

# 2025 Mid-Year Outlook

Macro, Equities, Retail, Funds, RMBS, CMBS, and CLO Insights

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# Executive Summary

De-globalisation, monetary policy divergence, and debt sustainability remain key global macro themes, as initial fears about the impact of higher US tariffs eased in H1. Tariff woes and trade tensions are further evidence of de-globalisation, and briefly dominated markets in March and April, as stagflation fears resumed. But a tariff pause drove a strong rally in risk assets. European central banks eased policy in H1, as they switched focus to weaker growth, but Fed caution on rates continues. Government debt sustainability fears have increased, driving steeper yield curves, particularly in the US and UK, with govt debt/GDP ratios now over 100%. However, higher rates and improved pension funding for DB schemes offers support for bonds via LDI flows with longer yields now near 15 yr highs.

Equities staged a V-shaped recovery in H1, following one of the sharpest and fastest sell-offs since 2008 and 2020, triggered by President Trump's "Liberation Day" tariff announcement. Most markets have since fully recovered, supported by signs that the eventual tariff impact may be less severe than initially feared in addition to expectations for two to three rate cuts over the next twelve months. Analyst revisions appear to have bottomed out across most global markets, suggesting a potential inflection point as earnings expectations remain resilient. S&P 500 Q2 earnings season is off to a strong start, following a better-than-expected Q1. We look ahead to Q2 results in the hope of receiving the clarity that Q1 lacked, on how companies are managing input costs, supply chains, and any impact on consumer demand.

Consumer spending remains supported by a strong labor market, but growth is beginning to slow amidst rising economic pressures. Heightened concerns over tariffs have dampened consumer sentiment and prompted many retailers to lower their earnings outlooks for the rest of the year. As a result, the LSEG Retail/Restaurant Index, which saw 7.5% earnings growth in Q1 2025, is projected to decline to -1.7% in Q2—its first negative performance since the pandemic. With earnings expected to stay in the low single digits through year-end, retailers are preparing for a volatile environment shaped by inflation, geopolitical uncertainty, and increasingly cautious consumers.

The most popular fund asset class over H1 has been bonds, despite fears of resurgent inflation, the potential compromise to the once impregnable safe haven of US Treasuries, and comparatively tighter spreads. While there are signs of increasing risk aversion, flows to equities were positive until June, indicating investors may be trimming positions after Q2's largely unexpected rally.

The first half of 2025 has been a pivotal period for the Agency Residential Mortgage-Backed Securities market. Amid persistent rate volatility and shifting political dynamics, the sector has shown resilience, supported by steady new issuance, modestly faster prepayments, and improving market sentiment. A modest rebound in home purchase activity, driven by rising inventory and builder incentives, has helped offset some affordability pressures. Meanwhile, tight housing supply continues to support home prices and credit quality. Looking ahead to the second half of 2025, the market appears well-positioned for cautious optimism, though participants should stay alert to policy developments, GSE reform, and interest rate changes.

We see healthy CRE and CMBS market growth in 2H2025 as distress in maturity refinance and office fundamentals continues to ease, but would also caution that tariff and inflation risk remains. Our updated projection for 2025 non-agency CMBS issuance has grown to \$140 billion (vs. original projection of \$130 billion) on SASB strength and CRE CLO revival. The delinquency rate of CMBS loans increased only by 47 bps to 6.34% in 1H2025 with office and multifamily stabilizing. For agency CMBS, we expect 2025 issuances to rise 38% to a total of \$165 bn by the end of 2025, and a modest increase in prepayment speeds as Fed easing resumes and multifamily property price improves.

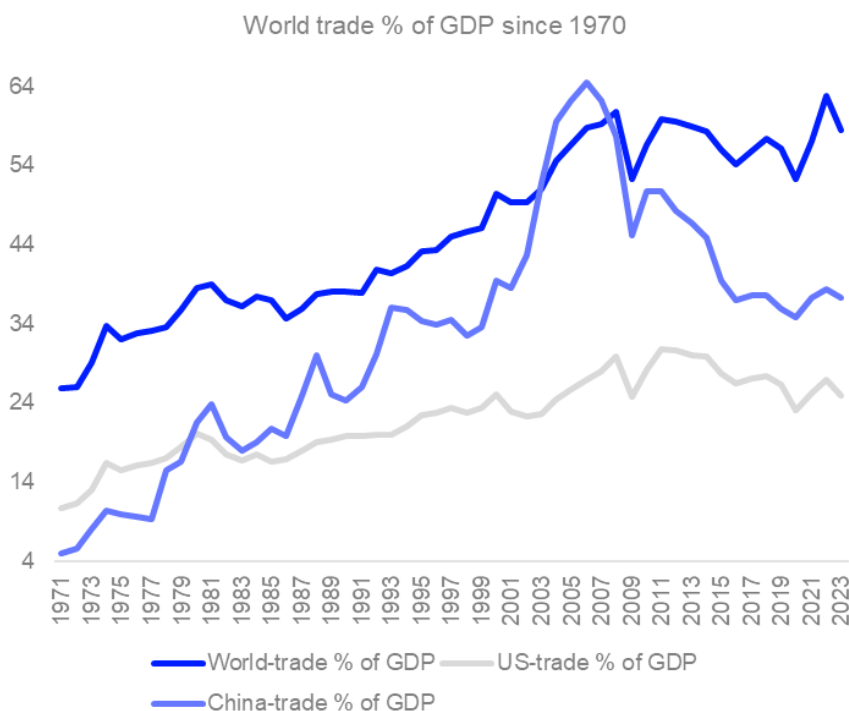
Expectation for Fed rate cuts later in the year is setting up renewed momentum for CLO market growth. Our full-year refinance and reset issuance projection for 2025 is revised upward to \$256bn (vs. \$215bn originally), while the new issuance forecast is tuned down to \$200bn. Though tariff-impacted industries have been underperforming, the overall CLO credit fundamentals are expected to stay steady in 2H2025 with the pace of downgrades decelerating. We look for BSL new issue AAA and BB spreads to tighten to 125 bps and 500 bps by year end, respectively.

# Section 1 – Macro Outlook

## De-globalisation, divergence and debt sustainability remain key

De-globalisation, divergence in growth and inflation and debt sustainability concerns remain the three key macro trends in the global economy, with developing US dollar weakness also an important factor. Ongoing tariff negotiations reflect de-globalisation and a re-structuring of world trade and may well mean the US economy is a less dominant global locomotive for growth in future, particularly given US dollar weakness and the related deterioration in the terms of trade for US consumers. Much of the recent discussion and commentary about tariff increases fails to recognize that the share of world trade in world GDP peaked before the GFC in 2008, and that the golden era of globalization – the integration of economies and financial markets globally – was from the early 1990s to 2008, as Exhibit 1 shows. The era since has been described as “slo-balisation”, and now outright de-globalisation.

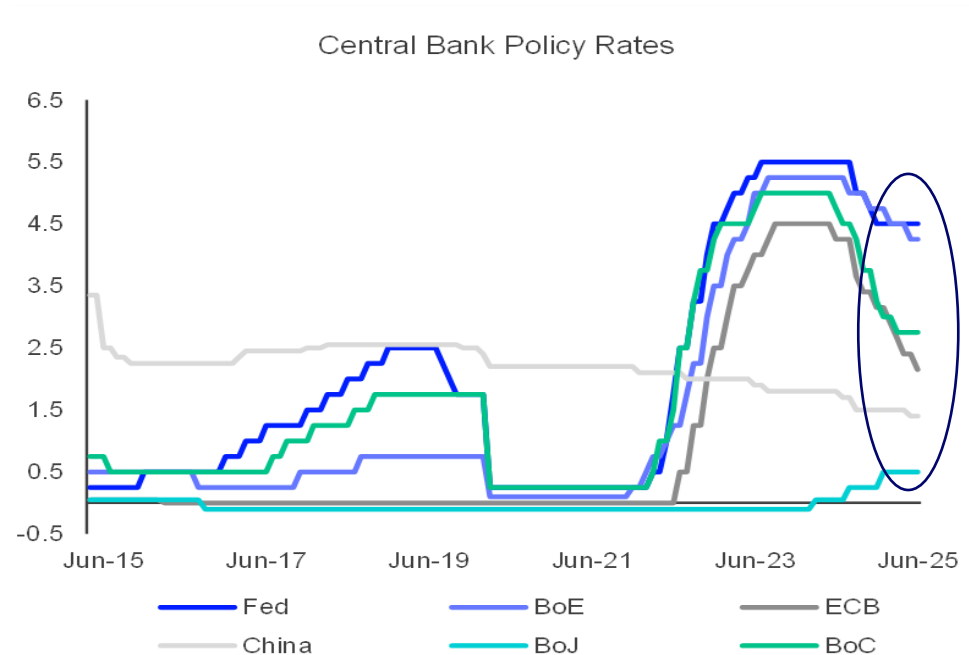
Exhibit 1: World trade as a % of GDP



Source: World Bank data to end-2023.

Notable features of the rapid globalisation era were high cross-border capital and portfolio flows, and close integration of economic and financial cycles, so major economies tended to go boom and bust together, and major central bank easing and tightening cycles were convergent, and led by the US Federal Reserve. But divergent policy approaches to Covid, varied inflation and supply-chain shocks, and the unravelling some free trade treaties agreed in the 1990s (ie, Brexit) have all driven a different monetary policy cycle. Thus the Fed and Bank of England have held rates higher for longer, and lagged well behind easing elsewhere in the G7 and China, as Exhibit 2 shows.

Exhibit 2 Policy rates in the G7 and China – an uncoordinated cycle.



Source: FTSE Russell data to June 30, 2025.

### After the tariff tantrums, debt sustainability moves centre stage

A related development has been a change in the relationship between monetary and fiscal policy in the G7, particularly since Covid in 2020, when governments have struggled to reduce gross debt/GDP ratios. The so-called consensus assignment<sup>1</sup> of monetary policy to the control of demand and inflation, and fiscal policy to the control of government debt prevailed during the rapid era of globalization before the GFC. It also allowed a bigger role for fiscal policy in the special circumstances in which monetary policy may be constrained by design, like a monetary union (Eurozone), or accident, like the zero lower bound on interest rates. But in each case, fiscal policy complements monetary policy by adjusting aggregate demand in the appropriate direction – it does not counter the thrust of monetary policy.

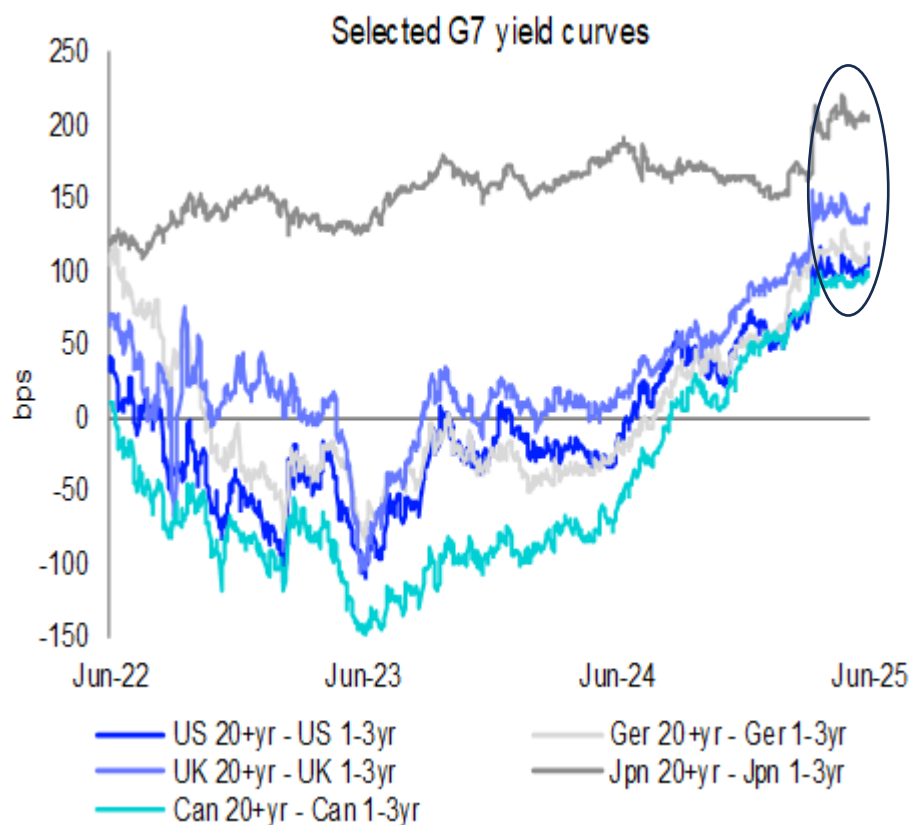
### Investor uncertainty over the nature of fiscal regimes may have driven steeper curves

But this consensus assignment now appears in doubt in several developed economies, increasing investor uncertainty. In our January 2025 Outlook note, we pointed out that investor concerns about govt debt sustainability were already emerging in the G7, as term premia increased and yield curves steepened (please see our Research note<sup>2</sup>). We also pointed out that increases in the stock of U.S. Federal debt, and higher Fed rates to control inflation, had combined to deliver a rapid increase in U.S. debt service costs and begun to transform government finances. Although market focus shifted to US tariffs in the 1<sup>st</sup> half of 2025, the bear steepening of yield curves continued in the G7 economies, as investor concern about G7 debt/GDP ratios above 100%, and stagflation risks increased, as Exhibit 3 shows.

<sup>1</sup> Monetary and Fiscal Policy Interaction: The Current Consensus Assignment in the Light of Recent Developments, [Tatiana Kirsanova](#), [Campbell Leith](#), [Simon Wren-Lewis](#), Economic Journal, 1<sup>st</sup> published, October 2009.

<sup>2</sup> [President-elect Trump and the bond market vigilantes | LSEG](#)

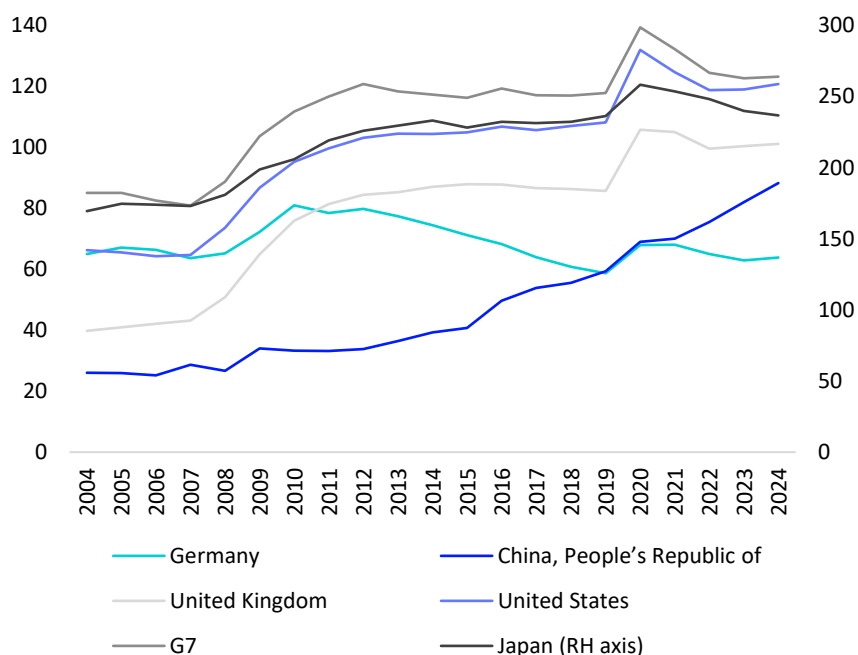
Exhibit 3: G7 government yield curves continue to steepen



Source: FTSE Russell data to June 30, 2025.

Concern over increases in govt debt/GDP ratios has extended to credit rating agencies, with Moody's downgrading its AAA rating on US Treasuries to AA+ in April 2025. More generally, it seems plausible that investor uncertainty over the nature of fiscal regimes may be a factor contributing to the increase in the term premium, due to fears about higher debt issuance. Some of these forces are structural, including the green transition, infrastructure, and defence spending. For example, Germany has now suspended the debt brake to allow for an increase in defence spending as a share of GDP. Exhibit 4 shows the extent of these increases in debt/GDP ratios, driven by the deflationary shocks of the GFC and Covid in 2008-09, and 2020-21, increased infrastructure spending and government support programmes for the economy.

Exhibit 4: Gross govt debt/GDP ratios in the G7 and China



Source: IMF data to end-2024.

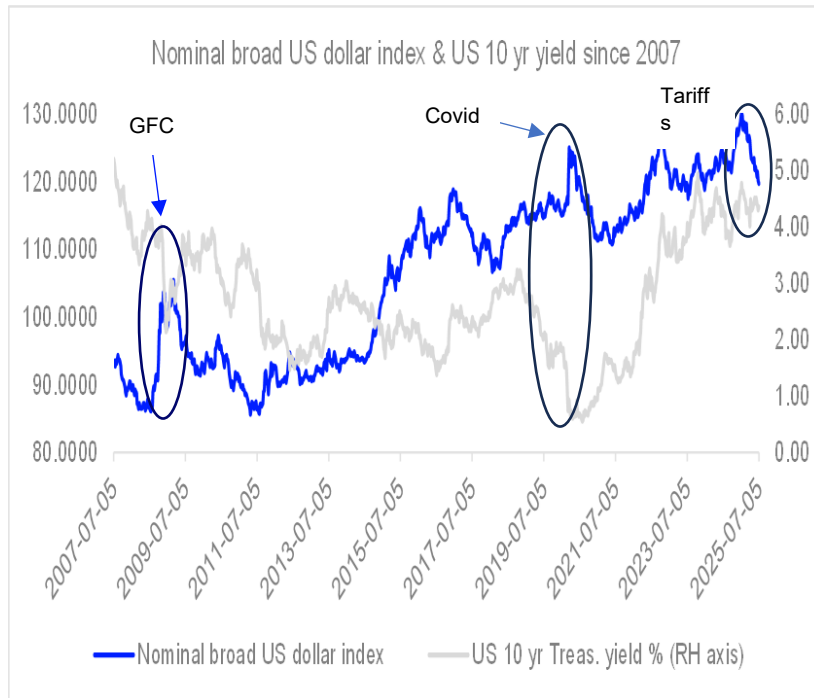
Reflecting these concerns, we also find that US Treasury sovereign spreads have widened against other major markets since Covid, and that the US dollar no longer proved a safe haven during the bout of equity market weakness in April 2025. US spreads have also failed to tighten since the Fed began its policy easing cycle in September 2024, which is in complete contrast to the easing cycles during Covid. Indeed, we find that the FTSE Russell debt capacity world govt bond index (DCWGBI) that adjusts country weights for debt/GDP and debt service costs/GDP has outperformed the unadjusted WGBI. This reflects the 15% underweight in US Treasuries in US Treasuries and the dollar<sup>3</sup>.

Meanwhile, the failure of either the US dollar or Treasuries to provide a safe haven during the tariff-related weakness in equity markets in April, was in stark contrast to Covid and the GFC. Other typical safe haven currencies, like the yen and Swiss franc, and safe haven assets like gold all performed well, suggesting the dollar weakness may be driven by other factors, like reduced foreign purchases of US Treasuries, and a revealed preference of the US administration for a lower US dollar. Exhibit 5 shows this under-performance by the US dollar, after a long period of dollar gains. Also note that the dollar has been subject to major swings in valuation since the Plaza Accord in 1985, both upwards and downwards, and that the 10% decline in 2025 versus some currencies follows an advance of over 30% in the last 10 years.<sup>4</sup>

<sup>3</sup> See [Government debt sustainability: An examination of the FTSE Debt Capacity World Government Bond Index after 10 years | LSEG](#)

<sup>4</sup> Also see [s://www.lseg.com/en/insights/ftse-russell/us-dollar-and-treasuries-reports-of-their-death-may-be-exaggerated#:~:text=Conclusion,as%20a%20global%20reserve%20currency](https://www.lseg.com/en/insights/ftse-russell/us-dollar-and-treasuries-reports-of-their-death-may-be-exaggerated#:~:text=Conclusion,as%20a%20global%20reserve%20currency).

Exhibit 5: US dollar and 10-year Treasury yields since 2007



Source: LSEG, US Federal Reserve, data to July 5, 2025.

### Consequences of higher long-dated yields for LDI and income investors

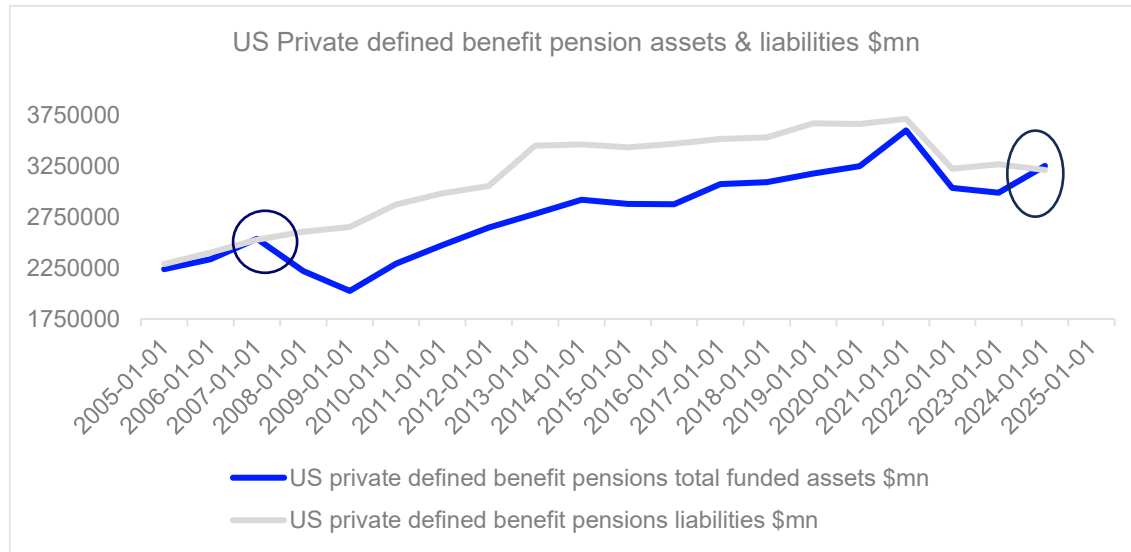
Steeper govt bond curves, and higher yields carry important consequences for both institutional and income investors. For liability-driven investors (LDI), like defined benefit (DB) pension funds – of which there are still about \$25 trillion worldwide – higher discount rates applied to future liabilities mean the valuation of those liabilities has fallen sharply as govt bond yields rose, and yield curves steepened. This is because pension regulators' discount rates and curves are mostly pegged to govt bond yields + a spread of about 50 bp, or a corporate bond yield. As a result, a large number of funds are now in a funding surplus – funded asset valuations exceed their liabilities – after years of deficits, even though the valuation of their fixed income assets has also fallen due to the increase in yields.

Exhibit 6 shows how US private sector DB funds have now moved into surplus for the first time in nearly 20 years. Thus the Milliman Pension funding index for the largest 100 US corporate DB schemes showed a funding surplus in fiscal year 2024, of 101%, for the first time since 2007<sup>5</sup> (using standardised corporate bond discount rates across the funds surveyed). These funding surpluses give an opportunity to these DB schemes to de-risk by matching longer term liabilities on the most favourable yield terms in fixed income since before the GFC. Unsurprisingly, LDI driven flows into fixed income/bonds appear to be increasing.

<sup>5</sup> Milliman 2025 Corporate Pension Funding survey, April 30, 2025.



Exhibit 6: Private pension schemes move into funding surplus

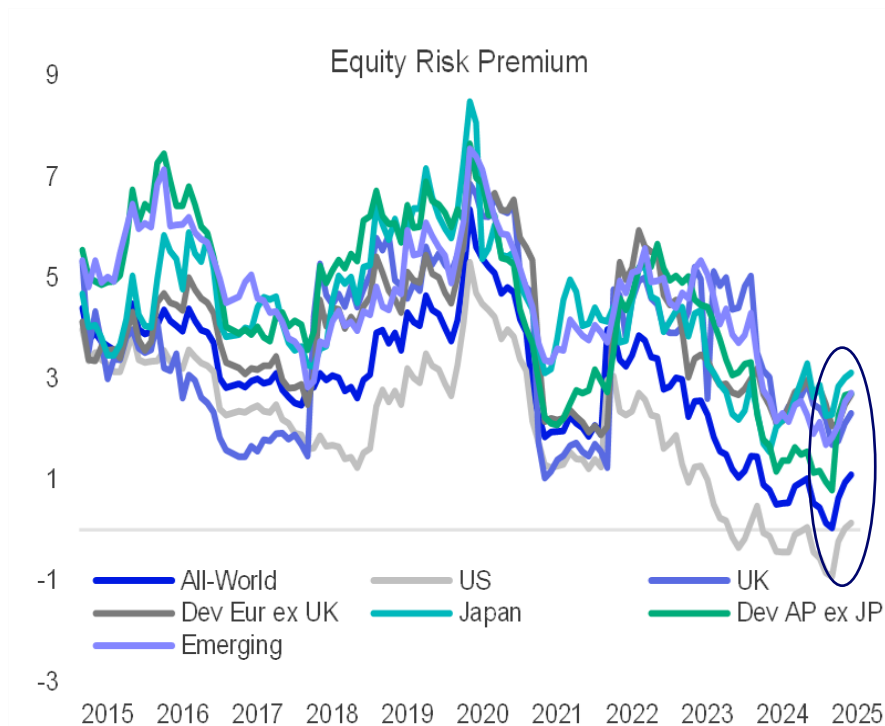


Source: US Federal Reserve (Financial Accounts Z1 of the US), June 2025.

### Relative valuation of fixed income now attractive versus equities and for income investors

Relative valuation of fixed income versus equities, particularly medium and longer dated govt bonds, has also become highly favourable on most metrics, after the steep rise in nominal and real yields since 2021, and strong recovery in equities. Looking at major markets, the US has the lowest equity risk premium, reflecting the higher market valuation relative to Europe and APAC, as Exhibit 7 shows.

Exhibit 7: Equity risk premia in major markets.



Source: LSEG data to July 2<sup>nd</sup>, 2025.

Finally, govt bond yields of 4.5-5.5% in parts of the curve are at the highest levels since before the GFC in UK gilts and Treasuries, particularly, and gives an attractive coupon income for investors. These higher yields are available just as the correlation between govt bond returns and equity returns has fallen back below the longer term mean of 0.4 (FTSE Russell WGBI versus FTSE Russell Global All Cap equities), enhancing the portfolio diversification benefits of govt bonds, as Exhibit 8 shows. These counter-vailing forces may cap the rise in govt bond yields in 2025-26, even if further central bank policy ensures yield curves retain positive gradients, after the normalization of curves in 2024-25.

Exhibit 8: Correlation between world stock and bond returns



Source: LSEG data to July 2<sup>nd</sup>, 2025.

## Section 2 – Equities Outlook

### Equities rebound from tariff shock amid resilient earnings and stabilizing revisions

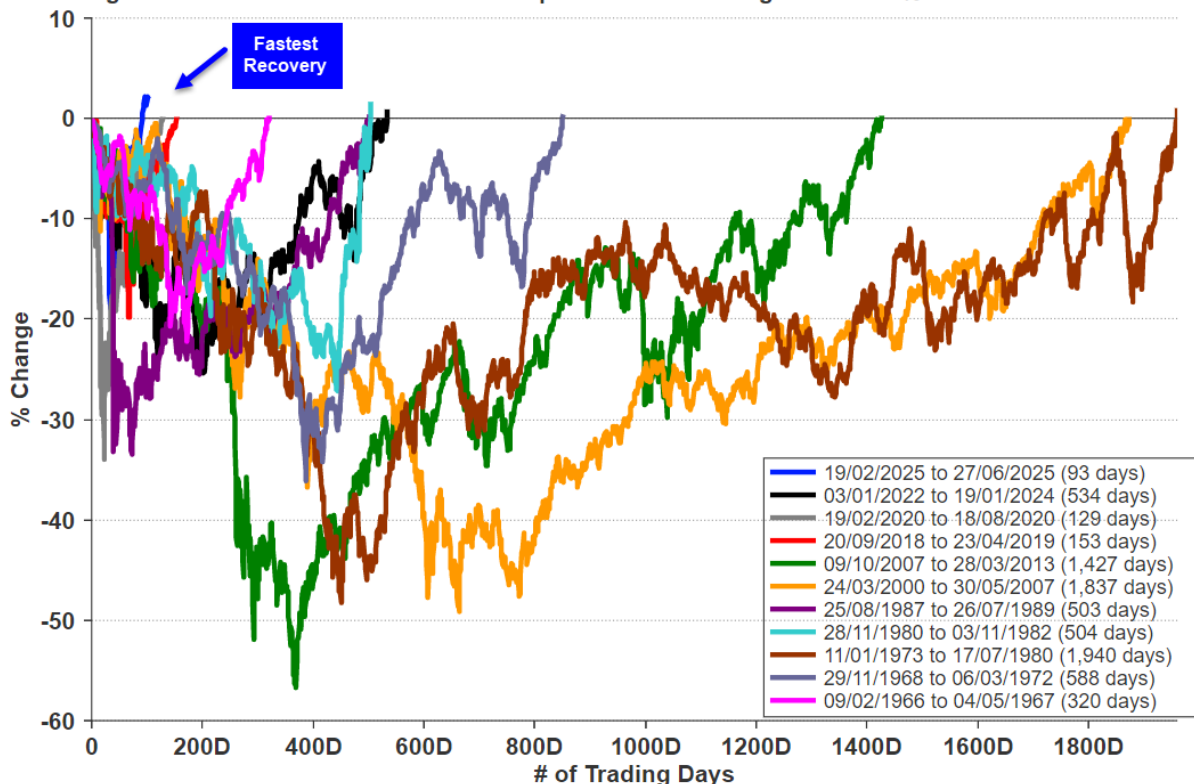
The first half of 2025 was a challenging environment for investors to navigate. The year began with strong optimism around the benefits of artificial intelligence and expectations of pro-growth policies being implemented, including tax cuts and deregulation. That optimism was upended when President Trump launched his campaign to address the fiscal deficit, which stood at 6.1% of nominal GDP (\$1.8 trillion at the end of 2024). This was centred on tariffs, and President Trump announced 'Liberation Day' on April 2<sup>nd</sup>, sending shockwaves through global markets. Markets grew concerned about the implications for global stagflation and corporate profitability as a higher inflation environment would raise input costs and disrupt supply chains, while also denting consumer demand.

'Liberation Day' triggered one of the largest *and* fastest equity market sell-offs since the Great Financial Crisis of 2008 and COVID-19 Pandemic of 2020. Exhibit 1 shows the most severe drawdowns in the S&P 500 over the past six decades. The index fell 18.9% from peak-to-trough between February 19<sup>th</sup> to April 8<sup>th</sup>. But a severe sell-off across both equity and bond markets prompted a 90-day deferral of the initial announcement on April 9<sup>th</sup>. Supported by resilient macro and labor conditions, the index staged the fastest recovery in history, reaching a new all-time high on June 27<sup>th</sup> – just 63 trading days after the initial 'Liberation Day' declaration.

Exhibit 1: Major S&P 500 Drawdowns since 1966.

### S&P 500 Drawdowns

How long it took the S&P 500 to recover to its previous all-time high after a 19%+ drawdown



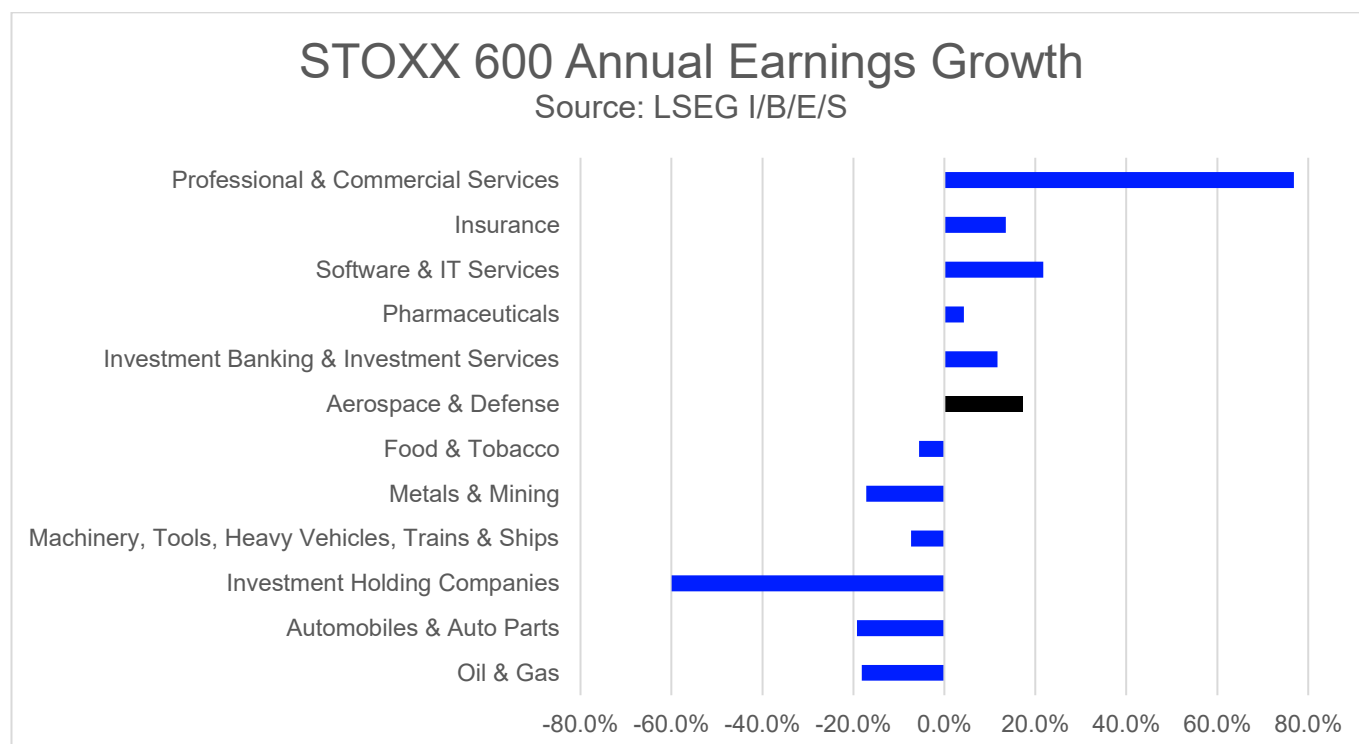
Source: LSEG Datastream

## European Defence Shares Surge in H1

While U.S. markets experienced extreme volatility in the first half of the year, European equities fared better and had their strongest start to the year since 1998. The European Union announced a €1.5 billion initiative to increase defence spending, with member states committing to raise expenditures from 2.0% to 5.0% of GDP. The FTSE Europe Aerospace and Defence Index has risen 75% year-to-date (USD terms), its strongest start to a year since the index's inception in 1993.

Both U.S. and European Aerospace & Defense companies have seen earnings estimates rise sharply. The STOXX 600 Aerospace & Defense industry is expected to post earnings growth of 121.2% this quarter, while the S&P 500 equivalent is forecast to grow 31.7%. Notably, both industries rank among the top five sectors for earnings growth within their respective index this quarter, highlighting a consistent positive outlook amongst geographies. Following the EU announcement, Aerospace & Defense is forecasted to have an annual earnings growth rate of 17.1%, which is the fifth highest of any industry from an earnings growth perspective (Exhibit 2).

Exhibit 2: STOXX 600 Annual Growth Rates



Even after the strong European rally, equities remain significantly undervalued versus the US, trading at a forward P/E of 14.2x, a 35% discount to the U.S. This can be explained by the index composition of the two markets, where the U.S. has a high-growth technology weighting of over 35% and yields a stronger earnings growth rate. Europe's forward 12-month earnings growth rate stands at 7.7%, compared to 12.0% in the U.S., according to LSEG Datastream.

Despite elevated valuations in the U.S., the S&P 500 has remained resilient in the face of multiple macroeconomic headwinds. This may be explained by tariffs having a limited impact thus far, as core CPI has surprised to the downside for five consecutive months. Furthermore, the passing of the One Big Beautiful Bill, net profit margins near a record high at 12.5%, anticipated rate cuts, and increased M&A activity via anticipated deregulation could all be considered positive catalysts for equity markets. This optimism appears in consumer and business sentiment, which bottomed out in April when looking at surveys including ISM, NFIB, Consumer Confidence, and AAI.

Nevertheless, tariffs remain a risk to the market in addition to other primary risks including geopolitical tension, and a rising fiscal deficit. Secondary risks include rising levels of student loan and credit card delinquency rates amongst households. Additionally, the equity bond-yield correlation turned negative in May, which puts further pressure on equities should yields rise further.

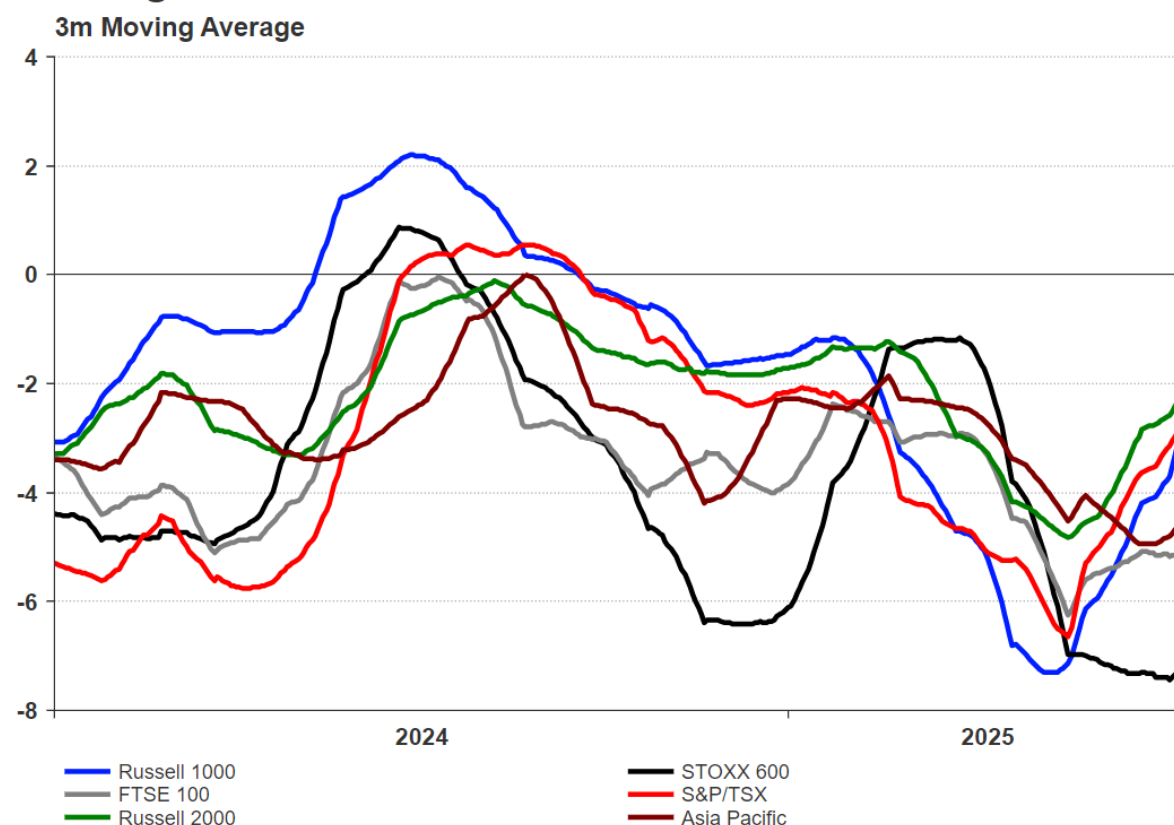
As it stands, U.S. equities are near all-time highs at a forward P/E of 22.4x – essentially unchanged from the start of the year and sit near the top decile of valuations relative to the past four decades. Given the current forward P/E and a consensus EPS estimate of \$280.06, the S&P 500 implies a fair value of 6,273, slightly above the consensus median price target of \$6,075, according to LSEG Workspace.

## Earnings Revisions Bottoming Out?

With many moving parts at play, we shift our focus to earnings, which remain the core lens through which investors evaluate companies' ability to manage tariffs and protect margins, and ultimately shape the trajectory of stock prices. The earnings revision ratio, which measures the balance of upward versus downward next-twelve-month (NTM) estimate changes has bottomed out in May across most major global markets, signalling a potential inflection point in analyst sentiment (Exhibit 3). Using the S&P 500 as an example, 2025 and 2026 estimates are currently \$263 and \$300 per share respectively – revised down by only four percent since the start of the year, despite tariffs and market uncertainty higher today than at the start the year.

Exhibit 3: Earnings Revision Ratio

## Earnings Revision Ratio



Source: LSEG Datastream

## S&P 500 Q2 Earnings Outlook: Another 'Earnings Hook'?

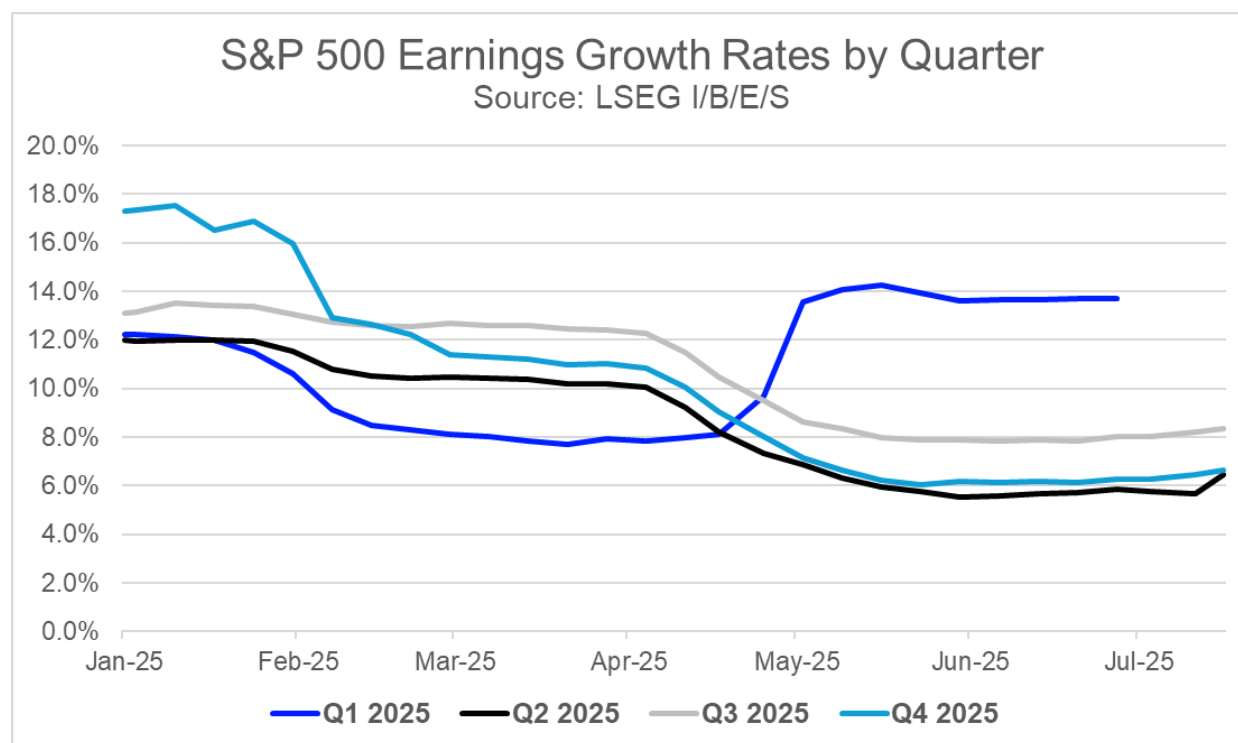
The LSEG Proprietary Research team provides real-time market insights during earnings season and using data from the S&P 500 Earnings Scorecard, Q1 saw year-over-year growth estimates decline by roughly 400 basis points to 8.0% heading into the reporting season. We note that the impact of tariffs was not yet visible, as results captured in the quarter preceded the April announcement. Companies were also able to manage immediate concerns as they had excess inventory on-hand and front-loaded purchases in anticipation of future tariff enforcement. Given the low expectations heading into the quarter, this resulted in an "earnings hook", with most companies beating analyst forecasts and surprising to the upside. Q1 earnings growth finished at 13.7%, a 580-basis point improvement from initial expectations.

More notable was the widespread absence or withdrawal of guidance. Transcript analysis from LSEG Workspace shows that many firms were unable to provide clarity on how tariffs would impact full-year results. In several cases, companies caveated their guidance ranges, explicitly noting the exclusion of tariff impacts, while a small handful withdrew guidance altogether. The

opacity around guidance was reflected in analyst estimates for Q2 and beyond, which were revised lower as Q1 results were released (Exhibit 4).

Turning to Q2, investors hope to receive greater clarity around tariffs and the impact on input costs, supply chains, and consumer demand. Heading into the Q2 reporting season, which starts in July, we saw 70 negative pre-announcements from S&P 500 companies, compared to 46 positive ones, yielding a negative-to-positive ratio of 1.5. This was an improvement from the prior quarter's ratio of 2.5 (a lower ratio typically signals greater optimism heading into earnings).

Exhibit 4: S&P 500 Earnings Growth Rate for 2025



Q2 growth expectations at the start of the earnings season were the lowest of any quarter for 2025 at 5.7%, after being revised down from 12.0% at the start of the year, creating another “earnings hook” setup. All sectors except for Real Estate saw downward revisions heading into the quarter, with Energy, Health Care, and Consumer Discretionary seeing the largest negative adjustments.

Only two sectors including Communication Services and Information Technology are forecast to post double-digit earnings growth this quarter. Seven sectors are forecast to post earnings growth ranging from -3% to +3%, highlighting narrow breadth.

Q2 kicked off with the banks reporting stronger results than expected, lifting earnings growth to 6.7% after the first week of results. Thus far, 81.4% of companies have exceeded analyst estimates, with an earnings surprise rate of 7.2% – both above long-term averages, signalling a strong start to the quarter.

## AI Capex Spend Reaches All-Time High

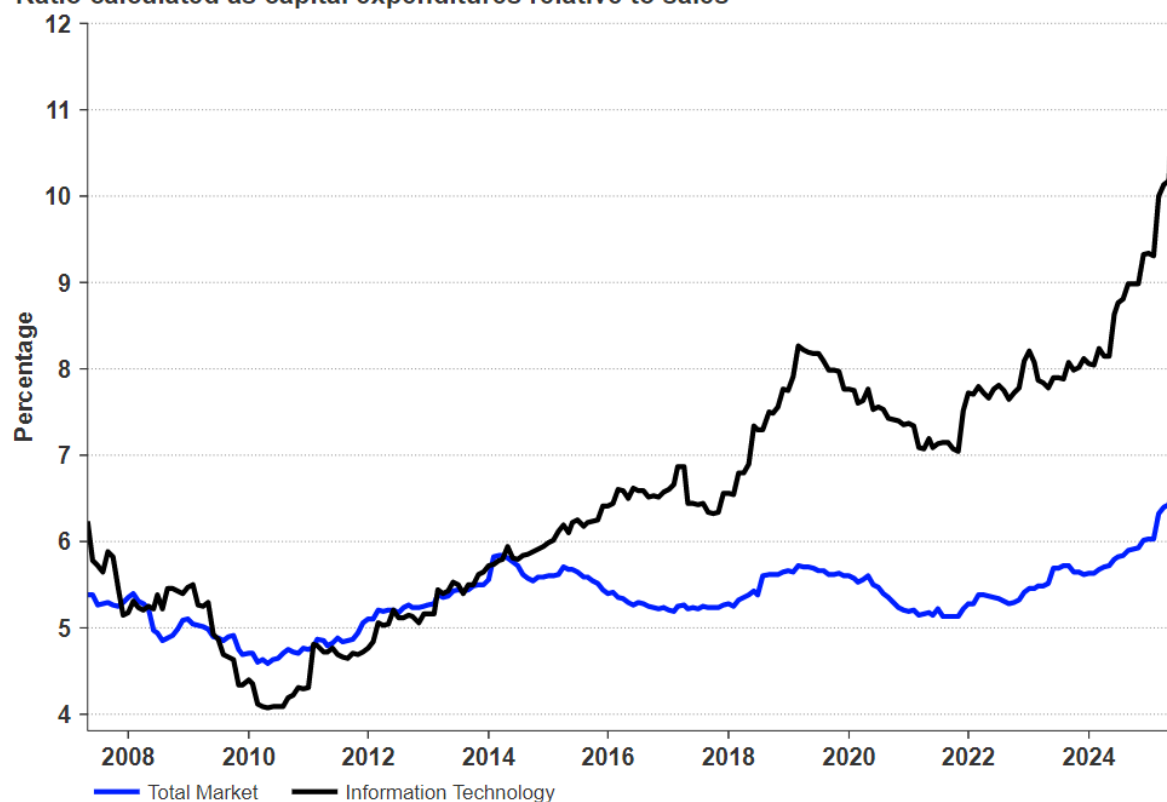
Information Technology is expected to deliver the strongest earnings growth contribution in Q2, which saw the sector sell-off in January due to the DeepSeek-R1 announcement. The sector has remained resilient so far as the Russell 1000 Equal Weight Index relative to the Russell 1000 has declined to 1.11 – its lowest level since May 2004, highlighting the outsized contribution of a concentrated group of companies including the Magnificent-7. The Mag-7 market-cap weight in the Russell 1000 remains near an all-time high at 31.4%.

The DeepSeek-R1 announcement questioned the scale of AI-driven capital expenditure budgets across many companies in the Mag-7, who combined, have committed hundreds of billions on AI investment. To illustrate this, capex intensity in the sector reached an all-time high at 11.2% according to LSEG Datastream, compared to 6.6% for the entire U.S. market (Exhibit 5).

Exhibit 5: Capital Expenditures Intensity Ratio

## Technology Capital Expenditures Intensity at an All-Time High

Ratio calculated as capital expenditures relative to sales



Source: LSEG Datastream

Within the Mag-7 (excluding Tesla), the group responsible for the lion's share of AI capex, the combined capital expenditure across the group totals \$333.8 billion, against total revenues of \$2.3 trillion. This yields an aggregate capex intensity ratio of 14.4%. The next-twelve-month (NTM) capex estimate using LSEG I/B/E/S data is projected to grow by 23.1% compared to the last-twelve-month actual (LTM).

Meta Platforms has the highest capex intensity ratio of 32.8% and a 52% increase in capex versus LTM, followed by Microsoft at 23.0% and Alphabet at 18.4%, with respective growth rates of 20.0% and 30.9%. Amazon, while showing a lower capex intensity of 13.9%, has the highest absolute capex spend at \$102.2 billion. In contrast, Apple and NVIDIA report much lower capex intensity ratios of 2.7% and 2.0%, respectively (Exhibit 6).

Exhibit 6: Mag-7 Capex Intensity Ratio

		NTM I/B/E/S Estimate (\$m)		Capex Intensity Ratio	NTM vs. LTM Growth in Capex
RIC	Name	Capex	Revenue		
META.O	Meta Platforms Inc	66,577	203,220	32.8%	52.0%
MSFT.O	Microsoft Corp	73,612	320,635	23.0%	20.0%
GOOGL.O	Alphabet Inc	75,533	411,325	18.4%	30.9%
AMZN.O	Amazon.com Inc	102,238	734,760	13.9%	9.8%
AAPL.O	Apple Inc	11,356	426,348	2.7%	2.6%
NVDA.O	NVIDIA Corp	4,511	228,481	2.0%	10.2%
Total		333,828	2,324,769	14.4%	23.1%

Source: LSEG Workspace, LSEG I/B/E/S

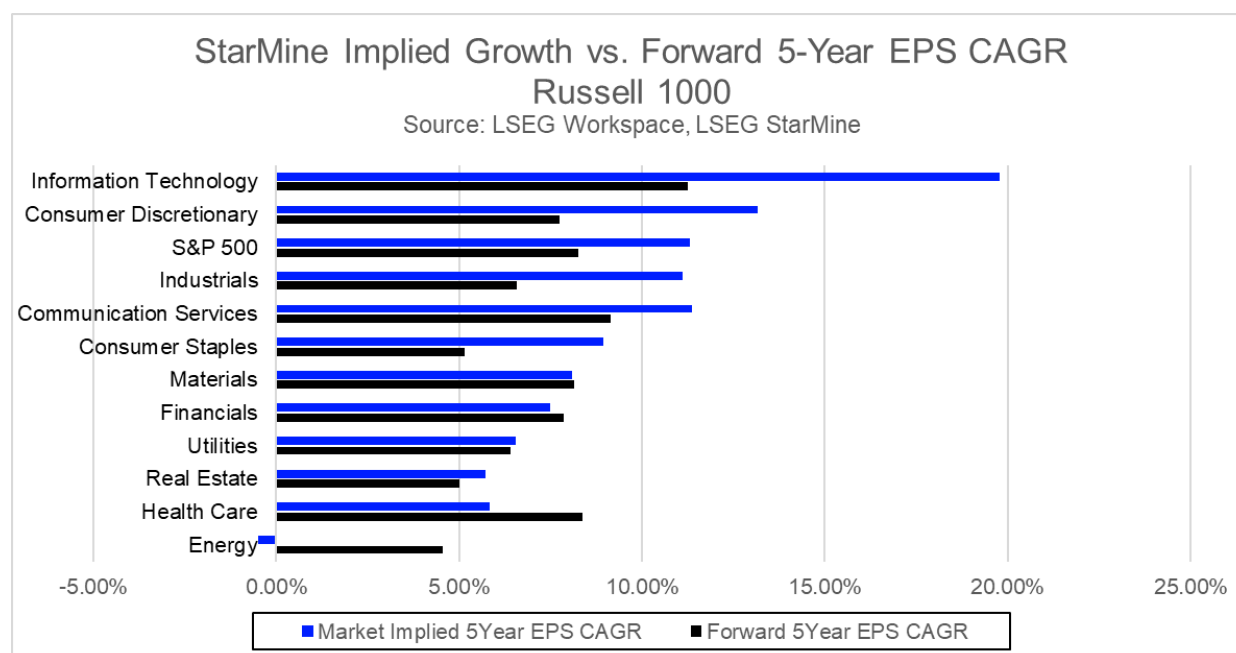


## Market-Implied Growth: What's Already Priced In?

The technology sector trades at a forward P/E of 29.7x, well above its 10-year average of 21.4x. Earnings expectations are elevated when viewed through the lens of the StarMine Intrinsic Value (IV) model, which estimates that Technology has the highest market-implied 5-year EPS CAGR of any sector in the Russell 1000 at 19.9% – significantly above its forward 5-year EPS CAGR of 11.9% (Exhibit 7). The forward growth rate begins with the StarMine SmartEstimate, which places greater weight on the timeliest and most accurate analysts. The IV model then adjusts the SmartEstimate to account for analyst optimism bias, creating a more refined starting point to calculate the stream of expected future cash flows. This adjusted stream is a central input into the IV model when calculating an intrinsic value, and the output of the model reinforces the view that current valuations are pricing in substantial long-term earnings growth.

Health Care and Energy are the only two sectors where the forward 5-year EPS CAGR materially exceeds the market-implied growth rate – a contrarian signal that current market pricing may be discounting these sectors too heavily relative to their fundamental earnings potential.

Exhibit 7: StarMine Intrinsic Value – Market Implied vs. Forward EPS CAGR



## Small-Cap Earnings Growth to Outpace Large-Caps

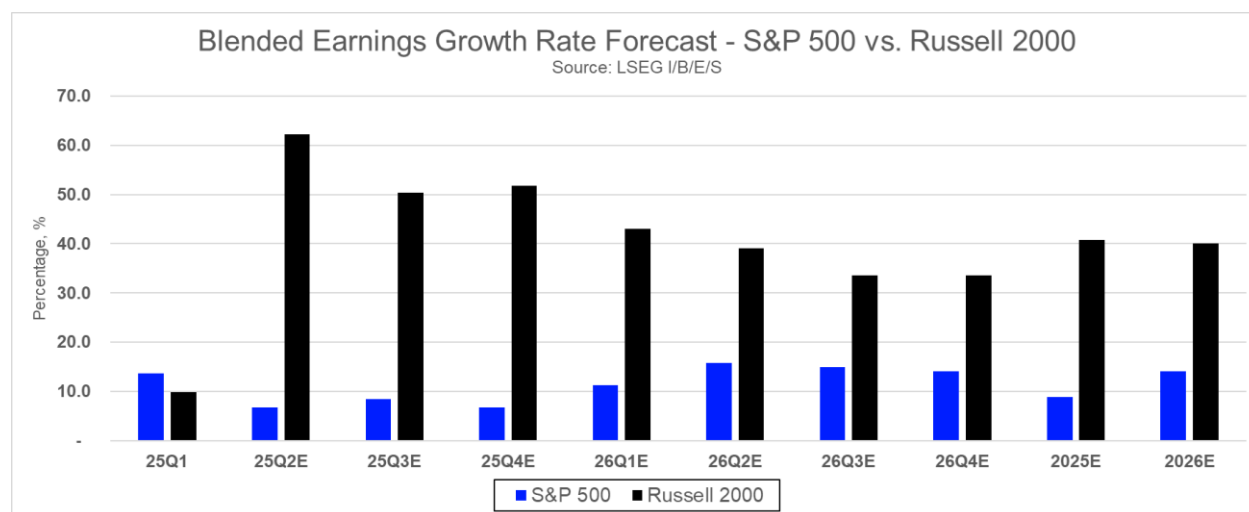
Given elevated valuations and high growth expectations embedded in large-cap equities, investors may begin to revisit other areas of the market that have lagged, including small caps, which have yet to participate in the current market rally. The Russell 2000 is flat year-to-date and 8% below its all-time high. Small-cap companies generally face greater challenges including less operational flexibility, limited scale, and higher sensitivity to interest rates and macroeconomic conditions. They structurally exhibit lower profit margins which contribute to them trading at a discount to large caps, reflected in a current forward P/E of 16.3x (excluding Health Care).

Encouragingly, the earnings outlook for small caps is notably stronger than their large-cap counterparts, based on consensus analyst estimates (Exhibit 8). Q2 earnings for Russell 2000 are expected to grow 62.2%, with full-year 2025 earnings projected to rise 40.8%, compared to 8.8% for S&P 500. This trend is expected to continue into 2026, with earnings growth of 40.1% for Russell 2000 versus 14.1% for S&P 500.

When excluding Health Care, full-year earnings growth estimates for the Russell 2000 fall to 16.1% in 2025 and 27.5% in 2026. The Health Care sector is currently unprofitable on an aggregate basis, and its large year-over-year growth contribution reflects companies losing less money than they did a year ago. While the trend toward reduced losses over the next two years is encouraging, it reflects a different growth profile, standing in contrast to sectors compounding from an already profitable base.



Exhibit 8: Forecast Earnings Growth Rate for S&amp;P 500 and Russell 2000



### International Revenue Exposure: Who is most Exposed?

With the U.S. dollar off to its weakest start to the year in three decades, and the Euro benefiting most, currency effects may provide a modest tailwind to U.S. companies with high international revenue exposure. Dollar weakness stems from inflation and fiscal deficit concerns, the latter causing Moody's to downgrade the U.S. long-term issuer rating to Aa1 in May. Our regression model, based on two decades of data, shows that for every 1% depreciation in the dollar, S&P 500 EPS growth historically improves by approximately 0.6 percentage points.

Using the StarMine Countries of Risk Model, approximately 38% of S&P 500 revenue is derived from international markets (including only constituents with available data), of which 7% comes from China. Information Technology, Consumer Discretionary, Health Care, and Industrials have the highest international exposure. For the Russell 2000, 32% of revenue is generated abroad, of which 5% comes from China. Industrials and Consumer Discretionary have the highest international exposure.

However, the expected benefits from a weaker US dollar may be modest in the current environment. Trade tensions and macro conditions could overshadow any FX-related upside. If the economy slows, weaker top-line growth across sectors can more than offset modest gains from currency translation.

### Conclusion

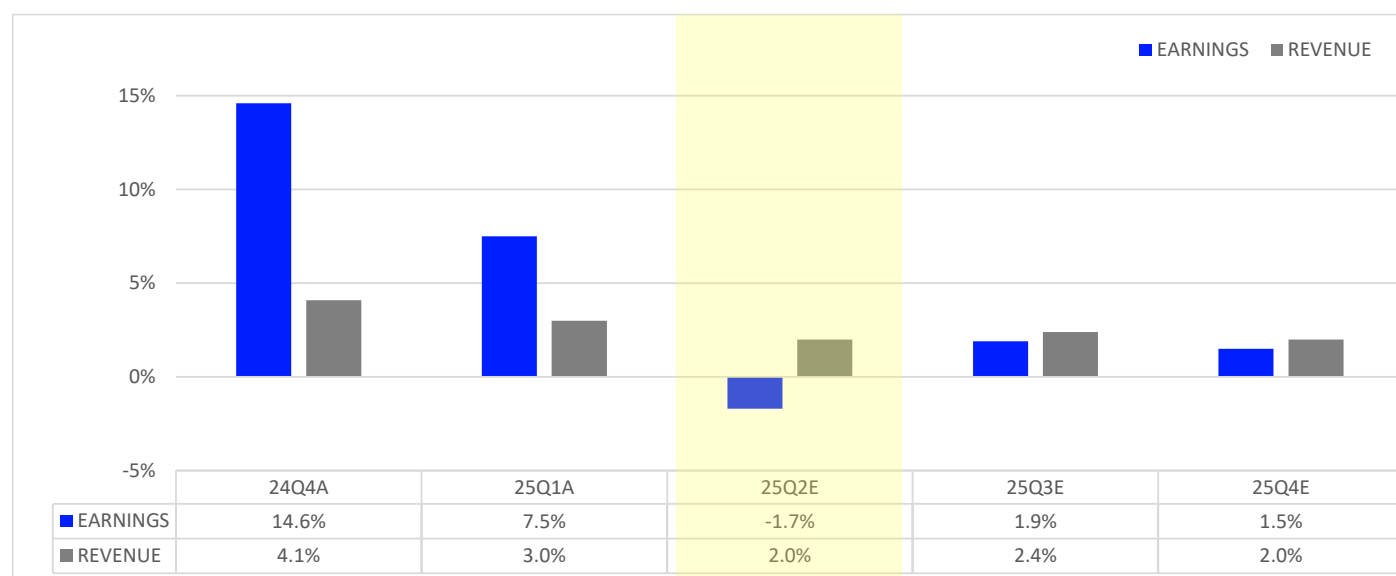
Looking ahead, investor sentiment appears cautiously optimistic, but the path forward will likely hinge on how companies navigate tariffs. Given current market pricing, we expect earnings to be a key driver of equity prices and note a potential downside risk should companies face rising input prices and weaker consumer demand, given how price sensitive and selective consumers are. Markets have priced in two to three rate cuts over the next twelve months, which should reduce yields and provide a cushion for equities to overcome any near-term headwinds from tariff uncertainty.

## Section 3 – Retail Consumer Outlook

### Retail's Reality Check: Growth Slows, Sentiment Sours, and Tariffs Loom

After seven consecutive quarters of double-digit growth, the LSEG Retail/Restaurant Index posted a 7.5% blended earnings growth rate for Q1 2025 (Exhibit 1). Of these companies, 65.0% reported earnings above analyst expectations, 5% matched and 30% reported earnings below analyst expectations. In a typical quarter, 71.5% of companies beat estimates, 3% matched and 25.4% missed estimates. Over the past four quarters, 69% of companies beat the estimates, 5% matched and 26% missed estimates. In aggregate, companies are reporting earnings that are 7.5% above estimates, which compares to a long-term average surprise factor of 12.9% and the average surprise factor over the prior four quarters of 8.3%.

Exhibit 1: The LSEG Retail/Restaurant Earnings Index: Q4 2022 Act – Q4 2025 Est.



Source: LSEG I/B/E/S

Consumer spending continues to benefit from a resilient labor market, though momentum has begun to moderate. The resumption of student loan payments in the U.S. has added financial pressure on households, compounding concerns over rising tariffs. Earlier this year, anticipation of new tariffs prompted a pull-forward in spending, particularly on big-ticket items like motor vehicles. All the heightened discussion around tariffs has not only impacted business strategies but also weighed on consumer sentiment. The constant media coverage and policy uncertainty have made consumers increasingly anxious about potential price hikes and economic instability, further dampening their willingness to spend. Moreover, it has led many retailers to revise their earnings outlook downward for the remainder of the year.

Accordingly, the Q1 2025 LSEG Retail/Restaurant Index's 7.5% earnings growth rate is expected to decline to -1.7% in Q2 2025, its first negative showing since the pandemic, underscoring a slowdown in consumer spending (Exhibit 1). The index is also estimated to remain in the low single digits for the second half of the year. Similarly, the blended revenue growth estimate for the 197 companies in this index is 2.0% for Q2 2025 (Exhibit 1). This is the weakest showing since the pandemic and is also expected to remain below 3.0% for the second half of the year. Looking ahead, retailers are bracing for a challenging and volatile environment. They report that consumers are increasingly value-conscious, navigating a landscape shaped by persistent inflationary pressures, geopolitical tensions, regulatory uncertainty, and tariff-related disruptions.

A closer look at the data reveals that this year's slowdown is concentrated around three main consumer sectors. The Leisure Products sector is expected to post the weakest Q2 2025 performance, with profits projected to decline by 44.7% (Exhibit 2). The Textiles, Apparel & Luxury Goods sector follows, with a -44.4% growth estimate that reflects underlying softness in earnings momentum. Both sectors are also forecast to deliver the weakest earnings growth in the second half of the year. Additionally, the Household Durables sector is on track to report negative earnings growth for 2025, further highlighting the pressure facing consumer discretionary categories.

Exhibit 2: The LSEG Retail Index Sectors: Q4 2022 Act – Q4 2025 Est.

GICS Industry	Q1 2025 Act.	Q2 2025 Est.	Q3 2025 Est.	Q4 2025 Est.	CY 2025
Distributors	-16.1%	-7.7%	7.6%	12.3%	-2.4%
Hotels, Restaurants & Leisure	11.4%	12.7%	11.6%	19.4%	13.5%
Household Durables	-17.5%	-23.2%	-16.5%	-18.1%	-18.7%
Household Products	0.6%	-0.9%	0.1%	5.1%	1.3%
Consumer Staples Distribution & Retail	-5.5%	0.0%	1.6%	5.6%	0.7%
Leisure Products	-16.1%	-44.7%	-15.3%	-8.7%	-23.4%
Broadline Retail	57.2%	3.1%	3.8%	-3.7%	10.7%
Personal Care Products	-15.2%	-22.6%	16.4%	21.7%	-1.3%
Specialty Retail	-0.8%	2.3%	4.8%	2.0%	2.1%
Textiles, Apparel & Luxury Goods	-42.1%	-44.4%	-22.9%	-9.1%	-27.1%
<b>TOTAL</b>	<b>7.5%</b>	<b>-1.7%</b>	<b>1.9%</b>	<b>1.5%</b>	<b>2.1%</b>

Source: LSEG I/B/E/S

This is in line with the LSEG/Ipsos Primary Consumer Sentiment Index, which finds that overall American consumer sentiment has declined for three consecutive months. The latest drop in consumer sentiment is driven by a sharp decline in purchasing comfort and the continued decline in current views of the job market. Previously, much of the unease shown by consumers was rooted in fears about the future of the economy. However, consumers are now more pessimistic about their current situation. American consumer confidence continues to demonstrate the broader economic uncertainty the public feels today.

Despite broader sector challenges, there are pockets of optimism. Looking ahead to Q2 earnings, analysts surveyed by LSEG are already bullish on Amazon. The consensus estimate for Amazon's Q2 2025 EPS stands at \$1.31. Notably, a highly rated five-star analyst with a very accurate rating has issued a Bold Estimate of \$1.53, above the consensus. This divergence suggests a potential earnings beat and the possibility of a positive surprise when Amazon reports.

The StarMine SmartEstimate is a weighted average of analyst estimates, with more weight given to more recent estimates and more accurate analysts. Our studies have shown that when the SmartEstimate differs from the consensus (I/B/E/S mean) by more than 2%, the company is likely to post subsequent earnings surprises, which are directionally correct 70% of the time. This percentage difference is referred to as the Predicted Surprise (PS%) (Exhibit 3).

Exhibit 3: Amazon StarMine Predicted Surprise %: Q2 2025 Est.

Earnings Per Share, Q2 Jun-25 (This QTR)	
▼ EARNINGS PER SHARE - Consolidated USD Per Share ⓘ	
Custom Calculated Mean	\$ 1.31
SmartEstimate®	\$ 1.35
Mean	\$ 1.31
Predicted Surprise %	3.14%
Median	\$ 1.32
Low: \$ 1.00 High: \$ 1.54	

Source: LSEG Workspace

Similarly, the companies listed below have a Predicted Surprise exceeding 2.0% for Q2 2025, Q3 2025, and the current fiscal year. This indicates a strong likelihood of outperforming earnings expectations and delivering positive surprises.

Exhibit 4: Strongest StarMine Predicted Surprise %: 2025 Est.

Identifier	Company Name	Earnings Per Share - Predicted Surprise PCT		
		Current Qtr (FQ1)	Next Qtr - (FQ2)	Current FY (FY1)
UEIC.OQ	Universal Electronics Inc	15.8%	7.9%	4.3%
FL.N	Foot Locker Inc	5.4%	2.6%	3.3%
WHR.N	Whirlpool Corp	5.2%	4.7%	2.9%
CHDN.OQ	Churchill Downs Inc	3.9%	4.7%	5.1%
DDS.N	Dillard's Inc	3.3%	5.2%	2.5%

Source: LSEG Workspace

Conversely, the companies listed below have a negative Predicted Surprise of less than -2.0% for Q2 2025, Q3 2025, and the current fiscal year; indicating they are likely to miss earnings expectations and deliver negative surprises.

Exhibit 5: Weakest StarMine Predicted Surprise %: 2025 Est.

Identifier	Company Name	Earnings Per Share - Predicted Surprise PCT		
		Current Qtr (FQ1)	Next Qtr - (FQ2)	Current FY (FY1)
ANDE.OQ	Andersons Inc	-7.3%	-3.6%	-2.3%
MGM.N	MGM Resorts International	-6.2%	-12.9%	-4.8%
SNBR.OQ	Sleep Number Corp	-4.6%	-8.3%	-25.0%
TLYS.N	Tillys Inc	-3.7%	-4.0%	-2.4%
AAP.N	Advance Auto Parts Inc	-2.8%	-2.2%	1.2%

Source: LSEG Workspace

## Pricing Pressures

According to the U.S. Bureau of Labor Statistics, the Consumer Price Index (CPI) rose 0.3% month-over-month from May to June 2025, and 2.7% year-over-year. Retailers continue to face headwinds from weak consumer sentiment and a value-conscious shopper grappling with elevated living expenses. The CPI data highlights that consumers are contending with higher costs for essentials such as food, electricity, medical care, and transportation compared to a year ago.

However, apparel prices have bucked the broader inflation trend, declining 0.3% month-over-month (unadjusted) and 0.5% year-over-year. This trend is consistent with LSEG data, which shows widespread apparel price reductions. In collaboration with Centric Market Intelligence, we are tracking weekly average original prices across selected categories in U.S. mall stores. Since December 2024, average prices have been monitored weekly through June 2025. Among the categories tracked, Men's Apparel has experienced the steepest decline, with prices falling 3.0%, followed by Women's Apparel falling 2.2% (Exhibit 6).

Exhibit 6: Average Price Changes: December 2024 – June 2025 Est.

	Women's Apparel	Men's Apparel	Footwear	Accessories	Backpacks
% Price Changes	-2.2%	-3.0%	-0.1%	0.6%	-1.4%

Source: Centric Market Intelligence.

Amid rising costs for essentials such as food, housing, and energy, apparel stands out as one of the few categories experiencing outright price declines. This deflationary trend may signal a broader consumer pullback. According to LSEG Retail Index data, the apparel sector is on track to post the weakest earnings growth in 2025. Brands caught between rising production costs and softening demand are increasingly turning to discounting strategies, an approach that risks eroding both margins and brand equity.

Despite inflation across most sectors, falling apparel prices, driven by subdued demand, excess inventory, and retailers' reluctance to pass on cost increases all highlight the strain on consumer spending. This underscores the delicate balance retailers must strike between maintaining competitiveness and protecting profitability in today's volatile economic landscape.

## Retail Same Store Sales

In the retail sector, approximately 42% of the companies in our SSS index are on track to deliver positive same-store sales (SSS) results for 2025. Aritzia led the pack with the strongest SSS performance in Q1 and is expected to maintain robust comps throughout the year. Similarly, Ralph Lauren and TJX are also projected to post consistently healthy same-store sales in 2025.

Exhibit 7: Retail Strongest SSS estimates: Q1 2025 – Q4 2025

Retailer	Ticker	Q1 2025 Act.	Same Store Sales Estimates		
			Q2 2025	Q3 2025	Q4 2025
Aritzia Inc	ATZ	26.0%	15.0%	8.4%	4.2%
CVS Corp	CVS	14.2%	10.1%	8.2%	8.1%
Ralph Lauren Corp	RL	13.0%	8.6%	3.3%	1.7%
Citi Trends Inc.	CTRN	9.9%	6.5%	3.0%	3.0%
Costco Wholesale Corp	COST	6.8%	5.7%	5.3%	5.2%
TJX Companies Incorporated	TJX	3.0%	3.2%	2.9%	3.0%

Source: LSEG I/B/E/S

Meanwhile, Kohl's is on track to report consistently negative comps in 2025. In fact, about 58% of the retailers in our SSS Index are on track to report consistently negative comps this year. Target reported a -3.8% comp in Q1 2025. While the following quarters' estimates remain negative, the results reflect a sequential improvement in performance (Exhibit 8).

Exhibit 8: Retail Weakest SSS estimates: Q1 2025 – Q4 2025

Retailer	Ticker	Q1 2025 Act.	Same Store Sales Estimates		
			Q2 2025	Q3 2025	Q4 2025
Kohl's Corp	KSS	-3.9%	-5.0%	-4.7%	-4.6%
Target Corporation (Consolidated)	TGT	-3.8%	-3.1%	-1.9%	-1.5%
Macy's Inc (Owned)	M	-2.0%	-0.6%	-1.7%	-1.5%
Kirkland's Inc.	KIRK	-8.9%	-5.0%	-1.2%	-1.1%
DSW(Total)	DBI	-7.8%	-4.7%	-1.2%	-0.6%

Source: LSEG I/B/E/S

## Restaurant Same Store Sales

In the restaurant sector, approximately 56% of the companies in our SSS index are on track to deliver positive same-store sales (SSS) results for 2025. Brinker led the pack with the strongest SSS performance in Q1 and is expected to maintain robust comps throughout the year. Texas Roadhouse is also projected to post consistently healthy same-store sales in 2025. Meanwhile, most other restaurants are anticipated to post modest, low single-digit gains.

Exhibit 9: Restaurant Strongest SSS estimates: Q1 2025 – Q4 2025

Restaurant	Ticker	Q1 2025 Act.	Same Store Sales Estimates		
			Q2 2025	Q3 2025	Q4 2025
Brinker International (Consolidated)	EAT	28.2%	18.9%	12.3%	2.6%
Texas Roadhouse Inc (Company)	TXRH	3.5%	5.1%	5.1%	4.9%

Source: LSEG I/B/E/S

Meanwhile, Jack In the Box is on track to report consistently negative comps in 2025. In fact, about 44% of the restaurants in our SSS Index are on track to report negative comps this year.

Exhibit 10: Restaurant Weakest SSS estimates: Q1 2025 – Q4 2025

Restaurant	Ticker	Q1 2025 Act.	Same Store Sales Estimates		
			Q2 2025	Q3 2025	Q4 2025
Jack In The Box (Company)	JACK	-4.0%	-3.1%	-2.6%	-0.8%
Bloomin Brands Inc	BLMN	-0.5%	-1.5%	-1.2%	-0.7%
Wendys International (Systemwide)	WEN	-2.1%	-1.4%	-0.2%	-0.8%
Denny's Corporation (Systemwide)	DENN	-3.0%	-0.7%	-0.7%	-0.5%

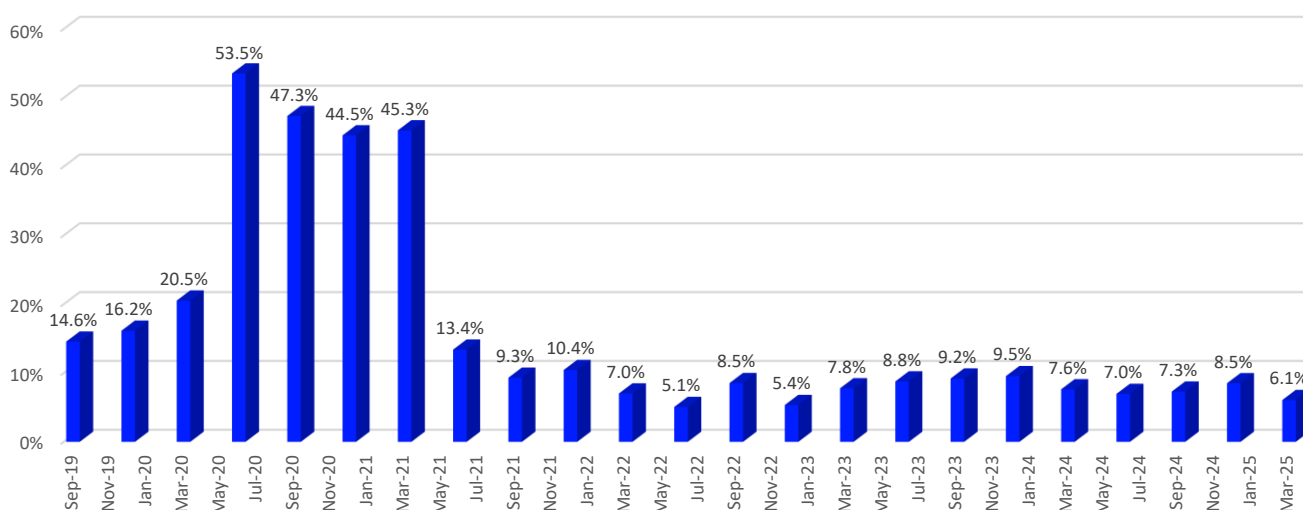
Source: LSEG I/B/E/S

## E-Commerce Sales

According to the latest e-commerce report from the U.S. Census Bureau, online sales reached \$300 billion in Q1 2025, representing a 6.1% year-over-year increase. However, this marks a slowdown from the 7.6% growth observed in 2024 over the past year (Exhibit 11). LSEG data indicates that total online consumer spending growth in 2025 is expected to fall short of 2024 levels.

E-commerce currently accounts for just 16.2% of total U.S. retail sales, indicating that the majority of consumers still prefer shopping in bricks-and-mortar stores. A significant portion of the retail market remains underpenetrated by major online players like Amazon.

Exhibit 11: E-commerce growth data



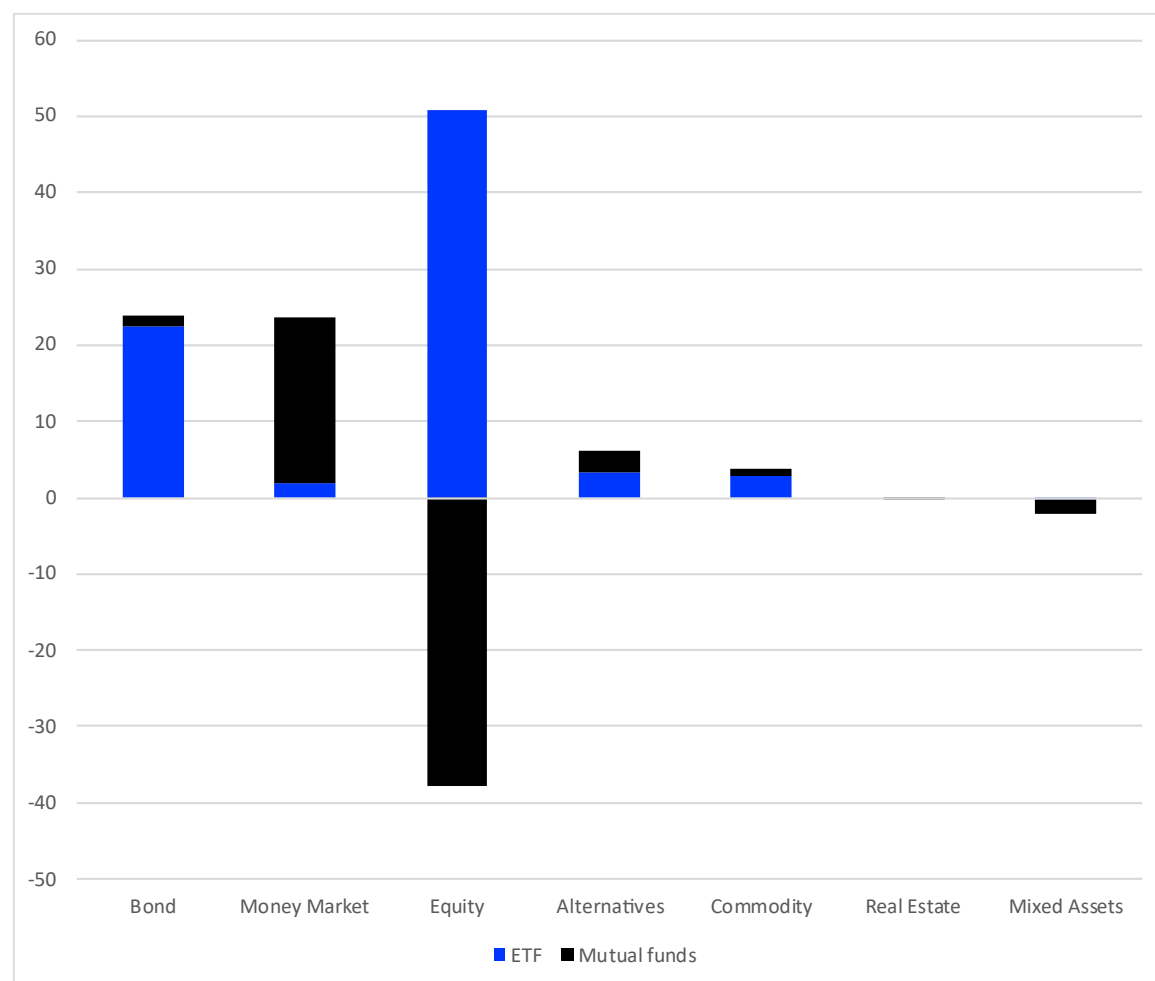
Source: LSEG Workspace

## Section 4 – Funds Outlook

### US investors redeem summer's equity gains, as global peers wait-and-see

How have global fund flows responded to the volatile global situation in the first half of 2025? The most popular asset class globally has been bonds, where fund investors have bought \$239.3bn, despite fears of resurgent inflation, the potential compromise to the once impregnable haven of US Treasuries, and comparatively tighter spreads. Money market funds followed closely, with \$235.9bn, then equities, at \$131.5bn (Exhibit 1).

Exhibit 1: Fund flows by asset class, global, H1 2025 (USD bn)

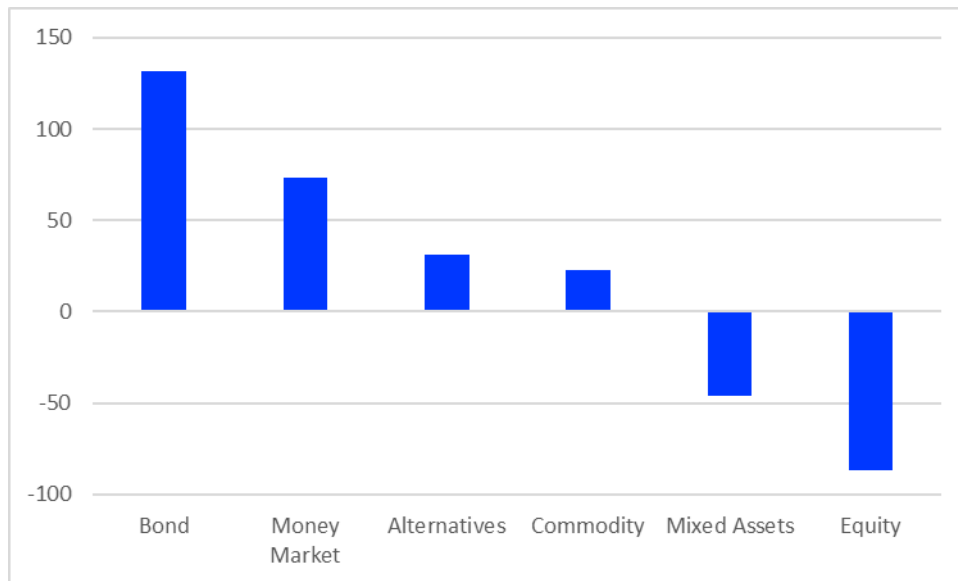


Source: LSEG Lipper

ETFs in particular saw strong estimated net inflows (\$818.0bn) over the course of H1. Inflows in the global ETF industry for H1 were driven by equity ETFs (\$509.3bn), followed by bonds (\$224.4bn), alternatives (\$32.9bn), commodities (\$27.5bn), money market (\$19.3 bn), and mixed assets (\$6.8bn).

However, when we split flows overall between US domiciled funds and the rest of the world, a more complex picture emerges. In terms of the former, while bonds and money market funds still lead the pack, equities have sold off by \$87.0 bn over H1 (Exhibit 2). Despite all the talk of boundless optimism of US retail investors, this was particularly evident in May (-\$24.9bn) and June (-\$49.7bn).

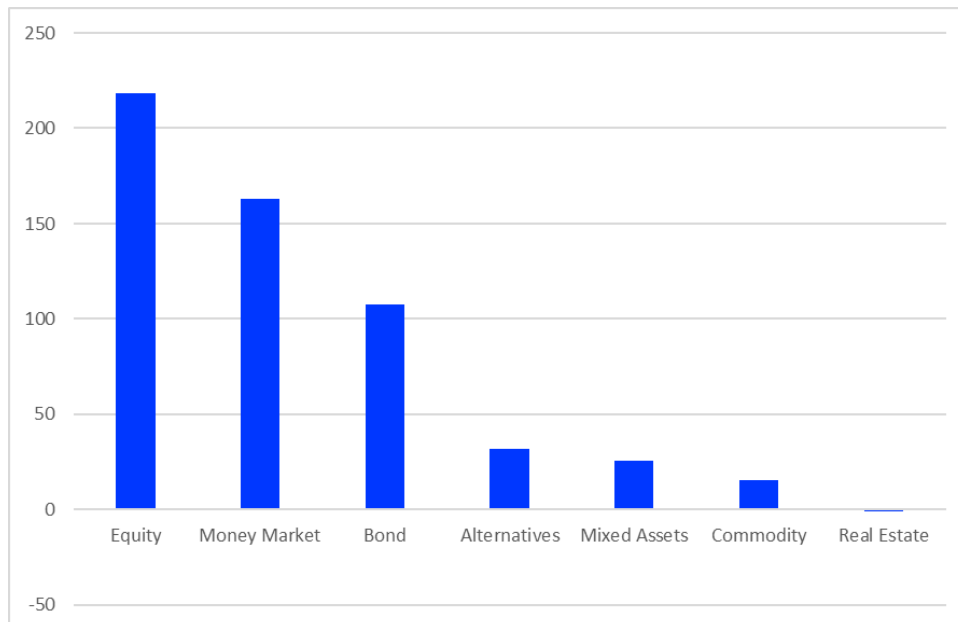
Exhibit 2: Fund flows by asset class, US-domicile, H1 2025 (USD bn)



Source: LSEG Lipper

It's therefore ex-US investors who have been buying equities in net terms over H1, to the tune of \$218.4bn, followed by money market (\$162.8bn) and bond flows (\$107.7bn) (Exhibit 3).

Exhibit 3: Fund flows by asset class, global ex-US-domicile, H1 2025 (USD bn)



Source: LSEG Lipper



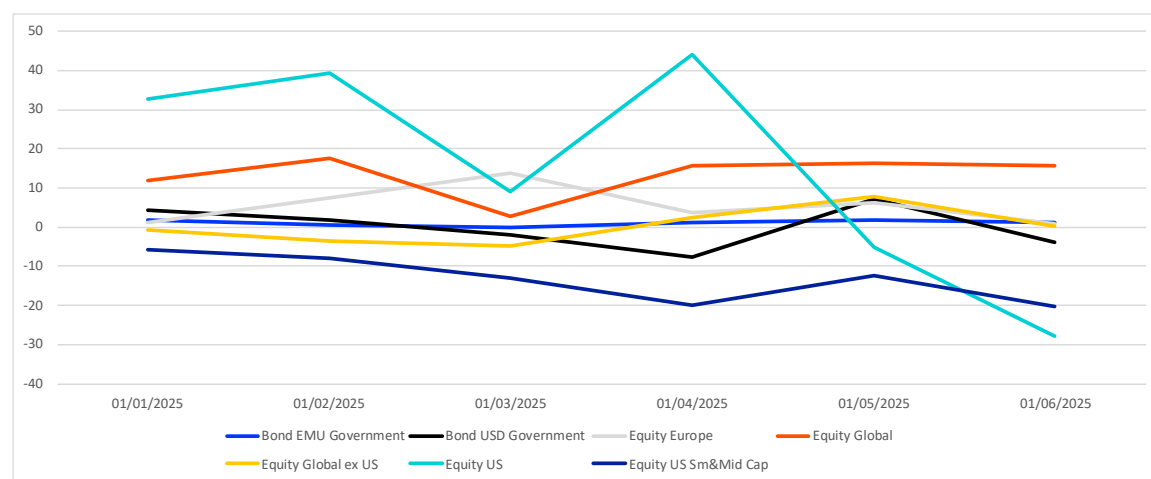
It's instructive to see how this plays out at a more granular level, using a selection of the larger equity and bond Lipper Global Classifications. The S&P 500 (along with other global indices) passed its previous peak, reached in February, in late June, recovering from early April's nosedive. Drilling down into ETF flows over H1, and given the dominance of the US as the leading ETF market, it was not surprising that Equity US (\$216.7bn) was the best-selling Lipper Global Classification for H1, followed by Equity Global ex US (\$58.4bn), and Equity Global (\$52.0bn)

Taking the fund market as a whole, it looks like investors have been using the equity rebound as an opportunity to take profits from US large caps, where sales peaked in April (\$44.0bn), subsequently selling off in May and, most heavily, June (Exhibit 4).

The Equity US selloff over these two months is being driven by US investors (Exhibit 5): while ex-US investors' enthusiasm for US equities has waned over the course of the year, it has remained in positive territory, albeit by a meagre \$573.0m in June (Exhibit 6).

US equity pain is being more strongly and consistently felt by blue chip's smaller siblings, as Equity US Small & Mid Cap has suffered \$79.1bn of redemptions, the worst month being June (-\$20.3bn). Indeed, US small and mid-caps haven't had a positive month so far this year. This is unsurprising, given that they are generally viewed as higher risk, and potentially more exposed to tariff impacts.

Exhibit 4: Select Classification Flows, Global, H1 2025 (USD bn)

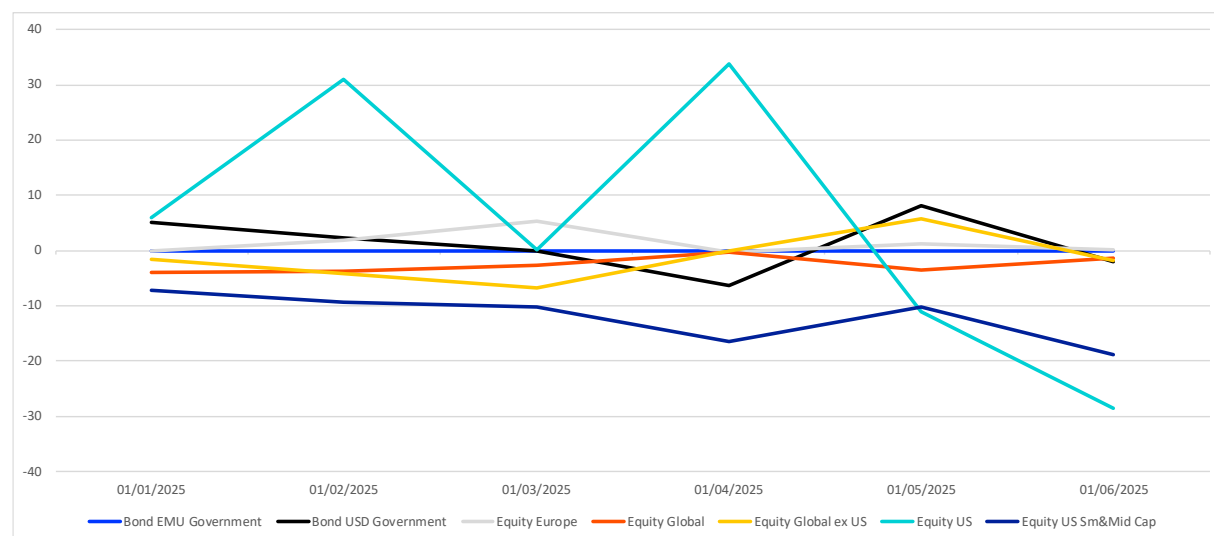


Source: LSEG Lipper

Where else is equity money going? Equity Global funds are the “spread your bets” option, and were the default home for the asset class before the US-exceptionalism story became the dominant market narrative. Flows here have stayed reasonably consistent over the year—between £12.0bn and \$18.0bn—except for March, when flows for the classifications were down to \$2.6bn (Exhibit 4). US investors, however, have been selling these funds, with US-domiciled Equity US funds suffering redemptions of \$15.4bn in H1, as their ex-US peers invested \$95.5bn.

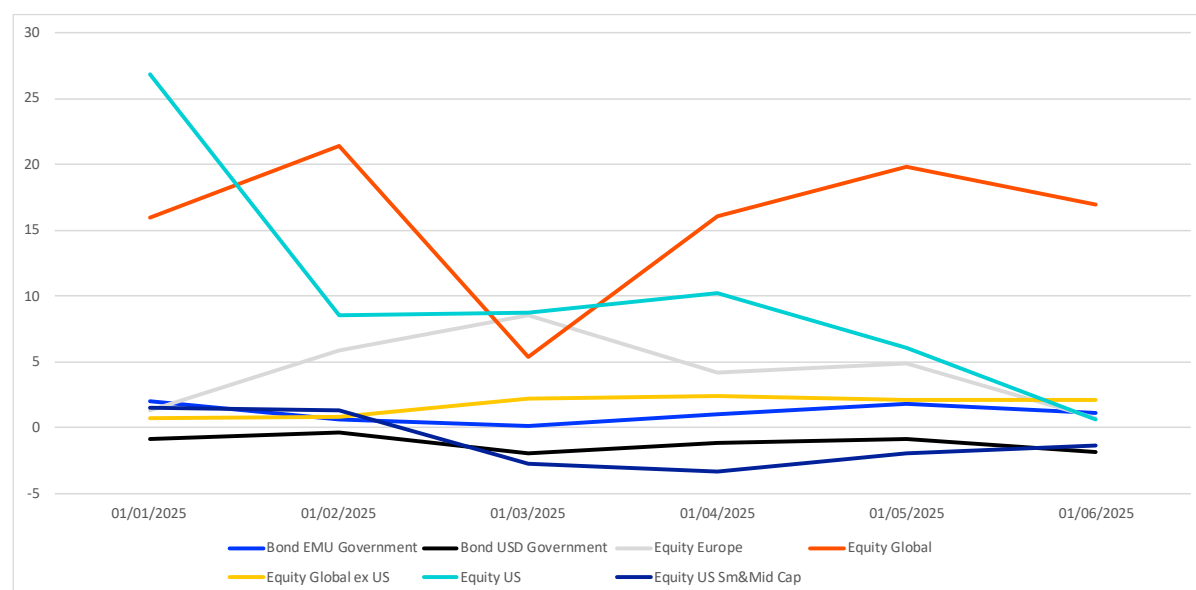
With the US now more than 60% of global indices, that still leaves investors exposed to a lot of US equity risk. However, US investors have sold \$8.8bn of Equity Global ex US funds over H1—about half the level of their Equity Global redemptions—with ex-US investors allocating \$10.2bn to these vehicles.

Exhibit 5: Select Classification Flows, US-domicile, H1 2025 (USD bn)



Source: LSEG Lipper

Exhibit 6: Select Classification Flows, non-US-domicile, H1 2025 (USD bn)



Source: LSEG Lipper

Given the outperformance of European equities over the first four months of the year, it's not terribly surprising to see [Equity Europe shift from outflows to inflows from the start of the year](#), with these non-US domiciled funds taking \$25.3bn over H1, and US investors taking a smaller (\$8.3bn) slice of this action. That said, the peak for Equity Europe sales was March (\$13.9bn), with the aggregate flows for Q2 not equalling that.

Regarding government bond markets, although Bond USD Government flows are volatile, US investors have been net-positive on these funds over H1 (\$7.1bn). However, this isn't quite enough to counterbalance redemptions in the rest of the world. For non-US investors, Bond USD Government funds have seen outflows each month in H1. The perceived heightened risk and weaker USD would likely inform this. That said, the \$7.3bn of YTD redemptions from non-US investors, seems quite modest. Adding a further codicil to this, although the total size of the US Treasury market is close to \$30 trillion, less than 12% of this is held within mutual funds and ETFs. To paraphrase Paul Simon, there must be 50 ways to dump your T-bills. Nevertheless, that \$7.3bn still represents about 2% of the market.

As things stand, that cash hasn't flooded into one mooted alternative to US Treasuries, Bond EMU Government funds, where sales have been net-positive each month, if summing to a fairly unexciting \$6.6bn over H1.

Does this tell us anything about the future trajectory of the fund market? You could see June's \$23.2bn of equity fund redemptions—the first negative month for the asset class this year—as a canary-in-the-coalmine moment. However, given the way markets have shrugged off major geopolitical concerns so far, that would be a brave (or foolish, depending on which way the wind blows) call.

# Section 5 – Agency RMBS Outlook

## Resilience and Cautious Optimism in a Shifting Landscape

### Summary

The first half of 2025 has been a pivotal period for the Agency Residential Mortgage-Backed Securities market. Amid persistent rate volatility and shifting political dynamics, the sector has shown resilience, supported by steady new issuance, modestly faster prepayments, and improving market sentiment. A modest rebound in home purchase activity, driven by rising inventory and builder incentives, has helped offset some affordability pressures. Meanwhile, tight housing supply continues to support home prices and credit quality. Looking ahead to the second half of 2025, the market appears well-positioned for cautious optimism, though participants should stay alert to policy developments, GSE reform, and interest rate changes.

### Housing Finance Reform and Mortgage Market Policy

- **Privatization of Fannie Mae and Freddie Mac**

The administration has revived efforts to privatize the GSEs, with President Trump stating that Fannie Mae and Freddie Mac are “ready to go public”. FHFA Director Bill Pulte has eliminated internal diversity and ESG initiatives, dismissed over 100 Fannie Mae employees, and consolidated board control. While the government may retain implicit guarantees, full privatization could reshape the Agency RMBS landscape, potentially increasing spreads and reducing credit access for marginal borrowers.

- **Adoption of VantageScore 4.0**

In July 2025, the FHFA approved VantageScore 4.0 for use in GSE mortgage underwriting, ending FICO’s monopoly. This change is expected to unlock up to \$1 trillion in new mortgage activity, bringing 5 million new borrowers into the field—many of whom were previously excluded due to thin or nontraditional credit histories. This shift will likely diversify Agency RMBS pools and alter prepayment dynamics.

- **Veteran Program Restructuring**

The VA scaled back proposed staffing cuts from over 80,000 to 30,000, and over 1,000 employees have already been dismissed. These significant reductions raise concerns about access to housing and healthcare services, particularly in rural areas. Related programs are under review, with a shift toward more community-based care.

- **Deregulation of Lending Standards**

Compliance requirements for lenders have been relaxed, reducing origination costs but raising concerns about long-term credit quality. This could lead to a shift in the risk profile of newly issued Agency RMBS.

### Fiscal and Trade Policy Influences on the MBS Market

- **The One Big Beautiful Bill Act**

The One Big Beautiful Bill Act (OBBBA) introduces a combination of tax incentives and structural reforms that are likely to have a mixed impact on the Agency MBS market. Several provisions support housing demand and affordability, while others—particularly the fiscal expansion—may exert upward pressure on interest rates, creating headwinds.

One of the most supportive measures is the expansion of the Low-Income Housing Tax Credit (LIHTC) program. OBBBA increases annual LIHTC allocations, lowers bond financing thresholds, and allows states to allocate more credits. While LIHTC targets rental housing, it can indirectly support agency MBS issuance, particularly GNMA, by increasing the supply of affordable housing and stimulating activity in lower-income housing segments.

The bill also reinstates the tax deductibility of mortgage insurance premiums, which directly benefits FHA borrowers by lowering their after-tax costs. This provision may boost demand for FHA-insured loans, contributing to stronger GNMA issuance and potentially faster prepayment speeds as affordability improves.

Additionally, OBBBA raises the SALT (State and Local Tax) deduction cap from \$10,000 to \$40,000 through 2030. This change could bolster homebuying activity in high-tax states, thereby supporting origination volume and agency MBS issuance, especially in the GSE space.

However, the fiscal cost of OBBBA is substantial, with projected deficits of \$3–4.5 trillion over a decade. The resulting increase in Treasury issuance may lead to higher yields, which tend to raise mortgage rates, slow housing activity, and extend MBS durations. This could widen agency MBS spreads and reduce investor appetite, especially if volatility persists.

In sum, OBBBA introduces meaningful tailwinds for GNMA and affordable housing-linked MBS, while also creating macro-level risks that may impact spreads, rates, and issuance across the agency MBS landscape.

#### • **Tariff and Fiscal Policies**

In 2025, the agency MBS market is being shaped by wider macroeconomic forces, particularly the trade policies and ongoing fiscal expansion. The Trump administration has revived and expanded tariffs on a broad range of imports, including those from China and other key trading partners. These policies are evolving quickly and often unpredictably, contributing to renewed supply chain pressures and adding to core inflation.

This inflationary pressure has complicated the Federal Reserve's outlook. As of mid-2025, it has held the federal funds rate steady at 4.25–4.50% and continues to unwind its balance sheet, allowing up to \$35 billion of agency MBS to run off monthly. These actions have helped keep interest rate volatility elevated and mortgage rates high.

At the same time, rising federal deficits have forced the Treasury to significantly increase debt issuance. The resulting supply of government bonds has driven long-term yields higher, creating additional headwinds for the mortgage market. Elevated mortgage rates have in turn limited refinancing activity, extending the average duration of outstanding MBS and increasing their interest rate sensitivity.

For investors, agency MBS offer a mix of risks and potential rewards in today's uncertain market conditions. Slower prepayments make for steadier cash flows, and the spread widening between MBS and Treasuries enhances relative value in MBS. In a bond market crowded with Treasury supply, agency MBS may attract more investor interest due to their strong credit quality and attractive higher yields.

## **Outlook for H2 2025**

The agency RMBS market in 2025 is entering a phase of cautious recovery, shaped by gradually easing mortgage rates, evolving policy developments, and persistent housing supply constraints. While mortgage rates remain historically high, they are expected to decline modestly toward 6.2%–6.3% by year-end, driven by anticipated Fed rate cuts and easing inflation. Lower rates may improve refinancing conditions and support mortgage demand, though affordability challenges could remain a drag on home sales.

Prepayment activity picked up in early 2025, particularly in Q2, reflecting improved housing inventory and more favorable refinancing windows. However, speeds are likely to remain moderate given lingering affordability pressures and a still-high mortgage rate environment.

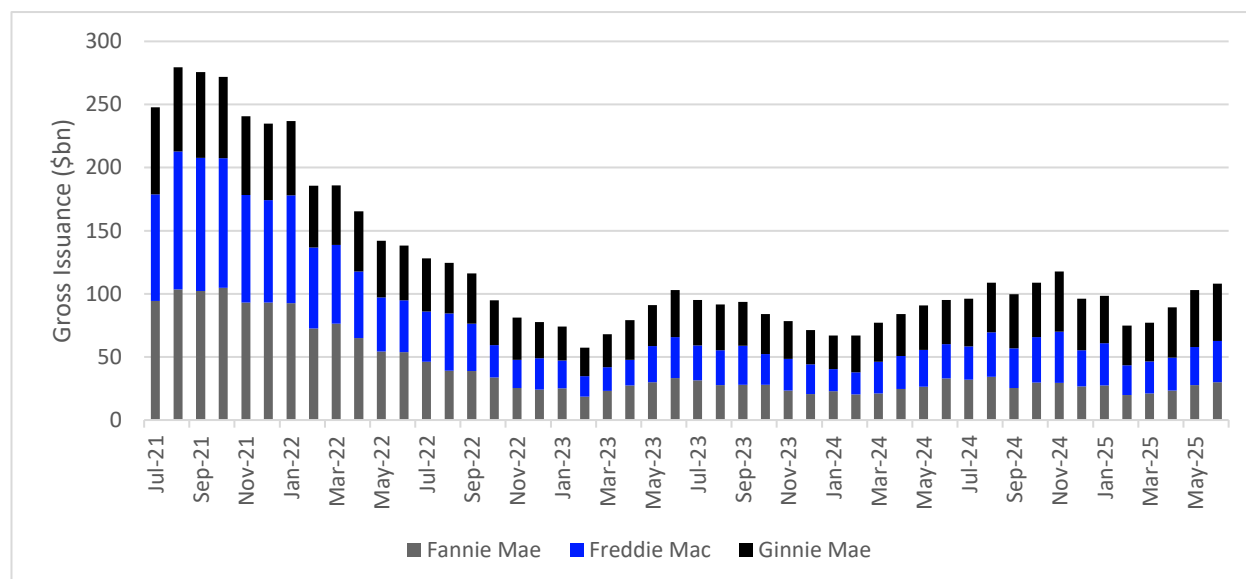
On the policy front, the passage of the One Big Beautiful Bill Act brings targeted housing incentives, such as expanded low-income housing credits and down payment assistance, which could help boost GSE loan originations and agency MBS issuance. Meanwhile, uncertainty around GSE reform and potential tariff policies under the new administration adds complexity to the policy landscape, with potential implications for investor sentiment and market structure.

Despite elevated Treasury issuance to fund a growing federal deficit, demand for agency MBS is expected to remain resilient. The market continues to offer attractive spreads relative to Treasuries and benefits from implicit government backing, making it appealing to risk-conscious investors. Total agency MBS issuance in 2025 is projected at \$1.2–\$1.4 trillion, supported by stable economic growth, steady purchase activity, and policy-driven housing support.

## Issuance

Gross issuance in 2025 has shown an overall increase compared to the same period in 2024. The most significant rebound occurred in January, with issuance rising 46% year-over-year relative to January 2024. While moderate gains continued throughout the subsequent months, the overall growth was primarily driven by GNMA activity. In contrast, GSE issuance has remained at historically low levels for the second consecutive year.

Exhibit 1: Agency RMBS Gross Issuance by Month

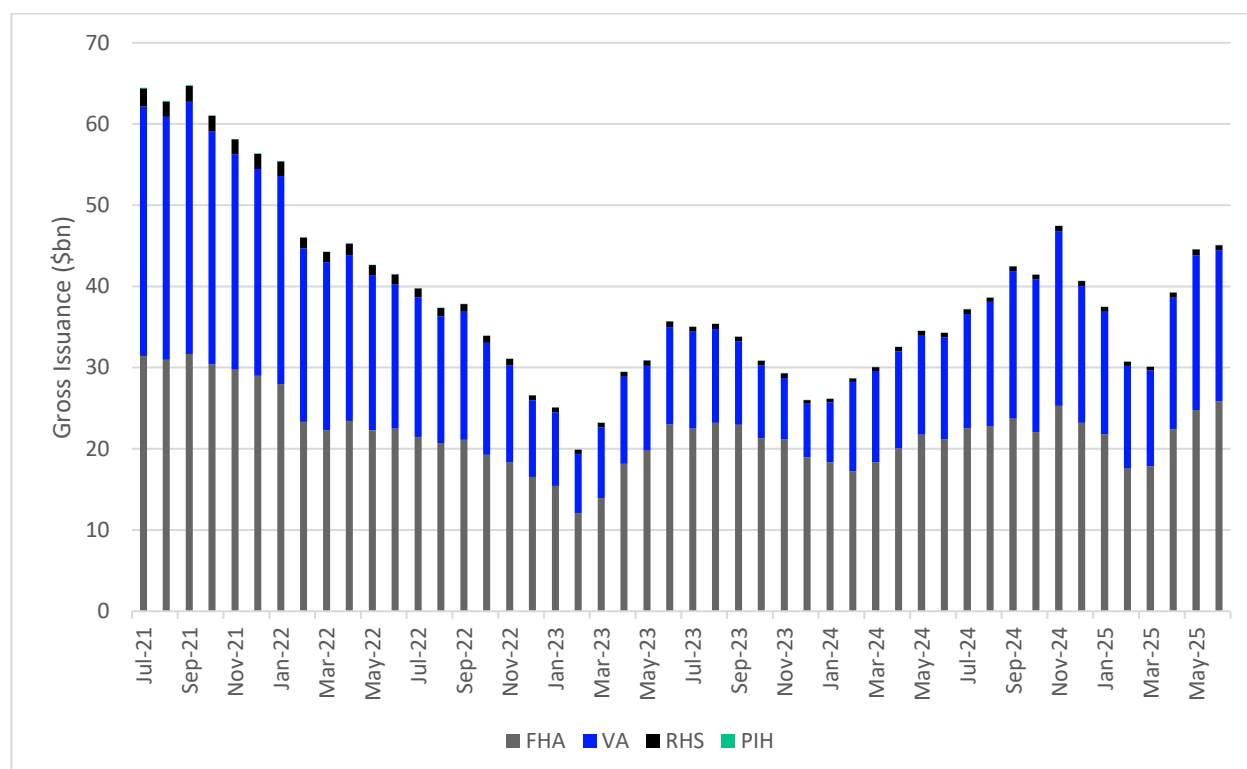


Source: eMBS

Within GNMA issuance, loans backed by the Federal Housing Administration (FHA) and the Department of Veterans Affairs (VA) continue to comprise the majority of total volume. VA-backed issuance has steadily increased from the low levels observed in 2023 and into 2024, despite staffing reductions at the VA and the termination of the Veterans Affairs Servicing Purchase (VASP) program. This upward trend highlights sustained demand and borrower interest in the VA loan market. Meanwhile, FHA-backed loans are expected to remain a key driver of GNMA issuance, particularly among first-time homebuyers and borrowers with lower credit scores. However, the potential for significant staffing cuts at the FHA introduces uncertainty around issuance volumes in the second half of the year.

The Rural Housing Service (RHS) and Public and Indian Housing (PIH) programs continue to account for only a small fraction of total GNMA issuance. While these programs are vital in serving targeted populations like rural and Native American communities, their issuance volumes remain relatively small compared to those of FHA and VA programs. Combined, RHS and PIH have consistently represented approximately 1.5% of GNMA issuance over the past year.

Exhibit 2: Ginnie Mae RMBS Gross Issuance by Guarantor



Source: eMBS

Assuming the economy remains resilient while navigating policy changes, and mortgage rates decline slightly to moderately over the remainder of the year, we expect agency RMBS issuance in the second half of 2025 to remain stable, with gradual growth compared to prior years. Total issuance for the year could reach \$1.2 trillion to \$1.4 trillion, supported by sustained investor demand for agency securities and a favorable rate environment that contributes to relatively low prepayment activity.

## Existing Home Sales and Inventory

According to the National Association of Realtors' June 23 report, existing home sales in May 2025 rose 0.8% compared to April, reaching a seasonally adjusted annual rate of 4.0 million units. This marks a recovery following a 0.5% decline in the previous month and exceeded market forecasts, which had anticipated a drop to 3.96 million.

The supply of homes available for sale increased modestly, with inventory rising 0.7% month-over-month and 20.3% year-over-year to 1.5 million units. This inventory level corresponds to roughly 4.6 months of sales at the current pace, up from 3.8 months a year earlier. Meanwhile, the median sales price for existing homes climbed 1.2% over the past year, reaching \$422,800.

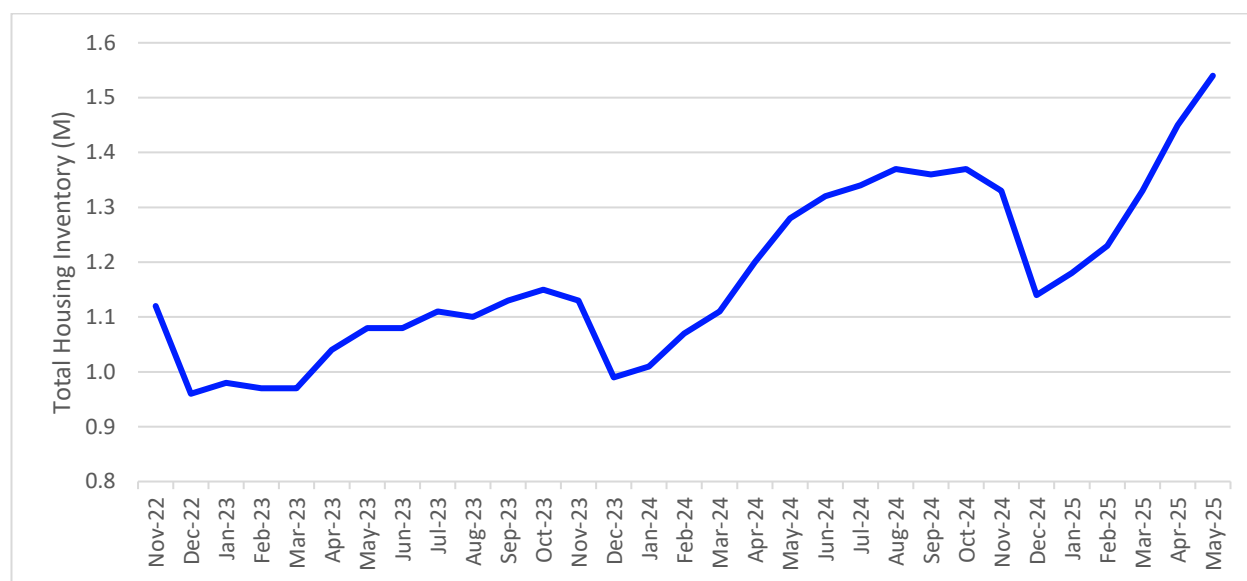
With mortgage rates and home prices remaining elevated, home sales have consistently lingered near their lowest levels over the past decade. Additionally, inflationary pressures have reduced consumers' disposable income, further dampening buyer demand. On the supply front, although the 1.5 million homes on the market in May match the volume seen in May 2020, they remain well below levels typical before the pandemic—such as the 1.8 million units available in August 2019. Still, recent months have seen a steady recovery in inventory compared to 2023 and 2024 figures.

Exhibit 3: Existing Home Sales and Inventory by Month

	05/25	04/25	03/25	02/25	01/25	12/24	11/24	10/24	09/24	08/24	07/24	06/24	05/24
Existing Home Sales (M)	4.03	4.00	4.02	4.27	4.09	4.29	4.17	4.03	3.90	3.93	3.98	3.93	4.06
Inventory (of homes) (M)	1.54	1.45	1.33	1.23	1.18	1.14	1.33	1.37	1.36	1.37	1.34	1.32	1.28
Inventory (of months)	4.6	4.4	4.0	3.5	3.5	3.2	3.8	4.1	4.2	4.2	4.0	4.0	3.8
Median Sales Price (\$K)	422.8	414.0	403.1	396.8	393.4	403.7	404.4	406.8	406.7	414.2	421.4	426.9	417.2

Source: National Association of Realtors

Exhibit 4: United States Total Housing Inventory



In the second half of 2025, the inventory of existing homes may face challenges stemming from limited new home construction and homeowners' continued reluctance to sell, partly due to historically low mortgage rates locked in from previous years, despite the steady inventory recovery observed in recent months. With fewer homes available on the market, existing home sales could be constrained even amid sustained demand.

Assuming stable economic conditions, a moderate decline in mortgage rates, and ongoing inventory constraints, existing home sales in 2025 are projected to total approximately 4.5 to 5 million units. This forecast reflects a gradual recovery following the elevated interest rate environment of 2023–2024, although affordability challenges and tight supply are expected to remain significant obstacles.

The 2025 outlook points to a modest rebound in existing home sales, supported by improving housing affordability and a stabilized economy. Notably, potential reforms to the GSEs could play a pivotal role in expanding access to homeownership and stimulating demand. However, uncertainty remains regarding the timing and scope of policy changes under the Trump administration.

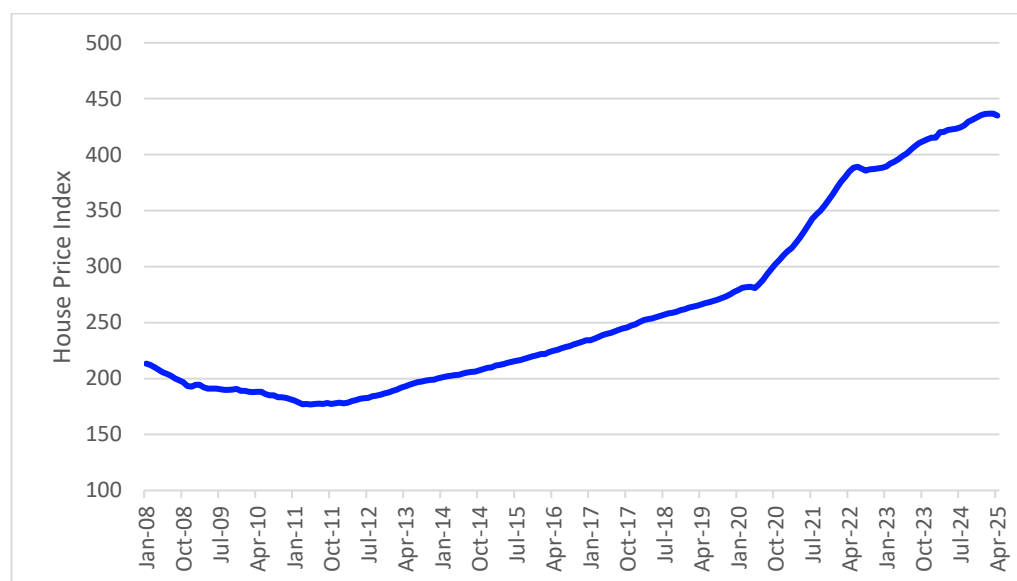
## House Price Index

The house price Index (HPI) in the United States reported a 0.4% decrease in April to 434.9 points from 436.7 points in March of 2025. HPI reported a 3.0% YoY increase from April 2024. The HPI in the United States reached an all time high of 436.8 points in February of 2025.

In the latest Fannie Mae HPI forecast, the quarterly YoY change for Q3 2025 is 4.8, and the annual HPI change for 2025 is 4.1. And in our model version 25.1 and version 97, Yield Book assumes annualized HPI of 3.0% for Q2-Q4 2025, 1.5% for 2026, and 3.0% thereafter.



Exhibit 5: US Monthly FHFA House Price Index (Purchase Only)



Source: Federal Housing Finance Agency

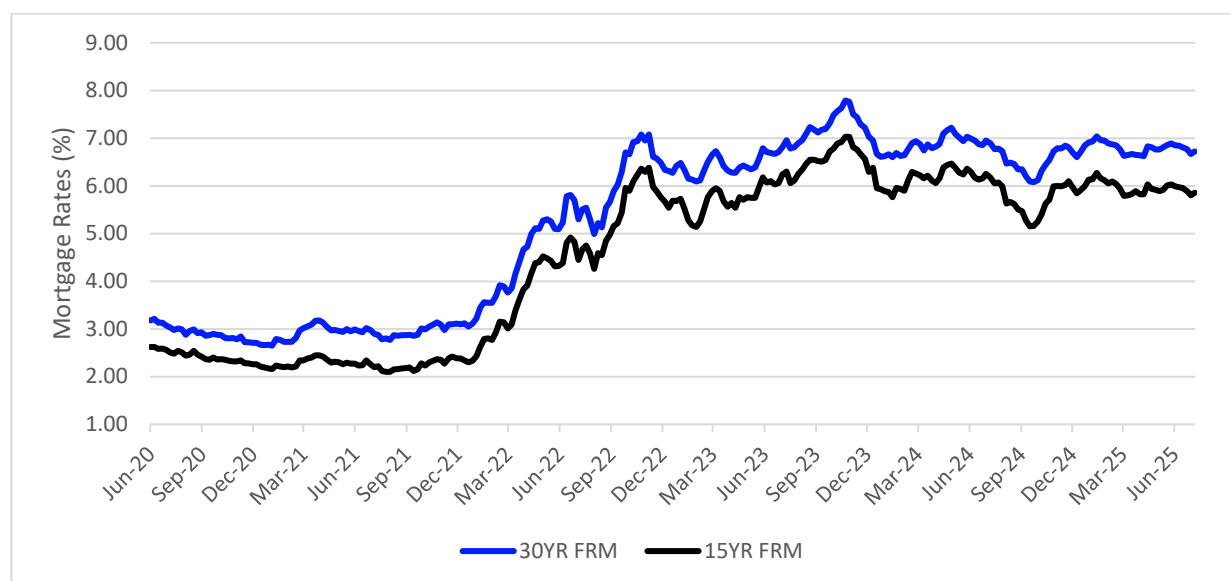
## Mortgage Rates

In 2025, mortgage rates have experienced a modest decline, yet they remain at relatively high levels compared to historical averages. The 30-year fixed mortgage rate has mostly hovered between 6.5% and 7.0% throughout 2025. As of mid-July, rate averages are around 6.72%–6.87%. This range represents a slight improvement from the one-year high of 7.15% seen in late 2024 but remains well above the historical lows of the pandemic era.

The Federal Reserve has held the federal funds rate steady at a target range of 4.25% to 4.50% since December 2024. Consensus forecasts anticipate 2–3 quarter-point cuts (50–75 bps) by year-end, beginning in September.

Although the federal funds rate does not directly determine mortgage rates, it influences them indirectly through a complex interplay of market expectations, inflation outlook, and Treasury yields. Mortgage rates in 2025 are expected to remain elevated relative to historical averages, though they are projected to follow a gradual downward trend in the latter part of the year. Market consensus suggests rates could decline to approximately 6.2% to 6.3% by year-end.

Exhibit 6: US Weekly Primary Mortgage Market Survey



Source: Freddie Mac

## Prepayment

Prepayment speeds for both conventional and GNMA securities showed a marked increase in the first half of 2025 relative to 2024, with the second quarter seeing particularly strong growth. This rise reflects a combination of factors, including a modest easing of mortgage rates following two years of elevated levels and a slow but steady improvement in housing inventory. As refinancing conditions improved, more homeowners seized the opportunity to refinance, driving a noticeable increase in prepayment activity across agency mortgage-backed securities.

Exhibit 7: US Weekly Primary Mortgage Market Survey

	RPB(\$B)	06/25	05/25	04/25	03/25	02/25	01/25	12/24	11/24	10/24	09/24	08/24	07/24	06/24
FNMA 30	2,907.9	7.1	7.4	7.4	6.6	5.0	5.1	5.9	6.3	8.4	6.4	6.6	6.5	6.0
FNMA 15	319.4	7.8	7.8	7.4	7.1	6.1	6.3	6.6	6.4	7.4	6.4	7.2	7.1	6.8
FHLMC 30	2,543.1	7.3	7.6	7.7	6.5	5.1	5.1	5.9	6.3	8.8	6.6	6.6	6.4	6.0
FHLMC 15	265.3	8.2	8.0	7.7	7.2	6.1	6.5	6.7	6.6	7.9	6.5	7.3	7.2	6.7
GNMAII 30M	1,884.0	8.7	10.3	11.1	9.4	7.0	7.5	8.2	9.3	13.2	11.0	10.1	8.6	7.5
GNMAII 30C	530.2	8.9	10.2	11.3	9.7	7.4	7.8	8.7	9.1	11.7	10.5	9.5	8.2	7.0
GNMAII 15M	13.7	11.4	11.2	11.1	11.1	9.3	9.7	9.5	9.7	10.5	9.6	10.6	10.2	8.9
GNMA 30	43.0	6.6	6.7	6.4	6.1	5.5	5.8	5.9	5.7	6.5	6.0	6.4	6.6	6.7

Source: eMBS

For out-of-the-money (OTM) agency RMBS, we expect turnover-driven prepayment speeds to remain at their lowest levels. This is largely due to the ongoing "lock-in" effect, where homeowners are disincentivized to sell or refinance given significantly higher mortgage rates compared to those on their existing loans. In addition, the persistent shortage in housing inventory continues to suppress overall transaction volume.

However, it's important to consider that some homeowners who delayed selling due to unfavorable market conditions or elevated financing costs may re-enter the market as these pressures ease. This pent-up supply could gradually be released in the coming year, potentially lifting housing turnover and, by extension, prepayment activity modestly.

Exhibit 7 presents projected prepayment speeds across various interest rate scenarios for the deeply OTM Fannie Mae 30-year cheapest-to-deliver (CTD) cohort originated in 2024 and 2018 with a 2.5 coupon. In a scenario where the rate curve declines by 200 basis points, prepayments are projected to rise by roughly 1.5 CPR over the next 12 months, primarily driven by increased turnover, followed by modest gains in cashout and curtailment activity. Conversely, if rates rise by 200 basis points, turnover speeds approach the model's assumed floor, indicating limited downside in prepayment under higher-rate conditions.

Exhibit 8: Projected Prepayment by Rate Scenario (% of Mortgage Paying Off in 1 Year)

Rate Change	Fannie Mae (FNM) Refinance / Home Sale	Ginnie Mae II (G2) Refinance / Home Sale
-3.00%	20.15% / 4.64%	37.98% / 5.13%
-2.00%	14.30% / 4.47%	27.07% / 4.92%
-1.00%	5.47% / 4.22%	12.16% / 4.70%
Current	1.33% / 3.87%	2.29% / 4.38%
1.00%	0.68% / 3.34%	1.05% / 3.79%
2.00%	0.46% / 2.71%	0.84% / 2.96%
3.00%	0.35% / 2.20%	0.70% / 2.28%

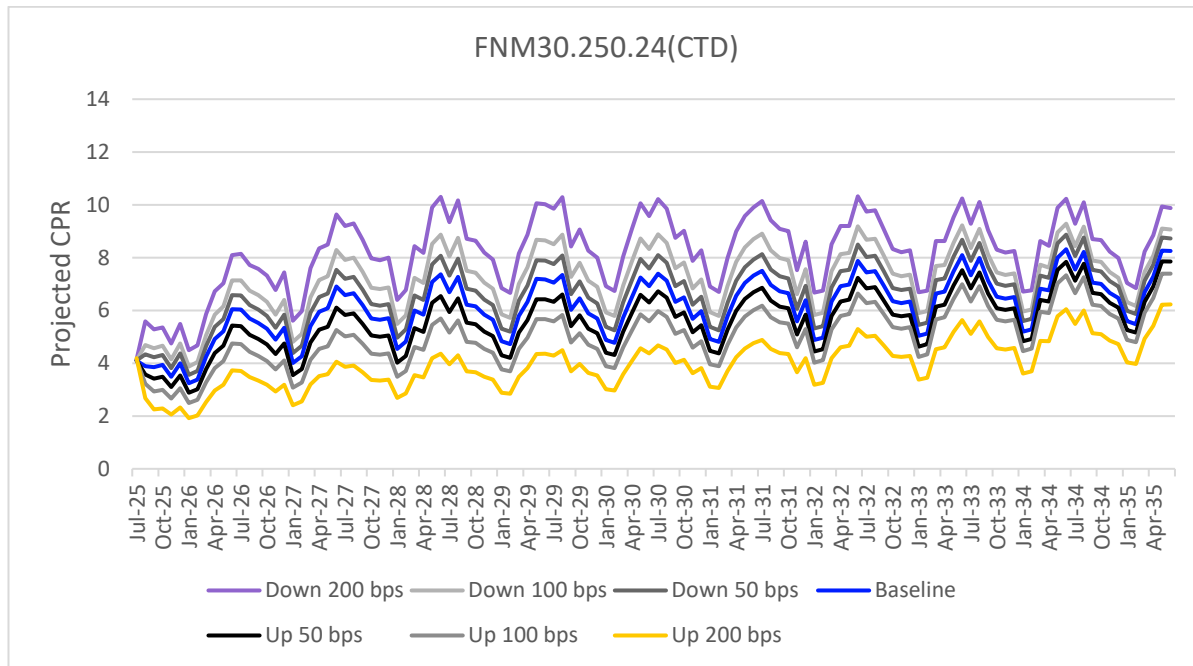
Source: Yield Book

For out-of-the-money (OTM) agency RMBS, we expect turnover-driven prepayment speeds to remain at their lowest levels. This is largely due to the ongoing "lock-in" effect, where homeowners are disincentivized to sell or refinance given significantly higher mortgage rates compared to those on their existing loans. In addition, the persistent shortage in housing inventory continues to suppress overall transaction volume.

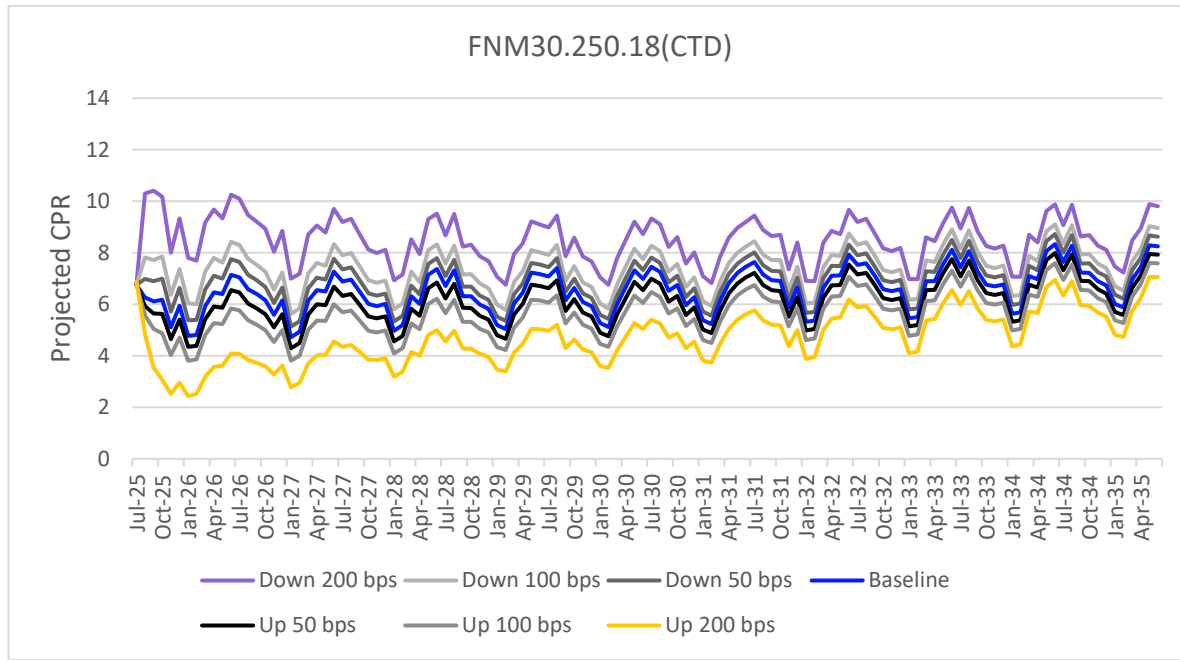
However, it's important to consider that some homeowners who delayed selling due to unfavorable market conditions or elevated financing costs may re-enter the market as these pressures ease. This pent-up supply could gradually be released in the coming year, potentially lifting housing turnover and, by extension, prepayment activity modestly.

Exhibit 9 presents projected prepayment speeds across various interest rate scenarios for the deeply OTM Fannie Mae 30-year cheapest-to-deliver (CTD) cohort originated in 2024 and 2018 with a 2.5% coupon. In a scenario where the rate curve declines by 200 basis points, prepayments are projected to rise by roughly 1.5 CPR over the next 12 months, primarily driven by increased turnover, followed by modest gains in cashout and curtailment activity. Conversely, if rates rise by 200 basis points, turnover speeds approach the model's assumed floor, indicating limited downside in prepayment under higher-rate conditions.

Exhibit 9: Yield Book Prepayment Projections for Different Rate Scenarios (OTM Cohort)



Source: Yield Book



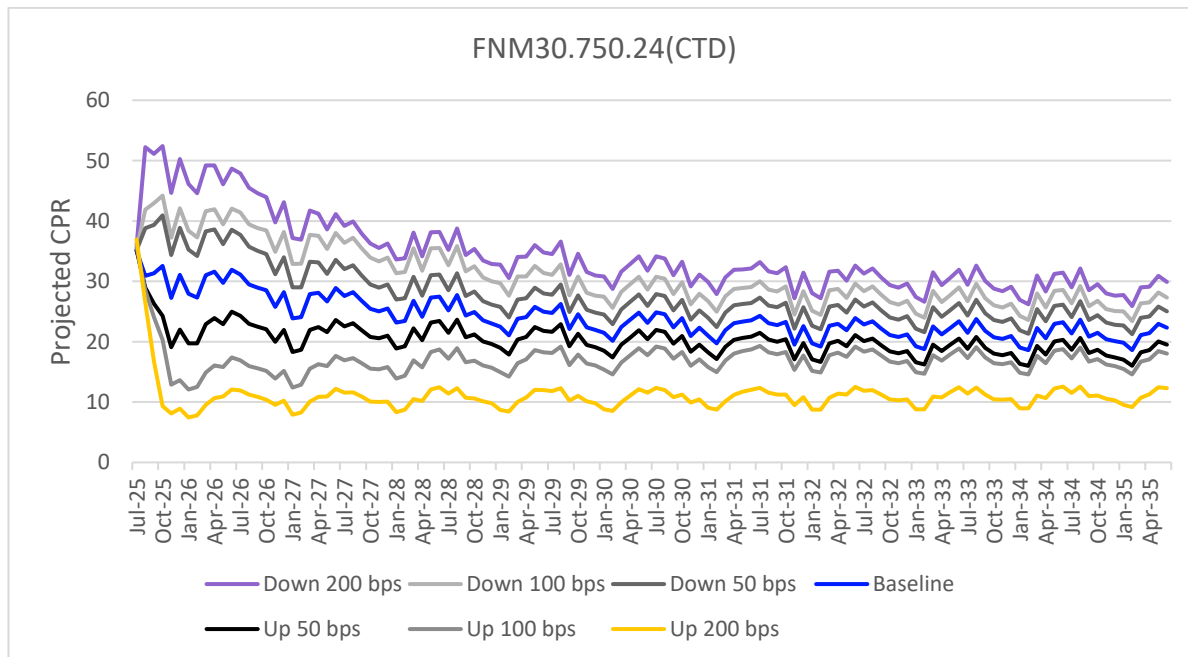
Source: Yield Book

For in-the-money (ITM) cohorts, Federal Reserve rate cuts in 2025 are expected to boost borrower responsiveness, resulting in a modest increase in prepayment speeds, particularly influenced by the media effect that heightens borrower awareness of refinancing opportunities. This response is expected to be more noticeable in newer vintages.

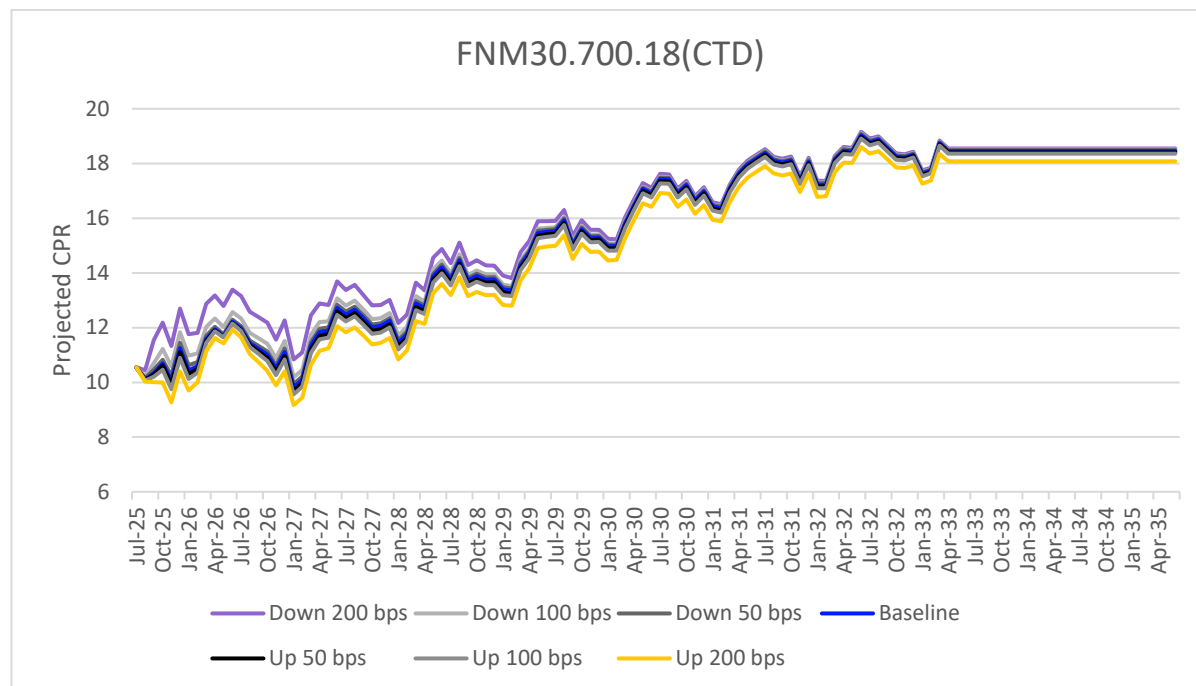
Exhibit 10 presents projections for two deeply ITM Fannie Mae 30-year cheapest-to-deliver (CTD) cohorts with 7.5% coupons, originated in 2024 and 2018. For the 2024 cohort, prepayment speeds show high sensitivity to both upward and downward rate shifts of 50 and 200 basis points, with refinancing activity driving most of the increase as borrowers react directly to changing mortgage rates.

For the older 2018 cohort, however, the increase in prepayment speeds is mainly driven by loan curtailments, which typically rise as loans mature. Refinancing activity remains limited due to borrower burnout, as many borrowers refinanced during the historically low mortgage rate period around COVID-19, reducing the pool eligible or willing to refinance again.

Exhibit 10: Yield Book Prepayment Projections for Different Rate Scenarios (ITM Cohort)



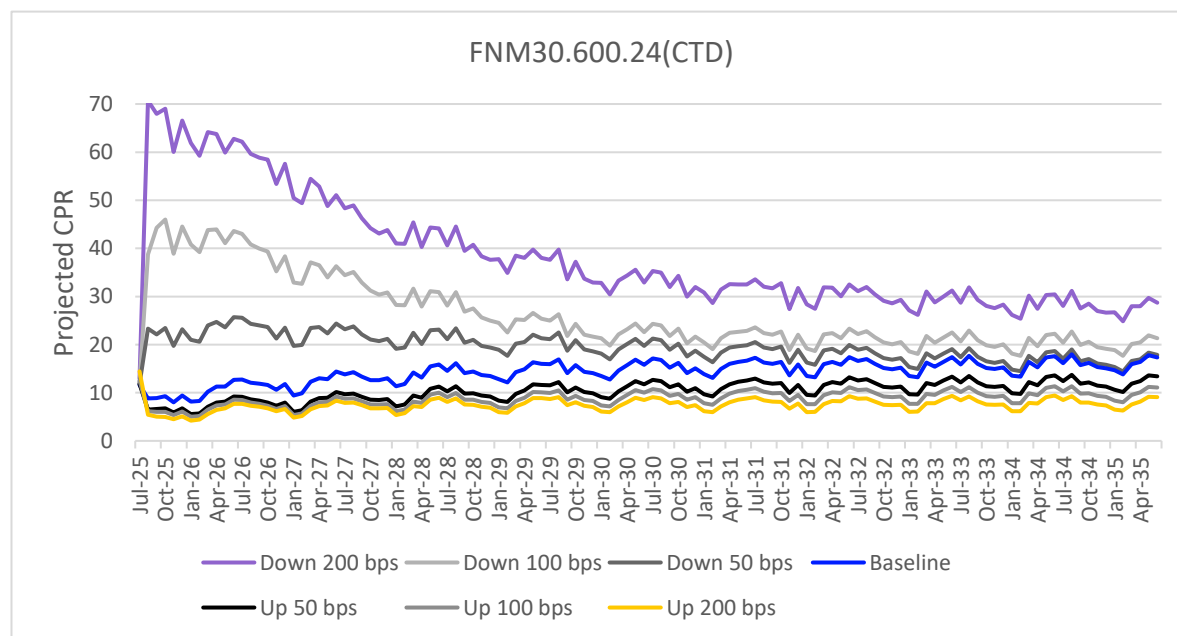
Source: Yield Book



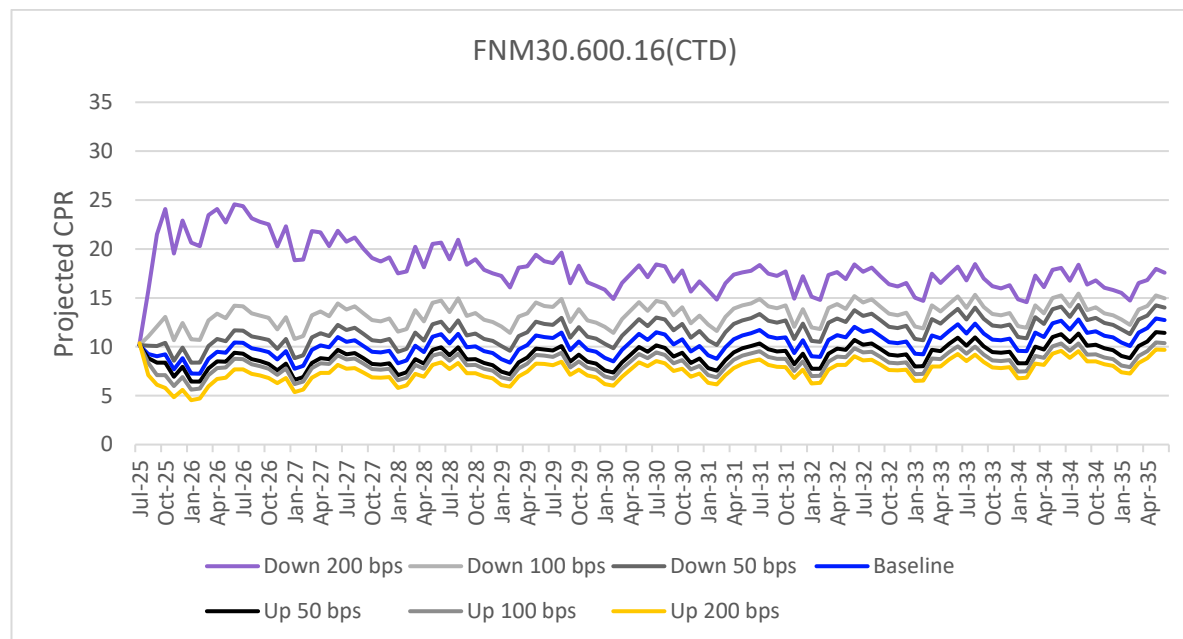
Source: Yield Book

Exhibit 11 presents projected prepayment speeds under various interest rate scenarios for the at-the-money (ATM) Fannie Mae 30-year cheapest-to-deliver (CTD) cohorts with 6.0% coupons, originated in 2024 and 2016. In both newer and older vintages, prepayment rates are projected to increase sharply in response to declining interest rates.

Exhibit 11: Yield Book Prepayment Projections for Different Rate Scenarios (ATM Cohort)



Source: Yield Book



Source: Yield Book

## Conclusion

The Agency RMBS market has shown resilience in the face of macroeconomic and political shifts. With steady issuance, improving sentiment, and a stable housing market, the sector is well-positioned for cautious optimism in H2 2025. Market participants should remain vigilant, particularly around policy developments, GSE reform, and interest rate dynamics.

# Section 6 – CMBS Outlook

## CRE fundamental bottoming out?

### Non-Agency CMBS Executive Summary

Despite inflation and rate uncertainty, we are cautiously optimistic for the outlook in 2H2025 and beyond. Our baseline scenario assumption is the tariff impact may turn out to be manageable and inflation data will stay relatively benign, allowing a few rate cuts to materialize. As the administration shifts focus to deregulations and “pro-business” policies post tariff, we would expect positive economic growth and rising demand for property space. In conclusion, we see healthy CRE and CMBS market growth in 2H2025 as distress in maturity refinance and office fundamentals eases, but would also caution that tariff and inflation risk remains.

We expect SASB deal flows to remain robust in 2H2025 as dynamics driving the SASB issuance (maturity schedule and private equity) persist. We are raising our 2025 full year issuance forecast from \$70 billion to \$80 billion for SASB, and from \$15 billion to \$25 billion for CRE CLO as the market staged a strong recovery in 2025. On the other hand, we would lower the forecast for conduit issuance from \$45 billion to \$35 billion, as availability of conduit loans for securitization remains a challenge. In total, our updated projection for 2025 non-agency CMBS issuance grows to \$140 billion (vs. original projection of \$130 billion).

Though maturity pipeline distress continued to fuel delinquency growth, the 30+ day delinquency rate of conduit and SASB loans increased only by 47 bps to 6.3% in 1H2025. We think it's on track to reach 7.0% level by YE2025 as we forecasted earlier. Delinquency rates on CMBS office loans declined by 34 bps in 1H2025, prompting us to reduce our YE2025 office delinquency rate projection to 13.0% from 14%. We also adjust our YE2025 forecast for CRE CLO delinquency rate down to 6.0% from 8.0% originally as sector fundamentals have stabilized.

We maintain our projection that conduit 5-year Super Senior AAA spreads may reach 80 bps before YE2025 (vs. 95 bps at mid-year) on the tailwinds of benign macro and investor optimism.

### Agency CMBS Executive Summary

Agency CMBS issuance from the three agencies rose significantly in 1H2025, with a total YTD of \$65.0bn in June, up by 43% YTD compared to last year, with GNPL up by 25% YoY to \$7.0bn, FN DUS up by 46% YoY to \$28.0bn, Freddie MF up by 43% to \$31.0bn, thanks to strong demand for agency multi-family securities.

We expect 2025 agency CMBS issuance to rise 38% to a total of \$165.0bn by the end of 2025 (vs. total of \$119.0bn in 2024), with \$11bn for GNPL (vs. \$9.0bn in 2024), \$76bn for Fannie DUS (vs. \$54.0bn in 2024), and \$78bn for Freddie Mac multifamily (vs. \$56.0bn in 2024), in our baseline scenario.

Agency CMBS spreads were mostly stable so far this year and are biased to tighten further in 2H2025 under the baseline scenario, depending on the issuance volume and agency RMBS basis. Potential rate cuts by the Fed may boost demand for agency CMBS.

We expect credit performance to remain stable for agency CMBS loans in the second half of 2025, with GNPL delinquencies trending down thanks to the recovery in senior housing.

Agency CMBS prepayment activities remained muted in 1H2025 due to high interest rates, lower property valuation and call protection. Heading into 2H2025, we anticipate a modest increase in prepayment speeds as Fed easing resumes and multifamily property pricing improves.

## Non-Agency CMBS Report Details

### Summary of 1H2025

The year 2025 started strongly, as we predicted at year end of 2024. Issuance spiked and spreads rapidly tightened amid market optimism and strong investor demand. However, capital markets were roiled in April as tariff announcements on “Liberation Day” ignited recession fear. Spreads quickly blew out and issuance came to a halt. Fortunately, the market rebounded shortly following a swift rollback and 90-day pause of tariffs. We then experienced a stunning recovery in the rest of Q2 as trade deals emerged and tariff and recession fear subsided.

The U.S. economy remains on a solid footing, with few recessionary signals and the labor market showing resilience. More importantly, inflation data has been cooling consistently, indicating that tariffs have done little to affect prices so far, contrary to market concerns earlier in Q2, even if this may partly be a timing effect.

Meanwhile, Congress passed the “One Big Beautiful Bill” which extends many of the 2017 tax cuts – which may boost business activities and tenant demand in general. It also includes tax code changes to make CRE investments more attractive as well as measures to incentivize affordable housing development such as Low-Income Housing Tax Credit (LIHTC). On the other hand, the bill risks significant deficit expansion and rising debt, putting pressure on treasury yields over time which can be problematic for the CRE market, as elevated borrowing costs stress maturity refinancing and hurt property valuation.

### Issuance

1H2025 non-agency CMBS issuance totaled \$79.9 billion, 66% higher than 1H2024. The huge volume spike this year is driven by CRE CLO (\$17.6 billion, up 458% from 1H2024) and SASB (\$47.1 billion, up 49%), while conduit issuance is also up 19% at \$15.6 billion. If the pace continues for 2H2025 as the economic outlook improves and inflation abates, we expect 2025 to set a record for annual issuance for non-agency CMBS post GFC.

We expect SASB deal flows to remain robust in 2H2025 as dynamics driving the SASB issuance (maturity schedule and private equity demand) persists. We are raising our 2025 full year issuance forecast from \$70 billion to \$80 billion for SASB, and from \$15 billion to \$25 billion for CRE CLO as the market staged a strong recovery in 2025 on stabilized multifamily fundamentals. On the other hand, we would lower the forecast for conduit issuance from \$45 billion to \$35 billion, as availability of conduit loans for securitization remains a challenge (CRE transaction volume, especially of acquisition, has been lower than anticipated). In total, our updated projection for 2025 full year non-agency CMBS issuance grows to \$140 billion (compared to \$115 billion of 2024 and our original projection of \$130 billion for 2025).

We saw office exposure rising to 26.1% in SASB deals so far this year (vs. 7.2% in 2024), as well as steady growth in office (16.4% vs. 14.7%) and multifamily (23.7% vs. 21.2%) exposure in conduit deals, reflecting broad funding condition improvement for these two property sectors. On the other hand, the underwriting on CMBS loan leverage seems to have weakened this year with higher LTVs a feature (56.9% vs. 55.4% for conduit, 64.2% vs. 61.2% for SASB, 65.7% vs. 63.7% for CRE CLO).

#### Exhibit 1: Non-Agency CMBS Issuance and Forecast

	2024 FY (\$bn)	1H 2025 (\$bn)	2025 proj. (\$bn) original	2025 proj. (\$bn) updated mid-year
<b>Conduit</b>	32.9	17.6	45	35
<b>SASB</b>	72.8	47.1	70	80
<b>CRE CLO</b>	8.7	15.6	15	25
<b>Total</b>	114.5	79.9	130	140

Source: LSEG Yield Book (July 2025)

### CRE Fundamentals

Though maturity pipeline distress continued to fuel delinquency growth, the 30+ day delinquency rate of conduit and SASB loans increased only by 47 bps to 6.3% over 1H2025. We think it's on the trajectory to reach a 7% level by YE2025 as we forecast in our earlier 2025 outlook.

While office space continued to make headlines with rising vacancies and federal office footprint cuts, delinquency rates on CMBS office loans actually declined by 34 bps in 1H2025 (10.3% in June 2025 vs. 10.6% in December 2024), reflecting accelerated resolution of troubled office properties (disposition and condo conversion) and early signs of stabilization for the sector. As a result, we would like to reduce our YE2025 office delinquency rate projection to 13% from 14% even though the maturity refinancing outlook of office loans remains challenging.



We are comfortable with our projections of the other property types, for example, the multifamily delinquency rate is currently at 5.00%, which happens to match our 2025 forecast exactly. We also think that the fundamentals of the overall multifamily sector seemed to have bottomed out this year as rent growth resumed and occupancy stabilized, offsetting rising expenses, though rent-control properties and some properties at over-supplied sunbelt regions remain problematic. Property fundamentals of retail and hotel remained steady, while industrials continued to outperform with surging demand for data centers.

We've also seen signs of improvement of CRE CLO credit this year as more deals were called and the transitional multifamily property owners managed to cope with rising expenses and construction/renovation costs, which is also consistent with the dramatic CRE CLO issuance revival in 2025. CRE CLO delinquency rates declined by 130 bps total in 1H2025 to 4.8%, prompting us to adjust our YE2025 forecast down to 6% from 8% originally.

#### Exhibit 2: Non-Agency CMBS 30 day+ Delinquency Rates and Forecasts

		Dec 2024	June 2025	YE2025 proj. - original	YE2025 proj. – updated mid-year
<b>Conduit and SASB combined</b>	Industrial	0.27%	0.44%	1%	1%
	Lodging	5.15%	6.20%	6%	6%
	Multifamily	3.62%	5.00%	5%	5%
	Office	10.61%	10.27%	14%	13%
	Retail	6.91%	6.38%	7%	7%
	<b>Overall</b>	5.87%	6.34%	7%	7%
<b>CRE CLO</b>		6.12%	4.82%	8%	6%

Source: LSEG Yield Book (July 2025)

#### Maturity Performance and Loan Disposition

Maturity performance of CMBS loans improved steadily in 1H2025 compared to 2024, with conduit CMBS maturity payoff up by 6.4% to 69.7% and maturity delinquency down by 2.2% to 21.3%. Meanwhile, SASB's maturity payoff jumped to 35.2% in 2025 vs. 4.9% in 2024. CRE CLO maturity payoff also rose to 36.6% in 2025 from 22.5% in 2024.

This reflects enhanced capital and liquidity in CRE financing in 2025, especially for SASB loans where refinancing is readily available for trophy properties with decent occupancy and cash flow.

Maturity performance for office loans also improved significantly as the lending market became more open to office refinance. Conduit office maturity payoff rose to 51.0% in 2025 from 43.8% in 2024, and delinquency dropped to 36.6% from 44.6%.

We believe the fact that more and more loans were able to obtain refinancing and pay off on time is an encouraging sign that the CRE property distress and CMBS credit risk, while still heightened, might be starting to taper off soon. We hope to see more maturity refinance successes in the second half of 2025 as CRE fundamentals continue to recover and the Fed resumes easing.

#### Exhibit 3: Non-Agency CMBS Maturity Performance

<b>Deal Type/Year</b>	<b>2024</b>			<b>1H2025</b>		
	<b>paid off %</b>	<b>dlq %</b>	<b>extension %</b>	<b>paid off %</b>	<b>dlq %</b>	<b>extension %</b>
Conduit	63.27%	23.52%	13.21%	69.68%	21.29%	9.03%
Conduit Office	43.80%	44.60%	11.60%	51.00%	36.60%	12.40%
SASB	4.91%	2.18%	92.94%	35.17%	4.46%	60.41%
SASB Office	10.20%	5.30%	84.50%	72.90%	5.70%	21.50%
CRE CLO	22.45%	7.66%	69.89%	36.58%	10.45%	52.98%

Source: LSEG Yield Book (July 2025)

We proved correct in predicting that CMBS disposition volume would pick up in 2025 as property price transparency improved and special servicers decided to liquidate troubled loans. These loans could not be turned around given the severity of impairment in property cashflow and valuation. The 1H2025 monthly average disposition volume reached \$258 mm, which is 20% higher than the 2024 level. We think it's moving in the right direction enabling the delinquent pipeline to be flushed out and for property prices to eventually bottom out. However, the realized loss severity of the dispositions came in at 48% for 1H2025,

lower than 2024's 60%, indicating that (1) the pace of CRE property price decline has slowed down in 2025, and (2) many of the worst properties which probably lost 70+% value may yet to be disposed of. We would look for loss severity to rise in 2H2025 when more distressed properties are liquidated.

#### Exhibit 4: Non-Agency CMBS Loan Disposition

	2023	2024	1H2025
Monthly Avg Disposition Volume (\$mm)	243	216	258
Avg Loss Severity	58%	60%	48%

Source: LSEG Yield Book (July 2025)

## Spreads

Conduit CMBS new issue spreads have tightened significantly since April, though they are not back to February tightness yet. We see the likelihood they will continue to tighten in the next few months, absent a resurgence in tariff distress. Rate volatility has subsided, and investor demand has been high, with a strong appetite for credit and yield. We maintain our projection that conduit 5-year Super Senior AAA spreads may reach 80 bps (in line with the tightest levels market priced in February) before YE2025 (vs. 95 bps at mid-year) on the tailwinds of benign macro and investor optimism.

On the other hand, new issue conduit BBB spreads stood at 393 bps at mid-year, still significantly wider than 300 bps as of YE2024. We would like to be cautious on the spreads of subordinate tranches as investors may remain wary of tail risk in collateral pools with exposure to office and loans short of a pristine credit profile. We think new issue BBB spreads may tighten to 350 bps by YE2025, which is 50 bps wider than our original forecast.

We continue to see compelling spreads and yields in SASB floaters and CRE CLO AAAs and believe they will remain well bid and have room to tighten in the second half of the year.

#### Exhibit 5: Conduit CMBS New Issue Spreads Forecast

Year	LCF AAA spreads (bps)	BBB spreads (bps)
Dec 2024	84	300
June 2025	95	393
YE2025 projection (original)	80	300
YE2025 projection (updated)	80	350

Source: LSEG Yield Book (July 2025)

## Outlook

Entering the second half of the year, the key question is whether tariff-induced inflation will emerge as it takes time to filter through the system to pressure inflation, which will be crucial for Fed rate decisions. Most goods remain unaffected by tariffs so far, though there are early indicators that prices of goods such as apparel, footwear, furniture, and bedding may be rising.

If tariffs reignite inflation and jobs data remains robust, we will likely see little rate cutting this year. Alternatively, if the tariff impact turns out to be muted indeed and inflation continues to trend down, there could be a couple of rate cuts coming later this year as expected. The worst-case scenario is resurgent inflation and a rapidly deteriorating labor market, which would put the Fed in a corner and raise the risk of stagflation.

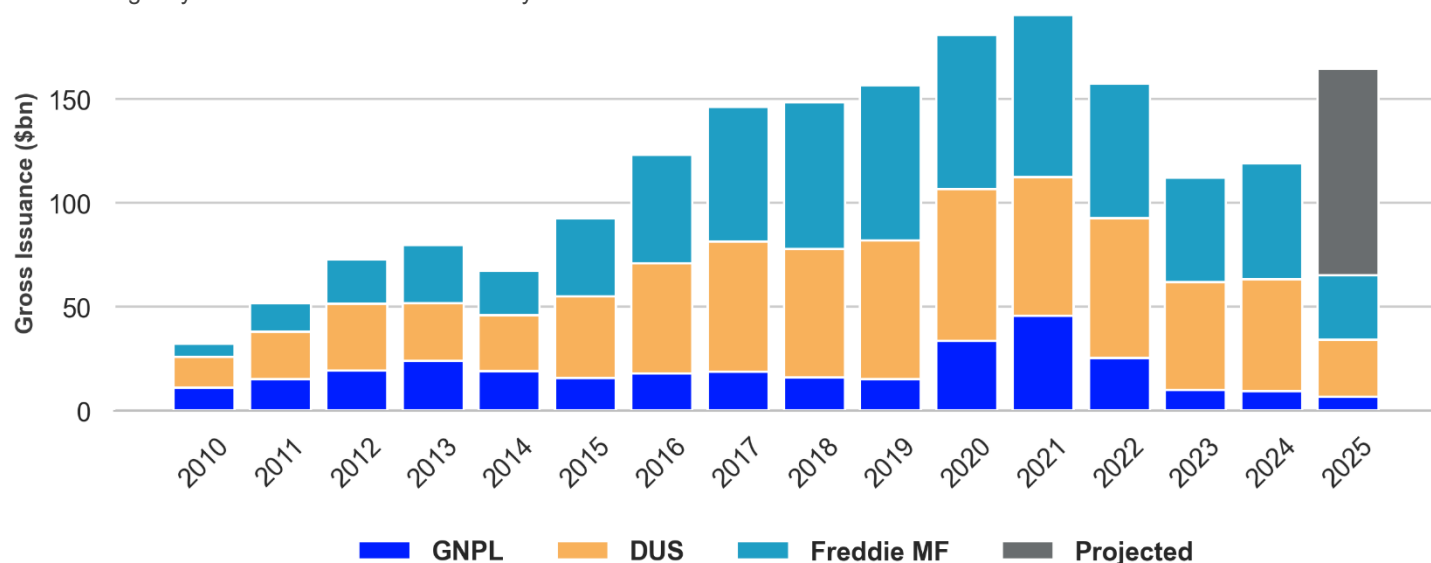
Despite inflation and rate uncertainty, we are cautiously optimistic for the outlook of 2H2025 and beyond. While we can't underestimate the risk of renewed turbulence in 2H2025, our baseline scenario assumption is the tariff impact may turn out to be manageable and inflation will stay relatively benign, allowing a few rate cuts to materialize. As the administration shifts focus to deregulations and "pro-business" policies post tariff, we would expect positive economic growth and rising demand for property space. In conclusion, we see healthy CRE and CMBS market growth in 2H2025 as distress in maturity refinancing and office fundamentals continues to ease, but would also caution that tariff and inflation risk remains.

## Agency CMBS Report Details

### Issuance

The agency CMBS issuance from the three agencies rose significantly in 1H2025, with a total YTD of \$65bn in June, up by 43% compared to 1H2024, with GNPL up by 25% YoY to \$7bn, FN DUS up by 46% YoY to \$28bn, Freddie MF<sup>6</sup> up by 43% to \$31bn, led by Freddie K (up by 33% to \$15bn) and Freddie Multi-PC (up by 57% to \$13bn), driven by improved multifamily fundamental and heightened competition for market share by Fannie Mae and Freddie Mac on Trump administration's advocacy to privatize the GSEs. Note that among the newly issued agency CMBS securities, over 70% of them are from refinance. Since the prepayment speeds were largely muted for agency CMBS securities this year, many of the refinancing activities likely came from non-agency multifamily CRE loans.

Exhibit 6: Agency CMBS Gross Loan Issuance by Year



Source: GNMA, FNMA, FLHMC, LSEG Yield Book (July 2025)

Entering 2H2025, we are expecting economic growth to continue with higher demand for multifamily assets. Property transactions will likely pick up, leading to higher acquisition fundings. Refinancing may also rise if the Fed starts to cut rates again. We see total agency CMBS issuance rising 38% to a total of \$165 bn by the end of 2025 (vs. total of \$119bn in 2024), with \$11bn for GNPL (vs. \$9bn in 2024), \$76bn for Fannie DUS (vs. \$54bn in 2024), and \$78bn for Freddie Mac multifamily (vs. \$56bn in 2024), in our baseline scenario.

### Market Spreads

Agency CMBS Market spreads were mostly stable since December, with Freddie K A1/A2/AM compressing by 3/5/6 bps to 48/42/46 bps, Freddie K AS widening by 2 bps to 60 bps, DUS 10/9.5 TBA contracting by 4 bp to 47 bps, and DUS SARM expanding by 2 bps to 62 bps. The trend is consistent with Agency RMBS, where FN 30-yr CC ZV spreads widened by 4 bp in 1H2025 to 139 bps. On the other hand, the spreads for the riskier Freddie K B and C tranches widened significantly from YE2024 and peaked at 205 bps and 305 bps during the risk-off phase in markets in April, and have since come down materially and settled at 179 bps and 279 bps in June, respectively.

We expect spreads to tighten further in 2H2025 and may have a chance to tighten another 5-10 bps to the extent agency RMBS spreads narrows further. Potential rate cuts by the Fed and strong demand for agency CMBS securities can be another tailwind for spread compression.

<sup>6</sup> Freddie MF includes Freddie K, SB, Q, ML and Multi-PC

Exhibit 7: Market Spreads for DUS and K bonds

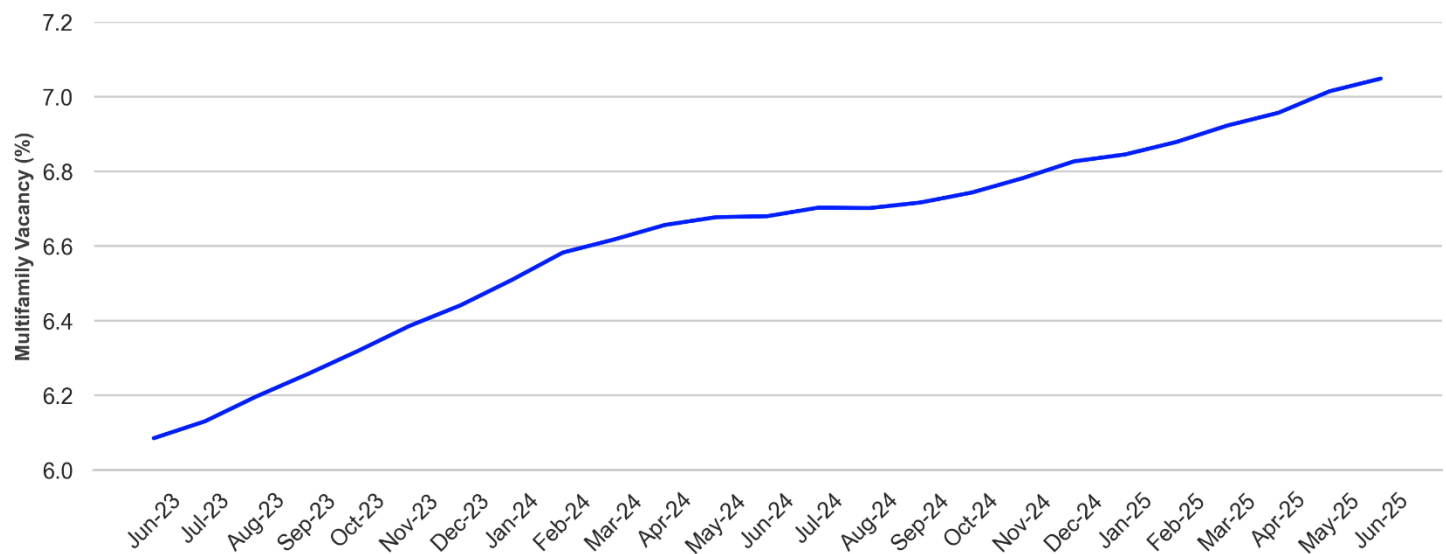
Product	Bond	Jul 24	Aug 24	Sep 24	Oct 24	Nov 24	Dec 24	Jan 25	Feb 25	Mar 25	Apr 25	May 25	Jun 25
Freddie K	A1	48	49	48	48	49	51	48	43	49	50	49	48
Freddie K	A2	51	51	48	49	47	47	40	41	49	49	45	42
Freddie K	AM	57	57	54	54	52	52	44	45	54	55	49	46
Freddie K	AS	58	60	59	59	58	58	53	54	59	63	61	60
Freddie K	B	173	173	130	114	115	125	125	144	190	205	181	179
Freddie K	C	272	273	222	203	209	228	226	245	290	305	281	279
DUS	10/9.5 TBA	53	55	58	56	52	51	48	49	56	54	49	47
DUS	Fannie SARM	63	64	64	62	60	60	58	60	60	65	64	62

Source: CMA, LSEG Yield Book (July 2025)

## Multifamily Fundamentals

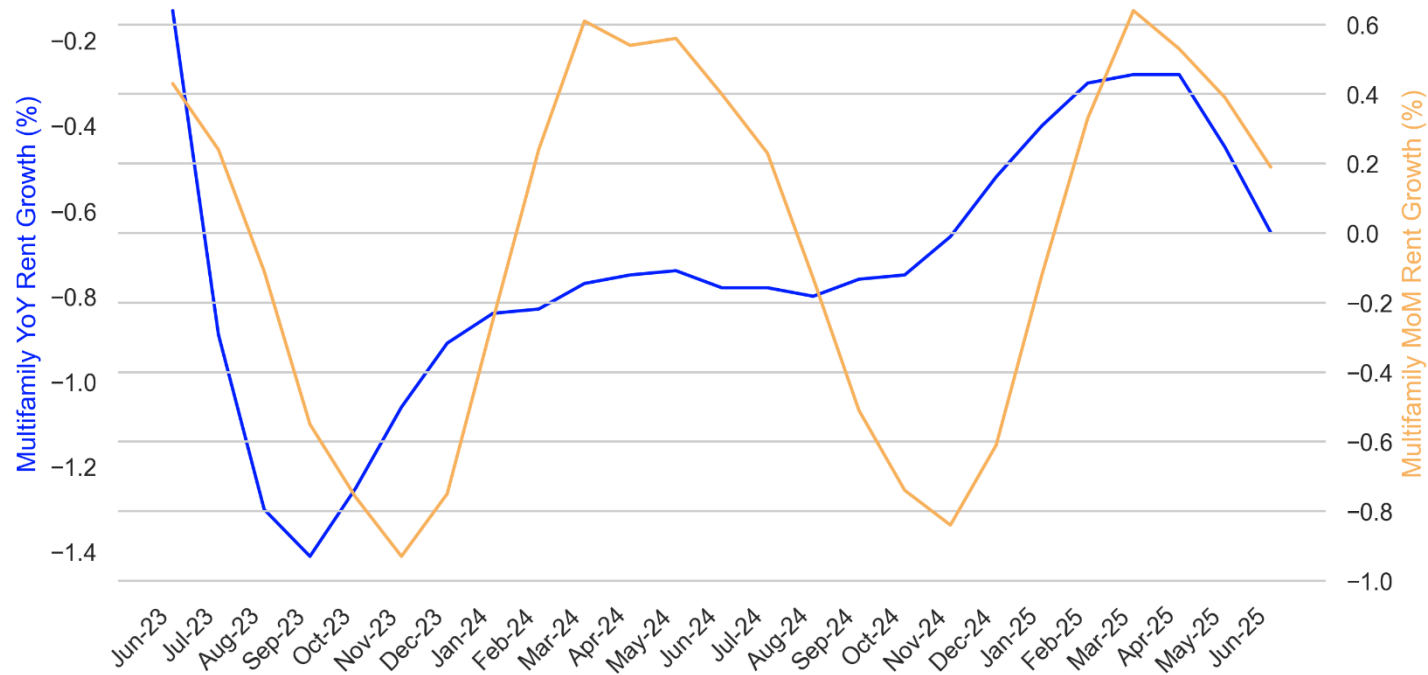
While multifamily fundamentals have been largely resilient in H1 2025, the sector still faces challenges. The surge of multifamily supply in 2024 continues to haunt this sector (despite the recent slowdown in new constructions), driving the national vacancy rate higher to 7.0% from 6.8% at the beginning of the year. Rental growth has also been under pressure, with YoY rent staying in negative territory for the last 2 years. The silver lining is MoM rent growth which stayed positive this year. For 2H2025, we expect the occupancy and rent to stabilize or improve for most geographic locations except some sunbelt metros which may continue to suffer from oversupply.

Exhibit 8: Multifamily Vacancy Rate



Source: Apartment List, LSEG Yield Book (July 2025)

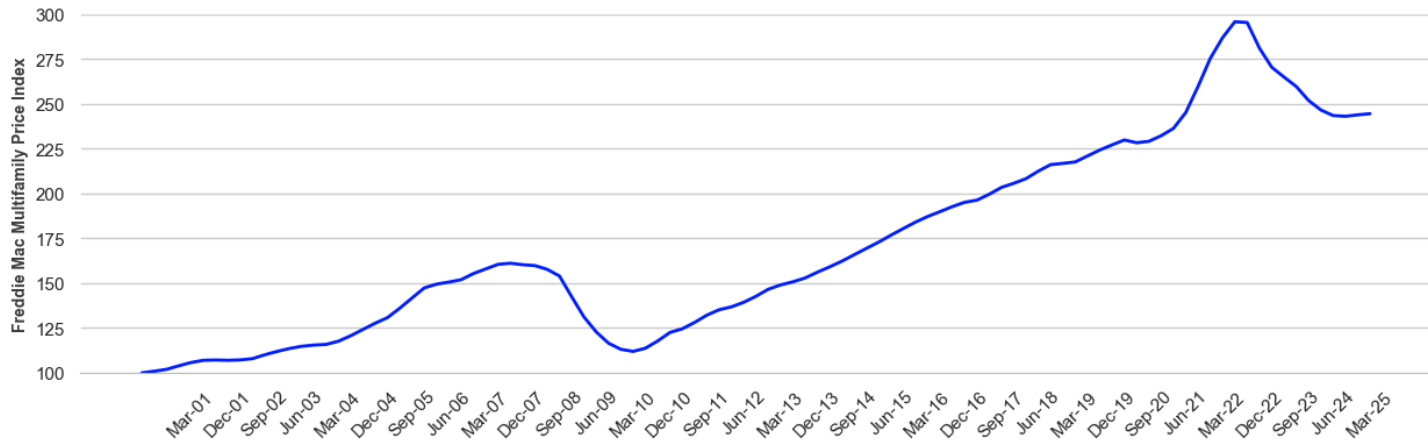
Exhibit 9: Multifamily Rent Growth Rate



Source: Apartment List, LSEG Yield Book (July 2025)

Multifamily property prices have been improving in the last few quarters after hitting bottom in 24Q3. Prices increased by 0.26% in 1Q2025 from 4Q2024, but were still down by 14.7% YoY. We expect the recovery of multifamily property values to continue into the second half of 2025.

Exhibit 10: Multifamily Property Price Index



Source: FHLMC, LSEG Yield Book (July 2025)

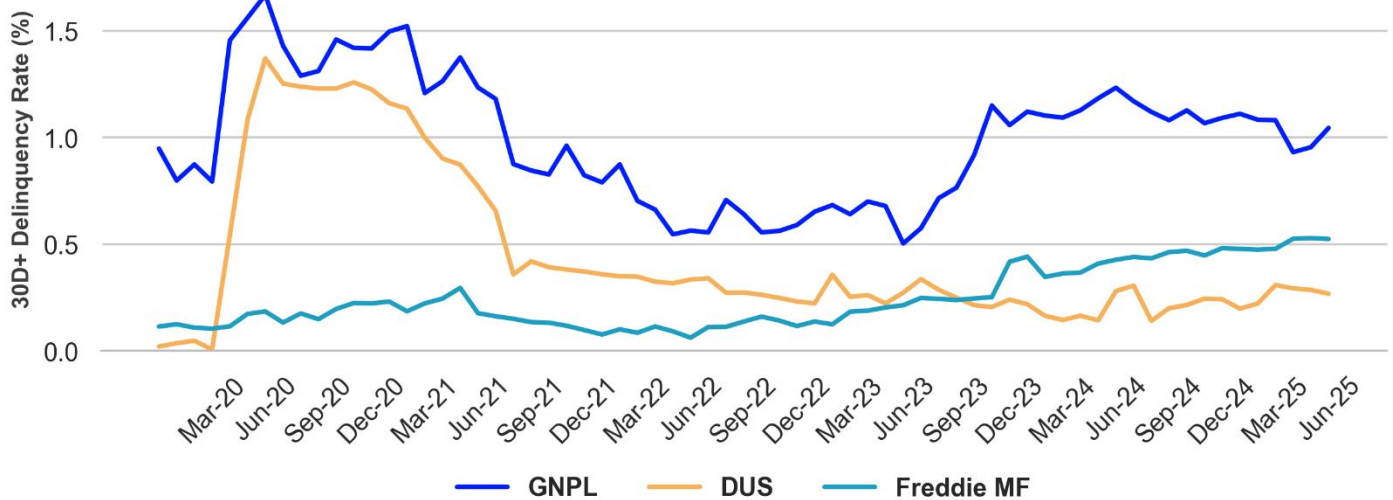
## Credit Performance

Credit performance for agency CMBS was steady in 2025:

- GNPL 30d+ delinquency rates fell 2 bps to 1.1% from December to June. Senior housing has been improving consistently since the peak of 4.26% last June and reached 2.6% this June, thanks to the growing baby boomer demand as they age. Excluding senior housing, GNPL delinquency has increased by 23 bps to 0.7% as of June.
- The DUS delinquency rate has been stable around 0.2-0.3% and was at 0.28% in June.
- Freddie MF delinquency was stable around 0.5% and settled at 0.5% in June. It is worth noting that Freddie MF is dominated by Freddie K and Multi-PC, where delinquency rates have remained stable this year and reached 0.4% and 0.2% in June, respectively.

Looking ahead, we expect the credit outlook for agency CMBS loans to remain stable as potential Fed rate cuts and improving property valuation facilitate maturity refinancing.

Exhibit 11: Agency CMBS 30D+ Delinquency Rates



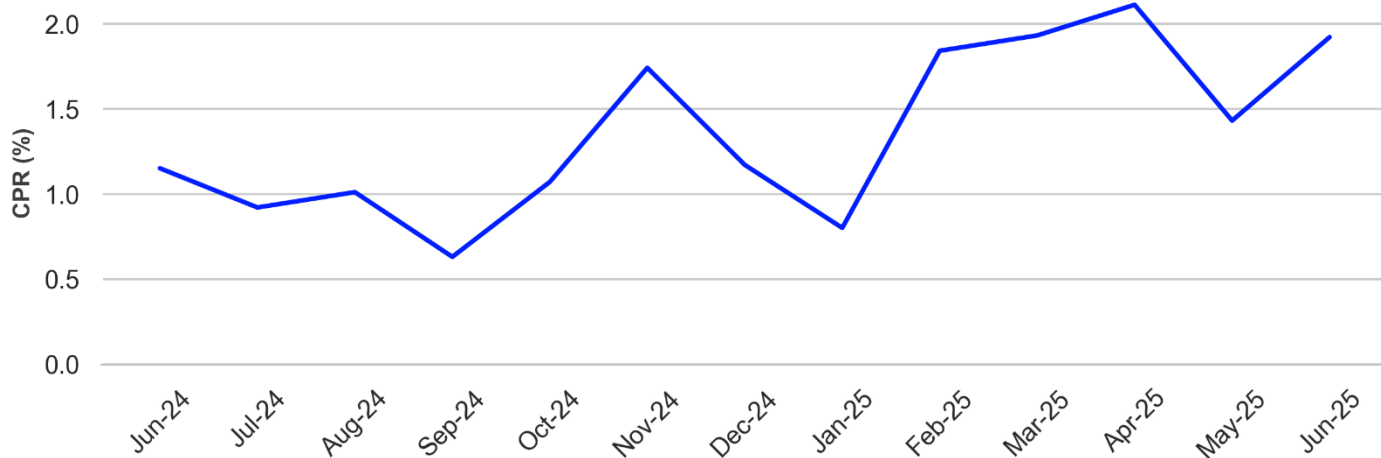
Source: GNMA, FNMA, FHLMC, LSEG Yield Book (July 2025)

## Prepayments

Agency CMBS loan prepayments have been muted in 1H2025, due to higher for longer interest rates, lower property valuations, and strict call protection.

The prepayment speeds for GNPL have been in low single digits in the last two years, as most loans are out of the money for refinance.

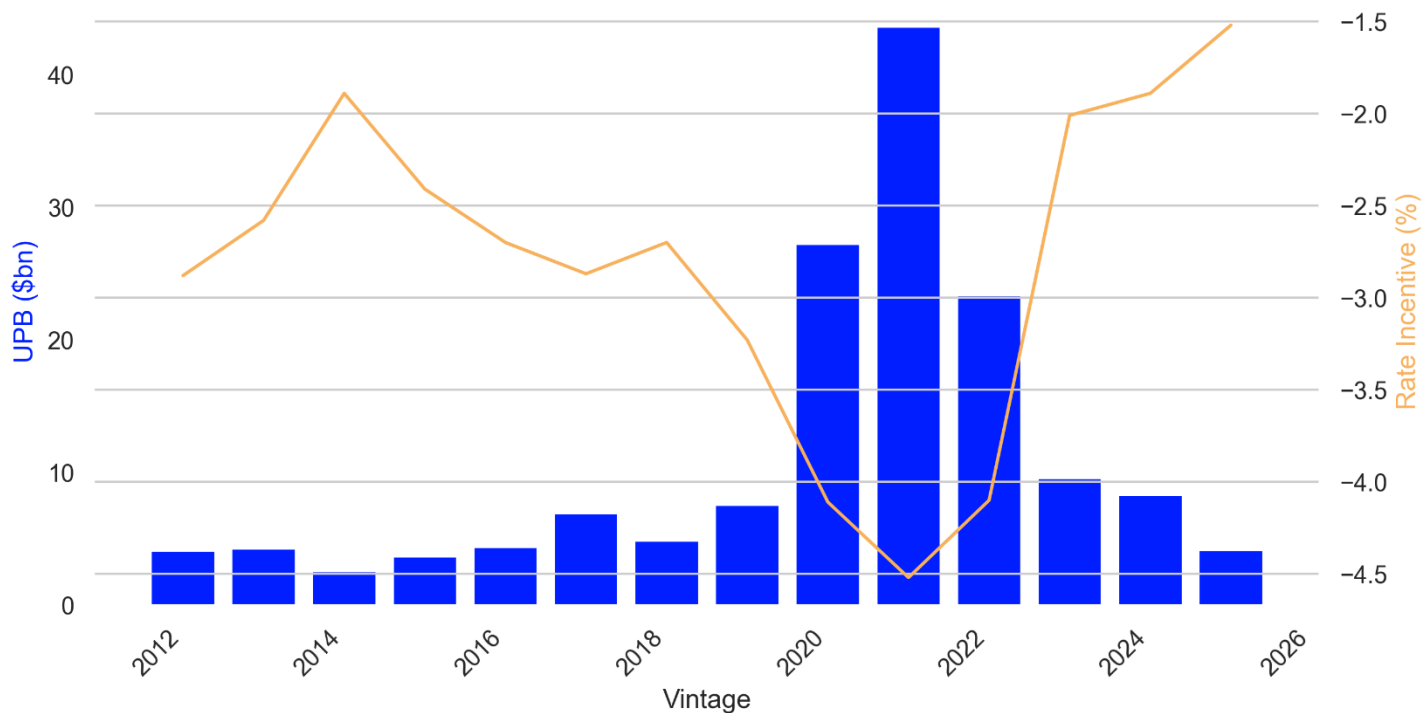
Exhibit 12: GNPL Actual Prepay Speeds



Source: GNMA, LSEG Yield Book (July 2025)

In fact, 78% of the outstanding GNPLs have coupon rates below 4% and the average rate incentive ranges from -1.5% to -4.5% across vintages. The 2020-2022 vintages have especially low-rate incentives as many seasoned loans got refinanced during those periods to take advantage of the record low interest rates.

Exhibit 13: GNPL Rate Incentive by Vintage



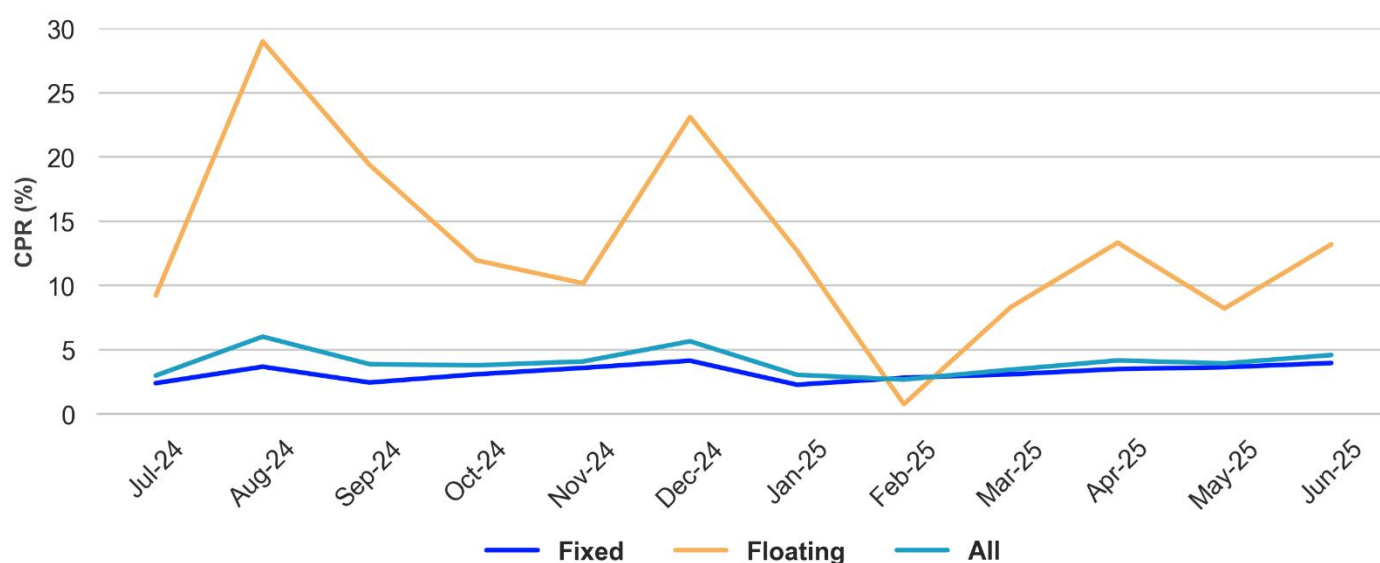
Source: GNMA, LSEG Yield Book (July 2025)

Despite the slow recovery in multifamily property valuations, the turnover for GNPL remained low. As rates decline and property valuation improves in 2H2025 in the baseline scenario, we expect the prepayment speeds to pick up.

Prepayment speeds for fixed DUS loans (88% of total) stayed mostly below 5 CPR as most of them are within yield maintenance period. We expect the prepayment speeds for fixed rate loans to remain at similar level in 2H2025.

As for DUS floating rate loans, Fannie Mae stopped purchasing floaters since November 2023 on credit concerns and only issued two pools since with a total of \$25MM (one in 2025 with \$20MM), leaving the already small population of DUS floaters in limbo. Despite the volatile nature, the prepayment speeds for floaters were much lower this year compared to last year as the agency tightened the underwriting standards. We expect the prepayment speeds for DUS floaters to continue to be choppy in the second half of 2025, ranging between 5 and 15 CPR.

Exhibit 14: DUS Actual Prepay Speeds by Coupon Type

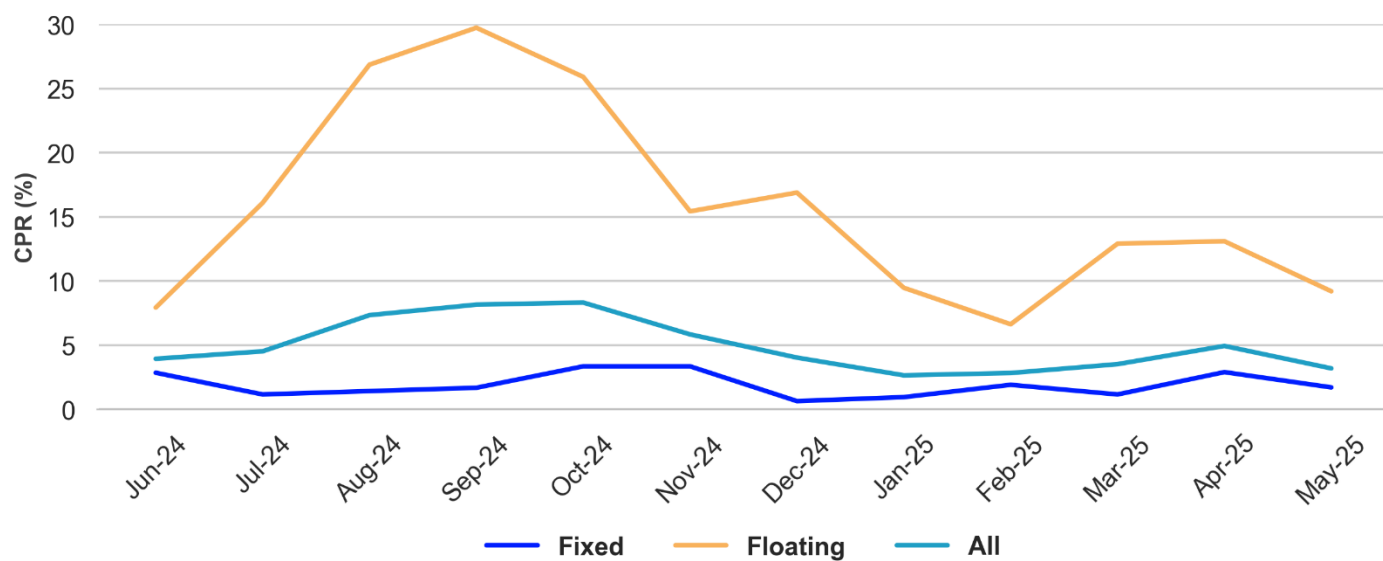


Source: FNMA, LSEG Yield Book (July 2025)

For Freddie K loans, 81% are paying a fixed rate with the rest paying a floating rate. The prepayment speeds for K fixed rate loans are particularly low and expected to remain low in the second half of 2025 due to strong call protection. Floating rate loan speeds have been declining from the peak last September and stayed within the range of 5-15 CPR this year as Freddie Mac joined Fannie Mae to fight fraud. We would expect the speeds for K floaters to remain in the same range for 2H2025.



Exhibit 15: Freddie K Actual Prepay Speeds by Coupon Type



Source: FHLMC, LSEG Yield Book (July 2025)

# Section 7 – CLO Outlook

## Tailwinds for issuance and spreads

### Market Overview

Despite tariff turmoil, the U.S. economy remains in good shape, supported by easing inflation pressure and a resilient labor market. Fears on tariff-induced recession have largely dissipated, offering a more stable backdrop for capital markets. Major stock indexes have been setting records with market sentiment lifted by the resilient economic outlook. Rate volatility has also eased and investor demand remains strong for credit.

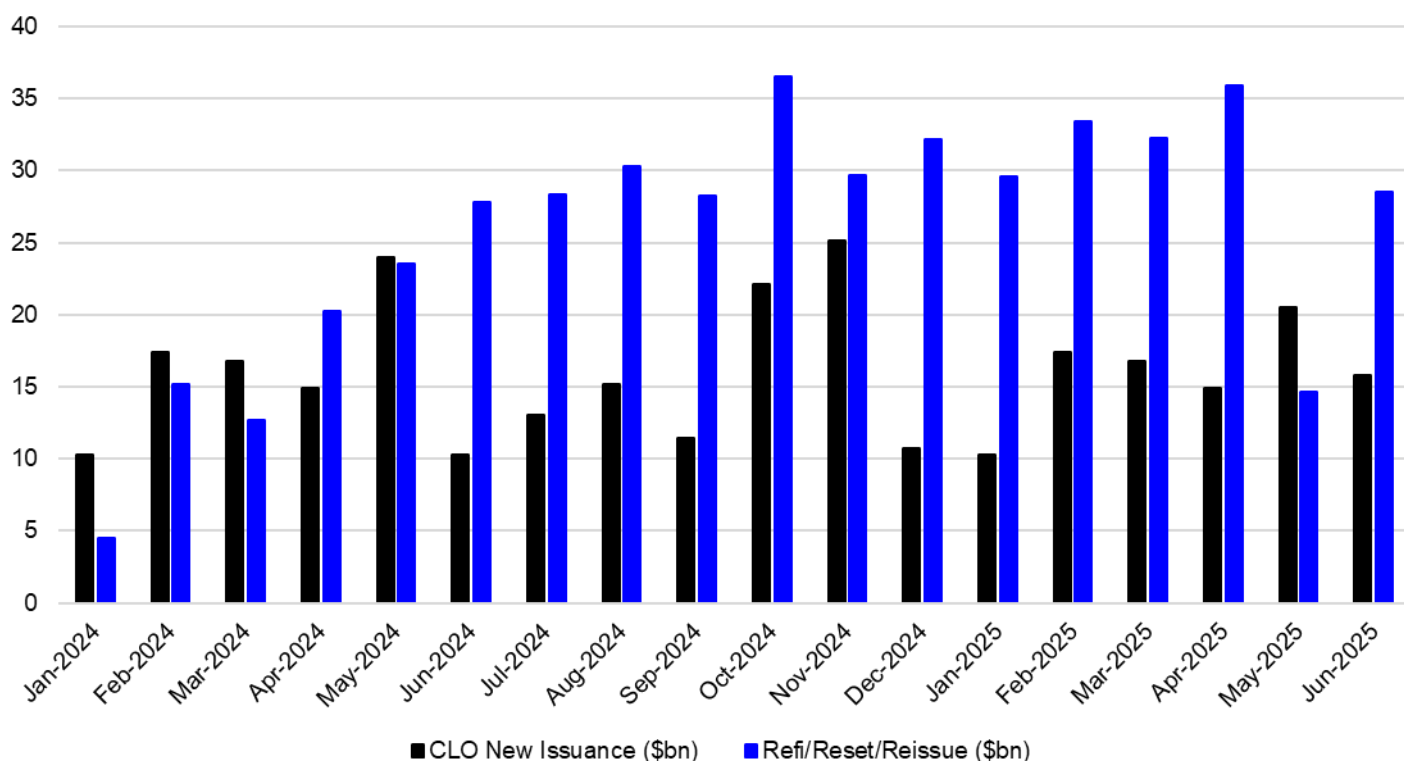
CLO had a very strong start in 1Q2025 but slowed down in 2Q with spreads widening due to tariff upheaval and policy uncertainty. However, the market soon rebounded from the dip as macro conditions stabilized and buyers returned for floating rate instruments. 1H2025 CLO issuance is 20% ahead of 2024's pace on strong technicals, driven by refinance/reset. Leveraged loan credit fundamentals remain stable in terms of CCC exposure and default rate, notwithstanding rising downgrade risk of tariff impacted sectors. While CLO equity performance has softened modestly in 2025, the structural integrity of deals remains solid, underpinned by healthy Junior OC cushions.

### Issuance and Spreads

Total U.S. CLO issuance reached \$245bn for 1H2025 which is 20% higher than 1H2024 level, driven by a 44% jump year-over-year in refinancing and reset activities, while new issuance volume is down a mere 4% from the record level of 2024 with BSL issuance on par with last year and Private Credit down 21%.

The outperformance in CLO issuance was fueled by solid investor demand as well as continued CLO ETF inflows in 2025 with total CLO ETF AUM surpassing \$30bn. High deal call/redemption volumes pressed net supply, contributing to the strong technicals. Meanwhile, CLO issuers have opted to structure more shorter-term deals to cater investor preference amid market uncertainty.

Exhibit 1: 2025 CLO Issuance



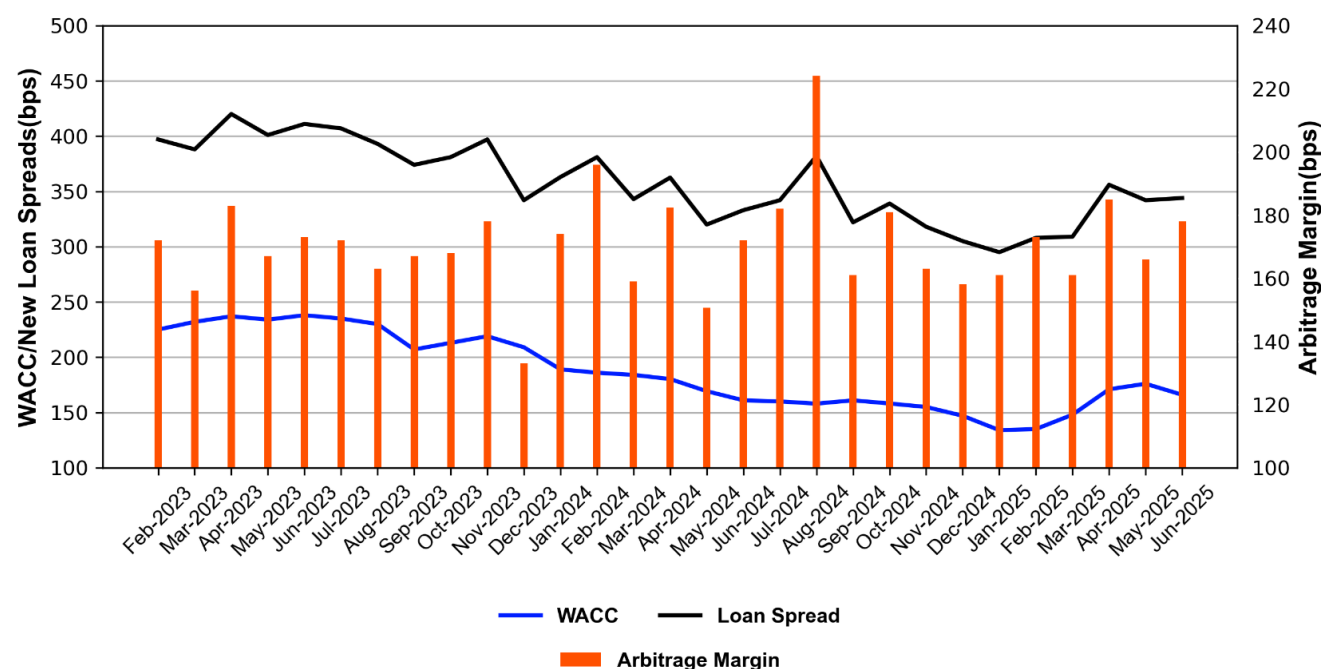
Source: Green Street, Yield Book (July 2025)

As we enter the second half of 2025, the economic outlook remains positive, bolstered by investor confidence and waning market volatility. Market expectations for Fed rate cuts later in the year are setting up renewed momentum for CLO market growth.

M&A transactions, along with LBO activities, are expected to ramp up in the coming months, boosting leveraged loan supply, which would in turn fuel CLO issuance.

While both leveraged loan spreads and the CLO Weighted Average Cost of Capital (WACC) have widened in 1H2025, the WACC has tightened more post “Liberation Day” turmoil compared to loan spreads, leading to CLO arbitrage margin improvement of 20 bps for the first half of the year (178 bps in June vs. 158 bps at year-end 2024). With WACC likely to trend lower amid persistent investor demand for CLO debts, the new issue arbitrage margin may remain healthy and conducive to robust CLO deal flow in 2H2025.

Exhibit 2: CLO WACC, new loan spreads and CLO arbitrage margin (new issues)



Source: Green Street, Yield Book (July 2025)

We maintain our forecast for 2025 full year BSL CLO issuance at \$160bn which would exceed last year's record of \$154bn.

Though we continue to be bullish for the growth prospect of private credit CLO market, the pace of its issuance has been below expectations in 1H2025 as it was more sensitive to market volatility than the BSL sector. We do think the pace of private credit issuance may pick up in 2H2025 on a benign macro backdrop, as more private credit asset managers enter the market to issue CLOs. We are adjusting our projection of the full year 2025 private credit issuance down to \$36bn (which would still more than double the 1H2025 volume) from \$50bn originally.

Our total 2025 CLO new issuance (BSL+Private Credit+Static) forecast is therefore \$200bn (down from \$215bn originally), slightly above 2024 new issuance of \$197bn.

Refinancing and reset transactions are expected to remain robust as spreads stay tight and more deals exit non-call and approach the end of the reinvestment period. We see a total of \$44bn (out of non-call by YE2025) in the money for refinance with an AAA spread greater than or equal to 145bps (10bps higher than the current new issue AAA spread level), and \$53bn (out of non-call by YE2025) prime for reset with deal WACC greater than or equal to 186bps (20bps higher than the current new issue WACC level). Hence we expect a total of at least \$97bn par volume potentially fit for refinance or reset in 2H2025 if the current spread level holds. We are aware that there could also be deals which would reset without being viable due to the need to extend CLO life and maintain AUM for managers. So we would add \$10bn more to the forecast.

We hence revise our full-year refinance and reset issuance projection for 2025 upward to \$256bn (from \$215bn originally).

Exhibit 3: 2025 CLO New Issuance Forecast

Year	BSL (\$bn)	Private Credit (\$bn)	Static (\$bn)	Total New Issue (\$bn)	Refinance/Reset/Reissue (\$bn)
<b>2024</b>	154	37	5	197	289
<b>1H25</b>	78	16	2	96	149
<b>Original Proj. 2025</b>	160	50	5	215	215
<b>Midyear Updated Proj. 2025</b>	160	36	4	200	256

Source: Yield Book (July 2025)

As of mid-year 2025, AAA and BB spreads in the BSL CLO space stood at 135 bps and 564 bps respectively, both modestly wider compared to YE2024 levels. For 2H2025, we think spreads are biased to tighten amid stabilizing credit fundamentals and a constructive macro environment.

We widen our projection of YE2025 BSL new issue AAA spreads slightly to 125 bps from 120 bps originally, with AAA spreads likely to see technical pressure from elevated primary supply. Meanwhile, we expect the spread curve to flatten and maintain our BSL BB spread forecast at 500 bps by YE2025 (vs. 564 bps now), due to the positive CLO credit outlook.

Exhibit 4: 2025 BSL CLO New Issue Spreads Forecast

Year	BSL AAA spread (bps)	BSL BB spread (bps)
<b>Year End 2024</b>	130	536
<b>June 2025</b>	135	564
<b>Original Proj. YE2025</b>	120	500
<b>Midyear Updated Proj. YE2025</b>	125	500

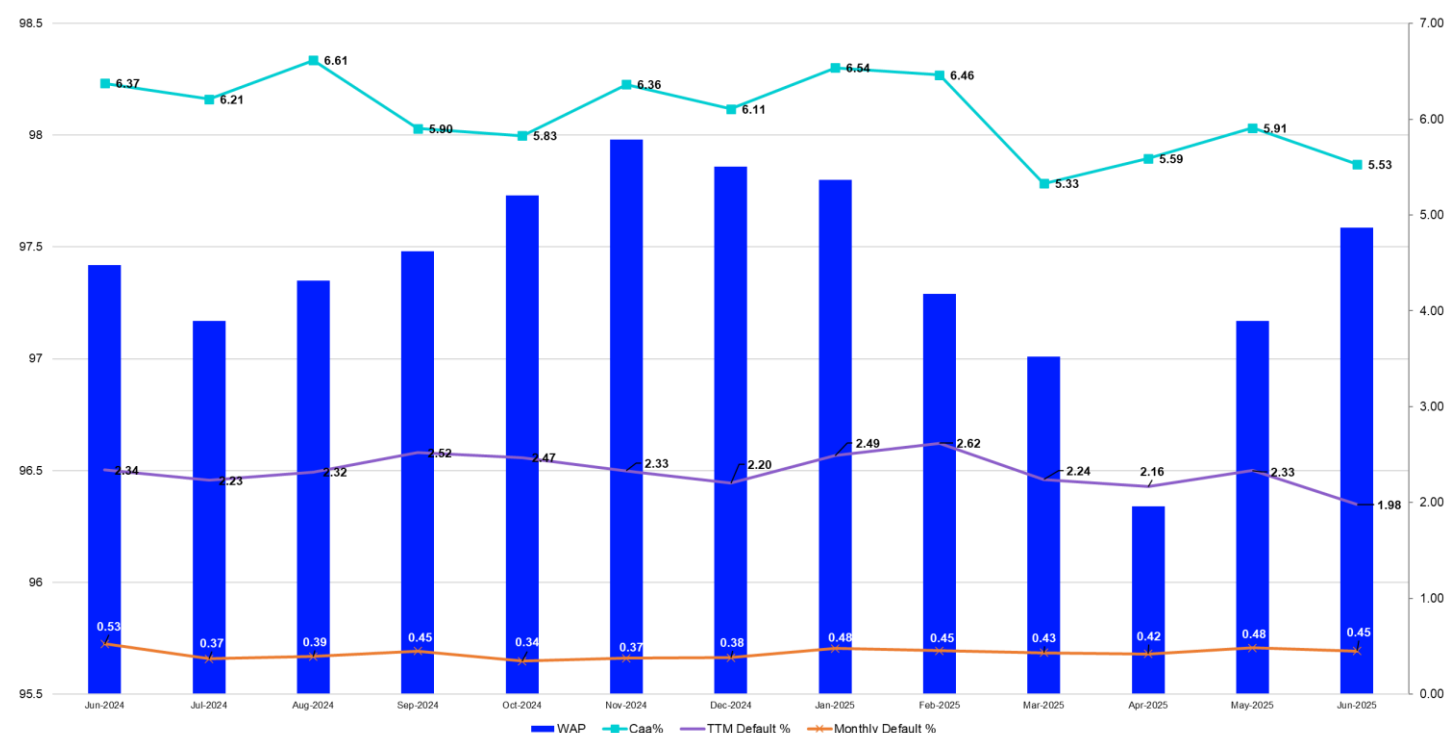
Source: LSEG Yield Book (July 2025)

## Credit Review

The credit fundamentals for CLO assets have been stable in 2025 with CCC exposure and default rates remaining low and steady.

While asset downgrade activities continue to outpace upgrades, they have slowed down in 2025 with a declining downgrade to upgrade ratio. Notably, net downgrade volume for the Caa bucket dropped sharply from a total of \$38.9bn in CLO collateral pool in 2024 to just \$7.9bn YTD in 2025, with signs of stabilization in corporate credit for leveraged borrowers.

Exhibit 5: Weighted Average Price, Caa %, TTM Default % of CLO Collateral in the last 12 months



Source: LSEG LPC, Trepp, Yield Book (July 2025)

Caa % exposure in CLO holdings decreased to 5.5% in June from 6.1% in December 2024, driven by active selling of Caa assets by CLO managers to maintain credit profile and portfolio clean-up for resets.

Meanwhile, monthly default rates for CLO collateral have been staying around 40-50 bps in 1H2025, while the TTM default rate for CLO loans dropped to 2.0% in June from 2.2% in December 2024.

Looking at the most recent collateral performance by industry, Services, Retail, Healthcare, and Wholesale led the way in Caa exposure, while Wholesale, Chemicals, Technology, and Retail reported the highest default percentages. In terms of tail risk, Retail has the the highest concentration of assets priced below 80, followed by Wholesale, Services, and Healthcare. As highlighted in our 2025 outlook, the Healthcare sector faces mounting challenges due to policy changes introduced by the Trump administration. Meanwhile, tariff-related pressures may have disproportionately affected Wholesale, Retail, and Chemicals.

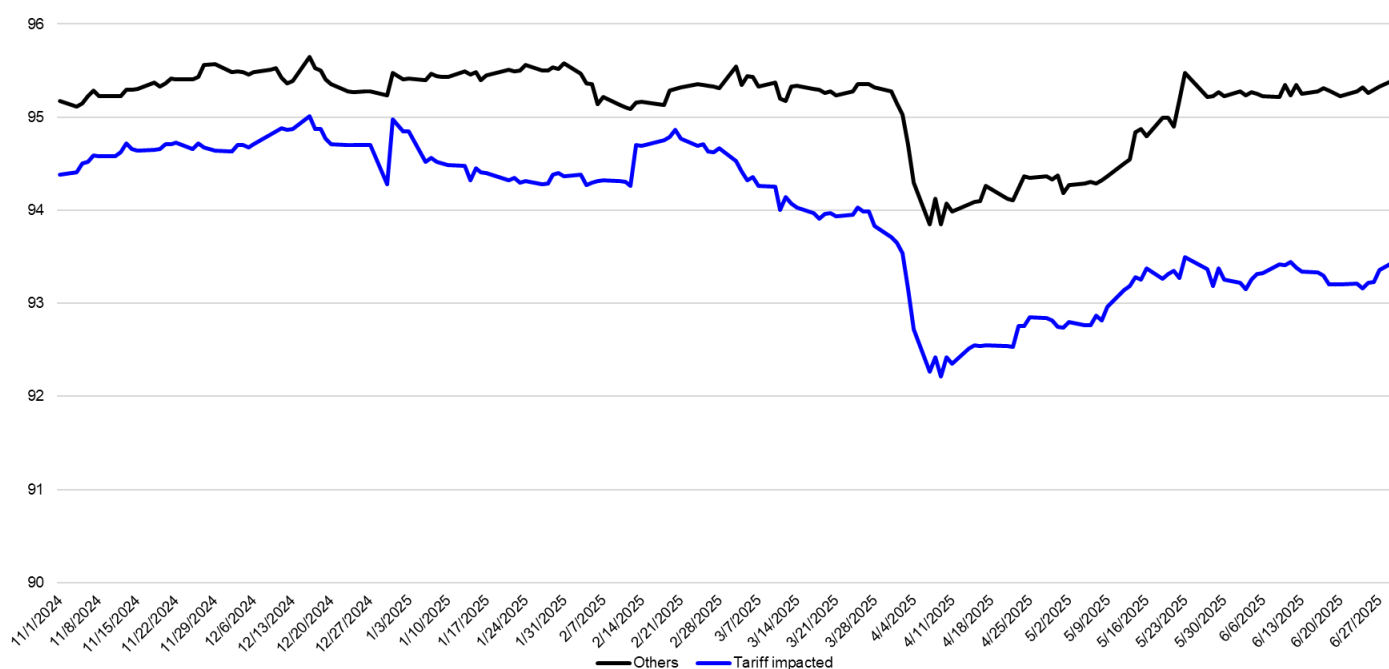
Exhibit 6: BSL CLO collateral performance of the top 10 industries by CLO exposure

Industry	CLO Exposure (%)	Caa or below (%)	Defaulted (%)	Price<80 (%)
Financial Services	13.95	1.64	0.15	1.23
Technology	13.38	6.57	0.89	3.45
Business Services	8.31	2.33	0.13	2.11
Healthcare	8.26	8.50	0.14	5.34
General Manufacturing	6.24	3.88	0.30	2.17
Services	5.94	11.41	0.77	5.51
Wholesale	3.90	7.35	1.46	8.68
Chemicals, Plastics & Rubber	3.55	6.20	1.13	4.46
Leisure and Entertainment	3.50	0.74	0.00	0.08
Retail & Supermarkets	3.24	9.74	0.87	9.32
Overall Market Average		5.55	0.45	3.24

Source: LSEG LPC, Yield Book (July 2025)

Furthermore, we identify six industries which might be vulnerable to tariffs and supply chain disruption, including General manufacturing, Wholesale, Chemicals, plastics & rubber, Retail & supermarkets, Automotive, and Construction, which together represent 22% of CLO par exposure. Loan price movement of these sectors has underperformed the other sectors since November 2024. The tariff-impacted sectors suffered steeper selloff and also lagged in the recovery, with price loss by the end of June at -1.95pts vs. -0.78pt for the non-impacted sectors. Heading into 2H2025, tariff-affected sectors may continue to face headwinds from ongoing trade policy shifts. However, if trade negotiations make meaningful progress and the final duty rates end up lower than people feared, there could be upside potential on price for these industries.

Exhibit 7: Market price change for tariff-impacted sectors vs. others



Source: LSEG LPC, Yield Book (July 2025)

Looking beyond policy uncertainties, CLO credit fundamentals are expected to be stable in 2H2025 with the pace of downgrades decelerating. Hence, we would like to reiterate our forecast for 5% Caa exposure (down from 5.5% at mid-year). We think TTM Default Rates may remain flat around 2% by YE2025 (vs. 1.98% currently) amid a stable credit environment in 2H2025. We also expect active trading and portfolio management from CLO managers to continue to play a key role in keeping the CCC bucket and defaults low in CLO assets.

Exhibit 8: 2025 Forecast of Caa% and Default Rate

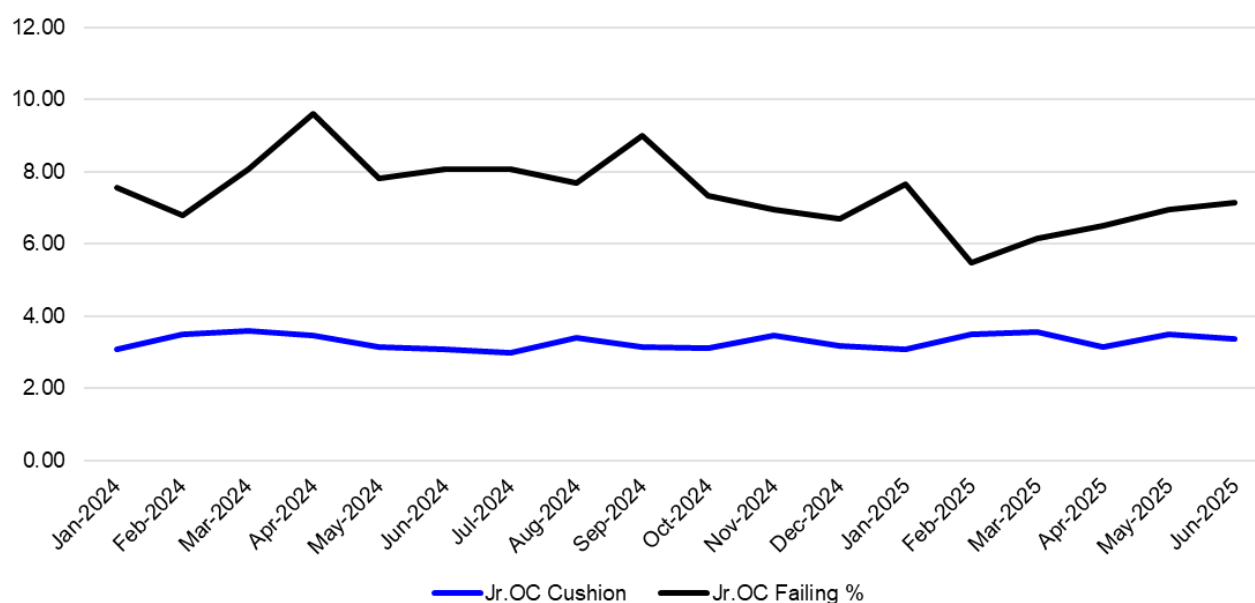
	Caa%	TTM Default %
Midyear 2025	5.53%	1.98%
Original YE2025 Forecast	5.00%	2.00%
Midyear Updated YE2025 Forecast	5.00%	2.00%

Source: Trepp, LSEG Yield Book (December 2024)

## CLO Performance

In 1H2025, the Junior OC cushion has remained steady at 3.38% in June 2025. The failure rate of Junior OC tests among CLO deals stood at 7.2% in June, in line with December 2024 level. As asset downgrades slow down, we expect the OC cushion and OC test performance to keep strong in 2H2025. The Junior OC cushion is projected to remain steady around 3.4% (vs. our original projection of 3.7%) while the OC test failing rate is likely to stay well under 8.0%.

Exhibit 9: Junior OC cushion and Junior OC test failing rate

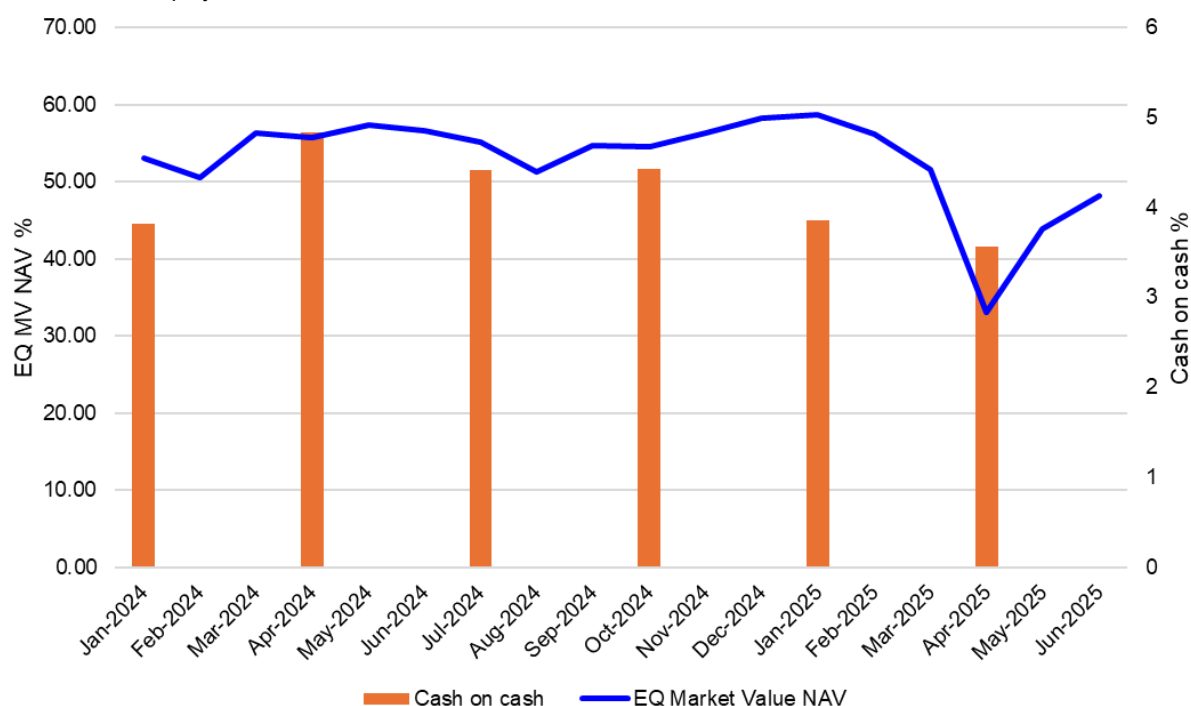


Source: Trepp, Yield Book (July 2025)

On the other hand, equity cash-on-cash return softened in 2025, as a loan refinancing/repricing wave squeezed the spread margin more than what can be offset by the tranche refinancing/reset. The equity cash-on-cash return (for BSL deals within RP) added up to 7.4% in 1H2025, down from 8.7% in 1H2024. The Equity NAV rebounded in late Q2 from an April low to 48.0% in June, but still lower than 58% in December 2024. As loan prices continue to rebound, the Equity NAV is expected to revert back to the 50-60% area.

We are revising our CLO equity cash-on-cash return projection for 2025 down to 14-15% from the original 17-18% due to the narrower excess spreads.

Exhibit 10: CLO Equity market value NAV and Cash-on-Cash Return



Source: Trepp, LSEG Yield Book (July 2025)

Exhibit 11: 2025 CLO Junior OC Cushion and Equity Cash-on-Cash Forecast

	Junior OC Cushion	Equity Cash on Cash
June 2025	3.4%	7.43%
Original 2025 Forecast	3.7%	17-18%
Midyear Updated 2025 Forecast	3.4%	14-15%

Source: Trepp, LSEG Yield Book (July 2025)

## Conclusion

Though the market rebounded as tariff and inflation fears eased, we are yet to see any material tariff impact which will likely come into effect in 2H2025. A rebound in inflation and slower growth due to tariffs remain top concerns for the CLO market.

We expect further credit deterioration on assets susceptible to tariff and inflation with rising material and labor costs, especially for issuers with weak financials and high leverage. Default and downgrade activities are likely to pick up too as the tariff impact starts to show up.

That said, there are multiple tailwinds supporting the CLO market, including the newly passed One Big Beautiful Bill which is likely to boost economic growth with tax cuts for corporates and consumers, the Trump administration's likely initiatives on deregulation, and the prospect of Fed easing later this year.

We are optimistic overall CLO credit fundamentals will remain solid in 2H2025, and the credit issues could be mitigated by strengthened financials of leveraged loan borrowers and proactive portfolio management by CLO managers.

We also think investor demand is likely to remain strong with renewed buying by ETFs and banks in the U.S. and Japan, supportive of robust deal flow and tight spreads.

Barring a resurgence in tariff and inflation stress, we are positive on the 2H2025 outlook as CLO remains the only scalable floating rate asset class for fixed income investors with compelling spreads and return.



## About Lipper

With a track record of over 50 years of independent content, LSEG Lipper was the first to develop fund classifications that place funds in their respective peer group.

LSEG Lipper data covers more than 380,000+ share classes in over 80 countries. The Lipper Leader ratings are available for mutual funds registered for sale in 47 markets.

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