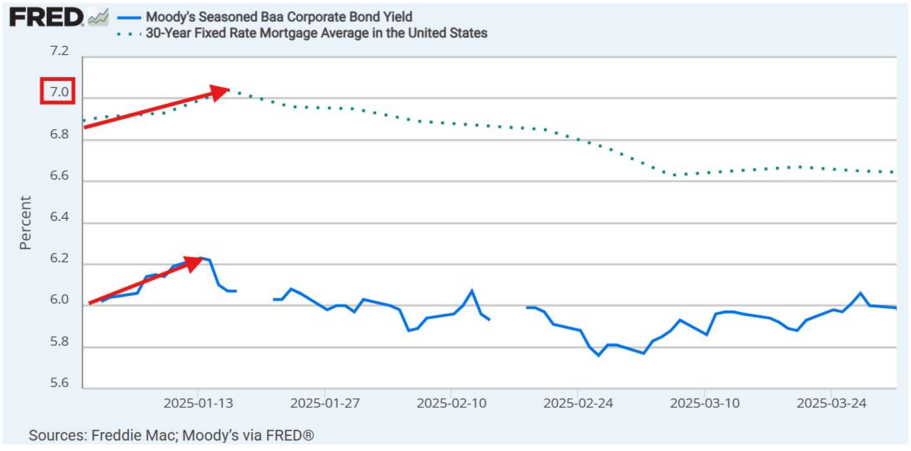
The first three months of 2025 might as well be a decade ago with all that has transpired since April 2nd, aka Liberation Day. The first quarter, though unkind to U.S. stocks, saw the inverse relationship between stocks and bonds hold up its end of the balanced portfolio bargain, with most sectors of the bond market turning in positive performances. In Q1, the S&P 500 fell 4.30%, but the broadest measure of the bond market, the U.S. Aggregate Index (the Agg), was up 2.78%.

Our view is that bonds, including U.S. Treasuries, continue to offer value, even on an inflation adjusted basis. Yields are sufficiently high as to justify the risk that stocks and bonds may from time-to-time experience periods of positive correlation, meaning that prices move in the same direction likely due to common circumstances. The 10-yr U.S. Treasury appears range-bound, as of this writing, between 4.20-4.50%, although outlier periods may occur during bouts of higher volatility. Treasury yields are at their highest level since 2007, and corporate bonds provide ample pickup over and above government bonds, presenting attractive entry points. If yields rise from here, the value of today's bonds will fall, but with the buffer of a higher yield, it will take a more significant rise in interest rates for returns to be negative. Of course, our intention is always to hold to maturity. Read on for further details on the past quarter, our assessment of current volatility, and our opinion of what's to come.

During the first quarter, the benchmark 10-yr U.S. Treasury briefly reached as high as 4.79% in January before falling to 4.20% by the end of March. Yields rose early in the quarter as the economy continued to project strength, notably in the jobs market, and amid signs inflation was not yet defeated. Nonfarm payrolls had recently grown by 256k versus expectations for additions of 155k and the CPI (the headline inflation number) rose by more than expected on a month-over-month basis, and back to the psychologically important level of 3% year-over-year. The rising rates pushed borrowing costs early in Q1 to their highest levels in 14 months for everything from corporate bonds to 30-year mortgage rates—which peaked over 7%—before economic concerns began placing downward pressure on yields.



In January, Fed Funds futures, which imply the market-based odds of a Fed rate move, were only pricing in one and a half rate cuts for 2025, meaning that sticky inflation and a healthy job market made aggressive economic loosening unlikely. By April, after the tariff announcements tanked the stock market and increased the likelihood of a recession, the market was pricing in almost three and a half rate cuts for 2025, despite being three months further into the year. Interestingly, post-Liberation Day, the Fed, which since 2022 had been almost constantly in the spotlight given high inflation, found themselves somewhat on the sidelines with little room to react to quickly shifting policy and a backdrop of strong, albeit rear-facing, economic data on which to base its policy decisions.

The April 2nd tariff announcement brought swift retribution to financial markets with a large selloff in the S&P 500 in the following days. Many had gone into the Trump presidency expecting some volatility but believing that a “Trump put” would mean he would reverse course if the stock carnage went too far. In fact, it may have been the bond market that forced the president’s hand. Trump granted a 90-day reprieve and reduced the tariff rate on most trading partners, except for China, after several days of falling bond prices in conjunction with a weakening dollar, warned of trouble in the all-important U.S. Treasury system. The unlikely combination of falling Treasury prices and a weakening dollar signalled capital flight at a time investors generally expect to see a flight to quality. Though the tariff reprieve was welcomed by the stock market, with stocks surging on the news, many nervous investors found themselves wondering if Treasuries, even at attractive levels around 4.50%, were worth the risk in their portfolios.

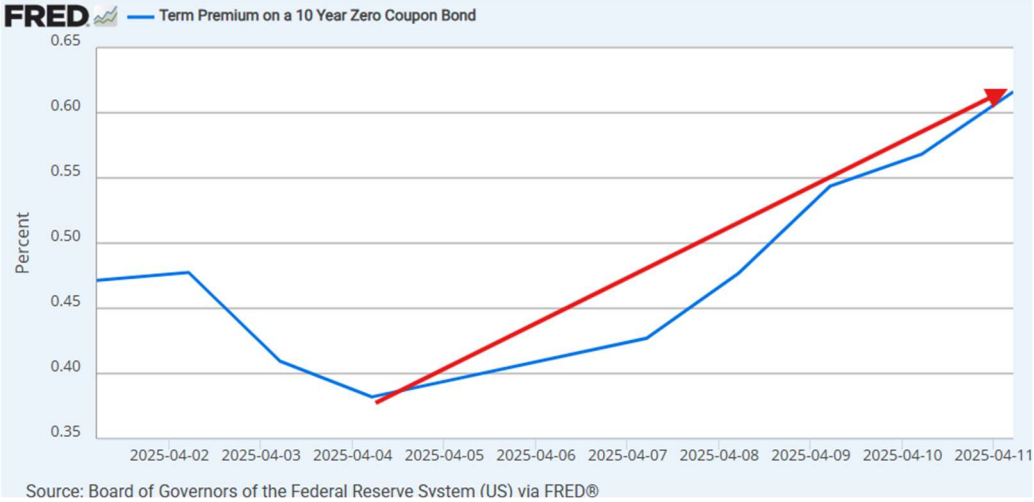
The reasons behind the bond selloff, though clearly a response to the tariff policy, are complicated. It’s worth noting that falling Treasury prices don’t mean U.S. default is on the horizon any more than Apple’s falling stock price means the company is going out of business. The stress in the Treasury market was born of numerous factors including: 1) as stocks tanked in the wake of tariff policy, margin calls and portfolio de-risking mandated raising cash throughout the system, much of which would have come from selling Treasuries; 2) the unwinding of a complex hedge fund strategy called the basis trade—a levered ploy by hedge funds to take advantage of small differences between the active treasury markets and futures or swaps—put undue and unusual pressure on Treasury bond prices; 3) the Fed's primary dealers (firms that buy securities direct from the U.S. government) were quite "full" on Treasuries, limiting how much supply they could absorb; 4) tariffs reinvigorated concerns about inflation[1]; 5) foreign holders of Treasuries

[1]While tariffs may indeed lead to higher relative prices by raising the price of imported goods, inflation in the macroeconomic sense is caused by an increase in the money supply, or money creation. Without a corresponding increase in the production of goods and services, a greater amount of money chasing the same goods and services will lead to higher prices.

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appeared to be selling as well, though the amount, motivation, and impact were unclear. In fact, according to the 2024 Fixed Income Market Structure Compendium put out in February 2025 by the Security Industry and Financial Markets Association (SIFMA), foreign holders of Treasuries have been reducing their holdings for almost a decade. The top ten countries represented 19.7% of total Treasury holdings in 2024, down from 31.6% in 2015. The publication observed that non-central bank holders of Treasuries, whose holdings of Treasuries have doubled as a percentage of the total, are more price sensitive, having the effect of increasing the term premium.

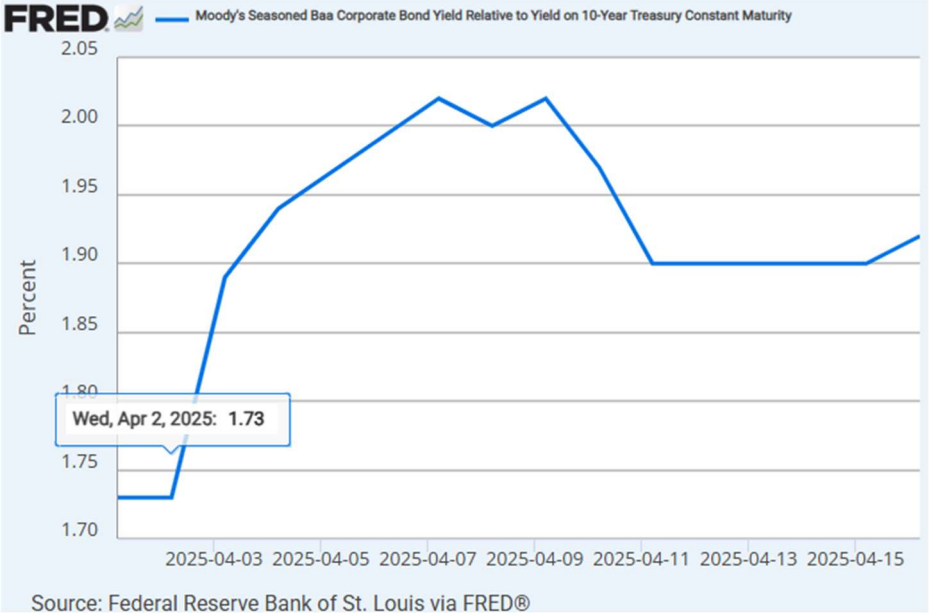
The term premium is the additional compensation investors require to lend the government money for a decade or more. While technically a theoretical measure that captures a variety of elements, it is one component of a bond's yield or interest rate, that may show perceived risks in future government policy and creditworthiness. The term premium rose quickly in conjunction with the shifting trade policy, alarming investors.



So where does all the upheaval put us now? The news cycle has temporarily moved on, leaving those of us who work with bonds for a living left to pick up the pieces and find value in a corner of the portfolio that is supposed to be, by design, somewhat boring. Yields are still not indicating a set course of policy, nor are they necessarily at capitulation levels. Instead, like stocks, we're likely in a period of price discovery as the president's policies shift and as recession and inflation forecasts come into focus. If the administration's policies end up in a zone that markets can tolerate, or at least become more predictable, the Fed, along with inflation and economic forecasts, can return to centre stage. In the meantime, corporate bonds, Treasuries, and some municipal bonds are offering compelling yields. Although recession calls have diminished somewhat as the most punitive

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tariffs remain only on China, corporate spreads (which represent the additional return investors demand for taking on the credit risk of companies, and which widened significantly on April 2nd) are still at their widest since 2023. The risk of recession may mean enhanced risks in corporate bonds, but it also means careful due diligence and financial statement analysis can uncover fixed income opportunities.



A final note on Treasuries. Recently, Tom Wipf, managing director at UBS, gave congressional testimony on behalf of SIFMA before the Financial Services Task Force on Monetary Policy, Treasury Market Resilience and Economic Prosperity. In his written testimony he said, “the U.S. Treasury market is the largest and most liquid bond market on the planet. Its smooth functioning is essential to: (1) achieving the lowest cost to taxpayers over time in connection with the financing of our debt, and (2) the overall efficient operation of the financial system and, more broadly, the world economy.” He went on to say “The U.S. Treasury market remains the most important financial market in the world. Any disruption to this market could strain financial stability, given the central role of the U.S. Treasury markets in the global financial system.” The testimony was a message to those in power to carefully consider how policy decisions impact this crucial market, to consider how reforms can better enhance liquidity and its functioning, and to offer reassurance that the Treasury market and related financial infrastructure is unlikely to break or be replaced overnight. However, an acknowledgment that this arrangement could change in the long term is necessary and constructive. Currently there is no obvious alternative to the dollar as the world’s reserve

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currency, especially with the global financial infrastructure in place to support it, and as such, default on Treasuries appears an unlikely near-term scenario.
It has been said that a bad year in the bond market is like a bad day in the stock market. Even if the prices of each go down within short periods, having the right mix of stocks, bonds, and cash can limit portfolio volatility within a range that is consistent with your risk tolerance. If you have concerns about your holdings, particularly your bonds, it may be a good time to revisit your asset allocation. Please reach out to schedule a portfolio review.

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