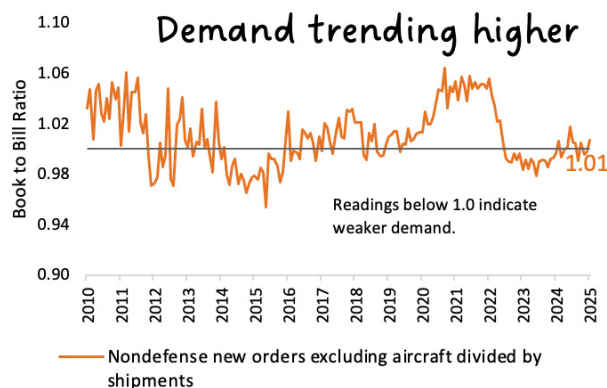




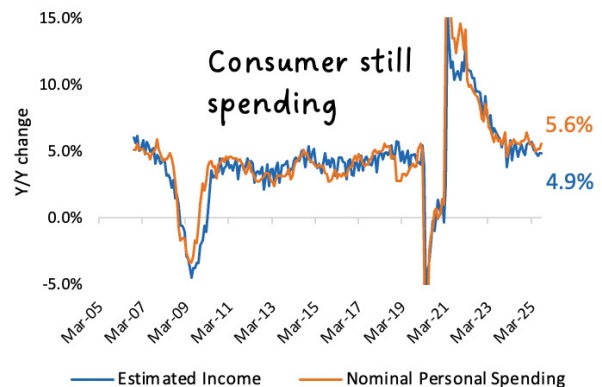
- ▶ **Reaccelerating:** The Atlanta Fed's GDP Now forecast is tracking 3.8% real GDP growth in Q3, consistent with strong Q2 economic growth. Consumption and capital expenditures are the key drivers. While softer labor market conditions may temper near-term growth, we see potential for a 2026 reacceleration, supported by tax relief, lower interest rates, and World Cup-related activity.
- ▶ **Inflation Waves:** At the same time inflationary pressures are resurfacing. The core PCE deflator reached 2.9% year-over-year in August, the highest since April. With tariff-related taxes expected to flow through to consumers, the risk of renewed inflation remains elevated.
- ▶ **Policy Conundrum:** As expected, the Fed cut rates by 25 basis points in September, despite dissent from newly confirmed Governor Steve Miran, who pushed for more aggressive easing. Chair Powell, under political pressure, acknowledged that risks have shifted from inflation toward employment. However, we question whether lower rates are warranted at this stage. While we expect the Fed to move cautiously, the risk of a policy mistake is increasing.
- ▶ **Déjà Vu All Over Again:** Congress failed to pass appropriation bills for the new fiscal year, triggering yet another government shutdown. Historically, shutdowns have been short-lived with limited economic impact, but this time around a prolonged disruption, permanent layoffs, and impoundments could raise the risk of broader damage.
- ▶ **Labor Market:** The job market is losing momentum, but tighter immigration policy has reduced labor supply, meaning fewer new jobs are required to sustain equilibrium. The government shutdown will likely delay economic data releases related to the job market, but we are watching closely for signs of further labor market deterioration, which would weigh heavily on the outlook.

Capital Goods Book to Bill Ratio



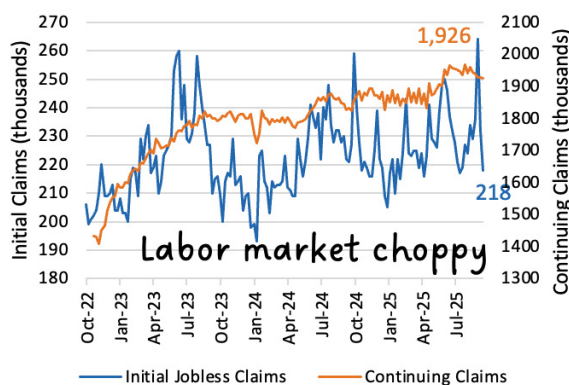
Source: Bloomberg. 15 years of monthly data through Aug 2025

Income and Spending



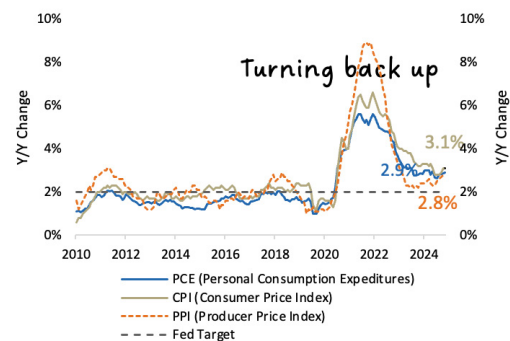
Source: Bloomberg. 20 years of monthly data through Aug 2025; Estimated Income is the product of number of employed, hours worked, and hourly wage.

Weekly Jobless Claims Data



Source: Bloomberg. 3 years of weekly data through Sep 19 2025

Inflation Measures Excluding Food & Energy

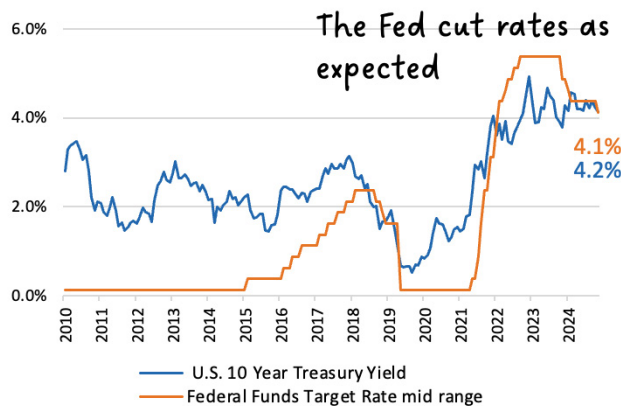


Source: Bloomberg. 15 years of monthly data through Aug 2025.



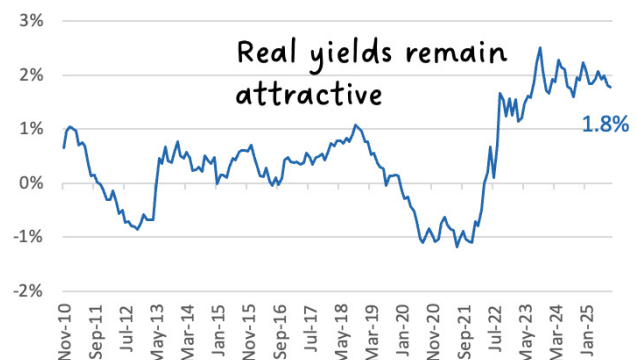
- **Neutral Fixed Income:** We shifted from a slight overweight to a neutral stance, as declining yields and tighter spreads have modestly reduced forward return potential. Strategically, fixed income remains essential for ballast and stable income in portfolios.
- **High-Quality Bias:** We remain tactically overweight investment-grade bonds, supported by attractive yields and lower economic sensitivity. Even after the recent rally, yields across investment grade credit still sit in the 70–80th percentile relative to the past decade, offering strong risk-adjusted value compared with history. Longer-term municipal bond yields currently look particularly attractive as a source for high quality income.
- **Watch the Long End:** We remain cautious on duration risk. Long Treasuries have rallied, but yields remain sticky at elevated levels, and we expect further curve steepening. Reaccelerating growth, persistent inflation, and little fiscal discipline will likely keep upward pressure on the long end. We currently favor intermediate maturities and will remain patient awaiting an opportunity to extend duration.
- **Spreads are Tight:** Corporate credit spreads are near their tightest levels in over a decade. While strong fundamentals support this, waning confidence in Treasuries may also be at play. The AAA corporate index yield trades at only a slight premium to Treasury yields of similar maturity today, with some short-term corporate yields trading at negative spreads. By contrast, ABS, MBS, and CMBS spreads remain closer to fair value, making them attractive alternatives.
- **Supply and Demand:** Demand for IG corporates has been insatiable, and issuers are rushing to meet it. September issuance ranked as the fifth largest on record and second highest outside the COVID era, as favorable funding costs, narrower concessions, and seasonality pulled forward supply. The balance between issuance and demand underpins the sector's recent performance.
- **Quality as a Safeguard:** While risk appetite remains firm, confidence could erode suddenly, though the trigger and timing are uncertain. This reinforces the case for maintaining a high-quality fixed income allocation within a diversified portfolio.

Interest Rates



Source: Bloomberg. 15 years of monthly data through Sep 2025

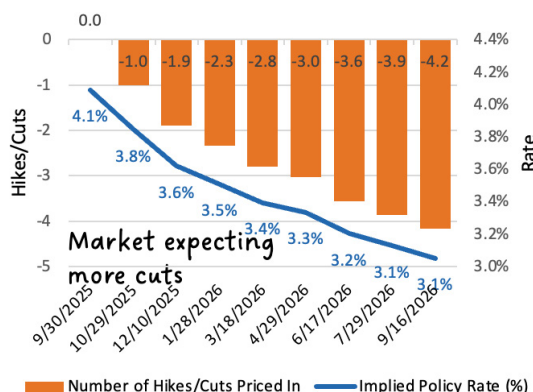
U.S. 10-year Treasury Inflation-Protected (TIPS) Yield



Source: Bloomberg. 15 years of monthly data through Sep 2025

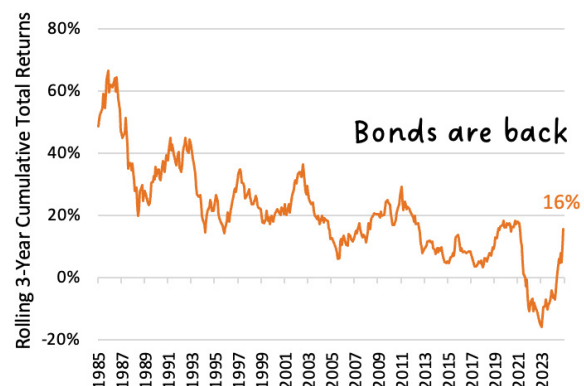
Federal Funds Rate

Implied Overnight Rate & Number of 25bp Hikes/Cuts



Source: Bloomberg. Data as of Sep 30 2025

Bloomberg US Aggregate Bond Index

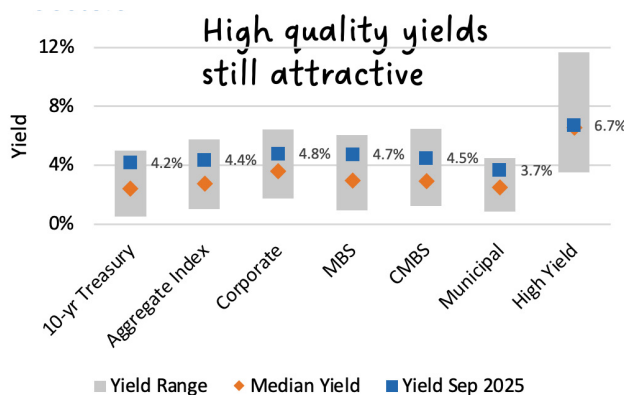


Source: Bloomberg. 40 years of monthly data through Sep 2025



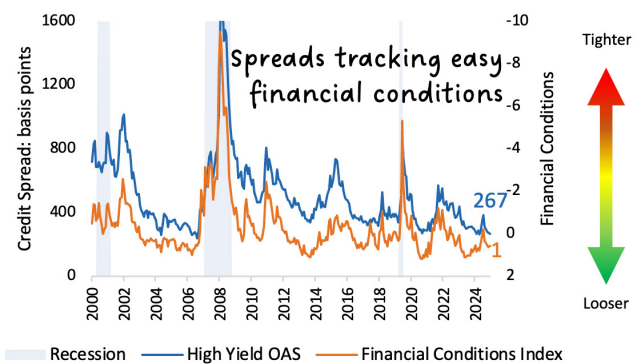
- ▶ **Cautious on Credit Risk:** We remain underweight high yield bonds as spreads remain tight. That said, resilient economic growth, loose financial conditions, and higher index quality reduce the need for a highly defensive posture. Importantly, our large structural allocation to below-investment-grade credit means we still maintain meaningful exposure to the asset class despite the underweight tactical stance.
- ▶ **Quality Control:** Since the GFC, the high yield market has shifted toward higher-quality BB-rated issuers and away from CCCs. Issuers now average \$1B in EBITDA, five times larger than 20 years ago, supporting more stable earnings and cash flow. Adjusted for this higher quality, spreads may still have room to grind tighter if economic growth remains strong.
- ▶ **Corporate Leverage Rising:** Low borrowing costs and deregulation have fueled a surge in M&A and LBO activity, with over \$1 trillion in deals announced since June and year-to-date volumes up more than 25% from 2024. While new debt can promote growth and tax efficiency, risks include reduced financial flexibility and heightened sensitivity to higher rates in a downturn. The \$55B privatization of Electronic Arts, the largest LBO on record, signals potential froth. While net leverage is still below the 2020 peak, it remains a key area of focus.
- ▶ **Hidden Risks:** Default risk in private credit may be understated, as practices like payment-in-kind interest and maturity extensions potential mask stress. These “selective defaults” are often excluded from reported data, suggesting we may be further along in the credit cycle than official figures imply. Rising risk in private markets also poses systemic concerns given bank’s loan exposure to the space.
- ▶ **Active Management Essential:** With attractive relative yields, late-cycle dynamics, and elevated deal activity, the credit space presents both risks and opportunities. This environment calls for disciplined, active management to navigate shifting conditions.

10-year Yield Range for Fixed Income Sectors



Source: Bloomberg. 10 years of monthly data through Sep 2025

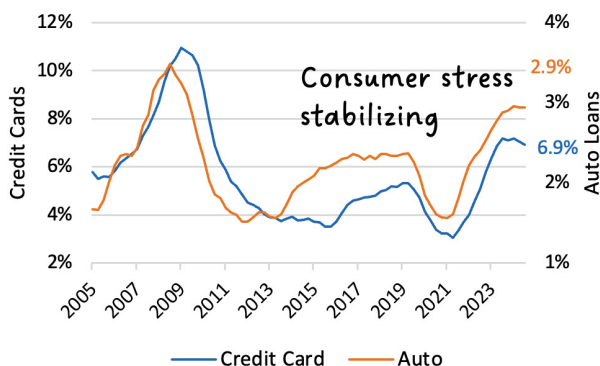
Bloomberg U.S. Financial Conditions Index



Bloomberg U.S. Financial Conditions Index: tracks the overall level of financial stress in the U.S. money, bond, and equity markets to help assess the availability and cost of credit.

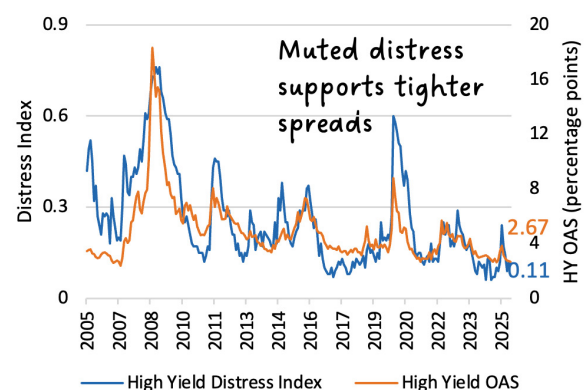
Source: Bloomberg. 25 years of monthly data through Sep 2025

NY Fed/Equifax Transition Rates to Delinquency



Source: Bloomberg. 20 years of quarterly data through Jun 2025

NY Fed Corporate Bond Distress Index



Source: Bloomberg. 20 years of monthly data through Sep 2025



Authors: Crit Thomas, CFA, CAIA / Erik M. Aarts, CIMA / Tim Paulin, CFA

October 2, 2025

The Indexes mentioned are unmanaged statistical composites of stock market or bond market performance. Investing in an index is not possible.

Total Returns						
	Sep 2025	YTD	2024	2023	2022	Duration years
Bloomberg Long Term Treasury	3.1%	5.6%	-6.4%	3.1%	-29.3%	14.7
Bloomberg U.S. TIPS	0.4%	6.9%	1.8%	3.9%	-11.8%	4.9
Bloomberg U.S. Aggregate	1.1%	6.1%	1.3%	5.5%	-13.0%	6.0
Bloomberg U.S. Agg Corporates	1.5%	6.9%	2.1%	8.5%	-15.8%	6.9
Bloomberg U.S. Agg ABS	0.6%	4.6%	5.0%	5.5%	-4.3%	2.8
Bloomberg U.S. Agg MBS	1.2%	6.8%	1.2%	5.0%	-11.8%	5.8
Bloomberg U.S. Agg CMBS	0.4%	6.3%	4.7%	5.4%	-10.9%	3.9
Bloomberg Municipal Bond	2.3%	2.6%	1.1%	6.4%	-8.5%	6.9
Bloomberg 1-3 year Corporate	0.4%	4.6%	5.3%	5.5%	-3.3%	1.8
ICE BofA Listed Preferreds	1.0%	5.1%	8.5%	9.8%	-18.1%	NA
Bloomberg High Yield	0.8%	7.2%	8.2%	13.4%	-11.2%	2.9
S&P UBS Leveraged Loan	0.5%	4.7%	9.1%	13.0%	-1.1%	NA
Bloomberg Global Agg	0.7%	7.9%	-1.7%	5.7%	-16.2%	6.5
Bloomberg Emerging Markets USD	1.1%	8.5%	6.6%	9.1%	-15.3%	6.1

Yields						
	Sep 2025	YTD Change bps	Last 10 years			
			Current Percentile	Median	Min	Max
10 year Treasury	4.2%	-42	82	2.5%	0.5%	5.0%
2 year Treasury	3.6%	-63	70	1.9%	0.1%	5.2%
10 year TIPS	1.8%	-45	82	0.5%	-1.2%	2.5%
Bloomberg U.S. Aggregate	4.4%	-54	72	2.7%	1.0%	5.7%
Bloomberg U.S. Agg Corporate	4.8%	-52	70	3.6%	1.7%	6.4%
Bloomberg U.S. Agg ABS	4.2%	-55	70	2.3%	0.4%	6.0%
Bloomberg U.S. Agg MBS	4.7%	-53	76	3.0%	0.9%	6.1%
Bloomberg U.S. Agg CMBS	4.5%	-68	70	3.0%	1.4%	6.6%
Bloomberg Municipal Bond	3.7%	-8	85	2.5%	0.9%	4.5%
Bloomberg 1-3 year Corporate	4.1%	-66	69	2.6%	0.5%	6.2%
Bloomberg High Yield	6.7%	-79	51	6.6%	3.5%	11.7%
S&P UBS Leveraged Loan	8.0%	-78	68	5.9%	3.6%	13.1%
Bloomberg Global Agg	3.5%	-20	73	1.8%	0.8%	4.4%
Bloomberg Emerging Markets USD	6.0%	-70	61	5.5%	3.5%	8.7%

Option Adjusted Spreads (bps)						
	Sep 2025	YTD Change	Last 10 years			
			Current Percentile	Median	Min	Max
Bloomberg U.S. Corporate Agg	74	-6	1	114	72	373
Bloomberg 1-3 year Corporate	46	-6	14	61	31	390
Bloomberg U.S. Agg ABS	49	5	47	51	22	325
Bloomberg U.S. Agg MBS	31	-12	29	36	7	132
Bloomberg U.S. Agg CMBS	75	-5	40	91	62	275
Bloomberg High Yield	267	-20	3	372	253	1100
S&P UBS Leveraged Loan (discount margin)	451	-24	26	479	379	1275
Bloomberg Emerging Markets USD	199	-21	1	300	187	720

For Index Definitions see: [TouchstoneInvestments.com/insights/investment-terms-and-index-definitions](https://touchstoneinvestments.com/insights/investment-terms-and-index-definitions)

2022 – The Fed embarked on one of its most aggressive tightening paths seen in decades as the inflation rate surged well above their goal. Interest rates rose across all maturities leading to one of the worst years for fixed income returns.

2023 – Inflation fell broadly while the economy grew with the labor market and consumer spending resilient. The Fed paused midyear helping rates and credit spreads fall late in the year and turning returns positive for the year.

2024 – Economic growth continued unabated, driven by consumer spending. Inflation moderated further. The Federal Reserve pause continued until September, after which it cut interest rates three times by a total of 1 percentage point. Bond yields rose in response, resulting in only modest gains for high quality fixed income but better returns for riskier areas of fixed income.



The Touchstone Asset Allocation Committee (TAAC) consisting of Crit Thomas, CFA, CAIA – Global Market Strategist, Erik M. Aarts, CIMA – Vice President and Senior Fixed Income Strategist, and Tim Paulin, CFA – Senior Vice President, Investment Research and Product Management, develops in-depth asset allocation guidance using established and evolving methodologies, inputs and analysis and communicates its methods, findings and guidance to stakeholders. TAAC uses different approaches in its development of Strategic Allocation and Tactical Allocation that are designed to add value for financial professionals and their clients. TAAC meets regularly to assess market conditions and conducts deep dive analyses on specific asset classes which are delivered via the Asset Allocation Summary document. Please contact your Touchstone representative or call 800.638.8194 for more information.

A Word About Risk

Investing in fixed-income securities which can experience reduced liquidity during certain market events, lose their value as interest rates rise and are subject to credit risk which is the risk of deterioration in the financial condition of an issuer and/or general economic conditions that can cause the issuer to not make timely payments of principal and interest also causing the securities to decline in value and an investor can lose principal. When interest rates rise, the price of debt securities generally falls. Longer term securities are generally more volatile. Investment grade debt securities which may be downgraded by a Nationally Recognized Statistical Rating Organization (NRSRO) to below investment grade status. U.S. government agency securities which are neither issued nor guaranteed by the U.S. Treasury and are not guaranteed against price movements due to changing interest rates. Mortgage-backed securities and asset-backed securities are subject to the risks of prepayment, defaults, changing interest rates and at times, the financial condition of the issuer. Foreign securities carry the associated risks of economic and political instability, market liquidity, currency volatility and accounting standards that differ from those of U.S. markets and may offer less protection to investors. Emerging markets securities which are more likely to experience turmoil or rapid changes in market or economic conditions than developed countries.

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Please consider the investment objectives, risks, charges and expenses of a fund carefully before investing. The prospectus and the summary prospectus contain this and other information about a fund. To obtain a prospectus or a summary prospectus, contact your financial professional or download and/or request one at TouchstoneInvestments.com/resources or call Touchstone at 800.638.8194. Please read the prospectus and/or summary prospectus carefully before investing.

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