March 31, 2025

Capital Markets Perspective

thrivent®
Asset Management

A Look Ahead: Q2 2025 Outlook

As we look ahead to the second quarter, our focus remains on the fundamental trends that drive markets, aiming to assess material changes such as tariffs that could alter the long-term outlook for stocks or bonds. In periods of high uncertainty, this is more difficult and can justify taking a more conservative tactical stance. But we stand by a core tenant that tolerating shorter-term periods of uncertainty and volatility rather than making large changes to investment portfolios in response to short-term data helps avoid the risk of locking in losses by being out of the market for the inevitable rebound in returns.

The first quarter of 2025 introduced a surge in uncertainty and volatility. While the pace of change may decelerate, we expect uncertainty to remain high in the coming months. The U.S. economy has slowed and further weakness is likely. Inflation has been sticky and likely to rise further. It will take time to determine the strength and length of the trend for both critical indicators.

We will closely monitor labor markets and consumer spending for signs of further weakness, as well as signs of margin pressures in U.S. companies that could lead to changes in their behavior, including increased layoffs and declining investment. Likewise, inflation data will remain a critical factor in assessing the outlook for both stock and bond markets, if only to better gauge how the Federal Reserve (Fed) will react to any further slowdown in economic growth.

Looking outside the U.S., the current Trump administration has embarked on a transformation of the role—largely in place since World War II—the U.S. plays on the global geopolitical stage. This can create volatility. But the historical record is pretty clear that geopolitical concerns usually take a back seat to economic ones over time. Nevertheless, the international stage bears watching as the current mix of tensions in Ukraine, the Middle East and Taiwan could still affect economies, and new pockets of tension could appear.

With a longer-term view, we remain constructive on the outlook for the U.S. economy once uncertainty clears and the ability of the global economy to weather a multitude of surprises. As such, we expect to maintain core, strategic exposures as markets can rebound quickly. Also, we would look to add exposure on significant weakness. But recent volatility and the persistence of uncertainty is a reminder that diversified stock and bond portfolios are often better able to withstand the inevitable periods of shorter-term volatility.

Contents

Asset class weighting

● Current quarter
○ Previous quarter (if changed)

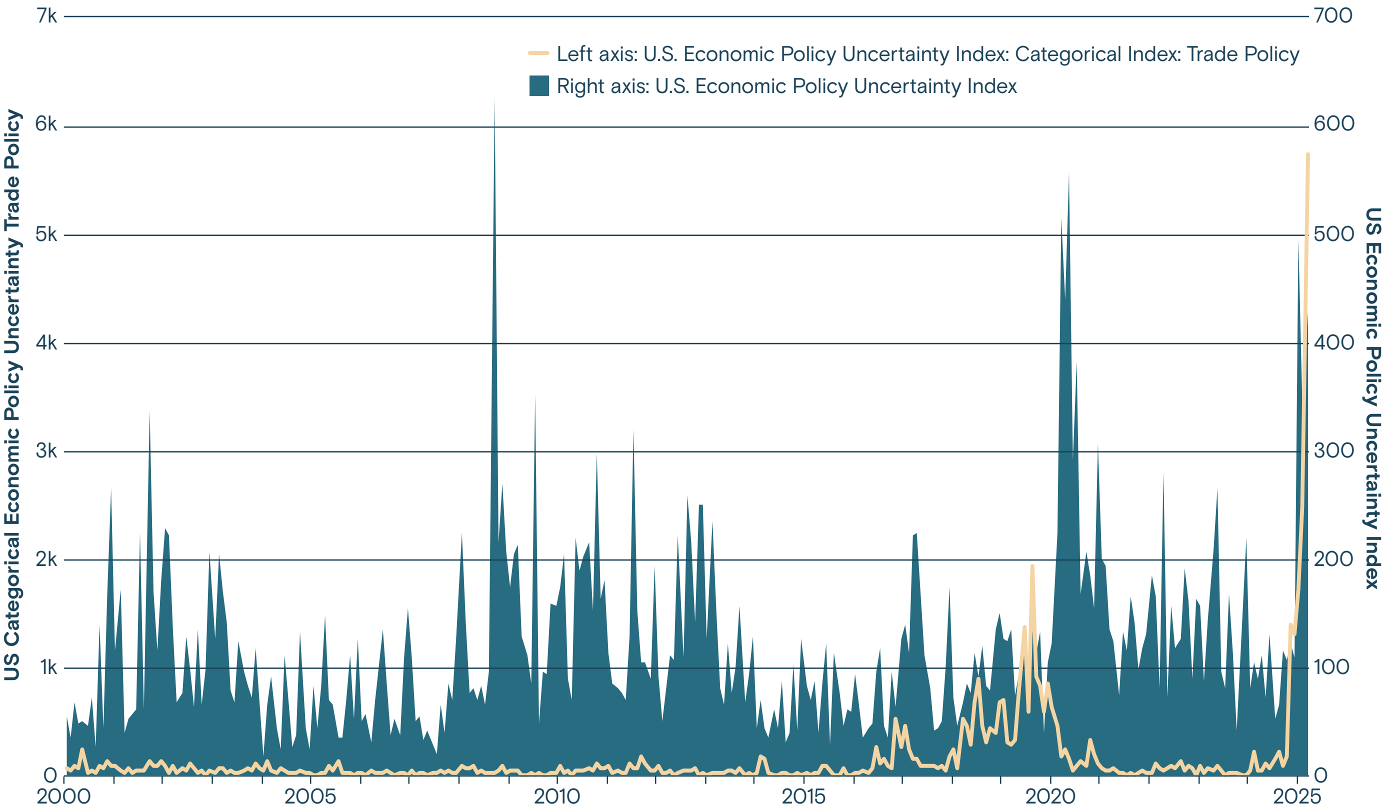
	Under		Neutral		Over
Equity overall				●	
U.S. large caps				●	
U.S. mid caps				●	
U.S. small caps			●		
Int'l developed		●			
Int'l emerging markets		●			
Fixed income overall		●			
Investment-grade corp				●	
High-yield bonds		●			
Securitized assets				●	
Emerging-market debt			●		
Municipals				●	

Quarterly Highlights

Trade and Economic Uncertainty

Two uncertainty indexes: trade policy and economic policy uncertainty

January 2000 – March 2025



Source: Baker, Bloom and Davis; Bloomberg

Uncertainty over economic and trade policies such as tariffs has surged to levels rarely seen outside of recessions or severe market turbulence. The news flow has been turbulent with changing policies relating to trade, immigration and the government's role and staffing. The resulting fog can make it much harder to price in market risks and the level of forward earnings, especially when the policy landscape is shifting frequently. How high and broad will tariffs ultimately be? Will the administration cut deals with trading partners? Will the impact on inflation be transitory? Recent uncertainty already has lowered consumer confidence and dented business confidence. The concern is that sustained uncertainty and the impact of tariffs ultimately will dampen spending. Lower business confidence impacts the economy as companies are more reluctant to invest in an uncertain environment and may rein in spending. Uncertainty also makes the Federal Reserve's job harder as it attempts to balance concerns about growth with concerns that inflation will accelerate. The lifting of the fog of uncertainty is a key to markets finding a bottom and moving forward.

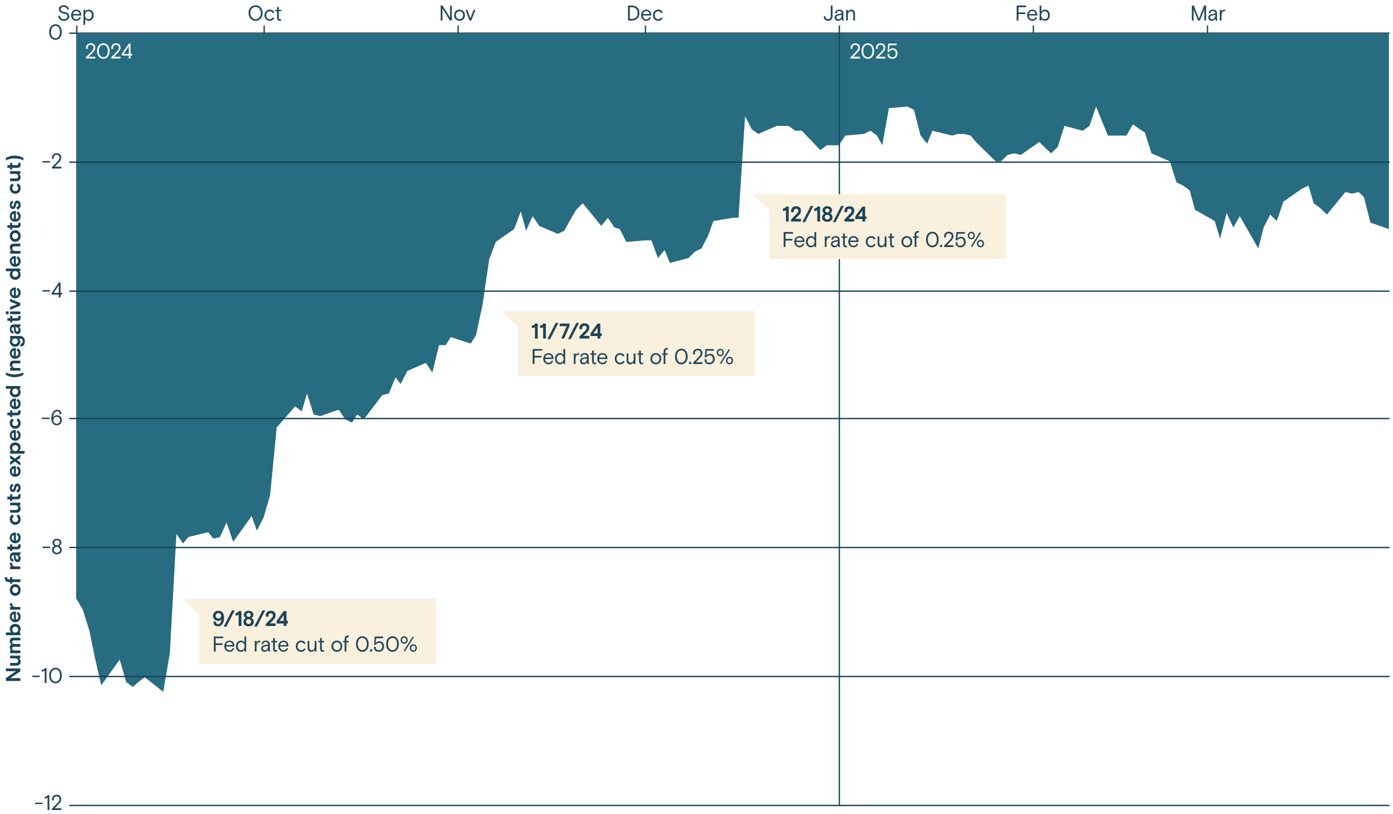
The U.S. Economic Policy Uncertainty Index: Categorical Index: Trade Policy reflects the frequency of articles in American newspapers that discuss policy-related economic uncertainty and also contain one or more references to trade policy.
The U.S. Economic Policy Uncertainty Index measures the level of uncertainty regarding economic policy in the United States.

Quarterly Highlights

Federal Funds Rate

Expected number of rate cuts by the end of 2025

September 2, 2024 – March 31, 2025



Source: Bloomberg

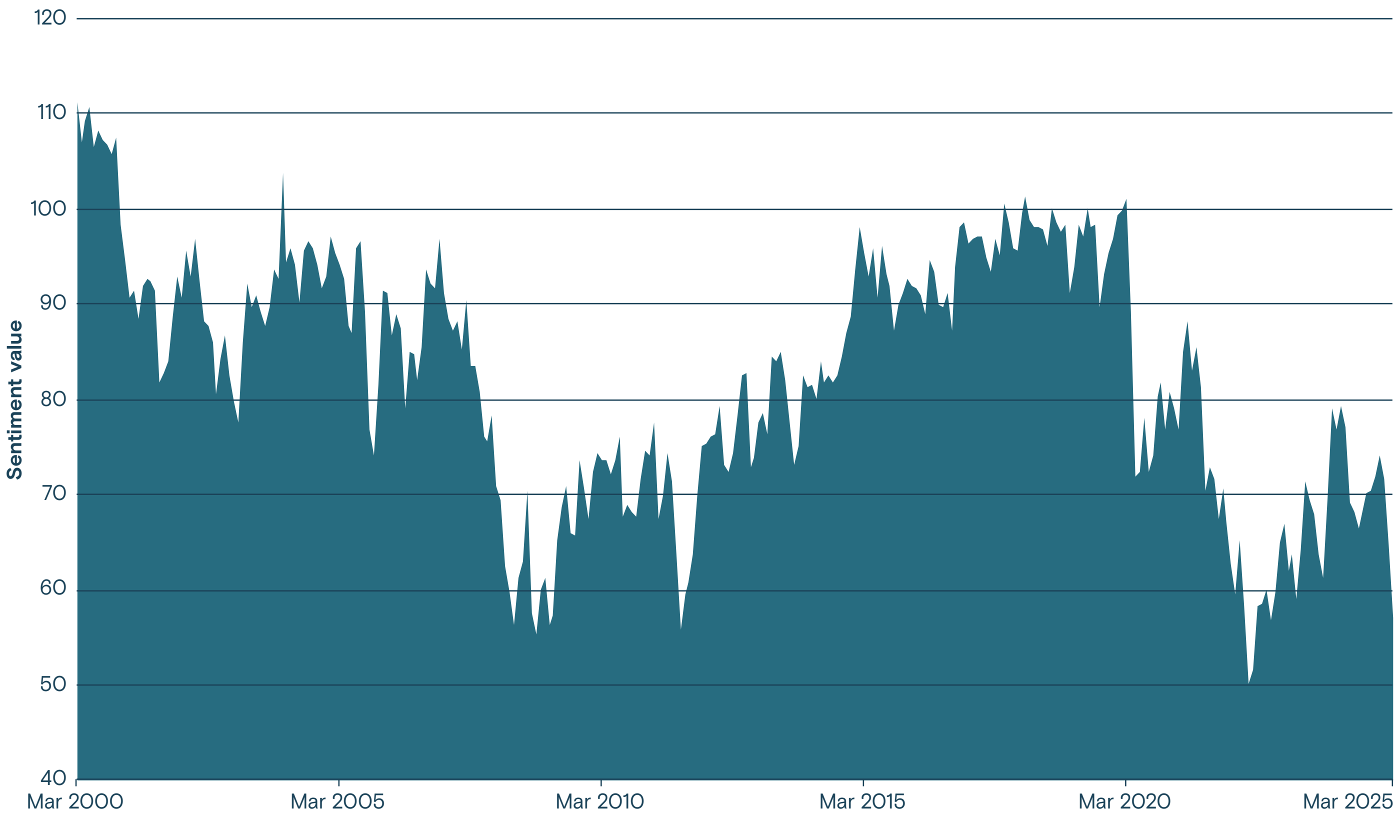
Expectations for Federal Reserve (Fed) interest rate cuts have fluctuated over the past year. The Fed in 2024 cut the Fed Funds interest rate three times for a total move of 1%, lowering the top end of the target range to 4.5% from 5.5%. But as economic and inflation data began to surprise to the upside last fall, the market priced in fewer expected cuts – less than two 25 bps cuts through 2025. By March growing concerns over slowing growth and the likely negative impact of tariffs prompted the market to price in up to four rate cuts in 2025, which was double the two cuts that Fed members had penciled for their most recent projections. Options markets in a key short-term financing rate (Secured Overnight Financing Rate – SOFR) show a heavy skew toward the Fed cutting rates meaningfully with the possibility of deep cuts, which implies a chance of a meaningful recession. Given that the Fed is coping with the same cloud of uncertainty as the financial markets, we expect it will wait until there is greater clarity on global trade policy before acting. Various committee members have recently indicated they see growing risks to economic growth. Several members, however, have focused on the risk of higher inflation, especially with consumer inflation expectations rising to the highest level since the early 1990s. The Fed wants to ensure that one-time tariff price hikes do not evolve into ongoing inflationary problems. As such, the Fed likely remains on hold without clear data pointing to a significant rise in unemployment. Ultimately, the Fed could be faced with a choice between inflation and jobs. We expect it will lean toward supporting jobs and start cutting the Fed Funds rate around mid-year outside of clear signs that inflation is sustainably and significantly rising.

Quarterly Highlights

Consumer Confidence

University of Michigan Consumer Sentiment Survey

February 2000 – March 2025



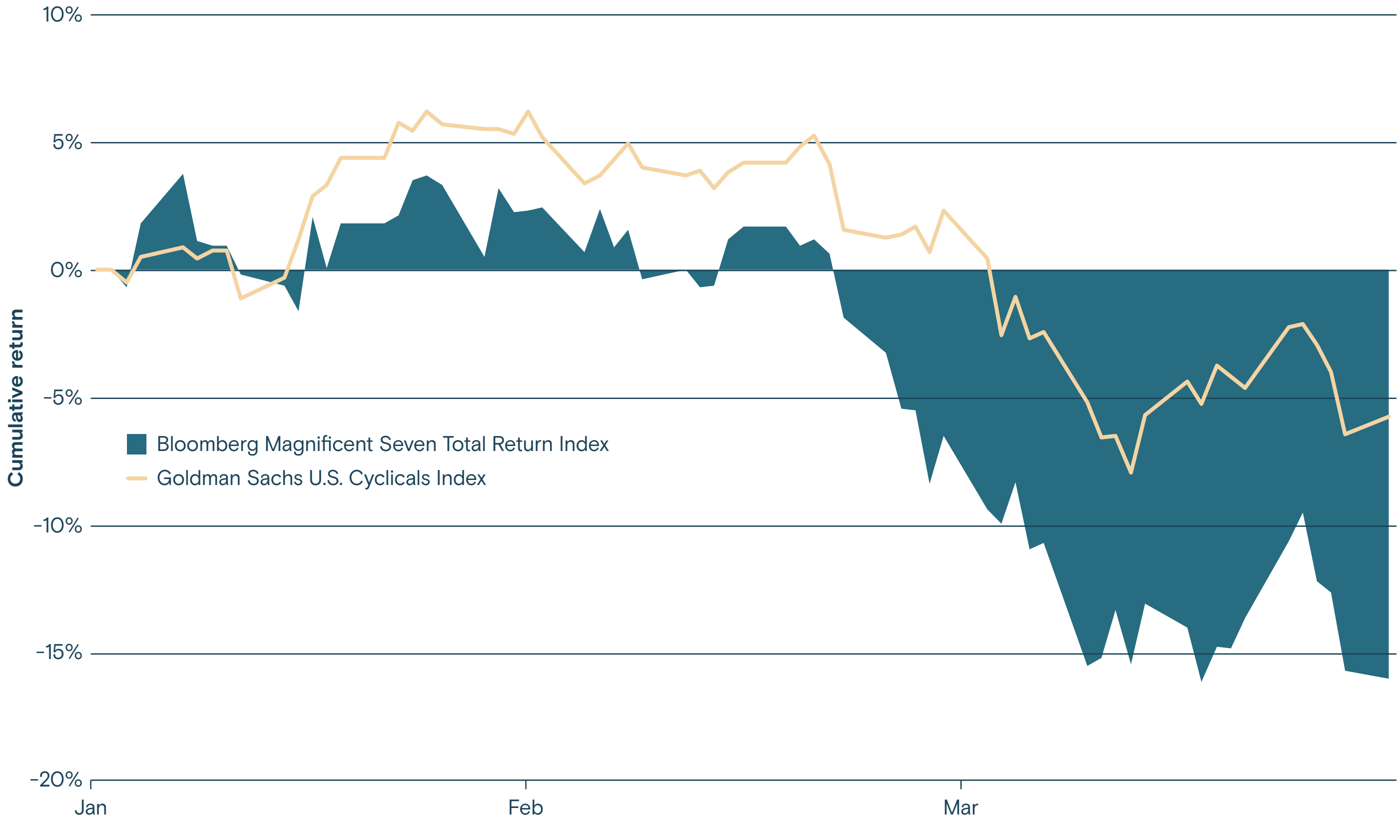
Source: University of Michigan, Bloomberg

Consumers are anxious. This is evident in consumer confidence surveys, such as a widely followed survey by the University of Michigan. Consumer confidence has fallen to levels seen during past recessionary periods. Consumers are worried about inflation and the high level of prices. The also are increasingly worried about jobs and household finances. Confidence also is political. Confidence has fallen materially over that past few presidential elections for those whose party fell out of power. Interestingly, consumers have consistently rated present conditions higher than expected conditions. This fits with solid consumer spending through the first quarter. Importantly, consumers do not always act on how they feel as long they have jobs and income. In other words, they keep spending. However, we expect the level of economic uncertainty and market volatility to impact actual spending if it persists. Fortunately, consumers in aggregate have solid balance sheets with low debt to income, which should help buffer the impact on households from slowing growth.

Quarterly Highlights

Magnificent Seven vs. Cyclicals

Comparison of Mag Seven & cyclical indexes | Normalized cumulative return (begins at 100) Jan. 1, 2025 – Mar. 31, 2025



Source: Bloomberg, Goldman Sachs

Volatility has shot up this year with markets falling sharply, particularly in response to uncertainty over trade and the level and breadth of tariffs. Concern over economic growth also has risen, with economists cutting their forecasts and upping the odds of a recession. Cyclical stocks and industries underperformed as expected as markets are worried about growth. The Magnificent Seven stocks also underperformed, more than cyclicals through the first quarter. Tesla fell due to company specific issues, but the other six stocks also have declined to varying degrees (Alphabet, Amazon, Apple, Meta, Microsoft and Nvidia) as valuation measures such as price to earnings ratios (P/E) fell. This signals that the market drawdown also was about resetting the extended market valuations of Magnificent Seven technology-related stocks, in part due to concerns over the high expectations for future earnings growth from artificial intelligence (AI). This includes the ability to monetize AI applications in addition to increased competition from global AI competitors, especially from China.

Overall Views

Equity vs. Fixed income

Overweight equities | Underweight fixed income

In times of significant market uncertainty, historical analysis often provides valuable insights for constructing a plan of action. This is especially true when experiencing extreme events. Accordingly, we have run a series of analyses examining comparable market patterns over the past 75 years. In so doing, we identified 21 examples with patterns similar to our recent experience, and three primary scenarios as the most probable paths forward.

The first scenario, known as the "V-bottom," is the least frequent and least likely outcome. It typically requires swift intervention by the Federal Reserve and a rapid resolution of the immediate catalyst driving the sell-off. Given the complexities of the present economic and geopolitical landscape, we consider this scenario improbable.

The second scenario entails a bear market accompanied by some manner of recession; a pattern we observed in almost half of the historical cases studied. Notably, because bear markets often contain abrupt, powerful rallies, we found multiple occasions where significant opportunities emerged, despite the threat of further economic deterioration. Of course, bear markets (and recessions) take multiple forms and can unfold in meaningfully different ways. For instance, Saddam Hussein's invasion of Kuwait offered a favorable entry point for investors (1990 recession), whereas the bankruptcy of Lehman Brothers (2008 recession) occurred long before the market bottom.

The third and most common scenario involves a period of consolidation after the initial sell-off, followed by a renewed market rally. Though the phase preceding the rally is likely to exhibit significant volatility and extend over several months, price movements generally remain within a reasonably defined range. Further declines can and do occur, but they don't typically result in meaningfully lower levels. We currently view this outcome as the most likely.

Interestingly, despite the initial volatility and unease following nearly all the cases we studied, our analysis indicates that the S&P 500 Index is positive 81% of the time one year later, with a median return of 24%. While historical parallels are imperfect and numerous factors could produce a materially different result, our findings suggest that reducing equity exposure now could prove to be an error over the long term. Consequently, we are actively seeking opportunities to enhance our modest overweight position in equities within allocations.

Equity: U.S. versus international

Overweight domestic | Underweight international

Led by Europe, developed international stocks outperformed U.S. large cap stocks in Q1 by 11.3%, undoing Q4 underperformance of 10.5%. We maintain a preference for domestic over international stocks, with our primary underweight being in Europe followed by emerging markets. We believe the main structural issues holding Europe back relative to the U.S. are largely still in place but the path in the short-term is more uncertain. Germany announced increases to public investment on defense and infrastructure while the United States is looking to cut spending, contributing to a dramatic shift in sentiment during Q1, from favoring the U.S. to preferring Europe. However, the global trade shock from tariffs could take some of the wind out of the sails of European equities' strong Q1 performance, as the region relies more heavily on exports. New tariffs are immediate while increasing investment will take time to implement, and significant increases in spending are likely contained to Germany within the EU. In China, despite strong Q1 performance after news related to Deepseek's R1 AI model, we still believe China faces considerable challenges related to their real estate market, and now a renewed trade war with a country (the United States) that is less dependent on exports for growth.

Equity: Market cap

Neutral small caps | Overweight mid caps | Overweight large caps

The S&P 500 Index continued to outperform small caps in Q1, this time by approximately 5% despite underperformance by the largest stocks in the S&P 500 Index. Domestically, we are overweight both large and mid-caps, while being neutral-to-modestly underweight in small-caps. 2025 earnings expectations in small caps declined in Q1 (a continuation from last year) to a larger extent than the S&P 500 Index, and the prospects for that trend reversing in the short-term are dim in our view. Economic growth is likely to disappoint expectations this year which should disproportionately weigh on small cap earnings. Additionally, small caps' ability to adapt to tariffs via passing prices increases to customers, among other measures, is less as compared to large caps. A shift towards reducing regulation would likely work to offset some of the added relative burden for small caps, but overall scale and higher profitability will continue to advantage large caps.

Overall Views

Fixed income: Duration and rates

Overweight duration

The Federal Reserve kept the Fed Funds rate steady in the first quarter after cutting the target rate three times in the last four months of 2024, lowering the upper band of the Fed Funds rate to 4.5%. Greater uncertainty over trade and economic policy and the potential impact on inflation and the path of the economy kept the Fed on hold. The benchmark 10-year less two-year treasury curve was essentially unchanged over the quarter with a moderately positive slope. Trade uncertainty and tariffs impact both sides of the Fed's dual mandate, which is price stability (inflation) and maximum employment (economy). The potential conundrum is that a move to address one side of the problem could worsen the other. Cutting rates to support the economy could worsen inflation. Raising rates to battle inflation could slow growth. As a result, we expect the Fed to move cautiously as it assesses the inflationary impact of tariffs potentially offset by slowing growth. As the Fed gets more clarity, we expect around two rate cuts in the second half of the year. However, the Fed may stay on hold longer should higher inflation expectations become embedded. The Fed would cut its target rate more aggressively should growth slow significantly and recession odds rise. Short-term Treasury rates should be driven by Fed Funds expectations over the next year, while longer-term rates will be driven by growth concerns and flight-to-quality flows offset by selling from international and leveraged investors, large deficits, and inflationary pressures from tariffs. Given the elevated level of policy uncertainty we expect continued volatility in rates. We are positioned close to neutral in duration with long positions in the short end of the Treasury curve and roughly neutral long-term Treasuries. We remain positioned for a steeper curve. The Treasury curve typically steepens as the Fed cuts rates.

Fixed income: Credit quality

Overweight investment-grade corporates | Underweight high-yield

Fixed income credit spreads increased moderately in the first quarter as concerns over economic growth slowing increased and equity markets declined amid greater volatility. Spreads, however, remain below long-term median levels. Credit total returns for the quarter generally were moderately positive in the low single digits due to lower Treasury interest rates. Excess returns, which are the returns over similar maturity Treasuries, were negative due to an increase in credit spreads. Economic growth has been solid, resulting in healthy corporate earnings and balance sheet fundamentals, which support lower spreads levels. But looking ahead, we expect high volatility with uncertainty over trade policy and the impact on economy. We expect slower growth and sticky inflation but with increasing tail risks of a more meaningful downturn. We also expect defaults to remain at relatively moderate levels. However, the risks are skewed toward episodic volatility and wider spreads with tariffs likely to dampen growth while pushing up prices. We are positioned roughly neutral credit risk versus our long-term strategy within broad fixed-income portfolios. We favor higher quality fixed income such as investment-grade corporates, securitized credit, and the higher rating tiers of high yield. We also favor high-quality collateralized loan obligations (CLOs) over leveraged loans. Securitized credit such as mortgages also look attractive. Should credit spreads continue to increase we would seek to opportunistically add exposure to credit.

Equity Views

Communication services

Communication services names underperformed the broader market in Q1. Softening macro data and concerns about tariff impact on e-commerce and related advertising were factors behind the weakness. In addition, AI is starting to drive early signs of changes in consumer internet behavior which is driving increasing debate on the sustainability of existing models and how share might shift as a result. Furthermore, the significant capex required to support AI efforts is raising questions about the returns of these businesses going forward. As a result, we remain focused on names that have opportunities to drive new avenues of monetization and face little secular risk from AI and are already seeing strong return on investment from existing AI investments.

Consumer discretionary

The consumer discretionary sector meaningfully underperformed the broader market in Q1. Outperforming segments in the quarter centered around auto-parts and restaurants. Lagging discretionary sectors included eCommerce, and all discretionary retail including auto dealers. Apparel, and footwear stocks were especially hard hit given their high dependence on southeast Asia supply sourcing. The threat of tariffs and trade-wars will have supply and demand implications and impossible to calibrate at this time leaving the stocks extremely vulnerable. We believe that companies that have limited import exposure such as restaurants and hotels will do better than firms may due better but overall consumer willingness to spend may be hampered as confidence indexes have taken a material step down. Our focus is on strong branded franchises that keep outrunning competition with new, better, more attractive products and service offerings.

Consumer staples

The consumer staples sector outperformed the overall market in Q1 as this sector tends to be a storm-shelter in turbulent markets. Tobacco, grocery, and non-alcoholic beverage companies were relative outperformers within staples while big-box retail, beer, and beauty companies underperformed. Should tariffs and trade-wars remain in effect during 2025 and beyond we believe that firms that will likely outperform in the near term if they have greater international exposure; or if they provide tremendous value for the consumer-such as club stores. We prefer strong franchises with leading brand positions that can offset private label encroachment as consumers seek value.

Energy

The energy sector significantly outperformed the broad market in Q1, but got a double whammy post quarter close as fear of lower demand post Liberation Day and higher supply following OPEC+'s announcement to bring curtailed barrels back at a faster pace. This was a greater quantity than previous messaged. There is a plethora of game theory out there as to why, but no-one outside OPEC+ members has an answer. As "typical" as an energy downturn can be, those caused by oversupply tend be more severe for the equities than a downcycle driven by lack of demand. In this case, the market is on its way pricing both types of downturns into the equities. As oil hovers around $60 per barrel, U.S. exploration and production producers have signaled slowing activity. If we drift into the $50's per barrel all but a few will cut activity. Cutting activity is the first step in correcting an oversupplied market. With downturn duration unknown, we are starting to look at left of cost curve producers who had been priced for perfection prior to this selloff.

Financials

The financials sector outperformed the broad market in Q1. Large money center and investment banks outperformed broader financials and the regional banks. Increased speculation of a more favorable post-election regulatory environment supported the performance of the capital markets sector, including money centers, investment banks, and brokers. Within asset managers, alternative and private market asset managers enjoy a favorable long-term dynamic that includes opportunities in private credit, retail democratization and a potential improvement in realizations in portfolios. The most attractive asset managers have diversified platforms that consistently have positive net inflows which currently favors alternative / private market managers. At the margin, market volatility induced by recent trade policy uncertainty will likely delay the recovery in capital markets activity and elevates near term earnings risks for the group. Credit quality deterioration remains a focus in select loan categories, especially office commercial real estate and lower income consumer credit. We remain highly selective in the insurance space favoring those with proven underwriting and conservative reserving as they are likely to enjoy margin and return expansion even in the face of softening pricing.

Equity Views

Healthcare

Healthcare modestly outperformed the market during Q1. Healthcare policy uncertainty dominates the present narrative. Healthcare services (i.e. healthcare providers, pharmacy benefit managers) and the biopharmaceutical industry face the largest implications from healthcare policy changes going forward. Higher-than-expected final Medicare Advantage rates is a positive relief to funding concerns. We believe this subsector is attractive, supported by stabilizing utilization, improving price discipline, and limited exposure to tariff/recession risks. The risk of Medicaid cuts and Affordable Care Act extended subsidy expiration are headwinds to the exposed managed care and healthcare providers. Healthcare utilization remains solid but appears to be moderating back to historical levels. In medical devices we prefer companies with unique product cycle catalysts, favorable procedure economics, and exposure to non-elective procedure categories. We see opportunity in BioPharma despite Medicare price negotiations, upcoming patent cliffs, and potential for FDA reform. Large pharmaceutical companies have come under pressure due to tariff anxiety. We see a meaningful rerating potential for the sector if a credible path emerges to reshore intellectual property to the U.S. We are closely following life science tools & contract research organization sectors for signs that the pullback in large pharma research and development spend and potential National Institute of Health funding cuts begins to reverse. Demand should normalize for companies exposed to commercial drug production driven by strong new biologic drug approval rates and upcoming biosimilar launches. This should in turn bode well for drug distributors.

Industrials

The industrial sector outperformed the broader market in Q1. U.S. Purchasing Managers Index (a monthly economic indicator that focuses on the performance of the manufacturing sector in the U.S.) readings were above 50 in January and February (first positive readings since October 2022), but fell below 50 in March, signaling contraction. Industrial production was sluggish but positive. April tariff announcements figure to have wide-ranging impacts on the business cycle, demand environment, and company profitability. Given this backdrop, we prefer businesses with pricing power, de-risked supply chains, and clean balance sheets. Housing affordability could improve if lower mortgage rates materialize, but input cost inflation likely serves as an offset. Complex supply chains and higher input prices could challenge machinery-company margins. Sentiment towards electrification and AI-related beneficiaries has dampened, with growing concerns about the durability of AI-related investment.

Information Technology

The technology sector underperformed the broad market in Q1. Technology hardware, electronics and semiconductor industries face a hard reset with the Trump tariff policy that spins up many derailment scenarios in the near term. Sourcing is mainly established within southeast Asia along with China, and it will be highly exposed to the higher cost of tariffs that threatens to dramatically increase costs which will ultimately hurt demand as businesses and consumers reduce spending given these higher costs and further policy uncertainty. Technology hardware and semiconductor earnings are very sensitive to the economic cycle and a downcycle will be problematic for associated stocks. To mitigate the negative impact, we are tilting exposure to higher quality, less cyclical stocks where earnings are less impacted. Given this is economic challenge is self-inflicted, we need to be vigilant on maintaining reasonable exposure in case there is a quick reversal in policy. Software underperformed the broader market in Q1, following an overall policy induced risk-off selloff. The AI monetization tailwind has yet to inflect with signs of it being pushed out to 2026 or later. With more significant economic uncertainty and the potential for enterprises to pause IT spend initiatives, we remain selective in software overall, focusing on quality names that are more mission-critical to customers in areas such as vertical software or cybersecurity.

Materials

The materials sector declined during the first quarter but declined less than broad benchmarks. For value funds vis-à-vis value benchmarks, the sector lagged. A deteriorating macro-economic outlook is generally unfavorable for materials. Commodity chemicals are especially sensitive to the economy and have struggled year-to-date, a trend that might continue. Copper and steel have done well so far in 2025 and are expected to continue to do so. Copper is a direct beneficiary of global electrification and new mine supply takes years to discover, permit and develop. Steel is sensitive to the building and construction end market, especially. A weaker economy might mean lower interest rates incenting new construction. The same dynamic is favorable to forest products too. In the very near-term tariff-induced earnings risk certainly exists. Valuations are much improved for new investment in front of sentiment improving at some future date.

Equity Views

Real Estate

Real estate investment trust (REIT) stocks rose slightly in 1Q, outperforming the declining market. ‘Safer’ sectors such as cell towers and healthcare outperformed, while more cyclical hotels and office underperformed significantly. Data centers also declined on concerns of a slowdown in AI-related spending. Looking ahead, the outlook for REITs remains unclear, particularly as tariffs and tax changes could disrupt consumer and corporate real estate demand. On the positive side, new real estate supply continues to materially decelerate, which should benefit existing landlords. Our process remains highly selective, favoring REITs with consistent long-term demand, high barriers to new supply, and flexible balance sheets. Sectors that stand out positively include cell towers, self-storage, and industrial (warehouses).

Utilities

In Q1, utilities was among the best performing sectors on both an absolute and relative basis due to their defensive characteristics. Despite the outperformance, valuation remains attractive relative to the market while dividend yields have improved relative to a lower interest rate environment. As volatility in the markets continue, regulated utilities are poised for further outperformance. Utilities are primarily domestic based companies with very little exposure to global trade issues. Higher expenses driven by inflation or tariffs are pass-through costs which utilities can recover through rates, allowing earnings per share to be more stable than most other sectors. Additionally, regulated utilities earn a return on invested capital so higher costs drive higher rate base and eventually higher EPS. De-regulated Integrated Power Producers (IPPs) underperformed in the quarter following strong outperformance in 2024. Concerns over a potential slowdown in the AI data center rollout was a major area of focus. However, the forecast for future power demand remains robust which should drive longer-term outperformance as there is still scarcity of new supply. Risks to the outlook remain financing costs which may be more difficult in the current market environment along with concern over customer bill increases. Focus stocks remain high-quality utilities with accelerating growth trends.

Fixed Income Views

Investment-grade corporates

Overweight investment-grade corporates

Investment grade corporate bonds underperformed similar maturity U.S. Treasuries during the quarter as credit spreads widened on significant policy uncertainty and growing risks to the economy. Despite this backup in credit spreads, we still do not believe potential downside risks are fully priced into valuations in the U.S. corporate bond market. Somewhat offsetting our concerns on valuations is our view that corporate balance sheets are in reasonably good shape and can withstand a modest slowdown or shallow recession. A continued demand for yield should also translate into supportive technicals. While we do not currently find much value in credit spreads, we do believe absolute yield levels for investment grade corporate bonds are quite attractive.

Risks to our outlook include a more severe economic downturn than currently anticipated. An inflation rate that remains above the Federal Reserve's target and that could be pressured even higher due to trade policy is also a risk as it may make it more difficult for the Fed to cut rates to support a weakening economy. The health of the consumer and businesses is also key to our outlook, and we continue to monitor both for any signs of weakness in the economic data. We are maintaining a defensive, up-in-quality risk profile and are waiting for a better opportunity to add credit risk.

High yield

Underweight high yield

Tariffs took the spotlight during the first quarter creating significant uncertainty regarding inflation prospects and economic growth. This uncertainty led spreads (the additional yield over risk-free Treasuries) to increase ninety basis points from the low point reached in January as economic growth estimates declined and inflation expectations rose. With the probability of a recession increasing markedly, we expect the high-yield market to remain under pressure and volatility to remain elevated over the near-term. Lower-quality CCC-rated bonds are expected to underperform along with industries most impacted by tariffs, such as Autos and Retail.

Securitized assets

Overweight securitized assets

Expectations for the Federal Funds Rate is 2-3 cuts for the remainder of 2025, however, due to the tariff announcements, there is a lot of uncertainty around the future path of the U.S. economy and interest rates. Mortgage-backed securities (MBS) spreads are impacted by volatility, so our expectation is that agency MBS spreads will remain on the wider end as long as the tariff-associated volatility persists in the market.

However, our allocation to Agency MBS remains high due to its defensive nature and we expect to see credit spreads widen more dramatically as tariff policies put stress on the U.S. economy. We are overweight on Agency MBS versus Treasuries as MBS spreads are wide to medium-term ranges and will look to add into further weakness or a drop in volatility.

Emerging-market debt

Neutral emerging-market debt

Emerging Market Debt (EMD) had a choppy first quarter as spreads widened 23 bps since mid-February, with rallying U.S. Treasury yields still generating a positive overall return. Returns were focused on higher quality names with spread decompression in high yield names an important theme. The best index performers were the investment grade Gulf Cooperation Council (GCC) names and investment grade names in Central and Eastern Europe and Latin America. Sub-Saharan Africa credits and Argentina were very soft during Q1. The key issue going forward is how Trump's tariffs will play out with global growth and risk appetite. If he does not reduce his unilateral trade barriers and declare victory, a U.S. recession is quite likely which would be bad for all risk assets. We do not expect the Fed to 'rescue' U.S. growth from this policy mistake, at least not right away, as inflation is likely to be significant. Uncertainty is always the enemy of risk markets.

Fixed Income Views

Municipals

Overweight municipals

Municipal yield levels continue to look attractive both on an absolute level and relative to other asset classes, especially Treasuries. We expect to see strong supply of new deals in the coming quarters. The market will likely experience continued volatility from policy changes emanating from Washington D.C. that affect the municipal market. A positive affirmation regarding continuing municipal bond tax exemption would firm up demand for municipal debt. We expect to see increased pressure on the higher education sector and the healthcare sector mainly financially, but in the case of the higher education sector, also politically.

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