Fixed Income:

Economic Backdrop

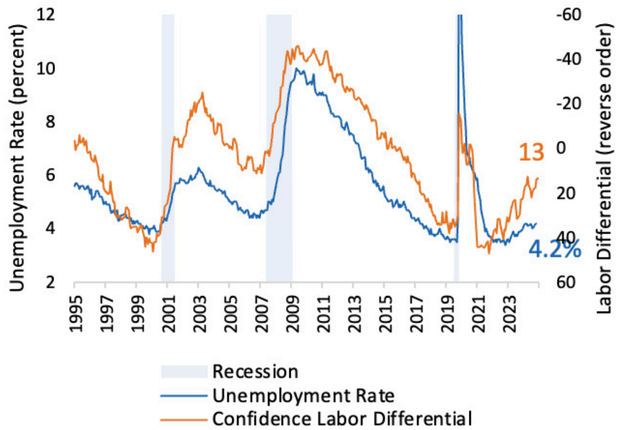
Touchstone Investments®
DISTINCTIVELY ACTIVE®

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

June 2, 2025

- **Caution Ahead:** Soft data (surveys) suggest recessionary conditions, while hard data (actual outcomes) remain resilient. Some recent consumer spending may reflect front-loading of purchases to avoid potential tariff-related price hikes. We expect the U.S. economic growth will slow in the second half due to weakening labor conditions, softer business investment, and diminishing fiscal support.
- **Command and Control:** The Trump administration's erratic trade policy rollout is creating significant uncertainty for both businesses and consumers. The unpredictable decision making from the White House is beginning to stall business activity, as indicated by stagnating new orders data. Bilateral trade deals typically take time to negotiate, and eroding global trust in the U.S. may further complicate the process.
- **Labor Market Cooling:** Labor market strength remains a key indicator for assessing the economic impact of the administration's tariff, spending, and immigration policies. We anticipate a slowdown in job growth. Should conditions deteriorate more sharply than expected, we would likely revise our outlook to reflect a harder landing.
- **More "stag", less "flation":** Companies are likely to pursue tariff workarounds (e.g., exemptions, sourcing shifts), while consumers may reduce or redirect spending. These dynamics suggest that one-off price increases may have less impact on inflation than feared. If we are correct, the Fed could be more aggressive with rate cuts if the employment picture were to darken significantly.
- **Regime Change:** Restructuring the economy , especially through reshoring, requires years of investment and capacity building. Deglobalization is inherently inflationary. The central question is how much economic and inflationary pain households and policymakers are willing to endure to allow for this transition.

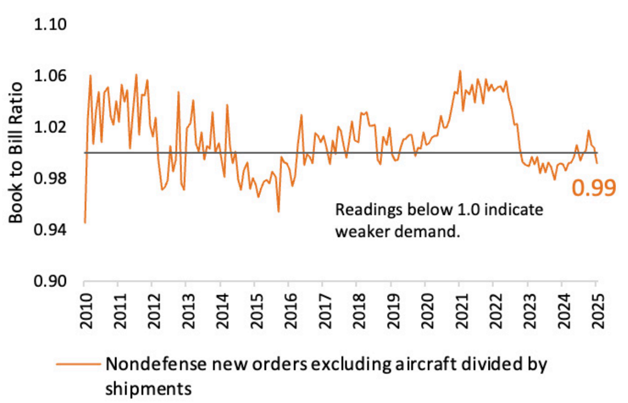
Employment Trends



The conference Board Consumer Labor Differential measures the difference between the percent of consumers responding jobs were plentiful versus those responding they were hard to get.

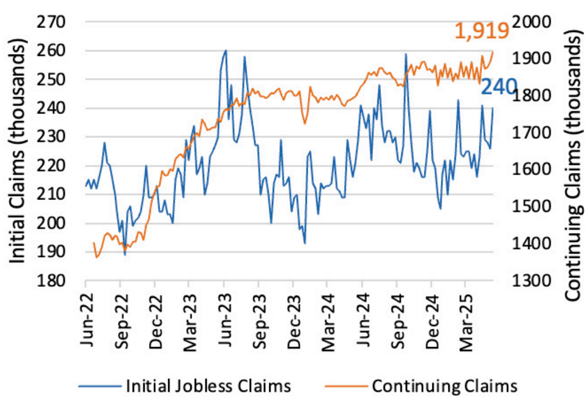
Source: Bloomberg. 30 years of monthly data through May 2025

Capital Goods Book to Bill Ratio



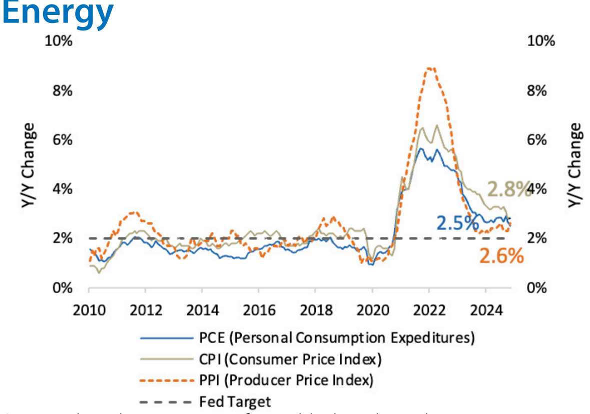
Source: Bloomberg. 15 years of monthly data through Apr 2025

Weekly Jobless Claims Data



Source: Bloomberg. 3 years of weekly data through May 23, 2025

Inflation Measures Excluding Food and Energy



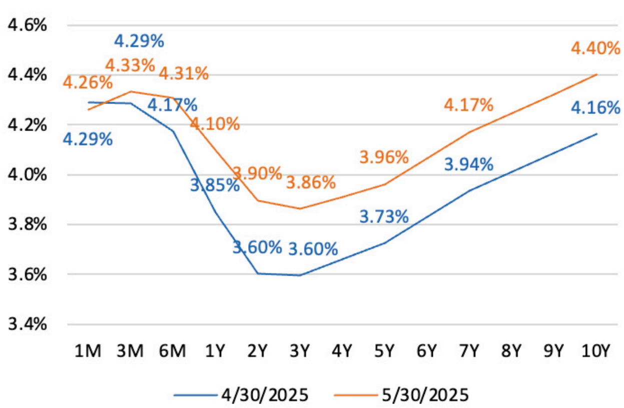
Source: Bloomberg. 15 years of monthly data through Apr 2025

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

June 2, 2025

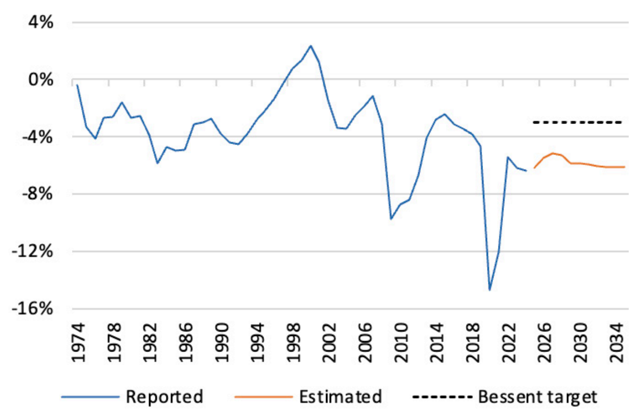
- **Overweight Fixed Income:** We have a slight overweight to fixed income within our models to help mitigate risk, given near-term concern of an economic slowdown and monetary policy that is likely to remain restrictive.
- **Leaning High Quality:** We favor investment grade bonds for their attractive risk adjusted return profile, appealing yields, and lower sensitivity to economic volatility.
- **Duration Neutral:** We remain neutral on interest rate risk. Intermediate maturities offer value, particularly if slowing growth pressures yields. However, we're hesitant to extend too far out the yield curve given the potential for investors to demand a higher term premium at the long end.
- **We Need a Bigger Boat:** The recently passed House reconciliation bill is estimated to raise the deficit by 15-24% over the next 10 years, with U.S. debt expected to nearly double. These fiscal plans are raising investor concerns, fueling higher interest rates and a weaker dollar. While these fiscal concerns are valid, if the yield on the 10-year Treasury were to retest cyclical highs we would likely consider adding to duration.
- **Monetary Policy Pause:** We believe the Fed's next move will be a cut, but it will likely wait for more clarity on how legislative and Executive Branch policy changes are affecting the economy. We believe the pace of rate cuts will depend mainly on labor market conditions.
- **Looking Beyond the Fog:** Longer term, we expect a steeper yield curve, with short end rates falling more than long end yields. This reflects our assumption that economic growth eventually settles into a more moderate pace, centered around 4% nominal and 2% real GDP.

Treasury Yield Curve vs Prior Month



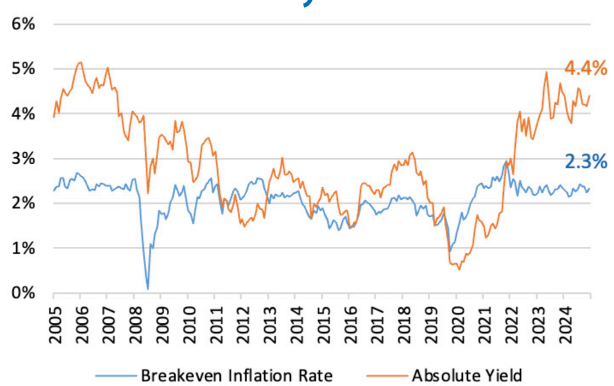
Source: Bloomberg

U.S. Budget Deficit or Surplus % of GDP



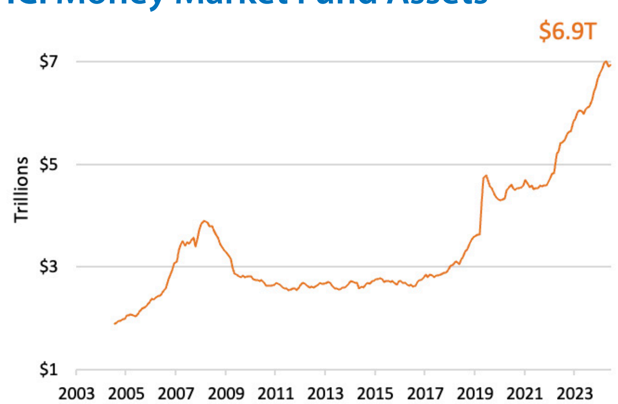
Source: Bloomberg. Annual data from fiscal 1974 through 2024; CBO annual estimates through 2035

U.S. 10 Year Treasury Bond



Source: Bloomberg. 20 years of monthly data through May 2025. Breakeven inflation rate is a measure of expected inflation derived from the difference between the 10-year Treasury yield and the 10-year TIPS yield.

ICI Money Market Fund Assets



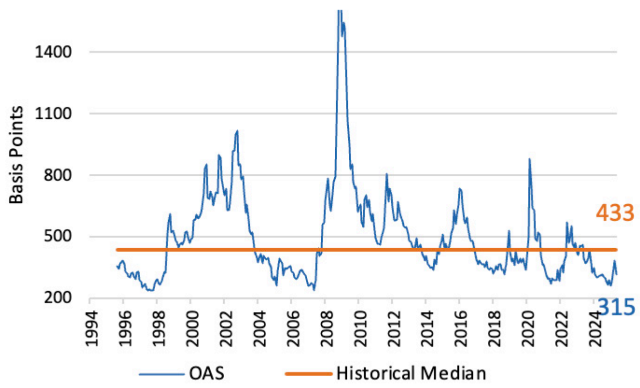
Source: Bloomberg. 20 years of monthly data through May 2025

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

June 2, 2025

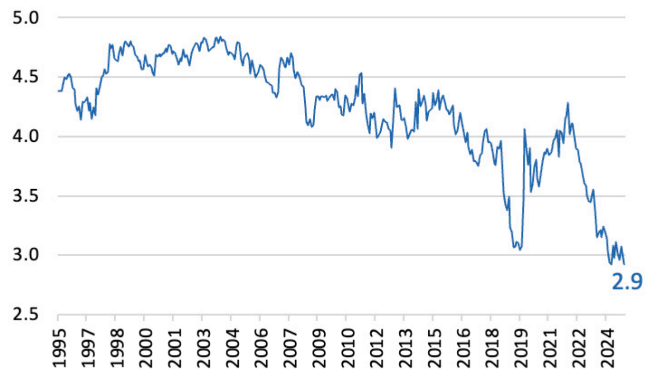
- **Cautious on Credit:** We remain slightly underweight non-investment grade bonds due to persistent macro risks. However, supportive credit conditions, higher index quality, and a manageable maturity wall prevent us from adopting a more defensive stance.
- **Spread Volatility:** Spreads widened sharply following Liberation Day but narrowed through late April and into May. Given ongoing policy uncertainty, we expect spread volatility to persist. Notably, the high yield index's sensitivity to spread changes, measured by spread duration, is near all time lows.
- **Ratings Watch:** Rating agency announcements of negative outlooks and reviews for downgrade are rising across high yield and the lower end of investment grade. Communications sector issuers are particularly exposed, though their wide spreads already reflect much of this risk. Importantly, these names have minimal tariff exposure, suggesting other economic factors are at play. We will continue monitoring profit margins, hiring trends, and changes in earnings estimates closely.
- **Should Opportunity Knock:** While we expect economic growth to slow in the second half, we are not expecting a recession. However, slower economic growth and ratings downgrades could spark wider spreads, presenting a possible opportunity to remove our underweight.
- **Active Management Required:** Current market conditions are likely to distinguish winners from losers, offering opportunities to both generate returns and manage risk. We remain focused on adjusting our tactical credit allocations as market dynamics evolve.

Bloomberg U.S. Corporate High Yield Credit Spread



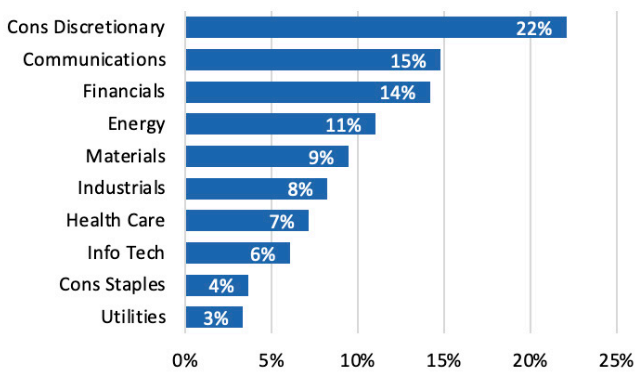
Source: Bloomberg. 30 years of monthly data through May 2025. Last observation percentile 17%

Bloomberg U.S. Corporate High Yield Index Spread Duration



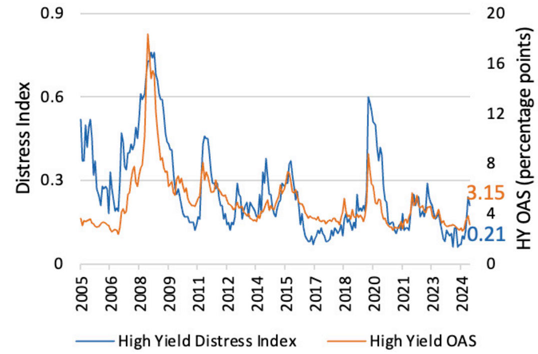
Source: Bloomberg. 30 years of monthly data through May 2025. Spread duration measures price sensitivity to changes in the credit spread.

Bloomberg U.S. Corporate High Yield Index Sector Weights



Source: Bloomberg. Data as of Apr 2025

NY Fed Corporate Bond Distress Index



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

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

June 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

	May 2025	YTD	2024	2023	2022	Duration years
Bloomberg Long Term Treasury	-2.9%	0.6%	-6.4%	3.1%	-29.3%	14.7
Bloomberg U.S. TIPS	-0.6%	3.7%	1.8%	3.9%	-11.8%	5.4
Bloomberg U.S. Aggregate	-0.7%	2.4%	1.3%	5.5%	-13.0%	6.1
Bloomberg U.S. Agg Corporates	0.0%	2.3%	2.1%	8.5%	-15.8%	6.8
Bloomberg U.S. Agg ABS	0.0%	2.0%	5.0%	5.5%	-4.3%	2.6
Bloomberg U.S. Agg MBS	-0.9%	2.4%	1.2%	5.0%	-11.8%	6.2
Bloomberg U.S. Agg CMBS	-0.3%	3.2%	4.7%	5.4%	-10.9%	4.0
Bloomberg Municipal Bond	0.1%	-1.0%	1.1%	6.4%	-8.5%	6.7
Bloomberg 1-3 year Corporate	0.2%	2.4%	5.3%	5.5%	-3.3%	1.8
ICE BofA Listed Preferreds	0.7%	-1.9%	8.5%	9.8%	-18.1%	NA
Bloomberg High Yield	1.7%	2.7%	8.2%	13.4%	-11.2%	2.9
S&P UBS Leveraged Loan	1.6%	2.1%	9.1%	13.0%	-1.1%	NA
Bloomberg Global Agg	-0.4%	5.3%	-1.7%	5.7%	-16.2%	6.5
Bloomberg Emerging Markets USD	0.7%	3.0%	6.6%	9.1%	-15.3%	5.9

Yields

			Last 10 years			
	May 2025	YTD Change bps	Current Percentile	Median	Min	Max
10 year Treasury	4.4%	-17	95	2.4%	0.5%	5.0%
2 year Treasury	3.9%	-34	76	1.7%	0.1%	5.2%
10 year TIPS	2.1%	-17	95	0.5%	-1.2%	2.5%
Bloomberg U.S. Aggregate	4.7%	-20	84	2.6%	1.0%	5.7%
Bloomberg U.S. Agg Corporate	5.2%	-12	81	3.5%	1.7%	6.4%
Bloomberg U.S. Agg ABS	4.6%	-11	76	2.1%	0.4%	6.0%
Bloomberg U.S. Agg MBS	5.2%	-12	93	2.9%	0.9%	6.1%
Bloomberg U.S. Agg CMBS	4.9%	-28	76	2.9%	1.4%	6.6%
Bloomberg Municipal Bond	4.0%	30	97	2.4%	0.9%	4.5%
Bloomberg 1-3 year Corporate	4.6%	-23	75	2.3%	0.5%	6.2%
Bloomberg High Yield	7.5%	-3	66	6.6%	3.5%	11.7%
S&P UBS Leveraged Loan	8.3%	-44	75	5.8%	3.6%	13.1%
Bloomberg Global Agg	3.6%	-11	81	1.7%	0.8%	4.4%
Bloomberg Emerging Markets USD	6.5%	-17	73	5.4%	3.5%	8.7%

Option Adjusted Spreads (bps)

			Last 10 years			
	May 2025	YTD Change	Current Percentile	Median	Min	Max
Bloomberg U.S. Corporate Agg	88	8	10	116	74	373
Bloomberg 1-3 year Corporate	57	5	37	62	31	390
Bloomberg U.S. Agg ABS	60	16	64	52	22	325
Bloomberg U.S. Agg MBS	42	-1	63	35	7	132
Bloomberg U.S. Agg CMBS	87	7	53	93	62	275
Bloomberg High Yield	315	28	18	377	253	1100
S&P UBS Leveraged Loan (discount margin)	472	-3	42	493	379	1275
Bloomberg Emerging Markets USD	224	4	6	304	205	720

For Index Definitions see: 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.

Authors: Crit Thomas, CFA, CAIA / Erik M. Aarts, CIMA / Tim Paulin, CFA **June 2, 2025**

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.

Performance data quoted represents past performance, which is no guarantee of future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than performance data given. ***For performance information current to the most recent month-end, visit TouchstoneInvestments.com/mutual-funds.***

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.