2025 MIDYEAR OUTLOOK

# CHARTING POTENTIAL OUTCOMES

TIAA Wealth Management

CIO PERSPECTIVES

# Executive Summary

June 25, 2025

- Given the ongoing uncertainty around the execution and sequencing of President Trump's policy priorities and their impacts on the economy, we continue to see a wide range of possible outcomes for the economy and financial markets in the second half of 2025 (H2).
- We expect markets to be driven by four themes over the next six months: the ongoing implementation of the new high-tariff regime, the ramifications of another multitrillion-dollar fiscal package, how quickly and effectively deregulation happens, and what role the Federal Reserve (Fed) decides to play.
- Our base-case scenario assumes that realpolitik and court rulings are going to lead to a gradual stabilization of trade tensions, and the Trump administration will pivot toward a more market-friendly policy mix where tax cuts and deregulation are prioritized. This scenario, in our view, would warrant small yet positive equity gains in H2, with recurring bouts of volatility caused by policy noise and a few possible negative surprises from jobs and inflation data as the economy adjusts to what remains a sizeable policy shift since January 20. Bond yields would stabilize, removing a source of economic pressure, and gradually decline as this outcome may enable the Fed to begin to project more monetary policy accommodation.
- We see markets anchored around our base-case scenario, but with risks of ongoing trade and fiscal policy uncertainty, that could eventually weigh on economic fundamentals—therefore bringing the bear-case scenario back to the fore. On the other hand, a shift into a bull-case scenario could be premature, in our view, until uncertainty fades and the government and monetary policy mix turns more decisively pro-growth.
- As a result, we reaffirm our neutral tactical view (relative to Strategic Asset Allocation, or SAA) within equities as we wait for more data to assess the balance of risks. Within fixed income, we continue to be overweight higher-quality investment-grade bonds and underweight riskier U.S. high-yield and emerging market bonds (relative to SAA) to better protect portfolios against a more adverse economic scenario.

TABLE OF CONTENTS



# CHARTING POTENTIAL OUTCOMES

**“While our base-case outlook for the second half of 2025 calls for small yet positive equity market gains, ongoing uncertainty remains about the execution and sequencing of President Trump’s policy priorities and their impacts on the economy and financial markets.”**

Three of the key themes in our 2025 Outlook “Finding Balance: Fiscal Adventures versus the Bond Market” were that inflation risks would keep bond volatility elevated, fiscal policy would be a key driver of markets and monetary policy, and global fragmentation would accelerate. Over the first six months of the year, the implementation of President Trump’s economic agenda has reinforced these views. The rapid and steep rise in trade tariffs (now subject to an intense legal battle as well) risks accelerating preexisting deglobalization trends and presents upside risks to consumer prices and downside risks to labor market conditions, sparking significant market volatility. And yet, a combination of “de-dollarization” linked to trade tensions and growing concerns about the sustainability of the U.S. fiscal position has kept bond yields elevated.

While our base-case outlook for the second half of 2025 calls for small yet positive equity market gains, ongoing uncertainty remains about the execution and sequencing of President Trump’s policy priorities and their impacts on the economy and financial markets. Therefore, we continue to see a wide range of possible outcomes for the economy and markets in the second half of 2025 as described below.

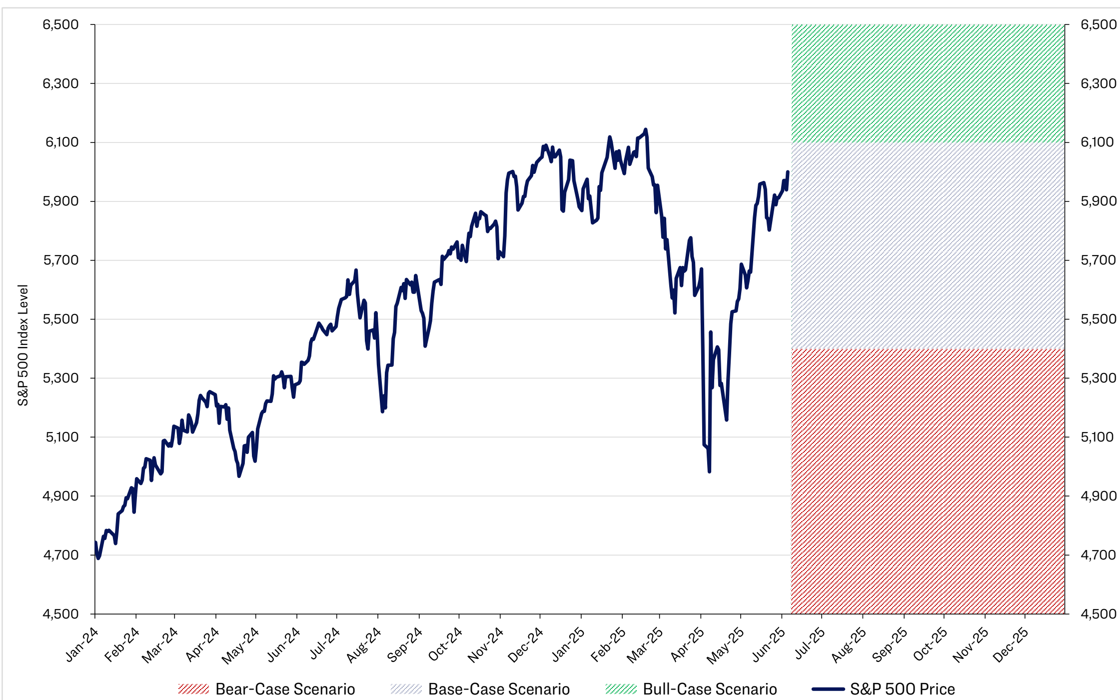
- Our **base-case scenario** assumes that realpolitik and court rulings are going to lead to a gradual stabilization of trade tensions, and the Trump administration will pivot toward a more market-friendly policy mix where tax cuts and deregulation are prioritized. **This scenario, in our view, would warrant small yet positive equity gains in H2, with recurring bouts of volatility** caused by policy noise and a few possible negative surprises from jobs and inflation data as the economy adjusts to what remains a sizeable policy shift since January 20. Bond yields would stabilize, removing a source of economic pressure, and gradually decline as this outcome may enable the Fed to begin to project more monetary policy accommodation.
- Our **bear-case scenario** assumes that economic fundamentals are going to buckle under the weight of what remains a significant policy adjustment for the U.S. and global economies. **In this scenario, equity prices would fall**, in line with prior recessions. Bond yields, which typically fall at the first hint of recession, could remain elevated in the near term due to the Fed’s holding pattern and fiscal sustainability concerns, contributing to an economic slowdown. Yields would begin declining only when weakness in hard data becomes evident.

- Our **bull-case scenario** assumes that trade tensions fade quickly, tax cuts stimulate the economy without causing fiscal sustainability concerns, and deregulation efforts take center stage. This environment could boost earnings expectations and justify a return of equity valuations to the cycle-highs touched in February 2025—and further boost earnings expectations—therefore **paving the way for more material equity upside in H2**. In this scenario, bond yields would remain elevated for the right reasons: strong productivity growth, higher rates of nominal and real gross domestic product (GDP) growth, and a higher neutral interest rate.[1]

As we outlined in our May Focus*Point* "Trade Tariffs Update: An ongoing balancing act," investor sentiment has fluctuated between our base-case and bear-case scenarios year to date (YTD) (Figure 1). The gradual decline in the U.S. effective tariff rate from ~27% immediately following April 2 to ~14% as of May 31, followed by the sharp recovery in equity prices (the YTD total return[2] for the S&P 500 was 3.4% as of June 12), has reduced the risk of a durable shift into a bear-case backdrop. However, our view is that a move into a bull-case environment would be premature, given the still significant policy shift facing households and businesses, lack of monetary policy support, and rising concerns about fiscal sustainability.

**FIGURE 1**

In our base-case scenario, U.S. equities may continue to trade within a range for the time being.




Source: Bloomberg, TIAA Wealth Chief Investment Office. Data through 6/6/2025.

[1]The neutral interest rate is the rate at which monetary policy is neither contractionary nor expansionary.
[2]The sum of the price change and dividends.

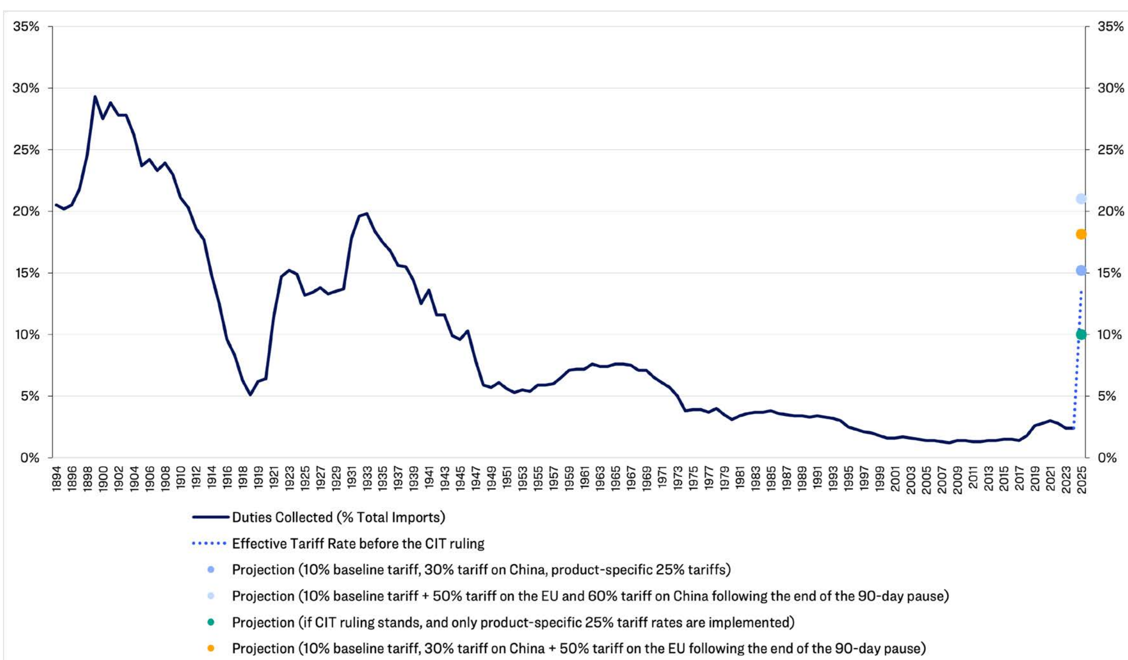
We expect financial markets to be driven by four themes over the next six months:

- **The ongoing implementation of the new high-tariff regime.** The May 28 ruling by the Court of International Trade (CIT) blocking most of President Trump's tariffs (all but the product-specific ones) opened a new front for the U.S. administration and is likely to lead to a Supreme Court ruling. While this legal setback introduces a potentially benign scenario for markets, it's important to note that tariff rates have been allowed to remain in place pending appeal, and the Trump administration can (and likely will) pursue other ways to implement what remains a top policy priority should the court order stand.

  As a result, U.S. trade policy and rhetoric may continue to shift frequently (Figure 2), with elevated uncertainty related to the likelihood of more product-specific tariffs (which alone could still lift the effective tariff rate to more than 10% of total imports), the relatively broad latitude at President Trump's disposal to reimpose tariffs through other authorities, future rulings by the court of appeals and potentially the Supreme Court, and the risk that impacts on corporate profit margins and households' purchasing power have yet to be fully felt (Figure 3).

**FIGURE 2**

The U.S. effective tariff rate could continue to fluctuate considerably.




Source: U.S. International Trade Commission, TIAA Wealth Chief Investment Office. Data through 5/29/2025.

**FIGURE 3**

## U.S. presidential authority on tariffs

| Presidential Authority on Tariffs* | Details | Investigation Required? | Requires Congressional Approval? |
|---|---|---|---|
| Section 122 of the Trade Act of 1974 | Authorizes the president of the United States to temporarily (150 days) increase tariffs on imports to as high as 15% on grounds of "significant balance-of-payments deficits." | No formal investigation required. | Congressional approval is required for an extension past 150 days. |
| Section 301 of the Trade Act of 1974 | Authorizes the U.S. government to address "unfair trade practices." No limit on the level or duration of these tariffs. | Yes, likely would take a few months. | No |
| Section 201 of the Trade Act of 1974 | Authorizes the U.S. president to impose tariffs (of up to 50% above the existing tariff rate) if the U.S. International Trade Commission finds that a surge in imports is threatening serious injury to a U.S. domestic industry. These tariffs are not meant to be permanent, and the statute requires that actions in place for longer than one year be phased down "at regular intervals." | Yes, results required within 180 days, and actions to be taken within 60 days. | No |
| Section 232 of the Trade Expansion Act of 1962 | Authorizes the U.S. president to impose tariffs on imports for national security reasons. Existing tariffs on autos, steel, and aluminum have already been imposed under this authority, and more investigations are ongoing. | Yes, likely would take a few months. | No |
| Section 338 of the Trade Act of 1930 | Authorizes the U.S. president to levy tariffs of up to 50% on imports from countries that are deemed to impose unreasonable charges or restrictions on U.S. goods. | No formal investigation required. | No |

*These authorities would likely put tariffs on more solid legal ground. However, they could still be challenged in court.

Source: TIAA Wealth Chief Investment Office.

**“Given the positive fiscal stimulus produced by this bill would likely not kick in until 2026, the main impact of fiscal policy on the U.S. economy over the next six months might be determined mostly by how bond yields react.”**

- **The ramifications of another multitrillion-dollar fiscal package.** Despite the administration’s apparent focus on cutting budget spending, daily Treasury data show budget outlays are higher by ~3% YTD through May 31 relative to the same period in 2024. As a result, the budget deficit remains stuck at 6.8% of GDP, a level that, if sustained, could undermine the U.S. fiscal position.

  As the GOP moves its budget bill through the reconciliation process,[3] policymakers are facing a challenging balancing act. Fiscal largesse could lead to growing fiscal sustainability concerns and higher bond yields (we estimate the current bill proposal would cause the budget deficit to average 6.9% of GDP over the next decade, and the public debt/GDP ratio to increase from 99% to at least 125%), while steep budget cuts (especially to spending categories like food stamps, Medicaid, and federal grants and contracts—with strong multiplication effects on the private sector) could more than offset any positive fiscal stimulus from tax cuts. We expect this tension to take time to resolve, given profound disagreements within House Republicans, and between House Republicans and Senate Republicans, on key items of the bill.

  Given the positive fiscal stimulus produced by this bill would likely not kick in until 2026, the main impact of fiscal policy on the U.S. economy over the next six months might be determined mostly by how bond yields react. The recent rise in the 10-year Treasury note term premium[4] and the U.S. rating downgrade by Moody’s (from Aaa to Aa1) in May are warning signs that fiscal sustainability concerns may be increasing, with potential negative implications for equity volatility and the U.S. dollar as well.

[3]It allows the Senate to forgo the 60-vote filibuster requirement, so the bill will not need Democrats’ support to pass.
[4]The extra compensation required to invest in long-maturity bonds rather than rolling over short-maturity bond holdings.

## Federal spending developments

At the start of 2025, optimism was high among politicians and many investors that the new administration would succeed where many others had failed: making meaningful progress in reducing federal spending; shrinking the size of federal agencies; and eliminating waste, fraud, and abuse in the federal government. The agency charged with this task—the Department of Government Efficiency (DOGE), led by Elon Musk—made headlines in the early days of the new Trump administration. It made recommendations to eliminate several government agencies and defund nongovernmental organizations, but ultimately fell far short of expectations from a spending perspective.

DOGE promised to find $2 trillion in savings (in a U.S. federal budget that included nearly $7 trillion in spending in fiscal year 2024) via job cuts, efficiencies, agency closures, and more. Although no official estimate exists, press reports put the actual savings from DOGE-related activities at closer to $100 billion, though more are likely to be realized later this fiscal year and next. In addition, DOGE activities led to a reduction of close to 250,000 federal workers (out of a total federal workforce of 2.4 million[5] and a U.S. workforce of 155 million) and the recommended closure of some U.S. government agencies, including the U.S. Department of Education (which would require congressional approval). Still, federal spending so far in fiscal year 2025 (which ends in September) is running ahead of last year.

Ultimately, the major drivers of the large and persistent U.S. budget deficits are demographics tied to entitlement programs like Medicare, Medicaid, and Social Security (for which benefits are set by law). The recently passed House budget bill did start to address the spending trajectory of Medicaid (which helps cover medical costs for some low-income people), but it didn't directly address Social Security or Medicare (federal health insurance for those age 65 and older). While DOGE attempted to address efficiency issues surrounding Social Security (payment systems, identifying potential fraud), it wasn't charged with solving the program's long-term sustainability—which still needs to be addressed by future Congresses or administrations.

According to the 2024 Old Age and Survivors Insurance Trust Fund report published in May 2024, the resulting projected fund (designated OASDI) would be able to pay 100% of total scheduled benefits until 2035—one year later than reported last year. At that time, the projected fund reserves will become depleted, and continuing total fund income will be sufficient to pay 83% of scheduled benefits.

[5]Excluding active-duty military and U.S. Postal Service employees.

**"Our view is that the Fed's reaction function remains asymmetrically biased toward cutting interest rates if the unemployment rate rises, with the bar to resuming rate hikes set extremely high (a significant and durable rise in long-term inflation expectations would be required)."**

- **How quickly and effectively deregulation happens.** All signs point to an acceleration in deregulatory efforts in the second half of the year, with federal agencies mandated to identify regulations that are unconstitutional or unlawful for elimination or modification. While some sectors (chiefly, energy and banking) might see faster progress, widespread economic benefits would require a broader deregulatory push. U.S. businesses with fewer than 100 employees face regulatory costs equal to ~5%[6] of total revenue (including 3% from economic regulations and 1% from environmental rules), with some sectors facing a heavier burden (~11% for manufacturing). Cutting these costs could therefore buffer the negative impact of tariffs on profit margins over the short term and boost productivity over the long term.
- **What role the Fed decides to play.** The Fed sees both upside risks to its price stability mandate and downside risks to its full employment mandate. This tension is challenging their ability to ease monetary policy before gaining a better understanding of the full impact of government policies on inflation and the labor market. Our view is that the Fed's reaction function remains asymmetrically biased toward cutting interest rates if the unemployment rate rises, with the bar to resuming rate hikes set extremely high (a significant and durable rise in long-term inflation expectations would be required). That said, it will be crucial to assess how quickly the Fed will respond if economic fundamentals weaken, with rising risks that monetary policy support might be delayed if higher inflation and softer jobs data materialize at the same time.

Against this backdrop, key economic fundamentals still appear resilient.

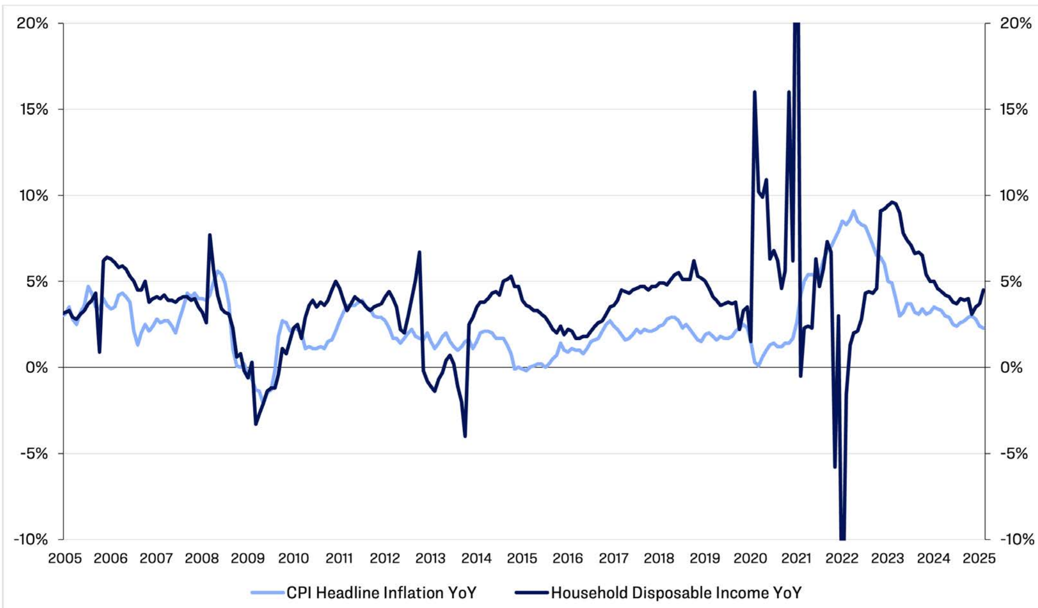
- Labor market conditions have softened but remain healthy and far from levels we would view as consistent with a recession. This supports nominal and inflation-adjusted income growth for now (Figure 4). That said, the Bureau of Labor Statistics' Jobs Openings and Labor Turnover Survey (JOLTS) points to falling hiring and voluntary quit rates, suggesting that while layoffs remain contained, labor market conditions have cooled.

[6]Estimated by TIAA Wealth Chief Investment Office, based on data from the National Association of Manufacturers and the Census Bureau.

- The positive wealth effect supporting household consumption remains intact. Market volatility represents a risk, especially for higher-income consumers (top 20% by income distribution) who account for 40% of total household spending and have 36% of their net worth invested in stocks (relative to 13% for the bottom 80% of households).
- Corporate earnings are still expected to grow 7% in 2025 and 13% in 2026, driven by continued strength in artificial intelligence (AI).
- Businesses still enjoy solid balance sheet fundamentals, with leverage and liquidity metrics stronger on average than in 2019.

**FIGURE 4**

Household income growth continues to outpace consumer price inflation.




Source: U.S. Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, TIAA Wealth Chief Investment Office. Data through 4/30/2025.

However, many data points have been subject to increased distortions (mostly caused by trade tariffs), and areas of vulnerability exist. We're keeping a close eye on:

- Rising credit delinquencies—with a spike in the student loan delinquency rate in Q1 2025 following the end of payment moratoria—suggest that a growing share of U.S. households face mounting pressure from debt burdens.

- Bank lending standards tightened again in the three months ending in April, suggesting that credit availability remains selective. Small businesses are more vulnerable to this dynamic than large businesses.
- Business and consumer confidence has returned to levels that, historically, would portend impending weakness in economic fundamentals. Household concerns aren't limited to price affordability like they were in 2022, as employment and income expectations are also beginning to sour.
- Inflation may once again rise over the next few months, while interest rates remain elevated at a time of moderating economic growth, thereby representing additional headwinds for consumers and businesses.

As we discussed in our recent Focus*Point*, we're monitoring a long list of high-frequency indicators to assess how economic fundamentals are reacting to elevated uncertainty. Weekly initial jobless claims, the term premium (the extra yield investors get for holding longer-term bonds), corporate earnings expectations, weekly retail sales, income growth, and credit spreads are some of the most important.

We see markets anchored around our base-case scenario, but with risks that ongoing trade and fiscal policy uncertainty could eventually weigh on economic fundamentals, bringing the bear-case scenario back to the fore. On the other hand, a shift into a bull-case scenario could be premature, in our view, until uncertainty fades and the government and monetary policy mix turns more decisively pro-growth (Figure 5).

As a result, we reaffirm our neutral tactical view (relative to Strategic Asset Allocation, or SAA) within equities as we wait for more data to assess the balance of risks. Within fixed income, we continue to be overweight higher-quality investment-grade bonds and underweight riskier U.S. high-yield and emerging market bonds (relative to SAA), to better protect portfolios against a more adverse economic scenario.

**FIGURE 5**

## Key economic drivers and how they may play out in our base-case, bear-case, and bull-case scenarios during H2 2025.

| Scenarios | Base Case | Bear Case | Bull Case |
|---|---|---|---|
| **Government Policy** | Trade tensions gradually stabilize, and the Trump administration pivots toward more market-friendly policies like tax cuts and deregulation. | The effective tariff rate remains at or above 15%, with ongoing uncertainty related to frequent changes by President Trump. In addition, the pivot toward fiscal policy causes more volatility, as either unfunded tax cuts accelerate fiscal sustainability concerns, or deep budget cuts exacerbate the economic slowdown. | President Trump recognizes the economic and political challenges brought about by his tariff push and decides to pause or reverse most tariffs, citing the kickoff of several trade negotiations as enough of a win for now. Tax cuts are implemented in a fiscally prudent way, and deregulation efforts accelerate. |
| **Economic Growth** | Income growth and therefore household consumption slow down only marginally from above-trend levels, in line with cooler but still healthy labor market conditions. Deregulation adds another tailwind to productivity growth. | The combination of a rapid deceleration in income growth and rising inflation dents consumer confidence and spending, the unemployment rate rises, and short-term productivity growth falls as business investments slow down. | Income growth and therefore household consumption continue to run above-trend thanks to a rebound in labor market conditions, and wage growth reaccelerates. Deregulation adds another tailwind to productivity growth. |
| **Inflation** | A less adverse tariff scenario limits the inflationary impact and its duration, allowing price inflation to resume its normalization later in the year. | Aggressive trade tariffs lift goods prices for households and businesses. However, higher prices cause a drop in household spending and corporate profit margins. As a result, weaker demand offsets the tariff-induced price increases after the initial spike. | Despite strong spending and wage growth, productivity growth minimizes the inflationary impact of elevated consumer demand and higher labor costs. |
| **Monetary Policy** | The Federal Reserve resumes cutting interest rates once inflation concerns subside. | The Fed faces a very challenging combination of rising prices as a result of tariffs and rising unemployment as a result of business uncertainty and falling profit margins. It cuts rates slowly at first but then has to ease aggressively to stimulate weak economic and labor market conditions. | The Fed establishes that the "neutral" rate is between 3.5% and 4% and only cuts rates a few more times, as the economy has entered a new phase and is able to generate solid growth at higher interest rate levels relative to the post-2008 decade. |
| **Cross-asset Implications** | In this scenario, we would expect small yet positive equity gains in H2 25, with recurring bouts of volatility caused by policy noise and a few possible negative surprises from jobs and inflation data as the economy adjusts to what remains a sizeable policy shift since January 20. Bond yields would stabilize, removing a source of economic pressure. | In this scenario, we would expect corporate earnings and therefore equity prices to face more downside, in line with prior recessions. Bond yields could remain elevated in the near term due to the Fed's holding pattern and fiscal sustainability concerns, contributing to an economic slowdown. Yields would begin declining only when weakness in hard data becomes evident. | This environment could justify a return of equity valuations to the cycle-highs touched in February 2025 and further boost earnings expectations, therefore paving the way for more material equity upside in H2. Bond yields would remain elevated for the right reasons: strong productivity growth, higher rates of nominal and real Gross Domestic Product (GDP) growth, and a higher neutral interest rate. |

Source: TIAA Wealth Chief Investment Office

# EQUITY OUTLOOK

**“The S&P 500’s trajectory in the second half of 2025 will be heavily influenced by the persistence and scope of tariffs, retaliatory trade measures, and their ripple effects on economic growth, inflation, and corporate earnings.”**

Investors, consumers, and corporations are all wrestling with economic uncertainty. The S&P 500’s trajectory in the second half of 2025 will be heavily influenced by the persistence and scope of tariffs, retaliatory trade measures, and their ripple effects on economic growth, inflation, and corporate earnings. Although earnings growth for the S&P 500 has not seen significant deterioration, growth was slowing prior to the tariff announcement on April 2 (“Liberation Day”). Further complicating the equity outlook is the paralysis in monetary policy, as the Fed remains in wait-and-see mode due to inflation concerns.

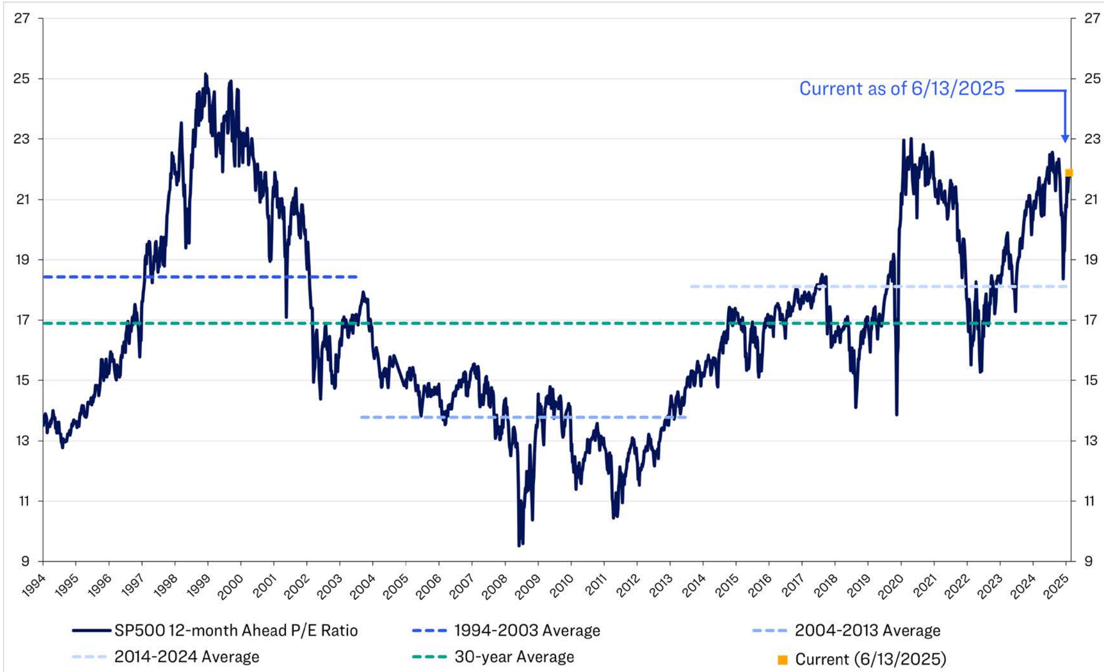
While the market hasn’t succumbed to outright gloom—many investors still view Trump’s tariffs as a negotiating tactic—tariff turmoil has created periods of exaggerated short-term volatility as investors adjust their views on the outlook in a much more bimodal world. More specifically, the increase in tariff levels (in their original form) would be the largest in over a century and would undoubtedly lead to a transitory bout of inflation that could slow 2025 – 26 U.S. GDP by ~1%. Given the on-again/off-again nature of the administration’s tariff plans, it’s proving extremely difficult for the market to anticipate the ultimate outcome. While tariff fallout has thus far been minimal, we expect it to become more pronounced should store shelves become sparse or prices start to move higher.

The crackdown at the U.S. southern border is injecting more uncertainty into an already complex situation. With new immigrants accounting for roughly half of incremental demand for apartments in recent years, the drop in border crossings will likely keep rent inflation in check this year and next. Lower rent inflation should counteract higher goods prices and contain the consumer price index (CPI). Conversely, lower immigration may put upward pressure on lower-end wages, thus putting upward pressure on prices.

Equity prices for the AI-related large cap technology companies began drifting lower in January with the introduction of China’s more affordable DeepSeek-R1 model. The rest of the S&P 500 followed suit on April 2 (Figure 6). While Q1 25 earnings largely assuaged fears that tech/AI was decelerating (the planned and highly publicized AI capital expenditures from Microsoft, Meta, Alphabet, and Amazon are just now starting to ramp up), the consumer has begun to moderate their spending, especially at the lower end. Consumers are eating out less, and retailers report shoppers across the socioeconomic spectrum are trading down to lower-cost substitutes.

**FIGURE 6**

## The S&P 500's P/E ratio moved toward the 30-year average in April but has since climbed higher.




Source: Bloomberg, TIAA Wealth Chief Investment Office. Data through 6/13/2025.

There's evidence of a buyer's strike in the residential real estate sector as homebuyers refuse to pay cycle-high prices and 7% mortgage rates. The universe of potential buyers has therefore decreased as rates have increased. Approximately 50 million Americans qualified for a mortgage on a $400,000 home when mortgage rates were at 3%, but this number dropped to just 20 million at 7%.

The S&P 500 is likely to face continued volatility in the second half of 2025 unless tariff tensions ease considerably. If the U.S. economy does succumb to the combination of higher tariffs and rising long-term interest rates, defensive sectors like health care, consumer staples, and utilities could be poised to outperform due to their domestic focus and stable demand, while the consumer discretionary, semiconductors, industrials, and materials sectors are likely to underperform due to tariff-related cost pressures and global trade disruptions.

# FIXED INCOME OUTLOOK

## Taxable fixed income outlook

Policy uncertainty weighed on taxable fixed income markets during the first half of the year as volatility increased and valuations fluctuated in a broad range—a trend that's expected to continue through the second half of the year. Tariff policy uncertainty has affected the outlook for the Fed and monetary policy. The Trump administration's broad-based tariff proposals, and subsequent changes and delays, have led to distortions in economic data, a pull forward of some economic activity by businesses and consumers, and a trimming of economic and earnings growth estimates for 2025 by Wall Street. The Fed paused the rate-cutting cycle and will remain in a data-dependent "wait and see" mode until there's further clarity on tariff policy and the effects it may have on inflation and employment. Treasury yields have experienced sizeable moves in both directions and will likely continue to fluctuate going forward as investor expectations adapt to multiple potential outcomes for the economy (Figure 7).

**FIGURE 7**

The 10-year Treasury yield has experienced significant moves in both directions over the last 12 months.


Source: Bloomberg, TIAA Wealth Chief Investment Office. Data through 5/29/2025.

Investment-grade corporate bonds began the year near multidecade rich valuations, briefly came under pressure after the initial tariff proposals, then retraced most of the entire move. Credit investors continue to be encouraged by solid corporate earnings and elevated all-in yields, with current spread levels (the yield premium over similar maturing Treasury securities) discounting most of the potential effects of tariffs on the economy and corporate earnings. Corporate bonds will likely come under some fundamental and technical pressures during the second half of the year. The impacts will be seen mainly in the form of higher input costs and whether companies choose to pass those costs along to the consumer or take the hit to their profit margins.

Fortunately, for investment-grade companies, credit metrics appear solid enough to largely cushion potential cost increases or a general growth slowdown. But bond valuations may still be impacted under such a scenario. While demand from investors seeking yield may continue to support the credit markets, barring a more dire trajectory for the economy, the balance of risks remains asymmetric to the downside at current levels.

## Tax-exempt fixed income outlook

Municipal bonds delivered mixed results through the first half of 2025, as a complex macroeconomic backdrop and an evolving technical landscape presented navigational challenges. Looking ahead to the second half of the year, the municipal market is likely to be shaped by four main factors: ongoing macro uncertainty, developments in tax policy, interest rate volatility, and a more supportive technical backdrop.

The Fed remains cautious amid trade-related uncertainties and shifting global growth expectations. Although inflation has moderated, unclear policy signals and ongoing trade negotiations complicate the Fed's path forward. A near-term rate cut seems unlikely, and we anticipate continued interest rate volatility as markets react to incoming data and headlines.

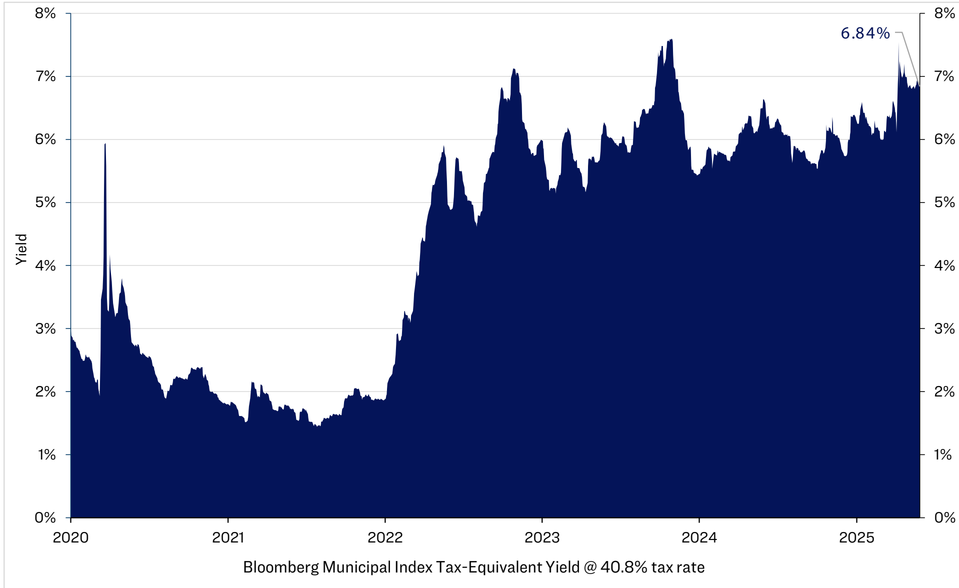
**"Although inflation has moderated, unclear policy signals and ongoing trade negotiations complicate the Fed's path forward. A near-term rate cut seems unlikely, and we anticipate continued interest rate volatility as markets react to incoming data and headlines."**

Tax policy remains a significant consideration for municipal bond investors. Concerns about the potential impairment or elimination of the tax exemption on municipal interest have eased since the House passed the Trump administration's "One Big Beautiful Bill Act," which didn't include any of the feared changes to the tax treatment of municipal bonds. While this development reduces headline risk, the legislative process remains fluid. With a narrow congressional majority and ongoing negotiations over the broader fiscal agenda, some uncertainty persists. For now, the outlook appears favorable, with no immediate threat to the tax exemption, but investors should stay alert to any shifts in fiscal negotiations and potential future tax reforms.

The municipal market is well-positioned heading into the second half of the year. Seasonal patterns, including reduced issuance and elevated reinvestment demand during the summer months, are expected to drive near-term market performance. Unlike the first half of the year, when issuers accelerated bond issuance amid concerns over potential tax law changes, those risks have since diminished. Supply is expected to moderate in H2, which could be good for municipal bond prices. Meanwhile, reinvestment demand from high levels of bond maturities and redemptions should provide additional support for the asset class. With interest rates near multiyear highs and municipals currently offering compelling after-tax yields compared to taxable alternatives, near-term valuations remain attractive. Given these conditions, municipal bonds present an appealing option for those seeking stable, tax-efficient income (Figure 8).

**FIGURE 8**

Municipal bonds have become more attractive, with tax-equivalent yields reaching 7%.




Source: Bloomberg, TIAA Wealth Chief Investment Office. Data through 5/28/2025.

Credit fundamentals remain stable across much of the municipal landscape. Most state and local governments continue to report stable revenue collections and maintain healthy budget reserves. We do, however, expect some risks to persist—particularly if trade-related economic headwinds worsen or if federal support for programs like Medicaid, FEMA, or education is reduced. Despite these challenges, municipal credit spreads have stayed within a narrow range and are likely to remain stable barring a broader economic downturn.

As we move through the second half of 2025, we expect episodic volatility to create tactical opportunities. Municipal bonds continue to offer an attractive blend of income, stability, and tax efficiency amid a volatile and uncertain market environment. Against this backdrop, investors should remain disciplined and attentive to market dynamics and consider selectively increasing exposure to high-quality issuers with strong fundamentals.

# POLITICAL AND GEOPOLITICAL THEMES FOR THE SECOND HALF OF 2025

Last year, roughly 70 countries held political elections in what was a defining stretch for global geopolitics. Issues that were top of mind for voters last year—and continue to drive geopolitical developments in 2025—include economic and strategic fragmentation and decoupling (accelerated by President Trump's trade tariffs), regional wars (still raging despite recurring hopes for ceasefires), and rising income inequality (driven by declining price affordability), which is fueling widespread discontent.

Despite the ongoing human tragedy, the Russia/Ukraine and Israel/Palestine hotspots have had very little impact on financial markets so far in 2025. We expect this to remain the case for the remainder of the year. That said, there are three geopolitical fronts we are monitoring closely that may have material ramifications for financial markets: ongoing trade and tariff negotiations, rising risks of a prolonged conflict between Israel and Iran, and escalating tensions between Taiwan and China (lower near-term probability).

- Trade tariffs straddle the macroeconomic and geopolitical realms. Besides the economic repercussions, trade tariffs are also contributing to escalating tensions between the United States and its strategic allies and adversaries alike. This is prompting Western countries to rethink the commitment of the United States to long-standing alliances. It's accelerating the fragmentation of the global economy into regional or strategic blocs. The role of the U.S. dollar as the global reserve currency and the participation of foreign investors in U.S. markets (including and most importantly the U.S. Treasury market) have therefore come into the crosshairs, with some potential long-term implications.
- On June 21, the U.S. military bombed several targets in Iran with the aim of disabling its nuclear capabilities. The airstrikes came in the wake of escalating tensions between Israel and Iran, which saw the two nations exchange long range ballistic missiles over the prior 7 days. While, historically, regional conflicts and geopolitical shocks have at times had significant yet generally short-lived impacts on market volatility, there are also examples where a sharp rise in oil prices exacerbated an already fragile economic and market backdrop. As a result, developments on this front will be important to watch for global investors, especially if other countries get involved militarily and the supply of petroleum products is impaired.
- Finally, while the risk of an imminent military confrontation between China and Taiwan seems low, increased U.S. economic and technological protectionism might play a key role in informing China's approach and timing. A war between China and Taiwan is the biggest geopolitical wild card for investors, especially given Taiwan's centrality in the semiconductor ecosystem (more than 60% of global production).

## Contributing Authors


**Niladri 'Neel' Mukherjee**
Chief Investment Officer

**John J. Canally Jr., CFA**
Chief Portfolio Strategist

**Alberto Favalli-Ragusini**
Director, Investment Strategist

**Robert Marshall**
Managing Director, Equity Portfolio Management

**Bryan White, CFA**
Director, Fixed Income Portfolio Management

**Jill Richman**
Sr. Director, Fixed Income Portfolio Management

**Ali Dellinger**
Director, Wealth CIO Communications

**John Greene**
Manager, Investment Content


## IMPORTANT DISCLOSURES

This material is for informational or educational purposes only and is not fiduciary investment advice, or a securities, investment strategy, or insurance product recommendation. This material does not consider an individual's own objectives or circumstances which should be the basis of any investment decision. The views expressed are based on information obtained from sources believed to be reliable, but not guaranteed. The information and opinions presented are current only as of the date of writing, without regard to the date on which you may access this information. All opinions and estimates are subject to change at any time without notice. This material does not take into account any specific objectives or circumstances of any particular investor or suggest any specific course of action. It is not an offer to buy or sell any securities or investment services. Investment decisions should be made based on the investor's own objectives and circumstances. Examples included herein, if any, are hypothetical and for illustrative purposes only.

Optional discretionary investment management services for a fee are provided through two separate managed account programs by TIAA affiliates: the Portfolio Advisor program offered by the Advice and Planning Services division of TIAA-CREF Individual & Institutional Services, LLC ("Advice and Planning Services"), a broker-dealer (member FINRA/SIPC), and SEC registered investment adviser; and the Private Asset Management program offered by TIAA Trust, N.A. Please refer to the disclosure documents for the Portfolio Advisor and Private Asset Management programs for more information. TIAA Trust, N.A. provides investment management, custody and trust services. Advice and Planning Services provides brokerage and investment advisory services for a fee. Investment Management Group (IMG) is the investment management division of TIAA Trust, N.A., and provides the underlying investment management services to the Portfolio Advisor and Private Asset Management programs. TIAA Trust, N.A. and Advice and Planning Services are affiliates, and wholly owned subsidiaries of Teachers Insurance and Annuity Association of America (TIAA). Each entity is solely responsible for its own financial condition and contractual obligations.

**The TIAA group of companies does not provide tax or legal advice. Tax and other laws are subject to change, either prospectively or retroactively. Individuals should consult with a qualified independent tax advisor and/or attorney for specific advice based on the individual's personal circumstances.**

All investments involve some degree of risk, including loss of principal. Investment objectives may not be met. Investments in managed accounts should be considered in view of a larger, more diversified investment portfolio.

**ASSET ALLOCATION AND DIVERSIFICATION ARE TECHNIQUES TO HELP REDUCE RISK. THERE IS NO GUARANTEE THAT ASSET ALLOCATION OR DIVERSIFICATION ENSURES PROFIT OR PROTECTS AGAINST LOSS.**

**Past performance is no guarantee of future results.**

Investing involves risk and the value of your investments may gain or lose value and fluctuate over time. Generally, among asset classes stocks are more volatile than bonds or short-term instruments and can decline significantly in response to adverse issuer, political, regulatory, market, or economic developments. Although the bond market is also volatile, lower-quality debt securities including leveraged loans generally offer higher yields compared to investment grade securities, but also involve greater risk of default or price changes. Foreign markets can be more volatile than U.S. markets due to increased risks of adverse issuer, political, market or economic developments, all of which are magnified in emerging markets. Foreign securities are subject to special risks, including currency fluctuation and political and economic instability.

**INVESTMENT, INSURANCE AND ANNUITY PRODUCTS ARE NOT FDIC INSURED, ARE NOT BANK GUARANTEED, ARE NOT DEPOSITS, ARE NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY, ARE NOT A CONDITION TO ANY BANKING SERVICE OR ACTIVITY, AND MAY LOSE VALUE.**

Investment Management Group, TIAA Trust, N.A.



4606293

TIAA Wealth Management

CIO PERSPECTIVES