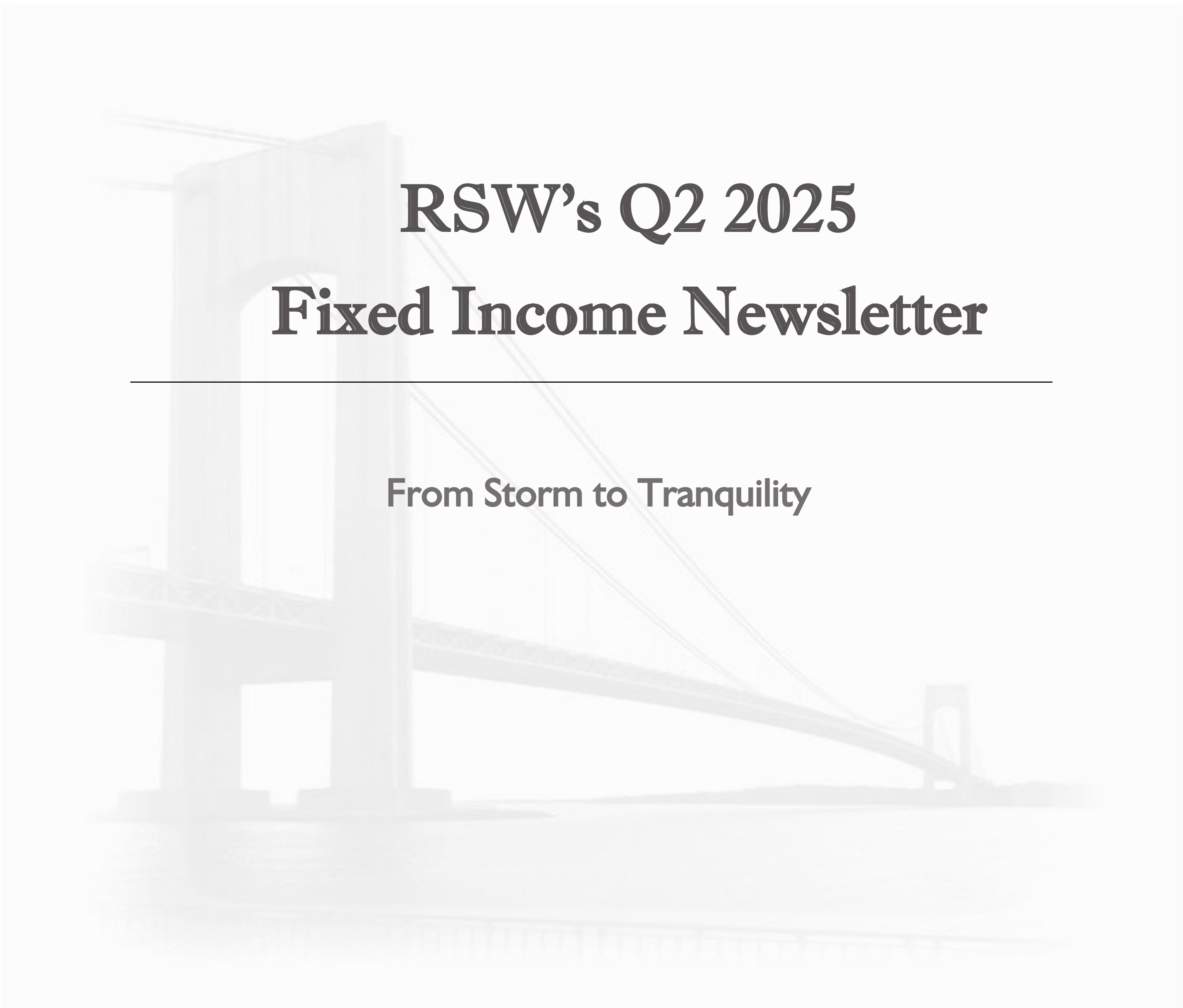
July 1, 2025



# RSW's Q2 2025 Fixed Income Newsletter

## From Storm to Tranquility

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## From Storm to Tranquility

While the body of RSW's quarterly communications are generally confined to our insights and predictions, this time is different, as the extraordinary circumstances commands a review. With much to explore in the municipal bond section, including our forecast, we will aim to be as brief as possible in this segment of the report.

**A Deluge of Headlines**

The second quarter was packed with significant events that sent bond yields on a turbulent ride. From the outset, market participants faced choppy conditions as President Trump simultaneously addressed multiple challenges including: An installation of sweeping tariffs, a 90-day tariff pause, proposed tax reforms, ambitious budget cuts, relentless efforts to influence interest rate policy, ending the Russia-Ukraine conflict, and navigating the escalation of tensions between Israel and Iran, ultimately leading to direct U.S. involvement. These developments injected significant volatility into fixed income markets, as investors constantly adjusted their forecasts for economic growth, inflation, and potential Federal Reserve policy changes.

**Winds of Change**

Interestingly, the quarter can be divided into two contrasting halves. Using 10-year U.S. Treasury bond yields as an indicator, rates surged from a low of 3.88% on April 4th to an intraday peak of 4.62% on May 22nd. The early yield rise was sparked by the shocking scale of tariffs levied and the fear that the pace of inflation was set to escalate. As rates rose and bond market liquidity dried up, it was likely that Scott Bessent (Treasury Secretary) and Howard Lutnick (Commerce Secretary) urged President Trump to pause the reciprocal tariffs on dozens of countries.

**Fiscal Storm**

While the administration's "about face" allowed bond yields to decline, this pause was also just a pause. The spotlight returned to the nation's troubling fiscal deficit as DOGE, under Elon Musk's leadership, fell well short of its $1–2 trillion goal for eliminating waste, fraud, and abuse. This, along with fears of a revenue drop if President Trump's "One Big Beautiful Bill" passed, rattled investors and probably prompted Moody's to downgrade U.S. government debt on May 15th. Ultimately, these events pushed 10-year Treasury yields to a high of 4.62% on May 22nd.

With the rate of inflation falling to 2.30% (source: Bloomberg) and economic data showing signs of cooling, rates began their decline. With many of the tariffs still on pause, attention turned to the Israel strikes on Iran and their retaliation. The back-and-forth diminished investors' appetite for risk and concurrently enhanced their demand for U.S. Treasury debt. Investors sought a refuge in the relatively safe haven of the U.S. Treasury market.

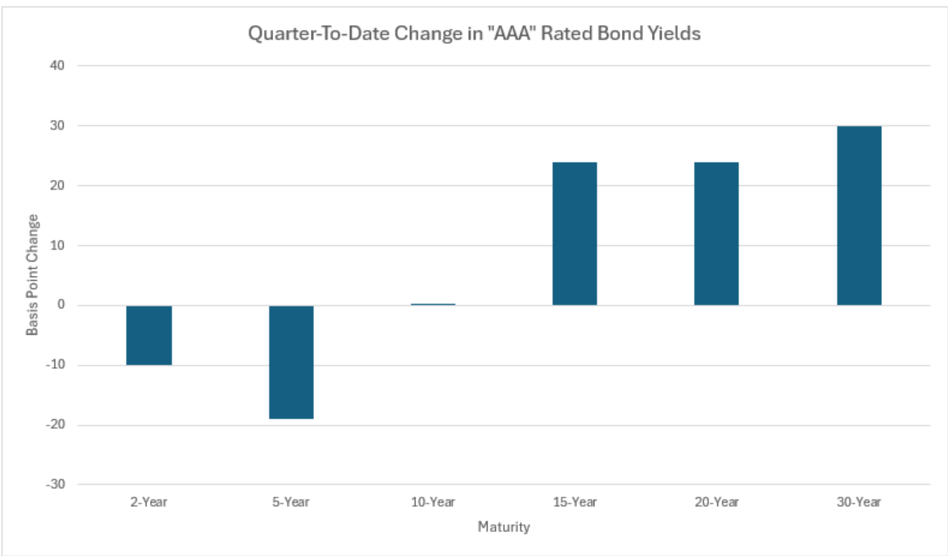
Yields continued their descent as the U.S. entered the conflict on June 21st by striking targeted Iranian nuclear sites and key IRGC facilities to address Iran's nuclear threats. During this period, oil lurched forward with the price of crude nearing $75 a barrel, causing greater economic uncertainty. All that changed on June 23rd when President Trump, along with Qatar, brokered a ceasefire deal causing oil to sink to $65 a barrel and 10-year U.S. Treasury yields to approach levels where they began the quarter, 4.23%.

**Municipal Market Commentary**

For the quarter and year-to-date period, while prices in the tax-exempt market were somewhat steady, the returns were hampered by challenging market technicals. Despite a steady U.S. Treasury bond market and robust demand for municipal securities, the waves of new tax-free issuance flooding the market outpaced what investors were able to absorb. In fact, the $153 billion issued during the quarter marked a record level of supply. Against this backdrop, the balance between supply and demand proved uneven, causing returns to differ significantly based on a bond's stated final maturity.

Notably, the greatest volume of new bond offerings included securities with maturities surpassing 10 years (source: JP Morgan). This concentration significantly influenced market movements, driving up yields on longer-maturity debt. In contrast, reduced new issuance in the shorter maturity segment, combined with strong demand, forced the prices of these bonds higher, resulting in lower yields.

The phenomenon described above is termed a steepening yield curve. This dynamic can best be understood by reviewing RSW's observations of yield changes occurring within each maturity bucket:




As you will notice, bonds in the 10–15-year maturity sector (RSW's intermediate duration strategy benchmark) failed to keep pace with shorter-maturity bonds. For example, yields on 5-year bonds declined by 19 basis points, while 15-year maturity yields rose by 24 basis points. While the changes may seem modest on the surface, these differentials could amount to over 246* basis points (2.46%) of return disparity. Is it now time for us to start exchanging what has performed relatively well to purchase assets that have been "beaten down"? You bet!!

**Right for the Wrong Reasons**

While our 2025 forecast called for 10-year yields to top 5% during the first half of the year, (that forecast proved to be inaccurate with a period high of 4.58%), we mitigated principal losses by cutting back on investments in the market's

**Assuming a duration of 3.6 years and 7.4 years for the 5-year and 15-year benchmark, respectively* poorest-performing sectors. In fact, as of March 31st, RSW's exposure to the 10–15-year area of the yield curve stood at the lowest level in our firm's 20-year history.

We are now in a solid position to raise client account allocations to this target maturity range toward more typical levels. In fact, where appropriate, we have already begun to do so. These additions will mainly be funded by exchanging lower-yielding shorter-term debt securities, thereby enhancing the portfolio's overall yield. To that end, new purchases have garnered yields around 4% (6.75% taxable equivalent yield assuming the highest federal tax bracket and Net Investment Income Tax).

While these moves might suggest a significant increase in duration, the impact to interest rate sensitivity should be limited. This is a notable benefit derived from our team's extensive reliance on premium coupon callable bonds in our investment process.

**Envisioning the Possibilities**

As we noted in RSW's Q1 2025 Newsletter, "the impact of tariffs to the pace of inflation and economic activity are often misunderstood." While we anticipated that the accelerated economic expansion during the early months of the year would lead to increased volatility in the bond markets, we never subscribed to the notion that tariffs would trigger a significant rise in inflation.

Looking ahead to the third quarter, we believe yields should continue to work their way lower. Sure, there will be plenty of information for the market to digest. Geopolitics, the passage of a budget reconciliation bill, and the potential resumption or modification of tariffs after a 90-day pause (early August 2025) should produce some swings in bond prices. We would welcome those periods as we methodically and systematically realign our client portfolios to capture the higher yields now afforded in RSW's targeted maturity range.

Robert S. Waas
Chief Executive Officer/Chief Investment Officer

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