Positioning Fixed Income Portfolios for Rising Growth Risks


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- While our base case remains that the US economy will continue to expand in 2025, recent economic and market data suggest the downside risks to this base case are growing.
- There are two simple ways to position fixed income portfolios for a possible slowdown: extending duration and holding an up-in-quality bias.
- The costs of taking these defensive moves remain relatively low now that the yield curve is positively sloped, and credit spreads remain narrow.
- In terms of portfolio construction, adding duration and increasing quality in fixed income are some of the most-efficient ways to provide some "insurance" against further declines in equity markets.

In our 2025 Outlook, we highlighted the probability that economic growth would continue through 2025, aided by solid consumer income growth and the upside potential of increased corporate investment. In the last several weeks, however, cracks have emerged in that façade of strong growth. While it remains our base case that growth will indeed persist, the risks of a slowdown—or, less likely, recession—are indeed growing. Evidence for this assessment comes from theory, economic data, and the behavior of financial markets in recent weeks.

The theory behind economic risks is simple: swings in policy, particularly around government spending and tariffs, make it tough for firms to invest. As a simple example, imagine a tech contractor that designs data centers for government clients. Today, many federal agencies are cutting budgets in hard-to-predict ways. Our canonical contractor will not invest in new servers when s/he is unsure whether the government might cancel planned projects. The longer the uncertainty lasts, the bigger the economic effects.

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