NEUBERGER BERMAN

Fixed Income Investment Outlook 3Q 2025

Riding the Rates Wave

In the wake of an eventful quarter, we believe that more benign inflation data and softer but still positive growth could soon prompt the Federal Reserve to resume rate cuts, joining other central banks that have maintained easing polices. While tepid, economic growth remains positive globally and, in the U.S., could improve toward the end of the year and into 2026. In this environment, we currently favor exposure to shorter-term U.S. Treasuries, as well as opportunities in high yield and local currency-denominated emerging market debt, with tariff-related volatility posing a key risk.

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Riding the Rates Wave

We believe the Federal Reserve is likely to soon join other central banks in further cutting interest rates, likely providing a tailwind for shorter-duration U.S. bonds.

The last few months have been eventful to say the least, from tariffs to Middle East conflict to the passage of U.S. budget legislation, but ultimately impacts on fixed income have been fairly muted.

The Trump administration's announcement of the tariff "Liberation Day" on April 2 inaugurated a period of extreme volatility in financial markets trying to assess the potential levels and impacts of proposed U.S. levies on imports. Postponement until July (and then August) of more severe tariffs helped risk assets reverse course, although the dollar continued its sharp decline amid foreign skepticism over U.S. deficit spending. In geopolitics, the sharp escalation—and swift apparent conclusion—of the Iranian conflict created a temporary spike in oil prices but otherwise had little effect on global markets. Meanwhile, the July 4th enactment of the U.S. President's "Big, Beautiful" budget law was greeted with a mixture of relief and worry over fiscal strains, only to be overshadowed within days by new tariff threats, perceived by some as a negotiation tactic.

As is often the case, bond investors had their eye less on the commotion and more on the ultimate drivers of returns—growth and inflation. There, the overall backdrop was relatively benign, with "hard" U.S. growth data coming in better than "soft" sentiment-driven data, and inflation continuing to recede even amid worries about the impact of tariffs on prices. In Europe, inflation is also fading, but growth weakness is being tempered by new spending, particularly in Germany given its new commitment to infrastructure and defense. Japan is in solid condition and China may be on the mend, aided by policy initiatives.

Looking ahead, we see broad potential for rate cuts, particularly in the U.S., where softer near-term growth, encouraging disinflation and more labor market ambiguity could curtail the central bank's wait-and-see stance on tariff impacts. (Current pressure on Fed leadership could conceivably prove a risk, which we are watching closely.) Easing could prove beneficial to short- to intermediate-term bonds, although longer-dated U.S. issues still face questions over deficit spending. While tariff noise may continue, the world appears likely to avoid recession, reinforcing the justification for tight corporate credit spreads. Among sectors, we think high yield bonds offer relative advantage, while emerging markets debt issued in local currencies could prove a bright spot given dollar weakness, moderate inflation and resilient growth.

We provide our key investment themes for the quarter on the following pages.

1. U.S. Growth and Inflation Are Easing, but Questions Remain

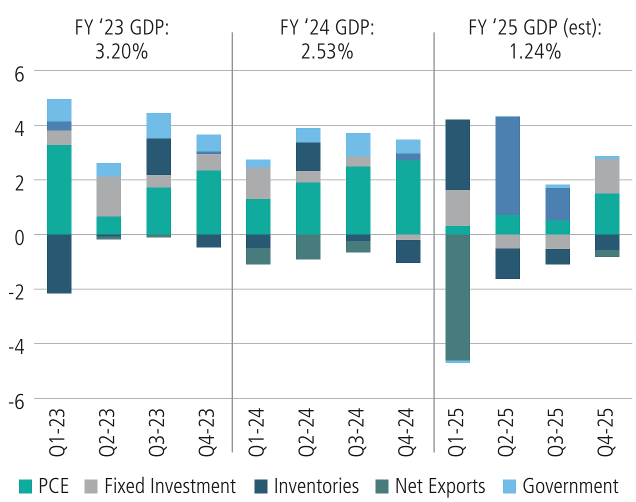
Tariffs have been a key stumbling block for corporate managements and investors this year, given the relatively extreme "opening bids" by the Trump administration and the wide range of potential outcomes for tariff levels and impacts, depending on results from negotiations across much of the globe. However, in the midst of this uncertainty, the U.S. economy has remained resilient, in part due to an acceleration of buying to front-run tariff impacts, even as sentiment has remained more negative. In our view, effects on growth are likely to show up more obviously over the next few months in inventories, consumption and investment.

That said, although friction around tariffs appears to ebb and flow (with August serving as the next hard deadline for dealmaking), we believe that uncertainty around trade could ebb toward the end of the year, providing more of a tailwind for growth in the second half of 2025 and into 2026. Supporting a reacceleration could be the ongoing deregulatory efforts of the Trump administration, combined with the passage of the tax and spending law, which took a major U.S. tax hike off the table and provided new incentives for corporate investment.

Inflation has been gradually easing, supported by declining shelter prices, with little impact from tariffs so far. One notable trend for pricing is the concentration of payroll growth in health and education, underscoring the muted condition of the broader labor market. Limits on immigration have helped keep the unemployment rate steady by dampening the overall supply of workers while muddying the broader labor picture. Tariffs could further drive consumer prices, but we believe that, even with worst-case levies, the inflation impact could be muted.

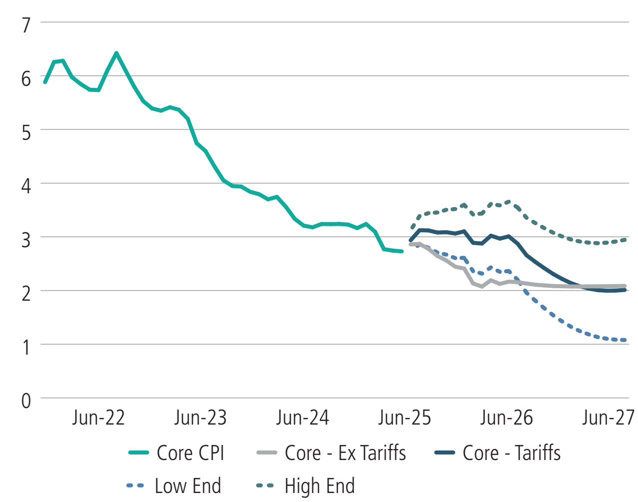
RECESSION WILL LIKELY BE AVERTED

GDP Components and Estimates



INFLATION IS BEHAVING DESPITE THE TARIFF WILDCARD

Core CPI Estimates (%)



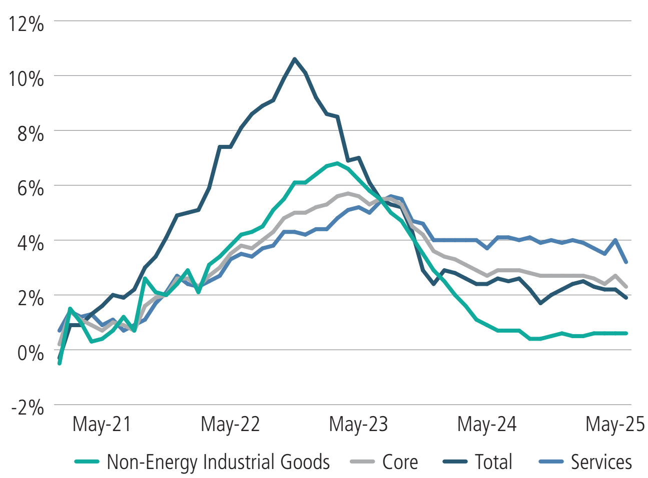
Source: U.S. Census Bureau, Tax Foundation, Neuberger Berman calculations, as of June 17, 2025. Tariff range spans the minimum (4.5%) and maximum (27.5%) estimates calculated from various proposals. The median estimate of the distribution, which includes ongoing negotiations and shifting trade balances, is 12.5%.

2. Even as Europe Stabilizes, Stagnation Remains an Issue

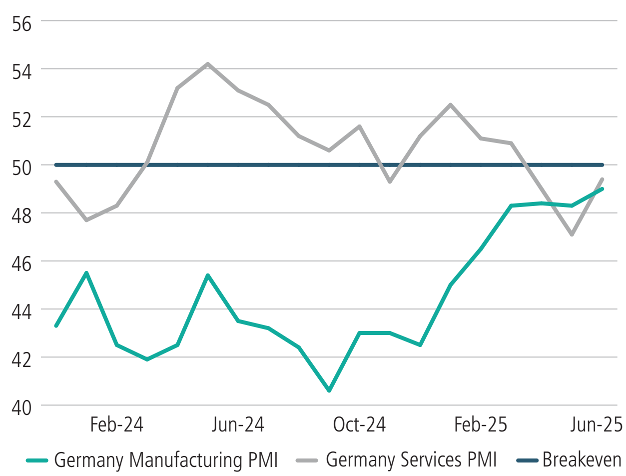
Despite still-sluggish growth, a key source of Europe's recent economic optimism is the current fiscal plan by the German government, moving past previous spending limits to help jumpstart infrastructure and defense. That said, the impacts appear to be largely stabilizing rather than inflationary given broader issues with economic weakness. For the bond market, a major issue is the absorption of new Bund supply, estimated at around €15 billion of additional issuance in the third quarter and around €10 billion for the fourth.

Meanwhile, U.S. tariffs remain an ongoing concern. The Trump administration's "90-day pause" followed by another month-long extension failed to remove uncertainty, which has weighed on capital expenditures and household spending, thereby contributing to persistently subpar growth. A strong tourist season should benefit the south of Europe, but the benefits will largely end by the fall.

EUROZONE INFLATION IS MODERATING



GERMAN PMIs ARE SHOWING IMPROVEMENT

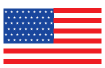
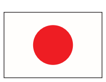


Source: EuroStat, Bloomberg, as of June 30, 2025.

3. The U.S. Is Poised to Join Global Easing Trend

Despite favorable U.S. inflation trends, the "known unknown" of tariff impacts has kept the Fed on hold for the past few months. Given a benign labor picture (and pressure to introduce rate cuts) we believe that U.S. central bankers will become more comfortable with further easing, likely reducing rates by a full percentage point within the next 12 months—and potentially sooner than the market expects. In Europe, German spending plans are helping the overall economic picture, but not enough to discourage further ECB rate cuts, of which two more appear likely this year. Although Britain continues to face inflationary pressure, the Bank of England may maintain its current quarterly rate-cutting pace. Often the outlier, Japan is likely to introduce another two rate hikes through 2026.

CENTRAL BANK POLICY RATE OUTLOOK (DEVELOPED MARKETS)

Central Bank	Neuberger Berman Expectations	Neuberger Berman Outlook
Fed 	• 2025: 2 Cuts • 2026: 2 Cuts • 2027: 0 Cuts • NR[1]: 3.50%	• The Fed remains firmly in an easing cycle, although uncertainty around tariff-driven inflation is keeping further rate cuts on hold for now. • That said, we think the Fed will soon resume rate adjustments, delivering four cuts from late 2025 to early 2026, with the neutral rate settling at around 3.25 – 3.75%. The timing of reaching that neutral rate remains uncertain due to the tariff issue.
ECB 	• 2025: 2 Cuts • 2026: 0 Cuts • 2027: 1 Hike • NR[1]: 2.00%	• The new German public plan has only slightly improved currently anemic European growth potential. Increased imports from Asia due to the trade war and core inflation close to the 2% target should lead the ECB to tiptoe toward a more accommodative monetary policy. • We expect the ECB to cut its key rate two more times this year to 1.5%, or below its 2% neutral rate.
BoE 	• 2025: 2 Cuts • 2026: 2 Cuts • 2027: 0 Cuts • NR[1]: 3.25%	• BoE commentary has pointed to more willingness to ease—even with persistent inflation pressures—given slow economic growth. Concerns about stagflation due to fiscal policies are an ongoing risk to this outlook. • We now expect easing to continue at a quarterly pace into 2026, with the policy rate landing at around 3 – 3.5%.
BoJ 	• 2025: 1 Hike • 2026: 1 Hike • 2027: 0 Hikes • NR[1]: 1.00%	• The BoJ raised rates by 25bps in January, in line with its stated goal of gradually moving policy to a neutral level. • Due to uncertainty around U.S. tariff negotiations, we expect the BoJ to raise rates only once more in 2025 (in Q4) and once in 2026 to reach a neutral rate of around 1%.
RBA 	• 2025: 3 Cuts • 2026: 1 Cut • 2027: 0 Cuts • NR[1]: 3.00%	• The RBA is now on hold. Uncertainty around the timing of impacts from U.S. tariffs should maintain its current caution. However, we think the RBA could deliver three more cuts this year and ultimately place its policy rate at around its 2.75% – 3% estimate of the neutral rate.

[1] NR = Neutral Rate

Source: Bloomberg, Neuberger Berman. As of July 7, 2025. Our expectations for 2025 reflect the remaining number of expected rate cuts/hikes in 2025.

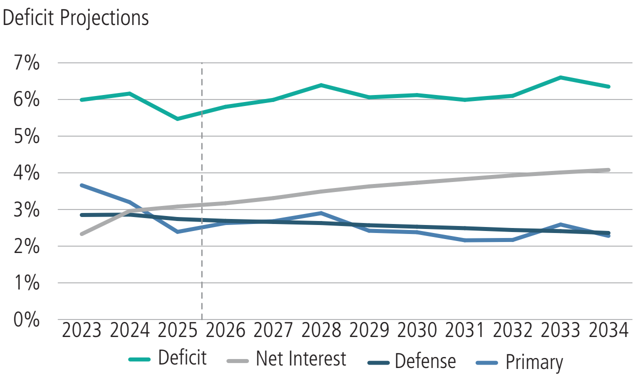
4. Term Premium and Foreign Sentiment Remain Key Variables for U.S. Fixed Income

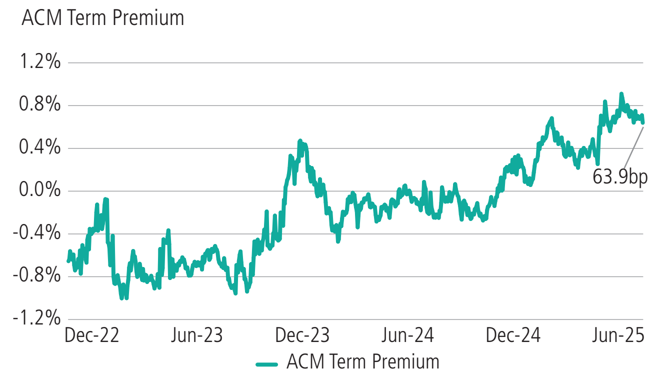
The passage of the U.S. tax and spending package reduced domestic economic uncertainty but reinforced the growing concern among global investors about the size of the U.S. budget deficit, which has helped drive up the term premium for U.S. bonds even as shorter bonds seem likely to benefit from the Fed's rate reductions.

Complicating matters is the role of non-U.S. investors in absorbing the debt needed to fund the deficit. Increased skepticism about the U.S. fiscal environment, coupled with a weakened dollar, has softened the appetite for U.S. securities, while decreasing U.S. trade deficits suggest that the Treasury could be forced to become more reliant on domestic sources. Overall, we do not anticipate any abandonment of U.S. assets, but see a reduced proportion of foreign investors (still the largest buyers of U.S. Treasuries) absorbing the new supply, while some may potentially limit their dollar exposure through hedging.

From an investment perspective, we see opportunity in the shorter end of the Treasury yield curve given likely moves by the Fed over the coming year, but we remain cautious on the long end due to debt sustainability and demand issues. While scope for additional European rate cuts remains in place, the opportunity may be more limited given the progress that has already occurred.

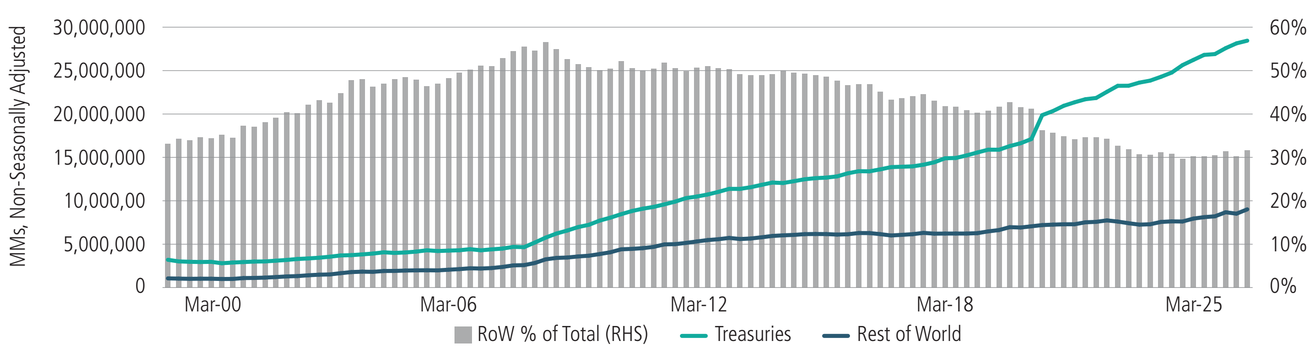
FISCAL WORRIES DRIVE UP PERCEIVED TERM PREMIUM





Source: U.S. Treasury, CBO, Bloomberg, as of July 1, 2025.

AS ISSUANCE HAS INCREASED, FOREIGN OWNERS HAVEN'T KEPT PACE



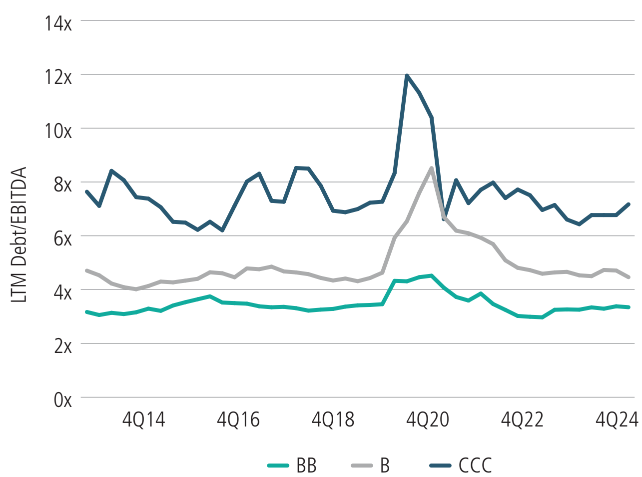
Source: Federal Reserve, as of 1Q25.

5. Credit Selection Remains Key Given Tight Spreads

Credit spreads remain historically tight, limiting obvious opportunities in the market and lending support to a focus on carry and individual sector and credit selection. In this environment, we believe that high yield provides relative potential given sustained fundamental strength as reflected in moderate debt and default levels. And although much of the spread advantage generated after April's tariff-related volatility has dissipated, we view relative and absolute yield levels as attractive.

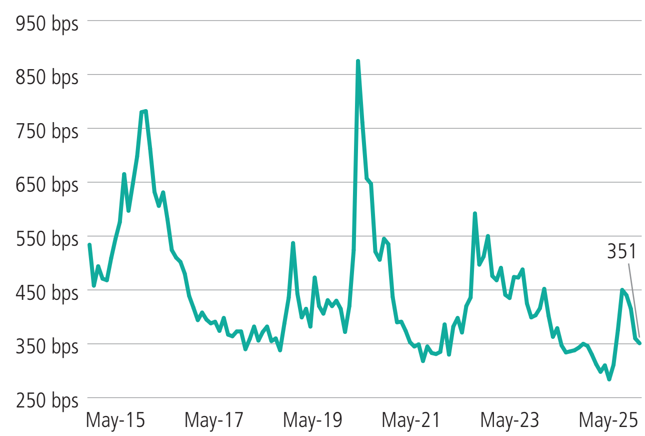
HIGH YIELD FUNDAMENTALS REMAIN HEALTHY

Leverage by Rating



HIGH YIELD SPREADS ARE OFF EXTREMES BUT STILL NARROW

Spread to Worst



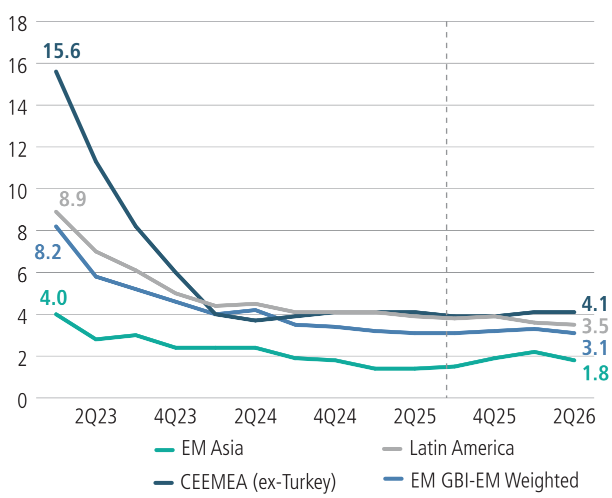
Source: ICE BofA U.S. High Yield Index, as of May 31, 2025.

6. Local Emerging Market Debt Stands Out

Despite the potential for market turbulence around the U.S. trade picture, we believe the risks for emerging market assets are mitigated by a continued healthy growth pick-up over developed markets. Subdued inflation, growth pressures from trade war escalation and expected rate cuts by the Fed should provide room for most emerging market central banks to maintain a bias toward easing monetary policy. Combined with emerging market real yields that are near decade highs, this should provide an attractive backdrop for local bonds.

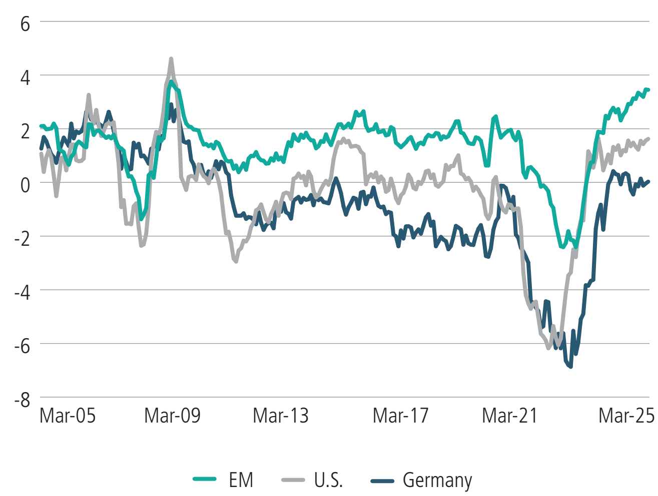
EMERGING MARKET INFLATION REMAINS BENIGN

Headline Inflation (YoY%)



LOCAL CURRENCY REAL YIELDS OFFER A MEANINGFUL PREMIUM

EM Real Yield vs. U.S. and Europe (%)



Source: (left) Bloomberg, EMD team forecasts from 1Q25, as of April 30, 2025. EM aggregate includes China, India, South Korea, Taiwan, Singapore, Indonesia, Malaysia, Philippines, Thailand, Czech Republic, Hungary, Poland, Romania, South Africa, Turkey, Brazil, Mexico, Colombia, Chile and Peru. Regional aggregates are equally weighted averages of corresponding countries. (Right) Bloomberg, JPMorgan, as of May 30, 2025. EM real yields based on the current GBI-EM Global country universe, excluding Dominican Republic, Serbia, Turkey and Uruguay; based on GBI-EM yields minus historical CPI for each country, and their current normalized GBI-EM GD Index weight fixed through time.

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