LM CAPITAL GROUP
GLOBAL BOND MANAGEMENT

LM Capital Group Perspectives

Investment Insights
1Q 2025

Michael Chalker

Senior Portfolio Manager, Senior Analyst

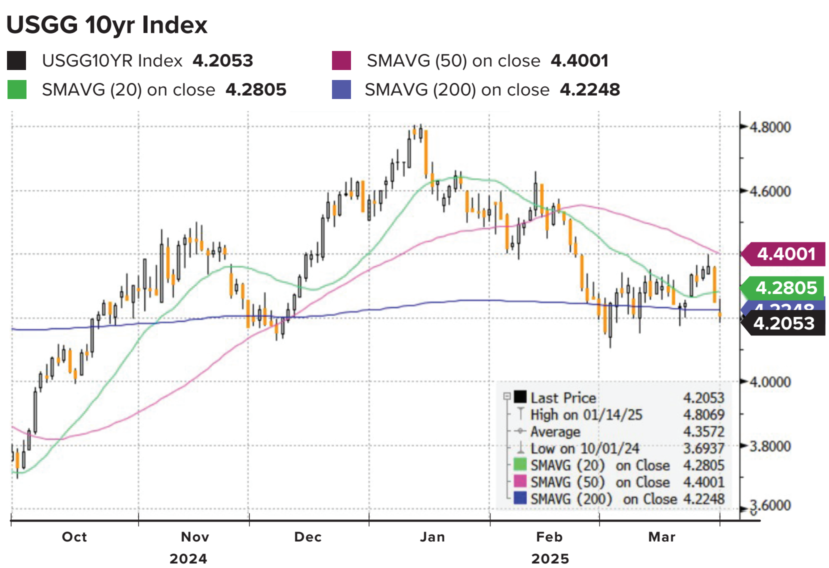
A World Now Unknown

Every sector of the fixed income markets performed positively this quarter, even as economic data continued to show more consumer weakness. Tariff-related headlines buffeted markets throughout the first quarter, following the imposition of new tariffs on US imports from Mexico, Canada and China in February. The Trump administration announced new tariffs on steel, aluminum, and autos, while shifting expectations around the severity of pending tariff announcements which drove swings in market sentiment. Investors continue to be attentive to any signs that uncertainty may be slowing growth activity, such as the recent fall in Capex intentions evidenced by recent small business surveys.

Given this elevated uncertainty, it's unsurprising that the Federal Reserve FOMC decided to take no action on interest rates during the quarter. Fed Chair Jerome Powell did, however, leave the door open to future rate cuts at the bank's upcoming meetings, suggesting that the Fed was more concerned about the downside risks to growth than the upside risks to inflation. Ultimately, we agree that the unanimous feeling across markets and amongst investors is that the amount of future unknowns has us in a "wait and see" mode.

Quarter in Review

The 10yr Treasury began the quarter at 4.58% and rose for the first half of January to a peak of 4.81% before it descended all quarter long to finish at 4.21%. Within this backdrop we saw a decent drop in rates across the curve from the 2-year out to the 30-year maturities. In the end, we're now trading back at levels seen in the fourth quarter – creating a bit of a head and shoulders pattern on the benchmark 10 year Treasury, as illustrated by the chart here. The US Dollar had a significantly weak quarter, finishing lower by -3.94% as continued confusion about global trade tariffs and economic weakness weighed on the greenback.



Source: Bloomberg

Even though corporates had positive total returns due to the Treasury move component, spreads across all sectors within the corporate landscape (IG, HY and EM) finished the quarter wider as the economic weakness narrative began to finally trickle into a sector that has shown impressive strength as of late. The High Yield sector was the big underperformer for once this quarter, closing out a substantial run as the markets persistent outperformer. Financials and Industrials were the best performers with very similar returns while Utilities dragged significantly. Securities across the quality ladder generally performed somewhat similarly, though the Aa bucket was a notable outperformer versus the other three buckets with a +2.94% return. Short and long maturity corporates produced somewhat similar performance though long dated Treasuries significantly outperformed shorter ones.

The High Yield (+1.00%), Government Agency Securities (+2.11%), Emerging Market Debt (+2.34%), Corporate (+2.31%) and Non-Dollar (+2.53%) sectors underperformed the broader Barclays US Aggregate Index's return of +2.78% during the quarter. The US Treasury (+2.92%) and Mortgage-Backed Securities (+3.06%) sectors outperformed the broader index's return.

Market Outlook

Recalling our last Market Outlook commentary, investors continued walking around barefoot in a dark room waiting for any news to illuminate the room with some concrete tariff facts and their impact. In March, we continued with our cautious stance and moved portfolio durations much closer to the benchmark index, averaging 1% short versus the benchmark indices, and continued reducing long duration credit exposure by shifting those profits to the MBS sector.

We remain positioned for a range bound market yet fully expect that economic data in the second quarter may meaningfully impact the market, although the direction remains unclear at this time. Our duration and sector allocation positions have allowed us to slightly outperform our benchmark indices while reducing portfolio risk during the quarter ending March 31. Our earlier concern regarding historically tight credit spreads, especially in US high yield, has proven correct as March saw a meaningful widening of spreads in all credit sectors.

We continue to expect positive fixed income returns for the first half of 2025 as the economy slows while the risks to rising inflation and unemployment increase. During this period, investors will have the opportunity to understand the impact of the April 2nd tariffs on the economy, including the probability of a recession later this year. The second quarter will also provide greater insight into fiscal policy, federal budget deficits and proposed tax cuts as the legislative process moves forward.

We do not expect to make significant changes to our portfolio positioning in the near future although we are prepared to move should certain scenarios come to pass. The first half of 2025 will continue to be filled with uncertainty and volatility due to the unknown impact of the newly imposed tariffs but a clearer picture of the economy and rates should occur later in the year.

Emerging Markets 1Q 2025 Review

As flagged in our Q4 2024 outlook, U.S. trade policy shifts in 2025 have rippled through global markets, hitting hardest in countries and sectors running trade deficits with the U.S.

Pablo Barrientos

Senior Credit Analyst

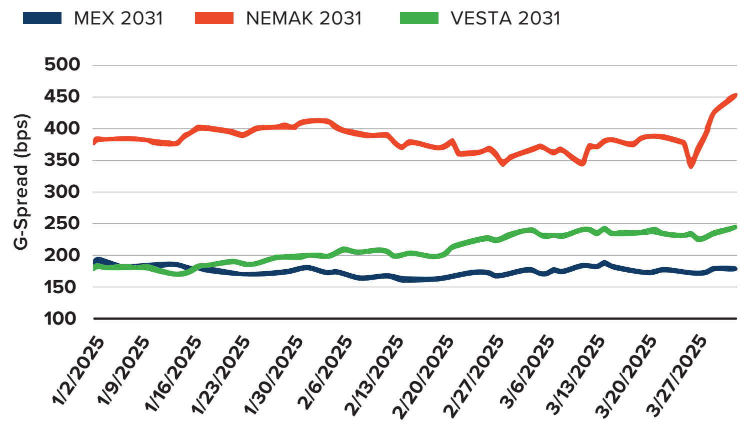
In Mexico, the new administration has fleshed out its domestic economic playbook, notably with Plan Mexico, which expands private participation in the country's energy sector. Yet, uncertainty tied to its hefty U.S. exports has left manufacturing—spanning industrial real estate to automakers—in a holding pattern. With economic growth slowing and inflation hovering near the 3% target, the Mexican central bank slashed rates twice by 50 basis points this quarter. The peso, meanwhile, has been a rollercoaster—peaking at a multi-year high of 20.8441 on January 16 before settling at 20.4711 by quarter's end, clawing back some ground.

China, another major U.S. deficit partner, faced a one-two punch from the current administration: a 10% tariff on all imports starting February 4, bumped to 20% by March 4, aimed at curbing drug trafficking and trade imbalances. Beijing countered with domestic stimulus, including a $411 billion package, to blunt the tariff sting. While our Rule of Law filter keeps us out of direct Chinese investments, we're zeroing in on commodity exporters to China, capitalizing on supply-demand dislocations sparked by these trade frictions.

Panama stayed in the headlines, partly over Panama Canal tensions, but the real story is its progress on pension reform and talks with First Quantum and local communities to restart the Cobre Panamá copper mine. If successful, it could meaningfully shrink Panama's fiscal gap.

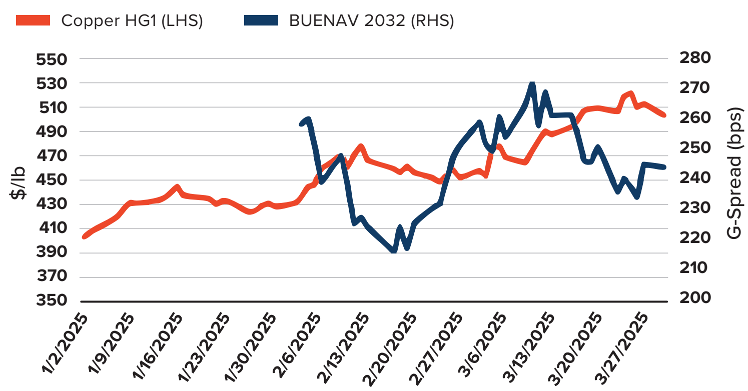
As we move into the second quarter, we expect U.S. policies to maintain their influence on emerging markets, especially with trade negotiations unfolding after the April 2nd announcement. Moreover, as highlighted in our prior newsletter, Romania's government bonds will remain a key focus, with the rerun elections slated for May poised to shape the sovereign's bond market dynamics.

Select Mexican Bond Benchmarks



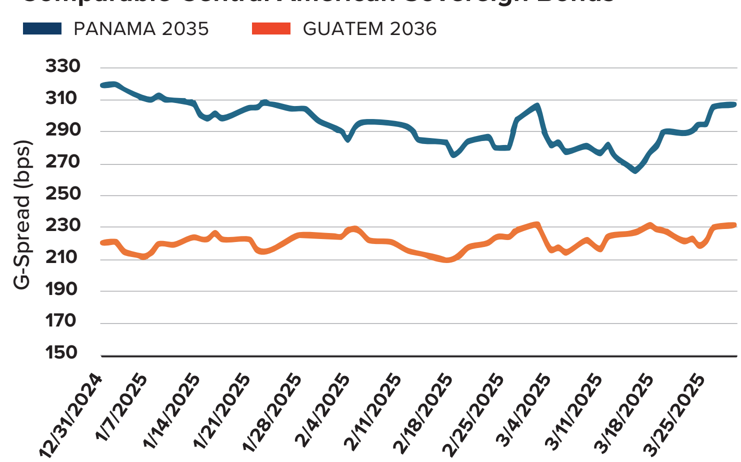
Source: Bloomberg

Notable Mining Bond vs. Copper Prices



Source: Bloomberg

Comparable Central American Sovereign Bonds



Source: Bloomberg

LM Capital Group Welcomes Adrienne Gaines as Senior Vice President, Business Development.

LM Capital Group is pleased to announce the addition of Adrienne Gaines as Senior Vice President, Business Development team. Adrienne joined the firm in March 2025, bringing over 35 years of experience in investor relations, business development, and corporate affairs within the Public and Taft-Hartley Plan Sponsor community.

Prior to joining LM Capital Group, Adrienne served as Senior Vice President of Business Development and Client Relations at Progress Investment Management Company. Before that, she was a Managing Partner at The Yucaipa Companies, a private equity firm, where she played a key role in investor relations, business development, and strategic acquisitions. Adrienne also held leadership positions as a Managing Director at Pacific Corporate Group, a private equity advisory and investment management firm.

Adrienne's extensive expertise and leadership will be instrumental in strengthening LM Capital Group's client relationships and business development initiatives. Please join us in welcoming her to the team!

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