April 15, 2025

Bond Market – Outlook

Multiple tariff policy changes have roiled global financial markets with major investment banks now increasing the odds of a U.S. recession.

Bonds, however, have not experienced the typical "flight to quality" that we have seen during past episodes of financial turmoil, leaving many to ask, "Will this happen and if not, why not?"

Bond Type	March Return	YTD Return
Long-term Treasuries	-0.89%	1.27%
Short-term Treasuries	0.37%	1.22%
Treasury Inflation-Protected Securities	0.94%	2.83%
Corporate Bonds	-0.29%	0.46%
Municipal Bonds	-1.69%	-2.09%
Preferred Stock	-3.18%	-5.14%
High Yield Bonds	-1.02%	-0.75%

So far in April, the 10-year Treasury yield increased from 3.99% to 4.49% and then retraced to its current level of 4.30%. We believe these moves have been driven by:

- Dollar weakening
- Hedge Fund "Basis Trade" Unwinding and Deleveraging
- Speculation that certain foreign U.S. Treasury holders, such as China and Japan, have been reducing holdings in response to Tarriff announcements
- Concerns that U.S. Tariff policy will fuel inflation and higher interest rates
- Potential for the U.S.'s Credit Rating to be downgraded

Municipal Bonds – Recession Concerns

- Tax collections reduced
- Property values decline
- Heightening default risk
- Maturing debt refinanced at higher rates

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Corporates

- Recession will hit lower-rated issuers, tariff-targeted industries disproportionately hard
- Credit spreads are beginning to widen but are still much tighter than in previous recession scares

Private Credit Funds

Have become extremely popular and heavily promoted by brokers.

Markets Served

- Unable to secure investment grade rating on a bond issue
- Not able to secure loans from bank due to risk assessment
- Amounts being borrowed not sufficient to incur costs of securing a rating

Common Criticisms

- High fees and limited regulatory oversight
- Opaque with limited transparency due to lack of required disclosures
- Significant discretion to compute values which may not correspond with a true market value if price discovery were to occur
- Highly illiquid

Our Views

- Treasuries are still the global safe haven of choice and despite the current tug-of-war with inflation concerns, a significant recession or market disruption would likely result in significant declines in long yields (prices up).

- Take advantage of the bond volatility and opportunities provided in Treasuries, and high-quality corporate and municipal bonds, for income and modest price appreciation potential.
    - Aggregate Municipal Bond yields are at 4.19%, near the 16-year high of 4.5%

- Rotate out of low-quality High Yield bonds due to (still) historically tight spreads.
    - High Yield bonds will be the first to be hit if a recession occurs

- Own individual bonds (rather than private credit funds) which offer daily liquidity and pricing.
    - Private credit typically has a lockup period or monthly liquidity at best
    - Illiquidity hinders the flexibility to react quickly in times of market stress

Brad Stanley, CFA
Chief Investment Officer of The Stanley-Laman Group. Designer of SLG's proprietary Ad-Star® System. Brad received a BS in Computer Science from Carnegie Mellon University and is a Chartered Financial Analyst Charterholder

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