TD Global Investment Solutions

Talking Points

Commentary | Mar 2025

For the month ended March 2025

Fixed Income Outlook

We emphasize 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. A U.S. recession within the year is not our base case; however, the U.S. administration's inconsistent and chaotic approach to economic and trade policy is causing greater uncertainty within the manufacturing and service sectors of the economy. Economic survey data is indicating a broad-based slowdown with above-target inflation. The U.S. labor market has been resilient but is expected to weaken during 2025. The Federal Open Market Committee (FOMC) is expected to slow the pace of rate reductions in 2025 due to elevated inflation readings, a resilient labor market, uncertain trade policy and an unknown fiscal package. 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

- Headline U.S. GDP increased 2.4% in 4Q 2024 (3.1% in 3Q 2024). Household consumption was the dominant driver to growth. Equipment spending and inventories were the main detractors to growth. Domestic demand is still relatively solid. Additionally, the pace of nominal GDP slowed to 4.8% from 5.0%.

- The current federal funds target range remained at 4.25%-4.50% after the FOMC's latest meeting. The FOMC's median federal funds forecast for year end 2025 is 3.875%. The policy rate is still restrictive. Uncertainty around the FOMC's economic outlook has increased.

- During the month, the U.S. Treasury curve steepened – shorter-term yields decreased while longer-term yields increased. Concerns regarding DOGE-related layoffs of federal employees, a slowdown in consumption data, and both elevated uncertainty and concern around the magnitude of trade policy changes are factors in this rate move.

- Corporate bond spreads widened month over month for the same factors highlighted above as markets demonstrate concern that volatile trade policy may impact business investment and consumption amidst an already decelerating growth backdrop.

Investment Professionals:

Dennis Woessner, CFA, CAIA
Vice President & Director

Russell Wald, CFA
Vice President

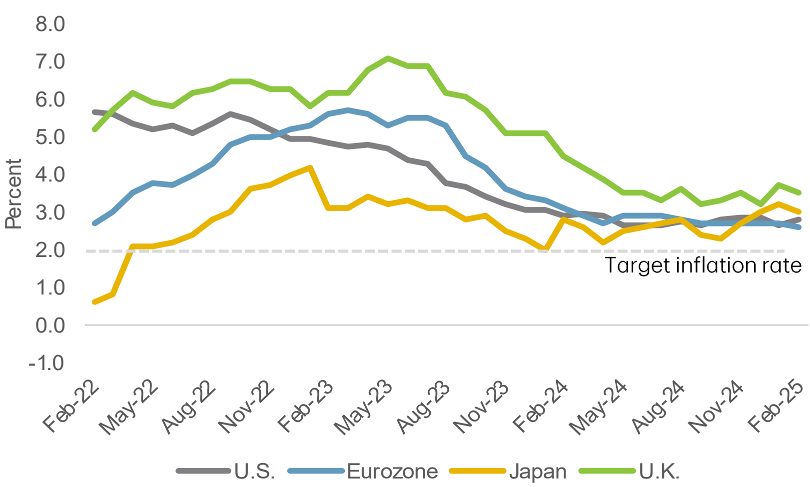
Macro Update

- U.S. real GDP increased 2.4% in 4Q 2024 (3.1% in 3Q 2024). Household consumption was the dominant driver to growth. Equipment spending and inventories were the main detractors to growth. U.S. final sales to private domestic purchasers (a proxy for domestic demand) remains solid. Quarterly measures of inflation remain above the FOMC's target rate.
- We expect U.S. growth (real GDP) to be below trend (~2.0%) in 2025 amid uncertain trade and fiscal policies. Weak 1Q consumption data, partly due to economic uncertainly, will not be as strong a driver of growth as experienced in 2024. Recent evidence shows that the labor market may be weakening.

Long-Term Views:

- U.S. growth remains positive while global economic growth remains relatively weak, especially in the Eurozone. Short-term interest rates are now moving lower in many developed markets as inflation moderates.
- 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.; March 31, 2025

Headline inflation in the U.S. and other major economies is no longer decelerating and remains above target levels. U.S. core prices remain elevated and above the FOMC's target as well. We expect inflation to remain anchored over the next twelve months, with elevated uncertainty, due to the administration's tariff policy.

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

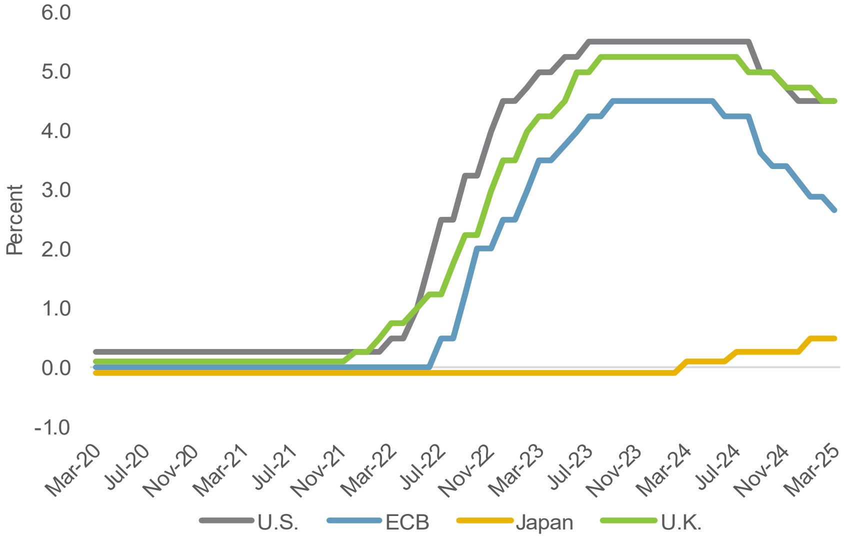
U.S. Central Bank Update

- The FOMC held the federal funds rate steady at its March meeting. The current range is 4.25%-4.50%. The pace of rate cuts will slow in 2025 as economic growth remains solid and the policy rate is less restrictive. The FOMC is mindful of heightened uncertainty within its economic outlook.
- The Federal Reserve's summary of economic projections for 2025 show below-trend growth, higher-for-longer inflation, a slightly weaker labor market, and a declining federal funds rate, to 3.875% by year end 2025. The GDP growth and inflation outlooks will most likely be modified when the administration's economic policies, specifically tariffs, are known and implemented.

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 in 2025; however, this outcome is highly uncertain due to the current administration's tariff and fiscal policy agenda. The FOMC indicated a willingness to look through tariff impacted inflation they view as one-off if growth is weakening more meaningfully
- The FOMC is committed to its monetary policy framework and market facilities to support price stability, labor markets, and financial market liquidity.

Central Bank Policy Rates



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

Central Banks have kept inflation expectations well anchored by raising their respective policy rates (becoming more restrictive) thereby slowing growth by reducing demand as inflation remains above target.

Most major Central Banks are now easing policy restrictions as data are showing moderating growth and disinflation, albeit at a much slower pace. Central Banks are communicating data dependency to determine future policy decisions.

The Federal Reserve reduced the federal funds rate by 1.0 ppt since it began cutting rates in September. The upper bound of its target range is 4.50% (as shown in graph).

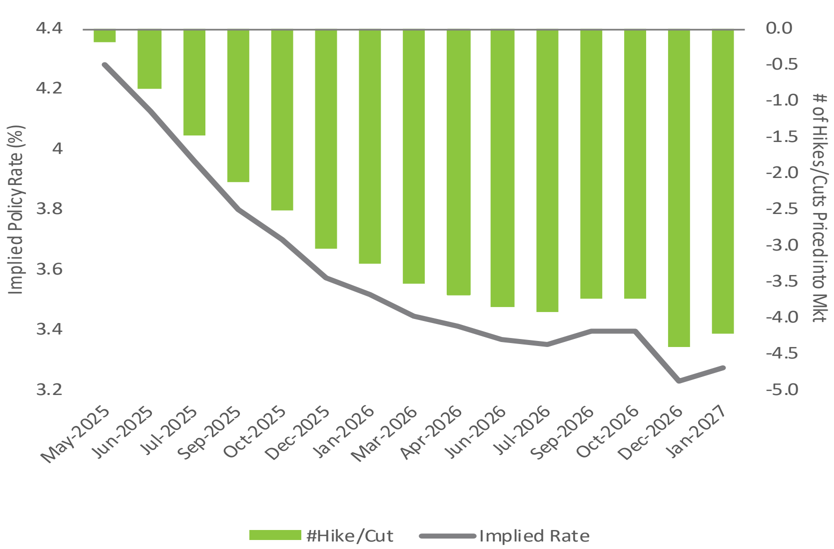
Cash/Short-term Market Update

- Short-end Treasury yields decreased during the month. Concerns regarding material layoffs of federal employees, a slowdown in consumption data, and uncertain tariff policy have been factors in declining rates.
- During the month, short-term credit spreads widened 6 bps, to 58 bps. The factors noted above negatively impacted non-Treasury assets. Solid fundamentals, attractive yields, and durable growth have supported credit spreads.
- Prime money fund assets increased $57.7 billion during the 3-month period ending March 2025. Total assets are $1.137 trillion (up 11% 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.; March 31, 2025

Fewer rate cuts are expected in 2025 as the FOMC's updated projections indicate that 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 now expected to decline along a much shallower path in 2025 due elevated inflation, slightly below-trend economic growth, and uncertainty with respect trade policies under the presidential administration.

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

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

At 58 bps, the index OAS is 6 bps wider from last month end. Year-over-year, the index OAS is 1 bp wider. Factors which may benefit spreads are moderating inflation, trend GDP growth outlook, 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 strong footing as growth slows to below trend. Financial conditions are not overly restrictive as the FOMC is easing policy restriction and spreads have risen from near multiyear tight levels.

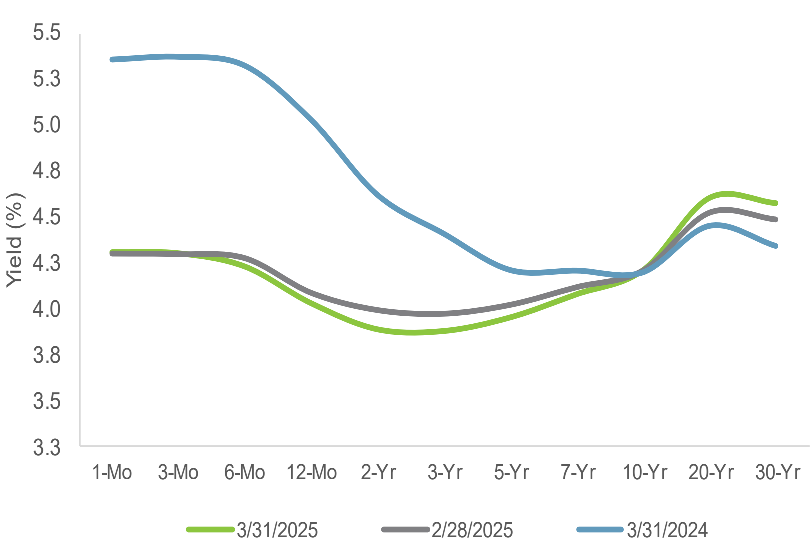
U.S. Treasury Market Update

- The U.S. Treasury curve steepened – shorter-term yields decreased while longer-term yields increased. Concerns regarding DOGE-related layoffs of federal employees, a slowdown in consumption data, and uncertain tariff policy have been factors in declining rates. Recent economic data indicate a weaker consumption outlook.
- The scale and scope of the Trump administration's trade, tax, immigration, and regulatory policies to expected real economic growth and inflation remains uncertain. Overall, these policies have elevated short-term implied inflation rates.

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

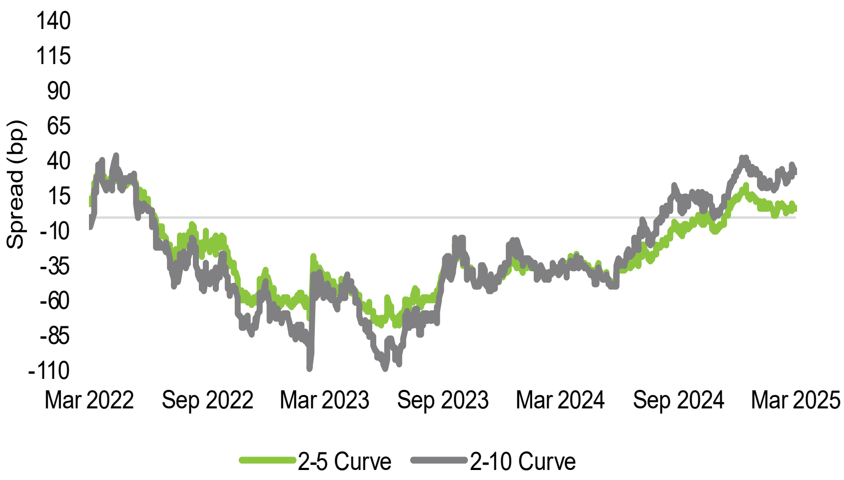


Source: Bloomberg Financial L.P.; March 31, 2025

The belly of the yield curve performed best as interest rates mostly decreased. The spread between 2- and 30-year maturities increased 19 bps, to 69 bps. The yield gap between the 3-month T-Bill and 10-year Treasury is -9 bps, unchanged from last month end.

We expect yields to move lower from current levels as the labor demand weakens and economic growth slows. The FOMC's policy framework is still restrictive. 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.; March 31, 2025

The belly of the Treasury curve steepened during the month as one more potential rate cut is being priced into the market. Investors maintain focus on indicators pointing to weaker economic growth and sticky inflation outlooks. The 2s10s curve rose 11 bps, to 32 bps. The 2s5s curve, at 7 bps, increased 4 bps.

Investment Grade Credit Market Update

- Corporate bond spreads widened 7 bps, to 94 bps, and the credit curve steepened relative to last month. Timely US economic data show both weakening household consumption and overall aggregate demand.
- Investors are showing greater focus on potential negative growth impacts of recent administration policies and policy uncertainty.
- Looking forward, corporate fundamentals should remain positive but will continue to weaken from very strong levels as the economy enters a period of slightly 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

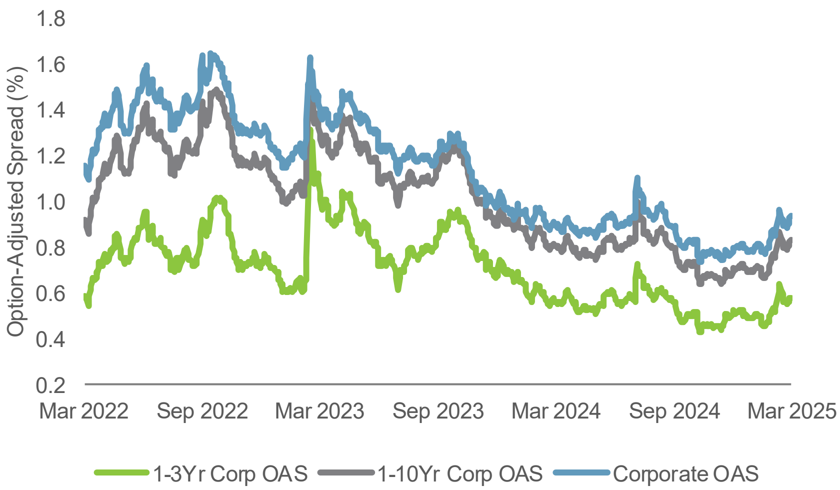
Corporate Spread & Issuance

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

In March, corporate bond issuance was $192 billion, a 29% increase from the same period last year. The cumulative 12-month change is 16.3%. The spread on the corporate bond index, at 94 bps, is 7 bps wider on the month.

Consensus 2025 corporate bond issuance is similar to 2024's tally of $1.55 trillion.

Corporate Spreads by Maturity



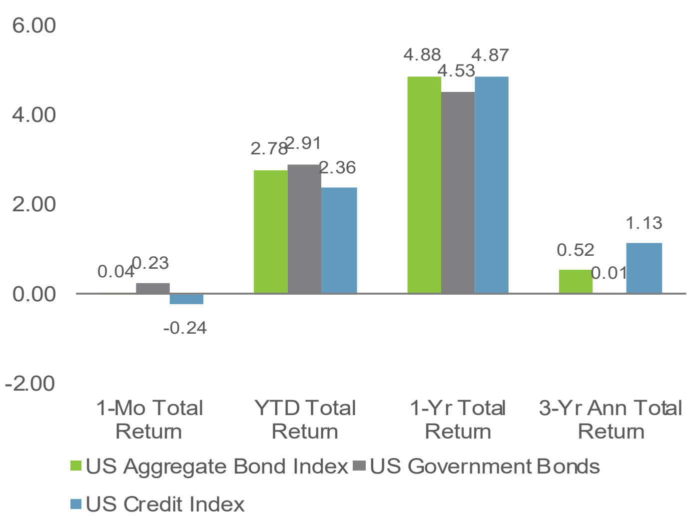
Source: Bloomberg Financial L.P.; March 31, 2025

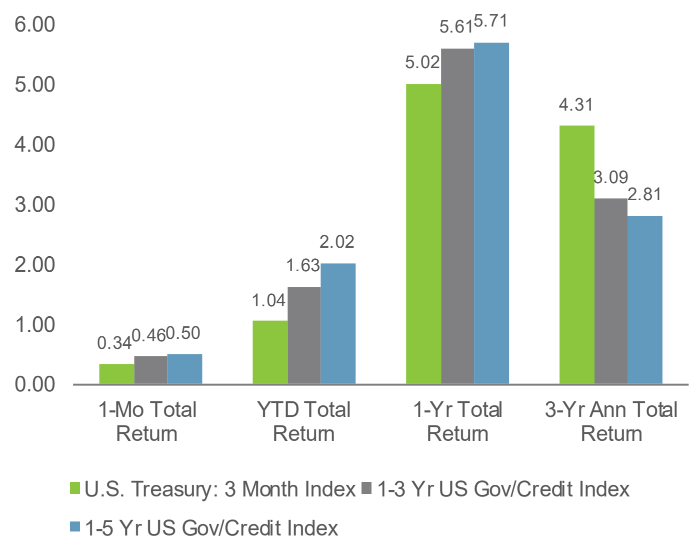
The Bloomberg U.S. Corporate Bond Index spread is 4 bps wider during the past 12-month period. There has been strong investor demand during a period of relatively higher yields and record issuance. Factors which may benefit future spreads are moderating inflation, trend GDP growth outlook, and an easing FOMC policy framework. Uncertainty from tariff and fiscal policies is negatively impacting spreads.

The corporate bond index OAS is 7 bps wider since last month end, currently 94 bps.

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	5/7/2025
CPI (YoY %)	2.80	2.70	3.20	4/10/2025
PCE (YoY %)	2.50	2.50	2.60	4/30/2025
Unemployment Rate (%)	4.10	4.20	3.90	4/4/2025
GDP (YoY %)	2.50	2.70	3.20	4/30/2025
Retail Sales (YoY %)	3.10	4.00	2.10	4/16/2025
Leading Indicators (YoY %)	-3.10	-3.00	-6.50	4/21/2025
Housing Starts (000s)	1,501	1,305	1,546	4/17/2025

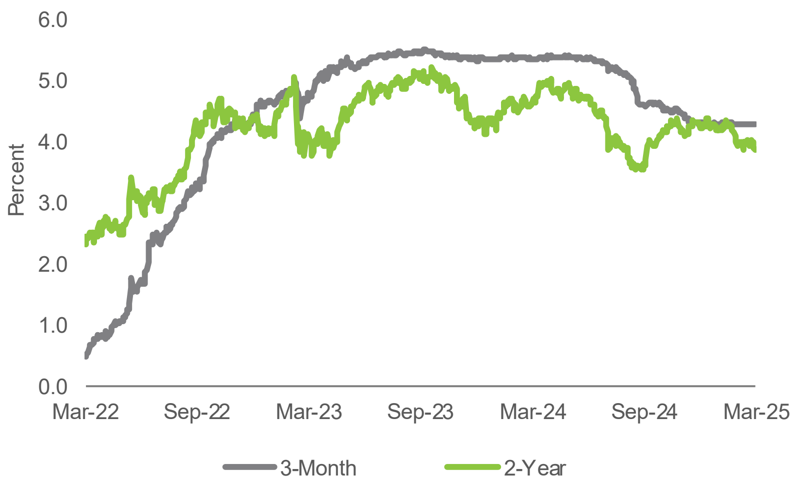
Description	Current	3-mo Ago	1-yr Ago
Fed Funds (%)	4.50	4.50	5.50
3-Mo U.S. Treasury Bill	4.30	4.32	5.37
6-Mo U.S. Treasury Bill	4.23	4.27	5.32
USD O/N Govt. Repo	4.52	4.50	5.39
U.S. 30-Day Comm Paper*	4.31	4.30	5.35
U.S. 90-Day Comm Paper*	4.33	4.39	5.41

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

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

Charts & Tables - continued

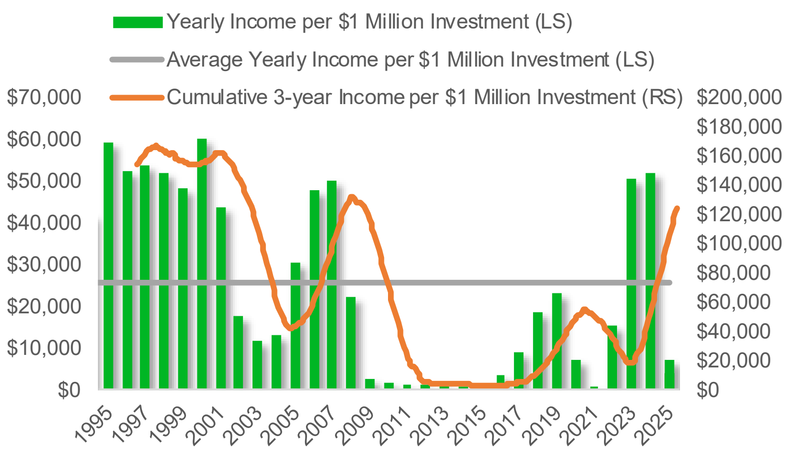
Treasury Market



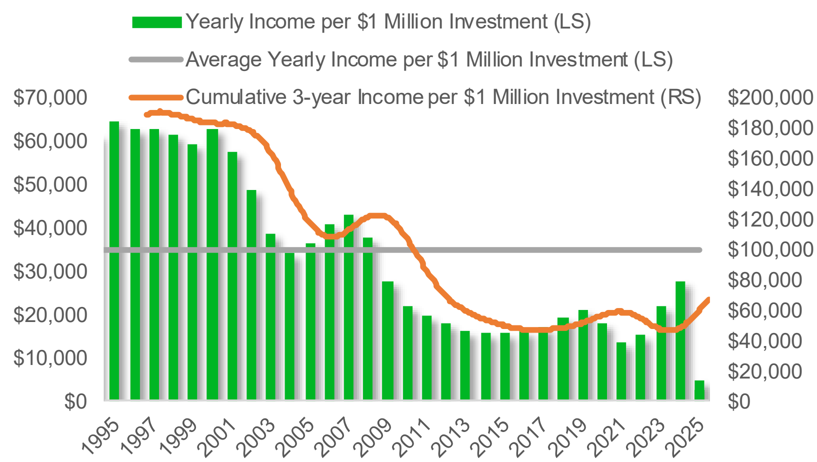
		Change in Yield Curve (basis points)		
Maturity	Yield Curve (%)	1-Mo Ago	3-Mo Ago	1-Yr Ago
1-Mo	4.31	0	2	-105
3-Mo	4.30	0	-2	-107
6-Mo	4.23	-5	-4	-110
12-Mo	4.03	-6	-13	-100
2-Yr	3.89	-11	-36	-74
3-Yr	3.88	-10	-40	-53
5-Yr	3.95	-7	-43	-26
7-Yr	4.08	-4	-41	-13
10-Yr	4.21	0	-37	1
20-Yr	4.60	7	-26	15
30-Yr	4.57	8	-21	23

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

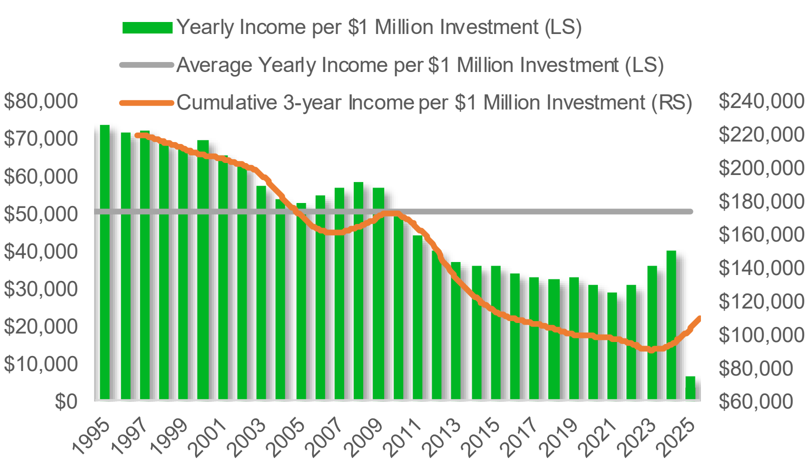
Bloomberg U.S. 3 Month Treasury Bill Index



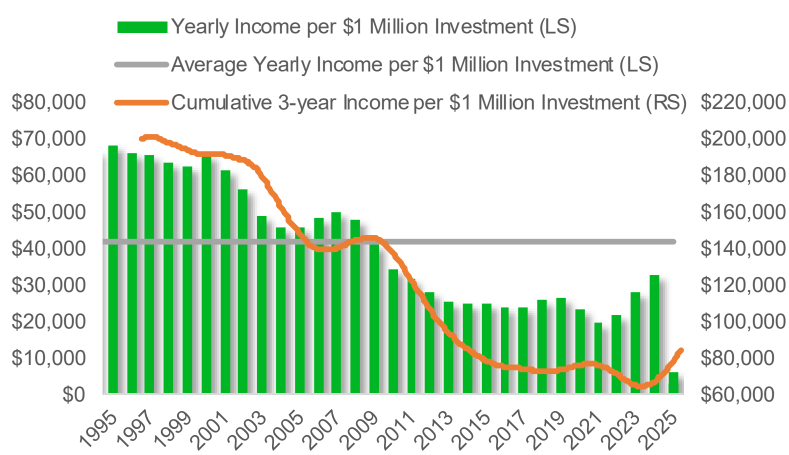
Bloomberg U.S. Treasury 1-5 Year Index



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.; March 31, 2025

Talking Points

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