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The Gathering Storm

Volatility in fixed-income markets surged in early April after the US tariff shock, but the 90-day suspension that followed helped stave off bigger losses.

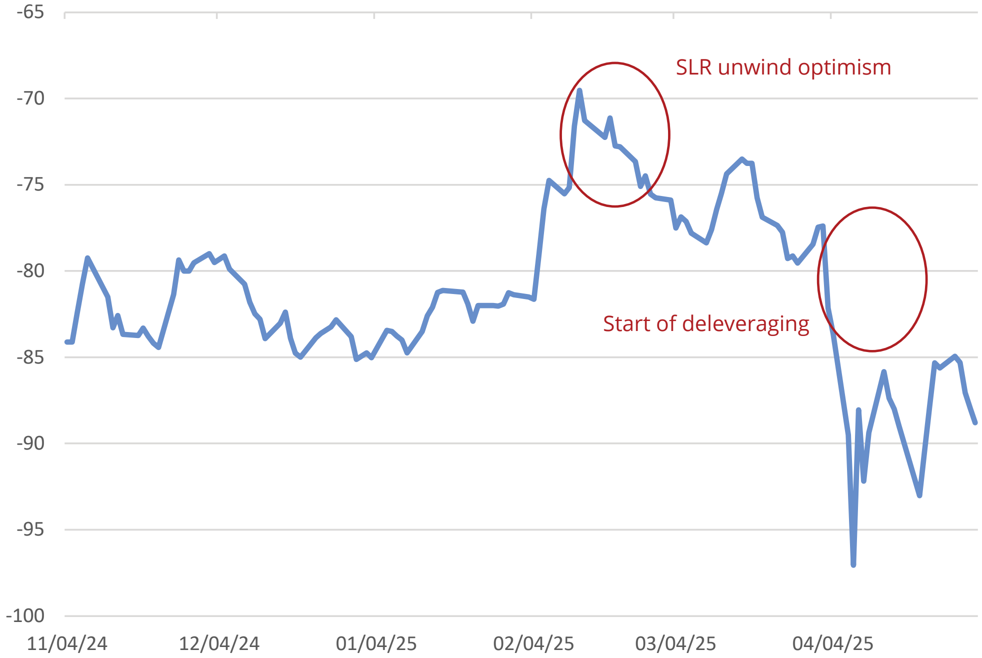
Insight from sub-adviser Wellington Management

Amar Reganti
Managing Director at Wellington Management LLP and Fixed-Income Strategist for Hartford Funds

What's Driving Markets...

1. **Deleveraging[1]:** While the initial April 3 tariff announcement was met with lower bond yields, longer-dated US Treasuries rose as the heavily invested swap-spread trade[2] unwound. As background: In February, Secured Overnight Financing Rate (SOFR)[3] swap yields started moving higher relative to Treasuries (though they remained below Treasury yields). The current negative differential has often been attributed to the post-GFC (Global Financial Crisis) regulatory environment that made cash bonds such as Treasuries less preferable to interest-rate swaps (which are synthetic[4] and require less cash to invest). The February change in swap spreads reflected the expectation that the Trump administration would undo some of those regulations (particularly the Supplementary Leverage Ratio (SLR)[5]) and was primarily driven by heavily levered[6] participants such as hedge funds. April's volatility led to the rapid unwinding of the trade (**FIGURE 1**), which quickly filled up balance sheets of traders who were expected to take delivery of long-dated Treasury bonds as hedge funds exited the trade.

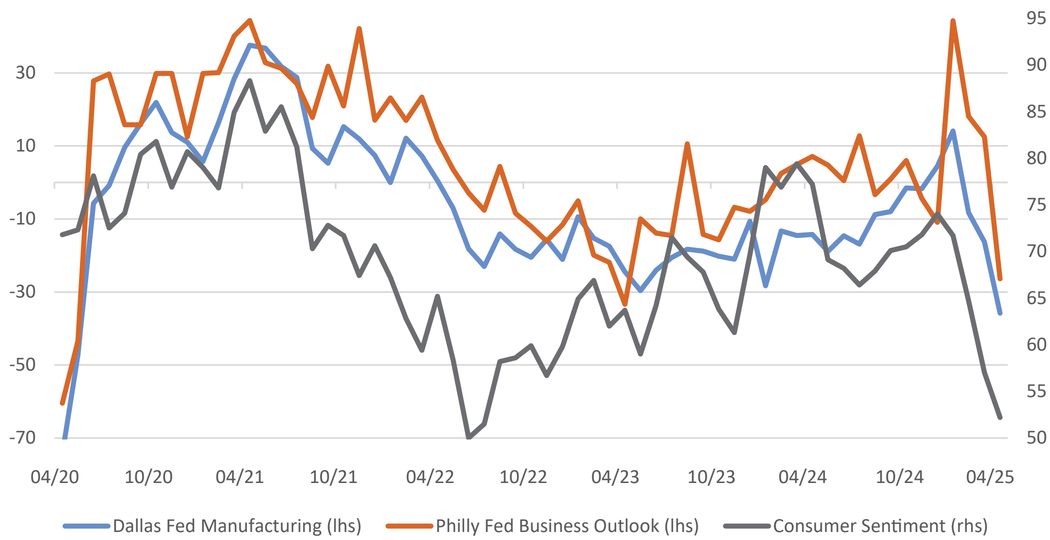
FIGURE 1
Investors Unwound Bets on US Treasury Rates as Tariffs Were Rolled Out
USD SOFR Swap vs. 30-year US Treasury Yield (bps[7])



As of 5/2/25. Data Sources: Bloomberg, Wellington Management, and Hartford Funds.

2. **Survey data:** Business and consumer confidence took a hit as a result of tariff uncertainty. Regional Federal Reserve Bank surveys and the University of Michigan Consumer Sentiment survey each represent important leading indicators for "hard" economic data and could portend weaker growth and labor markets in the months ahead. This would be especially true if businesses pull back on capital investment and hiring while consumers tighten their purse strings and build up savings rather than spend on goods and services (**FIGURE 2**).

FIGURE 2
Tariff Uncertainty Has Eroded Business and Consumer Confidence
Leading Business and Consumer Surveys (April 2020–April 2025)



As of 4/30/25. Data Sources: Bloomberg, University of Michigan, Wellington Management, Hartford Funds.

3. **Credit spreads[8] kept it together:** Credit markets recouped most of their initial sell-off rather quickly after the Trump administration granted a 90-day reprieve on reciprocal tariffs, likely reflecting optimism that bilateral negotiations may bear fruit. With credit spreads now trading tight to historical median levels (**FIGURE 3**), we think the downside from tariff developments is not fully reflected. Credit fundamentals entered this period of volatility in relatively good shape, but we prefer to stick to more stable credit profiles and less-cyclical issuers that should be better positioned to withstand a weaker growth environment.

FIGURE 3
The 90-Day Tariff Reprieve Kept Credit Spreads Tight, But for How Long?
Credit-Market Spreads (%), May 2024–May 2025

As of 5/2/25. Investment grade is represented by the **Bloomberg US Corporate Bond Index**, which covers all publicly issued, fixed rate, nonconvertible, investment grade debt. High yield is represented by the **Bloomberg US Corporate High-Yield Bond Index**, an unmanaged broad-based market-value-weighted index that tracks the total return performance of non-investment grade, fixed-rate, publicly placed, dollar-denominated and nonconvertible debt registered with the Securities and Exchange Commission. Data Sources: Bloomberg, Wellington Management, and Hartford Funds.

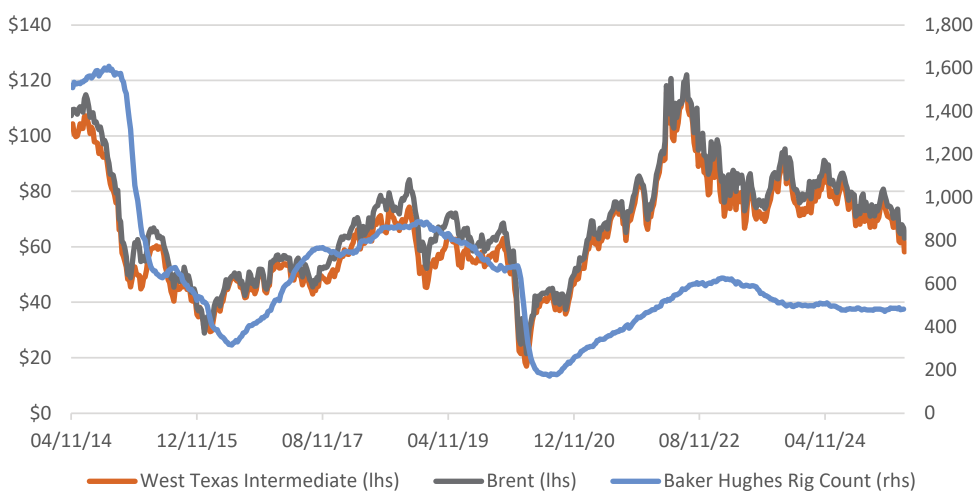
4. **To cut or not to cut:** The Federal Reserve (Fed) faces a rather unenviable task of navigating this period of uncertainty. Normally, the Fed would respond to the growth shock with cuts to its policy rate, but inflation remains above its target and is likely to rise further with tariff implementation. The futures market is pricing in nearly 100 bps of rate cuts by spring 2026 and, up until recently, had priced in those cuts by year end. However, the Fed faces a credibility issue if it cuts policy rates with inflation still well above its target (more in "What's Keeping Us Up at Night" section below). We're skeptical the Fed will cut by as much as markets expect, absent a material *realized* degradation of labor markets.

5. **Oil prices** are playing the role of Cassandra in the current market. The collapse of energy prices (**FIGURE 4**), spurred both by expected economic weakness and the anticipated additional output by OPEC, is driving oil prices below the important $60-per-barrel threshold, which could have a material impact on the US. Unlike the early part of the century, the US is a large energy exporter and a substantial downturn in energy prices is likely to be a drag on GDP. It may, however, cushion (somewhat) the expected cost pass-through from new tariffs to goods prices.

FIGURE 4

Economic Weakness and a Rise in OPEC Output Drive Oil Prices Down

Per-Barrel Oil Prices and Rig Counts (2014-2025)



As of 4/30/25. Data Sources: Bloomberg, Wellington Management, and Hartford Funds.

What's Keeping Us Up at Night…

1. **Negotiations under way:** As of this writing, there appears to be little progress on negotiating lower tariffs between the US and most of its trading partners. The Trump administration seems intent on keeping the highest tariff rates on China while close trading partners such as Mexico and Canada are likely to secure better deals. We'll be monitoring developments closely between now and the 90-day deadline on July 9, but we expect most rates will settle to levels well below the reciprocal rates first proposed by the Trump administration given the otherwise severe damage to trading relationships, global growth, and financial conditions—not to mention US borrowing costs.

2. **Fed independence questioned:** On April 17, President Trump posted to Truth Social that Fed Chair Jerome Powell's "termination cannot come fast enough," followed by another intra-month sell-off in stocks and longer-term US Treasury yields. By April 22, Trump stated he had "no intention" of firing Powell, the start of a nine-day rally in stocks. Powell has remained steadfast in his public comments that the Fed would continue to conduct monetary policy independent of any political pressure while also asserting that he'll serve out his term as Chair, which ends in May 2026. Any attempt

> "Any attempt to fire Fed Chair Powell would likely face legal challenges and would likely roil markets given the sanctity of Fed independence.

to fire Powell would likely face legal challenges and would likely roil markets given the sanctity of Fed independence. We would also expect US Treasury yields to rise and the dollar to decline as investors would likely demand more compensation for the uncertainty and inflation volatility that would ensue from compromised monetary policy.

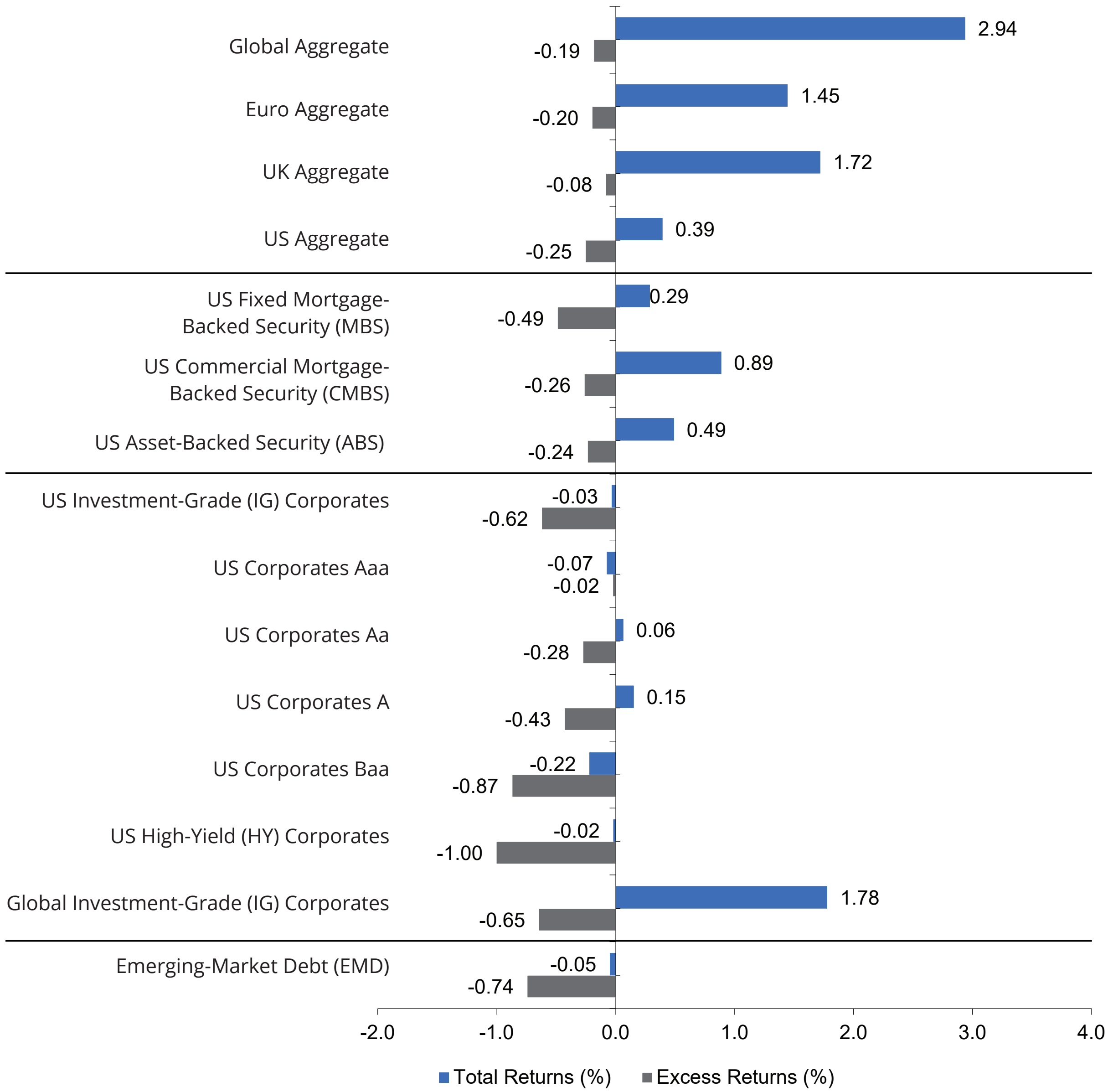
3. **India/Pakistan:** A terrorist attack killed tourists at Pahalgam, a city in the Indian-administered portion of Jammu and Kashmir. Since the April 22 attack, the militaries of India and Pakistan have exchanged fire across the Line of Control in the region. Pakistan's government expects a retaliatory attack by Indian armed forces. In the meantime, the Indian government has suspended the Indus Water Treaty, referring to the waterway that provides much of Pakistan's water. Conflict between two regional, nuclear-armed powers is cause for substantial concern.

Investment Implications for Consideration

While the below positions have been static for some time, it's a reflection on how drawn out the current cycle has been due to the underlying strength of the economy.

- The risks of a recession have increased, yet tariffs are also likely to add to the current inflationary impulse. Given these dual risks, we still favor higher-quality total-return strategies that are less constrained by benchmarks. These could include global sovereign and currency strategies that potentially shine during these periods, or "go-anywhere" strategies[9] that may be able to navigate the late cycle.
- Core-bond and core-bond-plus[10] positions may make sense for all-in yields, and we think recession/growth risks may likely outweigh inflation risks over the medium term. Intermediate government/credit may be useful as a more risk-balanced way of adding a high-quality ballast into asset allocations. Moreover, recent slowing of economic data highlights a cooling of economic conditions.
- Securitized credit[11] could be a potential hedge against rate volatility since it generally offers attractive risk-adjusted spreads. Senior parts of the capital structure, in particular, may offer attractive carry[12] with substantial subordination[13] in case the cycle turns negative faster than expected. While these sectors may face headwinds from non-US buyers finding more attractive opportunities in home markets, we think the hedge against rate volatility that subordination can provide will remain important in volatile markets. For clients looking for higher expected returns, we favor select CLO[14] equity, which allows locked-in, non-recourse, term financing for an actively managed pool of bank loans.

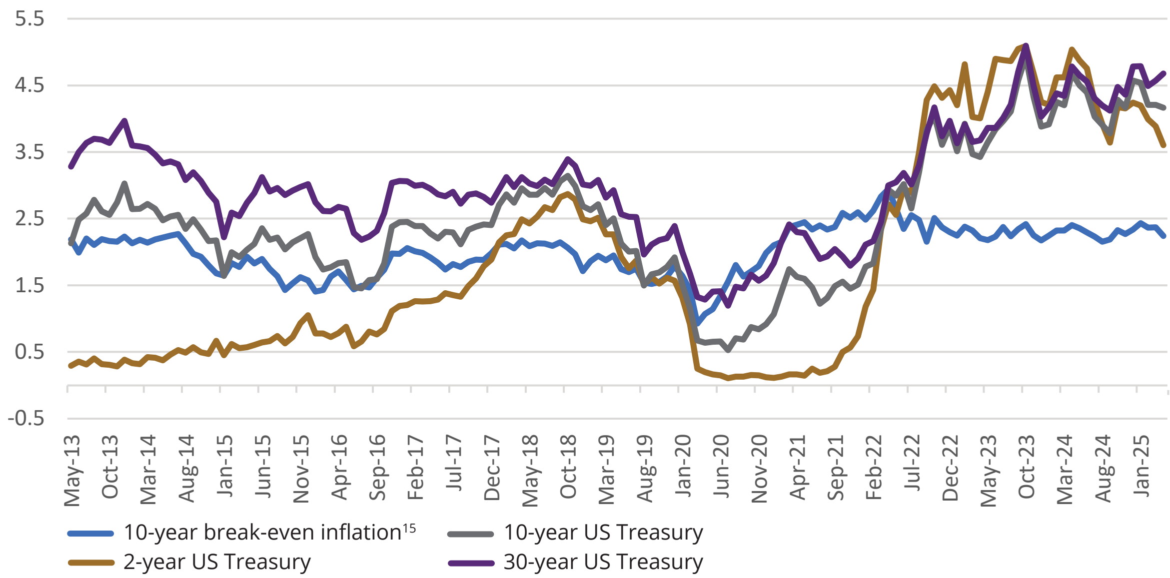
FIGURE 5: Monthly Fixed-Income Sector Total and Excess Returns



Monthly data as of 4/30/25. **Past performance does not guarantee future results.** Excess returns are defined as investment returns from a security or portfolio that exceed a benchmark or index with a similar level of risk. Indices are unmanaged and not available for direct investment. See last page for representative index definitions. Data Sources: Bloomberg and Wellington Management.

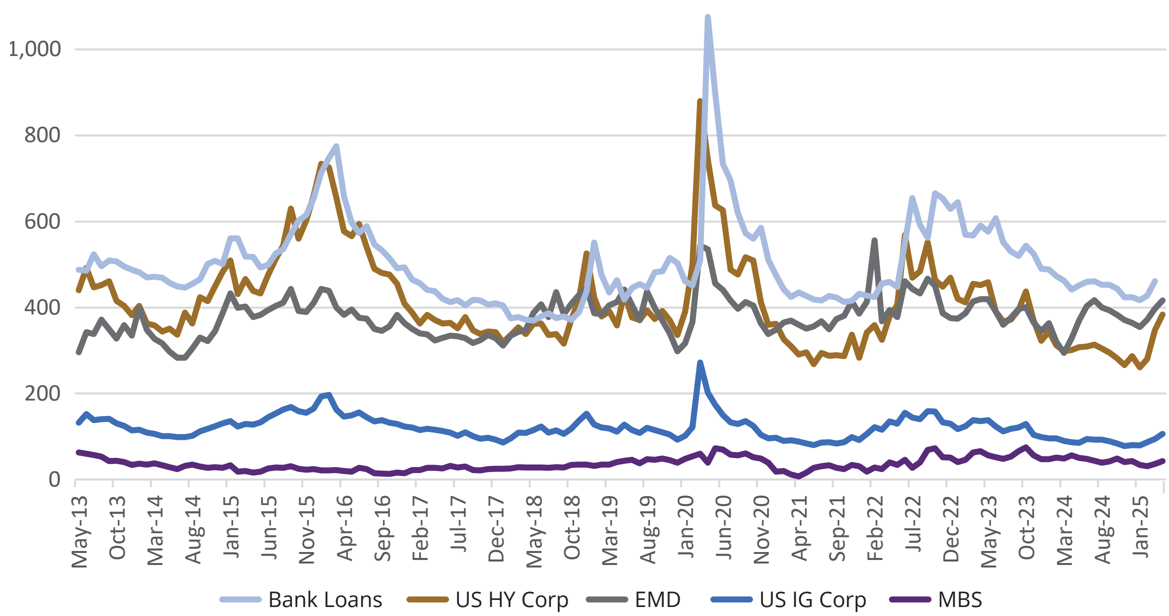
To learn more about opportunities in fixed income, please talk to your financial professional.

FIGURE 6: US Yields (%)



As of 4/30/25. Data Sources: Bloomberg, Wellington Management.

FIGURE 7: Fixed-Income Spreads (basis points)



As of 4/30/25. **Past performance does not guarantee future results.** US IG Corp is represented by the **Bloomberg US Corporate Bond Index**; US HY Corp is represented by the **Bloomberg US Corporate High Yield Bond Index**; EMD is represented by the **J.P. Morgan EMBI Global Diversified Index**; MBS is represented by the **Bloomberg US MBS Index**; Bank Loans are represented by the **Morningstar/LSTA US Leveraged Loan Index**. See last page for representative index definitions. Data Sources: Bloomberg, JP Morgan, Morningstar LSTA, and Wellington Management.

[1] Deleveraging is when a company or individual attempts to decrease its total financial leverage. In other words, deleveraging is the reduction of debt and the opposite of leveraging. The most direct way for an entity to deleverage is to immediately pay off any existing debts and obligations on its balance sheet. If unable to do this, the company or individual may be in a position of an increased risk of default.

[2] A swap spread is the difference between the fixed component of a given swap and the yield on a government security, usually from the US Treasury, with the same maturity. Swaps are derivative contracts to exchange fixed interest payments for floating-rate payments.

[3] A SOFR swap rate is the fixed interest rate paid in an interest rate swap where the other party pays an interest rate based on the Secured Overnight Financing Rate (SOFR). SOFR is a benchmark rate reflecting the cost of borrowing overnight, backed by US Treasury securities. In essence, it's a swap where one party locks in a fixed rate while the other receives a floating rate based on SOFR.

[4] A synthetic interest-rate swap is a way to create the effect of a fixed-rate loan on a floating-rate loan, or vice versa, by using a swap contract to exchange interest payments. It's a method for managing interest-rate risk without changing the underlying loan's structure or principal.

[5] The Supplementary Leverage Ratio (SLR) is a regulatory requirement in the US for banks to maintain a specific amount of capital relative to their total assets, regardless of risk. It acts as a backstop to the risk-based capital requirements, ensuring a minimum level of capital even for low-risk activities.

[6] In finance, "levered" describes a situation where debt or leverage is used to amplify potential returns on an investment or business. It essentially means using borrowed funds to increase the scale of an investment, with the hope of generating higher returns.

[7] A basis point is a unit that is equal to 1/100th of 1% and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security.

[8] Spreads are the difference in yields between two fixed-income securities with the same maturity but originating from different investment sectors.

[9] Go-anywhere strategies are typically benchmark-agnostic and not bound by limits on exposure by sector, quality, currency, or country. Whereas traditional core-bond-plus strategies generally have flexibility to invest across the fixed-income landscape, they generally have upper limits on the amount that can be invested in securities rated below-investment-grade, domiciled outside the US, non-US-dollar-denominated, or reside in a particular sector (e.g., emerging markets).

[10] Core/core plus strategies typically invest in a baseline of investment-grade bonds such as government, corporate, and securitized debt. Core-plus funds can take that baseline and add additional sectors such as corporate high-yield, emerging-market debt, or non-US currency exposures to enhance returns.

[11] Securitized credit involves pooling a large number of loans into an investable asset. Examples include mortgage-backed or asset-backed securities.

[12] Carry generally refers to the return or cost associated with holding an asset, often used in the context of currency or asset trades, where investors borrow in a low-interest currency and invest in a higher-yielding one.

[13] Subordination refers to a lower priority level of debt or securities. Subordinated debt ranks below senior debt in terms of claims on assets and earnings. This means that in the event of a default or liquidation, subordinated debt holders are paid after senior debt holders. Subordinated debt is often considered riskier because it has a lower claim on assets, but it typically offers higher interest rates to compensate for this increased risk.

[14] A collateralized loan obligation (CLO) is a type of security that allows investors to purchase an interest in a diversified portfolio of company loans. There are two types of CLO tranches: debt tranches and equity tranches. Debt tranches are treated like bonds and have credit ratings and coupon payments. These debt tranches come first in terms of repayment, and there is also a pecking order within the debt tranches. Equity tranches do not have credit ratings and are paid out after all debt tranches. Equity tranches are rarely paid a cash flow but do offer ownership in the CLO itself in the event of a sale. Because equity tranche investors usually face higher risks, they often receive higher returns than debt tranche investors.

[15] The break-even inflation rate is a measurement that aims to predict the effects of inflation on certain investments, by analyzing known market inflation rates from recent years. It can be calculated by comparing the yield of an inflation-based bond (such as Treasury Inflation-Protected Securities, or TIPS) with a nominal bond of the same maturity period. The difference represents the break-even inflation rate, or the rate that inflation would have to be for an investor to “break even”—or earn the same return—between purchasing TIPS or nominal Treasuries.

Representative Indices from Figure 5:
Global Aggregate: Bloomberg Global Aggregate Bond Index; Euro Aggregate: Bloomberg Global Aggregate Bond Index - European Euro; UK Aggregate: Bloomberg Global Aggregate Bond Index - United Kingdom; US Aggregate: Bloomberg US Aggregate Bond Index; US Fixed MBS; Bloomberg US MBS Index; US CMBS: Bloomberg CMBS ERISA Eligible Bond Index; US ABS: Bloomberg Asset-Backed Securities Index; US IG Corporates: Bloomberg US Corporate Bond Index; US Corporates Aaa: Bloomberg Aaa Corporate Bond Index; US Corporates Aa: Bloomberg Aa Corporate Bond Index; US Corporates A: Bloomberg A Corporate Index; US Corporates Baa: Bloomberg Baa Corporate Bond Index; US High-Yield Corporates: Bloomberg US Corporate High Yield Bond Index; Global IG Corporates: Bloomberg Global Credit - Corporate Bond Index; Emerging-Markets Debt: Bloomberg Emerging Markets Hard Currency Bond Index.

Index Definitions:
Bloomberg Global Aggregate Bond Index is a broad-based measure of the global investment-grade fixed-rate debt markets.

Bloomberg Global Aggregate Bond Index - European Euro includes fixed-rate, investment-grade Euro denominated bonds.

Bloomberg Global Aggregate Bond Index - United Kingdom includes fixed-rate, investment-grade sterling-denominated bonds.

Bloomberg US Aggregate Bond Index is composed of securities from the Bloomberg Government/Credit Bond Index, Mortgage-Backed Securities Index, Asset-Backed Securities Index, and Commercial Mortgage-Backed Securities Index.

Bloomberg US MBS Index tracks fixed-rate agency mortgage backed passthrough securities guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

Bloomberg CMBS ERISA Eligible Bond Index measures the performance of investment-grade commercial mortgage-backed securities, which are classes of securities that represent interests in pools of commercial mortgages. The index includes only CMBS that are Employee Retirement Income Security Act of 1974.

Bloomberg Asset-Backed Securities Index, the ABS component of the Bloomberg US Aggregate Index, has three subsectors: credit and charge cards, autos, and utility.

Bloomberg US Corporate Bond Index covers all publicly issued, fixed rate, nonconvertible, investment-grade debt.

Bloomberg Aaa Corporate Bond Index is designed to measure the performance of investment-grade corporate bonds that have a credit rating of Aaa.

Bloomberg Aa Corporate Bond Index is designed to measure the performance of investment-grade corporate bonds that have a credit rating of Aa.

Bloomberg A Corporate Bond Index is designed to measure the performance of investment-grade corporate bonds that have a credit rating of A.

Bloomberg Baa Corporate Bond Index is designed to measure the performance of investment-grade corporate bonds that have a credit rating of Baa.

Bloomberg US Corporate High Yield Bond Index is an unmanaged broad-based market-value-weighted index that tracks the total return performance of non-investment grade, fixed-rate, publicly placed, dollar denominated and nonconvertible debt registered with the Securities and Exchange Commission.

Bloomberg Global Credit - Corporate Bond Index is an unmanaged index considered representative of fixed rate, non-investment grade debt of companies in the US, developed markets, and emerging markets.

Bloomberg Emerging Markets Hard Currency Bond Index includes USD-denominated debt from sovereign, quasi-sovereign, and corporate EM issuers.

Morningstar/LSTA Leveraged Loan Index is a market-value-weighted index that is designed to measure the performance of the US leveraged loan market based upon market weightings, spreads, and interest payments.

J.P. Morgan EMBI Global Diversified Index is a broad-based, unmanaged index which tracks liquid, US Dollar emerging-market fixed- and floating-rate debt instruments issued by sovereign and quasi-sovereign entities.

Important Risks: Investing involves risk, including the possible loss of principal. • Fixed income security risks include credit, liquidity, call, duration, and interest-rate risk. As interest rates rise, bond prices generally fall. • Investments in high-yield ("junk") bonds involve greater risk of price volatility, illiquidity, and default than higher-rated debt securities. • Mortgage-related and asset-backed securities' risks include credit, interest-rate, prepayment, and extension risk. The value of the underlying real estate of real estate related securities may go down due to various factors, including but not limited to strength of the economy, amount of new construction, laws and regulations, costs of real estate, availability of mortgages, and changes in interest rates. • Loans can be difficult to value and less liquid than other types of debt instruments; they are also subject to nonpayment, collateral, bankruptcy, default, extension, prepayment and insolvency risks. • Foreign investments may be more volatile and less liquid than US investments and are subject to the risk of currency fluctuations and adverse political, economic and regulatory developments. These risks may be greater, and include additional risks, for investments in emerging markets. • The risks associated with mortgage-related and asset-backed securities as well as collateralized loan obligations (CLOs) include credit, interest-rate, prepayment, liquidity, default, and extension risk.