INVESTMENT STRATEGY GROUP

OUTLOOK 2025
MID-YEAR UPDATE

JANNEY MONTGOMERY SCOTT LLC

Published: June 2025

Janney

OUTLOOK 2025: MID-YEAR UPDATE

OVERVIEW

The *Mid-Year Update* offers the Janney Investment Strategy Group's baseline prognostications for the economy, the equity and fixed-income markets, their evolution, and investment implications for the remainder of 2025.

- The economy continues to trend at a solid pace. Worries that costly and uncertain trade policies would exert a negative impulse on growth have dissipated somewhat for now.
- Employment conditions are key to sustaining consumer spending, a critical feature of an expanding economy. Today's low unemployment and decent wage growth are supports.
- The pro-growth initiatives of deregulation and the likely legislation of the One Big Beautiful Bill Act. Together, they may counteract the cost of tariffs.
- Lowered corporate profits expectations offer an upside surprise if the tariff rate first announced on Liberation Day is reduced. Stock prices can rise on beating estimates.

- Interest rates have chopped around but ultimately gone nowhere for the last 12 months.
- In the short term, we expect economic conditions to dominate interest rates, and on that count, we are biased negatively.
- Deterioration in labor markets—if it occurs—will likely lead to four to five additional rate cuts this cycle.
- In the longer term, the combination of a wider fiscal deficit and narrower trade balance are untenable for the bond markets.

ECONOMY & EQUITY MARKETS

MARK LUSCHINI, CMT
Chief Investment Strategist

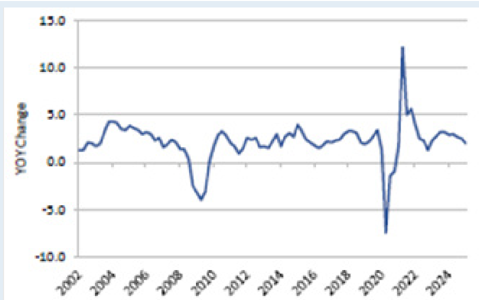
President and Chief Investment Officer, Janney Capital Management

Mark Luschini serves as Janney's Chief Investment Strategist and leads the Investment Strategy Group, which sets the firm's view on macroeconomics, as well as the equity and fixed income markets. In addition, Mark is the President and Chief Investment Officer of Janney Capital Management (JCM), the asset management subsidiary of Janney Montgomery Scott. Under his leadership, JCM has delivered competitive results across its suite of investment strategies and grown its assets under management to more than $3.7 billion.

Mark has spent more than thirty years in the investment industry. He draws on that experience to speak on topics related to macroeconomics and the financial markets at seminars, client events and conferences. He is frequently quoted in publications ranging from the Wall Street Journal and Barron's to the New York Times and USA Today. In addition, he regularly appears in various media outlets including CNBC, Fox Business News, and Bloomberg Television and Radio. He has an undergraduate degree in Psychology and an MBA in Finance from Gannon University and holds the Chartered Market Technician (CMT) designation from the Market Technicians Association.

The economy continues to expand at a solid rate. Although the GDP release for the first quarter appears grim when taken at face value, posting a slightly negative print, it can largely be attributed to the massive swing in gold imports that was catalyzed by an unusual pricing arbitrage between the London and U.S. metals exchanges. Looking at the underlying and most important component of economic activity, consumption (as measured by real final sales to private domestic purchasers), the first quarter did show a slight moderation from the end of last year but was still near trend. The second-quarter data released so far portrays a similar picture, suggesting that the positive momentum should continue well into the second half of this year, if not beyond.

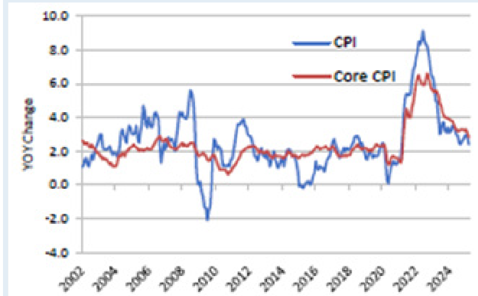
Chart 1: US GDP



(Source: Janney ISG, BEA)

Inflation has mercifully receded from its mid-2022 peak but remains above the Federal Reserve's target of 2%. Forecasts portray readings on inflation grinding lower over the coming months, but the potential pass-through from tariffs impacting consumer prices poses a variable that puts that prognosis at risk. While tariffs act like a regressive tax, with a more severe impact on the less affluent, their magnitude and duration will determine the pricing distortion and friction applied to crucial discretionary spending across all income cohorts. Since more than 50% of personal consumption comes from those in higher income brackets, and that same group has been spending at an above-normal pace, any measurable downshift could weigh on economic activity.

Chart 2: Consumer Price Index vs Core CPI



(Source: Janney ISG, BLS)

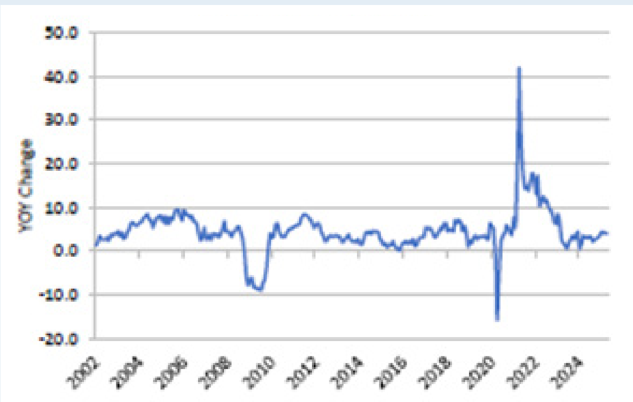
Recent surveys of consumer attitudes have displayed deteriorating sentiment. Known as "soft data" because measuring "feelings" is intangible, it has historically correlated well with actual behavior, that is, until the last four years. The abundance of excess savings that accrued during the pandemic, which, according to research by the San Francisco Federal Reserve, has now been exhausted, served to artificially boost spending despite consumers remarking that conditions were far less than optimal. The last report from the Conference Board showed some improvement, but it was still within the range of confidence levels that are rare outside of recessions.

Chart 3: Conference Board Consumer Confidence

(Source: Janney ISG, Conference Board)

Today, the key driver of spending will be wages and income growth. Fortunately, even as wage growth has decelerated, inflation is falling at a faster rate. Therefore, real (inflation-adjusted) wages are running positive, helping to provide a favorable impulse for spending. Indeed, retail sales, which represent “hard data” because the information is quantifiable, are a timely and important gauge to determine if what consumers are saying is congruent with what they are doing. So far, it is not. Sales across all retail enterprises (excluding the highly volatile auto category) are growing firmly and eliciting no evidence of a major retrenchment among households. That is not to say that it is uniformly strong, but the aggregate still paints a reasonably healthy picture, suggesting that consumers are still opening their pocketbooks for purchases of goods and services.

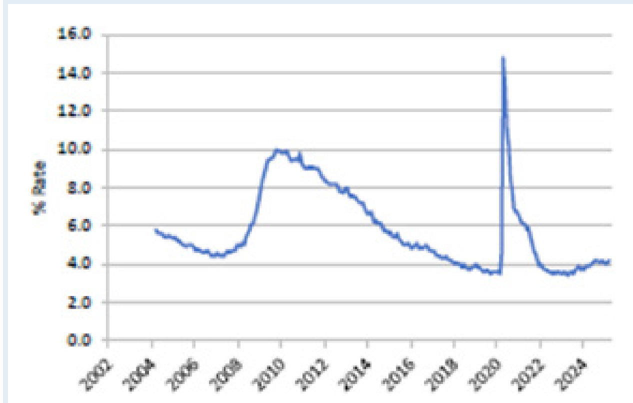
Chart 4: US Retail Sales Ex Autos



(Source: Janney ISG, US Census Bureau)

Ultimately, the labor market holds the key to sustaining the economic expansion currently underway. Job growth has slowed, but not to the extent that new entrants and displaced workers can’t find employment. That has helped keep the unemployment rate in the low 4% range and below what Federal Reserve officials estimate to be full employment. A frequently updated measure of the labor market, weekly jobless claims, has been trending in a narrow range for the past three years, which is an encouraging indication that companies have not purged workers at an alarming clip. Although job losses were expected to mount as the Department of Government Efficiency sought ways to reduce costs across federal agencies, either by way of severance packages or finding a new job, a tracker of job losses in this space shows no meaningful change. This may change, however, as those federal employees and millions of others in private industry tied to the government through contractual work that is being reduced or eliminated could surface in the coming months. A sharp rise in the unemployment rate will herald concerns of a recession and likely spring the Federal Reserve into action. However, given the notorious lag associated with changes in monetary policy, one or multiple rate reductions will have little discernable effect, possibly for months, leaving the economy vulnerable to an extended slowdown or outright contraction in activity. Labor conditions appear stable now, but unfilled job openings are far fewer in number than at any time in the past three years, making any rude shift in the balance of jobs available to job seekers a potential cause for the picture to degrade rapidly.

Chart 5: US Unemployment Rate



(Source: Janney ISG, Bloomberg)

Not all is copacetic, however. A few items on the household liability front have begun to flash yellow in recent months. Delinquency rates on consumer loans of all types have increased, especially for credit cards and autos. In addition, with repayments on student loans starting, delinquencies have spiked on those lines, and the Department of Education estimates that millions may be at risk of default. Even if avoided, many individuals could still see their credit scores affected, reducing their ability to access credit lines or raising their cost of servicing debt. In addition, it has been reported that an increasing number of people feel they are struggling to meet their current financial obligations. The latter is to be determined, but in the meantime, household coverage of the interest owed on current debt is manageable and does not demonstrate ubiquitous signs of undue stress, suggesting that balance sheet capacity exists for additional credit should it be desired or needed.

Chart 6: US Household Debt Service Ratio

(Source: Janney ISG, US Census Bureau)

Immediately following the election, business optimism jumped in anticipation of President Trump's reboot of the 2016 playbook, where deregulation and tax relief were on the immediate agenda. Instead, although those are still evolving and should lead to a positive fiscal thrust later this year, tariffs have usurped the macroeconomic narrative. Business leaders despise uncertainty, and their reaction to it is to stop or stall investment and hiring to avoid burdening their cost structure and undermining profits should things devolve. The good news is that the economy has remained sufficiently strong, so they have not had to undertake large cost reductions either, especially by way of shedding employees. To be sure, surveys of the manufacturing and services industries report sluggish activity. Respondents discuss the tariff uncertainty that has led to front-running purchases and higher prices, followed by languid and unsteady reordering. The data is mostly still compromised, given the fluid state of tariff announcements, but a clearer picture is likely to emerge in the next couple of months. In the meantime, companies are employing mitigation strategies, such as negotiating with suppliers, shifting supply chains, and improving operating efficiencies to get ahead of the ultimate costs of tariffs, which are likely going to be stiffer than those preceding April 2, a.k.a. Liberation Day.

Chart 7: ISM Manufacturing Index

(Source: Janney ISG, ISM)

Chart 8: ISM Non-Manufacturing Index

(Source: Janney ISG, ISM)

How all this will play out is unknown but handicapping the outcome leans toward a moderation in growth and marginally higher domestic prices. In our view, it is not enough to impede the expansion from continuing, but the inertia that existed pre-Liberation Day will likely lose some of its viscosity. Having said that, the stimulative impulse from deregulation and tax benefits imbedded in the pending extension of the major initiatives found in the Tax Cuts and Jobs Act of 2017 in the new rendition called the One Big Beautiful Bill Act (OBBB). If that were to occur, the second half of 2025 could produce firmer economic conditions and set up 2026 for the better.

RISKS TO MONITOR

- Domestically, the potential deleterious effect of ongoing trade instability and tariff implications could weigh on growth. Business activity could falter, causing a rise in unemployment and triggering consumers to retrench, followed by an ensuing recession.
- Inflation expectations could become unmoored if high or rising price levels persist. The Federal Reserve may be reluctant to lower rates even if the labor market starts to weaken, and monetary conditions that remain too tight could breed an economic fallout.
- Overseas, the war in Eastern Europe could escalate, but a greater threat may be Iran's nuclear development. If mishandled, oil could be weaponized by Iranian officials, disrupting supply flows and causing an unwelcome and damaging spike in prices.

INVESTMENT IMPLICATIONS

The economic conditions we foresee persisting underscore our constructive stance on risk assets. Inflation is slowly dissipating, and monetary authorities are vigilant but prepared to lower rates to foster a healthy labor market and promote economic growth. Overseas, China's growth is stable but weaker than officials had targeted, leading many to believe that stimulative measures will be taken to buttress the economy, especially with its export activity jeopardized by mounting trade tensions. European growth, while lackluster, is being primed by its central bank loosening monetary policy and fiscal actions undertaken by policymakers to build defense and infrastructure assets, thereby facilitating greater unity across the economic bloc.

- **Global Equity Markets** — While valuations are somewhat rich, they should not impede an advance in stock prices if earnings growth is delivered as expected. Further descent in trade uncertainty will serve to lift optimism about the economy and stoke business and household spending. The outlook for corporate profits will also be boosted by the passing of the OBBB, which incents capital spending and onshoring.

- **Sectors** — International stocks have appeal because of their wide valuation discount to U.S. equities. Developed market equities in Europe offer unusual promise as secular changes are taking place to invite greater fiscal conformity and address underinvestment in infrastructure and military assets. Emerging market bourses, such as India and Mexico, are compelling because of their growth and friend-shoring advantages as supply chains reorder, which should attract greater foreign investment.
- **Commodities** — Metals such as copper and uranium are poised to benefit from construction and new power sources necessary to support technological needs and an aging grid. Gold, and to a lesser and more volatile extent, silver, offer a hedge against geopolitical fallout or financial tumult. Exposure to the direct movement of the spot price of either is preferred, but the common shares of publicly traded miners customarily provide a means to amplify returns.

VARIOUS ECONOMIC SCENARIOS AND PROBABLE OUTCOMES

Our prognostication for the U.S. stock market's path forward includes three potential outcomes that stem from various economic scenarios that could unfold; below, we assign a probability to each. In preview, we continue to hold a constructive view but acknowledge the actions taken on trade policy by the Trump Administration over the next few months will have an outsized role in determining the variance between each one.

Scenario 1: Blue Skies

A recession is avoided despite some modest economic drag induced by tariffs, which are applied at an elevated but stable level. Trump's pro-growth policies of deregulation and the passage of the Tax Cuts and Jobs Act extension, rekindle animal spirits and ignite a capital spending cycle. The unemployment rate rises only slightly as job losses occurring across government and private industry are limited. Interest rates are range-bound to lower, and inflation remains relatively benign, allowing the Federal Reserve to lower its target rate. Earnings projections are moved higher given the improving macro backdrop and investor sentiment lifts. Valuation is not an impediment for some multiple expansion, and the S&P 500 reaches 6,600.

Probability: 35%

Scenario 2: Mostly Sunny with Patchy Clouds

The job market's delicate balance, where hiring has been strong enough to absorb new entrants as well as those recently unemployed, is undermined by lingering trade uncertainty and tariff implications. As the unemployment rate rises, albeit modestly, consumers' bold spending patterns wane, thereby crimping economic activity. As growth moderates and inflation decelerates, the Federal Reserve reduces rates, spurring investors emboldened by policymakers' stimulative measures. Gold breaks to all-time highs as monetary easing lowers real rates concomitant with ongoing concerns about the untenable fiscal situation in the U.S. The S&P 500's advance, while choppy, eventually eclipses the February high and breaches 6,250.

Probability: 55%

Scenario 3: Downpour

Ongoing trade uncertainty and the costs from an elevated effective tariff rate to business and consumers alike slows growth meaningfully. The unemployment rate climbs as businesses shed workers to protect their margins from the corrosive effects of higher import costs and export headwinds. Households boost savings to brace against potential layoffs, and higher prices chew into discretionary spending. While the Federal Reserve begins to steadily lower interest rates to address rising labor market concerns, the number of cuts is limited because inflation remains above target. Bond yields fail to fall partially due to the term premium increasing on worries that the bloated budget deficit will cause a systemic crack to emerge. The S&P 500 falls below 5,400.

Probability: 10%

BOTTOM LINE: ENSEMBLE FORECAST

Our weightings lean favorably with a clear tilt to stock prices reaching and exceeding the peak last established in mid-February. However, we acknowledge the risk that the potential deleterious effect of tariffs may cause the hard data to "catch down" to the soft data's depiction of relatively grim business and consumer sentiment and could possibly undermine the positive momentum in the economy and, in turn, pressure stock prices.

FIXED INCOME & INTEREST RATES

GUY LEBAS, CFA®
Chief Fixed Income Strategist

Head of Fixed Income for Janney Capital Management

Guy LeBas is responsible for providing direction to the firm's clients on the macroeconomic, interest rate, and bond market investing climate.

Guy authors bond market periodicals which provide relative value recommendations across the fixed income spectrum.

With Janney Capital Management, Guy is responsible for overseeing the firm's discretionarily managed bond portfolios, which take a client-tailored approach to generating consistent income across interest rate environments.

Guy joined Janney in 2006. Prior to joining Janney, Guy served as Interest Rate Risk Manager for U.S. Trust's bank asset and liability portfolios, a role in which he oversaw risk and return on $20 billion of bank assets and derivatives.

Guy is also a frequent guest on CNBC, Bloomberg TV, and Fox Business News, as well as a regular speaker at financial industry conferences. He received his education from Swarthmore College, holds an M.S. in Applied Economics from Johns Hopkins University, and is a CFA Charterholder.

The U.S. bond market finds itself in a holding pattern in mid-2025, following a year of ups and downs. Interest rates have whipsawed on the back of policy swings, yet ultimately sit near the same levels as one year ago. Looking ahead to the next six to 12 months we find our outlook is shaped by late-cycle economic conditions.

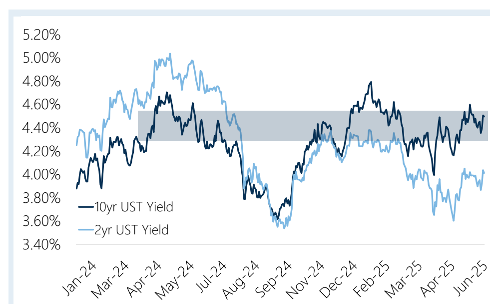
- **Rangebound:** After significant volatility, Treasury yields are roughly unchanged from mid-2024 levels, as short-term market swings and technical flows have offset each other. With real yields near 2%—historically high—we find bond valuations attractive and favor adding duration, though we would avoid going significantly longer than the 10-year part of the curve.
- **Deceleration:** Signs of economic deceleration are emerging—growth has downshifted, and inflation is cooling—which we expect to dominate near-term rate direction. This should bias interest rates modestly downward in the coming months as investors anticipate an easier Fed policy stance.
- **Easing:** The Fed's next moves hinge on the labor market. If unemployment rises even modestly, we anticipate the Fed could cut rates an additional four to five times this cycle (totaling roughly 1.0% to 1.25% of easing).
- **Deficits:** Large fiscal deficits (running above 6% of GDP) combined with a narrower trade/capital inflow balance (~4% of GDP) to form a structurally untenable mix. Over the longer term, this imbalance risks pressuring interest rates higher or undermining the dollar if demand for Treasuries cannot keep pace with supply.
- **Valuations:** Credit spreads in both investment-grade and high-yield markets are historically tight. Therefore, we continue to advocate an up-in-quality bias. We like agency MBS over many areas of the credit markets.

RANGEBOUND RATES AMID VOLATILITY

Over the past year, interest rates have been on a wild ride—only to finish almost where they started. The 10-year Treasury yield hovers at 4.40% as of publication time, close to its mid-2024 levels, despite seeming violent peaks and troughs. The 2-year yield, which is more sensitive to Fed policy expectations, has slipped from roughly 4.70% a year ago to about 3.90%, reflecting both 1.00% of executed and more in anticipation of rate cuts. In essence, the Treasury market has oscillated within a broad range but made no sustained progress in either direction.

An increasingly important technical factor in the interest rate markets is Treasury supply. Throughout most of the last several decades, markets have cared little about the volume of Treasuries being issued, but on two occasions in as many years, issuance has become a focal point. The U.S. Treasury continues to issue debt at a rapid clip to fund fiscal deficits. While the dollar amount of debt outstanding grabs headlines, our concern is more about the plumbing through which that debt flows. The Treasury market size is outstripping the ability of banks and dealers to readily intermediate in the markets, which increases short-term volatility and makes Treasury yields more sensitive to flows and less sensitive to economic conditions. That theme is on display in the underperformance of 30-year bonds this year.

Chart 9: 2-year and 10-year U.S. Treasury Yield



(Source: Janney ISG; Bloomberg)

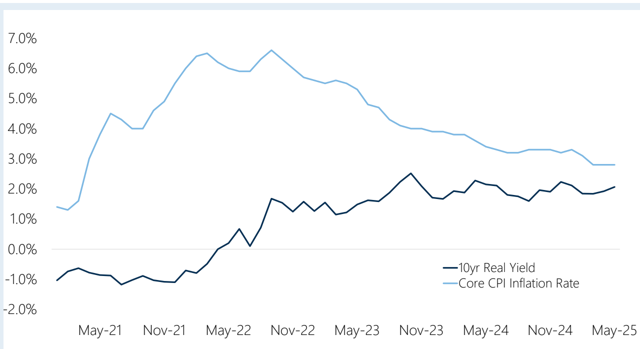
The ideal tactic in this environment is to fade extremes and add duration when 10-year yields approach the high end of the range (around 4.50%) but trim exposure when yields approach the low end (around 3.75%). This tactical approach has been effective amid the oscillations, and we expect the trading range to hold, barring a major shift in economic fundamentals.

ECONOMIC DECELERATION SKEWS TOWARDS LOWER YIELDS

Although supply and flow have proven more important than usual, in a period of slowing growth, the macroeconomic backdrop is poised to be the dominant force for interest rates. In the near term, signs of economic deceleration have become increasingly evident. U.S. GDP contracted at a -0.3% annualized rate in 1Q25. Some of this drop was due to technical factors—namely, wild import swings related to new tariffs—but it nonetheless underscores a downshift in momentum. On the inflation front, the news is more encouraging. Headline inflation has retreated, with the Fed's core PCE inflation gauge easing to 2.5% as of April. While that level is above the Fed's 2% target, it is close enough that, if labor market weakness emerges, the central bank has good cover to reduce interest rates.

In our view, this combination of slower growth and cooling inflation suggests that interest rate risks skew modestly to the downside in the short run. Barring any upside surprise in economic activity, each weak data point (e.g., a softer jobs report or consumer spending miss) is likely to bolster the case for Fed easing and thus put downward pressure on yields. We expect the 10-year Treasury yield to gravitate toward the lower end of its recent range over the next six to 12 months, potentially testing the 3.50% to 3.75% area if the data continue to weaken. The balance of evidence (from slowing retail sales to rising inventory levels and cautious business sentiment) suggests that growth is more likely to disappoint than overshoot in coming quarters. As such, our strategy is oriented toward a mild rate decline.

Chart 10: Real Yields Near Highs Even As Inflation Generally Stable



(Source: Janney ISG; Bloomberg; Bureau of Labor Statistics)

Even if economic activity does not decelerate meaningfully, elevated real yields mean that returns in the U.S. fixed-income markets will likely be higher over the next 12 to 24 months than for much of the last two decades. The 10-year Treasury "real" yield (yield minus inflation) is currently around 2.00%, which is well above the post-2000 average of about 1.00% and near the highest real yields we've seen in over a decade. Historically, when real yields have been at such elevated levels, subsequent total returns on bonds have been attractive as investors lock in substantial inflation-adjusted income. Our modeling of real yields versus future returns suggests that the Aggregate Bond Index could deliver on the order of mid-single-digit percentage gains over the next year as the compensation for interest rate risk is quite healthy by past standards. In practice, this means we favor high-quality, longer-maturity bonds (Treasuries and Agency securities) a bit more than we did a year ago.

FED POLICY: LABOR MARKET HOLDS THE KEY

The Federal Reserve's reaction function at this juncture centers on the labor market. Simply put, if the job market cracks, the Fed will come to the rescue with rate cuts, and the magnitude of easing will hinge on how hard the landing is. So far, the labor market has been resilient but is showing small cracks. The unemployment rate has edged up off its lows (hovering around the lower-4% range), and monthly payroll gains have downshifted from last year's brisk pace to a more moderate ~100K to 150K range recently. Forward-looking labor indicators, such as job openings and initial jobless claims, hint at cooling: job openings are down by over 15% from their peak, and new claims for unemployment benefits have trended modestly higher from extreme lows.

For now, Fed communications suggest a patient stance, with no urgency to cut rates despite a subtle slowing in labor market conditions. Still, with inflation coming off the boil, Fed officials have economic permission to cut any time labor data warrant. In a slowing (though non-recessionary) scenario, we see these cuts amounting to another 50 to 75 bps of overnight rate reductions through mid-2026. An outright recession is far from certain, but we need to acknowledge the risk. In that downside scenario, the Fed's terminal rate for this cycle could fall toward the 2% range by early 2026, implying roughly an additional 150 bps of rate reductions.

Table 1: Historical Rate Cut Cycles

Recession Period	Number of Fed Cuts	Rate Cut Magnitude	Change in 10yr Yields
Apr 1960 – Feb 1961	5x	2.50%	-1.50%
Dec 1969 – Nov 1970	4x	2.00%	-1.20%
Nov 1973 – Mar 1975	10x	5.25%	-3.00%
Jan 1980 – Jul 1980	7x	4.75%	-2.50%
Jul 1981 – Nov 1982	9x	5.75%	-3.25%
Jul 1990 – Mar 1991	3x	1.75%	-1.00%
Mar 2001 – Nov 2001	6x	3.25%	-1.75%
Dec 2007 – Jun 2009	10x	5.00%	-3.50%
Feb 2020 – Apr 2020	5x	2.25%	-1.25%
Median Ex-Extremes*	5x	2.38%	-1.38%

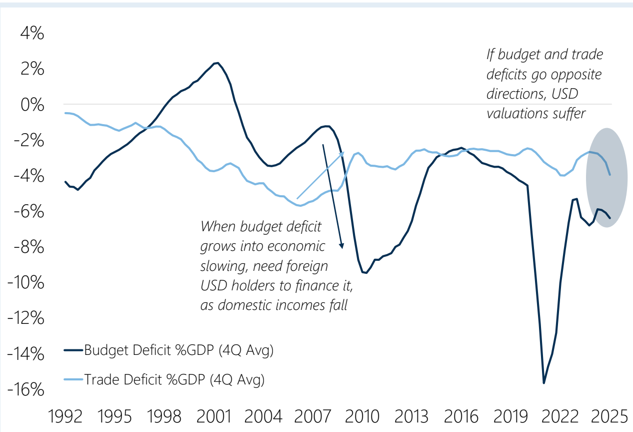
*Italicized periods represent extremes; change in 10yr yields rounded

(Source: Janney ISG; Bloomberg; Federal Reserve Board)

STRUCTURAL IMBALANCES: DEFICITS AND THE BOND MARKET

Structural forces are becoming increasingly important in the longer-term outlook. The combination of a widening fiscal deficit and a potentially narrowing trade balance has become the "twin deficits" for the U.S. bond market. Inclusive of the 2025 tax legislation, the U.S. will be running a fiscal deficit of roughly 6% to 7% of GDP, similar to the last two years, but well up from a historical range of 3% to 4%. On its own, this deficit might not be a problem, particularly since foreign Treasury buyers have been willing to fund it. But in a world in which trade patterns are swinging wildly, the U.S. may be importing less in goods and services and, therefore, sending fewer dollars abroad. Those overseas dollars generally come back to the U.S. economy as financial investments.

Chart 11: Attempts to Shrink Trade Deficit Conflict with 6-7% Federal Budget Deficits



(Source: Janney ISG; Bureau of Economic Analysis; US Treasury Dept)

This dynamic is ultimately unsustainable. In bond market terms, if we need U.S. consumers to finance more of the budget deficit, they are going to require higher yields. If we need foreigners to finance the same amount of the budget deficit, they are going to require a weaker dollar. Neither scenario means an imminent crisis, but both suggest a risk of interest rates drifting higher over time. In the short term, market technicals dominate; in the intermediate term, economic conditions dominate; but in the long term, structural flows establish the level of global interest rates.

MARKET VALUATIONS AND SECTOR OPPORTUNITIES

When it comes to credit sectors, the story is mixed. On the one hand, corporate fundamentals are in solid shape. Profits, while off the peak, have been resilient and even show a modest uptrend recently. The proposed 2025 tax bill could further support after-tax cash flow. These factors have kept credit default rates low and supported a benign credit environment so far.

On the other hand, valuations in credit are optimistic considering the economic risks. Current spreads for both investment-grade (IG) and high-yield (HY) bonds are slightly tighter than their long-run averages. That is significantly more favorable pricing than six months ago when spreads were in their narrowest decile, but it hardly makes for extraordinary value.

Given rich valuations and the late-cycle economic backdrop, we are neutral to modestly underweight on IG and HY credit risk at this juncture. We do not see a major near-term downside for high-quality credit; however, the pickup in yield does not, in our view, compensate for the potential volatility and tail risk if the economy slows later this year. We prefer to source income from other sectors with better relative value.

Chart 12: Credit Spreads Remain Tighter than Long Run Averages Despite Economic Risks

(Source: Janney ISG; Bloomberg)

At the risk of sounding like a broken record, one such area we like is the agency mortgage-backed securities (MBS) market. We've liked the sector since March 2024, and returns in the sector have outstripped Treasuries by about 1% over that time frame. Agency MBS and other callable or prepayment-sensitive bonds (such as callable Agency debentures) have materially underperformed in recent years due to the surge in interest rate volatility during 2022 to 2023. That underperformance has left valuations in the MBS sector cheaper than their historical norms. As with credit, there are no obvious catalysts in the MBS sector, but income generation remains attractive.

CONCLUSION AND STRATEGY IMPLICATIONS

As we reach the midpoint of 2025, the U.S. fixed income outlook is shaped by the risk of a decelerating economy and an interest rate outlook that is somewhat skewed to the downside. Still, hefty supply and long-run fiscal imbalances sound a note of caution. On balance, we expect the next six to 12 months to favor bondholders—with interest rates likely grinding lower (our base case:

the 10-year Treasury yield ends 2025 around 3.75% to 4.00%, and the 2-year around 3.00% to 3.50% as Fed cuts resume). The wild card is the labor market: a sharper downturn could accelerate those rate declines and boost bond returns further via price gains, whereas an unexpected economic reacceleration would limit or reverse the rally. We will be closely watching employment trends and Fed signals as trigger points for adjusting our rate stance.

Table 2: Forecasts

	2Q25 (Act)	4Q25 (Proj)		2Q26 (Proj)	
		Most Likely	Alternate	Most Likely	Alternate
Federal Reserve	4.38%	3x Cuts	1x Cut	2x Cuts	1x Cut
2yr UST	4.00%	3.50%	3.90%	3.25%	4.10%
10yr UST	4.48%	3.80%	4.50%	4.00%	4.70%
IG Spreads	85bps	120bps	85bps	120bps	80bps

(Source: Janney ISG; Bloomberg; Federal Reserve Board)

In terms of portfolio strategy, we recommend a neutral-to-slightly long duration posture to capture the attractive yields in the 5- to 10-year area of the curve but are hesitant to go significantly longer. On the sector front, our preferences are tilted toward high-quality sectors that can weather a softening economy with ease. At the top of the list is Agency MBS, where we see a compelling mix of high quality and relative value. We also favor U.S. Treasurys (on any selloffs to the 4.50% 10-year area) for their portfolio ballast if growth surprises to the downside. Within corporate credit, we lean toward higher-rated investment-grade corporates, but only at market weight or a tad underweight, given valuations. For those needing tax-exempt income, municipal bonds (not a focus of this outlook, but worth mentioning) also appear reasonably attractive given stable and improving state finances.

Finally, a word on the bigger picture: the structural deficit issue implies that, once the cyclical dust settles, interest rates may face upward pressure in the longer term. That is not a 2025 worry, or perhaps not even a 2026 one, depending on how economic conditions evolve; however, it is hard to see how a policy environment or both expanding deficits and shrinking trade can be anything but negative for interest rates in the long run.

By staying disciplined and selective—favoring sectors with solid fundamentals and attractive valuations—investors can navigate the remainder of 2025 and beyond with confidence in their fixed-income allocations. The goal is a portfolio that can benefit from a downturn via quality duration exposure, but also withstand potential volatility from structural challenges.

Disclosures

This is for informative purposes only and in no event should be construed as a recommendation by us or as an offer to sell, or solicitation of an offer to buy, any securities. The information given herein is taken from sources that we believe to be reliable, but is not guaranteed by us as to accuracy or completeness. Opinions expressed are subject to change without notice and do not take into account the particular investment objectives, financial situation, or needs of individual investors. Employees of Janney Montgomery Scott LLC or its affiliates may, at times, release written or oral commentary, technical analysis, or trading strategies that differ from the opinions expressed here.

Returns reflect results of various indices based on target allocation weightings. Weightings are subject to change. Index returns are for illustrative purposes only and do not represent the performance of any investment. Index performance returns do not reflect any management fees, transaction costs, or expenses. Indexes are unmanaged, and you cannot invest directly in an index.

Performance data quoted represents past performance and is no guarantee of future results. Current returns may be either higher or lower than those shown.

This report is the intellectual property of Janney Montgomery Scott LLC (Janney) and may not be reproduced, distributed, or published by any person for any purpose without Janney's prior written consent.

This presentation has been prepared by Janney Investment Strategy Group (ISG) and is to be used for informational purposes only. In no event should it be construed as a solicitation or offer to purchase or sell a security. The information presented herein is taken from sources believed to be reliable, but is not guaranteed by Janney as to accuracy or completeness. Any issue named or rates mentioned are used for illustrative purposes only and may not represent the specific features or securities available at a given time. Preliminary Official Statements, Final Official Statements, or Prospectuses for any new issues mentioned herein are available upon request. The value of and income from investments may vary because of changes in interest rates, foreign exchange rates, securities prices, and market indices, as well as operational or financial conditions of issuers or other factors. Past performance is not necessarily a guide to future performance. Estimates of future performance are based on assumptions that may not be realized. We have no obligation to tell you when opinions or information contained in Janney ISG presentations or publications change.

Definition of Ratings

Overweight: Janney ISG expects the target asset class or sector to outperform the comparable benchmark (below) in its asset class in terms of total return.

Marketweight: Janney ISG expects the target asset class or sector to perform in line with the comparable benchmark (below) in its asset class in terms of total return.

Underweight: Janney ISG expects the target asset class or sector to underperform the comparable benchmark (below) in its asset class in terms of total return.

Benchmarks

Asset Classes: Janney ISG ratings for domestic fixed income asset classes including Treasuries, Agencies, Mortgages, Investment Grade Credit, High Yield Credit, and Municipals employ the "Barclays U.S. Aggregate Bond Market Index" as a benchmark.

Treasuries: Janney ISG ratings employ the "Barclays U.S. Treasury Index" as a benchmark.

Agencies: Janney ISG ratings employ the "Barclays U.S. Agency Index" as a benchmark.

Mortgages: Janney ISG ratings employ the "Barclays U.S. MBS Index" as a benchmark.

Investment Grade Credit: Janney ISG ratings employ the "Barclays U.S. Credit Index" as a benchmark.

High Yield Credit: Janney ISG ratings employ the "Barclays U.S. Corporate High Yield Index" as a benchmark.

Municipals: Janney ISG ratings employ the "Barclays Municipal Bond Index" as a benchmark.

Analyst Certification

We, Mark Luschini and Guy LeBas, the Primarily Responsible Analysts for this report, hereby certify that all views expressed in this report accurately reflect our personal views about any and all of the subject sectors, industries, securities, and issuers. No part of our compensation was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed in this research report.