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Second quarter 2025 outlook

Bonds have provided a steady hand in volatile markets

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The Trump administration's flurry of executive orders has heightened market uncertainty—especially the recent tariff announcements. Stocks declined, but bond markets remained more stable, reinforcing fixed income's role in balancing equity exposure and generating returns through income. In this environment, bonds may continue to offer attractive income and total return potential, as well as provide a source of liquidity. Active managers may help investors navigate turbulent markets.

KEY TAKEAWAYS:

- We believe volatility will remain high given the fluid tariff situation and the difficulty in assessing its effect on growth and inflation.
- Starting yields continue to remain higher than historical levels, providing steady, attractive income amid elevated uncertainty.
- We particularly favor senior loans, preferred securities and securitized sectors such as commercial mortgage-backed securities that have less direct exposure to the effect of tariffs.

TARIFFS SLOW GROWTH, AND UNCERTAINTY RUNS HIGH

Economic activity remained strong in the first quarter, although we see signs of potential slowing ahead. Tariff uncertainty remained elevated due to a wide range of possible policy outcomes and disparate economic impacts. This uncertainty affected surveys of consumer and business sentiment, which softened in March. At the same time, consumer inflation expectations moved higher. Nevertheless, actual data regarding job creation, personal income, retail sales and industrial production remained healthy.

While economic data had been generally solid, the Liberation Day tariff announcements on 02 April clouded our economic forecasts. The Trump administration announced higher tariffs on every trading partner (except Canada and Mexico). Although the final details remain unclear as the situation evolves, we expect the new trade policy will negatively impact global growth.

As a result, we reduced our 2025 U.S. GDP growth estimate to around 0.5%, low but still positive. Tariffs will likely increase inflation as prices rise to reflect their cost. We currently expect U.S. core PCE inflation to move materially higher to around 3.5% this year.

Globally, we anticipate slower economic growth and retaliatory tariffs to be levied against the U.S. Our European growth outlook is more balanced because of increasingly supportive monetary and fiscal policy, but the potential impact of a global trade war looms large. This factor also weighs on our China forecast: our expected 2025 growth range is now 3.75%-4.25%, below the government's target. Both Chinese and European growth trends should depend largely on the scope of tariffs and the speed of implementation.

THE PACE OF RATE CUTS IS SLOWING

We expect the Fed to continue cutting interest rates but at a slower pace. Uncertainty around the U.S. macroeconomic and fiscal policy outlooks has increased, complicating the Fed's path forward. We think the central bank will wait to see the final scope of the policy and tariff changes and their impact in the hard economic data before resuming cuts.

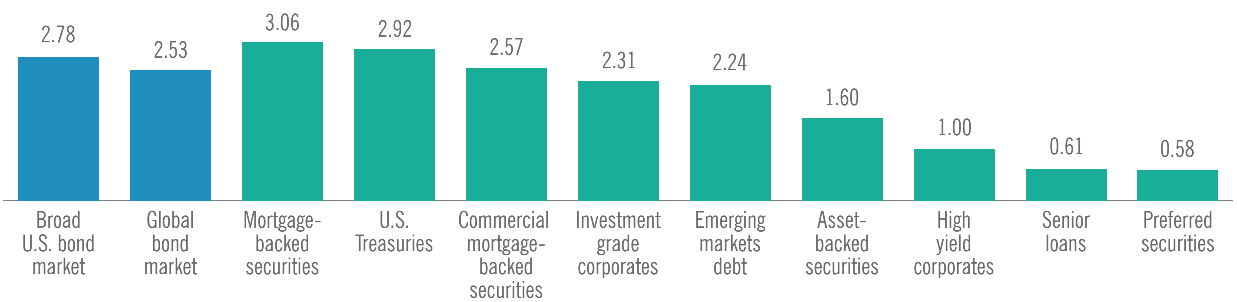
Our current base case forecast is for two more 25 basis points (bps) cuts this year, depending on inflation and growth data. This shift would take the fed funds rate to around 3.75%-4.00% by year end.

Outside the U.S., other central banks —including the European Central Bank (ECB), Bank of England and Bank of Canada — cut rates during the quarter, while the Bank of Japan hiked rates in January to their highest level since 2008.

Although we see increasing risks to growth, central bank reactions seem less certain due to reflationary pressures and previous policy rate reductions. We anticipate two more rate cuts from the ECB, although additional expectations for fiscal easing have reduced the need for significant monetary support. In China, policymakers will likely continue fiscal policy support, although substantial monetary easing is unlikely.

Figure 1: Fixed income performed well across the board

First quarter 2025 total return (%)



Data source: Morningstar Direct, 31 Mar 2025. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: broad U.S. bond market:** Bloomberg U.S. Aggregate Index; **global bond market:** Bloomberg Global Aggregate Index; **mortgage-backed securities (MBS):** Bloomberg U.S. Mortgage-Backed Securities Index; **emerging markets debt:** JPM EMBI Global Diversified; **U.S. Treasuries:** Bloomberg U.S. Treasury Index; **investment grade corporates:** Bloomberg U.S. Corporate Investment Grade Index; **commercial mortgage-backed securities (CMBS):** ICE BofA AA-BBB U.S. Fixed Rate CMBS; **high yield corporates:** Bloomberg U.S. Corporate High Yield 2% Issuer Capped Index; **preferred securities:** ICE BofA U.S. All Capital Securities Index; **asset-backed securities (ABS):** ICE BofA AA-BBB US Fixed Rate ABS; **senior loans:** S&P UBS Leveraged Loan Index.

BOND ALLOCATIONS MAY BALANCE EQUITY RETURNS

During the first quarter, bonds performed their traditional portfolio role of helping to steady overall returns during a volatile period (Figure 1). The Bloomberg U.S. Aggregate Index, a broad measure of investment grade bonds, finished in positive territory with a 2.78% total return. In contrast, stocks reacted negatively to extreme policy uncertainty, with the S&P 500 Index declining -4.27%. This difference in returns underscores the importance of maintaining asset class diversification, especially during times of market stress.

Intermediate- to longer-term yields declined due to concerns about tariffs and an economic slowdown, representing a general flight to quality as equities sold off and the market interpreted the March Fed meeting as dovish. The 10-year Treasury yield fell -0.35% in the first quarter, finishing at 4.23%. Fixed income asset classes posted positive returns across all major sectors due to declining rates, continued income generation and only modestly widening credit spreads. Higher quality, more rate-sensitive sectors — such as mortgage-backed securities and U.S. Treasuries — performed best.

INCOME HAS CONSISTENTLY DRIVEN RETURNS

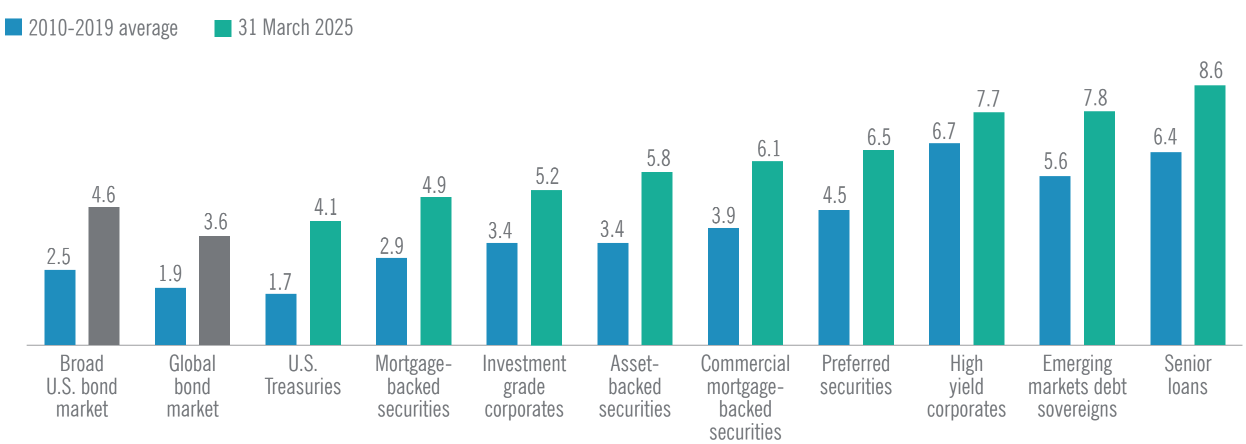
While investors sometimes focus on the impact of changing interest rates on bond prices, it is important to remember that bonds are designed to produce income. Not surprisingly, income has been the largest driver of fixed income returns over time, accounting for almost all of the broad U.S. bond market's returns.[1]

Starting yields remain at levels higher than we've seen in the past, continuing to create generous income potential (Figure 2). This income will help to steady fixed income returns, regardless of rate changes. If the Fed continues to respond slowly, as we currently expect, the shortest rates can also remain elevated. Longer-term rates can be more difficult to assess as they incorporate the growth and inflation outlooks, which are extremely fluid due to the new tariffs.

We reduced our year-end 10-year yield forecast to 4.0%, and expect a much broader range of potential outcomes.

Figure 2: Fixed income offers generous, historically high yields

Yield-to-worst (%)



Data source: Bloomberg, L.P., BofA, Standard & Poor's, 31 Mar 2025. **Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: broad U.S. bond market:** Bloomberg U.S. Aggregate Index; **global bond market:** Bloomberg Global Aggregate Index; **U.S. Treasuries:** Bloomberg U.S. Treasury Index; **mortgage-backed securities (MBS):** Bloomberg U.S. Mortgage-Backed Securities Index; **investment grade corporates:** Bloomberg U.S. Corporate Investment Grade Index; **asset-backed securities (ABS):** ICE BofA AA-BBB US Fixed Rate ABS; **commercial mortgage-backed securities (CMBS):** ICE BofA AA-BBB U.S. Fixed Rate CMBS; **preferred securities:** ICE BofA U.S. All Capital Securities Index; **high yield corporates:** Bloomberg U.S. Corporate High Yield 2% Issuer Capped Index; **emerging markets debt:** JPM EMBI Global Diversified; **senior loans:** S&P UBS Leveraged Loan Index.

ACTIVE MANAGEMENT MAY HELP NAVIGATE VOLATILITY

During more challenging markets, it can be especially comforting to know that professional managers are actively monitoring portfolios and adjusting their composition as the economy slows or new policies are implemented. Intensive bottom-up fundamental research can help uncover industries, companies and securities that may benefit from evolving conditions.

We continue to allocate to higher yielding credit sectors across our portfolios, with an eye toward quality as the economy slows. We remain relatively conservatively positioned and are generally at the mid-point of our risk budgets across our portfolios.

Wider credit spreads have recently made the higher yielding credit sectors more attractive, but the uncertain environment makes us somewhat cautious about adding risk or making major changes too quickly. However, we are maintaining higher levels of liquidity in our portfolios to allow flexibility to add risk in the event that valuations become compelling.

We continue to balance credit risk with duration risk across our portfolios. Broad diversification across sectors, correlations and risk factors should cushion unexpected volatility.

EMPLOY MULTISECTOR STRATEGIES

By allocating to strategies that use a wide range of sectors, investors can take advantage of relative value opportunities across and among sectors as they arise. Additionally, such multisector strategies tend to have high correlations to the bond market and low correlations to equities, making them useful tools for offsetting stock market volatility.

As we look across the fixed income landscape, we see several attractive opportunities. Senior loans could yield upwards of 8%, even after the 50 bps of Fed rate cuts we anticipate this year. Preferred securities also offer attractive yields, and banks and insurance companies (the largest issuers of preferreds) continue to exhibit healthy underlying fundamentals. Securitized sectors — including collateralized loan obligations and certain commercial mortgage-backed and asset-backed securities — offer attractive valuations compared to other investment grade sectors, with less direct exposure to the effect of tariffs.

To deploy these concepts in a portfolio, consider these investment ideas:

Multisector bond funds. Broadly diversified, multi-sector bonds across investment grade and high yield securities offering potential for high income and reduced interest rate sensitivity.

Core plus funds. Traditional U.S. fixed income with up to 30% in higher yielding plus bond sectors, which provide diversification and potential for additional return.

Core impact funds. Core U.S. fixed income focused on impact and ESG leadership with goal of providing favorable returns versus the broad bond market.

Senior loans. Below investment grade senior loan securities with the potential for reduced interest rate sensitivity and high income.

Preferred securities. Preferred and other income producing securities offering attractive income potential, qualified dividend income and risk/reward balance.

OUTLOOK

Tariffs are slowing growth

We lowered our U.S. economic growth forecast to around 0.5% for 2025, reflecting the headwinds from higher tariffs. We continue to anticipate a modest rise in unemployment but now expect core PCE inflation to move materially higher to around 3.5% this year. These forecasts remain highly fluid depending on how tariff policies play out in the months ahead.

We expect the Fed to continue cutting interest rates but at a slower pace. We forecast two more 25 bps cuts this year, bringing the policy rate to around 3.75%-4.00%. The ECB is set to lower rates further as well — with two more cuts likely this year — although expectations for additional fiscal easing have reduced the need for significant monetary support. In China, policymakers will likely continue fiscal policy support, although substantial monetary easing is unlikely.

We have lowered our year-end forecast for the 10-year Treasury yield to 4.00% but also broadened the potential year-end range to 3.25%-4.50%, reflecting the uncertainty around tariff policies.

We continue to favor spread sectors and credit risk in asset allocation, with an up-in-quality bias within asset classes. We believe credit spreads will likely widen in the coming months, which could present more attractive entry points for increasing risk.

For more information, please visit us at nuveen.com.

Endnotes

1 As of 31 Mar 2025, 100% of the annualized total return of the Bloomberg U.S. Aggregate Bond Index was derived from coupon return (as opposed to price appreciation from 31 Jan 1976 to 31 Mar 2025).

Sources

Inflation: U.S. Bureau of Labor Statistics Consumer Price Index for All Consumers. **Employment:** Bloomberg, L.P., Bureau of Labor Statistics, Nuveen. **Global debt and yields:** Bloomberg, L.P.

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