

TARIFFS, THE DOG THAT BARKED (A LOT) BUT DIDN'T BITE?



SUPPORTIVE EM BACKDROP
EMERGING MARKETS

FAVORABLE IG FUNDAMENTALS, TECHNICALS
INVESTMENT GRADE

EMBRACING A SOFT-LANDING SCENARIO
HIGH YIELD AND BANK LOAN

Letter From The CIO

Perhaps the most widespread question for investors is why US economic activity has not weakened despite the magnitude of tariffs imposed since April. After beginning the year around 2%, the average US tariff rate has increased significantly, with current estimates in the mid-teens.¹ In comparison, the average tariff rate peaked just above 3% during the first Trump administration, a period where the US economy continued to grow. Today's tariff rate may not have even peaked, as the Trump administration negotiates with numerous trading partners and moves forward with implementing Section 232 tariffs on different sectors.

In this newsletter, we share our views on why the economic impact of tariffs has been limited so far and, more importantly, how that has influenced our investing outlook.

Three specific reasons for economic resilience come to mind. First, the US dollar has depreciated. A weaker dollar can help alleviate the negative impacts of tariffs on growth by improving the pricing of US products abroad, thereby driving higher exports. Consistent with this, the chart below shows that previous periods of dollar depreciation were periods of GDP growth.² The weaker dollar should also help those US corporations that generate part of their revenue abroad report higher

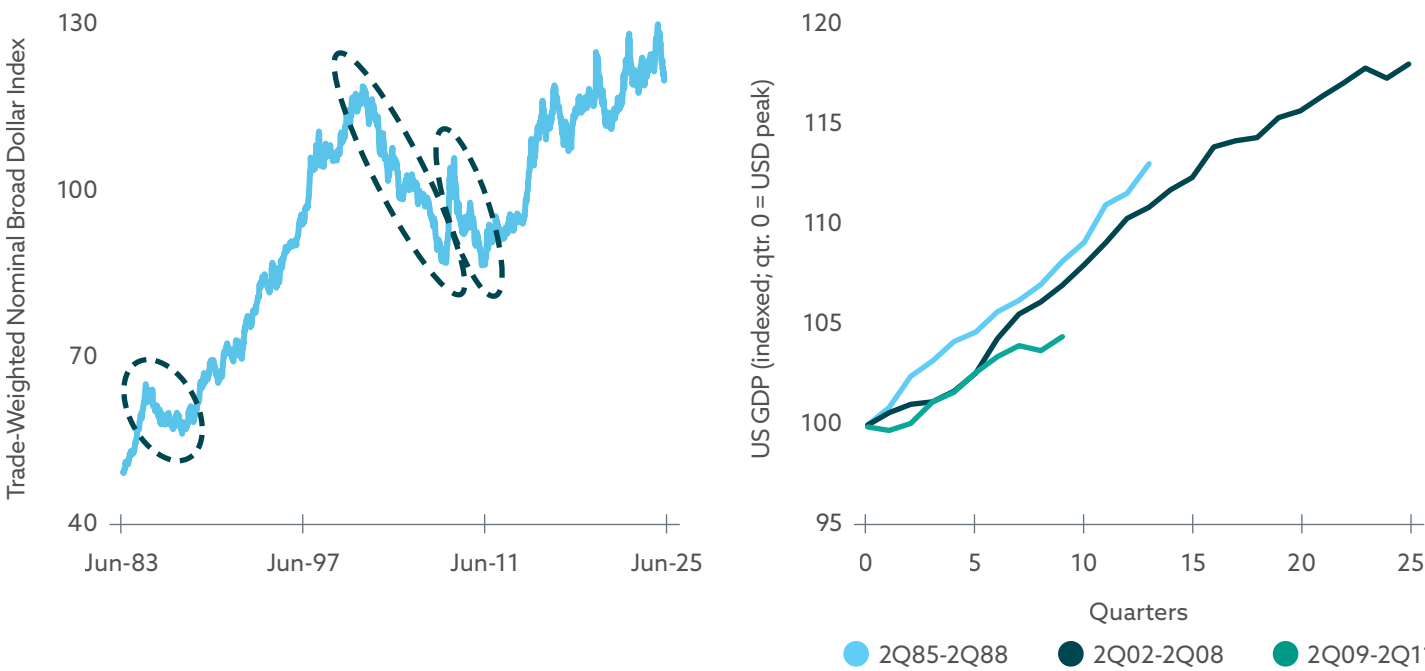
earnings. Second, gas prices are near multi-year lows, which can be a tailwind for consumption. Third, tax legislation may have supported equity markets, thereby keeping financial conditions loose.

There are, however, some caveats to these tailwinds. For instance, the impact of lower gas prices on the economy is potentially double-edged as the benefit to consumers is offset by the cost to US oil producers. Goldman Sachs recently estimated that lower gas prices will result in only a 0.1 percentage point boost to GDP growth in 2025.³

Even with the three offsetting factors outlined above, there may be a simpler explanation for US economic resilience, which is [a lag](#) between the announcement of tariffs and their economic impact. This lag may be reflected in the trajectory of forecasted GDP growth in 2025. While forecasts for second quarter GDP growth have rebounded (currently around 2% after dipping below 1%), forecasts for the third quarter are weaker (currently sub 1%).⁴ Indeed, Fed Chair Powell has noted that it may not be until the third quarter before we begin seeing the effects of tariffs, in particular on inflation numbers.

Having said that, one takeaway from the 2018 tariff episode that potentially points to a mitigated impact this

PRIOR PERIODS OF DOLLAR WEAKNESS HAVE AIDED GDP GROWTH²



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time is that US inflation did not broadly increase. Although there were sector-specific price increases, they eventually reversed.⁵ Given the same or similar scenario today, if economic data were to weaken in reaction to tariffs, the Fed seems poised to cut rates. Lower rates should be a tailwind for both the economy and financial markets.

As the preceding paragraphs show, the economic situation is evolving. Market trading levels have tightened significantly and may not adequately compensate for risks to the economy. Despite this uncertainty, we believe there are some conclusions that can be drawn based on the factors supporting growth as well as the example of the 2018 tariff war. These conclusions help frame our investment outlook for the second half of 2025.

- > We expect economic growth to be lower than 2024 but still positive as a weaker dollar and lower taxes help offset tariffs somewhat. However, risks to growth are more to the downside than upside.
- > In this economic scenario, we believe corporate earnings growth will also likely slow but remain positive, historically a good environment for credit markets. Tax legislation should be a tailwind, while dollar weakness should support companies that generate revenue overseas.

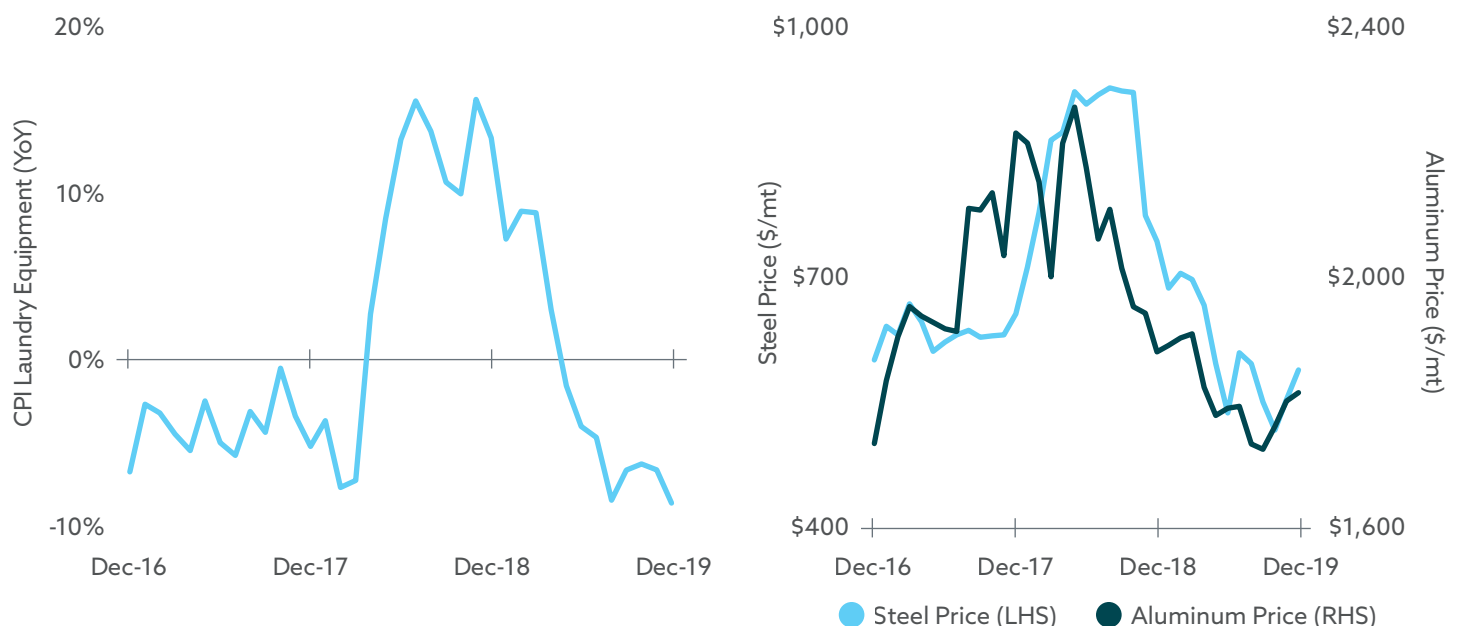
- > Tariffs will likely provide a one-time inflation impulse, but more so for specific sectors. In our opinion, the impacts will be temporary as was the case in 2018.

The combination of economic outcomes outlined above, along with emerging concerns about US deficits, should keep Treasury market yields higher-for-longer, even if eventual Fed cuts were to lead to lower short-term rates. Our expectation is for higher yields to continue to drive inflows in the US credit markets.

Higher-for-longer yields have implications for how active managers position their portfolios. At PPM, our investment grade portfolio managers have been leaning into this narrative for a while. They have seen and continue to see opportunities to improve credit quality with bonds of similar yields or shorten duration without giving up too much yield by moving down corporate curves.

Our leveraged credit team has researched the effects of higher-for-longer yields on issuers, in particular issuers of floating rate liabilities. This analysis has led us to increase exposure to companies who possess the pricing power to offset the impact of higher interest expense while reducing exposure to those who lack this pricing power.

THE 2018 TRADE WAR BROUGHT SELECT INFLATION SHOCKS⁵



Along those lines, it is worth highlighting that the macro uncertainty arising from trade policy creates an ideal background in which our rigorous approach to research on industries, companies and credit curves can be a differentiator.

Rate levels also affect private markets. Specifically in private equity, exit activity could rebound slower than hoped if rates stay high, as they result in higher borrowing costs. But our team still expects “good” assets to trade (e.g., through continuation vehicles).

We believe that the economic background of slower but positive US economic growth, a weaker dollar and a Fed that is more likely to cut than hike favors both hard and local currency emerging market (EM) debt. In the immediate aftermath of reciprocal tariffs, EM debt generally outperformed its US counterpart amid positive fundamental and asset allocations trends that we expect to continue. We see highly-attractive opportunities in [investment grade-rated EM](#) and [local currency supranational bonds](#).

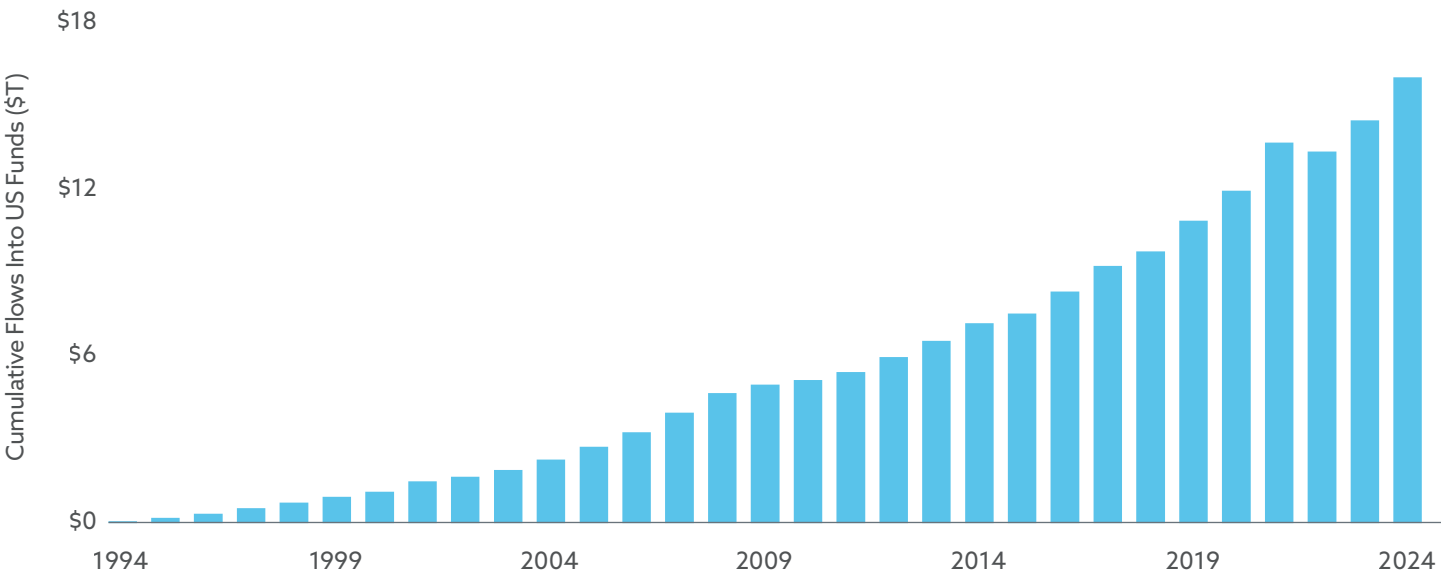
Finally, we conclude by opining on the hotly-debated issue of whether tariffs will lead to the diversion of investment flows away from US markets – the so-called “end of US exceptionalism.” Our belief is that continued inflows into EM and US markets can co-exist.

Foreign investment into US credit markets as tracked by J.P. Morgan shows continued demand, similar to the flows we have seen from our own non-US domiciled clients.⁶ Despite the weaker dollar and associated higher hedging costs for foreign investors, there is nothing to suggest that the US’s spot as the global investment hub has changed. While certain investors may tactically reallocate to other markets on the margin, the US has the advantage of deep, liquid markets. Many are the largest in the world, in particular the Treasury market. We believe the pillars of US markets remain attractive to investors.



OGECHI NWACHUKWU
Chief Investment Officer

US MARKETS HAVE SEEN CONSISTENT INFLOWS⁷



(6) J.P. Morgan. “HG Credit Foreign Demand Monitor.” 21 July 2025. For example, monthly overnight TRACE flows show net buying of high grade US credit over the past 12 months and July to-date. (7) Morningstar. Based on monthly flows across all US category groups for open-end mutual funds, ETFs, money market funds, funds of funds and feeder funds through 31 December 2024.



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KEY TAKEAWAYS

- > Policy uncertainty in the US introduced a significant amount of volatility across global markets in the first half of the year, possibly leading to a reassessment of investment opportunities outside of the US
- > The backdrop for investing in emerging markets (EM) overall remains supportive given stable-to-improving fundamentals and countries' ability to implement counter-cyclical monetary policy
- > Given our positive outlook on EM, we believe that institutional investors seeking total return would most benefit from thinking beyond the benchmark and adding strategies such as EM Frontier and EM Local Currency Supranationals

GLOBAL ECONOMIC SHIFTS

Policy uncertainty in the US introduced a significant amount of volatility across global markets in the first half of the year. With the markets shrugging off some of the most disruptive policy elements (e.g., retaliatory tariffs, fraying global alliances, aggressive fiscal policy, etc.), the investing landscape may not feel that different than it did at the beginning of 2025. However, when looking at it through a global investment lens, two factors have changed: 1) the predictability of the US investment environment and 2) the outlook for US growth.

Does this foretell the end of "US exceptionalism," a recent period in which growth and investment opportunities pulled capital into the US? In our view, the influx of the uncertainty mentioned above coupled with the elevated valuations of US equities and the dollar puts the US on

a more fragile footing from an investment perspective. We posit that this opens the door to more flows going to other parts of the world.

EMERGING MARKETS IN THE SPOTLIGHT

While we expect US growth to slow, the willingness of both Europe and China to take policy steps to buttress growth creates a supportive backdrop for investing in EM overall, in our opinion. EM countries have bounced back from the headwinds of 2020 to 2022 (e.g., COVID, inflation, a Fed hiking cycle) after pursuing tough decisions for both monetary and fiscal policy to avoid a loss of market access. While EM fundamentals are not uniformly moving in the right direction, they are generally stable-to-improving in aggregate. This trend is in contrast to core developed markets, where balance sheet deterioration looks likely to accelerate, most notably in the US. Furthermore, the decoupling of EM versus US central bank policy may be beneficial for EM relative growth as high real rates allow EM central banks to cut irrespective of Fed behavior.

Given our positive outlook on EM, we believe that institutional investors seeking total return would most benefit from adding the following strategies to their portfolios:

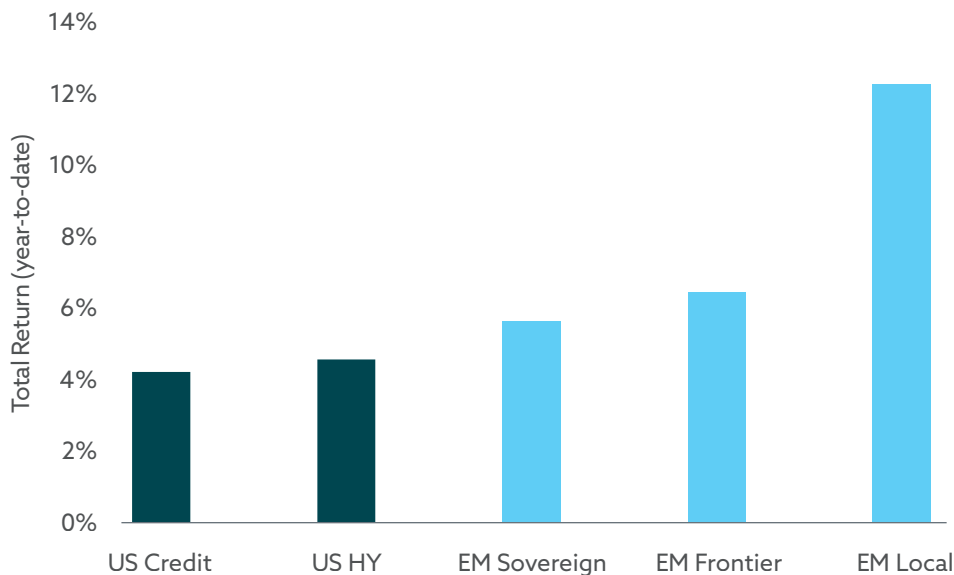
- > **EM Frontier:** The growth and maturation of the market for lower-rated sovereign credit has created an investable asset class with attractive correlations and total return potential. In our view, today's frontier market fundamentals resemble the favorable conditions of the early days of EM in the 1990s and 2000s.
- > **EM Local Currency Supranationals:** Our bespoke solution for investors interested in non-USD assets buys EM local currency-denominated supranational issuers. These bonds have a number of features that help underpin an attractive risk-reward proposition, including AAA ratings, offshore settlement, competitive yields and shorter duration.

US ASSET VALUATIONS NEAR HISTORICALLY HIGHS¹



Both US public equities and the US dollar entered the year at stretched valuations from a historical perspective. Given the potential for slowing growth in the US and an already depreciating dollar in 2025, investors may look elsewhere to diversify their portfolios.

EM BONDS OUTPERFORMING US CREDIT YEAR-TO-DATE²



A clear indication of the favorable EM investment environment has been the outperformance of various EM debt strategies compared to both US investment grade and high yield markets. In fact, EM local currency bonds (which we express through supranationals) have returned nearly triple their US high yield counterparts through Q2 2025 (12.3% vs. 4.6%).

(1) Macrobond. The Real Effective Exchange Rate (REER) measures the value of a currency against a basket of other currencies. Through March 2025. (2) Bloomberg. Year-to-date total return through 30 June 2025. US Credit, US HY, EM Sovereign, EM Frontier and EM Local as represented by the Bloomberg US Credit Index, the Bloomberg US Corporate High Yield Index, the J.P. Morgan EMBI Global Diversified Index, the J.P. Morgan Next Generation Markets Index and the J.P. Morgan GBI EM Global Diversified Index, respectively.



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KEY TAKEAWAYS

- > The resilience of the US investment grade market was on display in Q2 2025 as spreads, aided by supportive technicals, tightened despite multiple headwinds
- > Our positioning fluctuated during the quarter, adding risk during weakness in April and selling into strength during the market rally in May and June; we are positioned to participate in upcoming new issuance
- > Given clarity on a handful of policy issues (taxes, federal jobs, deportations), we anticipate spreads remaining in a tight range; a potential antagonist is the tariff endgame and its impact on inflation

IG MARKET SHOWS RESILIENCE

The resilience of the US investment grade (IG) market was on display in Q2 2025 as spreads tightened despite evolving tariff news, rising geopolitical tensions and a pending tax bill with potential impacts on the deficit. The spread of the Bloomberg US Credit Index (Index) widened as much as 22 bps in early April at the height of tariff uncertainty before reversing and finishing the quarter 10 bps tighter to 79 bps.¹ The Index produced an excess return of 100 bps for the quarter, turning the year-to-date excess return positive to 26 bps. The spread tightening also led to a positive quarterly total return (1.82%), which improved the year-to-date return to 4.22%.

SUPPORTIVE TECHNICALS IN PLACE

Supportive supply and demand technicals have helped drive historically tight spreads in the IG market. We expect continued demand across the US corporate bond market, driven by attractive yields and the sector's relative safety versus equities. Foreign investors, however, may add exposure at a slower pace than in recent years given rising hedging costs.

Gross corporate issuance so far this year has kept pace with 2024's elevated levels. However, expectations remain for lighter net corporate issuance overall as aggressive pandemic supply continues to mature to size. We also anticipate gross supply to taper as the year progresses.

APRIL WEAKNESS PROVIDED OPPORTUNITY

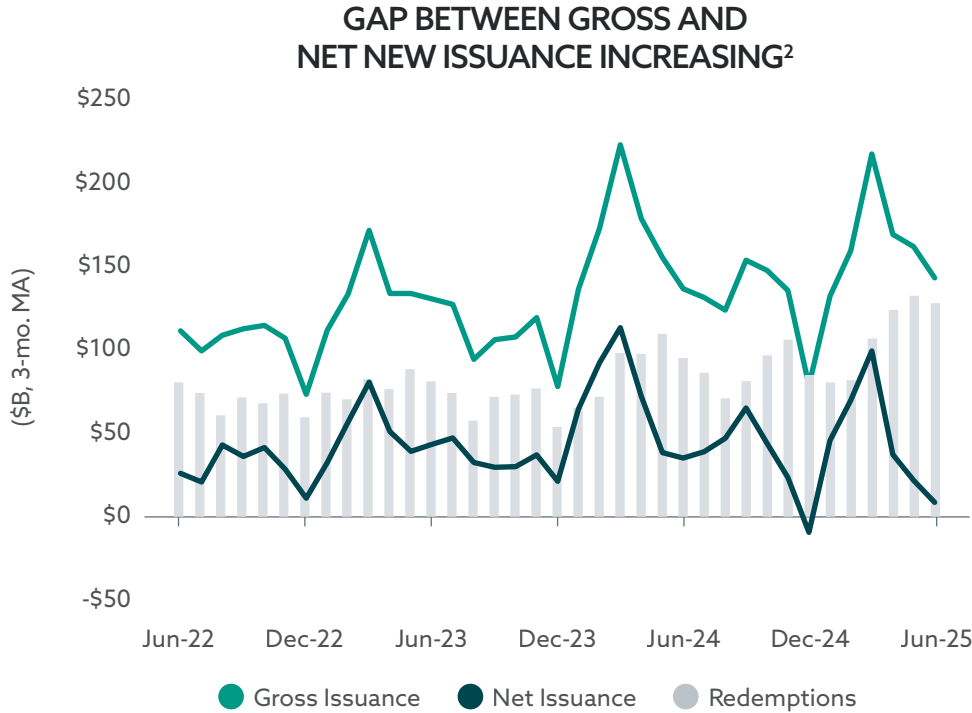
When spreads significantly widened following the reciprocal tariff announcement in April, our investment team identified undervalued securities in the credit market. In May and June, we then sold into strength as spreads tightened significantly during the rally, moving up-in-quality and re-establishing a risk budget in cash and US Treasuries.

ASSESSING KNOWN AND UNKNOWN

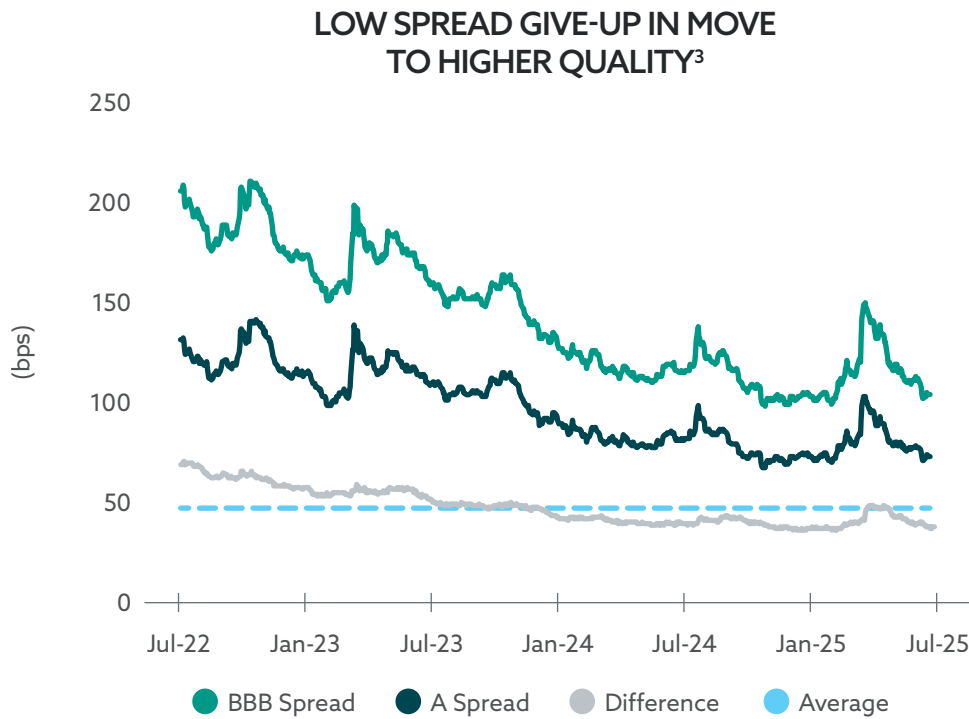
We came into the year with a number of policy unknowns, but have begun to get clarity on a handful of issues such as the tax bill, government job cuts and the size of deportations. One potential antagonist that still remains is the tariff endgame and its impact on inflation.

Our base case is that the effective tariff rate settles at a point where growth slows but remains positive, which is typically beneficial for credit markets. However, a higher rate than anticipated may ultimately harm consumer spending, corporate earnings and the credit quality of corporate bond issuers.

(1) Unless indicated, data sourced from Barclays. 1 July 2025.



Although gross supply has remained quite robust over the past year as issuers continue to meet demand, we are noticing that net new issuance has subsided over the past 15 months. In December 2024, the IG market experienced its first negative net monthly issuance in five years. Additionally, the \$11B in net new issuance this past month is the third lowest number since December 2019.



As part of our risk-adjusted return approach, we moved up-in-quality as the markets rallied in May and June. In doing so, we minimized spread give-up since the difference between A rated and BBB rated bonds are at multi-year lows.

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KEY TAKEAWAYS

- > Economic data has been mixed but we observe a shift toward below-trend growth in the US; we are focused on early signs of a slowdown in the labor market
- > High yield market indicators remain supportive considering positive rating trends, a low distress ratio and a below average default rate
- > After an intense but short-lived sell-off in April, the market discounted tariff bluster and embraced a soft-landing scenario; high yield rallied aggressively through the quarter, and we are looking to reduce risk at these higher prices

The US high yield market sold off sharply in the first nine days of April, only to recover over the rest of the quarter and post a robust 3.57% return.¹ This theme applied across broad rating categories, with BB, B and CCC all selling off in early April and then recovering. Segments of the market like Energy and distressed bonds underperformed so much in April that, despite a solid recovery, they still lagged market returns for the quarter (2.03% and 1.01%, respectively). Healthcare was a notable outperforming sector (5.04%) while Retail lagged on lingering tariff concerns (2.47%).

We saw the early April market moves – with yields increasing close to 100 bps in the first week of April to peak at 8.71% – as an opportunity to add credit risk at more

attractive valuations. We added in three main areas with some actions overlapping: Healthcare and Technology & Electronics as non-cyclical sectors; Energy as a sector that was unduly punished; and credits with specific catalysts from M&A, covenants or levers to refinance near-term maturities. Given the recovery through the quarter, we are now looking to reduce risk at these higher prices.

HIGH YIELD FUNDAMENTALS REMAINED SUPPORTIVE

Amid the volatility, macro fundamentals proved surprisingly resilient. Economic data was positive through much of the quarter, but has come in softer recently. Weaker data such as continuing jobless claims are aligning with survey data and pointing toward below-trend growth in the US. Potential inflationary tariff impacts are also appearing. We are focused on early indications of a slowdown in the labor market.

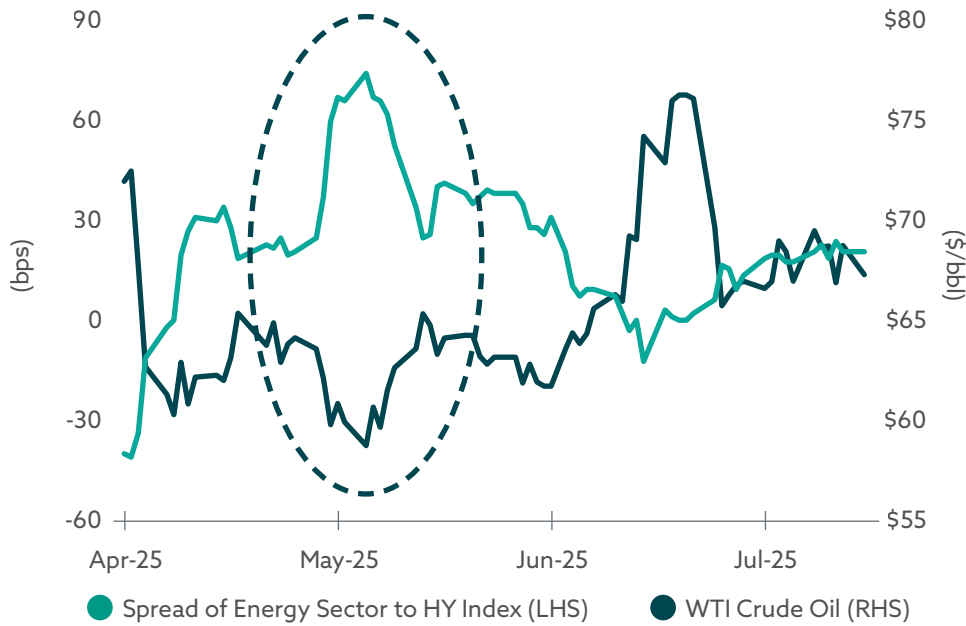
Meanwhile, high yield fundamentals continued to be supportive. The default rate increased 39 bps during Q2 2025 to 2.61%, but remained below the average since 2006 of 3.95%.^{2,3} The distress ratio, a predictor of future defaults, decreased 44 bps to 5.42%, remaining well below the average since 2006 of 10.73%. Further, the asset class saw more bonds upgraded (\$93B) than downgraded (-\$80B) during the quarter.

TECHNICALS ALSO REMAINED POSITIVE

The asset class experienced a seventh straight quarter of inflows (\$2B), even as April (-\$10B) represented the largest outflow in high yield since February 2023.⁴ High yield companies issued \$76B in bonds during the quarter, mostly in-line with the \$78B issued in Q2 2024 and elevated versus 2022 and 2023.

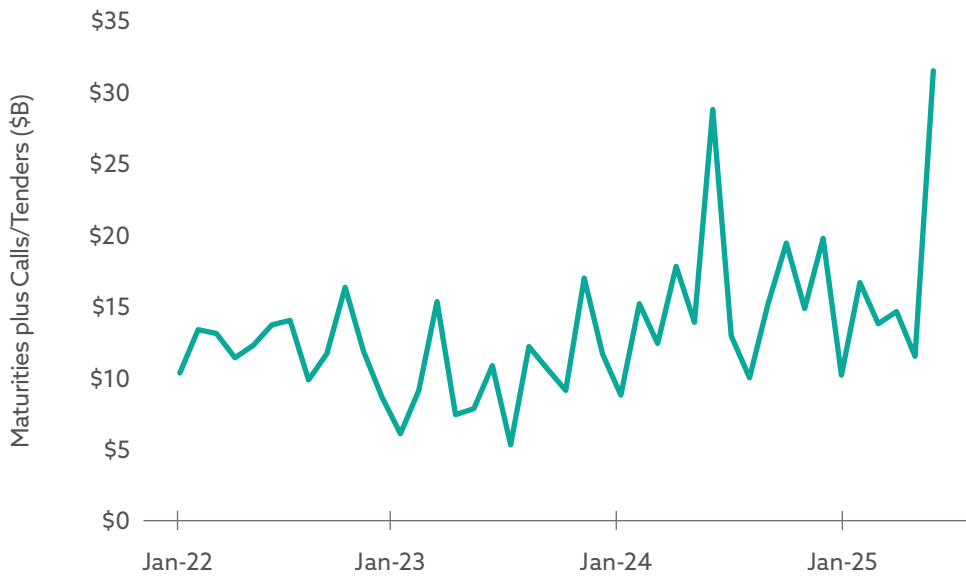
(1) Unless indicated, data sourced from ICE Data Services. 1 July 2025. Data for the ICE BofA US High Yield Constrained Index. (2) Data for default/distress, upgrades/downgrades and issuance sourced from BofA Global Research. 1 July 2025. (3) Default rate calculated at the issuer level for the last 12 months. Distress defined as bonds with spreads above 1,000 bps on a par basis. (4) Morningstar. Monthly flows for the US OE High Yield Bond category (including ETFs) through 30 June 2025.

ENERGY WIDENED AMID CRUDE OIL SELLOFF⁵



Energy was a focus during the quarter. The strategy added risk in April, as most bond prices declined with crude oil prices, even though Energy has sub-sectors with less oil sensitivity. We then reduced Energy risk in June to end the quarter with lower exposure overall.

COMPANIES REDEEMING MORE BONDS, REDUCING NET ISSUANCE⁶



Technicals have been an important part of the recent strength in US high yield. Apart from an outflow in April, the asset class has seen consistent inflows for over a year. On the supply side, higher levels of gross new issuance support leveraged issuers through better opportunities to refinance. But there is an underlying trend – an increasing amount of redeemed bonds has reduced net new issuance.

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KEY TAKEAWAYS

- > Economic data has been mixed, but we are starting to see convergence toward below-trend growth in the US; we are focused on early indications of a slowdown in the labor market
- > The loan market continues to experience rating downgrades and an elevated default rate, but the distress ratio remains below long-term averages
- > After an intense but short-lived sell-off in April, the market discounted tariff bluster and embraced a soft-landing scenario; loans rallied aggressively through the quarter, and we are looking to reduce risk at these higher prices

The Morningstar LSTA US Leveraged Loan Index (Index) posted a 12th consecutive quarter of positive returns (2.32%), even as the Index was negative in April (-0.05%).¹ All rating categories rallied during the quarter: BB (2.13%), B (2.46%) and CCC & Lower (2.32%). The percentage of loans trading par and above increased from 10% in March to 41% in June.

During the quarter, the strategy added to Financial Services and Insurance Broker names with non-cyclical cash flows. We also took advantage of the market recovery from mid-April lows to trim some cyclically-exposed names that have recovered in price. Given loans rallied aggressively through the quarter, we are looking to reduce risk overall at these higher prices.

TECHNICALS WEAKENED IN Q2 2025

Loans experienced outflows (-\$8B) during the quarter. Outflows spiked in April (-\$10B) with not much money coming into the market in May and June as the asset class rallied.² CLO issuance, a large source of demand for loans, totaled \$51B during the quarter, mostly in-line with Q2 2024 (\$53B).

On the supply side, loan issuance of \$80B was well below Q2 2024 (\$146B). Issuance stalled in April (\$7B) at the height of tariff uncertainty before rebounding in May and June (see next page).

MIXED LOAN FUNDAMENTALS

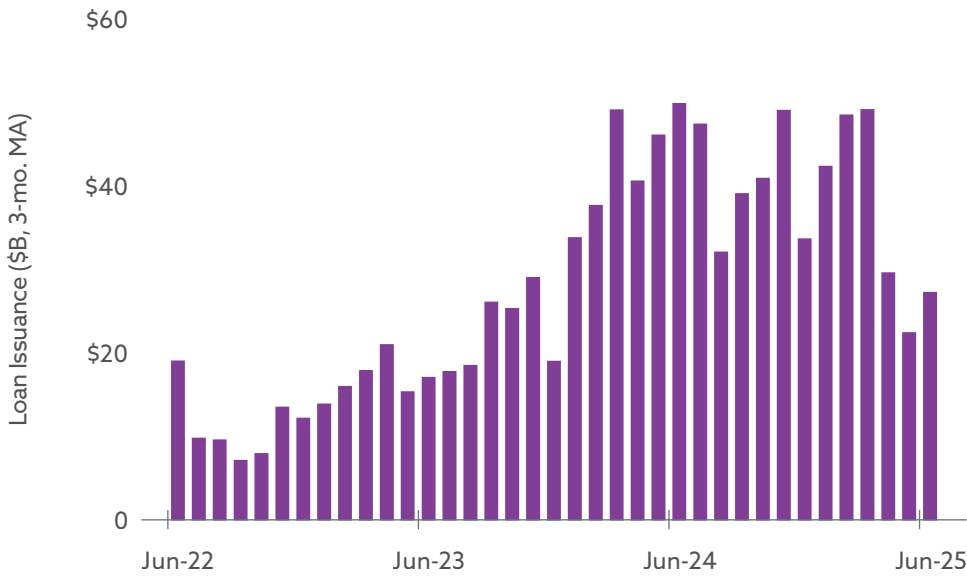
Amid the volatility, macro fundamentals proved surprisingly resilient. Economic data was positive through much of the quarter, but has come in more mixed recently. Weaker data such as continuing jobless claims are aligning with survey data and pointing toward below-trend growth in the US. Potential inflationary tariff impacts are also only beginning to be felt. We are focused on early indications of a slowdown in the labor market.

Meanwhile, loan fundamentals remain mixed. The asset class saw 25 loans upgraded but 77 loans downgraded in Q2 2025, the 13th consecutive quarter of net downgrades. The Index default rate increased a modest 2 bps to 1.25%, remaining below the average since 1999 of 2.42%.³ When including distressed exchanges, the default rate is notably higher at 4.46%, an increase of 15 bps during the quarter.

However, distressed loans, which we define as trading under 80 cents on the dollar and view as an indicator of defaults, decreased by 14 bps to 3.06%. That remains well below the average since 1999 of 6.15%.

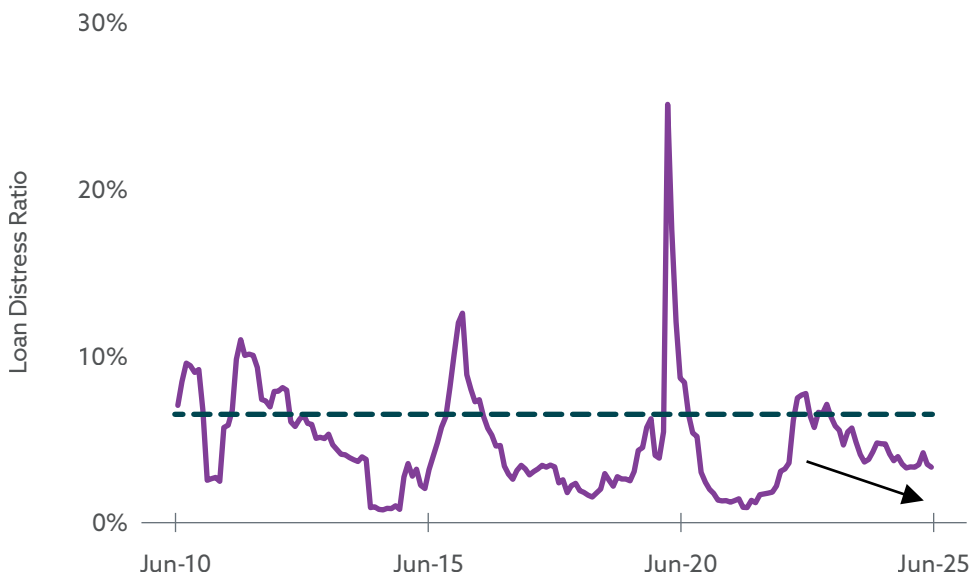
(1) Unless indicated, data sourced from PitchBook Data, Inc. 1 and 7 July 2025. (2) Morningstar. Monthly flows for the US OE Bank Loan category (including ETFs) through 30 June 2025. (3) Default rate calculated at the issuer level for the last 12 months.

LOAN PRIMARY MARKET REMAINS OPEN⁴



While down in the second quarter, the new issue market remains historically elevated and, if June is any indication (\$44B), could trend upward in the third quarter. An open primary market is positive for leveraged credits, as it allows names to refinance upcoming loan maturities. Companies can issue loans to meet CLO demand, which also remains historically elevated.

LOAN DISTRESS RATIO BELOW AVERAGE AND MOVING LOWER⁵



Despite downgrades and an elevated number of distressed exchanges, overall distress levels in the US loan market remain healthy. Loans trading below 80 cents on the dollar represented just 3.06% of the Index in June, not only below their long-term average but lower than in recent years.

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(1) AUM includes committed but unfunded capital for PPM's private equity and commercial real estate businesses. AUM includes both securities issued by PPM CLO vehicles held by PPM separately managed account clients and the underlying collateral assets of the CLO vehicles managed by PPM.

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The **ICE BofA US Corporate Index** provides a broad measure of the USD-denominated investment grade corporate debt securities publicly issued in the US domestic market.

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The **Morningstar LSTA US Leveraged Loan Index** provides a broad, market value-weighted measure of US institutional leveraged loans. It includes the institutional tranches of loans syndicated to US loan investors.

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