First Quarter 2025 Bond Market Review and Outlook

Cincinnati Asset Management, Inc.
Investment Grade & High Yield Bond Specialists

"Volatility is the price of admission. The prize inside is superior long-term returns. You have to pay the price to get the returns." (Morgan Housel)

Market Review and Outlook

The U.S. Corporate Bond market found itself at a pivotal moment at the end of Q1 2025, given a unique combination of geopolitical and policy-related developments. According to a Bloomberg survey of economists, the probability of a recession over the course of the next year rose during the first quarter. Throughout January and most of February this indicator was at 20% but then it rose steadily to 30% by the end of March (source: Bloomberg 3/31/25).

Understandably, investors have entered Q2 with a heightened level of caution. In the first quarter of 2025, the 10 year Treasury yield decreased 36 basis points, opening the year at 4.57% and closing the quarter at 4.21%. Yields rebounded to 4.49% on 4/11/25. The Bloomberg US Corporate Index option adjusted spread ("OAS") widened 33 basis points from 80 basis points to 113 basis points on April 11th. The average over the past 5 years was 114 basis points. The Bloomberg US Corporate High Yield Index OAS widened 132 basis points moving from 287 basis points to 419 basis points on April 11. The average over the past 5 years was 386 basis points (source: Barclays Daily Credit Call 4/14/25).

While spreads widened broadly, the FOMC elected to hold its policy rate steady at both the January and March meetings. They also released an updated dot plot in March with a few changes at the margin from December. The latest version of the plot showed that policymakers at the median continued to expect two rate cuts (50bps) in 2025. However, examining the details, there were more policymakers expecting zero or just one cut than there were in December (source: Fed SEP 3/19/25). Fed chair Jay Powell's interview on Friday at the SABEW conference sought to reassure markets by indicating the US central bank has not been jolted by Donald Trump's "Liberation Day" tariffs. Powell sounded mildly hawkish, but will hold for hard data confirming the effects of the new trade measures before changing stance (source: Financial Times 4/7/25).

One theme we have been writing about over the course of the past few letters is the re-steepening of the 2/10 Treasury curve (see above chart). We view this

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Yields* on 03/31/2025	**Yield***
CAM Broad Market (corporate core plus) Strategy (6.5 year maturity; 5.0 duration)	**5.48%**
CAM Investment Grade (100% corporate bonds) Strategy (7.0 year maturity; 5.7 duration)	**5.00%**
CAM High-Yield Strategy (only BA & B rated purchased) (4.1 year maturity; 3.6 duration)	**6.42%**
CAM Short Duration Strategy (2.9 year maturity; 2.4 duration; 50% IG & 50% HY)	**5.44%**
CAM Short Duration Investment Grade Strategy (2.6 year maturity; 2.2 duration)	**4.57%**
U.S. Treasury** (10 year maturity)	**4.21%**
U.S. Treasury** (5 year maturity)	**3.95%**
U.S. Treasury** (2 year maturity)	**3.89%**

* The lower of yield to maturity or yield to worst call date ** Source: Bloomberg

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CAM's Key Strategic Elements

- Bottom-up credit analysis determines value and risk.
- Primary objective is preservation of capital.
- Larger, more liquid issues preferred.
- Target is always intermediate maturity.
- No interest rate forecasting.
- All clients benefit from institutional trading platform and multi-firm competitive bids and offers.

CAM returns are after CAM's average management fee & all transaction costs but before any broker, custody or consulting fees. **The indices are unmanaged and do <u>not</u> take into account fees, expenses, and transaction costs.**	Total Return (%)	Annualized Returns (%)				
	1Q '25	YTD	1-YEAR	3-YEARS	5-YEARS	10-YEARS
CAM Broad Market Strategy—Net 1/3 high yield, 2/3 investment grade	1.92	1.92	5.65	2.25	2.72	2.42
CAM High Yield "Upper Tier" Strategy—Net only purchase BB and B; no purchases of CCC & lower	1.09	1.09	6.13	3.63	5.30	2.98
Bloomberg US Corporate High Yield Index	1.00	1.00	7.69	4.98	7.29	5.01
CAM Investment Grade Strategy—Net 100% corporate bonds	2.34	2.34	5.46	1.60	1.56	2.15
Bloomberg US Corporate Index	2.31	2.31	4.90	1.14	1.51	2.43
CAM Short Duration Strategy—Net 1/2 investment grade, 1/2 high yield	1.26	1.26	5.83	3.63	4.03	2.34
CAM Short Duration Investment Grade Strategy—Net 100% corporate bonds	1.61	1.61	5.58	2.81	2.11	1.94

Relative Performance Review 03/31/2025

CAM's **Investment Grade Strategy ("IG")** produced a gross total return of 2.40% in the quarter ended March 31, 2025, compared to 2.31% for the Bloomberg U.S. Corporate Index. CAM always positions a majority of the portfolio within intermediate maturities. Longer dated securities (10+ years) returned 2.38% for the period, slightly outperforming the broader index. CAM's underweight in this duration bucket produced a -2 basis point contribution to excess return. Conversely, shorter-dated securities (1-3 years) returned 1.62% for the period, underperforming the broader index. The allocation effect of CAM's underweight in that duration bucket was a +11 basis point contribution to excess return. CAM's positioning within the Technology and Electric Utilities industries had the largest positive impact on performance, with a +5 and +4 basis point contributions to excess return, respectively. Our positioning within the Airline industry was the largest negative contribution of -3 basis points. The LTM return for the CAM IG strategy was 5.71%, outperforming the Index return of 4.90%. CAM's positioning within the Technology and Electric Utility industries were the largest positive impact to performance, with a +14 and +10 basis point contribution to excess return, respectively. Our zero weight positioning within the Finance Company industry was the largest negative contribution of -3 basis points.

The **High Yield Strategy ("HY")** delivered a gross total return of 1.17% in Q1 while the Bloomberg US Corporate High Yield Index returned 1.00%. CAM's overweight and security selection within the Electric Utility, Technology, and Automotive industries had the largest positive impact on performance relative to the index with +7, +7, and +5 basis point contributions to excess return during the quarter. For negative impact relative to the index, CAM's positioning and security selection within the Consumer Products, Food & Beverage, and Home Construction industry groups was a -7, -6, and -6 basis point contribution to excess return, respectively. CAM does not purchase securities rated CAA and lower, and this cohort's performance was significantly weaker than that of the higher quality portion of the Index. The result of CAM's underweight was a +12 basis point contribution to excess return. The HY LTM return was 6.44% while the Index returned 7.69%. CAM's overweight and security selection in the Property & Casualty Insurance, Banking, and Packaging industries had the biggest positive impact on performance relative to the index with a +19, +13, and +9 basis point contributions to excess return, respectively. As far as negative impact relative to the index was concerned, CAM had no exposure to Wirelines, which was a -30 basis point impact to its performance relative to the Index.

Our **Broad Market Strategy ("BM")** – a 67%/33% blend of the IG and HY strategies above – produced a gross total return of 1.99% for the quarter compared to 1.87% for the Index, a similar blend of Bloomberg IG and HY corporates. At 3/31/2025 the modified duration of CAM's broad market portfolio was 5.56 while the modified duration of the Blended Benchmark was 5.85. CAM's positioning was a -4 basis point detriment to excess return as Treasury rates moved lower during the quarter. The LTM return for the CAM Broad Market strategy was 5.93% compared to a blended Index return of 5.84%. CAM's positioning in the Electric Utility, Consumer Cyclical Services, and the Property and Casualty Insurance industries had the biggest positive impact on performance relative to the index with +8, +6, and +6 basis point contributions, respectively. As far as negative impact relative to the index was concerned, CAM's positioning within the Pharmaceuticals, Banking, and Wirelines industry groups yielded -19, -14, and -7 basis point contributions to excess return, respectively.

Bloomberg Bond Indices Returns vs. CAM Gross (annualized %)

Periods ended 03/31/2025	**10-yrs**	**20-yrs**
U.S. Aggregate	**1.46**	**3.18**
U.S. Corporate	**2.43**	**4.15**
CAM Investment Grade Strategy (gross)	**2.39**	**4.27**
CAM Investment Grade Strategy (net)	**2.15**	**4.03**

<u>Better Asset Allocation Might Result from More Exacting Analysis</u>

CAM looks to minimize the overall volatility of our High Yield strategy by focusing on the upper tier of High Yield credit (BA-B), as well as the conservative portion of a firm's capital structure. The chart to the right indicates 5, 10, and 20-year performance for the High Yield credit quality cohorts. While the CAA-rated cohort outperformed BA and B -rated bonds for the more recent 5 and 10-year periods, it underperformed higher quality BA-rated bonds over the longer 20-year period. Not shown in the table is the pronounced volatility that has characterized the CAA-rated and lower subsectors. For example, the CAA credit tier returned -20.55% in Q1-2020 (i.e. start of the COVID pandemic) versus -12.69% for the HY Index as a whole. In fact, over the 20-year period the standard deviation of the CAA credit tier has been approximately 61% greater than the broader Bloomberg US Corporate HY Index (16.53% versus 10.28%). This shows investors may not be rewarded for the additional volatility and risk of the CAA-rated and lower subsectors.

Upper tier High Yield credit (BA-B) has also outperformed the Bloomberg US Aggregate Index (the "Agg") for all periods, indicating these credit quality stripes have also kept better pace with inflation.

The above points suggest that upper tier High Yield bonds deserve consideration as a core holding over a complete market cycle.

Total Return of High-Yield Bonds by Credit Quality

(periods ended 03/31/2025) Source: Bloomberg US Corporate Indices **(annualized %)**

High-Yield Bond Sectors	**5-years**	**10-years**	**20-years**
BA-rated bonds	**6.61**	**4.99**	**6.70**
B-rated bonds	**6.83**	**4.62**	**5.83**
CAA-rated bonds	**9.94**	**5.33**	**6.36**
CA & D-rated bonds	**20.88**	**5.32**	**4.00**

Performance of Other Asset Classes

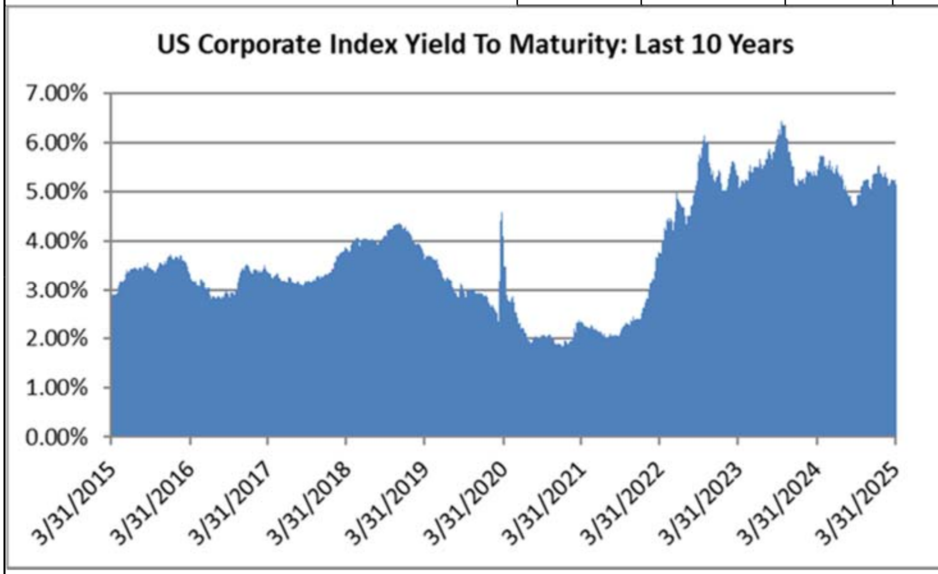
(periods ended 03/31/2025) Source: Bloomberg & Lipper

S & P 500 Stocks	**18.59**	**12.50**	**10.22**
Bloomberg U.S. Aggregate	**-0.40**	**1.46**	**3.18**

The March 31 spread levels (shown at the right) enhance the value of corporate bonds versus U.S. Treasuries. As of 3/31/2025 all spread cohorts have widened since 12/31/2024 while Treasury yields moved lower, reflecting a higher level of caution. The 10-year U.S. Treasury opened 2025 at 4.57% and closed the quarter at 4.21%, a 36 basis point decrease.

We have a positive stance on the investment grade credit market for the year ahead. The "all-in" yield of the asset class continues to trade at much higher levels than recent history, providing a comfortable margin of safety for spread widening while still generating positive total returns.

Credit Rating	20-Year Average Spread (as of 12/31/24)	03/31/25	12/31/24	12/31/23	12/31/22	12/31/21	Tightest This Decade (as of 12/31/24)
A	1.28%	0.80%	0.68%	0.85%	1.09%	0.74%	0.63%
BAA	1.88%	1.15%	0.97%	1.21%	1.59%	1.13%	0.95%
BA	3.51%	2.19%	1.79%	2.01%	2.95%	1.94%	1.58%
B	4.88%	3.46%	2.77%	3.10%	4.89%	3.13%	2.54%
CAA	8.95%	8.52%	7.03%	8.09%	11.54%	5.96%	4.91%



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steepening as a product of investors reacting to the 100bps of cuts that the Fed delivered in the final months of 2024 as well as the anticipation of additional cuts in 2025 and beyond. As active managers, we applaud a steeper Treasury curve because it creates a more opportunistic environment.

US Trade Policy

A major source of concern for credit markets in 2025 has been the introduction of new trade tariffs by the Trump administration. These tariffs have rekindled fears that the U.S. is bringing down the curtain on U.S. support for the turbocharged era of globalization that powered the world economy for decades (source: WSJ 4/4/25). The looming specter of a renewed trade war has led to a significant repricing of risk across financial markets.

We believe that tariffs will have a limited impact on our portfolio, not only because of the companies we own but also due to the contractual nature of bonds and their position within the capital structure. If a company suffers a lapse in profitability due to tariffs, then it may need to adjust its financial policy as a result. There is no requirement or enforceable agreement for a company to pay dividends or repurchase shares. If financial performance is impacted enough then discretionary shareholder returns become levers that can be pulled to increase financial flexibility. There is no such optionality for a company when it comes to interest expense and debt obligations. If a company were to default on its debt obligations, then bondholders would take control of the assets of the company.

Technicals and Flows

Technically, the corporate bond market remains well-supported in terms of overall demand. According to LSEG Lipper, total quarter-to-date flows into investment grade funds were positive at +$19.66 billion, while high yield funds stood at +$6.67 billion (source: LSEG Lipper).

Despite near-term headwinds, the broader fixed income environment is much more attractive than in recent years given elevated yields. For long-term investors, this may even represent an improved entry point compared to the ultra-low yields

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over the past decade (see chart above).

Credit Fundamentals

From a fundamental perspective, most IG-rated U.S. corporates still exhibit solid balance sheet health, strong interest coverage, and manageable debt maturity profiles. Margins are very near all-time highs but we look for those to erode in some industries as companies bear the burden of higher input prices due to tariffs (source: S&P Global 4/3/25).

In the high yield market, the year started with fairly strong issuance. The $86.6 billion figure was one of the largest quarterly totals in the past four years. Of the issuance that did take place during Q1, Discretionary took 19% of the market share followed by Materials at 17% share and Financials at 16% share. (source: Bloomberg)

Despite the volatility, high-grade issuers have continued to sell bonds and the buy side has kept gobbling them up (source: Bloomberg 3/28/25). In fact, Q1 2025 volume was the highest on record (see chart to right).

Closing Remarks

The first quarter was a busy one -- record primary volume, macroeconomic uncertainty and spread variability made for some long days. Looking ahead to the remainder of 2025, the corporate bond market will be influenced by a data-dependent Federal Reserve and continued escalation of trade tensions and/or retaliatory tariffs from major U.S. trading partners.

Sharpe Ratios (risk & reward relative value) Inception-Q1 2025

CAM Investment Grade Strategy 0.32
Bloomberg U.S. Corp Bonds 0.28

CAM High Yield Strategy 0.47
Bloomberg High Yield Corp Bonds 0.47

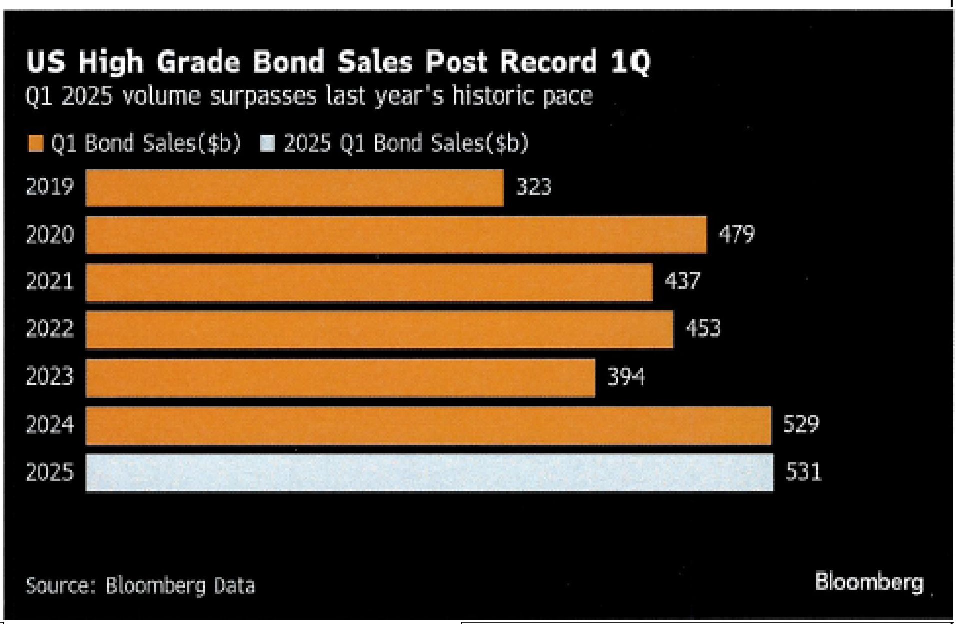
CAM Short Duration 0.42
Bloomberg Weighted Benchmark
(1/2 Interm. HY & 1/2 U.S. Corporate 1-5) 0.51

CAM Short Duration IG Strategy 0.74
Bloomberg U.S. Corporate 1-5 Yr 0.77

CAM Broad Market Strategy 0.52
Bloomberg Weighted Benchmark
(2/3 Corporate and 1/3 High Yield) 0.54

An important objective for all Cincinnati Asset Management investment strategies is to deliver superior risk-weighted returns versus the benchmark. A quantitative indication of our success is the Sharpe Ratio that calculates total return per unit of risk. The data on the left indicates we have largely been successful. The Sharpe Ratio of the Investment Grade Strategy exceeded its respective benchmark by approximately 14%! The High Yield Sharpe Ratio approximated its benchmark, and the Short Duration Investment Grade and Broad Market strategies fell modestly short of their respective benchmarks.

Given the price action in the first trading days of the second quarter it appears that volatility is here to stay. We will continue to lead with our focus on preservation of capital, carrying out our responsibilities with attention, care and a desire to please our clients. Credit selection and an ability to be nimble are paramount in order to successfully navigate what lies ahead.



Rating	BA	B	CAA
Avg Spread	349	504	943
Std. Dev.	165	220	404
03/31/2025	**219**	**346**	**852**
Lowest Spread	151	228	378

<u>Spreads to Treasuries by Credit Rating</u> show significantly lower risk of BA and B rated bonds. Source: Bloomberg, Barclays Research (12/31/99 to 03/31/2025)