

## The fog has lifted, but what we see is a less bond-friendly environment and a lot of people scratching their heads wondering if either party is listening to the bond vigilantes. What will it take for current two parties to take our national debt seriously?

Some readers may recall that in our fourth quarter 2024 commentary we spoke about the DOGE effort and the likelihood of success. Our statement was not based on “political beliefs”, but rather on an informed understanding of our country’s budgeting process and spending management. We got some mixed feedback on our following comment:

*“We are a team of rational thinking long-term fixed income investors. The folly of thinking that there are \$2 trillion of spending cuts to be made to the budget (recently reduced to a still irrational \$1 trillion) is an illusion. There are no easy solutions and no silver bullets. Frankly, a balanced budget is not a rational expectation. What is rational is perhaps a near-term deficit of a trillion dollars (from the current approximate three trillion), closer to the pre-tax cut 2017 deficits of approximately \$500 billion. To bond vigilantes, this display of seriousness would be a huge step in a favorable direction and be rewarded with a decline in the term premium.”*

Clearly, we have made no progress as a country on taking our debt burden and spending habits seriously. The recently passed tax and spending bill only adds trillions more to our debt. We remain steadfast in our thought that not only are spending cuts needed but also that our tax regime needs serious upward adjustments to attempt to gain control over the annual budget deficit. We are not pounding the table for draconian measures, simply modest and unrelenting positive steps over many years. We did not get into the current position in one budget cycle, nor will we be able to correct it in one. We remain the strongest and most successful country in the world, period. It’s time we bring some rational behavior to Washington.

### Tariffs 2.0:

Since our last quarterly publication there have been over 50 tariff announcements, with seemingly multiple headlines each hour. In addition, the timing of when these tariffs will be implemented remains in flux. The initial 90-day delay of “Liberation Day” tariffs was set to expire on July 9th before being extended at the 11th hour until August 1st, a deadline the Administration insists will not be further extended. The Administration has agreed to trade deals with just two countries – the U.K. and Vietnam – despite predictions of 90 deals during this 90 day pause. Prognosticating in such a dynamic, chaotic environment often proves futile, but nevertheless, the goal of this writing is to provide an update on where trade policy currently stands and what the potential impacts are on the economy.

On July 7th, the Administration extended the pause on reciprocal tariffs and revealed new tariff rates on 14 countries. Most notably, the new tariff rates include 25% tariffs on imports from trading partners Japan and South Korea, which together accounted for 8.9% of total imported value in 2024. Based on what we know as of this writing, the most recent estimates of the effective tariff rate are ~16.5%. A 16.5% effective tariff on \$3.4 trillion of imported goods amounts to a tax of over \$550 billion on U.S. business and consumers.

Confidence is a key component of a healthy economy – it’s necessary for consumers to continue spending at current levels and for businesses to continue hiring and increasing capital spending budgets. And right now, the constant uncertainty around trade policy is starting to impact the confidence of consumers and businesses alike. CEO confidence is declining which is affecting capex plans, reflected in

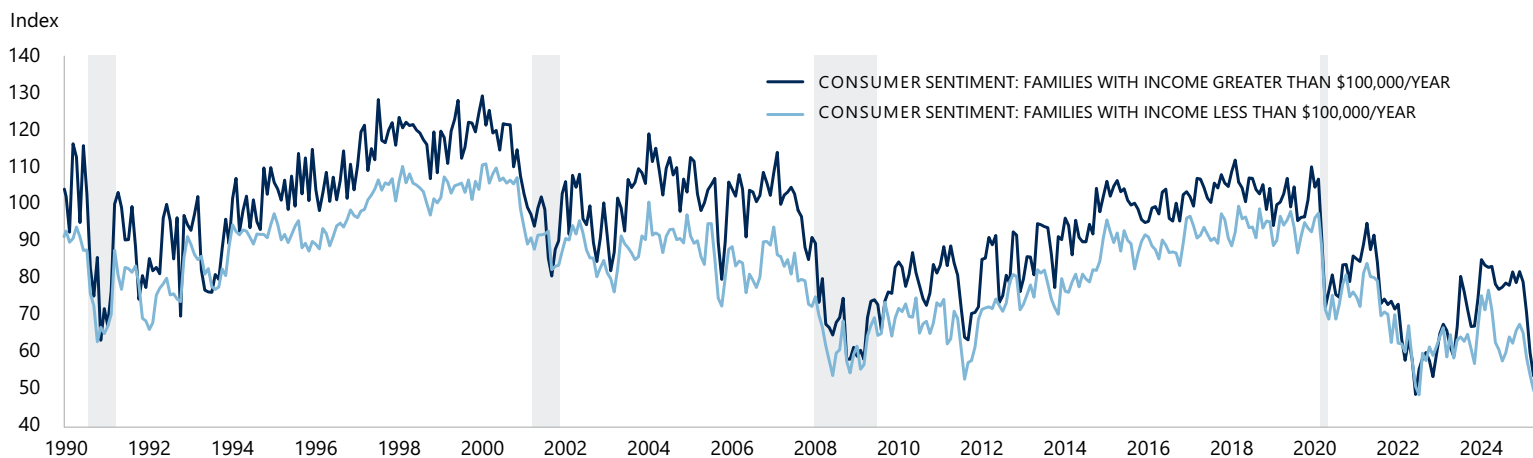
falling new manufacturing orders. Similarly, consumer confidence is at recent lows after five consecutive months of declines, and recently has seen the sharpest declines among the \$100k+ income cohort (see chart below). To make matters worse, the threat of harsher reciprocal tariffs continues to hang out there, and the full impact of policy lags several months before it shows up in the hard economic data. Thus, it’s entirely possible, even likely, the worst is yet to come.

**Monetary Policy:** Much of the economic uncertainty related to tariffs that arose in the first quarter of 2025 remains unresolved and the Fed remains in wait-and-see mode. Recent inflation data have been encouraging. There have been hints of tariff-induced inflation in core goods categories, such as apparel, appliances, and furniture, with a significant share of imports from China, but this has not been significant enough to offset modestly disinflationary trends in services. Economic growth in the first half of 2025 has been difficult to read, given the distortions driven by the evolving trade war. Averaging the two quarters to smooth out the trade distortions, trend GDP growth in the first half is likely around 2%, a significant downshift from the high 2% rate in the final three quarters of 2024. Cooling employment and wage growth, combined with a modest uptick in inflation, will keep real labor income growth low and consumer spending muted. Financial conditions will mostly be a tailwind for the economy. Equity indices are at all-time highs with elevated valuations. Credit spreads are at historically low levels. The US Dollar is weakening. Interest rates remain somewhat elevated relative to the post-GFC era, but not out of the ordinary in a longer historical context. We believe GDP to grow 1%-2% in the second half of 2025. Recession risks, from unanticipated shocks, including an intensification of the trade war, are somewhat elevated in the below trend growth environment we anticipate.

**Interest Rates:** The Federal Reserve remains on hold for the time being, waiting for evidence to surface that rising inflation or unemployment is becoming the more pressing concern. At the June FOMC meeting, the median projection of Federal Reserve Board members for the federal funds rate at year end 2025 was left unchanged at two expected cuts. Notably, seven members of the FOMC saw no cuts in 2025 while 10 members saw two to three cuts, underscoring the uncertainty and tensions in economic forecasting in the current environment. The Fed would certainly respond aggressively to a break in the labor market, but will be reluctant to cut into a rising and above target inflation environment which we think is more likely into late 2025. Rate cuts may take longer to emerge than current consensus expectations of a first cut in September or October of this year. Therefore, we believe the resumption of the rate cutting cycle to begin in December or early 2026. Ten-year treasury yields will most likely remain range bound between 4.20%-4.60% through year end. Longer-term, without sustained improvement in federal budget deficits, we would anticipate – without guarantee - moderate upward pressure on the long end of the yield curve.

**Investment Grade Corporate Bond Outlook:** Recent earnings calls suggest that price increases are likely on the way and consumers and businesses are understandably anxious as we stated above. However, we believe corporate spreads versus Treasury bonds to widen only modestly from their past tight levels as strong balance sheets, corporate credit fundamentals and rating trends remain strong. We will continue to stay up-in-quality and believe credit selection will be paramount in both investment grade and high yield, as the focus will shift toward fundamentals and the ability of corporates to navigate this macro uncertainty with U.S. economic growth slowing.

**High Yield Bond Outlook:** All of the comments we made about our investment grade corporate outlook are applicable to the high yield bond market. We believe an increase in both defaults and spreads later



Data as of May 2025. Sources: University of Michigan, Haver Analytics, Apollo Chief Economist

this year versus the record setting lows of 2025 witnessed to date are coming. Given our consistent tilt to quality, higher rated high yield bonds, we anticipate our total return in this asset class to be less favorable in 2025 relative to the past year. However, we remain confident that coupon payments will be realized and opportunities will present themselves to put those funds back to work in the asset class.

#### Investment Grade Corporate Bond Second Quarter Performance:

U.S. investment-grade bonds, as represented by the Bloomberg U.S. Aggregate Bond Index, returned +1.21% during the quarter as interest rates fell in June over geopolitical concerns and on hopes of a Fed cut later this year. The Bloomberg U.S. Aggregate Bond Index is composed of securities from the Bloomberg Capital Government/Corporate Bond Index, Mortgage-Backed Securities Index and Asset-Backed Securities Index. Risk sentiment also improved with this downward move in rates as corporate spreads tightened 10 bps in the quarter per the Bloomberg U.S. Credit Index. This index measures the investment grade, U.S. dollar denominated, fixed-rate, taxable corporate bond market. In our opinion, the securities are well positioned to weather the current market cycle.

#### High Yield Bond Sector Second Quarter Performance:

High yield fixed income bonds, as represented by the U.S. High Yield Corporate Bond Index, had a return of +3.4% in the second quarter. High yield spreads started the quarter at 350 bps and ended at 298 bps, retracing most of the widening from the first quarter as tariff headlines abated. The quarterly return was comprised of +1.8% from price and +1.6% from changes in income. From a quality perspective, all ratings buckets performed admirably, with BBs and single-Bs at +3.3%, and CCCs slightly outperformed in the risk-on environment at +4.2%. High yield bond data is representative of the U.S. High Yield Corporate Bond Index which is designed to track the performance of U.S. dollar-denominated, high-yield corporate bonds issued by companies whose country of risk use official G-10 currencies, excluding those countries that are members of the United Nations Eastern European Group (EEG).

### One Final Comment

We are frequently asked about our thoughts on political issues. As fiduciaries for our clients, we have a responsibility, taken exceedingly seriously, not to get caught up in politics but rather be students of various policies that are being considered or implemented by political parties. After working as a team for nearly 25 years, it is not to say we don't have our individual opinions, we do, but we stay levelheaded and grounded when it comes to implementation of strategies to address the changing landscape. One thing we do know through our market experience is that rash investment decisions are never good decisions. We look out over the horizon, prepare for the worst and hope for the best of investment climates. As you would rely on, we believe we are well positioned to withstand the current policy volatility in your portfolios.

If you have any questions on strategy, performance or business development, please do not hesitate to contact us.

**Leo J. Dierckman**

(317) 843-3603

Leo.Dierckman@opco.com

**Peter Vars, CFA**

(317) 843-3606

Peter.Vars@opco.com

**Matt Burrell**

(317) 843-3605

Matthew.Burrell@opco.com

**Michael Richman, CFA**

(317) 843-3602

Michael.Richman@opco.com

**Eric Thornburgh, CFA**

(317) 843-3635

Eric.Thornburgh@opco.com

## DISCLOSURES

Oppenheimer Investment Management LLC ("OIM") is an investment adviser registered with the Securities and Exchange Commission and is an indirect wholly owned subsidiary of Oppenheimer Asset Management Inc., a registered investment adviser and an affiliate of Oppenheimer & Co. Inc., registered investment adviser and broker-dealer. SEC registration is not an endorsement of the firm and does not imply OIM has achieved a specific level of skill or ability. The opinions expressed herein are those of the portfolio managers and not necessarily those of OIM or its affiliates and are subject to change without notice. Some of the information in this document may contain projections or other forward-looking statements regarding future events or future financial performance of countries, markets or companies. Actual events or results may differ materially. The information and statistical data contained herein has been obtained from sources we believe to be reliable. Any securities discussed should not be construed as a recommendation to buy, sell, or hold those securities and there is no guarantee that they will be held in a client's account or that they will be profitable. Investing in fixed income securities involves risk and may result in loss of principal. The risks associated with investing in fixed income include loss of principal, risks related to interest rate movements (interest rate risk as bond prices fall as interest rates rise), reinvestment risk (if bonds are sold or called, the proceeds may have to be reinvested at a lower coupon), the risk of credit quality deterioration (credit or default risk) and liquidity risk (the risk of not being able to buy or sell investments quickly for a price close to the true underlying value of the asset). Strategies that invest in lower-rated debt securities (commonly referred to as high yield or junk bonds) involve additional risks because of the lower credit quality of the securities in the portfolio. An investor should be aware of the possible higher level of volatility and increased risk of default. An index should only be compared with a mandate that has a similar investment objective. An index is not available for direct investment, and does not reflect any of the costs associated with buying and selling individual securities or management fees.

Past performance is not a guarantee of future results. Adtrax 8190804.1