**FIXED INCOME INSIGHTS** / 2Q 2025

# Resilience or Teflon?

Weitz | INVESTMENT MANAGEMENT




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Resilient or Teflon-like—both describe the bond and stock markets' reaction to the seeming barrage of "body blows" in the second quarter. From President Trump's so-called "Liberation Day" tariff announcement on the quarter's second day that caused endless media handwringing, to a policy pause a week later, to a U.S. debt downgrade, to bitter wrangling over a contentious budget bill, to war between Israel and Iran, and ultimately the U.S. bombing of three Iranian nuclear sites.

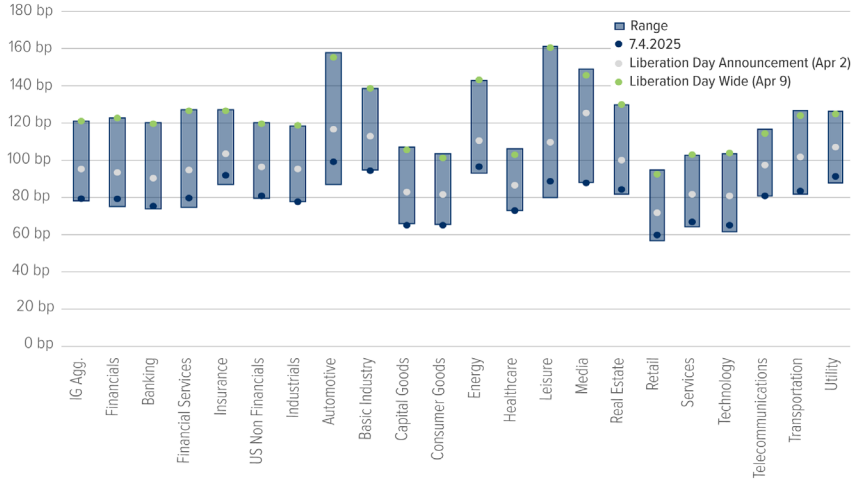
Those familiar with the Looney Tunes character Marvin the Martian might have echoed his famous line amid the second-quarter commotion: "Where's the kaboom? There's supposed to be an earth-shattering KABOOM!"

There was, indeed, a tariff tantrum of sorts. The Cboe Volatility Index, or VIX—also known as the fear index—breached 50, a rare level not seen since the peak of the COVID scare in 2020. The S&P 500 entered bear market territory, defined as a decline of 20% or more. But then resilience set in, with the index staging the fastest-ever recovery from a 20% drop (using intraday levels), reaching a new all-time high in just 57 trading days—something not seen since the Long-Term Capital Management debacle of 1998.

Corporate credit spreads widened in sympathy with the equity market selloff, only to rally back as equities surged higher. The charts to the right highlight the range of credit spreads across a broad cross section of the corporate bond market—including Investment Grade (IG) and High Yield (HY)—during the first half of 2025. The widening of credit spreads following the "Liberation Day" announcement was swift and steep—but brief—by quarter end, nearly all segments of the corporate bond market were at the lower end of their spread ranges for the year. We identified opportunities to deploy capital into favorable credit-related investments during the quarter, particularly in HY. Please see the 2Q25 Core Plus Income Fund Commentary for details.

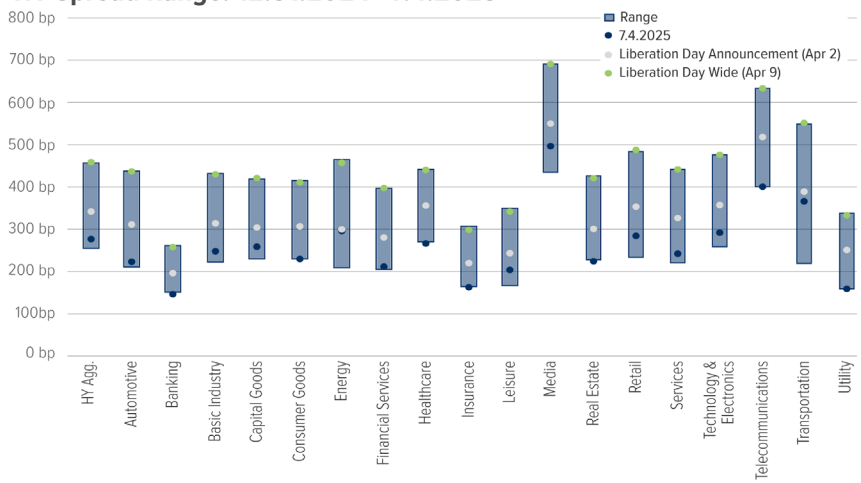
The two charts on the following page provide a 25-year look back at IG and HY spreads, highlighting notable events that occurred in that timeline. The upshot: credit spreads in both IG and HY remain very tight. Since 2000, both spreads have traded at tighter levels than today less than 10% of the time.

**IG Spread Range: 12.31.2024 - 7.4.2025**




Source: Creditsights, Factsheet, ICE Data Indices, LLC

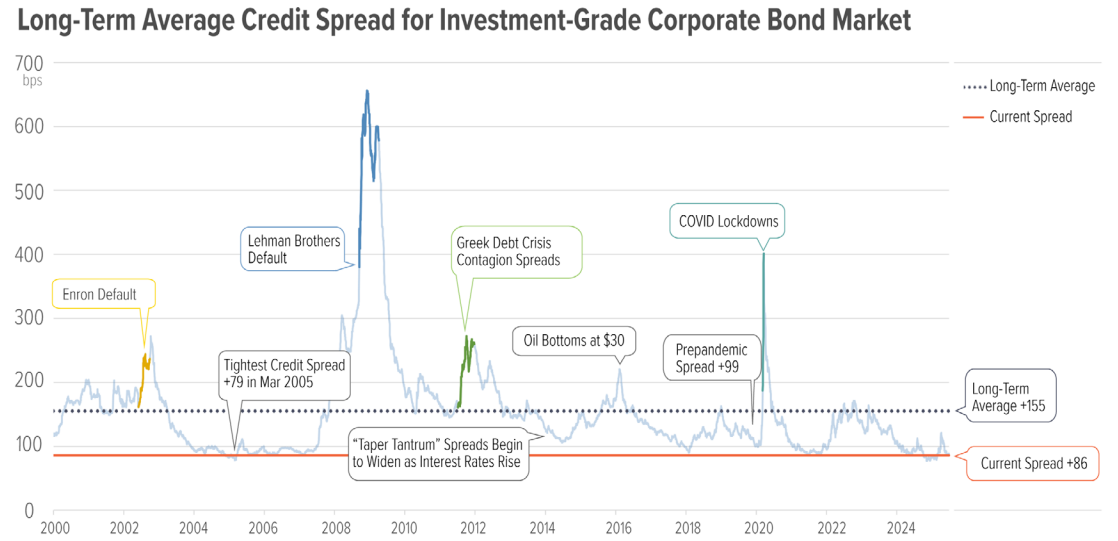
**HY Spread Range: 12.31.2024 - 7.4.2025**

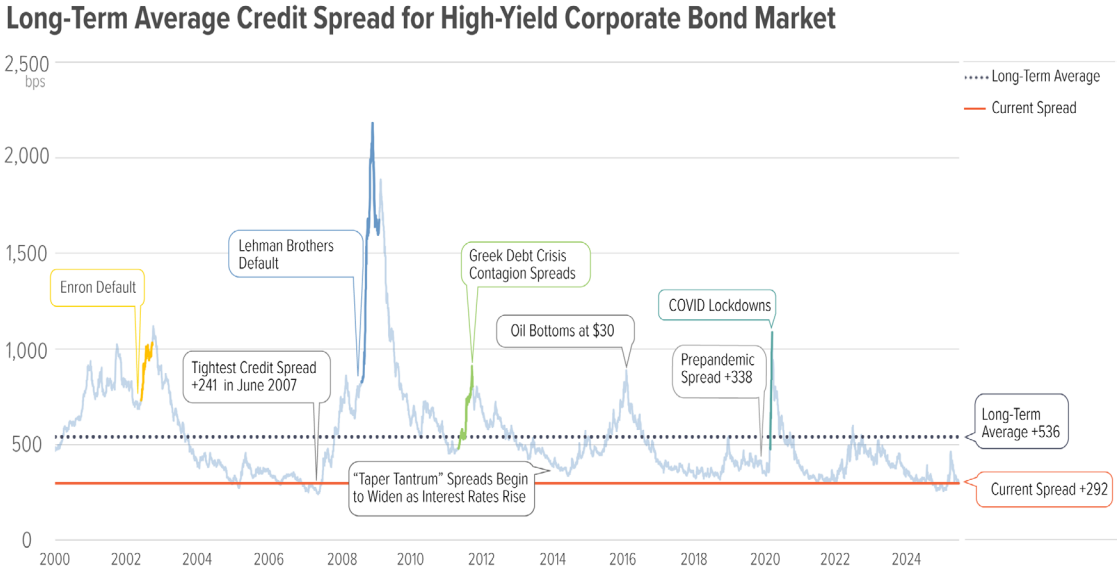



Source: Creditsights, Factsheet, ICE Data Indices, LLC

## **FIXED INCOME INSIGHTS:** RESILIENCE OR TEFLON?

Despite expensive valuations and emerging cracks in credit fundamentals, strong technicals, especially persistent demand from insurance companies, are helping to keep spreads tight and markets stable. But valuations appear expensive relative to history, and small fundamental cracks are beginning to emerge. For example, there were more downgrades than upgrades in corporate credit during the second quarter—the weakest upgrade/downgrade ratio in four years.



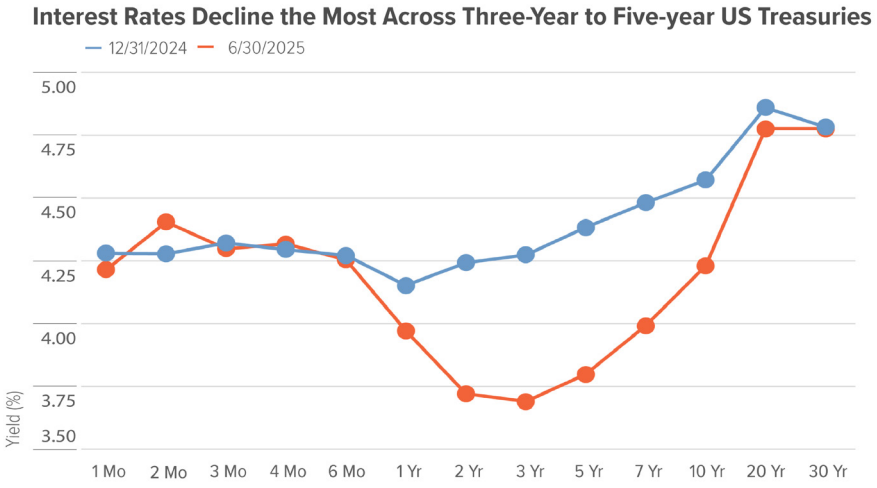

Source: Federal Reserve Economic Data as of 6.30.2025

In the U.S. Treasury bond market, Moody's downgrade of the U.S. government's long-term credit rating from AAA to AA+ in May—which followed similar actions by Standard & Poor's in 2011 and Fitch Ratings in 2023—created more headlines than actual impact on U.S. Treasury trading levels. The 10-year Treasury yield, for example, rose to a high of 4.6% during the quarter, only to finish almost exactly where it started (4.2%).

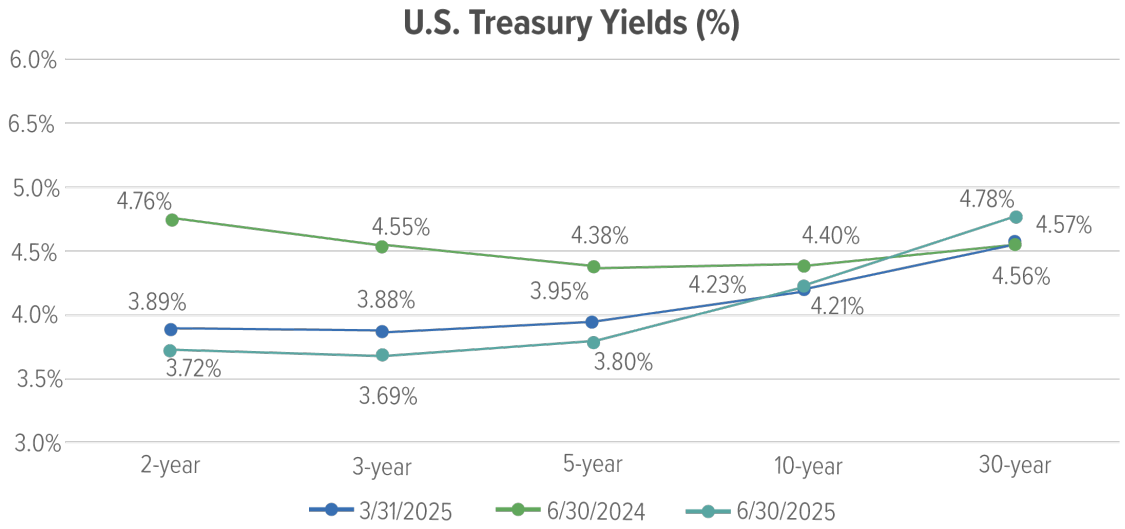
Year-to-date, the Treasury yield curve has shifted lower, with primary outperformance in the belly of the curve. Yields on 3-year and 5-year Treasuries declined 58 basis points (bps), whereas at the longer end, the 10-year yield fell 34 bps and 20- and 30-year yields declined the least.

It's hard to spot the Moody's downgrade in the picture to the right.

Shown below is a chart we often highlight: U.S. Treasury yields across three time periods. The shift lower in the belly of the curve is particularly evident compared to a year ago. The market is increasingly pricing in cuts to short-term interest rates by the Federal Reserve. When and how much will depend on upcoming economic data—but recent indicators, both "hard" (like GDP and inflation) and "soft" (such as consumer sentiment and surveys), point to a slowing economy with little effect (so far) from tariff-related price pressures.




The term premium (or difference) between 2-year and 30-year Treasury bonds has increased (i.e., the yield curve has steepened). Should short-term rate cuts materialize in the months ahead, this term premium could expand to levels not seen since the Global Financial Crisis of 2008-2009. Or it could be a precursor of much lower long-term interest rates.




## Outlook

As we stated in the first-quarter *Fixed Income Insights*, our goal—our north star—remains to be patient and focused on being a risk manager, not a prognosticator. Time will tell if the second-quarter market dislocation brought about by the "Liberation Day" tariff announcement was a minor storm that came and went—or if we're in the calm eye of a hurricane. August could bring more turbulence as the tariff rollercoaster potentially picks up steam.

Clear skies or not, we like the all-weather make-up of our current portfolio positioning—and believe we are particularly well positioned to take advantage of further, and potentially more meaningful, choppy waters in the second half of the year.

## IMPORTANT DISCLOSURES

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**Basis Points (bps)** refers to a unit of measurement that is equal to 1/100th of 1%, or 0.01%.

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