CHIEF INVESTMENT OFFICE

Fixed Income Spotlight

2025 Mid-Year Update — Playing for Time

All data, projections and opinions are as of July 7, 2025 and subject to change.

SUMMARY

- The Federal Reserve (Fed) is playing for time, weighing resilient hard economic data against trade and fiscal policy uncertainties. We consider U.S. real yields attractive at current levels and maintain a neutral duration position to seize potential investment opportunities.
- While the technical and fundamental backdrops should be supportive of performance in the Investment-grade (IG) and High Yield (HY) markets, we are maintaining our neutral view based on rich valuations with more limited room for upside versus duration-matched Treasurys.
- Agency Mortgage-backed Securities (MBS) offer relative value versus other high-quality Fixed Income, but technical and macro headwinds hold our recommendation back at neutral.
- Muni bonds significantly underperformed in the first half of the year. However, we believe munis will outperform in July and August due to stronger technical factors and stable fundamentals.

View the CIO Viewpoint ▶ View the CIO Asset Allocation Guidelines ▶

ASSET CLASS WEIGHTINGS

Asset Class	Underweight		Neutral		Overweight
Global Fixed Income		●			
U.S. Governments		●			
U.S. Mortgages		●			
U.S. Corporates		●			
International Fixed Income			●		
High Yield			●		
U.S. Investment-grade Tax Exempt		●			
U.S. High Yield Tax Exempt		●			

These Chief Investment Office (CIO) views relate to fully-diversified, multi-asset class portfolio and use the asset class breakdown of the CIO "High Tax/Balanced" Allocation. Source: Global Wealth & Investment Management Investment Strategy Committee as of July 8, 2025.

FIXED INCOME U.S. RATES FORECAST

(% end of period)	3Q25	4Q25	1Q26	2Q26	3Q26	4Q26
Fed Funds Range	4.25–4.50	4.25–4.50	4.25–4.50	4.25–4.50	3.75–4.00	3.25–3.50
2-Year T-Note	3.80	3.80	3.75	3.75	3.80	3.90
5-Year T-Note	4.05	4.10	4.15	4.20	4.23	4.30
10-Year T-Note	4.40	4.50	4.55	4.60	4.68	4.80
30-Year T-Bond	4.90	5.00	5.03	5.05	5.08	5.10

Source: BofA Global Research U.S. Rates Research; July 11, 2025; spot price as of that date. Note: Federal funds rate forecasts are model expectations; other values are for market rates. The forecasts in the table above are the baseline view from BofA Global Research team. The Global Wealth & Investment Management (GWIM) Investment Strategy Committee (ISC) may make adjustments to this view over the course of the year and can express upside/downside to these forecasts. **There can be no assurance that the forecasts will be achieved. Economic or financial forecasts are inherently limited and should not be relied on as indicators of future investment outcomes.**

FIXED INCOME AT A GLANCE

Rates Markets	30-Jun	Last Month	Change
Fed Funds rate	4.38%	4.38%	+0 bps
3-month Treasury Bills	4.30%	4.34%	-4 bps
U.S. 2-year Note	3.72%	3.90%	-18 bps
U.S. 5-year Note	3.80%	3.96%	-17 bps
U.S. 10-year Note	4.23%	4.40%	-17 bps
U.S. 30-year Note	4.78%	4.93%	-16 bps
FF / 10s Curve	-14 bps	+3 bps	-17 bps
2s / 10s Curve	+51 bps	+50 bps	+1 bps
German 10-year	2.61%	2.50%	+11 bps
UK 10-year	4.49%	4.65%	-16 bps
Japanese 10-year	1.43%	1.49%	-6 bps

Credit Markets	30-Jun	Last Month	Change
U.S. Investment Grade (Spread)	+83 bps	+88 bps	-5 bps
U.S. High Yield (Spread)	+290 bps	+314 bps	-24 bps
U.S. High Yield (Yield)	7.06%	7.46%	-40 bps
Emerging Markets (U.S.$, Spread)	+220 bps	+224 bps	-4 bps
10-year AAA Municipal	3.21%	3.31%	-10 bps
10-year Muni / Treasury Ratio	75.9%	75.2%	+0.6%

Index Returns	1-month	12 months	Year-to-Date
U.S. Treasury	1.3%	0.0%	3.8%
U.S. MBS	1.8%	0.0%	4.2%
U.S. ABS	0.9%	0.0%	2.9%
U.S. CMBS	1.3%	0.0%	4.3%
U.S. Corporate	1.9%	0.0%	4.2%
U.S. High Yield	1.8%	0.0%	4.6%
U.S. Leveraged Loans	0.8%	0.0%	2.8%
U.S. Municipals	0.6%	0.0%	-0.3%
U.S. Municipal High Yield	0.6%	0.0%	-0.3%

Bps refers to basis points. Source: Bloomberg. Data as of June 30, 2025 and subject to change. **Past performance is no guarantee of future results. Please refer to the end of the document for asset class proxies and index definitions.**

The Fed has been "playing for time" in 2025—leaving rate policy unchanged while assessing the economic and inflationary impacts of trade and fiscal policy. The labor market and consumer spending remain healthy, while underlying inflation has slowed. Gross domestic product (GDP) growth should be below trend in the second half of 2025, while unemployment rises slightly, potentially allowing the Federal Open Market Committee to cut interest rates. However, tariff-related inflationary pressures may keep the Fed on hold, and growth may improve with front-loaded tax reductions and delayed spending cuts in the One Big, Beautiful Bill Act. On the other hand, material labor market deterioration may accelerate rate cuts; the Fed's expectations are for two rate cuts this year even with a small increase in unemployment (from 4.2% to 4.5%). Thus far, the Fed's wait-and-see approach amidst significant uncertainty has been prudent—and correct, in our view.

The rates market also expects two 25 basis points (bps) rate cuts for 2025, with the Treasury curve steepening: Short-term Treasurys have outperformed, whereas the long end of the curve remains basically where it started 2025. The 10-year declined around 50 bps from its January peak to around 4.4% recently, while 30-year yields have been volatile as federal deficit and trade policy concerns have led to selling pressure. While selling can cause short-term increases in rate volatility and yields, the primary determinant of long-term interest rates is the path of short-term rates—which is driven by inflation expectations and economic growth, not selling. We therefore view any significant yield increase without higher inflation as a potential buying opportunity. Real yields remain near the highest levels in decades—compelling historically and relative to global alternatives.

These yields have provided attractive compensation for inflation and market risk; we suggest a sizable allocation to Fixed Income, even though we are overweight Equities. Our sector positioning could also be characterized as playing for time—we remain neutral across sectors. We are slightly more favorable on duration than when the 10-year was below 4% but recommend neutral duration to allow flexibility to maneuver should opportunities arise. Like the Fed, we are in "wait-and-see mode" until and unless we see those better opportunities.

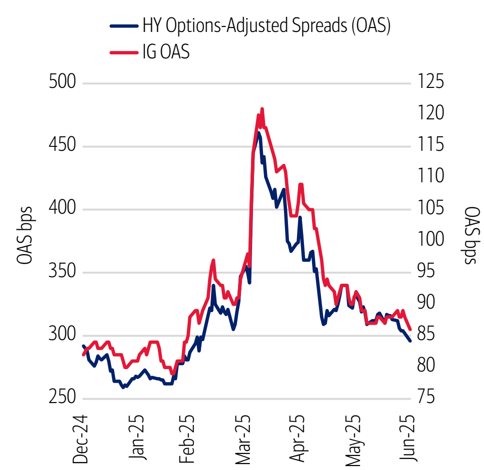
Neutral Taxable IG and HY—Credit Spreads to Remain Range-Bound at Historically Tight Levels. Credit spreads have retraced most of their underperformance, ending the first half modestly higher with IG and HY spreads both wider by 4 bps (Exhibit 1). Coupon carry has offset modestly wider spreads, with positive returns driven by bull steepening in the yield curve.

We expect this positive environment to persist, with several caveats. Economic data points to a healthy consumer with positive (albeit slowing) GDP growth, while inflation gradually moves to 2% despite lingering tariff concerns. IG fundamentals remain on sound footing with positive top- (revenue +4% year-over-year (YoY)) and bottom-line growth (earnings before interest, taxes, depreciation, and amortization +5% YoY) during Q1, resilient margins, and better gross leverage. HY fundamentals are more mixed; however, default rates should move lower near-term, which should support HY spreads. Technicals remain the strongest argument for short-term credit outperformance. Credit is a yield-driven market; the bottom line is that current yield levels attract incremental buyers but few sellers. Furthermore, net supply should contract, providing a further tailwind. Fed policy and potentially lower Treasury yields are key factors to watch.

The environment is thus supportive for credit, yet tight spreads keep our recommendation at neutral for now.

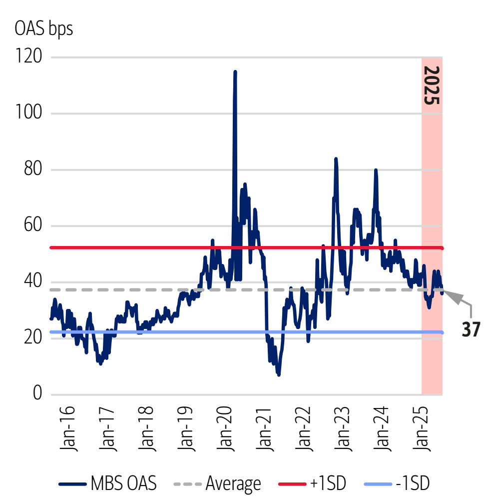
Neutral Agency MBS—Valuations appear Fairly Valued Amid Structural Uncertainties. We are—and expect to remain—neutral Agency MBS. Risk-reward is balanced; relatively attractive valuations are offset by rate volatility and challenging technicals. MBS OAS remain rangebound (Exhibit 2). Year-to-date MBS excess returns are +0.10%, and carry is attractive. MBS continues to offer compelling value relative to assets such as IG, which is trading just above multi-decade tights.

Exhibit 1: Credit Spreads Have Retraced April Widening and Are Trending at Historically Low Levels—Expect to Remain Range-Bound over the Near Term.



Source: BofA Global Research; Bloomberg. As of June 2025.

Exhibit 2: Agency MBS Spreads: Holding Steady Despite Macro Volatility.



Source: Bloomberg. As of June 2025.

Structural demand headwinds persist, however. The Fed's MBS portfolio—25% of the market—is running off. Domestic banks and overseas investors have muted appetites amid elevated rate volatility. That leaves marginal demand from more spread-sensitive investors, including institutional investors and funds. Money managers increased MBS overweight positions in response to more attractive yields; however, positioning now seems extended. Technical overhangs and rate volatility concerns may keep spreads in their recent range.

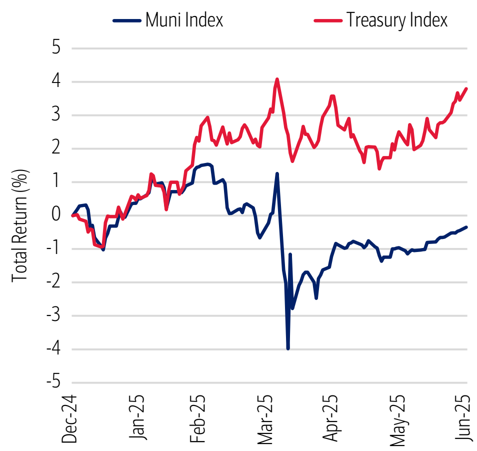
Housing fundamentals remain solid, supported by price appreciation. Affordability remains challenged by elevated mortgage rates, tight inventory and low turnover, which may constrain net supply. Rate volatility has decreased; although still high historically due to deficits and geopolitical instability, the MOVE index dropped from 140 to 90. Fed policy remains less predictable; rates may remain higher-for-longer, reinforcing that a neutral stance on MBS is prudent. Two policy developments—quantitative tightening and Government-Sponsored Enterprise (GSE) privatization efforts—may materially impact MBS demand and spreads and justify careful monitoring.

Munis Poised for Better Relative Performance in The Second Half. Munis underperformed through April (Exhibit 3) due to tariff-related economic concerns, uncertainty regarding future federal aid to municipal issuers and the muni tax exemption, strong new issue supply, seasonally low redemptions, and pre-Tax Day selling. However, munis outperformed in May; those concerns had mostly dissipated while technicals strengthened (an end to Tax Day selling and an increase in redemptions). In June, valuations cheapened slightly amidst robust issuance.

We expect strong summer technicals; BofA Global Research forecasts $143 billion principal and interest payments versus $108 billion issuance in July and August. Fundamentals should remain stable; cuts in federal funding may weigh on municipal finances, but state Rainy-Day funds are still near all-time highs from pandemic stimulus and tax revenues. Therefore, any actual federal funding reductions should be manageable for most issuers.

We expect munis to outperform Treasurys this summer due to those strong technicals. From September onward, technicals should normalize, and munis may more or less keep pace with Treasurys.

Exhibit 3: Munis Underperformed in First Half But Are Now Poised for Outperformance on Stronger Technicals.



Source: Bloomberg. As of June 2025. Please refer to index definitions at the end of this report. **Past performance is no guarantee of future results.**

Asset Class Proxies and Index Definitions

Securities indexes assume reinvestment of all distributions and interest payments. Indexes are unmanaged and do not take into account fees or expenses. It is not possible to invest directly in an index. Indexes are all based in dollars.

S&P 500 Equity Index includes a representative sample of 500 leading companies in leading industries of the U.S. economy. Although the index focuses on the large-cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market.

U.S. Financials/U.S. Industrials/AA-Credit/BBB-Credit/A-Credit/ICE BofA U.S. Corporate Index tracks the performance of U.S. dollar denominated investment grade corporate debt publicly issued in the US domestic market.

U.S. Municipals/Bloomberg Muni Bond Index measures the performance of the Bloomberg U.S. Municipal bond market, which covers the USD- denominated Long-Term tax-exempt bond market with four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.

U.S. High Yield/BB-Credit/B-Credit/CCC-Credit/Bloomberg U.S. Corporate High Yield Index: The Bloomberg U.S. Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.

U.S. Municipal High Yield/Bloomberg High Yield Municipal Index is a benchmark that covers the high yield portion of the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.

Emerging Market/Bloomberg Emerging Market USD Index is a flagship hard currency Emerging Markets debt benchmark that includes USD-denominated debt from sovereign, quasi sovereign, and corporate EM issuers.

Cash/U.S. Treasury/Bloomberg U.S. Treasury Index Total Return measures U.S. dollar-denominated, fixed-rate, nominal debt issued by the U.S. Treasury. Treasury bills are excluded by the maturity constraint, but are part of a separate Short Treasury Index. STRIPS are excluded from the index because their inclusion would result in double-counting.

U.S. Mortgage-backed Securities (MBS)/ABS/Bloomberg U.S. Mortgage-backed Securities 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).

U.S. Corporates/Bloomberg U.S. Corporate Index measures the investment grade, fixed-rate, taxable corporate bond market. It includes U.S. dollar-denominated securities publicly issued by U.S. and non-U.S. industrial, utility and financial issuers. The U.S. Corporate Index is a component of the U.S. Credit and U.S. Aggregate Indices.

Bloomberg Capital Asset-Backed Securities (ABS) Index is composed of debt securities backed by credit card, auto and home equity loans that are rated investment grade or higher by Moody's.

Bloomberg U.S. Commercial Mortgage Backed Securities (CMBS) Index is the Bloomberg Non-Agency Investment Grade CMBS: BBB Total Return Index Unhedged.

Muni High Yield/Bloomberg Muni High Yield Index is a market-value-weighted index that tracks the performance of the U.S. dollar-denominated, tax-exempt, non-investment grade municipal bonds issued by U.S. states, the District of Columbia, U.S. territories, and local governments or agencies.

ICE BofA Investment-grade Index tracks the performance of U.S. dollar-denominated, investment grade (IG), asset-backed securities publicly issued in the U.S. domestic market.

ICE BofA High Yield tracks the performance of U.S. dollar denominated below investment grade corporate debt publicly issued in the U.S. domestic market.

ICE BofA U.S. Corporate Index tracks the performance of U.S. dollar denominated investment grade and sub-investment grade corporate debt publicly issued in the U.S. domestic market.

The MOVE Index measures interest rate volatility in the U.S. Treasury market, serving as a tool for investors, traders, and analysts to assess risk and uncertainty in the bond market.

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Investing in fixed-income securities may involve certain risks, including the credit quality of individual issuers, possible prepayments, market or economic developments and yields and share price fluctuations due to changes in interest rates. When interest rates go up, bond prices typically drop, and vice versa. Income from investing in municipal bonds is generally exempt from Federal and state taxes for residents of the issuing state. While the interest income is tax-exempt, any capital gains distributed are taxable to the investor. Income for some investors may be subject to the Federal Alternative Minimum Tax (AMT). Tax-exempt investing offers current tax-exempt income, but it also involves special risks. Single-state municipal bonds pose additional risks due to limited geographical diversification. Interest income from certain tax-exempt bonds may be subject to certain state and local taxes and, if applicable, the alternative minimum tax. Any capital gains distributed are taxable to the investor. Investments in high-yield bonds (sometimes referred to as "junk bonds") offer the potential for high current income and attractive total return but involve certain risks. Changes in economic conditions or other circumstances may adversely affect a junk bond issuer's ability to make principal and interest payments. Treasury bills are less volatile than longer-term fixed income securities and are guaranteed as to timely payment of principal and interest by the U.S. government. For investments in Agency Mortgage-backed Securities (AMBS) and Mortgage-backed Securities (MBS), generally, when interest rates decline, prepayments accelerate beyond the initial pricing assumptions, which could cause the average life and expected maturity of the securities to shorten. Conversely, when interest rates rise, prepayments slow down beyond the initial pricing assumptions, and could cause the average life and expected maturity of the securities to extend, and the market value to decline. Most senior/leveraged loans are made to corporations with below investment-grade credit ratings and are subject to significant credit, valuation and liquidity risk. The value of the collateral securing a loan may not be sufficient to cover the amount owed, may be found invalid or may be used to pay other outstanding obligations of the borrower under applicable law. There is also the risk that the collateral may be difficult to liquidate, or that a majority of the collateral may be illiquid. Investments in a certain industry or sector may pose additional risk due to lack of diversification and sector concentration. Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates, and risk related to renting properties, such as rental defaults.