Monthly Newsletter

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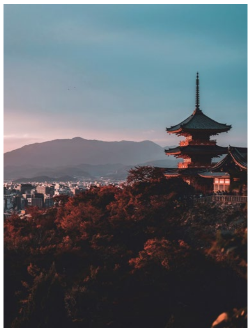

ADAPTING TO FUNDAMENTAL SHIFTS SHAPING BOND INVESTING

Surveying the Fixed-Income Landscape

The U.S. bond market declined 0.7% in May with Treasury securities posting their first negative month of 2025. While headlines focused on tariff turbulence, fiscal policy uncertainty and Moody's credit rating downgrade, the underlying story reveals markets adapting to fundamental shifts that may reshape bond investing for years to come.

Resilience Through Volatility

The sweeping tariff announcements in early April triggered significant bond market volatility. By late May, 30-year Treasury bonds were yielding above 5% for the first time since 2023, though they began declining moderately in recent weeks.

But despite the downgrade and uncertainty, the Treasury market continues to be a destination for capital during periods of global and domestic stress. The U.S. remains highly rated (Aa1/AA+) and has the confidence of investors who can move large amounts of capital both into and out of the market with relative ease—so it's still a destination for investors seeking quality and liquidity. In our view, any immediate weakness in the aftermath of the downgrade has more to do with other headlines (budget, deficits, tariffs) than a deep-rooted concern that Treasury bonds will miss either a principal or interest payment.

Judging by the market's response, it appears as though some investors shrugged off the downgrade, in part because it was neither surprising nor revelatory. We don't shrug when a bond issuer in our portfolios is downgraded, but we do continue to feel very comfortable and confident in our Treasury allocations and the purpose they serve in a portfolio.

The Policy Uncertainty Premium

Much of the recent rise in longer-term Treasury yields reflects an elevated "term premium"—the extra compensation investors demand for the level of risk over the life of a bond. This premium has reached decade highs, signaling genuine market concern about fiscal and trade policy trajectories.

The Trump administration's proposed tax legislation could expand deficits by $3 trillion to $4 trillion over the next decade, while tariff policy remains fluid with average effective rates potentially rising into the high teens. This uncertainty supports our expectation of a steeper yield curve, with long-term yields remaining elevated relative to short-term rates.

The U.S. is averaging over 100,000 new jobs created every month. Combined with an inflation rate above the Fed's 2% target, we believe the central bankers will keep rates steady throughout the summer. That said, consumer inflation expectations have risen—if those expectations become reality, it could constrain the Fed's policymaking ability.

A Treasury Dynamic Worth Watching: Japan's Structural Challenge

While broad fixed-income opportunities have improved, one development in Treasury markets warrants close attention: Japan's growing need to reduce its $1.1 trillion Treasury position—the largest foreign holding of U.S. government debt.

Japan's policymakers are under pressure to get their financial house in better order. Government debt at 235% of GDP combined with an aging population requiring domestic savings for retirement could disrupt the status quo. Rising interest rates in Japan could lead to a repatriation of assets out of Treasurys and into Japan's sovereign bond market.

How did Japan's Treasury position get so large? Over four decades, Japan has quietly recycled trade surpluses into Treasury purchases, effectively subsidizing American consumption. This arrangement helped both economies but created structural dependencies that are now unwinding.

We began to see this in August 2024, when the Bank of Japan (BoJ) raised interest rates and strengthened the yen against the dollar. Uncertainty arose over the "yen carry trade," a longstanding practice of investors borrowing the lower-interest-rate yen to make investments in high-yielding assets abroad. If the BoJ continues tightening and the yen strengthens further (it's increased nearly 8% in value against the dollar this year), we could see this strategy become less advantageous for investors.

This could result in higher rates in the Treasury market (and worldwide), which would raise borrowing costs for businesses and individuals, an obstacle to economic growth. It could also be a headwind for U.S. tech companies that have benefited from the yen carry trade.

The big question is if there will be a tipping point when investors dump Treasurys for Japanese government bonds en masse, causing yields to spike suddenly, or if it will be a slower process that gives markets and investors time to adjust. We are keeping a close eye on this dynamic and will adjust portfolios as necessary.

Current Opportunities Across Fixed Income

Despite volatility concerns, the broad fixed-income landscape has become fundamentally more attractive. Treasury yields around 4% to 5% now provide meaningful returns above inflation—a dramatic improvement from the zero-interest-rate era. The Bloomberg U.S. Aggregate Bond Index remains positive year-to-date, with the income generated by those higher yields offsetting price declines across sectors.

Investment-grade corporate bonds offer yields in the 5.2% range, while high-yield corporates provide approximately 7.5%—levels that could generate positive real returns over intermediate horizons. Municipal bonds present particularly compelling opportunities for higher-tax-bracket investors, with taxable-equivalent yields (TEY) of 5.40% to 5.59% for the top two federal brackets significantly exceeding comparable investment-grade alternatives. And when you factor in exemptions from state taxes (where applicable), that advantage grows even larger. For example, in Massachusetts, the home of RWA's headquarters, the TEY ranges from 6.34% to 6.59%. In comparison, Apple bonds (Aaa/AA+) were trading around 4.87% at month-end.

We focus on short- and intermediate-maturity bonds as a general rule, given our belief that fixed income should function as a store of wealth for capital preservation and liquidity purposes in a portfolio. Considering the yields available, we urge clients to review their cash: Is yours accumulating in a bank account? Is it invested in certificates of deposit that are set to roll over into less attractive rates? Now could be a great time to add to your short- and intermediate-term bond portfolio and lock in higher yields, making your cash work harder for you.

Managing the Transition

We're witnessing a fundamental shift from the extraordinary monetary policy support of the post-2008 period toward more market-driven pricing mechanisms. While this creates near-term volatility, it ultimately strengthens the investment case by restoring normal risk-return relationships.

The Treasury market is proving adaptable to these changes. April's stress test demonstrated that enhanced market infrastructure and Fed implementation tools can maintain order even during significant volatility. The real question isn't whether Treasury markets will remain volatile—they likely will—but whether current yield levels adequately compensate for these risks.

The evidence suggests they do. Real yields significantly above the pace of inflation restore the benefits investors historically receive for holding government debt. For clients seeking to balance income generation with portfolio stability, the current fixed-income environment offers opportunities not available since before the financial crisis in 2008. From Treasury securities to corporate bonds to municipal debt, yield levels now provide meaningful compensation for risk. The key is positioning appropriately across sectors for both the income benefits and the transition risks ahead while monitoring structural developments like Japan's potential Treasury reallocation. We'll continue to do just that.

STARTER CAREER SAVINGS ADVICE

Turning Early Earnings Into a Bright Financial Future

Young people across the country are taking on their first jobs. Do you remember your early work experiences? Did you mow lawns, lifeguard at the local pool or intern at a friend's business? If you're enjoying retirement and the fruits of a lifetime of discipline, these memories are more than nostalgia. They are a reminder of the first lessons in earning, saving and investing that shaped your journey to financial independence.

Today, you have a unique opportunity to help the next generation learn these lessons. You can help lay the foundation for their own financial security. With the benefit of experience and the resources to make a difference, you can guide your children and grandchildren as they take their first steps into the world of work and savings.

In this article, we'll explore practical strategies to help young people get started. And we'll place a special focus on how you can use your influence and support to give them a true head start.

Why Early Savings Matter

One of the most powerful lessons you can impart to young people is the value of starting early. Compounding is the process by which investment returns generate their own returns. And it offers enormous rewards to those who begin saving and investing as soon as possible. Even modest sums, when given decades to grow, can become meaningful amounts.

Consider this: If a 16-year-old saves $2,000 from a summer job and invests it in a Roth IRA, assuming a 7% annual return, that single contribution could grow to over $30,000 by age 65. If they make similar contributions for five summers, the total could exceed $150,000. The earlier they start, the greater the impact, which is something we've seen play out in the portfolios we manage over the years.

IRAs for Young Earners

Many young people working summer jobs or starting their careers are eligible to contribute to an IRA, even if their earnings are modest. For most, a Roth IRA is a good choice because contributions are made with after-tax dollars and qualified withdrawals in retirement are tax-free. This could be helpful for young workers, whose current tax rates are likely lower than they will be later in life.

How You Can Help

You can gift or match your child or grandchild's earned income up to the annual IRA contribution limit (currently $7,000 for those under 50 in 2025). So if they earn $3,000 this year, that's the maximum that can be invested in an IRA. The funds do not have to come from the young person's own pocket—you can provide the cash for the contribution instead.

Consider making this an annual tradition, matching summer job earnings with a Roth IRA contribution each year.

And here's why Roth IRAs are so powerful for young savers:

- Contributions can be withdrawn at any time, tax- and penalty-free, offering flexibility if funds are needed for education or a first home.
- Investment growth is never taxed if withdrawn properly in retirement.
- Starting early allows decades of tax-free compounding.

Other Savings Strategies for Young People

While IRAs are a powerful tool, they are not the only way to help young family members build good habits and financial security. Here are three more strategies:

- **Custodial accounts (UGMA/UTMA):** These accounts allow you to gift assets to a minor, who gains control at the age of majority. While not as tax-advantaged as IRAs, they are flexible and can be used for a variety of purposes.
- **529 college savings plans:** If higher education is a goal, consider directing summer job earnings or matching gifts into a 529 plan. These accounts offer tax-free growth when used for qualified education expenses.
- **Savings challenges:** Encourage young people to set aside a portion of each paycheck and deposit this money into a high-yield savings account. Matching their savings can provide extra motivation.

Pairing With Other Estate Planning Techniques

Parents and grandparents may also use estate planning techniques to help younger generations start off right. For example, while not typically a primary savings vehicle for young people themselves, Crummey trusts can be a valuable tool for parents or grandparents to gift assets to minors while taking advantage of the annual gift tax exclusion. You might also consider directly paying education or medical expenses.

If you're using these tools, we encourage you to make your child or grandchild aware of how you're saving on their behalf as soon as you feel the time is right. More often than not, these conversations are motivational and can help fuel a young person's sense of personal responsibility, encouraging them to take the lead on investing in their future.

This can also set the table for conversations around asset allocation, planning and taxes, with you and your advisor as guides. You can help answer questions like "Should my custodial account or my Crummey trust have a more aggressive asset allocation?" and "When I need cash, which is the best account to take it from based on income or estate tax considerations or creditor protection?"

These conversations can be eye-opening and help demystify family wealth, making it more tangible in a way that's manageable for a young person starting out in life. While receiving a surprise trust in one's 30s would hardly ever be considered a bad thing, the ability to plan ahead is arguably more valuable. Financial literacy can help your child or grandchild navigate down payments, saving for retirement, career changes and anything else that might come their way.

Teaching the Habits That Last a Lifetime

While the mechanics of opening an account and contributing are important, the most valuable gift you can give is the wisdom of experience. Talk to your children and grandchildren about:

- The importance of living within their means
- The difference between saving and investing
- The value of patience and long-term thinking
- The lessons you learned from your own successes and mistakes

Many clients find that sharing stories, rather than giving advice, is the most effective way to inspire good habits. Invite your child or grandchild to join you for a conversation about investing or offer to review their first pay stub with them. These moments can become cherished memories and lasting lessons.

Five Steps To Make It Happen

If you'd like to help a child or grandchild open their first IRA or savings account, here's how to get started:

1. **Confirm earned income:** The young person must have taxable earned income (from a job, not from investments or gifts) to contribute to an IRA.
2. **Choose the right account:** For most, a Roth IRA is the best choice. Many custodians offer accounts specifically for minors, and these are managed by an adult until the beneficiary reaches age 18 or 21.
3. **Fund the account:** You can provide the funds for the contribution, up to the amount of the young person's earned income or the annual limit, whichever is less.
4. **Select investments:** Help choose a diversified, low-cost investment such as a total market index fund.
5. **Celebrate the milestone:** Mark the occasion with a family dinner or a handwritten note. Recognize the young person's achievement and reinforce the importance of what they've started.

Your Legacy Is More Than Dollars

We believe that wealth is about more than financial security. It's about purpose, meaning and the impact you have on those you love. Helping the next generation learn to save and invest is one of the most enduring gifts you can give. It's a way to pass on not just assets but the values and habits that have served you well.

If you'd like to discuss strategies for supporting your children or grandchildren, or if you have questions about IRAs, 529 plans, or other savings tools, please reach out to your advisor. We're here to help you make the most of every season, and we're ready to help your family do the same.

UNDERSTANDING ECONOMIC TRENDS

What Q1 GDP Is Telling Us About the Possibility of Recession

When U.S. GDP contracted by 0.3% over the first three months of the year, the specter of recession cast a shadow over the economic conversation. But is this really a signal of weakening growth or just a quirk of how GDP is calculated? The answer lies in understanding what GDP actually measures—and why a surge in imports ahead of potential tariffs created this temporary headwind.

GDP measures domestic production using a simple formula: GDP = C + G + I + NX, where C is consumer spending, G is government spending, I is business investment and NX is net exports (exports minus imports). The reason imports are subtracted from this calculation is because they represent foreign production, not domestic output. When you buy an imported smartphone, that purchase doesn't reflect American economic production—it reflects production that happened elsewhere.

This helps explain what happened in early 2025. Anticipating new tariffs from the Trump administration, importers rushed to bring in goods before potential price increases could take effect. Imports surged 10% in January alone, with particularly large increases in pharmaceuticals, medical products, computers and electronic components. Since imports subtract from GDP, this buying spree created an immediate drag on first-quarter growth, even though the underlying economy remains healthy.

But here's where the story gets more interesting: Those same imported goods that hurt GDP in the short term could boost other parts of the calculation once they're sold or put to use. The computers and electronic parts flowing into data centers show up as business investment. The pharmaceuticals and consumer goods hitting store shelves drive consumer spending. Both these components add to GDP, creating a positive offset that plays out over subsequent quarters.

This dynamic illustrates why single-quarter GDP numbers can be misleading. The Bureau of Economic Analysis noted that "real final sales to private domestic purchasers"—essentially consumer spending plus business investment—grew 3.0% in Q1, suggesting the underlying economy remains robust despite the headline GDP decline.

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For investors, this episode offers a valuable reminder about the disconnect between markets and economic timing. While a recession does not seem imminent, it's good to have the historical context. Research shows that over the past 150-plus years, the correlation between stock market returns and GDP changes is very low, and if you strip out the 2020 pandemic period, it's close to zero. Markets often peak months before recessions begin and can post positive returns even during economic contractions. In fact, during 16 of the 31 U.S. recessions since the Civil War, stock markets delivered positive returns.

The Q1 2025 GDP print likely reflects temporary distortions from trade policy uncertainty rather than fundamental economic weakness. As those imported goods work their way through the economy, boosting consumption and investment in coming quarters, GDP growth could resume a more normal pattern. That said, if global trade slows significantly and the administration is unable to strike deals with our trading partners, it could put a damper on growth.

This reinforces the importance of looking beyond headline numbers and maintaining diversified portfolios designed for long-term growth rather than trying to time short-term economic fluctuations.