TD Global Investment Solutions

Talking Points

Commentary May 2025

For the month ended May 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. A U.S. recession within the year is not our base case; however, the U.S. administration's often-chaotic implementation of economic and trade policies is causing uncertainty within households and businesses leading to a pullback in spending. Economic survey data is indicating a broad-based slowdown with above-target inflation. The U.S. labor market continues to be resilient but is expected to weaken during 2025. We expect The Federal Open Market Committee (FOMC) to slow the pace of rate reductions in 2025 due to elevated inflation readings, a slightly softer labor market, uncertain trade policy, and a yet-to-be-finalized 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

- U.S. GDP decreased 0.2% in 1Q 2025 (2.4% in 4Q 2024). A sequential slowdown in household consumption driven mostly by a decline in goods purchases. Both equipment spending and inventories surged and were main contributors to growth. Domestic demand is still relatively solid. Historically high imports detracted from GDP growth.
- 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%. The policy rate is still restrictive. Uncertainty around the FOMC's economic outlook has increased.
- U.S. Treasury yields increased, and the yield curve flattened. Hard economic data continue to indicate a resilient U.S. economy with limited impact from tariff-related policies. A slowdown in consumption data, and elevated uncertainty around the magnitude of trade policy changes and fiscal spending continue to affect interest rates.
- Corporate bond spreads narrowed month over month due to mostly-firm economic data, an announced trade deal between the U.S. and the U.K., and de-escalation of trade risks between the U.S. and China.

Investment Professionals:

Dennis Woessner, CFA, CAIA
Vice President & Director

Russell Wald, CFA
Vice President

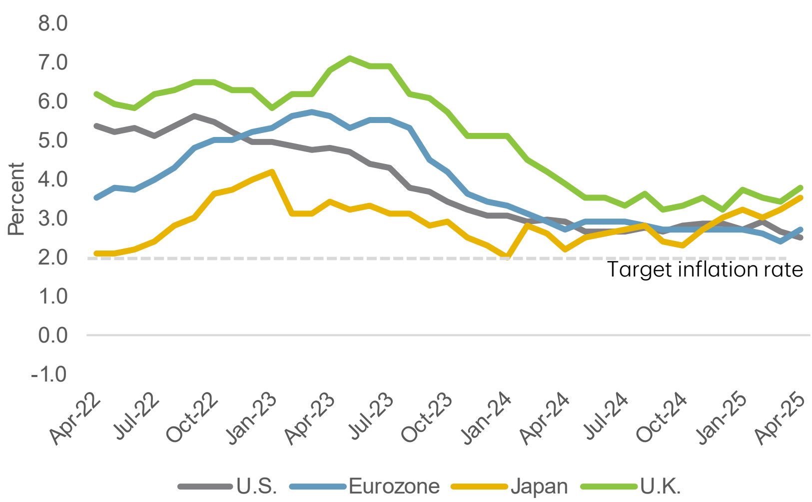
Macro Update

- U.S. real GDP decreased 0.2% in 1Q 2025 (2.4% in 1Q 2024). A sequential slowdown in household consumption driven mostly by a decline in goods purchases was more than offset by the surge in equipment spending and inventories. Net exports detracted from growth as imports surged during the quarter, likely pulled forward due to tariffs. Domestic demand remains firm but will likely soften in the coming months.
- We expect tariff policy and uncertain fiscal policy will push U.S. growth (real GDP) to be below trend (~2.0%) in 2025. These negative impulses will constrict household consumption and business spending. We believe the labor market will weaken during the remaining part of this year.

Long-Term Views:

- U.S. growth will be positive, at the margin, 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.; May 31, 2025

Headline inflation in the U.S. and other major economies remain above target levels. Near term trends have diverged, with US inflation decelerating as other developed markets have proven stickier. We expect inflation to be biased upward in the US and to remain anchored over the next twelve months due to effects and elevated uncertainty from the administration's tariff policy.

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

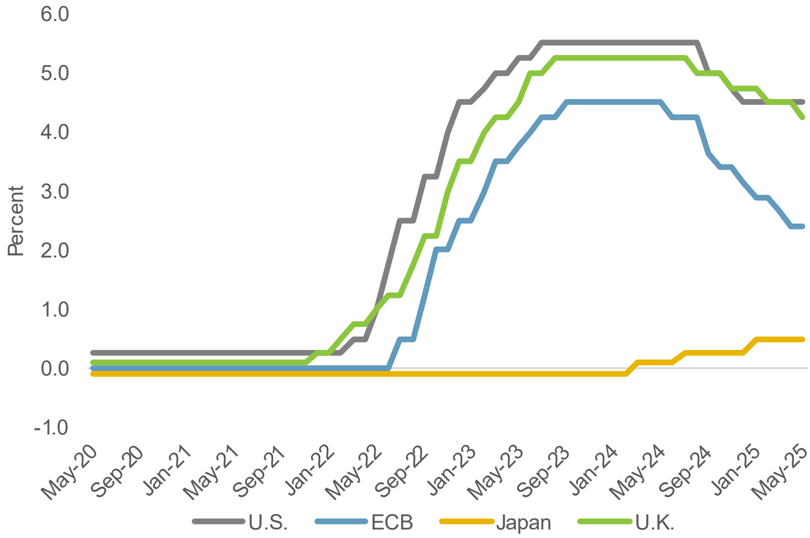
U.S. Central Bank Update

- The current federal funds target range is 4.25%-4.50%. The pace of rate cuts will slow in 2025 due to above-target inflation, a slightly weaker labor market, and a less restrictive policy rate. The 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 FOMC's summary of economic projections report shows 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. These projections 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 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.; May 31, 2025

Most major Central Banks are lowering policy rates 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 in the latter third on 2024. Additional cuts remain unclear due to uncertain trade and economic policies. 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 increased during the month as fears of a deeper economic slowdown were assuaged by a temporary reduction in U.S.-China tariffs and a U.S./U.K trade deal. A softening macro economic setting without a positive fiscal impulse will provide resistance to the rate increase.
- Short-term credit spreads narrowed 17 bps, to 57 bps during May. The positive trade-related news were main factors in the spread move. Solid fundamentals, attractive yields, and durable growth have supported credit spreads.
- Prime money fund assets increased $27.9 billion during the 3-month period ending May 2025. Total assets are $1.147 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.; May 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 the uncertain economic impact from trade and economic policies.

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

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

At 57 bps, the index OAS is 17 bps tighter from last month end. Year-over-year, the index OAS is 5 bps wider. 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 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.

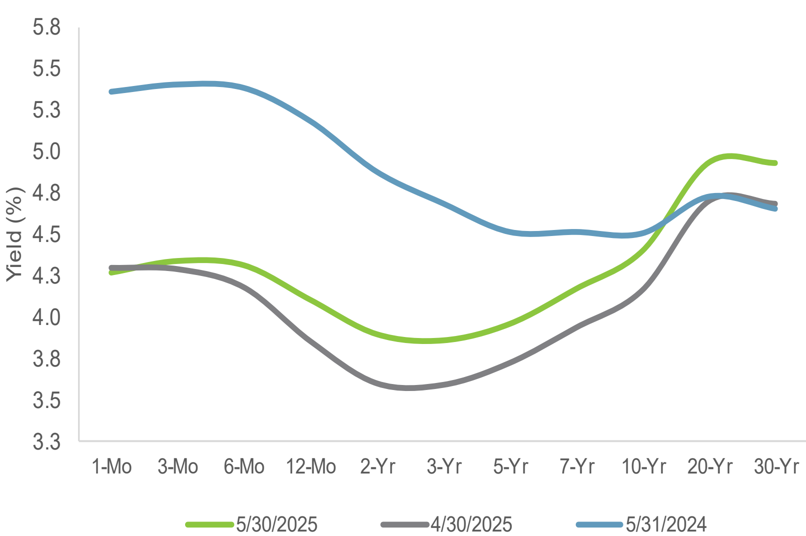
U.S. Treasury Market Update

- U.S. Treasury yields increased, and the yield curve flattened as concerns of a deeper economic slowdown were mitigated by a temporary reduction in U.S.-China tariffs and a U.S./U.K trade deal. Hard economic data continue to indicate a resilient U.S. economy 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.

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

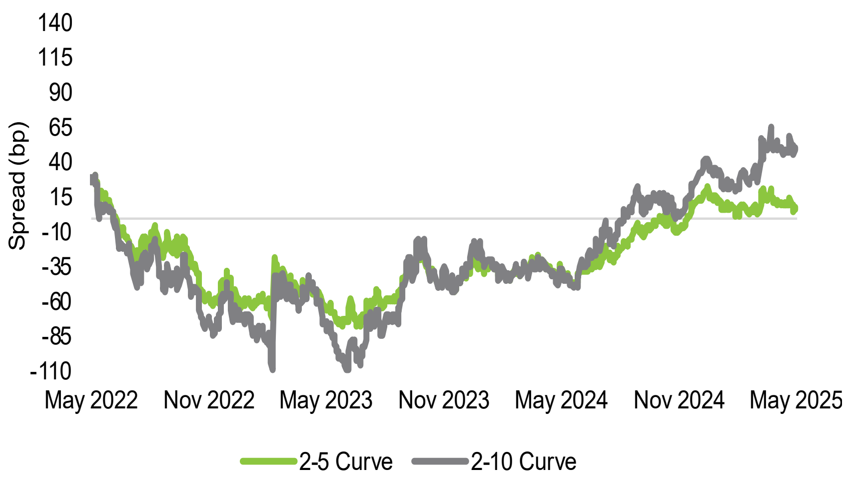


Source: Bloomberg Financial L.P.; May 31, 2025

Treasury yields increased during May. The spread between 2- and 30-year maturities decreased 5 bps, to 103 bps. The yield gap between the 3-month T-Bill and 10-year Treasury is 6 bps, 19 bps steeper from last month end.

We expect yields to move lower from current levels as labor demand weakens, and economic growth slows without stimulative fiscal policy. 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.; May 31, 2025

The belly of the Treasury curve bear flattened during the month as markets weighed fewer near-term interest rate cuts, higher than expected fiscal deficits, and potentially higher rates over the medium and longer term. Investors maintain focus on indicators pointing to weaker economic growth and sticky inflation outlooks. The 2s10s curve decreased 6 bps, to 50 bps. The 2s5s curve, at 6 bps, decreased 6 bps.

Investment Grade Credit Market Update

- Corporate bond spreads narrowed 18 bps, to 88 bps, and the credit curve slightly steepened relative to last month. Mostly-firm economic data, an announced trade deal between the U.S. and the U.K., a 90-day temporary reduction in tariffs between the U.S. and China, and higher yields were positive factors.
- Investors are monitoring U.S. trade policy and potential retaliatory measures as it relates 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.; May 31, 2025

In May, corporate bond issuance was $155 billion, a 10% increase from the same period last year. The cumulative 12-month change is 14%. The spread on the corporate bond index, at 88 bps, is 18 bps tighter on the month.

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

Corporate Spreads by Maturity

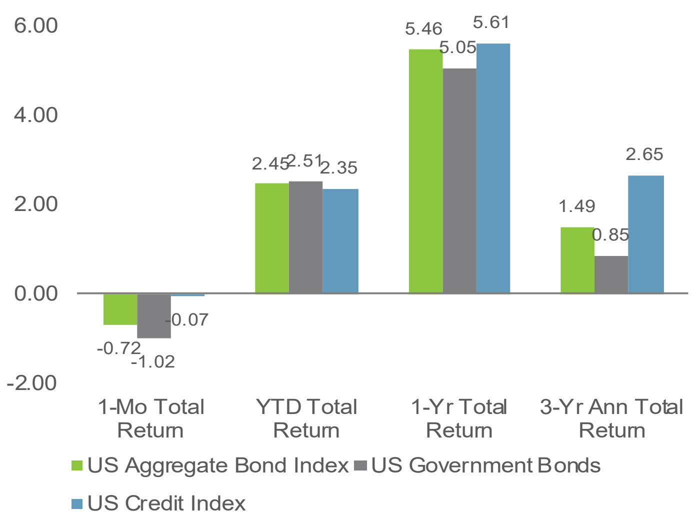
Source: Bloomberg Financial L.P.; May 31, 2025

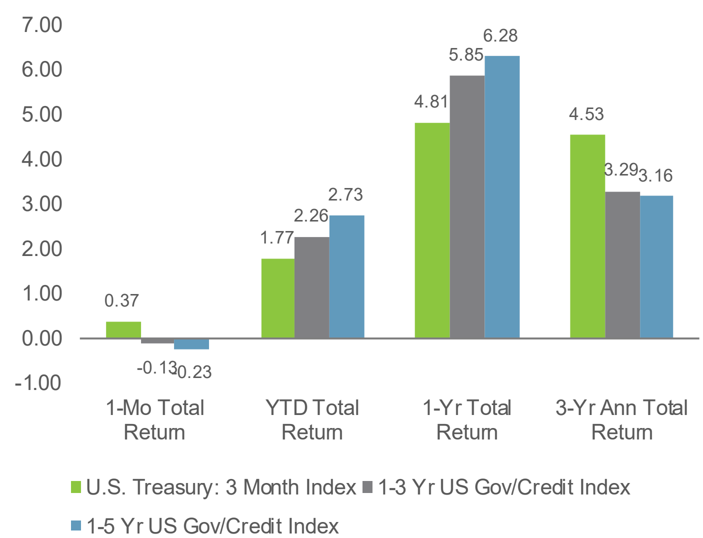
The Bloomberg U.S. Corporate Bond Index spread is 3 bps wider during the past 12-month period. There has been strong investor demand during a period of relatively higher yields and record issuance. Factors which may benefit future spreads are trend GDP growth outlook, solid fundamentals, and an easing FOMC policy framework. Uncertainty from tariff and fiscal policies is negatively impacting spreads.

The corporate bond index OAS is 18 bps tighter since last month end, currently 88 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	6/18/2025
CPI (YoY %)	2.30	3.00	3.40	6/11/2025
PCE (YoY %)	2.10	2.50	2.70	6/27/2025
Unemployment Rate (%)	4.20	4.00	3.90	6/6/2025
GDP (YoY %)	2.10	2.50	2.90	6/26/2025
Retail Sales (YoY %)	5.20	4.60	2.70	6/17/2025
Leading Indicators (YoY %)	-4.00	-2.70	-5.40	6/20/2025
Housing Starts (000s)	1,361	1,358	1,385	6/18/2025

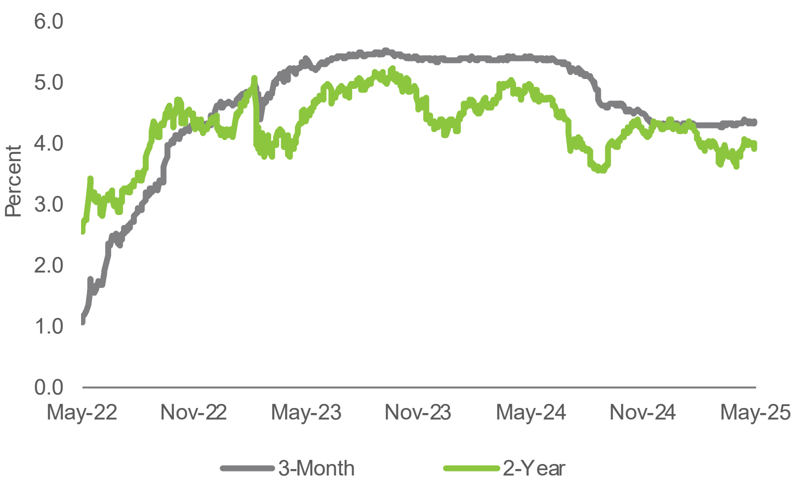
Description	Current	3-mo Ago	1-yr Ago
Fed Funds (%)	4.50	4.50	5.50
3-Mo U.S. Treasury Bill	4.34	4.30	5.41
6-Mo U.S. Treasury Bill	4.32	4.28	5.38
USD O/N Govt. Repo	4.34	4.41	5.45
U.S. 30-Day Comm Paper*	4.35	4.32	5.32
U.S. 90-Day Comm Paper*	4.37	4.34	5.38

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

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

Charts & Tables - continued

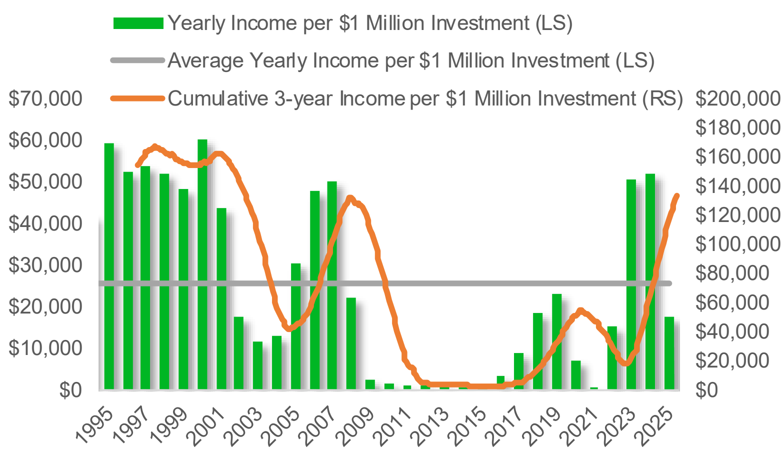
Treasury Market



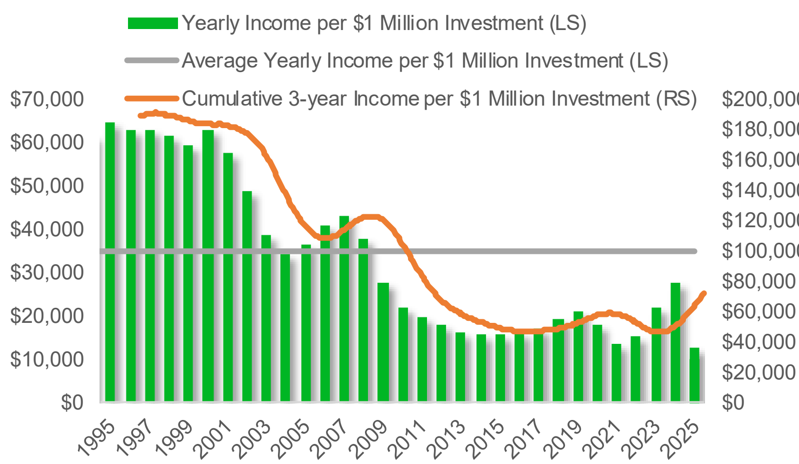
Maturity	Yield Curve (%)	Change in Yield Curve (basis points) 1-Mo Ago	3-Mo Ago	1-Yr Ago
1-Mo	4.27	-2	-3	-109
3-Mo	4.34	5	4	-106
6-Mo	4.32	14	4	-107
12-Mo	4.11	25	2	-107
2-Yr	3.90	30	-9	-97
3-Yr	3.86	27	-11	-82
5-Yr	3.96	24	-6	-55
7-Yr	4.17	24	6	-33
10-Yr	4.40	24	19	-10
20-Yr	4.94	24	41	21
30-Yr	4.93	25	44	28

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

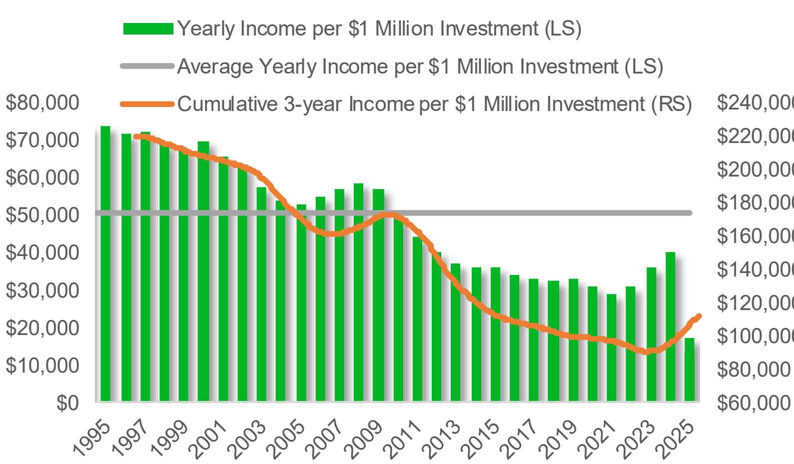
Bloomberg U.S. 3 Month Treasury Bill Index



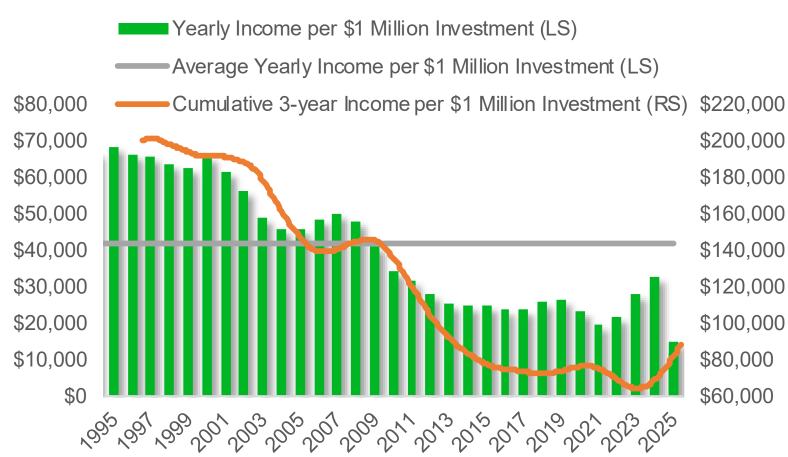
Bloomberg U.S. Treasury 1-5 Year Index



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.; May 31, 2025

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