Touchstone Investments®
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Fixed Income:

Economic Backdrop

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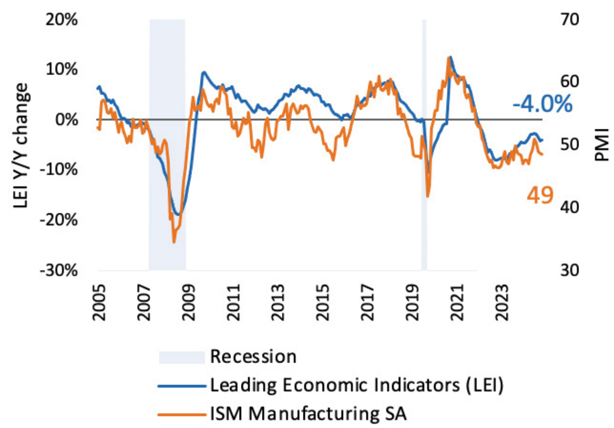
July 1, 2025

- **Caution Ahead:** Recent hard data point to emerging weaknesses in the economy. Consumer spending and personal income have slowed, while continuing jobless claims are rising, indicating that finding a job is getting harder. Meanwhile, inflation remains sticky. We expect U.S. economic growth to slow in the second half, driven by a weakening labor market, reduced business investment, and fading fiscal support
- **Living with Tariffs:** With temporary pauses on punitive tariffs set to expire in July, uncertainty continues for businesses and consumers. While tariff threats may prompt negotiations, such as Canada's unexpected reversal of its digital services tax, comprehensive trade deals remain difficult and time-consuming. The implemented 10% universal tariff, in essence, a regressive consumption tax, increasingly appears permanent and will likely weigh on economic growth.
- **Labor Market Headwind:** A stricter immigration stance could unintentionally strain the labor market. U.S.-born labor force growth is projected at just 0.2% annually over the next decade, compared to 0.7% for the total labor force over the past 10 years. While stronger productivity growth would help offset the slowdown, achieving the necessary gains may be challenging. The result may be a lower long term potential growth rate for the economy.
- **More "Stag," Less "Flation":** Tariffs are likely to dampen growth more than fuel inflation. Companies are likely to pursue tariff workarounds (e.g., exemptions, sourcing shifts), while consumers may reduce or redirect spending. Tariffs could cause a onetime price bump, but the drag on growth is expected to persist. This environment may give the Fed room to cut rates more aggressively, especially amid a cyclical labor market slowdown.
- **Regime Change:** Reshaping the economy, particularly through reshoring, demands long term investment, labor force expansion, and steady, coordinated policy. In today's polarized, populist climate, meeting these conditions is a challenge. The key question is how much economic hardship households and policymakers are willing to bear, and for now, tolerance appears low.
- **Employment Remains Key:** Our economy has proved to be much more resilient over the past two years than many forecasters expected, including ourselves. While evidence of a slowdown is growing, we need to keep an open mind. We believe the employment picture is the key to our economy, and if conditions remain tight through the second half of the year, we may need to adjust our views.

Leading Economic Indicators



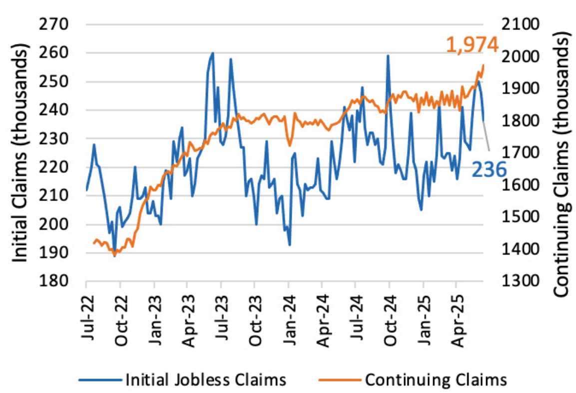
The conference Board Consumer Labor Differential measures the difference between the percent of consumers responding jobs were plentiful versus those responding they were hard to get.

Source: Bloomberg. 20 years of monthly data through May 2025

Citi Economic Surprise Index - U.S.

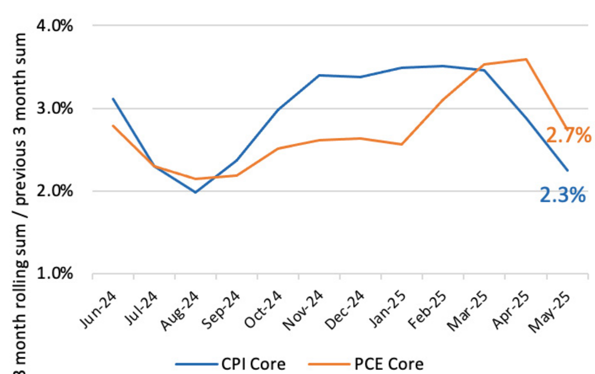
Source: Bloomberg. 3 years of daily data through Jun 30 2025. The Surprise index measures data surprises relative to market expectations. A positive reading means that data releases have been stronger than expected.

Weekly Jobless Claims Data



Source: Bloomberg. 3 years of weekly data through Jun 20 2025

Core Inflation Q/Q Annualized



Source: Bloomberg. 1 year of monthly data through May 2025

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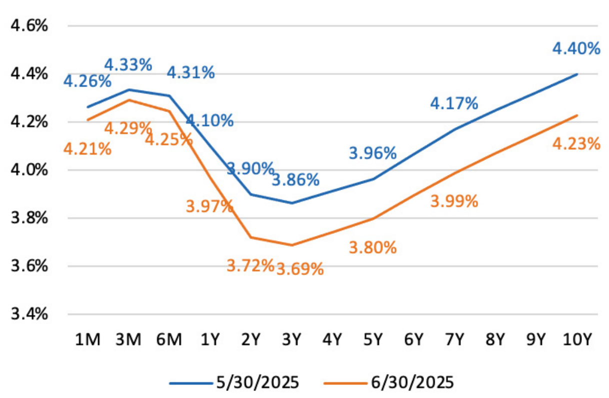
- **Overweight Fixed Income:** We maintain a modest overweight position amid near-term economic uncertainty. With bond yields near decade highs, fixed income offers attractive income and competitive returns versus equities.
- **Favoring High Quality:** We are tactically overweight investment grade bonds, drawn by their higher yields and lower sensitivity to the economic weakness we expect in the second half. They offer strong risk-adjusted return potential.
- **Neutral on Duration:** We hold a neutral stance on duration, as interest rate risks appear balanced. Slowing growth may pull yields lower, while rising public debt and budget tension could elevate term premiums.
- **Action Required:** The One Big Beautiful Bill Act passed into law as extraordinary measures to keep the government running were nearing exhaustion. Last-minute vote deals and accounting maneuvers have inflated deficit estimates beyond the original House proposal. With debt growing far faster than the economy, increased Treasury issuance across the curve may require higher yields to attract investors.
- **Monetary Policy Currently Constrained:** We continue to expect modest Fed rate cuts in response to slowing growth, though the timing will likely hinge on the economic impact of the final budget and tariff developments. Political interference further complicates policy execution.
- **Looking Beyond the Fog:** Over the longer term, we expect a steeper yield curve, driven by short-term rates declining more than long end yields. This view reflects our assumption that economic growth potential will normalize to around 4% nominal and 2% real GDP growth.

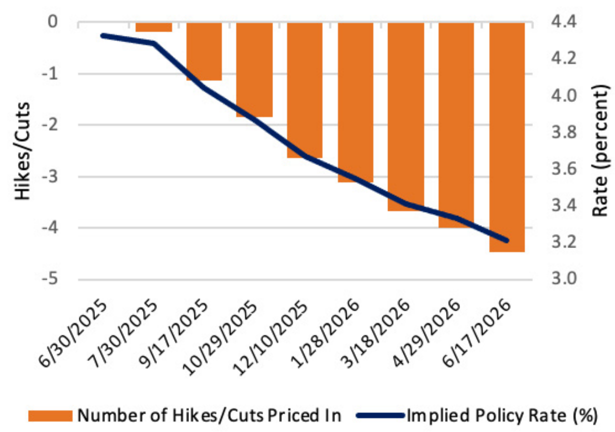
Treasury Yield Curve vs Prior Month



Source: Bloomberg

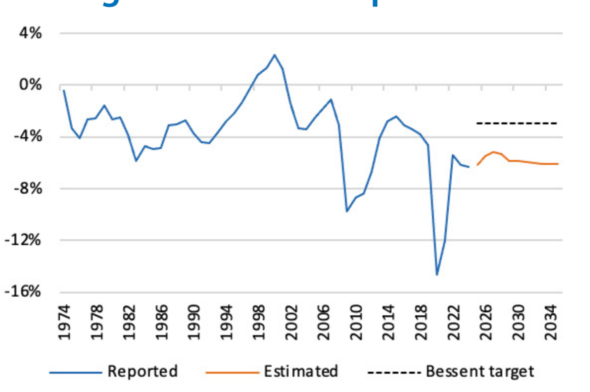
Federal Funds Rate

Implied Overnight Rate & Number of 25bp Hikes/Cuts



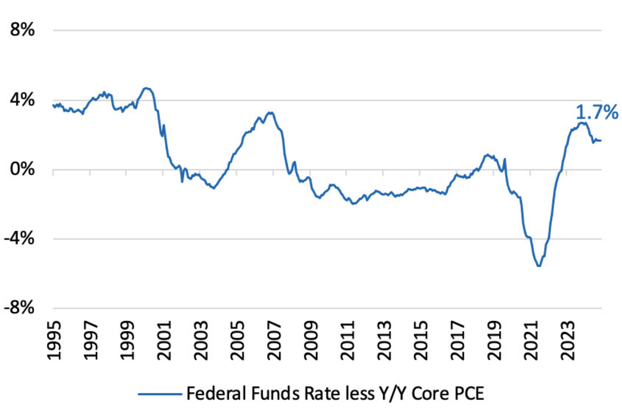
Source: Bloomberg. Data as of Jun 30 2025

U.S. Budget Deficit or Surplus % of GDP



Source: Bloomberg. Annual data from fiscal 1974 through 2024; CBO annual estimates through 2035, based on Jan 2025 update.

Real Federal Funds Rate



Source: Bloomberg. 30 years of monthly data through May 2025

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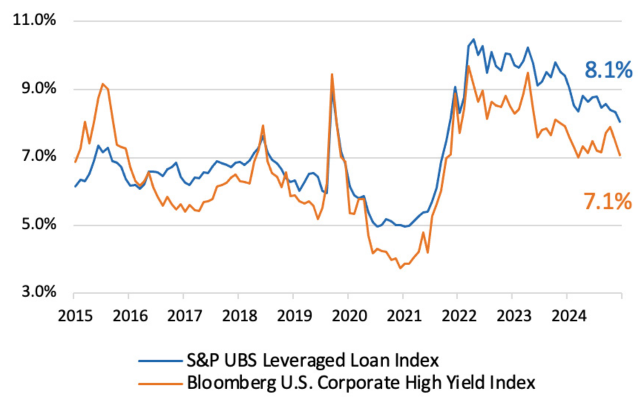
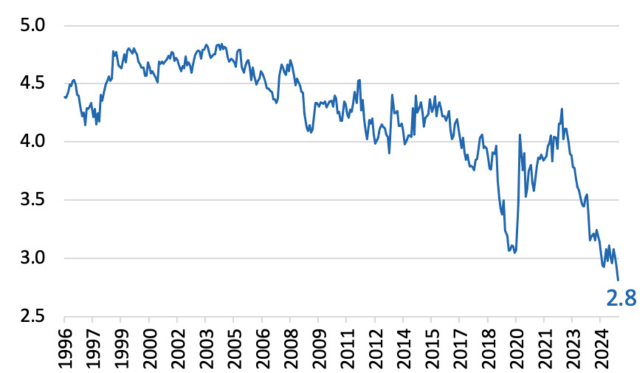
- **Cautious on Credit:** We've increased our underweight in high yield bonds as spreads have tightened despite signs of economic weakness. That said, loose financial conditions, improved index quality, and a manageable maturity wall reduce the urgency for a more defensive stance.
- **Spreads Grind Tighter:** After Liberation Day spreads widened to 453 basis points above similar duration risk free rates. Spreads have since retraced that move and more, ending June at just 290 basis points. Sentiment improved despite rising geopolitical risk and signs of slowing growth. Given ongoing uncertainty, we expect spread volatility to remain elevated.
- **Credit Watch:** Rating agency credit watch warnings and downgrades have increased relative to upgrades across both investment grade and high yield corporate credit this year compared to the same period last year, reflecting signs of a weakening economy. However, the ratio of upgrades to downgrades improved modestly in the second quarter versus the first. We continue to monitor profit margins, earnings estimate revisions and hiring trends for insights into the overall health of the corporate credit markets. We maintain a preference for higher-quality fixed income over below-investment-grade credit.
- **Liquidity Risk:** Alongside rising ratings pressure, liquidity issues are gaining attention. Trading volumes in corporate credit have grown relative to shrinking dealer inventories, raising concerns. If passive ETFs face selling pressure, spreads could widen sharply. This could present an opportunity to reduce our underweight position.
- **Active Management Required:** Deregulation and tariff negotiations are likely to create clear winners and losers across corporate and securitized credit, presenting opportunities for both return generation and risk management. We remain focused on actively adjusting our tactical credit allocations as conditions evolve.

Non Investment Grade Yields



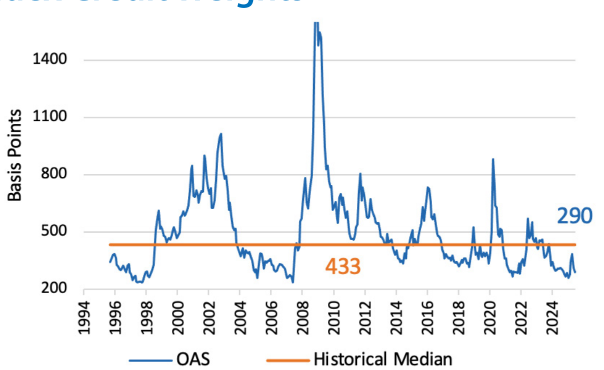
Source: Bloomberg. 10 years of monthly data through Jun 2025

Bloomberg U.S. Corporate High Yield Index: Spread Duration



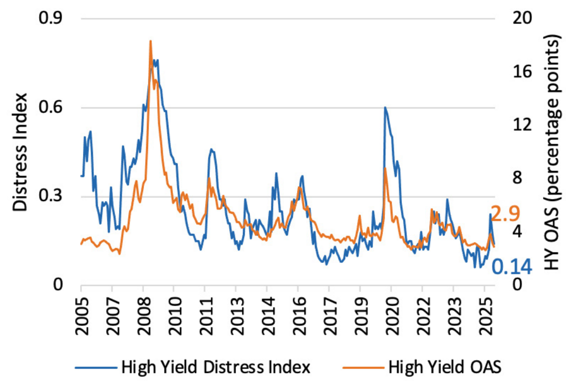
Source: Bloomberg. 30 years of monthly data through Jun 30 2025. Spread duration measures price sensitivity to changes in the credit spread.

Bloomberg U.S. Corporate High Yield Index Credit Weights



Source: Bloomberg. 30 years of monthly data through Jun 2025.
Last observation percentile 10%

NY Fed Corporate Bond Distress Index



Source: Bloomberg. 20 years of monthly data through Jun 2025

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The Indexes mentioned are unmanaged statistical composites of stock market or bond market performance. Investing in an index is not possible.

Total Returns

	Jun 2025	YTD	2024	2023	2022	Duration years
Bloomberg Long Term Treasury	2.5%	3.1%	-6.4%	3.1%	-29.3%	14.7
Bloomberg U.S. TIPS	1.0%	4.7%	1.8%	3.9%	-11.8%	4.9
Bloomberg U.S. Aggregate	1.5%	4.0%	1.3%	5.5%	-13.0%	6.1
Bloomberg U.S. Agg Corporates	1.9%	4.2%	2.1%	8.5%	-15.8%	6.8
Bloomberg U.S. Agg ABS	0.9%	2.9%	5.0%	5.5%	-4.3%	2.7
Bloomberg U.S. Agg MBS	1.8%	4.2%	1.2%	5.0%	-11.8%	6.0
Bloomberg U.S. Agg CMBS	1.2%	4.5%	4.7%	5.4%	-10.9%	4.0
Bloomberg Municipal Bond	0.6%	-0.3%	1.1%	6.4%	-8.5%	6.8
Bloomberg 1-3 year Corporate	0.7%	3.1%	5.3%	5.5%	-3.3%	1.8
ICE BofA Listed Preferreds	1.8%	-0.1%	8.5%	9.8%	-18.1%	NA
Bloomberg High Yield	1.8%	4.6%	8.2%	13.4%	-11.2%	2.8
S&P UBS Leveraged Loan	0.8%	3.0%	9.1%	13.0%	-1.1%	NA
Bloomberg Global Agg	1.9%	7.3%	-1.7%	5.7%	-16.2%	6.5
Bloomberg Emerging Markets USD	1.9%	4.9%	6.6%	9.1%	-15.3%	6.0

Yields

			Last 10 years			
	Jun 2025	YTD Change bps	Current Percentile	Median	Min	Max
10 year Treasury	4.2%	-34	91	2.4%	0.5%	5.0%
2 year Treasury	3.7%	-52	74	1.7%	0.1%	5.2%
10 year TIPS	1.9%	-30	90	0.5%	-1.2%	2.5%
Bloomberg U.S. Aggregate	4.5%	-40	79	2.6%	1.0%	5.7%
Bloomberg U.S. Agg Corporate	5.0%	-34	75	3.5%	1.7%	6.4%
Bloomberg U.S. Agg ABS	4.4%	-32	74	2.2%	0.4%	6.0%
Bloomberg U.S. Agg MBS	4.9%	-34	85	2.9%	0.9%	6.1%
Bloomberg U.S. Agg CMBS	4.7%	-50	74	2.9%	1.4%	6.6%
Bloomberg Municipal Bond	4.0%	22	95	2.4%	0.9%	4.5%
Bloomberg 1-3 year Corporate	4.3%	-45	73	2.4%	0.5%	6.2%
Bloomberg High Yield	7.1%	-43	55	6.6%	3.5%	11.7%
S&P UBS Leveraged Loan	8.1%	-72	71	5.8%	3.6%	13.1%
Bloomberg Global Agg	3.5%	-21	76	1.7%	0.8%	4.4%
Bloomberg Emerging Markets USD	6.3%	-39	68	5.5%	3.5%	8.7%

Option Adjusted Spreads (bps)

			Last 10 years			
	Jun 2025	YTD Change	Current Percentile	Median	Min	Max
Bloomberg U.S. Corporate Agg	83	3	4	116	74	373
Bloomberg 1-3 year Corporate	52	0	26	62	31	390
Bloomberg U.S. Agg ABS	57	13	56	52	22	325
Bloomberg U.S. Agg MBS	37	-6	51	35	7	132
Bloomberg U.S. Agg CMBS	84	4	51	93	62	275
Bloomberg High Yield	290	3	4	376	253	1100
S&P UBS Leveraged Loan (discount margin)	459	-16	36	491	379	1275
Bloomberg Emerging Markets USD	220	0	1	303	205	720

For Index Definitions see: TouchstoneInvestments.com/insights/investment-terms-and-index-definitions

2022 – The Fed embarked on one of its most aggressive tightening paths seen in decades as the inflation rate surged well above their goal. Interest rates rose across all maturities leading to one of the worst years for fixed income returns.

2023 – Inflation fell broadly while the economy grew with the labor market and consumer spending resilient. The Fed paused midyear helping rates and credit spreads fall late in the year and turning returns positive for the year.

2024 – Economic growth continued unabated, driven by consumer spending. Inflation moderated further. The Federal Reserve pause continued until September, after which it cut interest rates three times by a total of 1 percentage point. Bond yields rose in response, resulting in only modest gains for high quality fixed income but better returns for riskier areas of fixed income.

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The Touchstone Asset Allocation Committee (TAAC) consisting of Crit Thomas, CFA, CAIA – Global Market Strategist, Erik M. Aarts, CIMA – Vice President and Senior Fixed Income Strategist, and Tim Paulin, CFA – Senior Vice President, Investment Research and Product Management, develops in-depth asset allocation guidance using established and evolving methodologies, inputs and analysis and communicates its methods, findings and guidance to stakeholders. TAAC uses different approaches in its development of Strategic Allocation and Tactical Allocation that are designed to add value for financial professionals and their clients. TAAC meets regularly to assess market conditions and conducts deep dive analyses on specific asset classes which are delivered via the Asset Allocation Summary document. Please contact your Touchstone representative or call 800.638.8194 for more information.

A Word About Risk

Investing in fixed-income securities which can experience reduced liquidity during certain market events, lose their value as interest rates rise and are subject to credit risk which is the risk of deterioration in the financial condition of an issuer and/or general economic conditions that can cause the issuer to not make timely payments of principal and interest also causing the securities to decline in value and an investor can lose principal. When interest rates rise, the price of debt securities generally falls. Longer term securities are generally more volatile. Investment grade debt securities which may be downgraded by a Nationally Recognized Statistical Rating Organization (NRSRO) to below investment grade status. U.S. government agency securities which are neither issued nor guaranteed by the U.S. Treasury and are not guaranteed against price movements due to changing interest rates. Mortgage-backed securities and asset-backed securities are subject to the risks of prepayment, defaults, changing interest rates and at times, the financial condition of the issuer. Foreign securities carry the associated risks of economic and political instability, market liquidity, currency volatility and accounting standards that differ from those of U.S. markets and may offer less protection to investors. Emerging markets securities which are more likely to experience turmoil or rapid changes in market or economic conditions than developed countries.

Performance data quoted represents past performance, which is no guarantee of future results. The investment return and principal value of an investment in the Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be higher or lower than performance data given. ***For performance information current to the most recent month-end, visit TouchstoneInvestments.com/mutual-funds.***

Please consider the investment objectives, risks, charges and expenses of a fund carefully before investing. The prospectus and the summary prospectus contain this and other information about a fund. To obtain a prospectus or a summary prospectus, contact your financial professional or download and/or request one at TouchstoneInvestments.com/resources or call Touchstone at 800.638.8194. Please read the prospectus and/or summary prospectus carefully before investing.