Highlights

- **Credit spreads widened as the threat of a global tariff war hit risk assets. Even though interest rates declined in a flight to safety, inflation worries returned.**
- **The economy likely slowed in Q1 as personal consumption eased after rising in Q4. The imposition of global tariffs may push the economy into recession by year-end.**
- **The new Administration took aggressive measures on tariffs, immigration, and government efficiency. The manner in which these measures were implemented raise questions about America's global leadership.**

Markets

		Returns (%)			
GIA	Average Quality	1Q25 Gross	1Q25 Net	12 Months Gross	12 Months Net
Core Plus Composite	**(A+)**	**2.48**	**2.39**	**5.36**	**4.99**
Global Investment Grade Composite	**(A-)**	**2.30**	**2.19**	**5.63**	**5.21**
Global Credit Plus Composite	**(BBB+)**	**2.07**	**1.94**	**6.31**	**5.78**
Global High Yield Composite	**(BB-)**	**2.11**	**1.95**	**6.93**	**6.29**
Emerging Market Corporate Debt Composite	**(BB+)**	**2.91**	**2.76**	**8.69**	**8.04**
Benchmark Bonds					
Bloomberg U.S. Agg. Index	(AA)	2.78		4.88	
Treasury	(AA+)	2.92		4.51	
Corporate	(A-)	2.31		4.90	
Mortgage	(AA+)	3.06		5.39	
Government/Credit	(AA)	2.70		4.66	
ICE BofA U.S. Corporate & Yankees	(A-)	2.40		5.20	
ICE BofA U.S. Corporate	(A-)	2.36		5.27	
ICE BofA U.S. High Yield	(B+)	0.95		7.60	
ICE BofA Global High Yield Constrained Index (USD)	(BB-)	1.99		8.01	
ICE BofA EM Corporate Plus	(BBB)	2.55		7.45	
ICE BofA Global Gov't ex-US	(AA-)	-1.27		-1.04	
JPM Emerging Markets EMBI GD	(BB+)	2.24		6.75	
JPM CEMBI Broad Diversified	(BBB-)	2.42		7.74	
JPM GBI-EM Global Diversified	(BBB+)	4.31		4.03	
Benchmark Equities					
S&P 500	NA	-4.59		6.80	
Nasdaq Composite	NA	-10.42		5.62	
Russell 2000	NA	-9.79		-5.30	
MSCI EAFE	NA	6.15		2.19	
MSCI Europe	NA	10.02		4.32	
MSCI Japan	NA	-0.84		-4.32	
MSCI Emerging Markets Equity	NA	2.41		5.58	

* Please refer to the respective factsheets for the long-term composite and benchmark returns for each strategy.

Markets

An apt quip to address financial markets during the first quarter would be "that was brief!" The enthusiasm displayed in equity markets, and other risk assets from anticipated policy shifts related to taxes and deregulation after Trump's election evaporated as tariffs, "government efficiency," and Russian appeasement took center stage. The flurry of announcements, retractions, injunctions, and pronouncements forced investors to reassess the economic implications of the administration's priorities and likely policy path. The tariff whirlwind led economists to downgrade growth forecasts and investors to downgrade market outlooks. Although equity markets peaked in mid-February less than a month after Trump took office, the quarter ended in negative territory. For the quarter, the S&P 500 lost 4.59% while the Nasdaq was down 10.42% and the Dow declined 1.28%. In early April, the imposition of across-the-board tariffs initiated a market rout. Meanwhile, bonds delivered positive returns for the quarter on declining interest rates and a flight to quality. The Bloomberg U.S. Aggregate Index returned 2.78% with treasuries posting a healthy 2.92%, corporate bonds lagging at 2.31%, and mortgages outperforming at 3.06%. The Bloomberg U.S. Dollar Spot Index declined 2.70% while the Bloomberg Commodity Index rose 7.74% on the back of a 17.02% move higher in gold.

Investment grade credit performed relatively poorly as spreads widened due to recession fears and lower earnings projections. Tariff wars would have a deleterious effect on corporate earnings and a recession would impinge on creditworthiness. Lower interest rates helped boost absolute returns, although the sector generated negative excess returns. For the quarter, the investment grade corporate bond index, the ICE BofA U.S. Corporate Index (C0A0), was up 2.36%, which underperformed government bonds and delivered negative 85 b.p. of duration adjusted excess returns. Corporate option adjusted spreads (OAS) widened by 13 b.p. to 95 b.p., while the yield to worst of the index declined 22 b.p. from 5.34% to 5.12%. Borrowing was healthy as issuers took advantage of tight spreads and reasonable rates early in the quarter. New credit issuance totaled $641.3 billion, which nearly matched last year's first quarter borrowing of $657.3 billion.

The high yield market suffered a significant reversal as the government's policy direction could have negative implications for earnings, creditworthiness, and financial flexibility. The ICE BofA U.S. High Yield Index (H0A0) was up 0.95% for the quarter, meaningfully underperforming higher quality sectors. At quarter-end, the spread to worst was wider by 63 b.p. from 308 b.p. to 371 b.p. The yield to worst rose to 7.65% compared to 7.41% in December. Fund flows were surprisingly positive considering the sector's tepid performance. Specifically, investors added $7.6 billion to high yield funds during the quarter following inflows of $16.4 billion in 2024. The default rate, including distressed exchanges decreased further to 1.20% from 1.47% at the end of December (0.27% not including distressed exchanges). While defaults remain well behaved for high yield bonds, the leveraged loan market experienced a still elevated default rate driven by distressed exchanges. The new issue market saw $68.3 billion of gross issuance with only $17.1 billion being net of refinancing. High yield borrowing remained modest with private market financing widely available.

Emerging markets hard currency bonds performed surprisingly well considering the behavior of investment grade and high yield bonds. In addition, emerging markets experienced withdrawals from retail investors while the other sectors had inflows. Significant contributions to performance came from Brazil, China, and Ukraine, countries that underperformed during the fourth quarter of 2024. Regionally, Latin America was the best performing, led by Brazil with Europe second on prospects for peace in Ukraine. The Emerging Market Bond Index – Global Diversified (EMBIGD), a dollar denominated sovereign index, was up 2.2% for the quarter. Similarly, the JPM Corporate Emerging Markets Broad Diversified Index (CEMBI BD) rose 2.4% over the last three months. The quarter's performance champion was the JPM Global Bond Index – Emerging Markets Global Diversified (GBI-EM Global Diversified), a local markets index, which returned an impressive 4.3% on the back of a recovery in many emerging market currencies.

Economy

The economic outlook has become blurrier. The fourth quarter of 2024 ended with solid economic momentum driven by consumer spending, low unemployment, declining inflation, and policy optimism from the incoming administration. We, along with other economists, forecast a continuation of moderate growth with risks tilting toward better over worse outcomes. As it turned out, consumers relaxed their spending, and the Trump Administration imposed arduous tariffs on the world. In addition to the tariffs, other harsh actions taken by the new administration damaged consumer confidence and led companies to withhold investments. The first estimate of Q1 GDP will be released on April 30, 2025, and the number will likely be below most forecasts. A widely followed economic forecasting model from the Atlanta Federal Reserve dropped precipitously in February after the first tariff announcements. The model now suggests the economy is trending downward, bringing the possibility of a recession into play.

A review of the Wall Street Journal Economic Survey for April 2025 reveals shocking adjustments to economists' forecasts. Acknowledging upfront that the survey was conducted after the "liberation day" tariff announcement and prior to the 90 day pause, in just three months, economists reduced their first quarter forecast from 2.17% to 0.44%. The full year 2025 number declined from 2.05% to 0.78%. Financial markets calmed after the tariff assault was paused, although the eventual impact of the tariff policy remains difficult to quantify.

While early corporate earnings releases showed a satisfactory first quarter, many companies withdrew their earnings guidance for the remainder of 2025. The volatility in stock and bond markets along with the ultimate outcome on tariffs makes forecasting difficult. Even service providers not subject to direct tariffs may find it challenging to estimate their earnings given the possible paths for the economy.

Away from the U.S., the outlook appears brighter, although tainted by the impact of tariffs. In a discernible reaction to the U.S.'s posture, many countries are taking measures to boost domestic consumption. European countries loosened fiscal expenditures which boosted stocks and raised the growth outlook. Other nations are aiding domestic investment. While a global tariff war may dampen their effectiveness, these measures should help defray the damage from reduced external commerce.

Scenarios

We propose three scenarios for the U.S. economy over the next 6 months:

1. Our most likely case has the U.S. economy growing at a reduced pace of about 0.5% over the next six months. The economy's momentum seems to have been severed by the imposition of global tariffs. While many of these have been temporarily paused, a trade war with China continues. Tariffs and other actions by the new administration eroded consumer confidence and may endanger the Administration's pro-growth policies. Furthermore, while foreign growth may be sustained at low levels, the tariff stand-offs will likely hamper global economic activity. PROBABILITY 55%

2. A second scenario has the economy slowing to a rate of 0.0% to -0.5% at an annual rate during the next six months. In this scenario, tariff negotiations yield modest adjustments to the originally imposed levels and acrimony amongst the world's largest economies leaves levies in those regions at prohibitively high levels. Inflation moves higher temporarily in reaction to tariffs preventing the Fed from cutting rates aggressively. High interest rates and deteriorating economic activity discourage investment. Ultimately, the U.S. economy settles at a recessionary growth rate. PROBABILITY 25%

3. A third scenario has the economy expanding at a stronger pace of 1.5% to 2.0% at an annual rate during the next six months. In this scenario, the tariff negotiations result in reduced trade barriers amongst most nations including China and Europe. Anticipating freer trade, many countries experience new investment and a boost to confidence.

In addition, congress passes other Administration pro-growth policies. While it takes time to repair the damage from the original tariff shock, the economy sets up for a long period of healthy growth. PROBABILITY 20%

Market Outlook

Credit spreads widened as the Administration's trade policy elevated recession risks. Prior to the tariff-induced financial market turmoil, creditworthiness was robust across IG, HY and EM corporate debt. While a recession will likely impinge on creditworthiness, we do not believe a debt crisis is imminent because leverage remains low and financing widely available. Furthermore, the most affected companies have the lowest credit ratings.

Volatile markets offer excellent opportunities to upgrade average quality while retaining attractive yield. While we will not likely increase credit exposure until the path for the economy becomes more ascertainable, we will look to add creditworthy names that get excessively sold due to poor liquidity or recession fears.

Commentary – On Tariffs, Governance, and Credibility

On November 4, 2024, the S&P 500 equity index closed at 5,712.69. On November 6, following the presidential election, the index closed at 5,929.04 in anticipation of the pro-growth agenda Trump touted while campaigning. The Index moved higher still to a record 6,144.15 on February 19, 2025, just before the president imposed tariffs on Mexico, Canada, and China. Since then, financial markets have been consumed with tariff pronouncements, retractions, retaliation, and escalation. By quarter end, equity markets retraced all the "Trump gains," and then collapsed further following April 2's "liberation day" global tariffs announcement.

The severe market reaction reflected the deleterious impact of a broad-based tax on U.S. consumers and the logistical challenge thrown at firms that rely on imports to manufacture and distribute goods. Under the guise of fairness, the President slapped friends and foe with prohibitive levies. The sudden and indiscriminate manner with which the tariffs were imposed also gave rise to prospects of a chaotic global trade war. Ironically, aside from the crude negative impact on other nations, the tariffs could spark a readjustment of trade relations based on lower tariffs (which may occur in negotiations currently under way). Specifically, in many nations tariffs and trade barriers were imposed years ago to protect domestic industries and employment. Technological advancements and vast understanding of global supply and demand dynamics have rendered many of these protectionist decrees mute in today's connected world.

Away from tariffs, President Trump moved aggressively to insert himself into the Russia/Ukraine crisis and to repatriate delinquent immigrants. The manner of these actions seemed to appease the aggressor in the conflict, and to disregard legal due process in the treatment of individuals. Furthermore, the Department of Government Efficiency took a hatchet to many departments leading to confusion, fear, and resentment among long-term government employees. Mr. Trump's instincts and rhetoric on these subjects resonate with most Americans. Fairness on trade, global peace, orderly immigration, and the elimination of government waste are clearly goals most citizens support. However, the ruthless approach taken to each of these evokes concern and resistance amongst most Americans.

Through and following Covid, the term American Exceptionalism appeared frequently in reference to America's advanced medical research, leadership in antidote discovery, and economic resilience. More recently, the country's technological innovation and entrepreneurship received plaudits for propelling the economy's productivity and boosting the standard of living. Exceptionalism is hard to define, and arguably a conceited term related to distinctiveness and exemplary behavior. Fundamentally, the term refers to characteristics citizens take for granted, yet they distinguish Americans from others. Rights and traits like freedom, democracy, morality, responsibility, integrity, the rule of law, and empathy are widely adopted and passed on across generations. We view ourselves as being good people who treat others fairly and with integrity.

This Exceptionalism is now at risk. A mere 72 days from inauguration President Trump hit the world with a global tax. He also publicly chastised an ally and indiscriminately rounded up delinquent immigrants. While he mentioned these matters on his campaign, the world expected implementation with a level of decorum, rationality, and consistency given the experience of his prior administration. However, approaching the world with isolationist indifference weakens America's message and threatens the Administration's credibility. Our leadership in matters of security, international law, and dispute resolution may be ignored when not grounded in moral legitimacy. Furthermore, after alienating members of his party, the extension of Trump's signature domestic policy accomplishment the Tax Cuts and Jobs Act of 2017, may be in jeopardy. Many economists raised the probability we will have a recession by the second half of 2025. While change often requires sacrifice, Americans did not sign up for a painful recession in an attempt to extract taxes from nations that formerly admired us.

April 15, 2025

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Index Definitions

Bloomberg U.S. Aggregate Index
The Bloomberg U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Bloomberg U.S. Treasury Index
This index is the U.S. Treasury component of the U.S. Government index. Public obligations of the U.S. Treasury with a remaining maturity of one year or more.

Bloomberg U.S. Government/Credit Index
The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries and agencies. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

Bloomberg U.S. Corporate Index
This index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD denominated securities publicly issued by US and non-US industrial, utility and financial issuers. (Future Ticker: I02765US)

Bloomberg U.S. Mortgage-Backed Securities Index
This index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

ICE BofA U.S. Corporate & Yankees Index
The ICE BofA U.S. Corporate & Yankees Index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market by US and non-US corporations and non-US quasi-governments.

ICE BofA U.S. Corporate Index
The ICE BofA U.S. Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

ICE BofA U.S. High Yield Index
The ICE BofA U.S. High Yield Index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

ICE BofA Global High Yield Constrained Index
ICE BofA Global High Yield Index tracks the performance of USD, CAD, GBP and EUR denominated below investment grade corporate debt publicly issued in the major domestic or eurobond markets and issuer exposure is capped at 2%..

ICE BofA US Emerging Markets Corporate Plus Index (EMUB)
The ICE BofA US Emerging Markets Corporate Plus Index is a subset of The ICE BofA Emerging Markets Corporate Plus Index including all securities denominated in US dollars.

ICE BofA Global Government Excluding the U.S. Index (N0G1)
The ICE BofA Global Government Excluding the U.S. Index tracks the performance of publicly issued investment grade sovereign debt denominated in the issuer's own domestic currency. N0G1 excludes U.S. government bonds.

Emerging Markets Bond Index Global Diversified (EMBI® Global Diversified):
The EMBI Global Diversified is a uniquely-weighted version of the EMBI Global. It limits the weights of those index countries with larger debt stocks by only including specified portions of these countries' eligible current face amounts of debt outstanding. The countries covered in the EMBI Global Diversified are identical to those covered by the EMBI Global.

JP Morgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI Broad Diversified)
The CEMBI tracks total returns of US dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries. Two variations are available: CEMBI Broad and CEMBI. The CEMBI Broad is the most comprehensive corporate benchmark followed by the CEMBI, which consists of an investable universe of corporate bonds. The CEMBI Broad Diversified limits the weights of those index countries with larger corporate debt stocks by only including a specified portion of these countries' eligible current face amounts of debt outstanding.

JP Morgan Government Bond Index-Emerging Markets (GBI-EM)
The GBI-EM is the first comprehensive, global local Emerging Markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. Variations of the index are available to allow investors to select the most appropriate benchmark for their objectives.

S&P 500 Index
An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

Nasdaq Composite Index
An index that tracks the change in the total market value of all companies listed on the Nasdaq Stock Market.

Russell 2000 Index
An index measuring the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small cap stocks in the United States.

MSCI EAFE Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe, Australasia and the Far East.

MSCI Europe Index
The index is a free-float weighted equity index measuring the performance of Europe Developed Markets.

MSCI Japan Index
The index is a free-float weighted equity JPY index.

MSCI Emerging Markets Equity

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.