

9 JULY 2025

# Midyear outlook: Global growth converges

Brandywine Global: With the US economy slowing, a convergence in global growth is expected. Our experts discuss the factors that may impact the economy and financial markets in the second half of the year.

## GLOBAL MACRO OUTLOOK

### Global growth convergence continues



**Paul Mielczarski**  
Head of Global Macro Strategy

The macroeconomic landscape remains fraught with peril. And the second half of the year looks no closer to resolution.

Going forward, we expect significant convergence in relative growth rates after a long period of US exceptionalism. Global investors are structurally overweight US dollar (USD)-denominated assets, and we believe there are both economic and geopolitical reasons for reducing these exposures over time. However, a further selloff in the USD may require definitive evidence of a deterioration in US economic growth.

Meanwhile, there are multiple crosscurrents affecting the US bond market, which are currently balancing each other out. On one hand, the US economy is gradually slowing down. On the other hand, additional US fiscal easing at a time when the government debt level is already high is pushing bond yields upward.

Despite a reprieve in tariffs, the trade war is far from over. We expect tariff rates to eventually settle at meaningfully higher levels than before the Trump administration took office. Tariffs lead to higher inflation and slower economic growth. Faced with stagflationary risks, the Federal Reserve (Fed) is likely to be cautious in reducing policy rates.

Even though short-term recession risks have diminished, we expect US growth to slow significantly in the second half of the year. This deceleration is due to the tax-like impact of tariffs along with trade policy uncertainty also depressing investment and hiring. Federal workforce layoffs, lower immigration, and a decline in international tourism may contribute additional drags on economic activity. What is unclear is whether the weakness in growth will be significant enough to trigger a more aggressive Fed policy easing cycle amid elevated short-term inflation risks. At the same time, the eurozone economy will be supported by the significant monetary easing delivered over the past 12 months and the massive multi-year German fiscal stimulus package.

## DEVELOPED MARKET RATES

### The uncertainty of times



**Jack P. McIntyre, CFA**  
Portfolio Manager

Charles Dickens had it about right when he penned his famous quote, “It was the best of times, it was the worst of times” in his novel, *A Tale of Two Cities*. However, to describe today’s world he needs to add, “It was the uncertainty of times.” This extreme uncertainty is captured in term premium, which for the first time in a long time is a larger influence in the pricing of bonds and the yield curve.

When you step back and think about the path of developed bond markets in the second half of 2025, what does not jump out is strong conviction. Assumptions run rampant given we are at the crossroads of politics and geopolitics for global economies and financial markets. We are still entrenched in the multi-year theme, “Year of the Coupon,” and I suspect that the next six months will remain anchored to it. That means rangebound developed market bonds, so earn the coupon and lean toward more tactical allocations that take advantage of an expected range trade.

### Key traditional drivers

Not surprising, the traditional major influences for developed market bonds are inflation and economic growth—and the labor market in particular. However, in a world where the largest aggregate consumer is facing a new consumption tax, which might increase, US economic data is not giving a clear signal. Think of it as noise versus information. More certainty on the impact of tariffs should come later in the second half

of the year. Our educated guess leans toward tariffs being more of a detriment to economic activity and igniting a renewed surge in inflation. That is what history shows.

## **Market views**

Globally, uncertainty and term premium remain elevated on geopolitical developments and the steady tension between the two largest economies, the US and China. The most popular trade has been positioning for steeper yield curves, which makes sense given the bias of central banks to ease policy (see Exhibit 1 and Exhibit 2). However, it is a crowded trade and susceptible to a reach for duration. Oil may have a larger influence on inflation expectations.

US Treasuries are expected to outperform. US consumers are facing headwinds as the job market continues to soften. Meanwhile, service inflation continues to moderate, and fiscal contraction is likely until 2026. The risk to Treasuries is a lack of fiscal fortitude from the government. Bond vigilantes are waiting in the wings. The administration's goal of lower 10-year yields could be tested.

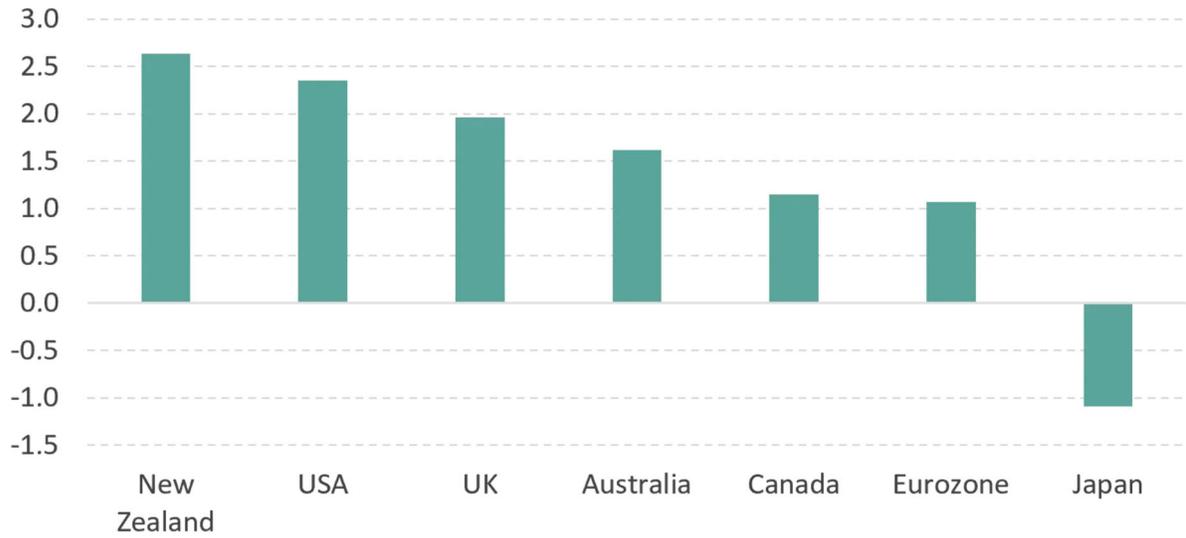
Core Europe is seeing a fiscal expansion regime shift in Germany, which could leak into broader eurozone fiscal measures. There is a renewed focus on economic resiliency with more domestic demand and less exports to the US. The ECB is now closer to a pause. We do not see overwhelming value in eurozone bonds given the tone change.

The UK offers better value. Lower inflation, mixed economic growth, and more fiscal responsibility all combine for better expected performance versus European peers. Meanwhile, Japan offers no compelling value, given its inflation problem and central bank that needs to continue to increase policy rates.

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## Real 10-Year Yields Based on Forward Core Inflation

%, Forecasts as of 9/30/2026 and 11/30/2026

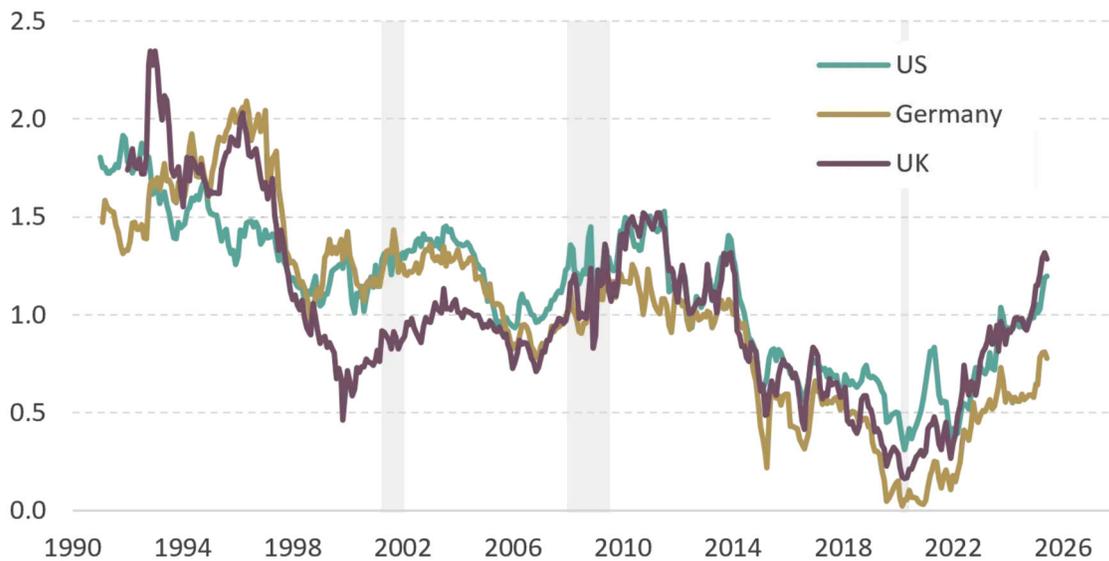


Source: Macrobond, JP Morgan, Bloomberg (© 2025, Bloomberg Finance LP)

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## G3 Bond Term Premium Estimates

%, As of June 20, 2025



Deutsche Bank Estimate = 10yr yield - 5yr yield + 0.2\*2yr yield

Source: Brandywine Global, Macrobond, Bloomberg (© 2025, Bloomberg Finance LP)

**INVESTMENT GRADE**

# Stable growth and constructive rates



**Brian L. Kloss, JD, CPA**  
Portfolio Manager

Investment grade (IG) corporate credit stands at a critical intersection. The Federal Reserve (Fed) has paused monetary policy, with market consensus now pricing in a modest easing bias for late 2025 or early 2026. Inflation, while still above the Fed's target, has moderated. Gross domestic product growth is expected to remain just in expansionary territory. This environment should be relatively constructive for IG credit, as companies gain more clarity on the outlook for growth and interest rates. Meanwhile, corporate balance sheets remain healthy, with leverage metrics generally improving since their peak in 2023.

As of mid-2025, IG spreads have tightened from the wide levels seen in late 2023 but remain marginally above the recent average, offering moderate value. We believe the appetite for income continues to grow as investors anticipate a decline in government bond yields and rising concerns about US equity valuations.

We expect spreads to remain rangebound in the second half of the year, with potential for modest tightening in select sectors. Technicals could become more supportive should issuance decline in late 2025, particularly if economic uncertainty leads corporates to defer capital markets activity. The financials and technology & communications sectors look attractive. Banks remain well capitalized, and there is potential for a more favorable regulatory environment. Telecom should benefit from an improving credit profile. Meanwhile, industrials should be monitored for margin pressure as the pricing power they commanded recently abates.

Monetary policy missteps, geopolitical events, and credit risks pose potential issues to the outlook. That said, maintaining a quality bias is preferred, with select duration decisions based on underlying fundamentals. However, we believe the remainder of 2025 offers a favorable backdrop for selective credit exposure, particularly as volatility across other asset classes begins to reemerge.

## HIGH YIELD

### Strong demand, low defaults continue

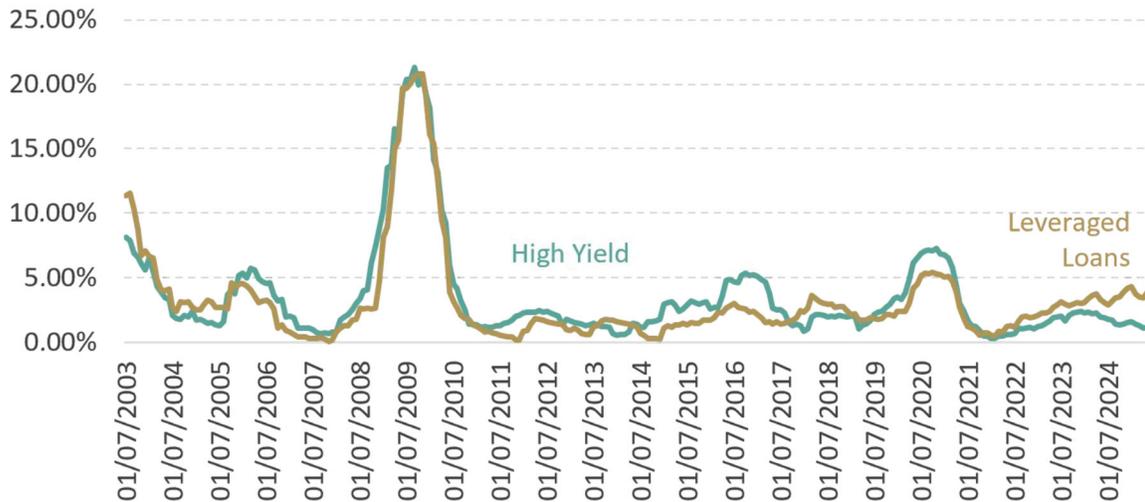


**Bill Zox, CFA**  
Portfolio Manager

High yield bonds have outperformed core fixed income and US stocks for the year to date, supported by low default rates and healthy leverage and interest coverage. High yield has also outperformed loans for the same time period, marked by an unprecedented divergence in which defaults for loans have been substantially higher than high yield bonds (see Exhibit 3).

### 3 Par-Weighted Default Rates

%, As of 5/31/2025



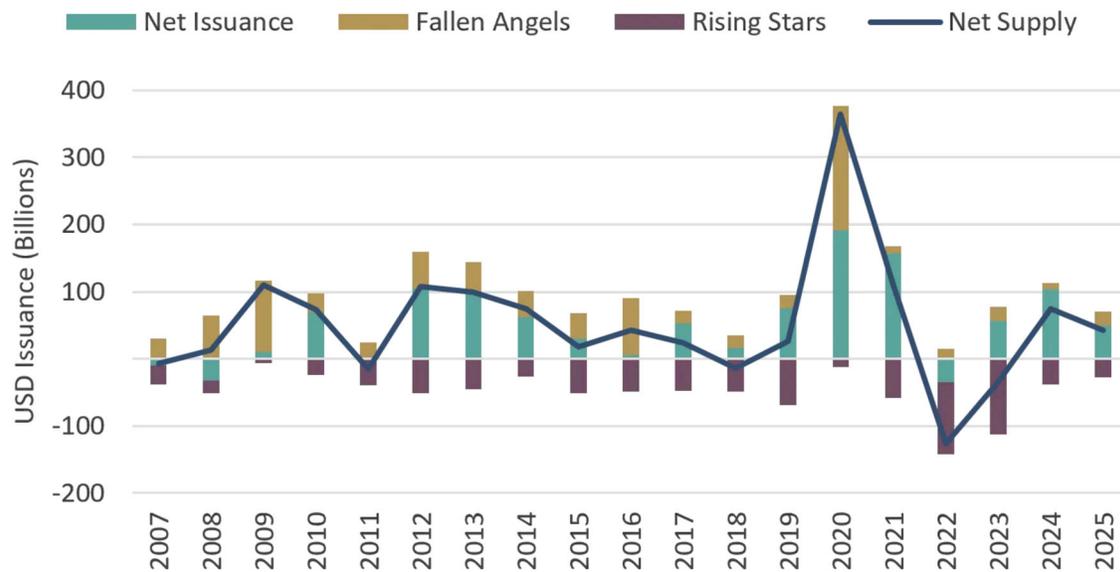
Source: ICE Data Services LLC, BofA Global Research

Demand for high yield is strong across all geographies and channels as many allocators favor shorter-duration credit over longer-duration sovereigns. However, strong demand has been met with muted net new supply as most new issuance has been for refinancing rather than mergers and acquisitions (M&A), dividends, or stock buybacks (see Exhibit 4).

After heightened volatility around the US tariff announcements, the high yield spread in the low 300s, yield around the mid-7% range, and dollar price of about 96 are all reasonably close to beginning-of-the-year levels. Of course, things can change. Bonds rated BB have outperformed single-Bs. Meanwhile, the largest issuers have outperformed the broader market by a wide margin year to date, indicating some concern about the challenges ahead.

## High Yield Annual Net Supply

\$ Billions, As of 5/31/2025



Source: ICE Data Services LLC, BofA Global Research

### EMERGING MARKETS

## Poised to benefit from potential catalysts



**Michael Arno, CFA**

Portfolio Manager, Senior Research Analyst



**Carol Lye**

Portfolio Manager, Senior Research Analyst

Despite elevated uncertainty, emerging markets (EM) have performed well this year. Local currency markets are up over roughly 10%, and hard currency sovereigns and corporates have returned just over 4% and 3%, respectively, for the year to date. In local markets, currencies have contributed a little over 50% of the return, and we believe there is still room for further appreciation. The US dollar remains elevated from a valuation perspective, and the world is overweight dollar-denominated assets

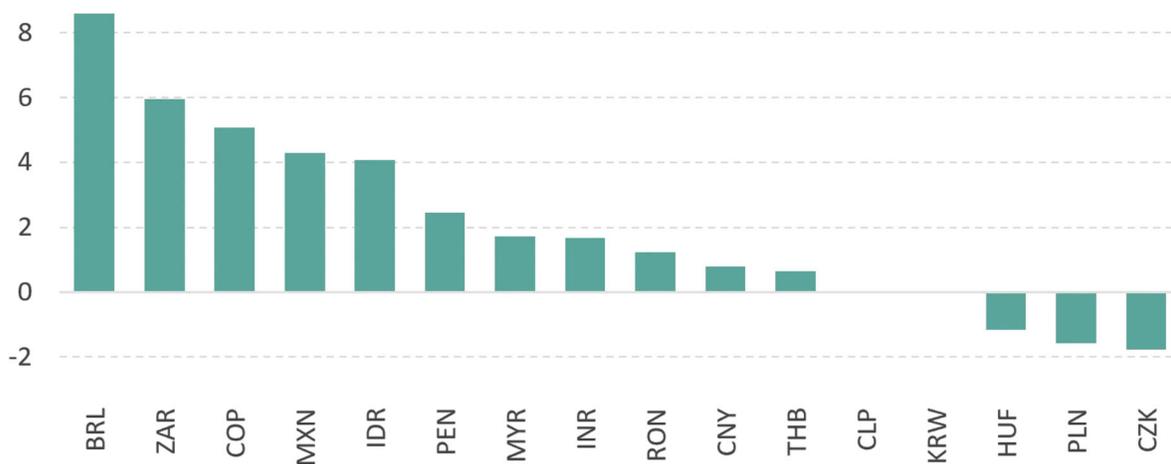
following years of outperformance. Some rebalancing out of the dollar and into undervalued or overlooked markets could benefit EM.

From a regional standpoint, Latin America offers elevated nominal and real yields (see Exhibit 5 and Exhibit 6). We will be following the heavy election calendar for signs of shift to more centrist candidates, which could reinforce investor confidence and act as a catalyst for the region. Central European markets are well positioned to benefit from a departure from Europe’s recent economic stagnation, especially if fiscal stimulus and targeted industrial policy gain traction.

A more aggressive trade rebalancing coupled with the cyclical and structural dynamics that are underway may expand opportunities in other EM. Some of these markets may be well positioned to benefit from a secular shift in global production and capital flows. US policy aimed at curbing state-subsidized overcapacity may accelerate the relocation of supply chains toward other markets, including EM economies. This trend could invigorate investment opportunities in infrastructure, local manufacturing, and upstream commodities across Asia, Latin America, and Africa.

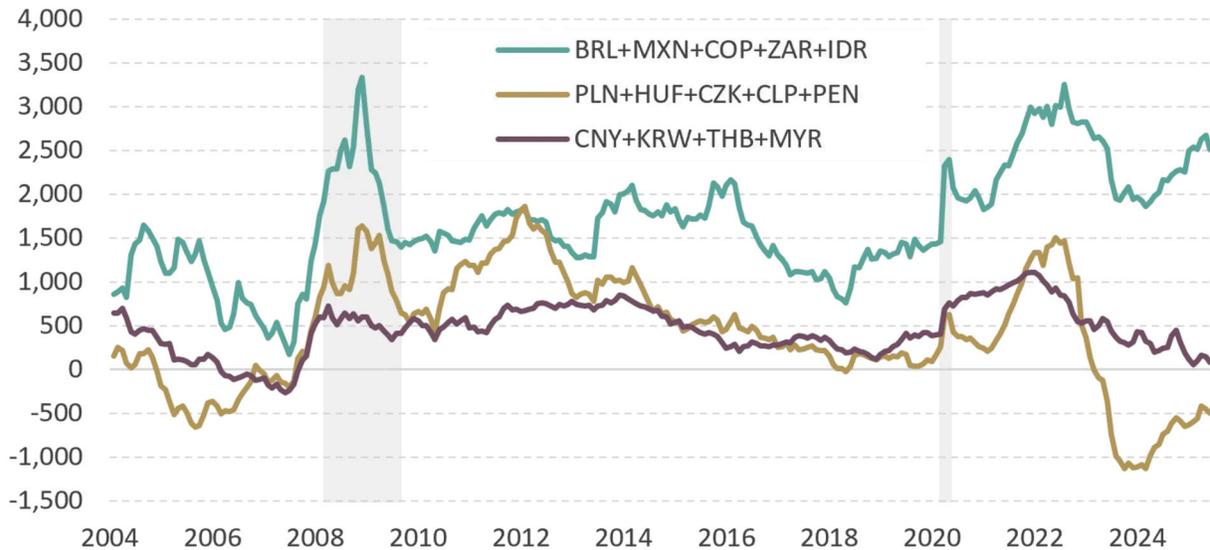
### 5 | EM Real Yield Based on Trend Inflation

%, excludes Turkey (TRY), As of 5/31/2025



Source: Macrobond, Bloomberg (© 2025, Bloomberg Finance LP)

Basis points, As of 6/17/2025



Source: Brandywine Global, Macrobond, Bloomberg (© 2025, Bloomberg Finance LP)

## SECURITIZED PRODUCTS

# Capturing value in top structured credit plays

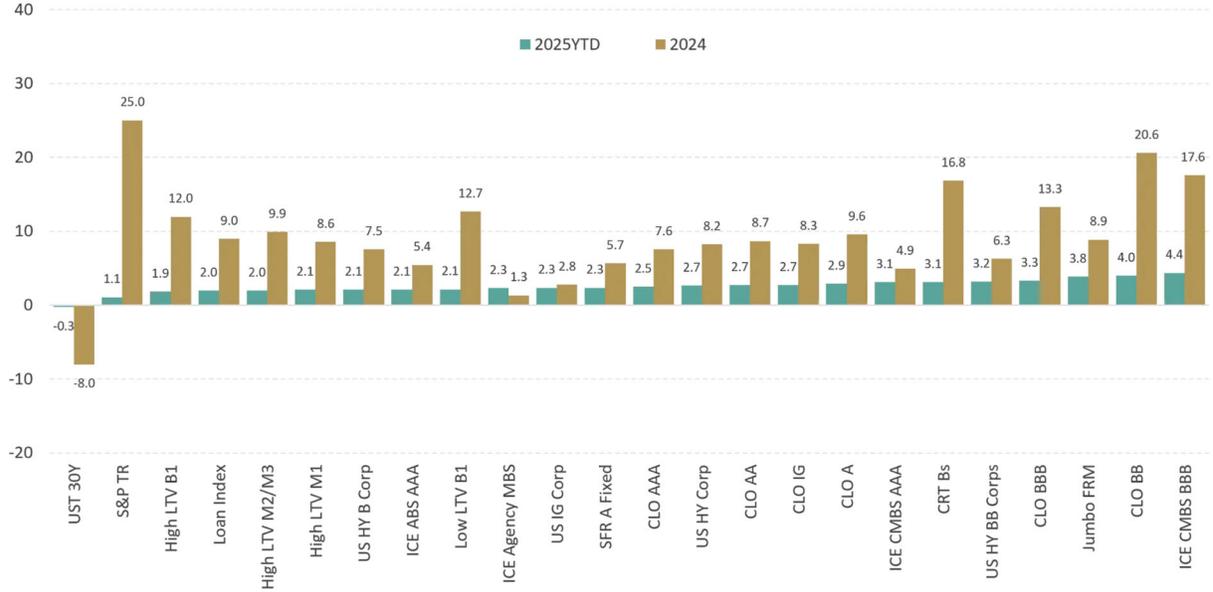


**Tracy Chen, CFA, CAIA**

Portfolio Manager

In the “high for longer” interest rate environment, various factors, including strong housing fundamentals, healthy household balance sheets, benign credit conditions, and robust market technicals drove outperformance in floating-rate sectors like credit risk transfers (CRT) and collateralized loan obligations (CLO) in the first half of 2025. Commercial mortgage-backed securities (CMBS) rated BBB also benefited from distressed valuations and stabilizing office markets (see Exhibit 7).

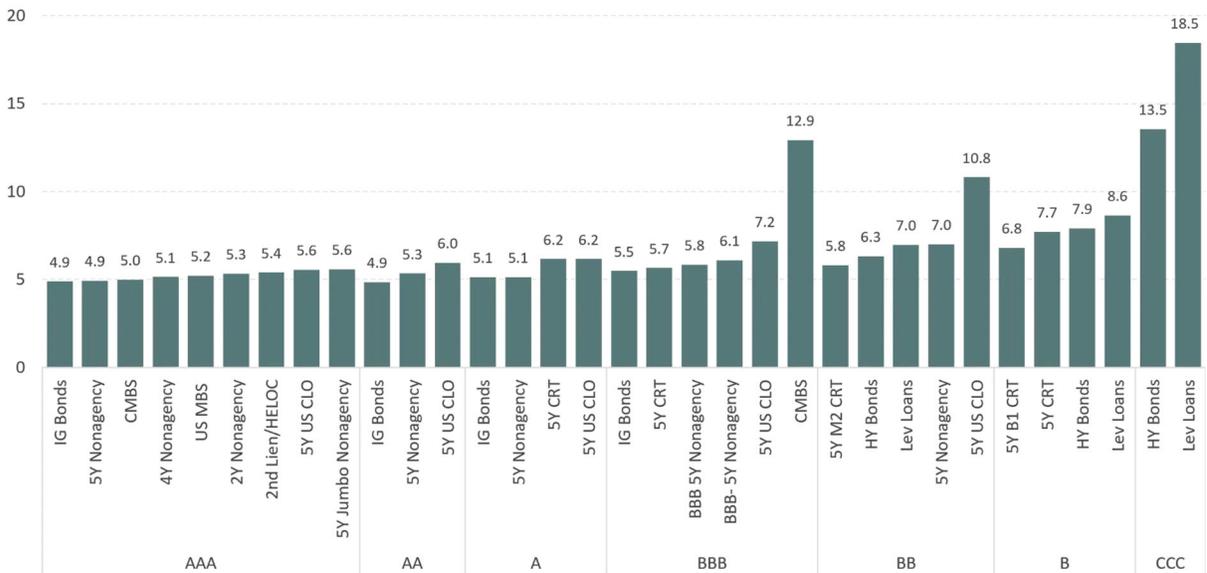
7 2024 and 2025 YTD Total Return of Fixed Income Market  
%, As of 6/6/2025



Source: BofA Global Research, Bloomberg (© 2025, Bloomberg Finance LP), LCD

Looking ahead to the second half of the year, resilient credit fundamentals, peak rate volatility, and easing bank regulations support further spread tightening (see Exhibit 8).

8 Yield by Rating Across Securitized Products  
%, As of 6/6/2025



Source: BofA Global Research, Markit, ICE Data Indices, S&P LCD

Key opportunities include:

1. **CRTs** offer high all-in yields and strong carry with government-sponsored enterprise (GSE) tender upside and reinvestment demand. Scarcity value exists due to limited non-investment grade issuance and ongoing rating upgrades. Solid credit performance is supported by tight labor markets and significant home equity.
2. **CLO** BBB and BB mezzanine tranches provide attractive yields and credit resilience. Renewed CLO ETF inflows boost liquidity and demand. Elevated spreads versus corporates provide room for tightening.
3. **Agency MBS** offer attractive valuations, historically low negative convexity, and potential bank demand, which exists amid cautious GSE reform.
4. **CMBS** may benefit from tightened underwriting, spread compression potential, and select secondary market upside.
5. **Asset-backed Securities (ABS)** are riding the tailwind of exponential growth of AI and data centers. Commercial ABS in data centers and fiber offer growth exposure, IG ratings, scalability, and attractive valuations.

In addition, light net issuance across sectors bolsters positive market technicals. These factors combine to offer compelling value in structured credit through the end of 2025.

## GLOBAL CURRENCIES

# Dollar set to weaken further



**Anujeet Sareen, CFA**  
Portfolio Manager

The outlook for the US dollar remains negative. Long-term valuation and positioning measures suggest the asymmetry for the dollar is to the downside. The catalysts for a weaker dollar are now emerging with a narrowing of growth differentials and asset performance.

From a valuation perspective, the dollar's real trade-weighted exchange rate remains near the top of a 50-year range. While US exceptionalism over the past decade in both economic and equity performance has been the catalyst for US dollar appreciation, the US net investment position suggests that the overweight in US assets by foreigners is now at an exceptionally high level. According to data from Haver Analytics, from 2014

to 2024, private investments (net) in US assets rose over \$18 trillion, a staggering 60% of gross domestic product (GDP), driven partly through new flows and partly through asset appreciation (see Exhibit 9). While the non-US private sector was underweight US assets in 2010, it now holds the largest overweight in US assets in history. The world has taken the view that US exceptionalism will last indefinitely.

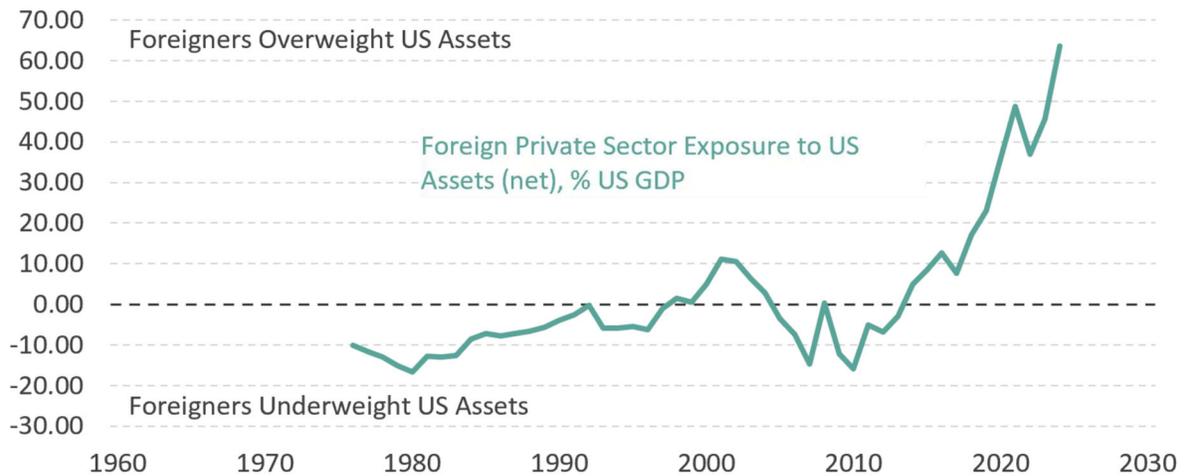
However, the cyclical forces that supported US outperformance are now reversing. First, the current US administration is pursuing a set of policies that overall are more likely to dampen economic growth. The combination of more restrictive immigration policies, lower federal employment, reduced government discretionary spending, and tariff policies will likely place downward pressure on US economic growth. Meanwhile, the policies in the rest of the world generally are moving to support stronger economic activity—higher defense and infrastructure spending, greater fiscal demand-side support, lower taxes, and deregulation. Additionally, since the US has eased monetary policy the least over the past 18 months, monetary policy is offering far less support to prospective economic growth relative to other countries around the world. Lastly, the structural headwinds to growth in Europe in the areas of competitiveness, energy, sovereign fiscal positions, and banking systems as well as in China's real estate sector are either diminishing or reversing altogether.

Finally, the strategic goal of the US administration to reverse some measure of globalization is dollar negative. A reversal of globalization will undermine corporate profitability, undercutting the case for owning US equities relative to prior trends. An improvement in the US external balance will require a weaker dollar as well.

Overall, the dollar is likely to weaken further through the balance of 2025.

## Foreign Private Sector Exposure to US Assets (net)

% US GDP, As of 12/31/2024



Source: Haver Analytics

## GLOBAL EQUITIES OUTLOOK

# Great expectations reversal



**Sorin Roibu, CFA**

Portfolio Manager & Research Analyst

The global equity landscape is experiencing a fundamental shift as the era of US market dominance faces mounting challenges. With first quarter gross domestic product (GDP) turning negative and trade policy uncertainty weighing on growth prospects, the US economy appears increasingly vulnerable to stagflationary pressures from tariff-driven inflation and constrained Federal Reserve policy. This environment is driving what we call the "Great Expectations Reversal," a strategic pivot away from overvalued US markets toward undervalued international opportunities.

The US faces multiple headwinds: shaky consumer confidence, heightened trade uncertainty, and a challenging handoff from government to private sector leadership. While labor markets remain resilient, downside risks are increasing. Equity markets continue to shrug off these growing warning signs, with US market valuation levels back to historic highs.

Europe is emerging as the standout destination, bolstered by German fiscal stimulus, attractive valuations, and resilient labor markets. European banks have already delivered exceptional returns, with some gaining 35% to 45% year to date.

Within emerging markets, Brazil presents compelling opportunities with strong fundamentals and solid economic performance. Meanwhile, China offers selective prospects, particularly in companies benefiting from AI.

With US market capitalization-to-GDP ratios reaching levels last seen in 1929 and 1936, the risk-reward dynamic increasingly favors international diversification. We believe investors should consider reducing US exposure while capitalizing on the fundamental strength emerging across global markets.

## US EQUITIES

# Overly optimistic market belies risks



**Patrick S. Kaser, CFA**  
Portfolio Manager

Given all that has transpired geopolitically and economically, we are surprised by the market's first-half strength. Earnings estimates have fallen relative to the start of the year, but the market remains near highs, leaving valuations more stretched than before Trump's April 2 "Liberation Day."

With economic data weakening in mid-June and future volatility measures quite elevated, we are concerned that the market is getting it wrong, even if near-term volatility has subsided. We believe a cautious stance is warranted and remain overweight less-cyclical sectors as risks continue to loom large and appear to not be factored into market valuations.

Early in the second half of the year, we will be watching for federal budget legislation and debt ceiling discussions; later in the year, we will be looking for evidence of tariff impacts and trade deals that so far have not been meaningful. Energy prices and Middle East tensions will continue to be among the many geopolitical headlines to watch, but we would be foolish to hazard a guess on anything other than continued uncertainty.

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## Index definitions

Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future results.**

**ICE BofA US High Yield Index** tracks the performance of USD-denominated below investment grade corporate debt publicly issued in the major domestic markets.

**ICE BAML BB US High Yield Index** is a subset of the ICE BAML US High Yield Index, including all securities rated BB1 through BB3, inclusive.

**ICE BAML B US High Yield Index** is a subset of the ICE BAML US High Yield Index, including all securities rated B1 through B3, inclusive.

**ICE BAML CCC & Lower US High Yield Index** is a subset of the ICE BAML US High Yield Index, including all securities rated CCC1 or lower.

**ICE BAML US Corporate Index** tracks the performance of U.S. dollar-denominated investment grade corporate debt publicly issued in the U.S. domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P, and Fitch), at least 18 months to final maturity at the time of issuance, at least one year remaining term to final maturity as of the rebalancing date, a fixed coupon schedule, and a minimum amount outstanding of \$250 million.

**ICE BAML AAA US Corporate Index**, a subset of the ICE BofA US Corporate Master Index tracking the performance of US dollar-denominated investment grade-rated corporate debt publicly issued in the US domestic market. This subset includes all securities with a given investment grade rating AAA.

**ICE BAML AA US Corporate Index** is a subset of the ICE BAML Corporate Index, including all securities rated AA1 through AA3, inclusive.

**ICE BAML A US Corporate Index** is a subset of the ICE BAML US Corporate Index, including all securities rated A1 through A3, inclusive.

**ICE BAML BBB US Corporate Index** is a subset of the ICE BAML US Corporate Index, including all securities rated BBB1 through BBB3, inclusive.

**ICE BofA AAA Fixed-Rate US Asset-Backed Securities Index** is the AAA-rated subset of the ICE BofA US Fixed-Rate Asset-Backed Securities Index, which tracks the performance of USD-denominated investment-grade fixed-rate asset-backed securities publicly issued in the US domestic market.

**ICE BAML US Agency Mortgage-Backed Securities Index** tracks the performance of U.S. dollar-denominated fixed rate and hybrid residential mortgage pass-through securities publicly issued by U.S. agencies in the U.S. domestic market.

**ICE BofA AAA US Fixed Rate CMBS Index** tracks the performance of U.S. dollar-denominated AAA-rated fixed rate commercial mortgage-backed securities publicly issued in the U.S. domestic market.

**ICE BofA BBB US Fixed Rate CMBS Index** tracks the performance of U.S. dollar-denominated BBB-rated fixed rate commercial mortgage-backed securities publicly issued in the US domestic market.

**Morningstar LSTA US Leveraged Loan Total Return Index** is a market value-weighted index designed to measure the performance of the US leveraged loan market based upon market weightings, spreads, and interest payments.

**S&P 500 Index** is a broad measure of US domestic large cap stocks. The 500 stocks in this capitalization-weighted index are chosen based on industry representation, liquidity, and stability.

## WHAT ARE THE RISKS?

**All investments involve risks, including possible loss of principal.** Please note that an investor cannot invest directly in an index. Unmanaged index returns do not reflect any fees, expenses or sales charges. **Past performance is no guarantee of future results.**

**Fixed-income securities** involve interest rate, credit, inflation and reinvestment risks; and possible loss of principal. As interest rates rise, the value of fixed income securities falls.

**US Treasuries** are direct debt obligations issued and backed by the “full faith and credit” of the US government. The US government guarantees the principal and interest payments on US Treasuries when the securities are held to maturity. Unlike US Treasuries, debt securities issued by the federal agencies and instrumentalities and related investments may or may not be backed by the full faith and credit of the US government. Even when the US government guarantees principal and interest payments on securities, this guarantee does not apply to losses resulting from declines in the market value of these securities.

**International investments** are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. These risks are magnified in **emerging markets**. Investments in companies in a specific country or region may experience greater volatility than those that are more broadly diversified geographically.

The government’s participation in the economy is still high and, therefore, **investments in China** will be subject to larger regulatory risk levels compared to many other countries.

There are special risks associated with investments in **China, Hong Kong and Taiwan**, including less liquidity, expropriation, confiscatory taxation, international trade tensions, nationalization, and exchange control regulations and rapid inflation, all of which can negatively impact the fund. **Investments in Taiwan** could be adversely affected by its political and economic relationship with **China**.

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