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Q2 2025 Bond Market Update: Bonds Stay the Course Amidst Volatility

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Despite a volatile start, fixed income broadly performed well in Q2 2025. Inflation continued to moderate, and while the U.S. Federal Reserve (Fed) held rates steady in May and June, the expectation for rate cuts later this year remain high. This solid performance was further supported by monetary easing from several other central banks, including the European Central Bank, the Bank of England, the Bank of Canada, and the central banks of Switzerland, Sweden and Norway. U.S. investment-grade and high-yield corporate bonds outperformed on both a quarterly and year-to-date basis, while municipal bonds lagged amid heavy new issuance, posting negative returns over both periods.

The charts below summarize the yield and performance of select fixed income tenors and indices as of June 30, 2025:

U.S. Treasury Yield Curve

Maturity	Yield	Change (Basis Points)	
		Month-to-date	Year-to-date
2-year	3.72	-18.0	-52.2
5-year	3.80	-16.5	-58.5
10-year	4.23	-17.3	-34.2
30-year	4.78	-15.6	-0.7

Source: Bloomberg, 30 June 2025 (US On/Off The Run Sovereign Curve)

U.S. Corporate (Investment Grade) Yield Curve

Maturity	Yield	Change (Basis Points)	
		Month-to-date	Year-to-date
2-year	4.32	-18.1	-38.6
5-year	4.60	-22.6	-45.5
10-year	5.19	-21.7	-28.5
30-year	5.80	-20.8	0.7

Source: Bloomberg, 30 June 2025 (USD US Corporate IG BVAL Yield Curve)

Municipal (AAA) Yield Curve

Maturity	Yield	Change (Basis Points)	
		Month-to-date	Year-to-date
2-year	2.61	-17.2	-20.7
5-year	2.72	-16.2	-18.2
10-year	3.21	-10.3	8.2
30-year	4.52	-2.0	64.9

Source: Bloomberg, 30 June 2025 (BVAL Muni AAA Yield Curve)

Index Characteristics and Returns

Index	Yield (Worst)	Modified Duration	Returns (%)	
			Q2 2025	Year-to-date
U.S. Treasury	4.06	6.01	0.76	3.79
U.S. Agency	4.20	3.68	1.30	3.44
U.S. Corporate Investment Grade	5.01	6.51	1.79	4.20
U.S. Corporate High Yield	7.05	3.06	3.57	4.55
U.S. Mortgage Backed Securities	4.97	5.90	1.13	4.14
Global Broad Market	3.72	6.25	1.16	2.39
Emerging Market Corporate	5.72	4.96	1.73	4.19
Municipal Investment Grade	4.04	6.61	-0.13	-0.63
Municipal High Yield	5.38	7.78	-0.73	-0.47
Municipal Taxable	5.08	7.65	0.77	3.70

Source: ICE DATA INDICES, LLC ("ICE DATA"), 30 June 2025. Past performance is no guarantee of future results. U.S. Treasury = ICE BofA US Treasury Index, U.S. Agency = ICE BofA US Agency Index, U.S. Corporate Investment Grade = ICE BofA US Corporate Index, U.S. Corporate High Yield = ICE BofA US High Yield Index, U.S. Mortgage Backed Securities = ICE BofA US Mortgage Backed Securities Index, U.S. Broad Market = ICE BofA US Broad Market Index March 2020 Regular Rebalance, Global Broad Market = ICE BofA Global Broad Market Index, Emerging Market Corporate = ICE BofA Emerging Markets Corporate Plus Index, Municipal Investment Grade = ICE BofA US Municipal Securities Index, Municipal High Yield = ICE US High Yield & Non-Rated Municipal Securities Index, Municipal Taxable = ICE BofA Broad US Taxable Municipal Securities Index.

Federal Open Market Committee (FOMC)

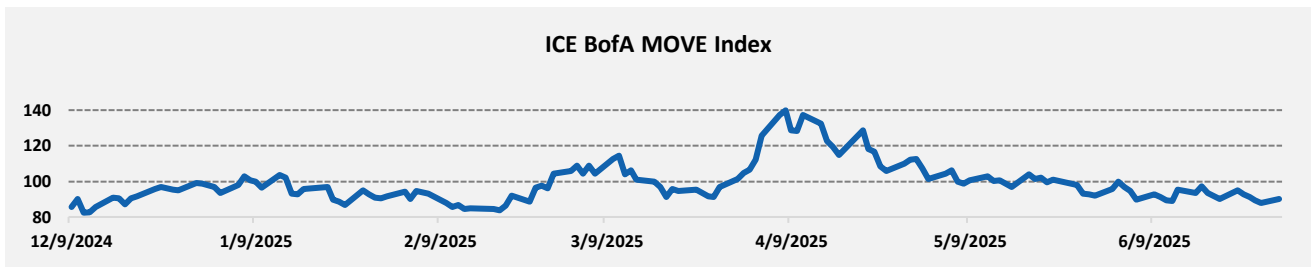
Fed Funds Rate - Upper Bound	4.50	Last FOMC Meeting	18-Jun-25
Fed Funds Rate - Lower Bound	4.25	Next FOMC Meeting	30-Jul-25
Fed Funds Effective Rate	4.33		
Discount Rate	4.50		

Source: Bloomberg, 08 July 2025

Source: Bloomberg. Past performance is not a guarantee of future results.

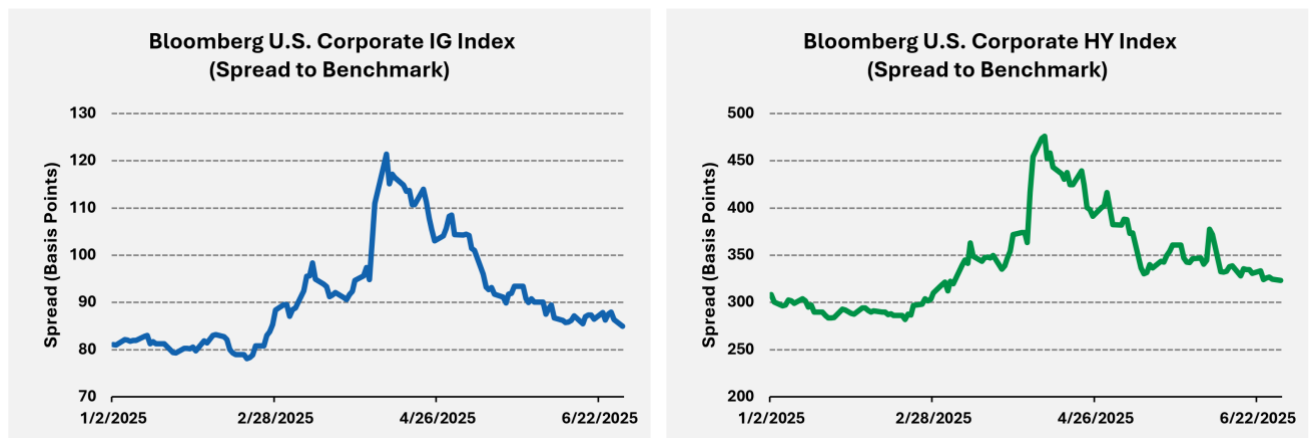
Volatility Gives Way to Opportunity

Volatility surged at the start of Q2 2025 following President Trump's April 2 "Liberation Day" as reciprocal tariffs heightened fears of higher inflation and slower global growth. The ICE BofA MOVE Inde — a widely followed measure of bond market volatility — briefly hit 140 on April 8, well above its 10-year average of 80. However, conditions stabilized in the weeks that followed, as the administration announced a 90-day delay of most reciprocal tariffs, allowing markets to grow optimistic about a de-escalation in trade tensions, as shown in the chart below.



Source: Bloomberg. Past performance is not a guarantee of future results.

Similar swings were also seen in the corporate bond market, where spreads, or the additional compensation bond investors earn over Treasury yields, tend to rise as uncertainty increases. Data from early April showed spreads for both high-yield and investment-grade corporates spike, only to trend significantly lower over the remainder of the quarter. The Bloomberg U.S. investment grade corporate index ended the quarter at +85 over Treasury yields, 36 basis points below April highs, while the high yield index tightened more than 150 basis points to +323, as illustrated in the charts below.



Source: Bloomberg. Past performance is not a guarantee of future results.

This tightening helped drive strong returns for lower-rated bonds, reversing the trend in Q1 of higher-rated outperformance. For example, the Bloomberg U.S. High Yield Index returned 3.53% in Q2, compared to 0.85% for the Bloomberg Aaa Corporate Index, as shown in the table below.

2025 Total Return - Treasury & Corporate Indices			
Index	Q1 Total Return	Q2 Total Return	YTD Total Return
Bloomberg U.S. Treasury Index	2.92%	0.85%	3.79%
Bloomberg Aaa Corporate Index	2.69%	0.84%	3.55%
Bloomberg Aa Corporate Index	2.43%	1.33%	3.79%
Bloomberg A Corporate Index	2.38%	1.80%	4.22%
Bloomberg Baa Corporate Index	2.21%	1.95%	4.21%
Bloomberg U.S. Corporate High Yield Index	1.00%	3.53%	4.57%

Source: Bloomberg. Past performance is not a guarantee of future results.

Despite ongoing geopolitical tensions, fixed income delivered solid results in Q2, underscoring the importance of diversification in a shifting macro environment. As we move into the second half of the year, markets will remain focused on the trajectory of inflation and developments in trade policy. While volatility is likely to remain high, attractive yields continue to create compelling

opportunities across fixed income sectors.

Fixed income. Flexible thinking.

A prudent approach to fixed income investing calls for diversification across both credit and duration exposure. As always, Dynamic recommends staying balanced, diversified and invested. Despite short-term market pullbacks, it's more important than ever to focus on the long-term, improving the chances for investors to reach their goals.

Bill Smith serves as president, Portfolio Management & Trading, of Harmont Fixed Income in Phoenix.

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