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## April 2025

The U.S. economy faces headwinds following the White House's sweeping tariff plan unveiled on April 2, 2025. The plan was more aggressive than expected, triggering sharp market volatility. Tariffs are likely to squeeze profit margins and potentially slow economic growth by up to 2% of GDP. However, consumer and corporate balance sheets remain relatively solid, offering a buffer against immediate shocks. Corporate margins remain near all-time highs, positioning many companies to partially absorb cost increases rather than fully passing them on to consumers. Additional tariff offsets may come via promised tax reductions for the lower and middle class as well as regulatory relief, particularly in energy, infrastructure, and financials.

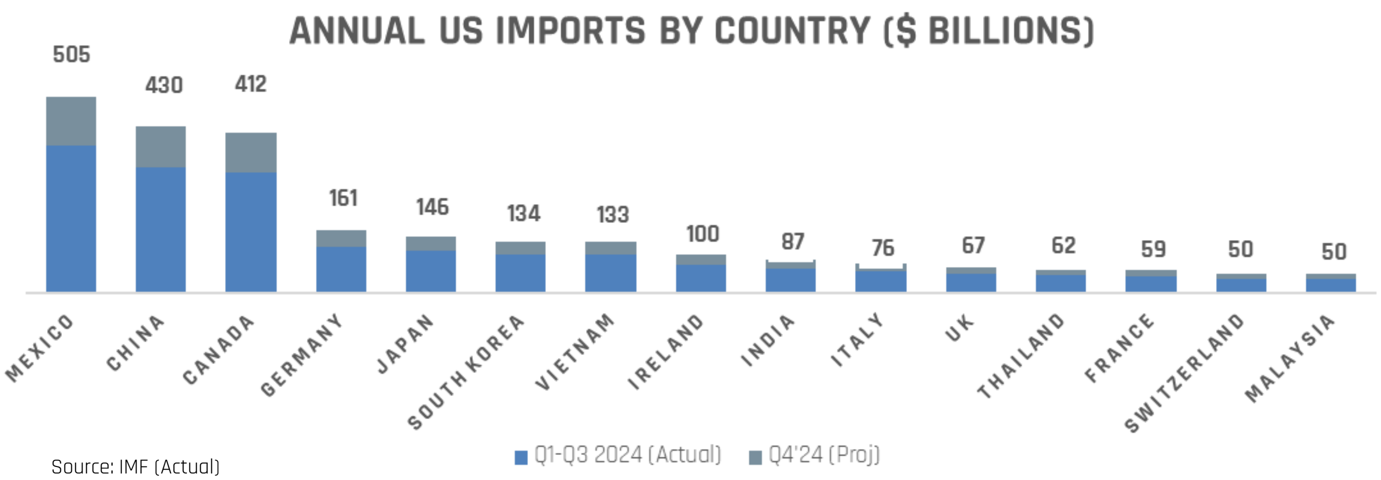
Geopolitical risks are intensifying amid global trade tensions. Europe could emerge as a modest growth engine if pressured by the U.S. to boost NATO defense spending as a share of GDP. However, retaliatory tariffs from partners like China and the EU could heighten inflationary pressures and further destabilize markets.

Treasury Secretary Scott Bessent recently said the administration is more focused on the 10-year Treasury yield than on stock performance and emphasized the need for an economic "detox." Given this stance, investors hoping for a "Trump put" to support risk assets may be disappointed.

U.S. payrolls rose by 228k in March, surpassing expectations of 140k, while the unemployment rate increased to 4.2%. Job growth was broad-based across sectors like health care and hospitality. However, layoffs also surged, with the third-highest monthly total on record, according to Challenger Gray. The spike was largely driven by the Department of Government Efficiency (DOGE), which has cut 280k federal workers and contractors over the past two months.

Consumer spending shows cracks forming in the economic foundation. February spending rebounded just 0.4% after January's 0.3% decline, missing the 0.5% forecast. Meanwhile, core personal consumption expenditures (PCE)—the Fed's preferred inflation gauge—rose 0.4% month-over-month and 2.8% year-over-year, slightly above expectations, fueling concerns of a potential inflation resurgence. The University of Michigan survey showed consumers' 12-month inflation expectations are now at their highest level in nearly 2.5 years, pointing to concerns over persistent price pressures.

Adding these factors up, we see a greater than 60% chance of a mild recession later this year. Markets now see a 25% chance of a rate cut at the Fed's May meeting. Bessent's comment that "we do not have a revenue problem, we have a spending problem" underscores the administration's fiscal tightening stance, which could further constrain growth. However, with inflation still elevated and uncertainty around how tariffs may impact prices, we believe the FOMC is likely to keep rates steady until at least July, followed by a series of 25 bps cuts in the second half of 2025.




Source: IMF (Actual)

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## Product Views

**Rates:** Markets reacted swiftly to the tariff announcement, with Treasury yields declining as investors moved into safe-haven assets. The 2s10s yield curve steepened, reflecting expectations of more aggressive Fed action—even as inflation pressures remain elevated.

Over the past month, we've recommended adding duration in the short- to intermediate-end of the Treasury curve. Even after yields fell 60–70 basis points, we still remain moderately constructive. Economic and policy uncertainty has increased, driven by emerging stagflation risks. Regulatory shifts, such as a possible reinstatement of the supplementary leverage ratio (SLR) for banks, could also boost demand for Treasuries and put further downward pressure on term premiums.

**Credit:** Credit performance largely mirrored the performance of broader risk assets in the recent downturn, with IG credit spreads widening 29 bps year to date. While corporate fundamentals are generally stronger than in past cycles, we remain cautious in this space.

**Securitized:** Year-to-date, MBS have returned 4.11%, notably outperforming credit assets, which returned 2.65%. This performance aligns with our view that Agency MBS tend to outperform in risk-off environments. Given the ongoing uncertainty, we believe MBS still offer room for relative outperformance within spread assets