NEUBERGER BERMAN

Fixed Income Investment Outlook 2Q 2025

Riding Out the Storm

The Trump administration's announced tariffs have introduced new turbulence to the markets as investors seek to assess the possible ramifications across economies and asset classes. While negotiations could ease their scope and severity, we believe that the net result could be to reduce economic growth and modestly increase inflation this year, adding complexity to central bank monetary decisions, but still providing room for rate cuts. Amid the dislocation, we are finding opportunities for careful credit selection, and anticipate that reshoring of foreign investment flows and a weak dollar may favor non-U.S. markets over time.

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Riding Out the Storm

Announced tariffs could have long-term implications, but are already creating windows of opportunity across the fixed income markets.

The Trump trade regime hit like a monsoon on April 2 as the U.S. president introduced across-the-board 10% tariffs on imports, as well as potential "reciprocal" tariffs on a range of trading partners, including 20% on the European Union, 46% on Vietnam and 34% for China (later increased to over 100%). Trump subsequently paused the reciprocal tariffs for 90 days to allow for negotiations with willing countries (notably excluding China) to reach accommodation.

With these announcements, markets were thrown into disarray as investors attempted to assess the possible ramifications across economies and asset classes. In subsequent days, equities plummeted, then rose, then fell, then rose again; the 10-year U.S. Treasury yield slipped, but later rebounded to higher levels; and credit spreads saw volatility and sharp widening. On balance, global economic growth estimates eased while projections for U.S. inflation moved upward.

Ironically, overall fundamentals for the economy and bond market had been relatively constructive over the first quarter of 2025. U.S. growth seemed likely to slow but remain positive, while inflation was above-target but on the wane, suggesting that the Federal Reserve could contribute a couple interest rate cuts by year-end. Credit spreads had widened, but still reflected underlying strength.

Now, the economic climate is murkier. We have reduced our U.S. growth forecast to below 1% regardless of how tariffs play out, and modestly raised our inflation forecast from 2.5% to 3%. Although the market is currently expecting four cuts in 2025, actual delivery may depend on the degree to which tariffs translate into higher prices. For our part, two or three cuts appear likely as the Fed balances softening growth with stubborn inflation that is perhaps incrementally increased by tariff policies.

For non-U.S. markets, overall economic weakness could also worsen due to tariffs. In Europe, it may take a while for Germany's coming infrastructure spend to reaccelerate industries across the continent, making more central bank cuts likely. For China, the U.S.'s announced levies have been severe and may get worse given the country's immediate retaliation—potentially shaving a percentage point off our previous 2025 growth estimate for China to about 3%. That said, its Purchasing Manager Indices have been improving, and fiscal and monetary stimulus could have a positive impact, especially later in the year. China's already reduced reliance on U.S. imports may help limit the damage. Emerging markets could be broadly impacted by tariffs, but the ultimate effects may be by country and subject to negotiation.

In terms of duration positioning, we see some potential value at the short end of the U.S. yield curve, but are cautious on longer maturities due to upward pressure on the term premium. In credit, current spreads are now attractive, but it may be worth holding some investment capacity should conditions deteriorate. We think credit selection could be increasingly important depending on the issuers' exposure to tariffs and (in the U.S.) dependence on cheap overseas goods or labor.

More broadly, we should recognize that the president's tariff regime likely ushers in an era of increased trade barriers for the U.S. Over time, this could mean fewer capital inflows and a higher equilibrium cost of capital. We could see higher-than-expected interest rates, a steeper yield curve and weaker dollar, along with an increased risk premium in credit markets. Tax cuts, deregulation and pro-growth policies may provide an offset, but global capital flows will likely change over the coming years, potentially inuring to the benefit of non-U.S. markets.

We will be watching closely to refine our views and positioning. The following pages show some of the key themes we currently see in global fixed income markets.

1. Tariffs Loom Large, But Other Policies Could Have Impact

The U.S. president's "Liberation Day" on April 2 was a shock to the system, with details that were more onerous than many anticipated, including an average tariff rate of roughly 20% by our estimate compared to the 3% of only a few weeks earlier. Now the question becomes whether the levies constitute a new source of U.S. revenue, an opening bid or a combination of the two—something that will become clearer as other countries seek to negotiate or retaliate against the moves that are now on the table.

In the near term, we think it likely that we see negotiation and some watering down of the announced tariffs, but the directional impulse of the policies is unlikely to change. The next stage in the process may involve a bifurcation between China and more natural U.S. allies, which is already being reflected in news announcements. Interestingly, the relatively favorable treatment of Canada, Mexico and Latin America suggests a deliberate policy of favoring the U.S. "sphere of influence" in a multipolar world.

Pending policies in Washington, D.C. could offer some mitigation of the economic effects in the U.S. The Trump administration is engaged in an ongoing effort to reduce regulation, while tax cuts later in the year could support consumption. That said, crafting a budget package could become more complicated amid market headwinds, while the ultimate output could weigh on the country's fiscal picture.

U.S. POLICY TOOLS COULD HAVE OFFSETTING IMPACTS

		Growth Impulse	Initial Readthrough
Announced	**Tariff Policy**	↓	• Preliminary read on tariff announcement: 20% weighted-average global tariff more aggressive than consensus expectation • Awaiting individual country responses and negotiations • Mexico/Canada spared from reciprocal tariffs; auto manufacturing likely to remain an issue
Expected	**Deregulation**	↑	• Still awaiting transparency and more news • Incentives capital expenditures, releases "animal spirits"
Expected	**Tax Cuts**	↑	• Act as positive offset to tariff-driven cost increases • Potential positive impulse for consumption • Scope of cuts subject to budget reconciliation • Potentially negative feedthrough to fiscal picture

Source: Neuberger Berman. As of April 2, 2025.

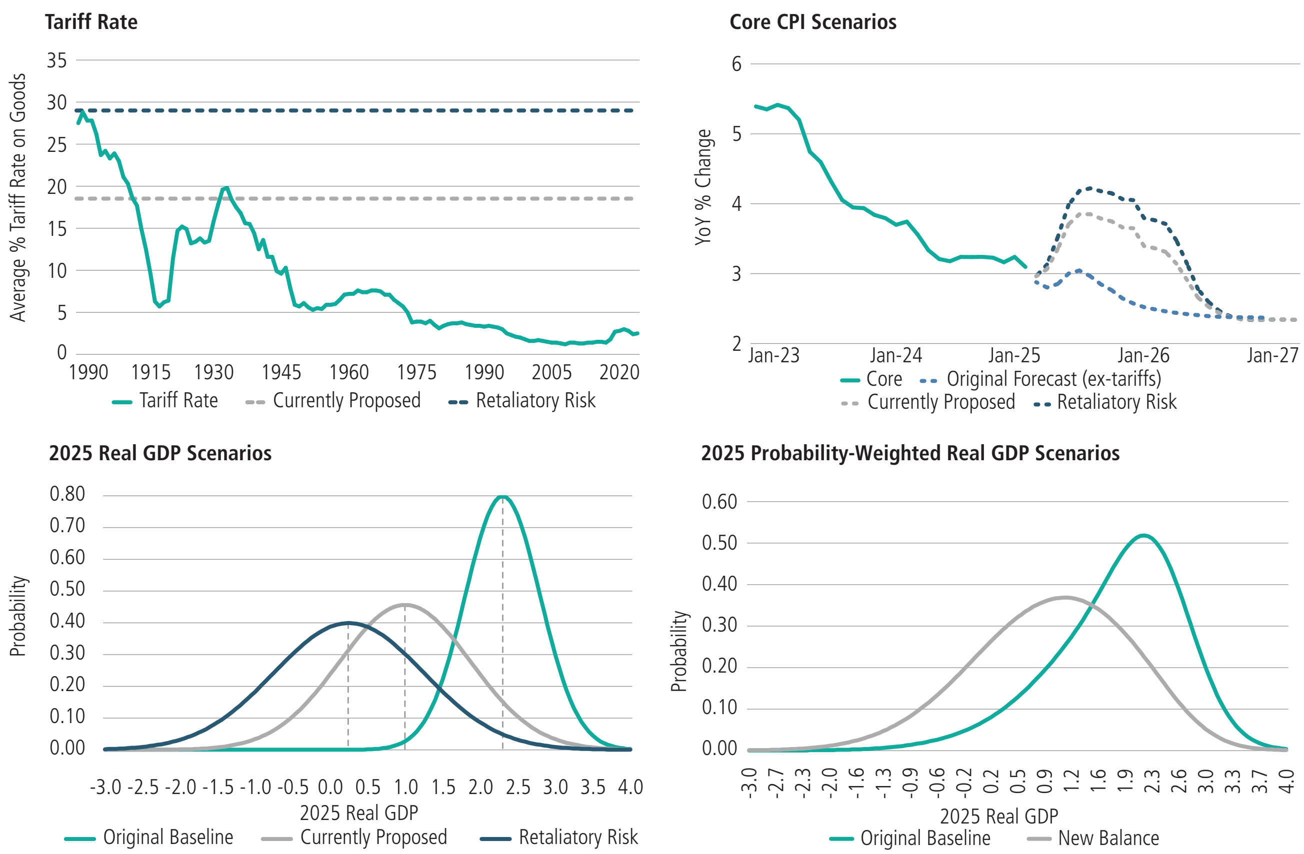
2. Growth and Inflation Are in Flux

With sharply increased tariffs, the task of the Fed has become more challenging, given their potential to suppress growth while also fueling inflation. While we came into the year with an expectation of 2.3% GDP growth in the U.S., that was later lowered to about 1.7% in the run-up to the tariff announcements. At this point, we believe that growth could come in under 1%, and could be worse depending on the degree of retaliation by other nations.

In export-dominated Europe, tariffs could also be somewhat impactful. In 2024, goods exports to the U.S. accounted for 3.2% of Eurozone (and 3.7% of German) GDP. We expect damage from the escalating trade conflict to primarily show up in lower real GDP, though the net effect on inflation will probably be small. Eurozone industries could stay close to recession in the first half of 2025 given subdued exports, the U.S. tariff war, weak consumption and real estate, and declining capex due to rising uncertainties. Services pricing could also fall, reducing core inflation from 2.4% in March to close to 2%.

With the elevated level of tariffs, the net impact on China could be a reduction of up to 2% of GDP, offset by RMB1 trillion in stimulus, for a net 1% reduction to growth, reducing our expectation to around 3.5% for 2025. The stimulus will likely focus on consumption, export subsidies and funds for stabilizing the equity market, a gradually weaker currency and lower bank reserve-requirement ratios and interest rates. The effect of tariffs will likely be felt more strongly in 2026 than in 2025 given front-loading of projected fiscal easing. Elsewhere in emerging markets, growth impacts from tariffs will be country-by-country, depending on exposures and potential for accommodation with the U.S.

TARIFFS' POTENTIAL IMPACT ON U.S. INFLATION, GROWTH



Source: U.S. Census Bureau, Tax Foundation, Caldara, Dario, Matteo Iacoviello, Patrick Molligo, Andrea Prestipino and Andrea Raffo (2020), "The Economic Effects of Trade Policy Uncertainty," *Journal of Monetary Economics*, 109, pp.38-59., Neuberger Berman calculations.

3. Balancing Act for Central Banks

Before news of the tariffs, we expected the Federal Reserve to ease two to three times this year as growth was already slowing. Now, the Fed will likely be balancing the tariffs' impact on inflation with any growth deterioration, with a focus on muted employment statistics. Inflation expectations appear well anchored, which creates scope for the Fed to respond to the growth changes if needed. Shortly after the tariff news, the market was priced for about 100 basis points of easing over the next 12 months. Unless we see major deterioration in employment data, however, we expect monetary policy to be on hold for the first half, followed by cuts at a gradual pace in pursuit of a neutral rate of around 3.25 – 3.75%.

We anticipate a similar response from other central banks, including the European Central Bank and Bank of England, that will balance the inflation impacts with the growth impacts. On the Continent, the current trend of declining inflation should continue through the summer due to lower domestic and import prices. With European core inflation potentially reaching 2%, the ECB will likely move to an accommodative monetary policy. Thus far, the ECB has been cautious, focusing only on inflation rather than the medium- to long-term picture. On balance, we expect the ECB to cut its key rate four more times this year to about 1.5%. The BoE is on track to cut rates three times this year, while the Bank of Japan remains an outlier with one more hike in store for 2025.

CENTRAL BANK RATES OUTLOOK, DEVELOPED MARKETS

Central Bank	Neuberger Berman Expectations	Neuberger Berman Outlook
FED	• 2025: 2 Cuts • 2026: 1 Cut • 2027: 1 Cut • NR[1]: 3.50%	• After recalibrating policy rates, the Fed has pivoted to a gradual phase of the easing cycle. Higher upside risks to inflation should keep the committee data-dependent for near-term policy adjustment. • We expect the Fed to be on hold but retain its easing bias, eventually delivering two cuts in 2025 and moving cautiously thereafter until the neutral rate settles at around 3.25 – 3.75%. We acknowledge the increasing uncertainty on the timing of reaching neutral rate due to tariff-related inflationary and economic volatility.
ECB	• 2025: 4 Cuts • 2026: 0 Cuts • 2027: 1 Hike • NR[1]: 2.00%	• Weak potential growth (switching from an export to a domestic model), the U.S. trade war weighing on global activity and falling core inflation below 2% should lead the ECB to adopt an accommodative monetary policy. • We expect the ECB to cut its key rate four more times this year to 1.5%, below its 2% neutral rate.
BoE	• 2025: 3 Cuts • 2026: 2 Cuts • 2027: 0 Cuts • NR[1]: 3.25%	• BoE commentary has pointed toward more willingness to ease even with some persistent inflation pressures given lower growth dynamics. Concerns about stagflation due to fiscal policies are risks to the forecast. • We now expect a continuation of the rate-cutting cycle at a quarterly pace into 2025 and 2026, with the policy rate settling at around 3.25 – 3.50%.
BoJ	• 2025: 2 Hikes • 2026: 1 Hikes • 2027: 0 Hikes • NR[1]: 1.00%	• The Bank of Japan raised rates by 25bps in January, in line with its stated goal of gradually moving policy to a neutral level. • Due to uncertainty stemming from U.S. tariffs negotiations, we expect the BoJ to raise rates only once more in 2025 in Q2, and once more in 2026 to reach a neutral rate of 1.00%.

[1] NR = Neutral Rate

Source: Neuberger Berman. As of April 15, 2025.

4. Evolving Fiscal Profiles May Help Drive Rates Opportunities

Since Trump's election, investors have generally been expecting a growing U.S. federal budget deficit and debt on the back of proposed tax cuts. Tempering these expectations have been ongoing expense reductions via the Department of Government Efficiency, or DOGE, as well as negotiations over budget "reconciliation" for the upcoming year. With the economy slowing in the U.S., we believe that shorter rates have the potential to fall further from here, but that fiscal uncertainty is likely to limit the rally at the longer end of the market as investors grapple with how to price the U.S. term premium, suggesting that the 10-year Treasury may maintain a range of 3.75 – 4.75% over time.

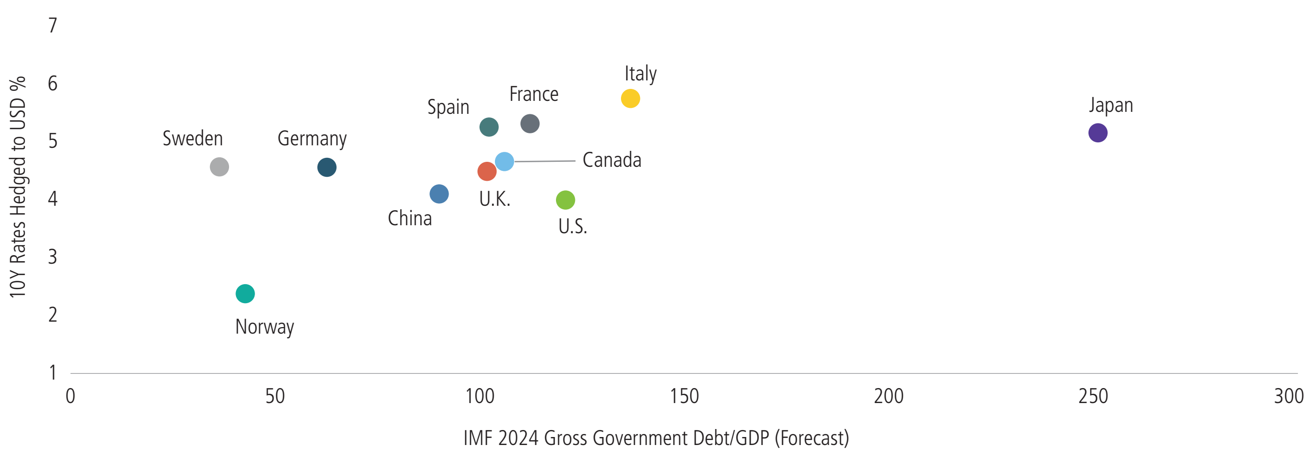
In Europe, the pending fiscal expansion in Germany around infrastructure and defense has created anticipation of economic growth across the continent, but also what we consider an overreaction in longer-dated Bunds by bond investors. Given still-slow economic growth and a continuing deceleration in inflation, investors could benefit from further ECB rate reductions (as noted above), with German yields in particular holding further potential to ease from here.

SHIFTING FISCAL DYNAMIC IN EUROPE

Germany Has Room to Expand Its Debt Level

Source: Eurostat, as of 3Q24. German data assumes instantaneous phase-in of €1.0 – 1.3 trillion defense/infrastructure proposal.

Relative Value Opportunities May Emerge With More Attention to Fiscal Issues



Source: IMF WEO October database, Bloomberg, Neuberger Berman calculations (10-year rates hedged to USD. Perentage uses Bloomberg Generic 10-year cash rates adjusted for three-month hedging costs. Hedging costs sourced from Bloomberg Ticker (EUR, GBP, JPY) or calculated using three-month forward/spot rates annualized (CAN, SEK, NOK, SWE). As of April 4, 2025 except for China, which is as of April 3, 2025.

5. Looking for Select Credit Opportunities

In recent quarters, narrow spreads backed by stable corporate fundamentals have limited the potential opportunity set in credit markets. In this environment, we have generally maintained reduced exposure to credit and an up-in-quality bias.

With signs of fraying growth during the first quarter, and then the tariff announcements, spreads have moved considerably wider, with U.S. high-yield spreads of close to 450 basis points as of April 7. Although less than the 600 – 800 basis points that might occur during a full recession, this suggests that, on balance, now may be an opportune time to selectively add to credits while leaving capacity for further investment if market fundamentals deteriorate further. In our view, a continued focus on quality and an understanding of tariffs' impacts on particular sectors and industries will likely be important.

Opportunities may develop on an idiosyncratic basis from here, as well. Germany's infrastructure spending could have potential fundamental benefits for a range of companies across Europe. Meanwhile, we are cognitive of price dynamics in light of current economic pressures. In emerging markets, we generally have been underweight Asia and overweight Latin America, and are maintaining this exposure, while seeing opportunities to slightly reduce emerging markets corporate risk given the strong performance this year. That said, markets outside the U.S. may continue to be viewed more favorably by investors. Thus, outperformance of European credit markets and emerging markets could continue.

CREDIT SPREADS SHOW SOME LIFE

Yield to Worst and Option-Adjusted Spread: March 2025 vs. December 2024

Source: ICE BofA, JPMorgan and Morningstar, as of March 31, 2025. Yields are in local terms (USD for EM Corp). ICE Indices shown: U.S. IG - C0A0; EUR IG – ER00; U.S. HY – H0A0; EUR HY – HE00; CMBS – CMBS; ABS – R0A0. JPMorgan: JPMorgan CEMBI Diversified Index (EM Corp); JPM CLOIE AAA Post-Crisis Index; JPM CLOIE BBB Post-Crisis Index. LSTA/Morningstar Leveraged Loans Index.

Market Views

Next 12 Months

	UNDER −−	−	NEUTRAL ◇	+	OVER ++	CHANGE NOTES
GOVERNMENT BOND MARKETS						
United States	○	○	●	○	○	
United Kingdom	○	○	○	●	○	
Germany	○	○ →	→	●	○	Significant repricing of market expectations due to fiscal expansion in Germany creates opportunity as economic growth remains slow, inflation is decelerating and the ECB's bias is to continue cutting rates.
France	○	○	○ →	●	○	See above.
Italy	○	○	○ →	●	○	See above.
Spain	○	○	○	●	○	
Japan	○	○	●	○	○	
Canada	○	○	●	○	○	
New Zealand	○	○	○	●	○	
Australia	○	○	●	○	○	
U.S. TIPS	○	○	○	●	○	
INVESTMENT GRADE SECTOR						
MBS	○	○	○	●	○	
Securitized Credit	○	○	○	●	○	
Corporate Credit	○	○	○	●	○	
Hybrids	○	○	○	●	○	
Municipals	○	○	●	○	○	

Market Views (continued)

Next 12 Months

	UNDER −−	−	NEUTRAL ◇	+	OVER ++	CHANGE NOTES
HIGH YIELD & EMERGING MARKETS						
High Yield	○	○	○	●	○	
Floating-Rate Loans	○	○	●	○	○	
CLO	○	○	○	●	○	
EM Hard-Currency Sovereigns	○	○	● ←	○	○	Relative outperformance and risks from tariffs have reduced current appeal.
EM Hard-Currency Corporates	○	○	●	○	○	
EM Hard-Currency Short Duration	○	○	● ←	○	○	Relative outperformance and risks from tariffs have reduced current appeal.
EM Local-Currency Sovereigns	○	○	○	●	○	
CURRENCY*						
U.S. Dollar	○	● ←	○	○	○	Long-term fair value overvaluation and portfolio flows out of U.S. should weigh modestly on the dollar.
Euro	○	○	○	→ ●	○	Balance of payments should support the euro in the medium term, along with fiscal stimulus in Germany and Europe.
Pound	○	●	○	○	○	
Yen	○	○	●	○	○	
Swiss Franc	○	○	●	○	○	
Australian Dollar	○	○	○	●	○	
Swedish Krona	○	○	●	○	○	
Norwegian Krone	○	○	●	○	○	
Canadian Dollar	○	○	●	○	○	
Mexican Peso	○	○	● ←	○	○	GDP is slowing on the back of tariff uncertainty, leading to front-loading of central bank easing. Markets had expected Mexico to be protected from tariffs under the USMCA, which turned out not to be the case.
South African Rand	○	○	○	●	○	
Brazilian Real	○	○	○	●	○	
Chinese Yuan	○	●	○	○	○	

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*Currency views are based on spot rates, including carry.

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