market reacted to its fiscal implications. However, we believe the combination of pro-growth policies, deregulation and discretionary budget cuts to follow later this year are likely to mitigate the deficit spending over time. Given this backdrop, we believe real yields (the "extra" money an investor earns after taking away the effects of inflation) are compelling. With the 10-year U.S. Treasury real yield near 2%, (Chart 2) in our view, bonds offer reasonable shock absorption—even if inflation remains somewhat sticky due to lingering tariff-related price pressures. These attractive real yields act as a buffer, providing potential protection against short-term inflation volatility.

Recent updates from the Federal Reserve ("Fed") underscore their balancing act: taming inflation without derailing economic growth, while signaling a prolonged path to sustained price stability. In our view, the Fed currently appears overly preoccupied with what "might" happen rather than responding to current data trends (Chart 3). With real yields at these levels, the Fed retains sufficient flexibility for further interest rate cuts. Ironically, their cautious "wait and see" stance regarding tariff impacts on inflation may inadvertently slow economic growth due to delayed policy effects.

Just like Phil Connors repetitiously awaking to the same alarm clock and song in Groundhog Day, bond investors find themselves balancing familiar risks and opportunities once again. Given attractive real yields, diminished near-term inflation expectations, and the Fed's capacity for further rate reductions, we maintain cautious optimism. Our investment strategy continues to favor intermediate-duration bonds, maintaining market-weight duration relative to the Bloomberg U.S. Aggregate Bond Index, as this positioning provides durability in an uncertain economic environment. Additionally, we are selectively seeking opportunities across a wide spectrum of credit quality. We believe discipline and adaptability will be key to successfully navigating the ongoing market uncertainty.

SECTOR POSITIONING

Ultra-Short Maturity

The Fed maintained its projection for two, 25 basis point cuts this year, with just one more expected in 2026. In contrast, markets are pricing in closer to five cuts by the end of 2026. We believe the Fed will remain data-dependent, adjusting monetary policy in response to incoming data, and that front-end rates will likely respond in kind. In our view, yields remain attractive on short maturity securities. We believe these conditions will continue into the second half of 2025. In this environment, ultra-short investments will continue offering principal preservation as well as a real yield that is attractive and beneficial within an investment strategy.

Mortgage-Backed Securities

We believe mortgage-backed securities (MBS) serve as a ballast relative to broader credit markets during a potential correction in risk assets or a recession. Agency MBS spreads widened since March and are notably above their long-term averages. Given the prevailing market volatility, we prefer a defensive approach, but also mortgages more broadly and would be selective about opportunistically taking positions that seek to enhance yields in commercial and non-agency securitized sectors.

U.S. Treasury Securities

The Fed's interest rate projections for 2025 remain unchanged from March, but they slowed their pace of cuts in 2026. We believe the short end of the yield curve is properly priced for expected Fed easing this year, but the long end of the yield curve may be a good value for longer-term investors. In the near term, government policies (tariff, budget/deficit) are likely to continue to introduce volatility. However, over time we expect the benefits of higher real yields and softer data on growth and employment to eventually feed through and outweigh these concerns.

High-Yield Bonds

High yield bonds are yielding well above the 15-year average and are at levels that have historically generated strong forward returns. In fact, forward 12-month returns have only been negative one time (-0.17%) in that time frame with starting yields above 7%. After widening sharply in April, high yield spreads have compressed but remain above recent lows. The asset class is well positioned for present risks, with limited tariff exposures owing to predominantly domestic revenues and supply chains. In the event of economic deterioration, our analysis indicates that current yield levels can provide a buffer against spread widening over time, especially considering the high yield market's increased composition of BB-rated (higher-quality) credits relative to history. Furthermore, declining interest rates, which often accompany periods of volatility, may also contribute additional support. We believe that an active management approach, focusing on higher-quality issuers, may allow for opportunistic investing given current macro uncertainties.

Senior Loans

Senior loans remain compelling, delivering top-quartile yields relative to their historical range and outpacing the yield of most other fixed income sectors, as the pace of rate cuts has slowed and the economy demonstrates resilience. Elevated inflation risks from trade policy and geopolitical instability may prompt the Fed to extend its pause, which we believe would further support the floating-rate structure of senior loans. Meanwhile, corporate default rates are low, which we believe reinforces the asset class's appeal in today's uncertain environment, particularly in an actively managed framework.

Emerging Market Bonds

There was a significant rally in emerging markets assets during the second quarter of 2025, driven by the declining U.S. dollar and strengthening emerging markets currencies. The U.S. dollar has come under pressure due to various factors, such as trade concerns, policy uncertainty, and improving economic prospects for the rest of the world, including Europe and China. Due to the continued high valuation of the U.S. dollar relative to both developed and emerging market currencies, it remains vulnerable to this ongoing uncertainty. With sentiment now shifting towards a weaker U.S. dollar, there is potential for further depreciation. The ongoing financial and trade tensions between the U.S. and China add to this uncertainty. We remain positive on emerging market local bond valuations driven by cheap emerging market currencies and high real interest rates.

Investment Grade Corporate Bonds

Investment grade corporate bond yields remain compelling relative to historical norms over the past 15 years, offering attractive income opportunities in a still-elevated rate environment. We believe these yield levels continue to provide a solid foundation for credit spreads, which currently sit near their 12-month average. Fundamentals remain broadly healthy and supportive of the asset class, in our view. That said, we anticipate growing divergence in valuations between cyclical and non-cyclical sectors as the economic cycle matures—making credit selection increasingly important. We believe risk to be more concentrated in the long end of the yield curve, where spread duration is greater and sensitivity to macro shifts is higher. In contrast, we see more compelling relative value in short- and intermediate-term investment grade bonds, where credit fundamentals are better insulated, and interest rate risk is more manageable.

Preferred Securities

Performance between retail and institutional preferred securities have diverged over the last three months with retail lagging causing valuations to widen. Looking forward, we believe that the combination of high-income potential, improved valuations, and the high-quality issuer base provides insulation against a weaker economic environment or geopolitical turmoil, characterized by lower rates and wider spreads. The recent first quarter of 2025 earnings season concluded with little change in credit fundamentals across the major sectors in the preferred market (banks, insurance, utilities, energy). We believe most return will likely be in the form of income until market volatility subsides and the Fed begins cutting rates again.

Municipal Fixed Income

Our base case scenario projects positive total returns for ultra-short and short-duration municipal bond strategies in third quarter of 2025, driven by a supportive technical picture with an imbalance between supply and reinvestment. Further out the municipal bond curve, we remain cautious due to the potential for higher U.S. Treasury interest rates, which could reverse municipal fund inflows. While a summer rally is historically expected in municipal bonds, for the third quarter of 2025 we maintain a cautious posture. Overall, our credit and return outlook remains positive but guarded due to uncertainty regarding the duration, magnitude and breath of tariffs and the impact on inflation coupled with the final composition of the "One Big Beautiful Bill Act" pending before Congress.