PIMCO®

Income Strategy Update: Navigating Uncertainty in 2025

Attractive yields and a broad opportunity set bolster active bond investments amid today's uncertain macroeconomic and market outlook.

AUTHORS

Daniel J. Ivascyn
Group Chief Investment Officer
Portfolio Manager

Esteban Burbano
Executive Vice President
Fixed Income Strategist

SUMMARY

- Attractive yields contribute to a compelling outlook for bonds, in our view, on an absolute basis and relative to equities – which we see as close to fully valued – as well as relative to cash, where yields are dwindling.
- In the Income Strategy, we slightly increased interest rate exposure while still being cautious with respect to longer-maturity bonds.
- We maintain an overweight to U.S. agency mortgages, as spreads remain uncharacteristically high versus those of investment grade corporates.
- As credit spreads tightened, we lowered our corporate credit exposure, though we believe corporate fundamentals are generally sound.

The persistence of attractive yields marks a potentially auspicious period for active fixed income managers, in our view, with economic uncertainty contributing to both risk and opportunity. 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 how the strategy is positioned amid high yields and high uncertainty, including potential shifts in fiscal and monetary policy in the first year of the second Trump administration.

Q: WHAT IS PIMCO'S OUTLOOK FOR THE ECONOMY AND MARKETS OVER THE COMING YEAR?

A: Bond yields remain high relative to the past two decades, and there is considerable uncertainty about the future of policy and economic growth, which likely means elevated volatility this year. President Donald Trump has been very clear about his focus on raising tariffs, extending tax cuts, and reducing some government spending. The key question for investors will be the degree to which this administration is willing to calibrate policy to economic realities and market signals.

Economic growth cycles around the globe have become less synchronized, and Trump's policies will likely exacerbate this trend. China is experiencing weak growth with disinflationary pressure, while Japan's inflation remains comfortably above their central bank's target. The U.S. continues to exhibit economic momentum, while we see a more mixed picture across Europe, the U.K., and Australia.

We believe the U.S. Federal Reserve (Fed) and other central banks want to lower interest rates further to the extent it's warranted given inflation and other economic data. But central

banks are operating with uncertainty, too, in the sense that fiscal policy has the potential to upend economic trends. This could make central banks more conservative and inclined to stay on hold for a period of time. There are even outlier scenarios – well outside our base case – where elevated inflation, and inflation expectations, prompt the Fed to reverse course and raise rates slightly this year. Or, if growth and job markets slump unexpectedly, the Fed may look to lower rates more quickly.

With so much uncertainty, investors could feel overwhelmed. The bottom line is with such attractive yields available across the global opportunity set, we find great value in fixed income markets today – plus the potential for a significant cushion against volatility.

Q: WITH SOME UNCERTAINTY ABOUT THE PATH OF INTEREST RATES, HOW SHOULD INVESTORS THINK ABOUT BONDS VERSUS EQUITIES OR CASH?

A: Bonds today are attractively priced, in our view, offering compelling yields relative to much of the past decade or two. By just about any metric, we find equities to be fully valued. Comparing the two asset classes, equities are arguably overvalued versus bonds, in our view. We believe this bodes well for bonds on an absolute basis and relative to equities looking five to 10 years out.

Many investors shifted into or stayed in cash in light of the flat yield curve. But with the recent rise in yields on longer-duration bonds, the yield curve is once again upward-sloping, providing attractive compensation for extending maturities even just slightly beyond cash. We will see how these trends evolve in 2025, particularly if central banks continue lowering policy rates.

Q: CONSIDERING PIMCO'S OUTLOOK, HOW ARE YOU THINKING ABOUT DURATION (INTEREST RATE RISK), YIELD CURVE, AND GLOBAL POSITIONING IN THE INCOME STRATEGY?

A: Markets already reflect quite a bit of optimism about U.S. economic growth. We've gradually been lowering our exposure to more economically sensitive areas, and leveraging the global opportunity set in higher-quality fixed income. Also, we used the sell-off late last year to increase the strategy's overall interest rate exposure, while remaining underweight duration versus passive alternatives.

Along the yield curve, we've been mainly emphasizing intermediate maturities for some time now. And with the more recent steepening, we've shifted some exposure a bit further out the yield curve, adding some 10-year-maturity exposure while still generally favoring the intermediate portion.

Even amid the standout momentum of the U.S. economy, the U.S. government is running a substantial deficit – leading many investors to raise questions about U.S. debt obligations. While we see the deficit as manageable, considering the U.S. dollar is the global reserve currency, we have also utilized markets outside of the U.S. to diversify exposure where we find the fiscal picture is better and economies are not expanding as rapidly. We have modest duration exposure to the U.K. and Australia, and even some of the higher-quality segments of emerging markets.

Q: THE INCOME STRATEGY HAS SIZABLE POSITIONS IN SECURITIZED SECTORS OF THE BOND MARKET. HOW ARE YOU ALLOCATING TO MORTGAGES, AND WHAT ARE YOUR THOUGHTS ON THE FUTURE OF GOVERNMENT-SPONSORED ENTERPRISES (GSES) UNDER THE SECOND TRUMP ADMINISTRATION?

A: We have been overweight U.S. agency mortgage-backed securities for some time. We continue to see a strong case for investing in these securities: They offer a yield advantage over most investment grade corporate bonds – that's a rare occurrence – and they are backed by a U.S. agency or the U.S. federal government. Also, mortgages are typically a very liquid segment of the market, so if fear were to creep back into credit sectors or mortgages became a bit too rich, we could look to shift some assets from agency mortgages to other opportunities.

The Trump administration will likely consider privatizing the GSEs or recapitalizing and releasing them from conservatorship. Whatever happens, we expect either a strong implicit or explicit U.S. government guarantee to be included, because we strongly believe the Trump administration and many members of Congress view the U.S. mortgage market as a model for the rest of the world and want to keep mortgage rates relatively low. In other words, any move to privatize the GSEs would likely drive continuing strength in their underlying credit fundamentals. Even so, any such development could contribute to volatility despite this being a well-known possibility.

Q: COULD YOU DISCUSS ALLOCATIONS TO NON-AGENCY MORTGAGES AND OTHER SECURITIZED CREDIT ASSETS?

A: U.S. households in general have good credit standing these days, with favorable consumer debt-to-GDP ratios and very high home equity. Our holdings of non-government-backed

mortgages tend to be very seasoned; loans we added in the fourth quarter of 2024 typically originated before the global financial crisis and featured loan-to-values below 50%. While these securities can be more complex than corporate bonds, they offer very attractive incremental yield with a downside cushion due to strong home equity levels.

We also favor other consumer credit markets. Regulatory scrutiny on lending to the consumer is robust relative to the non-financial corporate space. We focus on households with considerable home equity, providing owners with other financing, such as auto loans, credit card loans, and parental-guaranteed student loans. We often hold only the investment grade sliver of that risk.

Q: DOES THE STRATEGY HAVE POSITIONS IN THE COMMERCIAL MORTGAGE-BACKED SECURITIES (CMBS) MARKET?

A: We currently have limited exposure to CMBS in the Income Strategy, and the majority is AAA senior diversified risk. A higher-for-longer rate environment is not ideal for commercial real estate. Also, if we experience unexpected economic weakness, then commercial real estate markets could soften, as could other floating-rate credit markets. That could be a buying opportunity for us.

Q: HOW ARE YOU VIEWING THE CORPORATE DEBT MARKET?

A: We have been letting our credit beta exposure drift lower over the course of the last several months in response to credit spreads tightening and equity valuations rising.

I don't want to sound alarmist; we believe fundamentals are strong in the traditional, fixed-rate investment grade and high yield segments of corporate credit. Many companies have termed out their debt maturities, net issuance has been relatively low, and earnings have held up. We continue to have some exposure in attractive areas across the fixed-rate credit spectrum, but we are adjusting the allocation simply due to the tighter spreads.

We have been more defensive in floating-rate credit markets, with limited exposure and mostly senior in the capital structure. We see a bit of froth in the senior secured loan space, with more pressure on companies to manage higher-for-longer interest rates, so we don't have much mezzanine or subordinate exposure. With our size and expertise in the marketplace, we typically can assert influence in the corporate credit space, such as pursuing better covenant considerations in deals. M&A activity likely will increase in 2025, and our position in the market could help allow us to capitalize on unique opportunities, while not necessarily increasing our exposure to credit beta.

Q: AND YOUR THOUGHTS ON BANKS?

A: Banks are fine, in our view. They still face a decent amount of regulatory pressure, and they are not taking the same types of risks that they took in the past. The Trump administration may relax some of the harsher regulations in the U.S., but we still expect the banking sector to remain sound.

With that said, our financials exposure is focused on senior positions in the capital structure. This is not because we are concerned about banks, rather because we are seeing more interesting opportunities in the consumer credit markets.

Q: TURNING TO EMERGING MARKETS, HOW ARE YOU POSITIONING THE INCOME STRATEGY?

A: We have a somewhat smaller exposure to emerging markets (EM) than we've had in the past, which is less about concerns over EM and rather because we see more interesting and resilient opportunities in some other sectors and regions. That said, we have invested in some higher-quality areas where we saw opportunity due to underperformance, including Mexico, some areas in the Middle East, and South Africa. In a world of less synchronized growth, we expect markets outside the U.S., both emerging and developed markets, will present significant opportunities to tactically trade and shift positioning.

We typically seek to run relatively low overall currency risk, and over the last year or so, we have taken an active relative value approach with overweights to select higher-yielding emerging markets and underweights to certain lower-yielding ones.

Q: ANY FINAL THOUGHTS FOR INVESTORS?

A: In the current environment, liquidity, or flexibility, seems a bit underappreciated. We believe the Income Strategy is in a very liquid position relative to the past, which provides flexibility to capitalize on opportunities as they arise. We believe that is important given the degree of uncertainty in the outlook.

And I'll add that patience can be valuable. With such attractive yields today, we can afford to be patient in the higher-quality segments of the fixed income markets. Last year was a good example: We saw many zigs and zags and rates rising toward year-end, yet active bond managers could still generate attractive returns. This year we see even higher bond yields, and with valuations stretched in other asset classes, we believe patience in bonds will be rewarded.

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), 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) and PIMCO Europe GmbH French Branch (Company No. 918745621 R.C.S. Paris, 50–52 Boulevard Haussmann, 75009 Paris, France)** are authorised 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). The Italian Branch, Irish Branch, UK Branch, Spanish Branch and French Branch 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 Tile V, Section I of the Law on the Securities Market (LSM) and in articles 111, 114 and 117 of Royal Decree 217/2008, respectively and (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. 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 Lt**d, 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 Carteiras 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.

CMR2025-0218-4248147