

Global Fixed Income Strategy

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Non-US exposure may enhance income, expand diversification and elevate total return potential

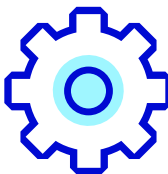
We believe global economic trends and policies provide a positive backdrop for non-US assets.



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Major rates and currencies 3-month outlook

We are overweight Australian and UK interest rates and neutral on US, European, Chinese and Japanese rates. We are overweight the euro, Chinese renminbi, Japanese yen and Australian dollar and underweight the US dollar and British pound.



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The US municipal market offers compelling tax advantaged yields, in our view. We highlight three sectors where we see opportunities.



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US economic resilience and strong market technicals have supported investment grade this year. Solid corporate fundamentals could support continued positive performance.

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Global macro strategy

Non-US exposure may enhance income, expand diversification and elevate total return potential

This year's market gyrations offer investors an opportunity to re-examine their portfolio risks – the US dollar's swoon has shown investors that they are likely over-exposed to the US dollar and missing out on the potential benefits of incorporating some non-US exposure.

We believe considering a wider opportunity set beyond a single market like the US is inherently beneficial in driving excess return because of the many opportunities to choose from across interest rates, yield curves, and relative country positions. The dominance of US markets has overshadowed other market opportunities over the past decade, but given the economic and policy divergences we see developing globally, we believe the non-US opportunity set is especially ripe.

Macroeconomic trends and policies favor non-US exposure

We believe current economic trends and policy responses have created a positive environment for both market and excess return. Interest rate volatility has declined sharply as global central banks have lowered policy rates and will likely continue lowering them. The US dollar's high valuation on a historical basis is starting to weigh on it and, given the large US exposure accumulated in portfolios over the past decade, this has recently led to the diversification of the marginal investment dollar. Flows into US dollar assets have shown signs of slowing, and we believe this trend will continue.

The current global economic cycle reflects economies and policy responses that are not synchronized in timing and magnitude; hence, country outcomes are likely to be divergent. Fundamentally, US policies are forcing all countries to re-evaluate their own domestic policies and reduce their reliance on the US to power global growth.

Developed market rates: Steeper yield curves offer opportunity

We believe the opportunity in rates globally is extremely attractive at this stage. In the US, the yield curve is relatively flat, and the market is pricing in almost 100 basis points of rate cuts over the next 15 months, which we believe will be delivered; however, the excess return from the expected move will likely be limited. In contrast, in Europe, we are at the end of the easing cycle and yield curves are much steeper, so even currency-hedged positions can offer a significant advantage over US rates. The same is true in Japan and Australia, where the steepness of the yield curves makes it attractive to extend into longer maturity bonds.

Emerging markets (EM) local debt: Potential for lower policy rates

In EM, we believe the opportunity to benefit from potential declines in interest rates is attractive. We expect the linkages between the US dollar and global monetary policy, especially in EM, to be a key driver of rate returns. Rate returns are dependent on the level of rates and the slope of yield curves, in addition to the direction of monetary and fiscal policy. There are several markets where monetary policy remains extremely tight, and, as the US Federal Reserve (Fed) eases policy and the US dollar likely weakens further, we see significant opportunities for EM central banks to further reduce their policy rates.

Credit: Tight valuations point to fewer opportunities

We are finding fewer opportunities in credit. Given our economic outlook and increasing risks, we find credit risk to be fully priced in the US and fairly priced in Europe and EM. We are cautious on US high yield, EM hard currency sovereigns and credit in general. While EM countries have improved their credit profiles over the years, the risk/reward relationship remains weak, in our view, given that spread levels are historically tight.

Currencies: Stable-to-weak US dollar offers additional total return potential

Within global markets, the US dollar dynamic has undergone the greatest change over the past six months. As we have seen on numerous occasions, when global growth is led by non-US countries, the US dollar tends to weaken. We believe the current policy mix within the US is turning dollar-negative.

We anticipate that the three primary drivers of the US economy will continue to be tariffs, affecting inflation and fiscal policy, the tax bill, affecting fiscal policy, and immigration, affecting the labor market. These three elements each increase economic uncertainty, and we expect their net impact to be lower potential growth and increased inflation. This is likely to be countered to some degree by a generational investment cycle in technology, data, and AI, which we expect to buoy the US economy and offset some of the policy effects. Nevertheless, the combination increases uncertainty and likely the volatility of economic outcomes. Lower growth, higher inflation and lower Fed policy rates could cause the US dollar to weaken further – in an orderly or disorderly manner – but more importantly, it significantly reduces the probability of a stronger US dollar.

For the past decade, the outperformance of US equities drew capital into the US, leading to US dollar appreciation. As a result, foreign investors benefited from holding US assets either unhedged or partially hedged, as both the underlying asset and the currency appreciated. Consequently, investors outside the US currently hold a large amount of dollar assets and investors inside the US hold relatively few assets abroad. We believe this dynamic is beginning to shift. As foreign investors scale back US allocations or repatriate capital, demand for US assets, and by extension the US dollar, may soften – further supporting global fixed income.

We have started to see this flow dynamic in countries with significant external asset positions, such as Taiwan. We expect this shift in flows to broaden given the size of the positions; the US negative net international investment position is more than USD30 trillion, which is the aggregate surplus held by other countries. Given the difficulty in hedging such large exposures, we would expect marginal global investment to be diversified away from the US, allowing foreign currencies to appreciate to their fair values.

As a result, we are finding significant opportunities to benefit from anticipated US dollar weakening. A weaker US dollar also allows other central banks, particularly in EMs, such as Mexico and Brazil, to reduce interest rates without concerns about causing domestic currency weakness. This feedback loop further enhances the benefits of allocating to non-US exposure.

Conclusion

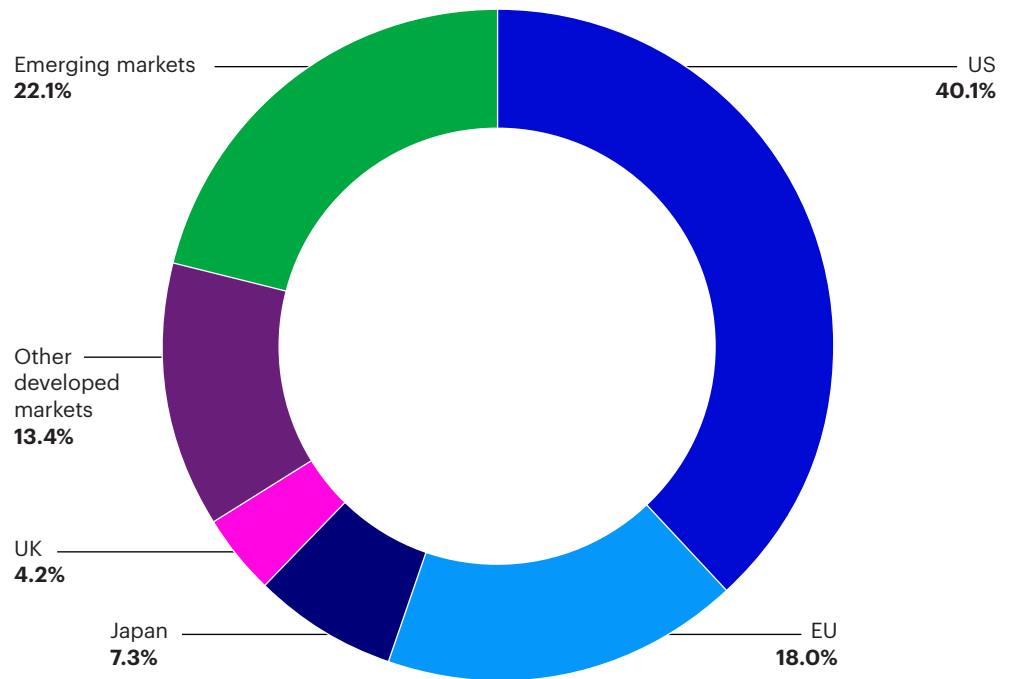
We believe different economic outcomes and policy shifts unfolding across the globe create multiple opportunities to generate alpha through active management in global portfolios. We currently see the best opportunities in foreign currencies, followed by rates and then credit.

We believe short-dated (five-year and under) government and credit securities in the US, Europe, Canada, Mexico and Brazil are particularly attractive, along with longer maturity bonds in Australia, Japan, South Africa, and India. We see potential opportunities emerging in Indonesia and Poland.

In credit, we find short-dated corporate bonds in the US, UK, and Europe compelling, both lower rated investment grade and higher quality high yield. We also see opportunities in structured credit in the UK and Europe, where the steepness of the yield curve provides a significant yield advantage, even on a hedged basis.

Given US assets' strong performance and flows over the past decade, investors are likely under-allocated to non-US fixed income, and potentially missing out on nearly 60% of the global fixed income market that is outside the US (Figure 1).

Figure 1: Global Bond Market Amount Outstanding – USD145 trillion



Source: SIFMA. Data as of Dec. 31, 2024.

We believe incorporating non-US exposure expands diversification, which is particularly valuable in periods of heightened uncertainty. Exposure to foreign currencies can also offer an additional source of total return potential — particularly in periods when the US dollar is either stable or weakening.

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Interest rate outlook

US: Neutral

Growth has slowed in the US, and inflation data, while generally benign, have shown some signs of a tariff impact. We expect tariff-driven price increases to keep inflation firm going into year-end, but we believe the US Federal Reserve (Fed) will cut rates twice by the end of the year. We expect longer-term yields to remain range bound, as conflicting signals from growth and inflation balance each other out. Over the long term, concerns about the US budget deficit will likely keep yield curves steep.

Europe: Neutral

The European Central Bank (ECB) maintained its deposit rate at 2% in July and is now expected to be on hold while it assesses the impact of the 200 basis points of cuts already delivered. While the outlook for the region's economy this year remains challenged due to a slowdown in global growth and tariff-related uncertainty, next year and beyond is more encouraging. We expect to see the impact of fiscal expansion in Germany begin to take effect, supported by additional military spending across the continent, while there are still substantial grants and loans from the NextGenerationEU stimulus program to be distributed to Southern and Eastern Europe. While the ECB remains ready to lower rates further if the economic backdrop deteriorates, many in the Governing Council assess that interest rates are now well placed for the current environment, and we expect rates to remain close to current levels.

China: Neutral

We continue to expect a very accommodative monetary environment and a potential paring back of fiscal easing. These factors are likely to continue to underpin onshore Chinese rates performance. At the same time, economic resilience and strong equity market momentum have provided a floor for onshore yield moves, in our view. Hence, we maintain our neutral view on China rates. We have also noticed the increasing popularity of the offshore renminbi (CNH) market, with rising bond issuance, inflows, and demand from various types of investors. We expect this trend to continue for the foreseeable future.

Japan: Neutral

Fiscal concerns ahead of the Upper House Parliamentary elections dominated price action in the Japanese government bond (JGB) market in July, sending 10-year yields higher. The unpopularity of Prime Minister (PM) Ishiba's government led to concerns that the ruling LDP/Komeito coalition would lose its majority, leading to easier fiscal policy, as opposition parties campaigned on a platform of larger consumption tax cuts and cash hand-outs than the governing coalition. The election saw the LDP/Komeito coalition fall short of a majority by three seats, but this was largely in line with polls. PM Ishiba has committed to remaining in office, meaning the LDP/Komeito will likely have to rule as a minority, as the opposition will likely not form a coalition under his leadership. The implications for policy are that fiscal policy will likely ease further, as the LDP/Komeito will have to cooperate with the opposition to draft the FY26 budget in the fourth quarter. However, the fragmentation of the current political environment leaves the LDP/Komeito requiring relatively few additional votes to gain a majority. Consequently, the more radical fiscal easing plans proposed during the election campaign are likely to be watered down. A permanent cut to the Value Added Tax (VAT) is unlikely, though there may be additional hand-outs, and/or a temporary cut to the VAT on foodstuffs.

It is unclear how much this will impact JGB issuance. Fiscal revenues have recently exceeded forecasts due to higher nominal GDP. In June, the Ministry of Finance took the unusual step of cutting super long JGB issuance for the remainder of FY25 to improve the supply and demand imbalance at the long end of the yield curve. Any further increase in issuance, if needed, may also be skewed to the short end of the yield curve. Therefore, it is unclear whether the risk premium in the long end will rise further ahead of fourth quarter budget discussions. While the long end of the curve

has seen yields spike, the short end has remained anchored, due to the Bank of Japan's (BoJ) relatively dovish stance in the face of tariff-related uncertainty. Recent inflation data continue to point to upside risk relative to BoJ forecasts. The BoJ may return to normalising policy, potentially as soon as the October meeting. This could push up front-end yields, which are pricing little risk premium for rate hikes in the near term.

UK: Overweight

The last month has been characterized by a continuation of the yield curve steepening trend evident in the UK and elsewhere over the last year. Yields on sub-five-year maturities are almost unchanged, while 30-year yields have risen. The price action reflects competing forces driving UK interest rate markets. The front end of the yield curve has been supported by lacklustre growth and employment data, which have supported expectations of continued quarterly Bank of England (BoE) rate cuts, despite a somewhat higher than expected inflation print in June. In contrast, the long end of the yield curve has continued to price additional fiscal risk premium, particularly after the government had to water down its welfare reform bill due to a rebellion from its own Members of Parliament. Although the short-term savings from these measures were not huge, the signal that, even with a large majority, the Labour government could not push through spending cuts is important. The combination of weaker than expected growth, higher yields and U-turns on spending cuts leaves the Chancellor with the unpleasant choice of further tax increases or fiscal slippage beyond her self-imposed rules. The former is politically difficult, while the latter would likely sap what little fiscal credibility the government has left. The gilt market has adjusted to this reality by adding more long-end risk premium to reflect the uncertainty ahead of the autumn budget. One potential positive for the long end is the expected dip in supply in August and the potential for the BoE to announce an end to active gilt sales in September. Recent comments from policymakers seem to show more sensitivity to long-end yields than previously.

Australia: Overweight

The Reserve Bank of Australia's (RBA) surprise decision to keep rates unchanged at its July meeting, despite the market pricing a high probability of a 25 basis point cut, has resulted in a jump in Australian 10-year government bond yields since the end of June, causing them to underperform US Treasuries, German bunds and New Zealand government bonds. The market continues to price a relatively front-loaded cutting cycle, and the recent weakness in June employment data makes this pricing look more reasonable. The terminal cash rate is likely to settle around 3%, making current 10-year yields at around 4.3% look relatively attractive, in our view.¹ The recent cross-market underperformance versus the US might also present an opportunity, given that Australia's relatively strong fiscal fundamentals relative to the US and UK should limit the rise in the relative long-end risk premium. There is also evidence that Japanese investors are increasing flows into Australia, possibly as an alternative to US Treasuries.

1. Source: Bloomberg L.P. Data as of July 21, 2025.

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Currency outlook

USD: Underweight

We remain broadly underweight the US dollar due to several factors. The Trump administration seems to favor a weaker dollar, which could support US domestic manufacturing and encourage overseas investment. We also expect the US economy to slow relative to the rest of the world, despite record capital expenditure by US technology companies in AI. Higher tariffs and inflation may prevent the Fed from lowering rates until the labor market deteriorates, which may be a headwind to growth. Finally, we have seen flows into US assets slow in recent quarters and some international investors may hedge their currency exposure to US assets after a stellar period of performance for the currency. The path is likely to be volatile given wider market uncertainty but, given our macro views, we expect a gradual depreciation of the dollar over the medium term.

EUR: Overweight

We remain positive on the euro, given the expected improvement in the fiscal backdrop in 2026 and our expectation that the region's economy will likely recover next year. Even though the ECB lowered rates by 200 basis points in this cycle, the euro has performed well and we expect that trend to continue in the medium term. While the US tariffs remain a headwind to the wider economy, the service side of the economy is performing relatively well, supported by lower interest rates and a strong labor market.

RMB: Overweight

We continue to be overweight the renminbi, as we expect continued momentum in exporters' selling of USD/RMB and in the development of the renminbi internationalization process. A strong fixing by the central bank, the substantial growth of China's trade surplus and exporters' sizable holdings of foreign currency are likely to support the renminbi's performance. Positive momentum in China's equity and offshore renminbi bond markets is also a helpful factor for the currency's medium-term trajectory, in our view.

JPY: Overweight

The yen has lagged its G10 peer currencies over the last month, depreciating by 1% versus the US dollar and 2.5% versus the euro.² The yen's underperformance has been driven by a combination of better global risk sentiment due to delays in tariff implementation, stronger growth expectations in Europe due to front-loaded fiscal spending, fiscal concerns around Japan's Upper House elections and the BoJ's relatively dovish reaction function to tariff-driven uncertainty relative to the ECB and Fed. Current yen valuations are now very cheap relative to interest rate differentials, in our view. Positioning has shifted toward being short yen, compared to April. Japanese investors have not hedged currency exposure and/or repatriated capital. However, the prospects of Fed rate cuts and cheaper valuations of domestic assets, such as JGBs, compared to international peers, could lead to a reversal of capital outflows.

2. Source: Bloomberg L.P. Data as of July 22, 2025.

GBP: Underweight

The British pound is facing several headwinds going forward. UK interest rates are likely to converge with lower yielding peers in Europe and Asia, as the weaker labor market leads the BoE to cut rates further and faster, reducing the carry the pound offers to investors. In addition, the recent U-turn on welfare reform raises questions about the UK government's fiscal credibility. A shift to a policy of higher taxes to fund spending might deter international investors and further dampen the domestic investment appetite, which was already hit by the rise in national insurance taxes in April.

AUD: Overweight

The recent repricing of front-end rate differentials and the recovery in commodity prices, particularly iron ore, should support the Australian dollar. Rising risk sentiment, particularly reflected in the outperformance of emerging market assets, should also be a positive driver for the Australian dollar. To date, the Australian dollar has lagged European currencies and the New Zealand dollar, but its long-term fundamentals probably justify some catch-up against the US dollar and on a cross basis.

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Global credit strategy

We see opportunities in three key muni sectors

The municipal bond market has faced volatility and underperformance in 2025. But despite disappointing returns, we believe most municipal issuers enjoy strong credit fundamentals. In our view, recent underperformance has led to compelling levels of tax-advantaged yields, creating an opportunity for active managers. Three municipal market sectors we currently find attractive are transportation, private higher education and municipal bonds subject to the Alternative Minimum Tax (AMT).

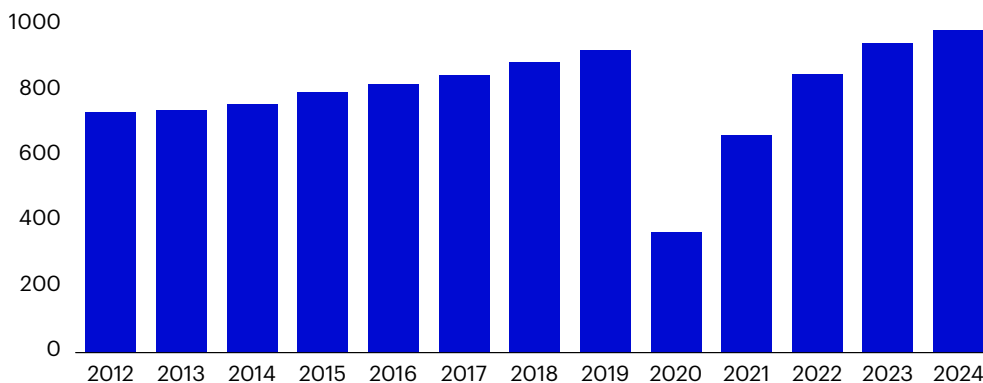
1. Transportation sector

The transportation sector came under pressure during the COVID pandemic, as the prospect of travel became uncertain. But the sector weathered the COVID storm well, from a credit standpoint, and we believe the outlook is generally positive. Below we discuss three large components of the transportation sector: airports, ports and toll roads.

Airports

Total passenger enplanements on US airlines surpassed pre-pandemic levels in 2024. (Figure 2). In 2025, we expect year-over-year enplanement growth to continue, in the low single digits. Many US airports are addressing capital needs by issuing debt in the municipal market, including for improvements at Lagoonia, John F. Kennedy and Newark airports. We believe airports in high growth regions with younger populations have a greater ability to increase revenues, which we prefer. We are also favorable on airports with diverse carrier mixes and revenue streams, as they are better able to withstand economic uncertainty. Credit metrics, particularly liquidity, days of cash on hand, and debt service coverage, generally remain strong for airports.

Figure 2: Total passenger enplanements on US airlines (in millions)



Source: Bureau of Transportation Statistics

Ports

Ports account for a small portion of the muni market - with approximately USD20 billion in bonds outstanding in a USD4.2 trillion market - but they are most likely to be affected by tariffs.³ The ultimate impact on ports will likely hinge on the level, extent and timeframe of levies. The operating structure of a port, whether it is a landlord, operator or hybrid port, will likely play a large role in how certain ports fare under new tariffs. We currently favor landlord ports over operator ports.

3. Sources: S&P Global. Data as of June 30, 2025. SIFMA. Data as of March 31, 2025.

Toll roads

When it comes to security selection in the toll road sector, credit expertise is critical, as we expect median traffic and revenue growth to be muted in 2025. For example, being situated in a high growth region is an important metric for toll roads, as with airports. Additionally, toll rates that are linked to inflation have provided additional credit safeguards recently. We believe strong financial profiles will allow toll roads to afford capital programs, while maintaining strong credit quality.

2. Private higher education sector

Top-tier private colleges and universities have been in the media recently as the Trump administration has begun to implement its agenda through The One Big Beautiful Bill (OBBB) and various executive orders. Ivy league schools, academic medical centers and prominent public universities are the largest recipients of federal grant funding, and the administration has proposed material cuts to this funding. Federal funding is concentrated among the top 20 recipients, which accounted for one third of federal research grants in fiscal year 2023.⁴ While this creates uncertainty in the short term for these institutions, they are well capitalized and have significant resources at their disposal, as they adapt to structural changes within their budgets and operations.

The OBBB will likely have several impacts on top-tier private universities, but the tax on annual endowment earnings is the clearest, and seems to be the largest. The Tax Cuts and Jobs Act (TCJA) of 2017 taxed annual endowment earnings of universities with at least 500 full-time equivalent students and an endowment greater than USD500 thousand per student at a rate of 1.4%. This tax affected 56 schools, which paid around USD381 million in 2023.⁵ The OBBB increases the enrollment criteria to at least 3,000 full-time equivalent students and removes the exemption for religious affiliated institutions. The OBBB creates three tiers of tax rates based on endowments of USD500-USD750 thousand, USD750-USD2 million, and greater than USD2 million per student, with corresponding tax rates of 1.4%, 4.0% and 8.0%, respectively. Other notable provisions include graduate student loan caps, expanding Pell Grant eligibility and funding for federal student aid.⁶

The Trump administration also issued Presidential Proclamation 10949, which suspends immigrant and non-immigrant visas, and which could affect enrollment. However, we believe top-tier private institutions with a significant proportion of international students should be able to adjust by increasing their acceptance rates, as these institutions generally have robust demand profiles.

Negative news surrounding top-tier private colleges and universities has created headline risk and rising credit pressure at the highest rated universities and academic medical centers in the country. However, we generally believe institutions with credit ratings of A or higher will be able to weather the storm. These schools generally have large balance sheets, low acceptance rates, strong demand profiles and significant fundraising capabilities.

4. Source: National Center for Science and Engineering Statistics Higher Education R&D Survey. Published Nov. 25, 2024.

5. Source: Internal Revenue Service. Data as of Dec. 31, 2023

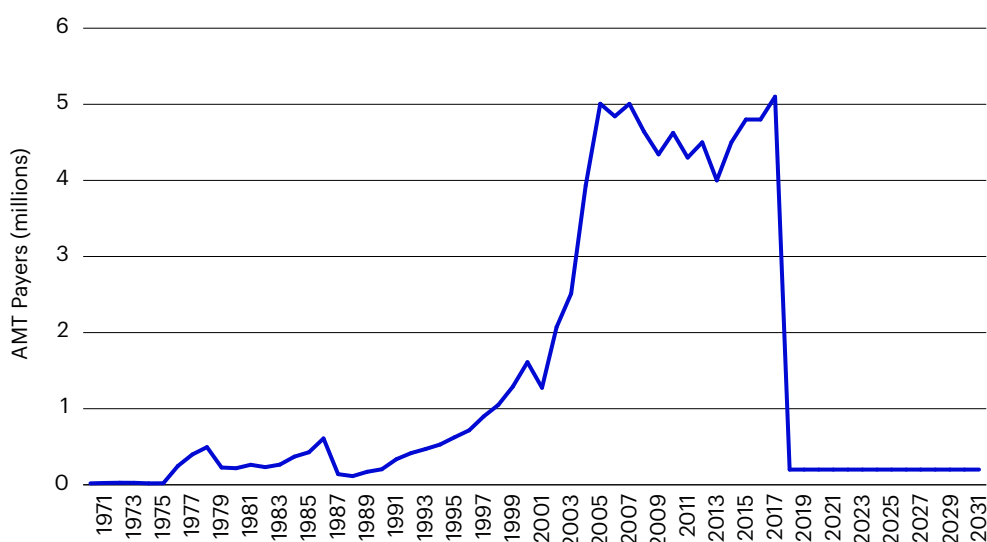
6. Source: Tax Foundation. Data as of July 23, 2025

3. Alternative Minimum Tax bonds

The TCJA of 2017 significantly reduced the number of taxpayers subject to the Alternative Minimum Tax (AMT). Prior to the TCJA, roughly five million taxpayers were subject to the AMT, but that number decreased to around 200,000 in the 2024 tax year.⁷ While the OBBB made some changes to the AMT, including exemption amounts and phase-out thresholds, we do not expect the number of affected taxpayers to change significantly from 2024.

Some municipal bonds, commonly called Private Activity Bonds (PABs), are subject to the AMT. While government entities issue these bonds, private entities benefit from the proceeds to fund projects. The private entities are responsible for payment of principal and interest. These bonds are often issued by sports stadiums, airports and 501(c)(3) organizations. Prior to 2017, these bonds typically paid a higher yield than non-PAB or non-AMT bonds since many wealthy taxpayers subject to the AMT would owe additional taxes on the interest income. Because the passage of the TCJA and OBBB resulted in fewer individuals being subject to the AMT, we would expect the spread between AMT and non-AMT bonds to shrink as a result. However, for now, the spread still exists, which could benefit investors seeking additional tax-exempt income.

Figure 3: Alternative Minimum Tax



Sources: Urban-Brookings Tax Policy Center Microsimulation Model (versions 0304-3, 0308-4, 1006-1, 0613-1, 0721-1); Harvey and Tempalski (1997); private communication from Jerry Tempalski; and SOI Division of Internal Revenue Service.

Note: AMT payers are those with higher income taxes because they either have positive AMT liability on form 6251 or have lower tax credits or deductions because of the AMT. Tax units that are dependents of other taxpayers are excluded from the analysis.

7. Source: Tax Policy Center. Data as of January 2025.

Panelists



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The bottom line

Thoughts from the Investment Grade desk

US bond markets have performed well this year. The Bloomberg US Aggregate Bond Index and Bloomberg US Corporate Bond Index are both up 3.6% year-to-date.⁸ After a strong second quarter, passage of the Trump administration's Big Beautiful Bill gave financial markets another leg up in July, and we expect the bill to provide a fiscal impulse to the US economy. However, while the US has shown resilience, including solid growth and subdued inflation, recent labor market data have softened. And, while tariff fears have eased, uncertainty remains, as the administration seeks to complete trade deals with numerous trading partners. The Fed has remained steadfast in its wait-and-see approach, emphasizing uncertainty in its outlook, but some Federal Open Market Committee members have begun voicing support for easing policy rates. We speak with Invesco Fixed Income portfolio managers, Matt Brill and Todd Schomberg, about what this backdrop means for investment grade investors.

Q: What have been the catalysts behind this year's bond returns, in your view?

Matt: It's been a better year than many people expected, given the noise around tariffs and inflation. For me, a key catalyst has been the US economy's resilience. Inflation hasn't been as bad as people feared, and, while the tariffs have been in the headlines, they haven't been as punitive as people had expected from an inflationary perspective. That may change as we see more data, but, overall, we think this means that the Fed is likely to cut rates at some point this year. This expectation has led some market participants to front run potential rate cuts with increased risk appetite.

Todd: Another catalyst behind this year's positive investment grade performance has been strong market technicals – in other words, a favorable balance between the supply and demand for bonds.

Bond issuance has been less than expected, especially from the banks. This may be due to the new Supplementary Leverage Ratio rules that won't require as much bank loss-absorbing capital via the issuance of debt.

Also, bond maturities have been heavy, as five-year bonds issued during the COVID rebound period have been maturing. So, investors are flush with cash from these maturities, which in some weeks have exceeded new bond issuance.

Additionally, tender activity has picked up this year. In a tender offer, an issuer offers to buy back some or all of its bonds from bondholders, usually at a premium to encourage bondholders to sell. Notably, June saw USD17.5 billion in tendered outstanding bonds, representing the highest monthly total since 2021, and bringing the year-to-date total up 14% versus a year ago.⁹

Finally with yields backing up, yield-based buyers have stepped in. Key levels like 5% on the 30 year US Treasury bond have led to increased investor interest further out the yield curve. On the other hand, companies have avoided issuing further out the curve because they don't want to lock in those higher rates for prolonged periods.

Q: The market appears to believe the Fed will cut rates in September and December. Do you agree with that - especially if inflation remains sticky - or do you think the market is being a bit aggressive in its rate cut expectations?

Matt: Looking at the economic data, especially around employment, the economy appears to be slowing. The Fed is currently in a restrictive stance, which could slow the economy even more, and I don't think it wants that. So, even though the US economy has been resilient, I'm concerned that, if the Fed delays cuts, it might fall behind the curve. I think Fed Chair Powell will explain his forward-looking views on rates at the Jackson Hole Economic Symposium in August. We think the Fed will cut in September and, if it finds itself behind the curve, we would expect potentially two more cuts by the end of the year. We believe the sooner the Fed cuts, the less it may have to cut overall.

8. Source: Bloomberg L.P. Data as of July 25, 2025.

9. Source: JPM. Data as of June 30, 2025

Q: Let's talk about credit spreads. The S&P 500 Index has been hitting new highs. Why are credit spreads struggling to keep up in this market?

Todd: It was frustrating to see credit spreads go sideways in June, while stocks just kept going up. But in July, investment grade was able to grind tighter as equities rose. Our view has been that the economy would hang in fairly well, and that many of the negative headlines would dissipate. Stock markets could potentially go higher in that scenario, which usually means credit spreads could go tighter. For now, it hasn't turned out that way. I think there are two reasons. First, spreads are already tight, making it harder for them to move tighter. Second, yields overall have come down. Yields on the investment grade index have traded at 5.0%-5.5% all year.¹⁰ As we have moved higher in that range, we have seen more buyers and as we have moved toward the lower end of that range, we have seen investors become more cost conscious.

Matt: Right now, it appears that institutional investors have pulled back somewhat, but I think we are still missing individual investors, who seem to be waiting to enter the bond market. I think that good returns year-to-date may motivate them to start moving off the sidelines. It may be FOMO – the fear of missing out – that motivates them to participate before yields go significantly lower.

Q: The market almost seems like it's on summer break right now. Stocks are at all-time highs and credit spreads at all-time tight. Do you think markets have been complacent?

Matt: There has probably been some complacency at play, but overall, I think there have been many good developments that have not been well reported. I continue to think the economy remains on great footing. Corporate fundamentals in particular have been solid from a balance sheet standpoint, so there is really no reason to panic, in my view. I think spreads may go tighter from here.

10. Source: Bloomberg L.P. Data as of July 25, 2025.

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Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Non-investment grade bonds, also called high yield bonds or junk bonds, pay higher yields but also carry more risk and a lower credit rating than an investment grade bond.

Mortgage- and asset-backed securities, which are subject to call (prepayment) risk, reinvestment risk and extension risk. These securities are also susceptible to an unexpectedly high rate of defaults on the mortgages held by a mortgage pool, which may adversely affect their value. The risk of such defaults depends on the quality of the mortgages underlying such security, the credit quality of its issuer or guarantor, and the nature and structure of its credit support.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

The performance of an investment concentrated in issuers of a certain region or country is expected to be closely tied to conditions within that region and to be more volatile than more geographically diversified investments.

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