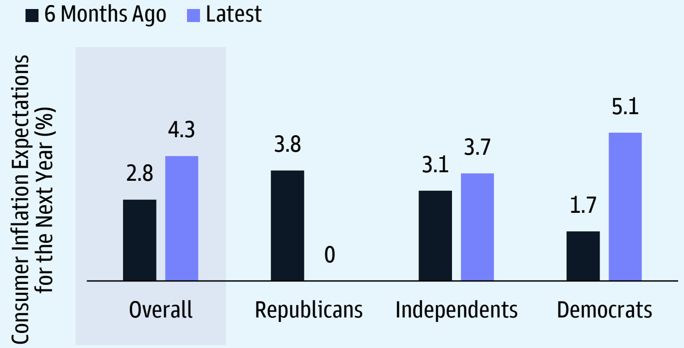
FIXED INCOME MUSINGS

FED: THE LUXURY OF PATIENCE

- **US Exceptionalism:** The US economy grew by **2.5%** in 2024, following a 3.2% expansion in 2023, and added 100,000 more jobs than previously estimated. The unemployment rate remains low at **4%**, and wage growth has recently increased. Meanwhile, core CPI inflation has stayed around **3.2-3.3%** since last May.
- **Fed Patience:** Economic strength and stalled disinflation progress suggest that the Fed will hold off on making further adjustments until there is more evidence of disinflation and clarity on trade policy. However, the likelihood of the Fed pivoting towards rate hikes in the near term is also low, as Chair Powell has noted that long-term inflation expectations remain anchored, and the labor market is not a source of inflationary pressure. Our central scenario is that the Fed will resume cutting rates in the second half of the year as inflation slows—a scenario that we believe is underpriced by the market.

Inflation Expectations Display a Striking Political Divide

Republicans appear to expect no inflation over the coming year while Democrat inflation expectations have tripled over the last six months



Source: University of Michigan, Bloomberg, Goldman Sachs Asset Management. As of February 2025.

ECB: GEOPOLITICAL RELIEF VS. TARIFF RISKS

- **Potential cyclical uplift from reduced geopolitical risks:** Markets currently estimate a **65%** chance of a ceasefire in Ukraine this year[1]. If a ceasefire occurs, Goldman Sachs Global Investment Research predicts that Euro area growth could increase by **0.2-0.5%**[2]. This growth would be driven by improved consumer confidence, a more stable flow of Russian natural gas, the reconstruction of Ukraine's infrastructure, and potentially easier financial conditions, which tightened across Europe at the onset of the conflict.
- **Continued headwinds from tariff risks:** However, the region's growth, which expanded by less than **1%** in 2024, still faces risks from potential US tariffs.
- New US tariffs on steel and aluminium, along with possible reciprocal tariffs on EU goods, are unlikely to significantly impact the region's growth rate. But a 10% tariff on all US imports from the EU could present a substantial growth shock, potentially offsetting any positive effects from a Ukraine ceasefire.
- **More ECB easing in store:** Given the prospects of lower headline inflation and modestly higher growth, we think a ceasefire is unlikely to significantly impact ECB policy in the near term. We continue to expect a series of rate cuts in the coming months.

Source: Goldman Sachs Asset Management, Goldman Sachs Global Investment Research CEEMEA Economics Analyst Ukraine — Rising Market Expectations for a Peace Deal (February 11, 2025), [2]European Economics Analyst Potential Economic Implications of a Ceasefire in Ukraine (February 13, 2025).

MARKET PERSPECTIVES

Bottom Line: So far this year, investors have processed a large volume of new information related to disruptive technologies, US policy shifts, and geopolitical uncertainties. Despite all the noise, fixed income spreads have remained relatively stable, and rate markets where we anticipate ongoing monetary easing, such as the UK, have performed well.

Key Fixed Income Themes

Income Essentials: Despite tight fixed income spreads, we don't foresee a turn in the credit cycle this year. The income potential in corporate bonds and securitized sectors remains attractive, with minimal downgrade and default activity expected. Given relative valuations, we prefer high yield corporate credit and securitized sectors over investment grade credit.

Diversified Duration: We are cautious about directional interest rate exposures considering near-term Fed policy uncertainty. Instead, we prefer relative value exposures, favoring interest rates in countries with weak growth and slowing inflation, where trade headwinds would support dovish central bank actions, such as Canada, the UK, and Sweden. In contrast, we expect continued rate hikes in Japan and a cautious easing cycle in Australia, so we are underweight rates in these markets on a relative value basis.

Divergent Curve Dynamics: US trade policy uncertainty implies a flatter US yield curve, as short-term yields stay high due to limited prospects of near-term Fed rate cuts, while long-term yields trend lower due to weaker growth implications of tariffs. We think Japan's yield curve may also flatten as market pricing adjusts to further near-term BoJ policy normalization. Conversely, we expect the European yield curve to steepen as the ECB continues its monetary easing. Additionally, there is potential for less demand for long-term European bonds over time as Dutch pension plans adjust their hedging to a new pension regime. This reduced demand eases the recent flattening pressure on longer-dated bond yields and may see longer-term yields rise.

Capitalizing on Currency Volatility: Currency markets have been highly responsive to trade headlines. For instance, the Canadian dollar was the worst-performing G10 currency in January, which was the most active month for currency options since February 2020. We see value in using options to capture investment opportunities in currency markets, helping us manage tariff risks and concerns around persistent US inflation. This strategy includes using currency options to benefit from increased currency volatility and a stronger US dollar. Additionally, we think the market underprices the risk of an eventual weakening of the Chinese yuan owing to ongoing tariff developments.

> Entering the year, we anticipated disruption from all angles—geopolitics and AI—emphasizing the need for dynamic investment exposures. Despite a headline-intense first seven weeks of the year, our core investment strategy for public markets remains steadfast: utilizing bonds for income, diversification, and stability, while broadening equity horizons beyond a narrow set of US large caps. As US policy shifts focus from trade to fiscal measures and deregulation, we stay vigilant for late-cycle behaviours that could accompany credit expansion and potentially alter our positive outlook on US corporate balance sheet fundamentals.
>
> **Ashish Shah, Co-head and Chief Investment Officer of Public Investing**

Source: Goldman Sachs Asset Management, Bloomberg.

CENTRAL BANK SNAPSHOT

	INTEREST RATE POLICY	BALANCE SHEET POLICY	OUTLOOK	OUR OUTLOOK RELATIVE TO MARKET-IMPLIED PRICING
Fed	**Federal funds rate:** 4.25-4.5% **Last change:** December and November 2024 (-25bps), September 2024 (-50bps) **Hiking cycle duration:** 17 months **Rate at the start of latest hiking cycle:** 0.25%	The Fed has been reducing its balance sheet passively since June 2022. The FOMC decided to decrease the pace of this reduction starting in June 2024, with the monthly runoff scaling down from $60 billion to $25 billion.	Recent labor market data delays the timeline for further rate cuts beyond Q1. **Expected rate at end-2025:** 3.75-4% **Neutral rate estimate:** 2.75-3.50%	Slightly dovish
ECB	**Deposit facility rate:** 2.75% **Last change:** January 2025, December, October, November and September 2024 (-25bps) **Hiking cycle duration:** 15 months **Rate at the start of the latest hiking cycle:** -0.5%	The ECB started reducing its balance sheet in March 2023 and ceased reinvestments from its APP in July 2023. The reinvestment of proceeds from maturing securities under the PEPP will gradually decrease starting July 2024 and conclude in December 2024.	We expect consecutive 0.25% rate cuts until the policy rate reaches 1.5%. **Expected rate at end-2025:** 1.5% **Neutral rate estimate:** 2.0 – 2.25%	Slightly dovish
BoE	**Bank Rate:** 4.5% **Last change:** February 2025 and November 2024 (-25bps) **Hiking cycle duration:** 21 months **Rate at the start of the latest hiking cycle:** 0.1%	The BoE has actively been reducing its balance sheet since November 2022. At the September 2024 meeting, the MPC voted to maintain the pace of gilt stock reduction at £100bn. Given higher redemptions, this implies a notable reduction in the pace of active sales.	We believe the BoE will cut rates at each Monetary Policy Report meeting in 2025 (May, August, November), and possibly in June. **Expected rate at end-2025:** 3.50% **Neutral rate estimate:** 2.50-3.0%	Dovish
BoJ	**Policy deposit rate:** 0.5% **Last change:** January 2025 (+25bps), July 2024 (+15bps), March 2024 (+20bps) **Duration of negative rates:** 98 months **Rate at start of the latest hiking cycle:** -0.10%	The gradual reduction plan for Japanese Government Bond purchases is from around ¥6tn per month to around ¥3tn over 18-months.	We anticipate additional rate hikes in 2025 given wage growth and price pressures. **Expected rate at end-2025:** 1% **Neutral rate estimate:** 1.0-1.50%	Hawkish

Source: Goldman Sachs Asset Management. As of February 14, 2025. Abbreviations: Pandemic Emergency Purchase Program (PEPP). The economic and market forecasts presented herein are for informational purposes as of the date of this document. There can be no assurance that the forecasts will be achieved. Please see additional disclosures at the end of this document. The neutral rate estimates come with a degree of uncertainty. They are derived from a combination of fundamental, market, and model-based assessments. The ranges for the Fed, BoE and BoJ reflect the diversity of these estimates. For the ECB, the range represents the spectrum of policymakers' estimates, which has been adjusted based on our discretionary perspective. Estimated neutral rates by central banks are as follows: BoE 2-3%, BoJ 1-2.5%, Fed 2.4-3.8%, ECB 1.5-3%. The economic and market forecasts presented herein have been generated by Goldman Sachs Asset Management for informational purposes as of the date of this presentation. They are based on proprietary models and there can be no assurance that the forecasts will be achieved. Please see additional disclosures at the end of this presentation.

SOVEREIGN BOND YIELDS (%)

	Latest (%)	Year-to-date Change (bps)	1-Year Change (bps)	Last 10-year Percentile
US 2 Year	4.3	6	-15	85
US 10 Year	4.5	-6	35	97
US 2-10 Slope	0.2	-12	50	35
US Treasury 10-Year Inflation-Protected	2.1	-16	15	95
Germany 2 Year	2.1	0	-72	79
Germany 10 Year	2.4	6	6	90
Japanese 10 Year	1.3	22	62	100
UK 10 Year	4.5	-7	34	97
Chinese 10 Year	1.7	-2	-78	1

Source: Macrobond, Goldman Sachs Asset Management. As of 14 February 2025.

EXCHANGE RATES

	Latest	Year-to-date Change (%)	1-year Change (%)
Euro (€ per $)	0.96	-0.3	3.1
British Pound (£ per $)	0.80	0.2	0.7
Japanese Yen (¥ per $)	153.10	-2.5	2.4
Chinese Yuan Renminbi (CNY per $)	7.31	0.1	1.6

Source: Macrobond, Goldman Sachs Asset Management. As of 14 February 2025.

FIXED INCOME SECTOR YIELDS (%)

	Latest (%)	Last 10 year average (%)	Year-to-date change (bps)	Last 10 year Percentile
US Investment Grade	5.3	3.7	-4	85
European Investment Grade	3.1	1.6	-9	76
UK Investment Grade	5.3	3.3	-19	80
US High Yield	7.2	6.7	-28	62
European High Yield	5.3	4.4	-19	67
EM External	7.7	6.4	-13	75
EM Corporate	6.4	5.4	-6	75
US Agency MBS	5.2	3.1	-5	95
US ABS	5.2	3.0	4	80
US Munis	3.7	2.5	1	92
US CMBS	5.2	3.2	-8	81

Source: Macrobond, Goldman Sachs Asset Management, ICE BofAML and J.P. Morgan. As of 14 February 2025.

FIXED INCOME SECTOR SPREADS (BASIS POINTS)

	Latest (bps)	Last 10 year average (bps)	Year-to-date change (bps)	Last 10 Year Percentile
US Investment Grade	81	127	-1	1
European Investment Grade	88	123	-13	8
UK Investment Grade	88	147	-3	0
US High Yield	265	431	-27	1
European High Yield	297	400	-14	10
EM External	8	6	0	14
EM Corporate	224	331	-2	1
US Agency MBS	43	37	1	60
US ABS	79	97	-2	42
US CMBS	87	97	-8	46

Source: Macrobond, Goldman Sachs Asset Management, ICE BofAML and J.P. Morgan. As of 14 February 2025.

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OUR INVESTMENT INSIGHTS

Read	Fixed Income Musings	Weekly views on the global economy, economic policy and fixed income markets.
	Navigating Fixed Income	Perspectives on investment opportunities across fixed income markets.
	Quarterly Fixed Income Outlook	Outlook on the economic landscape and key investment views.
	Fixed Income Espresso	Quick-take insights on market-moving events.
	Asset Management Perspectives	Explores today's risks and tomorrow's solutions across public and private markets.
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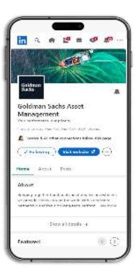
Insight Highlight

Fixed Income Musings Explore Prior Editions



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Investments in fixed income securities are subject to the risks associated with debt securities generally, including credit, liquidity, interest rate, prepayment and extension risk. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline in the bond's price. The value of securities with variable and floating interest rates are generally less sensitive to interest rate changes than securities with fixed interest rates. Variable and floating rate securities may decline in value if interest rates do not move as expected. Conversely, variable and floating rate securities will not generally rise in value if market interest rates decline. Credit risk is the risk that an issuer will default on payments of interest and principal. Credit risk is higher when investing in high yield bonds, also known as junk bonds. Prepayment risk is the risk that the issuer of a security may pay off principal more quickly than originally anticipated. Extension risk is the risk that the issuer of a security may pay off principal more slowly than originally anticipated. All fixed income investments may be worth less than their original cost upon redemption or maturity.

The risk of foreign currency exchange rate fluctuations may cause the value of securities denominated in such foreign currency to decline in value. Currency exchange rates may fluctuate significantly over short periods of time. These risks may be more pronounced for investments in securities of issuers located in, or otherwise economically tied to, emerging countries. If applicable, investment techniques used to attempt to reduce the risk of currency movements (hedging), may not be effective. Hedging also involves additional risks associated with derivatives.

Emerging markets investments may be less liquid and are subject to greater risk than developed market investments as a result of, but not limited to, the following: inadequate regulations, volatile securities markets, adverse exchange rates, and social, political, military, regulatory, economic or environmental developments, or natural disasters.

Collateralized loan obligations ("CLOs") involve many of the risks associated with debt securities, including interest rate risk, credit risk, default risk, and liquidity risk. The risks of an investment in a CLO also depend largely on the quality and type of the collateral and the class or "tranche" of the CLO. There is the possibility that the strategy may invest in CLOs that are subordinate to other classes. CLOs also can be difficult to value and may be highly leveraged (which could make them highly volatile). The use of CLOs may result in losses.

When interest rates increase, fixed income securities will generally decline in value. Fluctuations in interest rates may also affect the yield and liquidity of fixed income securities.

International securities may be more volatile and less liquid and are subject to the risks of adverse economic or political developments. International securities are subject to greater risk of loss as a result of, but not limited to, the following: inadequate regulations, volatile securities markets, adverse exchange rates, and social, political, military, regulatory, economic or environmental developments, or natural disasters.

High-yield, lower-rated securities involve greater price volatility and present greater credit risks than higher-rated fixed income securities.

Mortgage-related and other asset-backed securities are subject to credit/default, interest rate and certain additional risks, including extension risk (i.e., in periods of rising interest rates, issuers may pay principal later than expected) and prepayment risk (i.e., in periods of declining interest rates, issuers may pay principal more quickly than expected, causing the strategy to reinvest proceeds at lower prevailing interest rates).

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Sector Spread Indexes

US Investment Grade Corporates: ICE BofAML US Corporate Index

US High Yield Corporates: ICE BofAML US Corporate High Yield Index

European Investment Grade Corporates: ICE BofAML Euro Corporate Index

European High Yield Corporates: ICE BofAML Euro High Yield Index

US Municipals: ICE BofAML Municipal Securities Index

ABS: ICE BofAML US Fixed Rate Asset-Backed Securities Index

MBS: ICE BofAML US Agency Mortgage-Backed Securities Index

CMBS: ICE BofAML Fixed Rate AAA Rated CMBS Index

EM External Debt: J.P. Morgan, EMBI Global Diversified Face Constrained Index

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Abbreviations: US Federal Reserve (Fed), European Central Bank (ECB), Bank of England (BoE), Bank of Japan (BoJ), Swiss National Bank (SNB), Central Bank of Sweden (Riksbank), Reserve Bank of New Zealand (RBNZ), Central Bank of Norway (Norges Bank) Bank of Canada (BoC), Reserve Bank of Australia (RBA), Quantitative Easing (QE), Quantitative Tightening (QT), Pandemic Emergency Purchase Program (PEPP), Consumer price index (CPI), producer price index (PPI), developed markets (DM), emerging markets (EM), Japanese Government Bond (JGB). Mortgage-backed securities (MBS), Asset-backed securities (ABS).

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