

AUTHORS



Daniel J. Ivascyn
Group Chief
Investment Officer



Esteban Burbano
Managing Director
Fixed Income Strategist

Income Strategy Update: Focused on Optimizing Income Amid an Evolving Rate Market

We see compelling opportunities for fixed income investments amid economic uncertainty and optimistic equity valuations.

Summary

- With high starting yields, high quality fixed income looks attractive, in our view, as the Federal Reserve has resumed easing and equity valuations remain lofty.
- We favor an overweight to agency mortgage-backed securities in the Income Strategy, given their higher quality and attractive yields versus investment grade corporates.
- We continue to see attractive return potential and resilience in senior structured credit, particularly investments linked to higher-income consumers. We have more limited exposure to corporate credit, given tight spreads.

Fixed income markets continue to enjoy elevated yields, adding to their appeal as the U.S. Federal Reserve (Fed) cuts rates and equities continue to reach all-time highs.

Here, Dan Ivascyn, who manages the PIMCO Income Strategy with Alfred Murata and Josh Anderson, responds to questions from Esteban Burbano, fixed income strategist. They discuss the macroeconomic landscape and how the investment team is positioning the Income Strategy in the current environment.

Q: PIMCO's latest Cyclical Outlook, "Tariffs, Technology, and Transition," analyzed growing tension among macro forces. How might this shape the global economic landscape?

A: The Trump administration's trade policy continues to create uncertainty. Tariffs are likely to put some downward pressure on growth with perhaps a bit of upward pressure on inflation, at least over the next few months.

Meanwhile, enthusiasm for AI and technological innovation – and the related capital spending – supports growth and may help offset tariff-related uncertainty.

We expect the net effects will include positive but limited growth in the U.S. – perhaps in the 1.5% to 2% annualized range – with a relatively low risk of recession, while economies outside of the U.S. may face greater challenges. Overall, we expect global growth will return to a trend-like 3% pace in 2026, with near-term risks tilted to the downside.

With tariffs exerting upward pressure on prices, inflation in the U.S. will likely remain above the Federal Reserve's 2% target over the near-term horizon. Longer-term expectations priced into markets suggest inflation will trend down over time.

We are cautiously optimistic about the outlook for modest growth amid notable uncertainty. But I'll note that today's record equity valuations and tight credit spreads reflect potentially excess optimism.

Q: What is our outlook for the Fed and other central banks?

A: Most central banks will likely continue easing. At the Fed, we think we could potentially see another cut in December or January, but it depends on macro data. Eventually, the fed funds rate should settle at about 3%. The Fed also announced the end of balance sheet reduction, yet we do not anticipate it will add to the balance sheet anytime soon. The bottom line: We see the Fed willing to provide some accommodation, especially if it sees further weakness in the labor market, but its approach is likely more data-dependent.

The Bank of England and Reserve Bank of Australia appear likely to cut more aggressively in the coming months as disinflation resumes, while we expect the European Central Bank and Bank of Canada – which are closer to neutral policy levels – will make smaller adjustments. The Bank of Japan remains an exception, with policy below neutral.

Q: What is PIMCO's outlook on the U.S. dollar, including its status as the world's reserve currency?

A: We do not think the dollar is at risk of losing its reserve currency status. However, we expect holders of the dollar or dollar-denominated assets to gradually diversify away over the next several years. Reasons for this could include the expensive levels of U.S. financial assets as well as U.S. trade and fiscal policy and related uncertainty.

This diversification theme is one reason we favor a slight underweight to the dollar, even though it is off its peak value from late last year. Of course, the dollar may be prone to bouts of strength.

Q: How are you thinking about positioning in the Income Strategy, beginning with interest rate risk?

A: This is an exciting environment for active investing. Given still elevated yields in the U.S. and other developed markets, such as the U.K. and Australia, we see value in high quality interest rate exposure (i.e., duration) in the Income Strategy. Our duration is in the 4- to 5-year range, albeit lower than it was earlier in the year when the 10-year U.S. Treasury yield was closer to 5%.

For some time, we have anticipated a steeper yield curve, particularly in the U.S., and have tended to concentrate our rate exposure in short to intermediate maturities. This has played out well this year as the long end of the yield curve has underperformed meaningfully. As Fed rate cuts have been priced into the front end of the curve, we have shifted some exposure from one- or two-year maturities to the five- to 10-year maturity range.

We also maintain selective exposure in other high quality sovereign bond markets with attractive yields, such as the U.K. and Australia.

A final point: Historically, starting yields have strongly indicated a bond portfolio's total return potential going forward. We view that as an attractive proposition when U.S. inflation is at 3%, equities are at all-time highs, and credit spreads are extremely tight.

Q: Agency mortgage-backed securities (MBS) remain a focus in the Income Strategy. What is your outlook for the position?

A: We continue to like agency MBS. They have been trading at wider spreads than investment grade corporates, which is highly unusual as corporates tend to be more sensitive to economic fundamentals. Also, the market for agency MBS offers an attractive liquidity profile, enabling us to remain nimble.

Agency mortgages tend to benefit from periods of low interest rate volatility, which has generally been the case this year, though the situation is evolving. Agency MBS also tend to perform well when the yield curve steepens as the Fed cuts short-term rates. Also, the Fed ending its balance sheet reduction should be another tailwind for the asset class.

We are often asked about the potential privatization of the government-sponsored enterprises (GSEs). Treasury Secretary Scott Bessent has clearly stated that any action on the GSEs must not raise borrowing costs or disrupt the mortgage market. Thus, we see privatization as a minor risk.

Q: With corporate credit spreads tight, where are we seeing opportunities?

A: We see generally solid fundamentals in the corporate credit sector; the economy has avoided a sustained period of economic weakness for some time. However, at these tight spreads and considering the uncertain macro outlook, we prefer more limited exposure to corporate credit in the Income Strategy. Instead, we favor other fixed income segments with more attractive relative value, such as higher-quality structured products.

We favor senior structured credit and investments linked to higher-income consumers. In aggregate, the U.S. consumer is in a good position after years of positive home price appreciation and balance sheet strengthening in the more carefully regulated markets that followed the global financial crisis.

We are less interested in floating-rate segments of the market, broadly syndicated loans, or mid-market direct lending. Those borrowers tend to have leveraged business models or capital structures and could be vulnerable to technological disruption or significant economic weakness.

Overall, we do seek to be opportunistic in the sector, looking for unique credit situations where we can leverage the firm's size and sourcing capabilities to find investments that are more attractive than generic forms of corporate credit.

Q: We have received questions from clients about what a rate-cutting cycle means for yields going forward. How are you thinking about this in the context of the Income Strategy?

A: Considering valuations from a multiyear perspective, we believe high quality yields remain quite attractive today, especially when one considers elevated equity valuations and tight credit spreads.

As I mentioned, we believe this is an optimal environment to construct a high quality, globally diversified portfolio with an attractive starting yield and potential opportunities to add alpha.

With the Fed cutting, the return on cash is coming down, and soon the rate on cash could approach that of the lowest yield on the Treasury curve. Investors with a significant cash position may want to consider moving out along the yield curve and locking in higher rates for years to come.

Q: Any final thoughts?

A: At a high level, what we're aiming to do today is to take advantage of the full toolkit we have as active global investors to target more liquid and higher-quality areas of the market, and to construct a highly diversified portfolio of income-oriented assets.

If there is an unanticipated shock to markets and the economy, then we believe the Income Strategy is positioned to remain resilient. It's poised to mitigate the downside and maintains the flexibility to target attractive opportunities in that kind of environment. We don't anticipate such a challenging environment as a base case, but we've focused on building a robust, resilient portfolio that seeks to deliver attractive income across a range of macro and market scenarios.

Past performance is not a guarantee or a reliable indicator of future results.

Investing in the **bond market** is subject to risks, including market, interest rate, issuer, credit, inflation risk, and liquidity risk. The value of most bonds and bond strategies are impacted by changes in interest rates. Bonds and bond strategies with longer durations tend to be more sensitive and volatile than those with shorter durations; bond prices generally fall as interest rates rise, and low interest rate environments increase this risk. Reductions in bond counterparty capacity may contribute to decreased market liquidity and increased price volatility. Bond investments may be worth more or less than the original cost when redeemed. Investing in **foreign denominated and/or domiciled securities** may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets. **Mortgage and asset-backed securities** may be sensitive to changes in interest rates, subject to early repayment risk, and their value may fluctuate in response to the market's perception of issuer creditworthiness; while generally supported by some form of government or private guarantee there is no assurance that private guarantors will meet their obligations. References to Agency and non-agency mortgage-backed securities refer to mortgages issued in the United States. U.S. agency mortgage-backed securities issued by Ginnie Mae (GNMA) are backed by the full faith and credit of the United States government. Securities issued by Freddie Mac (FHLMC) and Fannie Mae (FNMA) provide an agency guarantee of timely repayment of principal and interest but are not backed by the full faith and credit of the U.S. government. **High-yield, lower-rated, securities** involve greater risk than higher-rated securities; portfolios that invest in them may be subject to greater levels of credit and liquidity risk than portfolios that do not. **Equities** may decline in value due to both real and perceived general market, economic, and industry conditions. **Derivatives** may involve certain costs and risks such as liquidity, interest rate, market, credit, management and the risk that a position could not be closed when most advantageous. Investing in derivatives could lose more than the amount invested. **Management risk** is the risk that the investment techniques and risk analyses applied by an investment manager will not produce the desired results, and that certain policies or developments may affect the investment techniques available to the manager in connection with managing the strategy.

There is no guarantee that these investment strategies will work under all market conditions or are appropriate for all investors and each investor should evaluate their ability to invest long-term, especially during periods of downturn in the market. Investors should consult their investment professional prior to making an investment decision.

This material contains the current opinions of the manager and such opinions are subject to change without notice. This material is distributed for informational purposes only and should not be considered as investment advice or a recommendation of any particular security, strategy or investment product. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed.

PIMCO as a general matter provides services to qualified institutions, financial intermediaries and institutional investors. Individual investors should contact their own financial professional to determine the most appropriate investment options for their financial situation. This is not an offer to any person in any jurisdiction where unlawful or unauthorized. | **Pacific Investment Management Company LLC**, 650 Newport Center Drive, Newport Beach, CA 92660 is regulated by the United States Securities and Exchange Commission. | **PIMCO Europe Ltd (Company No. 2604517, 11 Baker Street, London W1U 3AH, United Kingdom)** is authorised and regulated by the Financial Conduct Authority (FCA) (12 Endeavour Square, London E20 1JN) in the UK. The services provided by PIMCO Europe Ltd are not available to retail investors, who should not rely on this communication but contact their financial adviser. Since PIMCO Europe Ltd services and products are provided exclusively to professional clients, the appropriateness of such is always affirmed. | **PIMCO Europe GmbH (Company No. 192083, Seidlstr. 24-24a, 80335 Munich, Germany)** is authorized and regulated by the German Federal Financial Supervisory Authority (BaFin) (Marie-Curie-Str. 24-28, 60439 Frankfurt am Main) in Germany in accordance with Section 15 of the German Securities Institutions Act (WpIG). | **PIMCO Europe GmbH Italian Branch (Company No. 10005170963, Via Turati nn. 25/27 (angolo via Cavalieri n. 4) 20121 Milano, Italy)**, **PIMCO Europe GmbH Irish Branch (Company No. 909462, 57B Harcourt Street Dublin D02 F721, Ireland)**, **PIMCO Europe GmbH UK Branch (Company No. FC037712, 11 Baker Street, London W1U 3AH, UK)**, **PIMCO Europe GmbH Spanish Branch (N.I.F. W2765338E, Paseo de la Castellana 43, Oficina 05-111, 28046 Madrid, Spain)**, **PIMCO Europe GmbH French Branch (Company No. 918745621 R.C.S. Paris, 50-52 Boulevard Haussmann, 75009 Paris, France)** and **PIMCO Europe GmbH (DIFC Branch) (Company No. 9613, Unit GD-GB-00-15-BC-05-0, Level 15, Gate Building, Dubai International Financial Centre, United Arab Emirates)** are additionally supervised by: (1) **Italian Branch: the Commissione Nazionale per le Società e la Borsa (CONSOB)** (Giovanni Battista Martini, 3 - 00198 Rome) in accordance with Article 27 of the Italian Consolidated Financial Act; (2) **Irish Branch: the Central Bank of Ireland** (New Wapping Street, North Wall Quay, Dublin 1 D01 F7X3) in accordance with Regulation 43 of the European Union (Markets in Financial Instruments) Regulations 2017, as amended; (3) **UK Branch: the Financial Conduct Authority (FCA)** (12 Endeavour Square, London E20 1JN); (4) **Spanish Branch: the Comisión Nacional del Mercado de Valores (CNMV)** (Edison, 4, 28006 Madrid) in accordance with obligations stipulated in articles 168 and 203 to 224, as well as obligations contained in Title V, Section I of the Law on the Securities Market (LSM) and in articles 111, 114 and 117 of Royal Decree 217/2008, respectively; (5) **French Branch: ACPR/Banque de France** (4 Place de Budapest, CS 92459, 75436 Paris Cedex 09) in accordance with Art. 35 of Directive 2014/65/EU on markets in financial instruments and under the surveillance of ACPR and AMF and (6) **DIFC Branch: Regulated by the Dubai Financial Services Authority ("DFSA")** (Level 13, West Wing, The Gate, DIFC) in accordance with Art. 48 of the Regulatory Law 2004. The services provided by PIMCO Europe GmbH are available only to professional clients as defined in Section 67 para. 2 German Securities Trading Act (WpHG). They are not available to individual investors, who should not rely on this communication. According to Art. 56 of Regulation (EU) 565/2017, an investment company is entitled to assume that professional clients possess the necessary knowledge and experience to understand the risks associated with the relevant investment services or transactions. Since PIMCO Europe GMBH services and products are provided exclusively to professional clients, the appropriateness of such is always affirmed. | **PIMCO (Schweiz) GmbH (registered in Switzerland, Company No. CH-020.4.038.582-2, Brandschenkestrasse 41 Zurich 8002, Switzerland)**. According to the Swiss Collective Investment Schemes Act of 23 June 2006 ("CISA"), an investment company is entitled to assume that professional clients possess the necessary knowledge and experience to understand the risks associated with the relevant investment services or transactions. Since PIMCO (Schweiz) GmbH services and products are provided exclusively to professional clients, the appropriateness of such is always affirmed. The services provided by PIMCO (Schweiz) GmbH are not available to retail investors, who should not rely on this communication but contact their financial adviser. | **PIMCO Asia Pte Ltd** (8 Marina View, #30-01, Asia Square Tower 1, Singapore 018960, Registration No. 199804652K) is regulated by the Monetary Authority of Singapore as a holder of a capital markets services licence and an exempt financial adviser. The asset management services and investment products are not available to persons where provision of such services and products is unauthorised. | **PIMCO Asia Limited** (Suite 2201, 22nd Floor, Two International Finance Centre, No. 8 Finance Street, Central, Hong Kong) is licensed by the Securities and Futures Commission for Types 1, 4 and 9 regulated activities under the Securities and Futures Ordinance. PIMCO Asia Limited is registered as a cross-border discretionary investment manager with the Financial Supervisory Commission of Korea (Registration No. 08-02-307). The asset management services and investment products are not available to persons where provision of such services and products is unauthorised. | **PIMCO Investment Management (Shanghai) Limited**. Office address: Suite 7204, Shanghai Tower, 479 Lujiazui Ring Road, Pudong, Shanghai 200120, China (Unified social credit code: 91310115MA1K41MU72) is registered with Asset Management Association of China as Private Fund Manager (Registration No. P1071502, Type: Other). | **PIMCO Australia Pty Ltd** ABN 54 084 280 508, AFSL 246862. This publication has been prepared without taking into account the objectives, financial situation or needs of investors. Before making an investment decision, investors should obtain professional advice and consider whether the information contained herein is appropriate having regard to their objectives, financial situation and needs. To the extent it involves Pacific Investment Management Co LLC (PIMCO LLC) providing financial services to wholesale clients, PIMCO LLC is exempt from the requirement to hold an Australian financial services licence in respect of financial services provided to wholesale clients in Australia. PIMCO LLC is regulated by the Securities and Exchange Commission under US laws, which differ from Australian laws. | **PIMCO Japan Ltd**, Financial Instruments Business Registration Number is Director of Kanto Local Finance Bureau (Financial Instruments Firm) No. 382. PIMCO Japan Ltd is a member of Japan Investment Advisers Association, The Investment Trusts Association, Japan and Type II Financial Instruments Firms Association. All investments contain risk. There is no guarantee that the principal amount of the investment will be preserved, or that a certain return will be realized; the investment could suffer a loss. All profits and losses incur to the investor. The amounts, maximum amounts and calculation methodologies of each type of fee and expense and their total amounts will vary depending on the investment strategy, the status of investment performance, period of management and outstanding balance of assets and thus such fees and expenses cannot be set forth herein. | **PIMCO Taiwan Limited** is an independently operated and managed company. The reference number of business license of the company approved by the competent authority is (112) Jin Guan Tou Gu Xin Zi No. 015. The registered address of the company is 40F, No.68, Sec. 5, Zhongxiao East Rd., Xinyi District, Taipei City 110, Taiwan (R.O.C.), and the telephone number is +886 2 8729-5500. | **PIMCO Canada Corp.** (199 Bay Street, Suite 2050, Commerce Court Station, P.O. Box 363, Toronto, ON, M5L 1G2) services and products may only be available in certain provinces or territories of Canada and only through dealers authorized for that purpose. | **Note to Readers in Colombia:** This document is provided through the representative office of Pacific Investment Management Company LLC located at Carrera 7 No. 71-52 TB Piso 9, Bogota D.C. (Promoción y oferta de los negocios y servicios del mercado de valores por parte de Pacific Investment Management Company LLC, representada en Colombia). | **Note to Readers in Brazil:** PIMCO Latin America Administradora de Carteras Ltda. Av. Brg. Faria Lima, 3477 Itaim Bibi, São Paulo - SP 04538-132 Brazil. | **Note to Readers in Argentina:** This document may be provided through the representative office of PIMCO Global Advisors LLC AVENIDA CORRIENTES, 299, Buenos Aires, Argentina. | No part of this publication may be reproduced in any form, or referred to in any other publication, without express written permission. PIMCO is a trademark of Allianz Asset Management of America LLC in the United States and throughout the world. ©2025, PIMCO.