PICTON INVESTMENTS

FIXED INCOME OUTLOOK

THE PICTON REPORT 2025 MID-YEAR UPDATE

Phil Mesman, CFA
Portfolio Manager,
Co-Head Fixed Income

Sam Acton, CFA
Portfolio Manager,
Co-Head Fixed Income

RATE MARKETS CONFRONT A NEW RISK

Exceptional rate volatility through April (71.8 bps trading range on U.S. 30 Year Treasury Yield, 4th highest month since 2011) has exposed a new risk for the rate market: foreign investors reducing their U.S. Treasury holdings due to a declining U.S. Dollar, U.S. policy uncertainty, or simply to rebalance from a generally overweight U.S. positioning stance.

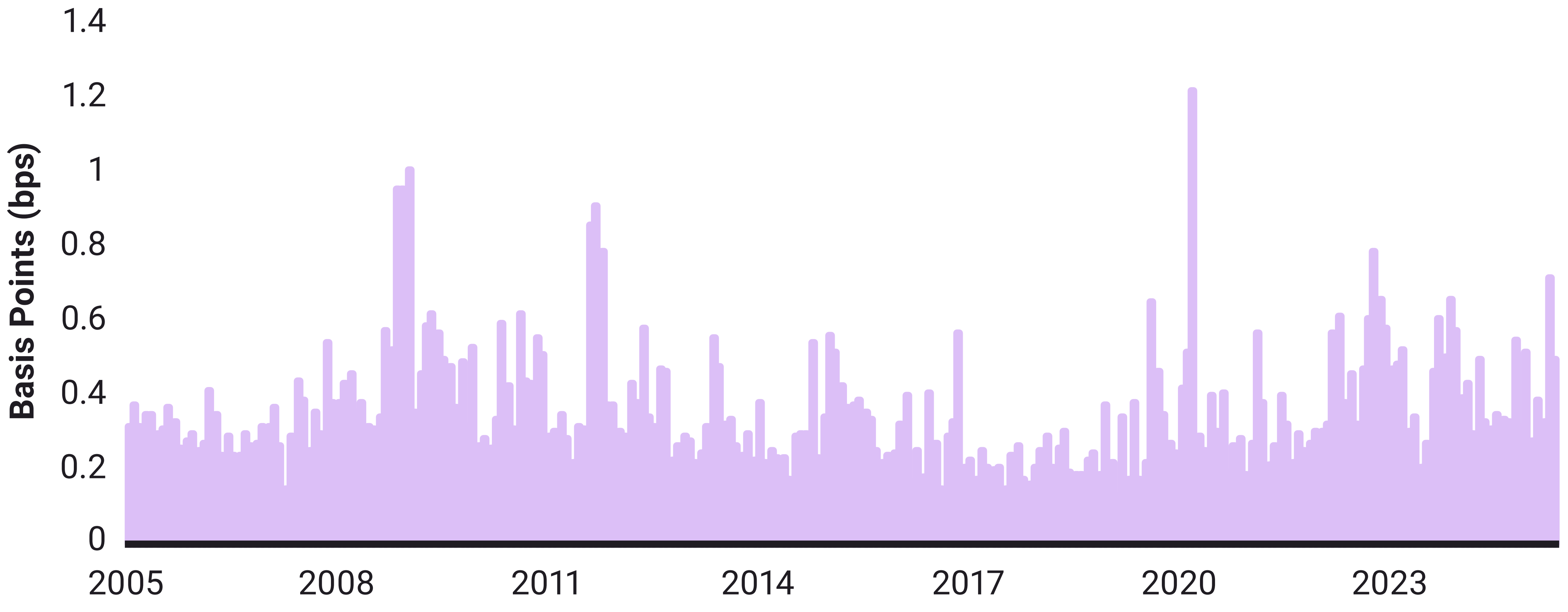
- Fiscal sustainability remains a key issue – interest expense continues to increase faster than any spending cuts
- The Rest of the World expanding their fiscal deficits, driven by defense spending and stimulus
- Taken together, we think this pressures the supply/demand balance especially at the back end of the yield curve – steepening of the yield curve should continue – and U.S. 2 Year Treasuries/ U.S. 10 Year Treasuries should have another 50 bps to go just to get back to long term average

Investors Need Better Yield to Take on Duration Risk

We believe investors will require a more significant yield pickup vs. money markets to justify taking on the volatility of longer-duration Treasury bonds. At the front end of the curve, we think the inflationary impact of U.S. tariffs likely limits the Fed's ability to be pre-emptive with rate cuts – and indeed may force them to be "late" if employment data rolls over.

FIGURE 1

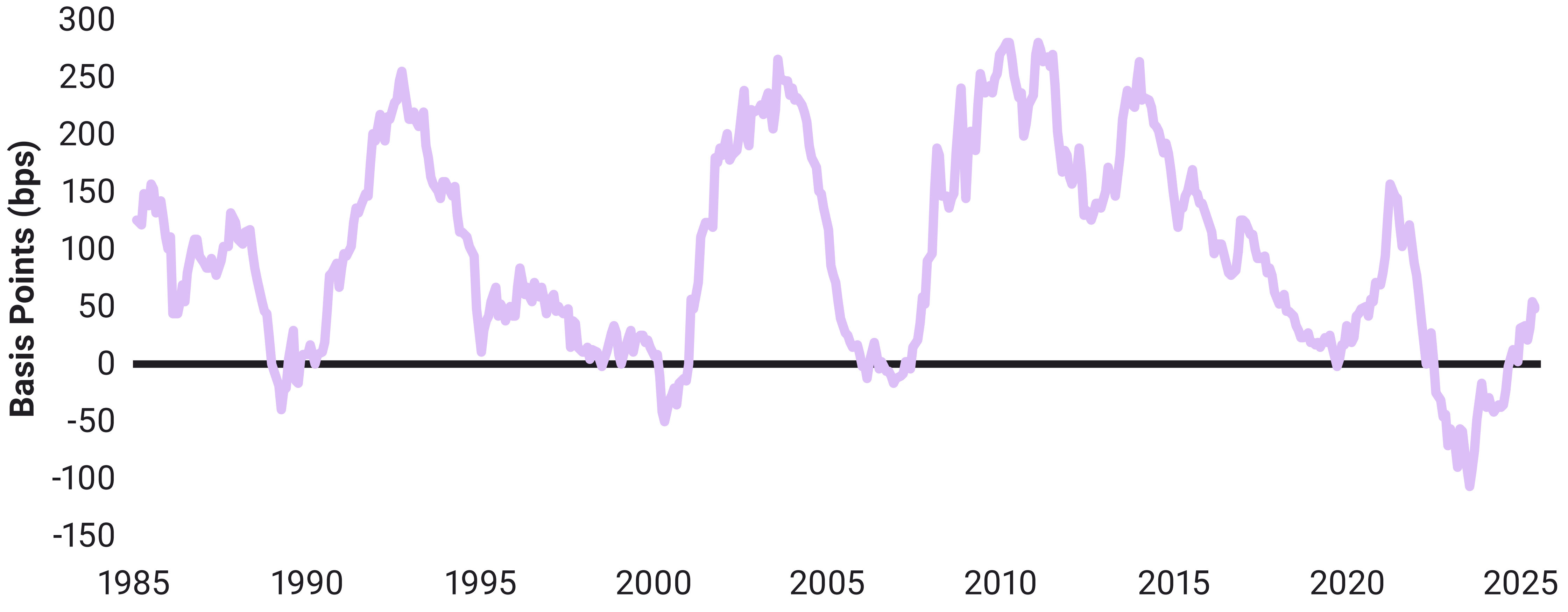
Monthly Trading Range of 30-Year U.S. Treasury Yields



Source: Bloomberg, L.P., Picton Mahoney Asset Management Research. Jan 2005 to May 2025.

FIGURE 2

Curve Appeal: U.S. Treasury 2 Yr/10 Yr Spread Should Continue Steepening



Source: Bloomberg, L.P., Picton Mahoney Asset Management Research. Jan 1985 to Jun 2025.

Credit Markets Fared Well During a Volatile April

Credit markets held up relatively well during the April swoon for equities. Despite spread volatility through March and April, we observed continued strong demand for high and mid-quality credit (i.e. BB-BBB). Remarkably stable inflows into corporate bonds combined with a slowdown in new issue supply created a strong technical set up for the market.

While spreads remained at the lower end of the range historically, there are some significant structural improvements that should be considered:

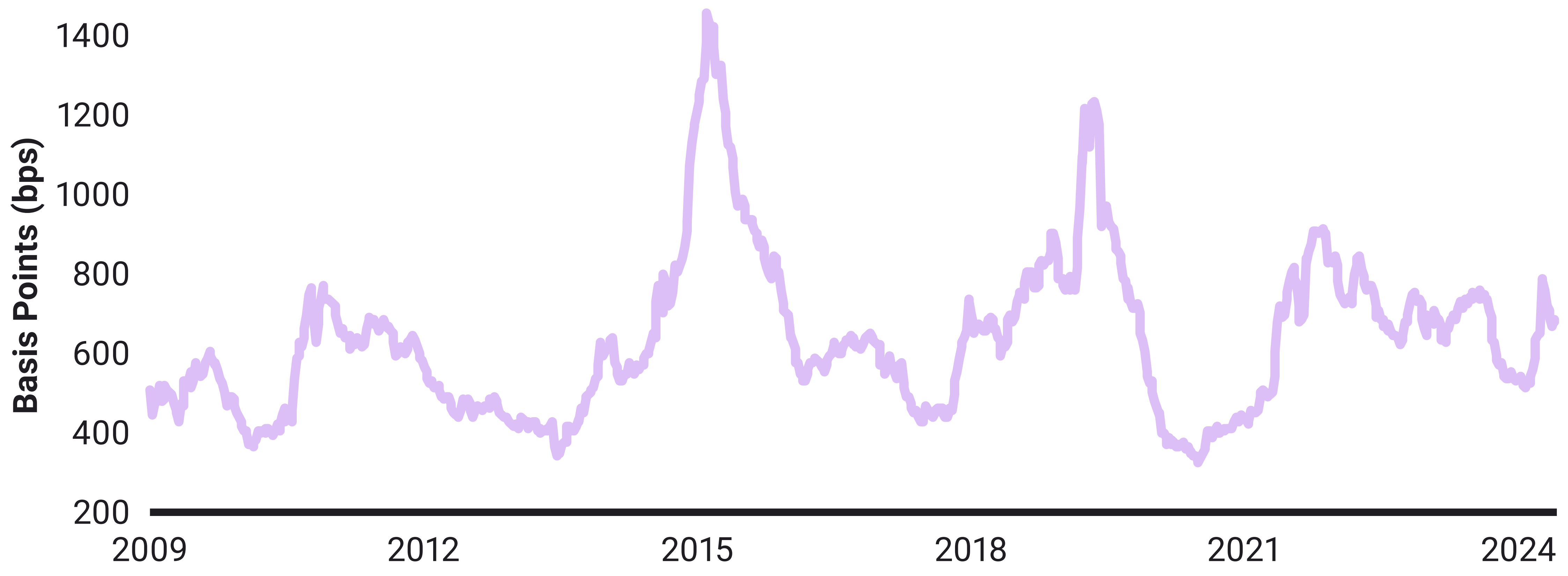
- Higher quality/ratings and more secured bonds within the ICE BofA U.S. High Yield Index
- Fed buying corporate bonds in 2020 sets a precedent
- Growth of private credit has shifted default risk out of public markets
- All-in yields look very attractive for mid to high quality credit, likely providing an additional margin of safety against potential spread widening

Outlook: Are Lower Quality Credits Telling Us Something?

However, we also observed increased divergence within credit markets where lower quality names sold off the most and subsequently rallied back the least. This could indicate that investor credit risk appetite is waning and could be an early warning sign to the broader credit market.

FIGURE 3

CCC - BB spreads: An Early Warning Sign of Future Weakness in Credit?



Source: Bloomberg L.P. Dec 31, 2009 to May 31, 2025. BB Bonds is represented by the ICE BofA BB US High Yield Index, & CCC Bonds is represented by the ICE BofA CCC & Lower US High Yield Index.

Head Office
33 Yonge Street, Suite 320
Toronto, Ontario
M5E 1G4

Telephone: 416-955-4108
Toll Free: 1-866-369-4108
Retail Sales: 1-833-955-1344

General Inquiries
invest@pictoninvestments.com

Vancouver
Four Bentall Centre
1055 Dunsmuir Street, Suite 3370
Vancouver, British Columbia
V7X 1L3

Calgary
Bankers Hall, West Tower
888 3rd Street SW, Suite 1015
Calgary, Alberta
T2P 5C5

Montréal
1155 Metcalfe Street, Suite 1529
Montréal, Québec
H3B 2V6

pictoninvestments.com

All figures provided are sourced from Bloomberg L.P. unless otherwise specified, and are based on data as at the dates indicated.

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