

Fixed Income Has Generated Strong Returns Year to Date, With Continued Momentum as the Economy Slows

This report is excerpted from the [Third Quarter 2025 Fixed-Income Sector Views](#).

Amid an economic slowdown, fixed income offers the potential for attractive yields, total return, and portfolio ballast, but credit selection is critical.

The macro backdrop remains supportive for fixed income and credit. Our baseline U.S. economic outlook projects real gross domestic product (GDP) growth to slow below 1 percent this year, with inflation rising above 3 percent, as tariff-induced price increases—which have yet to be felt—filter through and cut consumer spending power. Business investment and hiring are slowing amid trade and regulatory uncertainty, a trend we expect will continue, boosting the unemployment rate and prompting the Federal Reserve (Fed) to start easing later this year. We expect Fed cuts to accelerate in 2026 as the one-time tariff price increases fade, taking the policy rate into the low 3s. The upcoming Fed leadership change may lead to markets perceiving a bias towards a lower fed funds rate.

Credit and Risk Positioning

Returns have been strong year to date across all categories of fixed income, with most sectors outperforming their starting yield. Returns have been very similar across categories, but that could change. Amid a slowing economy and bouts of market volatility, our investment approach is guided by key market dynamics: real yields are very attractive; credit spreads have tightened; risks to our baseline economic outlook are heightened; and corporate fundamentals are strong, but we expect them to diverge among industries as some are more vulnerable to tariffs, international demand or a more stretched consumer.

We continue to prioritize diversification with a high level of income generation. We prefer higher quality credit as credit curves have flattened, particularly structured credit, where spreads remain wider relative to fundamental risk, and defensive assets like infrastructure, which has historically offered inflation-linked income and downside resilience. We prioritize high carry instruments, including non-Agency residential mortgage-backed securities (RMBS), senior collateralized loan obligations (CLO) tranches, and commercial asset-backed securities (ABS). In corporate credit, we favor higher quality high yield (BB-rated) securities with low expected direct and indirect vulnerability to tariff and regulatory risks. We are making tactical rotations, using market weakness to add, and strength to rotate, diversify, and capture opportunities created by the volatility.

Duration and Interest Rate Views

The 10-year Treasury yield should remain range-bound between 3.75–4.75 percent as policy changes unfold, with upward pressure from fiscal policy offset by slowing growth and easing monetary policy. Elevated volatility in the 10-year Treasury presents opportunities for us to tactically add duration when yields reach the higher end of the range and sell when near the lower end. Over the next year, we anticipate the yield curve to steepen further, led by rate cuts on the front end, and persistently higher yields on the long end as investors require greater term premiums to compensate for the risk of growing fiscal deficits. In this environment, we favor the belly of the curve, which we believe is poised to outperform as the Fed eases.

As growth slows and policy uncertainty creates a wider range of economic outcomes, higher quality credit can offer attractive real yields, diversification, and portfolio ballast to help buffer downside risks. As credit performance diverges among industries, however, and the yield curve shifts, active selection and risk management are critical.

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