Monthly Fixed Income Market Update

VICTORY income investors®
A VICTORY CAPITAL® INVESTMENT FRANCHISE

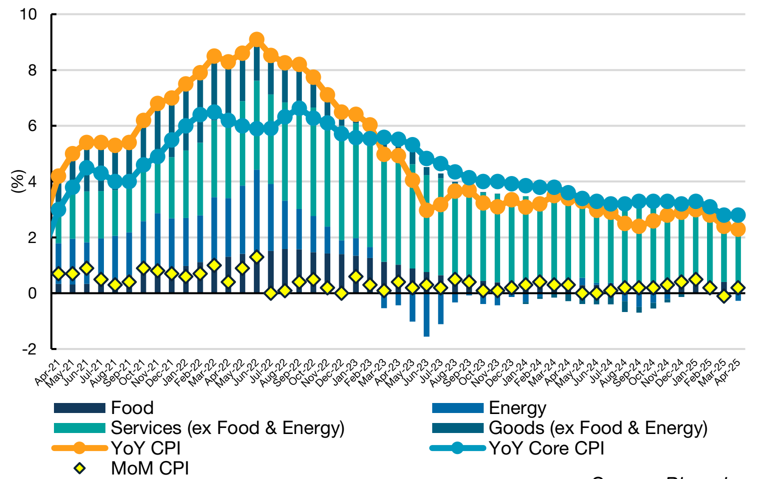
As of May 31, 2025

Key Takeaways

1. Treasury yields rose in May, in tandem with those of other developed markets, driven by strong economic data, elevated inflation expectations and concerns about the U.S.'s fiscal future. The 10-year yield ended the month at 4.50%, up from April's 4.16%.
2. Risk assets performed well in May, recovering from April's lows, as delays in the most severe tariffs encouraged the stock and credit markets to rally. Divergences in the hard and soft economic data, however, reflect that the consumer is still hesitant to believe we are out of the woods.
3. What does Moody's downgrade of U.S. debt mean for investors? We've investigated the rationale for past downgrades and put them into context for our readers.

The Month in Charts

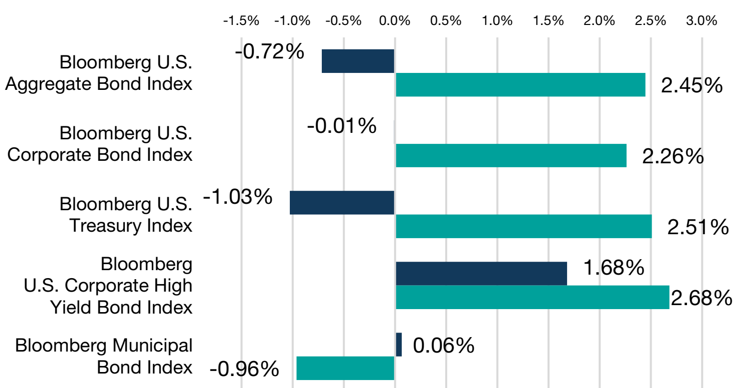
April CPI, reported in May, fell to 2.3% year-over-year and Core CPI held at 2.8% year-over-year. The Federal Reserve (the Fed) kept rates at 4.25%-4.50% at their May meeting. The minutes from the Fed's May meeting noted increased inflation projections and lower GDP forecasts for 2025 and 2026 relative to their March meeting. While through the remainder of the month markets reacted positively to the adjustments made to certain higher-than-expected tariff announcements in April, there is considerable uncertainty in the Fed's economic outlooks. Market pricing for future interest rate reductions has moved to two rate cuts throughout the rest of the year, less than the four priced at the end of April.



Source: Bloomberg

Performance was mixed in May; high yield corporates were the best performers while Treasuries declined.

Returns (%) for Fixed Income Indices

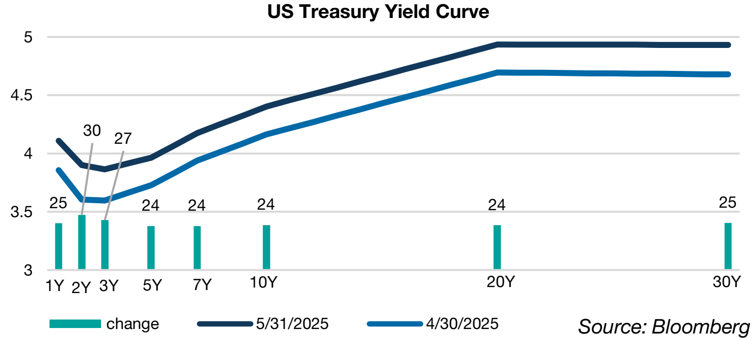


Performance as of May 31, 2025 ■ Month to Date ■ Year to Date

Past performance is no guarantee of future results. *Source: Bloomberg*

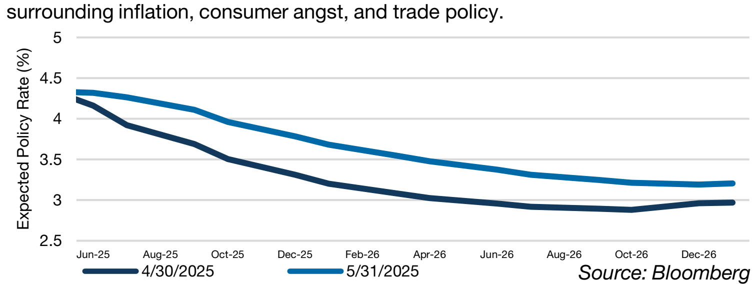
The Treasury yield curve spiked mid-May but moved down toward the end of the month as concerns surrounding tariffs eased somewhat. Yields ended higher month-over-month. The rise in yields for longer maturities made headlines amidst the fiscal discipline concerns with the One Big Beautiful Bill Act (H.R. 1), the broad taxation and spending package that has already passed in the House and now heads to the Senate. Large, sustained deficits played into Moody's decision to downgrade U.S. debt to AA1 from AAA.

US Treasury Yield Curve



Source: Bloomberg

Markets reduced rate cut expectations through 2025 following uncertainty surrounding inflation, consumer angst, and trade policy.



Source: Bloomberg

Credit spreads tightened month-over-month as the volatility following "Liberation Day" settled and preliminary trade agreements took effect. Investment grade spreads tightened 18 bps and high yield spreads tightened 69 bps.

				Quarter		Change		
Asset Class	Yield	Spread	Qtrly Trend	Tight	Wide	MoM	QoQ	YoY
U.S. Treasury	4.19							
U.S. MBS	5.15	42		33	49	-2	11	-9
U.S. Corporate	5.22	88		85	118	-18	1	4
U.S. Corporate High Yield	7.72	315		282	452	-69	33	10
CMBS	4.91	88		78	101	-10	8	-7
ABS	4.62	58		48	74	-15	9	6
A	5.08	75		74	101	-15	-1	2
BBB	5.46	112		106	146	-22	5	6
BB	6.38	193		175	302	-56	17	10

Source: Bloomberg; Asset Classes represented by: ICE BofA US Treasury & Agency Index, Bloomberg US MBS Index, Bloomberg US Agg Total Return Value Unhedged USD, ICE BofA US High Yield Index, ICE BofA US Fixed Rate CMBS Index, ICE BofA US Fixed Rate Asset Backed Securities Index, Bloomberg US Agg A Total Ret Index, Bloomberg US Agg Baa Total Ret Index, Bloomberg Ba US High Yield TR Index. MoM/QoQ/YoY as of 05/31/2025

Frequently Asked Questions

What does Moody's downgrade of U.S. debt mean for investors? In the table at right, we show the historical downgrades and the surrounding economic conditions. While the health of the economy as measured by inflation and unemployment varies across each downgrade, a common thread through each of the rating agencies' rationale for downgrade is the looming federal deficit and lackluster attempts to rein in spending.

Markets reacted quickly to each downgrade – in 2011 equity markets sold off sharply in response to S&P's downgrade with the S&P 500 dropping 19%-plus, peak to trough. In 2023 the S&P 500 fell 6% following Fitch's downgrade, and this past month's reaction was even more muted (not even reaching the lows we saw following "Liberation Day"). With each subsequent downgrade of U.S. debt, market reactions mellowed, highlighting investor acquiescence with the credit rating agencies assessment of the U.S. government's ability to repay debt. Concerns surrounding the deficit and potentially unsustainable fiscal trajectory are not new and are unlikely to unseat the U.S. Treasury as the largest and most liquid bond market. It is our view that this downgrade is simply telling a story that the market had already priced in. For those concerned that rising fiscal debt may introduce higher volatility and reduced growth, we believe a well-diversified portfolio inclusive of high-quality fixed income could offer a buffer.

S&P August 2011	Fitch August 2023	Moody's May 2025
Low Inflation	High Inflation	Moderate Above Target Inflation
High Unemployment	Low Unemployment	Lower Unemployment
Low Fed Policy Rates	High Fed Policy Rates	Easing, But Higher Fed Policy Rates

What We'll Be Watching in the Month Ahead

We will be watching the economic health indicators, inflation, and the following in the month to come:

- **June 6th, the Nonfarm Payrolls and Unemployment Rate:** These reports will be critical for the Fed in assessing the health of the labor market and help inform future rate reductions.
- **June 11th, the next CPI will be released:** This report will offer insight into whether inflation is continuing to trend downward towards the Fed's 2% target.
- **June 18th, the next FOMC Rate Decision:** We, alongside the rest of the market, do not expect a rate cut at this meeting. However, the press conference following may provide further insight into the Fed's approach to tariff policies.

Bonding over Bonds

Our video series on the fixed income markets

In our #BondingOverBonds video series, experts discuss notable activity in the fixed income markets: Watch Now

All investments carry a certain degree of risk including the possible loss of principal, and an investment should be made with an understanding of the risks involved with owning a particular security or asset class. Interested parties are strongly encouraged to seek advice regarding the best options for their particular circumstances from qualified tax and financial experts.

The opinions are as of the date noted and are subject to change at any time due to changes in market or economic conditions. The comments should not be construed as a recommendation of individual holdings or market sectors, but as an illustration of broader themes.

Index performance includes reinvestment of dividends and other income but does not reflect management fees, transaction costs or expenses. One cannot invest directly in an index. **Past performance does not guarantee future results.**

Basis point "bps" is 1/100th of a percentage point. **Credit spread** is the difference in yield between a U.S. Treasury bond and another debt security of the same maturity but different credit quality. Credit spreads are the additional compensation that investors require to hold securities that are not as safe and liquid as those issued by the US Treasury. **The Treasury Yield Curve** shows the relationship between the US bond yield and the time to maturity. Yield and price have an inverse relationship. As the yield curve lowers, the price of bonds increase. **Core CPI:** CPI excluding food and energy. **Consumer Price Index (CPI),** a popular measure of inflation and deflation calculated by the Bureau of Labor Statistics, measures the monthly change in prices paid by U.S. consumers. **Personal Consumption Expenditure Price Index** is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services and is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior.

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