TD Global Investment Solutions

Talking Points

Commentary

2025

Aug

For the month ended August 2025

Fixed Income Outlook

TD Asset Management emphasizes capital preservation in our active fixed income portfolios while seeking to maintain a yield advantage relative to the benchmark. We expect U.S. growth (real GDP) will slow to below trend in 2025 with a slight uptick in 2026 due to a fiscal policy boost. The height of policy uncertainty has passed as trade agreements/frameworks continue to be realized, mitigating the more extreme tariffs, and the signing of the One Big Beautiful Bill into law. The U.S. labor market has deteriorated and is expected to remain weak into 2026. This provides the Federal Open Market Committee (FOMC) with valid case to reduce its policy rate in September. If the labor market weakens further, we expect additional cuts later in 2025 and into 2026 even with inflation well above the FOMC's target. Policy uncertainty remains high, however. We remain constructive, and very selective toward corporate credit and are comfortable with our strategic credit positioning. Corporate bonds continue to offer some value over government bonds; thus, we maintain our preference for high-quality investment grade corporates. We continue to be positioned with an emphasis on liquidity and quality.

Focal Points

- 2Q 2025 U.S. real GDP was revised up a more-than-expected +0.3%, to 3.3% despite weaker contributions from net exports, inventories, and government. Real final sales to private domestic purchasers (core GDP in effect) was revised to 1.9% (same as 1Q) from 1.2% mostly due to an upward revision to business spending.

- The current federal funds target range is 4.25%-4.50%. The FOMC's median federal funds forecast for year end 2025 is 3.875%. Amid the uncertainty, the FOMC expects, above-target inflation, a weakening labor market, and below trend economic growth in 2025 and 2026. A 0.25% rate cut is expected at the FOMC's September meeting.

- Treasury yields decreased, and the yield curve steepened in August. Timely economic data indicate a weakening labor market and elevated inflation. Tariff uncertainty and tariff-related price hikes will negatively impact real household and business spending into 2H 2025. This may allow interest rates to move lower from current levels. Political pressure around Fed independence is contributing to yield curve steepness.

- After reaching a multi-decade low in spreads, corporate bond spreads widened month over month as investors prepare for a historically-heavy September issuance calendar.

Investment Professionals:

Dennis Woessner, CFA, CAIA
Vice President & Director

Russell Wald, CFA
Vice President

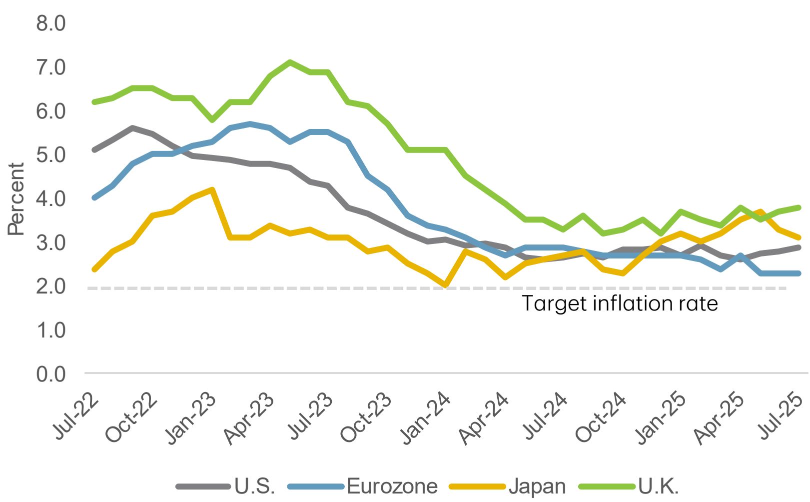
Macro Update

- U.S. real GDP in 2Q 2025 was revised up a more-than-expected +0.3%, to 3.3%. Real final sales to private domestic purchasers expanded at 1.9% in 1H 2025 which is near the economy's trend growth rate of ~2.0%.
- We expect the administration's tariff and immigration policies to reduce household consumption. This will slow U.S. growth (real GDP) to below trend (~2.0%) in 2025 with a slight uptick in 2026. We believe inflation will remain elevated and the labor market will weaken during the remaining part of this year.

Long-Term Views:

- U.S. growth will be positive while global economic growth remains relatively weak, especially in the Eurozone. Short-term interest rates are moving lower in many developed markets as growth and inflation moderate.
- Federal Reserve policy will focus on economic growth if inflation moves toward its target rate and the unemployment rate rises. Nominal and real interest rates may remain elevated as U.S. economic growth remains positive.
- Additional disinflation in developed markets may find some resistance due to higher wages, higher food prices, and geopolitical events such as tariffs and on-going conflicts.

Inflation



Source: Bloomberg Financial L.P.; August 31, 2025

Headline inflation in the U.S. and other major economies remain above target levels. US inflation is consolidating above the FOMC's target. We expect inflation to be biased upward in the US and remain elevated over the next twelve months due implementation of tariff and trade-related policies.

Attaining and remaining at the FOMC's two-percent target rate on a sustained basis may be a challenge.

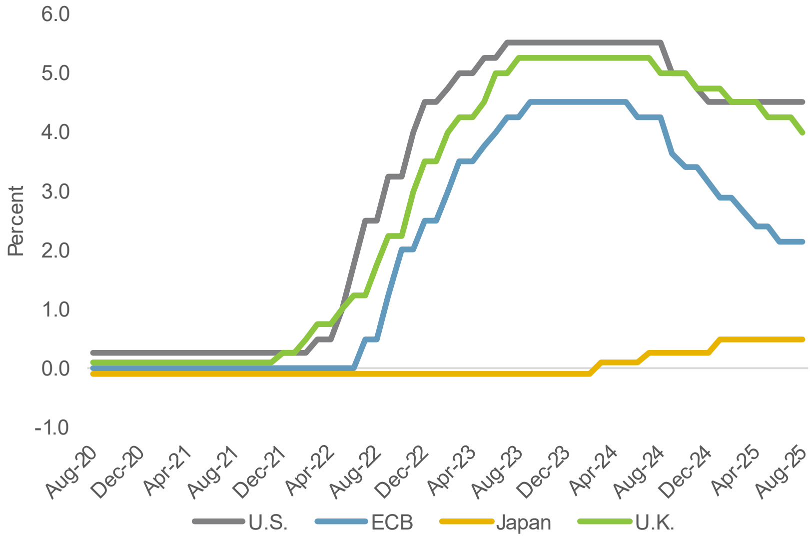
U.S. Central Bank Update

- The narrative on FOMC policy has shifted following Chair Powell's Jackson Hole speech where he noted "...with policy in restrictive territory, the baseline outlook and the shifting balance of risks may warrant adjusting our policy stance." Additionally, he stated "... downside risks to employment are rising." This change follows July labor reports which indicate the U.S. jobs market is much weaker than previously known.
- FOMC is mindful of heightened uncertainty within its economic outlook and indicated a willingness to look through tariff-impacted inflation they view as one-off if growth meaningfully weakens.
- The current policy target range is 4.25%-4.50%. A 0.25% rate cut is expected at the FOMC's September meeting. This will be the highest inflation backdrop for a rate cut in ~30 years.

Long-Term Views:

- The federal funds effective rate will become less restrictive as the FOMC continues decreasing interest rates. We expect a shallower federal funds rate cut path through 2026; however, this outcome is highly uncertain due to the Trump administration's trade and fiscal policies, and desire to exert more control over FOMC policy contributing to a sustained steeper yield curve.
- The FOMC is committed to its monetary framework and market facilities to support price stability, labor markets, and financial market liquidity.

Central Bank Policy Rates



Source: Bloomberg Financial L.P.; August 31, 2025

Most major Central Banks are lowering policy rates as data are showing moderating growth even as inflation remains sticky. Central Banks remain data dependent when determining future policy decisions.

The Federal Reserve reduced the federal funds rate by 1.0 ppt in the latter third of 2024. The trajectory of rate cuts through 2026 will likely be shallower as the U.S. economy continues to expand while the policy rate becomes less restrictive.

The upper bound of FOMC's policy range has been held at 4.50% since last December (as shown in graph).

Cash/Short-term Market Update

- Short-end Treasury yields decreased during the month as timely economic data show a weakening labor market while inflation remains elevated. Tariff uncertainty will negatively impact household and business spending into 3Q 2025 which may contribute to a softening macro economic setting.
- Short-term credit spreads widened 2 bps, to 50 bps, during August. Lower interest rates and a historically-heavy September issuance calendar we two of the factors.
- Prime money fund assets increased $53.4 billion during the 3-month period ending August 2025. Total assets are $1.2 trillion (up 13.9% YoY).

Current Positioning:

- Short and Short/Intermediate Government/ Credit models prefer high-quality investment grade corporate bonds and have a similar duration profile relative to their respective benchmark.

Number of Hikes/Cuts Priced into Market

Source: Bloomberg Financial L.P.; August 31, 2025

Five rate cuts are expected through 2026. The FOMC's economic projections indicate inflation will remain higher for longer. It expects the PCE price index to reach the 2.0% target by year-end 2027.

The implied policy rate reached a peak rate of 5.3% in 2024. This rate is expected to decline along a slightly steeper path relative to last month due to a much weaker labor market data. The FOMC expects elevated inflation, slightly below-trend economic growth, and the uncertain economic impact from trade and economic policies.

1-3 Year Corporate Option-Adjusted Spread (OAS)

Source: Bloomberg Financial L.P.; August 31, 2025

At 50 bps, the index OAS is 2 bps wider from last month end. Year-over-year, the index OAS is 8 bps tighter. Factors which may benefit spreads are trend GDP growth outlook, solid fundamentals, and an easing FOMC policy framework. Uncertainty pertaining to trade and fiscal policies are negatively affecting corporate bond spreads.

Corporate fundamentals are expected to weaken from a strong base as growth slows to below trend. Financial conditions are not overly restrictive as the FOMC is easing policy restriction and spreads remain near multiyear tight levels.

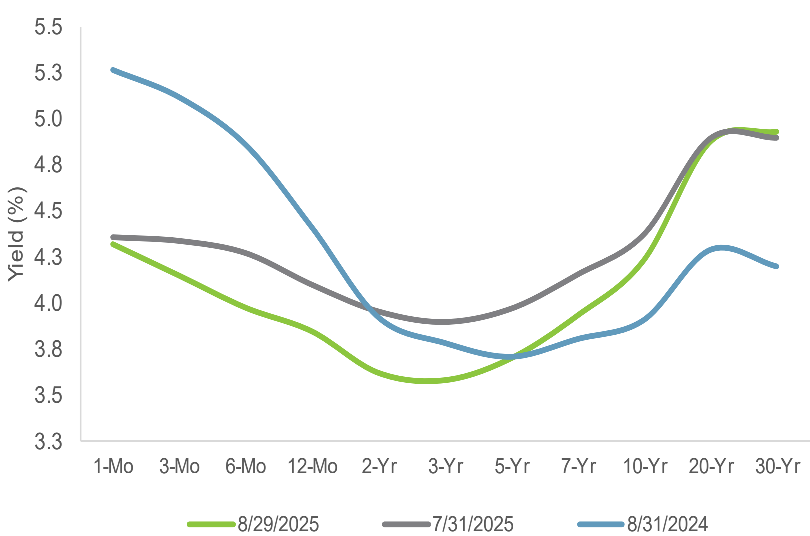
U.S. Treasury Market Update

- U.S. Treasury yields mostly decreased as the yield curve bull-twisted. Some pullback in household and business spending is expected to reduce economic growth during the next couple quarters. Hard economic data indicate a weakening U.S. labor market with limited impact from tariff-related policies.
- The scale and scope of the Trump administration's trade, tax, immigration, and regulatory policies to expected real economic growth, inflation, and fiscal deficits remains uncertain. Overall, these policies have elevated short-term implied inflation rates and steepened the yield curve.

Current Positioning:

- Government models have similar duration profiles relative to their respective benchmark. We expect interest rates to be more volatile during this period of uncertain fiscal- and trade-related policies.

Treasury Yields

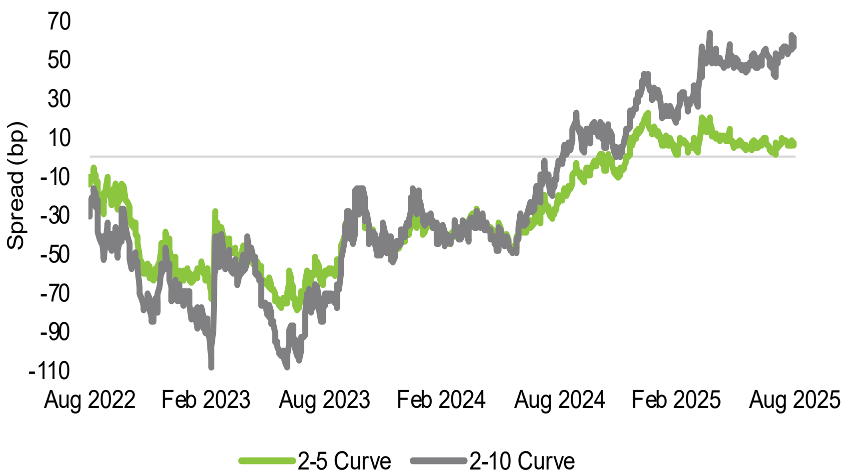


Source: Bloomberg Financial L.P.; August 31, 2025

Treasury yields mostly decreased during August. The spread between 2- and 30-year maturities increased 37 bps, to 131 bps. The yield gap between the 3-month T-Bill and 10-year Treasury is 8 bps, 5 bps steeper since last month end.

We expect yields to be range-bound at current levels as labor demand weakens, and economic growth slows. Stimulative fiscal policy will contribute to growth later this year and through 2026 which may push yields higher. The FOMC's policy framework is still restrictive but some degree of restrictiveness will be gradually removed in the coming months. We expect interest rates to be more volatile during this period of uncertain fiscal- and trade-related policies.

Treasury Curves



Source: Bloomberg Financial L.P.; August 31, 2025

The belly of the Treasury curve bull steepened during the month as markets priced for a September rate cut after Chair Powell noted during his Jackson Hole speech a "shifting balance of risks may warrant adjusting our policy stance."

The 2s10s curve increased 19 bps, to 61 bps. The 2s5s curve, at 8 bps, increased 6 bps.

Higher fiscal deficits may pressure term premiums higher over the medium and longer term. Investors maintain focus on indicators pointing to weaker economic growth and sticky inflation outlooks.

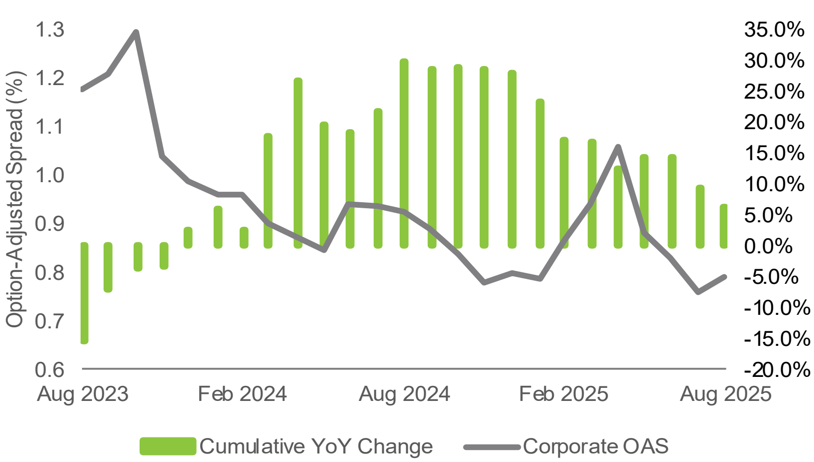
Investment Grade Credit Market Update

- Corporate bond spreads increased 3 bps, to 79 bps, while the credit curve flattened relative to last month. Lower interest rates, due to a weaker labor market, and a historically-heavy September issuance calendar were factors contributing to wider spreads. Corporate bond yields moved lower during the month.
- Investors are monitoring U.S. trade policy and potential retaliatory measures as it relates to economic growth and corporate earnings.
- Looking forward, corporate fundamentals should remain solid but will continue to weaken from very strong levels as the economy enters a period of below trend growth.

Current Positioning:

- Government/Credit models remain overweight the corporate sector, mostly in the banking industry, and have similar duration profiles relative to their respective benchmark.

Corporate Spread & Issuance

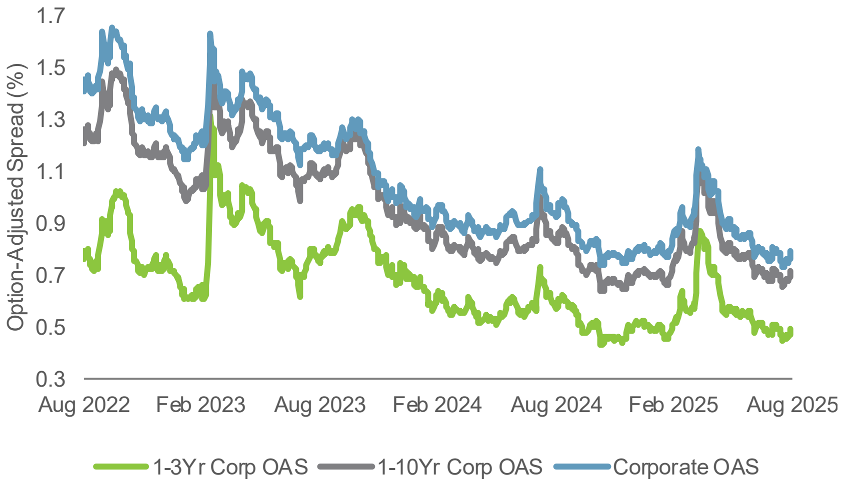


Source: Bloomberg Financial L.P.; August 31, 2025

In August, corporate bond issuance was $105.8 billion, a 2% decrease from the same period last year. The cumulative 12-month change is 6%. The spread on the corporate bond index, at 79 bps, is 3 bps wider on the month.

YTD issuance is $1.154 trillion. Expected corporate bond issuance for 2025 is $1.55 trillion; therefore, we expect a slowdown in issuance for the remainder of 2025.

Corporate Spreads by Maturity



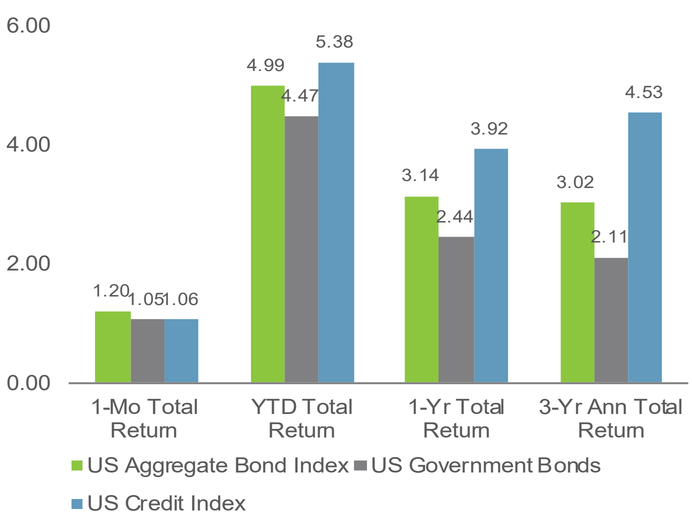
Source: Bloomberg Financial L.P.; August 31, 2025

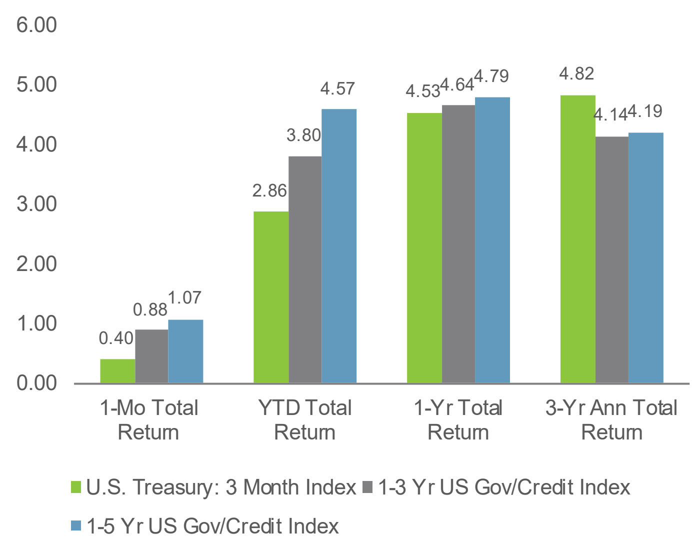
The Bloomberg U.S. Corporate Bond Index spread is 14 bps tighter during the past 12-month period. There has been strong investor demand during a period of relatively higher yields and record issuance. Factors which may benefit future spreads are trend GDP growth outlook, solid fundamentals, and an easing FOMC policy framework. Uncertainty from tariff and fiscal policies is negatively impacting spreads.

The corporate bond index OAS is 3 bps wider since last month end, currently 79 bps. The 1-10- year corporate bond index OAS, at 72 bps, is 4 bps wider for the month.

Charts & Tables

Fixed Income Indices





Economic Figures & Short-term Rates

Description	Current	3-mo Ago	1-yr Ago	Next Release
Fed Funds (%)	4.50	4.50	5.50	9/17/2025
CPI (YoY %)	2.70	2.30	2.90	9/11/2025
PCE (YoY %)	2.60	2.20	2.50	9/26/2025
Unemployment Rate (%)	4.20	4.20	4.20	9/5/2025
GDP (YoY %)	2.10	2.00	3.00	9/25/2025
Retail Sales (YoY %)	3.90	5.00	3.00	9/16/2025
Leading Indicators (YoY %)	-3.60	-4.30	-4.70	9/18/2025
Housing Starts (000s)	1,428	1,398	1,265	9/17/2025

Description	Current	3-mo Ago	1-yr Ago
Fed Funds (%)	4.50	4.50	5.50
3-Mo U.S. Treasury Bill	4.15	4.34	5.12
6-Mo U.S. Treasury Bill	3.97	4.32	4.86
USD O/N Govt. Repo	4.37	4.34	5.39
U.S. 30-Day Comm Paper*	4.26	4.35	5.22
U.S. 90-Day Comm Paper*	4.21	4.37	5.06

*A1/P1/F1 rated U.S. Commercial Paper

Source for all charts and tables: Bloomberg Financial L.P.; August 31, 2025

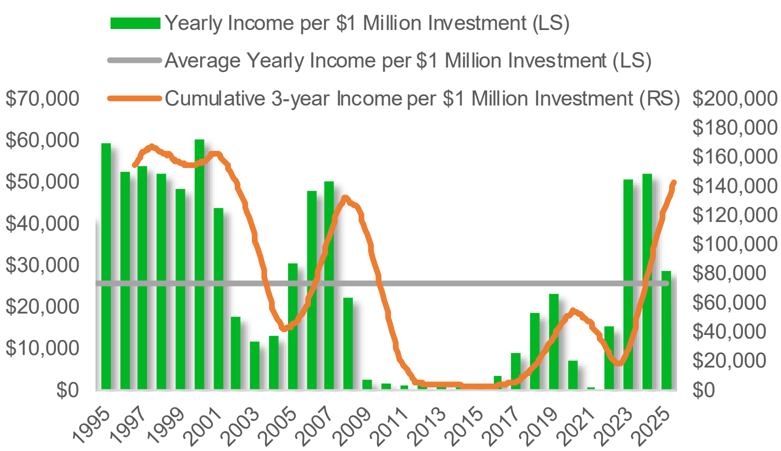
Charts & Tables - continued

Treasury Market

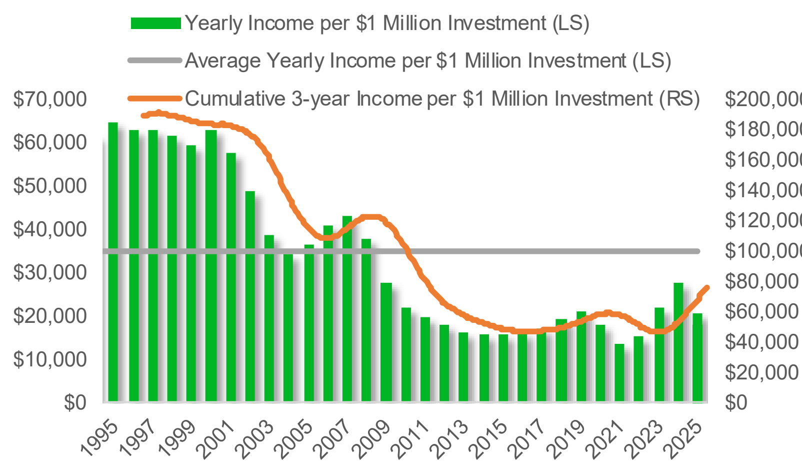
		Change in Yield Curve (basis points)		
Maturity	Yield Curve (%)	1-Mo Ago	3-Mo Ago	1-Yr Ago
1-Mo	4.32	-4	4	-95
3-Mo	4.15	-20	-20	-97
6-Mo	3.97	-30	-34	-89
12-Mo	3.84	-26	-27	-57
2-Yr	3.62	-34	-28	-30
3-Yr	3.58	-32	-29	-20
5-Yr	3.70	-28	-27	-1
7-Yr	3.93	-23	-25	13
10-Yr	4.23	-15	-17	33
20-Yr	4.87	-2	-6	59
30-Yr	4.93	3	0	73

Investment Income per $1 Million Invested in Index (No reinvestment of income)

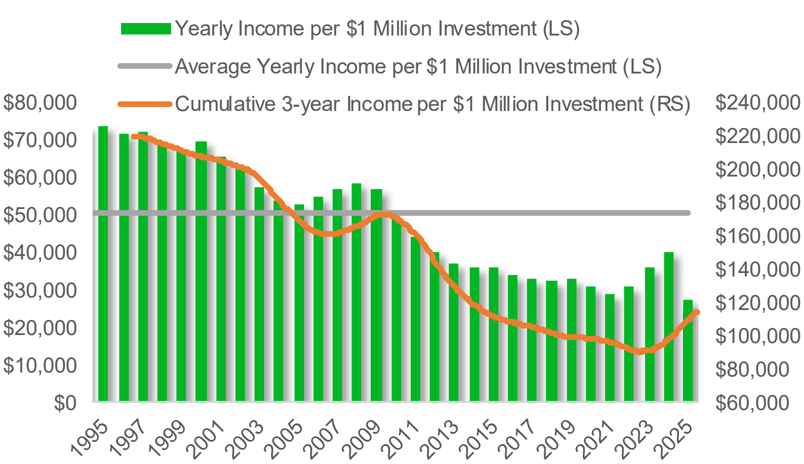
Bloomberg U.S. 3 Month Treasury Bill Index



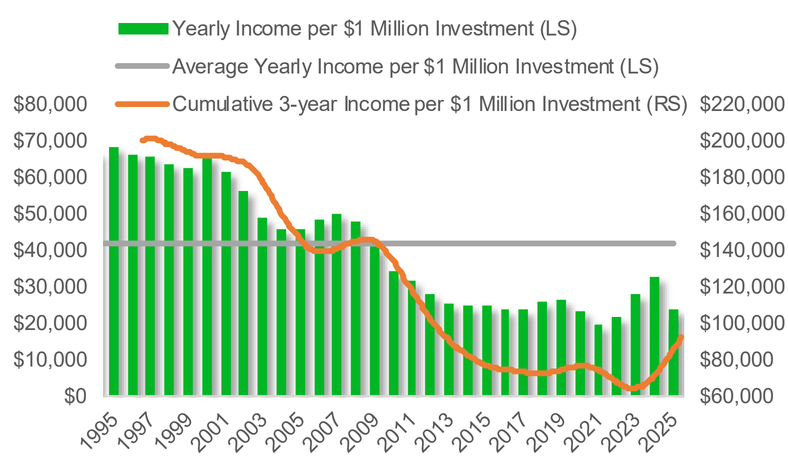
Bloomberg U.S. Treasury 1-5 Year Index



Bloomberg U.S. Corporate Bond 1-5 Year Index



Bloomberg U.S. Intermediate Government/Credit Index



Source for all charts and tables: Bloomberg Financial L.P.; August 31, 2025

Talking Points

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