

## Positioned for a Bond-Friendly Environment

### Fixed income offers attractive yield and total return potential with easing monetary policy, but credit selection is critical amid tighter valuations.

The economic backdrop for portfolio positioning is broadly supportive for fixed income, with solid growth and moderating inflation. Our baseline U.S. economic outlook projects an economy closer to equilibrium by the end of 2026, supported by strong productivity growth, artificial intelligence (AI) business investment, and some fiscal stimulus early in the year. We expect sticky core inflation will ease in the second half of the year as tariff pass through fades and rent and wage pressures cool. Lower inflation should allow the Federal Reserve (Fed) to resume rate cuts later in the year to a neutral rate of 3 percent, helping ease pressure on interest-sensitive industries.

### Credit and Risk Positioning

Our investment approach is guided by key market dynamics: Real yields are very attractive; the Fed is easing; credit spreads are near historic tightness with little differentiation between high and low quality securities; investor demand for credit is robust, absorbing heavy issuance; and corporate fundamentals are strong, with divergence among industries more vulnerable to tariffs and interest rates.

In this environment, our positioning remains primarily defensive, prioritizing income generation and diversification. We prefer higher quality credit, particularly structured credit, where spreads remain wider relative to fundamental risk, and defensive assets like infrastructure and energy, which offer some inflation protection and downside resilience. We favor high carry instruments, including non-Agency residential mortgage-backed securities (RMBS), senior collateralized loan obligations (CLO) tranches, and commercial asset-backed securities (ABS). In corporate credit, we prefer investment grade financials, where supply is expected to remain stable, as well as select industrial and utility credits. We are maintaining liquidity to take advantage of market overshoots when they occur.

### Duration and Interest Rate Views

The Treasury yield curve has steepened dramatically and, if expectations for the Fed's terminal rate declines further, we would expect more steepening, as upward pressure from growing fiscal deficits keeps long rates elevated, and the 10-year Treasury yield remains rangebound between 3.75 and 4.75 percent. In this steeper curve environment, we are positioning a bit further out on the curve, including in longer maturity Treasury Inflation-Protected Securities (TIPS), enabling roll down—or price gains as time to maturity shrinks and yields decline—to become an additional driver of return. We are also taking positions in short maturities and tactically rotating in and out of the 10-year tenor as it moves within its range. Divergent global central bank policies create additional opportunities in sovereign markets outside the United States.

As the Fed balances sticky inflation against a softening labor market, and downside risks to a stabilizing economy remain prevalent, higher quality credit offers attractive real yields, potential price appreciation, and portfolio diversification. Still, with credit performance diverging across industries and spreads remaining tight, active selection and risk management are critical.

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