

ANNALY[®]

Macro & Market Musings

Key Findings

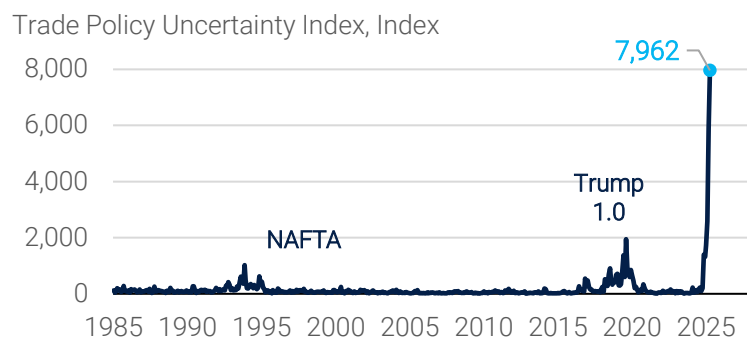
- Trade policy measures announced by the Trump Administration led to widespread market volatility and heightened policy uncertainty in April. Markets ultimately recovered a large portion of their early month declines as the Administration showed some flexibility and the near-term impact of their April 2nd announcement proved somewhat limited
- Economic activity has remained relatively solid despite the negative GDP print in the initial estimate of Q1 economic activity. While survey data continues to show declining sentiment and expectations, economic activity and the labor market are exhibiting resilience
- The decline in the U.S. Dollar has raised questions about foreign demand for U.S. assets. There does not appear to be large-scale foreign selling as of now and the U.S. remains the center of global financial markets, though markets signaled some nervousness about potential changes in April

A Month to Remember

April 2025 will likely be remembered in the annals of financial market history as the month of tariff-induced volatility. Following the Trump Administration's April 2nd announcement of "reciprocal tariffs" aimed at balancing trade with nations across the globe and reshoring manufacturing to the United States, financial markets experienced one of the more pronounced bouts of volatility in recent years. Combined with earlier measures, the tariffs raised policy uncertainty further, as consumers, companies, and market participants feared large scale changes to the global trading system (see *panel 1*). Measures announced in March and April would have lifted U.S. effective tariff rates from 2.5% in 2024 to the 15–20% range, depending on import substitution and further policy changes. As we enter May, however, volatility has eased, supported by constructive corporate earnings, solid economic data, and signs of flexibility from the Trump Administration around trade negotiations, all of which have helped to soothe market sentiment. While there have been limited concrete announcements thus far, market participants assume a portion of the announced tariffs will be re-negotiated in new country-specific trade deals.

Panel 1:

Trade Policy Uncertainty Hits Historical Highs



The U.S. Economy

U.S. economic activity data received through the end of April has held up better than expected following the Trump Administration's multiple tariff announcements. Economic survey data continued to deteriorate in line with [our prior narrative](#), with consumer and business confidence falling and inflation expectations rising. However, economic activity data have not followed the sentiment survey data, with the economy still displaying healthy activity, even if a meaningful portion of the strong consumer spending seen in March came from car purchases ahead of auto tariff deadlines.

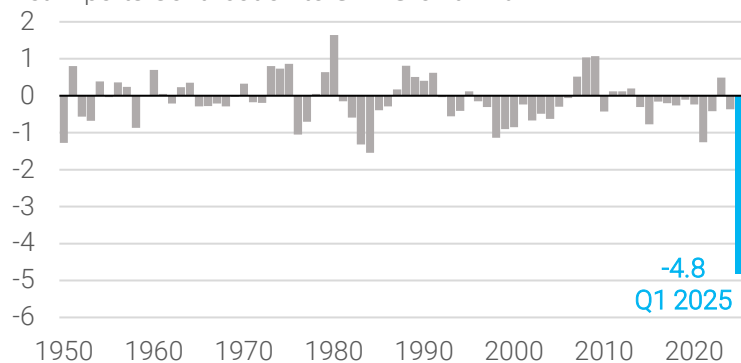
Economic Growth

According to the initial estimate from the Bureau of Economic Analysis ("BEA"), the U.S. economy contracted by 0.3% seasonally adjusted annualized growth rate ("SAAR") in Q1 after GDP had expanded by 2.8% SAAR in 2024. The negative headline significantly understates the economic activity in the quarter. Consumers pulled forward goods demand and firms stocked up on industrial supplies and consumer goods, resulting in a significant increase in goods imports. Driven by the jump in imports, net trade, the difference between the quarterly change in imports and exports, subtracted 4.8 percentage points from Q1 growth, the largest drag on record going back to 1947 (see panel 2). However, outside of imports, real final sales to private domestic purchasers, the sum of consumer spending and gross private fixed investment grew at a pace consistent with the pace of growth seen in the past three years.

Panel 2:

GDP Weighed Down by Import Surge

Net Exports Contribution to GDP Growth* %



* Shows the annual contribution of net trade to US GDP growth.

Consumption grew 1.8% SAAR in the first quarter, as strong March spending helped offset more muted activity in January and February. Even though a significant monthly increase in car sales drove the higher personal spending in March, many services spending categories rebounded as well. Taking a step back and looking at Q1 holistically, three high level factors appear to have shaped consumer spending:

1. Moderation of spending from higher levels at the end of 2024,
2. A historically cold January, and
3. Elevated trade policy uncertainty that might have led consumers to frontload purchases.

The rebound in services spending seen in March suggests that the first two factors mattered more than the last one, at least for now. Underpinning the U.S. consumer, even with lower confidence, were continued robust personal income gains anchored by solid wage growth. Thus, we would expect personal consumption to hold up until income growth weakens or price pressures start bubbling up in the economic activity data.

Finally, it seems fair to assume that the negative impact from net trade in Q1 data should be reversed and result in a tailwind for Q2 GDP. A slowdown in imports, which has been visible in part in declining U.S. port volumes in April, should reverse the drag on

GDP seen in Q1 as trade patterns either settle into historical averages or weaken beyond them. Assuming real final sales to private domestic purchasers do not slow at a rapid pace in Q2, GDP should be positive for the quarter. This does not necessarily constitute a strong economy, but it would likely push a feared economic downturn further out the calendar.

Labor Market

Turning to the employment picture, data received for April painted a labor market with low levels of hiring, but limited firing or layoffs and moderating wage growth. Nonfarm payrolls increased by 177,000 and the unemployment rate remained unchanged at 4.2%. However, downward revisions to job growth in the prior two months took some shine off the report and left the three-month average pace of hiring essentially unchanged from initial estimates of the same metric one month ago. Hiring was relatively broad-based across industries, with the diffusion indices⁽¹⁾ improving for both 1- and 3-month measures. Following meaningful disagreement between surveys for most of last year, the household survey was in line with the employer survey for a second consecutive month. Notably the overall labor force participation rate ("LFPR") improved to 62.6%, with the prime age (25–54 years old) LFPR rising to the highest level since September 2024, as 518,000 people entered the labor force – of those, 436,000 were able to find a job.

Nevertheless, there are some signs worth monitoring as overall employment growth has moderated and employers are growing cautiously pessimistic about the outlook. According to the Bureau of Labor Statistics, job openings fell more than expected to 7.2 million in March across a broad set of industries. This led to the job openings per unemployed ratio to drop to 1.02 – a post-pandemic low. Labor market entrants and re-entrants continue to have difficulty finding a job as the hiring rate was unchanged at 3.4% despite a slight uptick in voluntary separations indicating that businesses' interest in bringing on new workers has cooled.⁽²⁾ The median duration of unemployment has gradually moved higher since mid-2022 and stood at 10.4 weeks in April, consistent with what appears to be a steady rise in continuing claims for unemployment insurance. Lastly, wage growth continues to moderate as shown in both the payrolls and the Q1 Employment Cost Index report. Despite the slowdown in wage growth, April saw a rise in total hours worked indicating stronger income growth in the aggregate. As noted above, solid income gains will be needed to support consumption as sentiment fades,⁽³⁾ especially considering that the savings rate declined to 3.9% in March and remains below historical averages.

Financial Markets

Uncertainty weighed heavily on markets in April as tariff-related announcements triggered a sharp and immediate deterioration in risk sentiment. Market participants quickly repriced expectations for U.S. growth resulting in a meaningful move across markets: equities declined and the dollar weakened, but unlike in a typical risk-off move, U.S. debt markets sold off. Ten-year Treasury yields traversed a 70-basis point ("bps") range within one week in early April as term premium surged. The ICE BofA Move Index – a measure of short-term implied interest rate volatility – rose to its highest levels since the fall of 2023.

By month-end, volatility had subsided as trade-related concerns shifted into a wait-and-see mode amid ongoing negotiations. First quarter corporate earnings helped improve sentiment as they have been relatively strong thus far, leading to only modest downward revisions to 2025 earnings expectations, though uncertainty around these forecasts has certainly increased. Altogether, April's price action highlights a few notable takeaways.

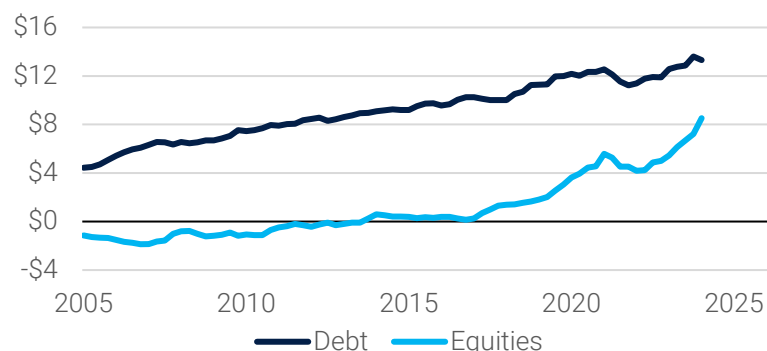
First and most importantly, the U.S. dollar depreciated significantly and remains weak, even after the worse-case tariff scenario was scaled back. Historically, import tariffs tend to strengthen the home currency, in turn alleviating some of the tariff's effect on raising import prices. However, following April's announcement, most G10 currencies appreciated against the dollar. It appears unlikely that foreign investors have sold U.S. assets on a large scale at this point. Nonetheless, foreign demand warrants increased attention going forward.

Over the past two decades, foreign investors have heavily allocated capital to U.S. assets due to economic outperformance and improved yields, leading the U.S. to be the center of global capital flows. For example, net portfolio investment in U.S. debt and equities, defined as the difference between investment holdings of foreigners in the United States minus the holdings of U.S. domiciled investors abroad, have doubled this decade – well ahead of potential market value gains on these portfolios (see panel 3).

Panel 3:

Foreign Investment into U.S. Stocks Has Been Strong

Net U.S. Portfolio Investment*, \$ trillion



* Represents the U.S. International Investment Position for portfolio investments according to the International Monetary Fund (IMF). Unlike the typical IMF accounting that subtracts liabilities from assets and shows a negative U.S. international investment position, we subtract assets (holdings of U.S. entities abroad) from liabilities (holdings of foreigners in the U.S.). Portfolio investments represent equity debt securities that are generally publicly traded in financial markets.

Flows have been particularly strong in equities as U.S. companies were seen as leading global innovation, such as in artificial intelligence, with the U.S. simultaneously offering the most efficient open capital markets worldwide.

The Trump Administration's trade policy has raised concerns about potentially slower economic growth and lower corporate earnings, in turn questioning whether U.S. economic exceptionalism will continue. While this could prompt foreign investors to seek investments in other jurisdictions, the process is

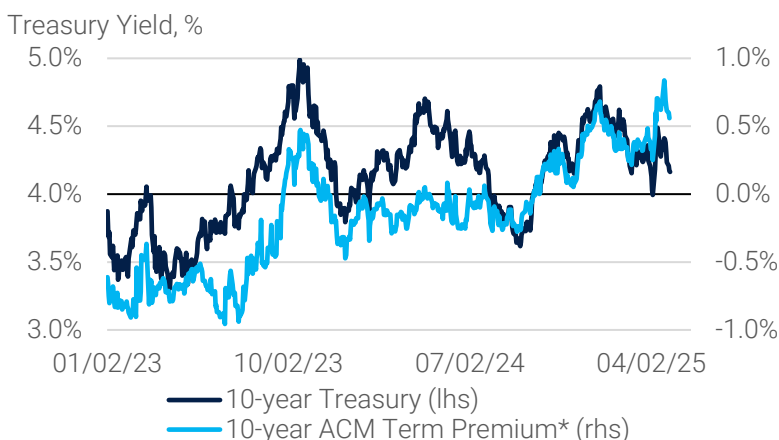
likely to be protracted over years rather than the first few days of April 2025. The U.S. dollar remains the centerpiece of global finance and U.S. markets represent foreign investors' "TINA" – there is no alternative.

Second, the uncertainty prompted widespread de-risking in U.S. fixed income markets. Treasury yields spiked relative to same-maturity swap yields, with 30-year spreads tightening by as much as 23 bps at the height of the bearish sentiment. This deleveraging drove broad cheapening across fixed income assets, as balance sheet intensive assets became costlier to hold for investors. Agency MBS were not unaffected by the environment, delivering a negative excess return of 38 bps in April,⁽⁴⁾ as sentiment and higher volatility weighed on mortgage spreads. Of note, weak risk sentiment pushed credit spreads even wider, resulting in a 62 bps negative excess return for the Bloomberg U.S. Aggregate Corporate Bond Index, though investment grade bonds arguably had tighter valuations than mortgages entering the month.

The episode highlights potential risks for Treasuries going forward, particularly as Congress readies to pass tax reform that is expected to further increase deficits in coming years. Assuming a portion of the concerns about international investors seeking alternatives to U.S. debt come to fruition, the U.S. Treasury Department would become even more reliable on price sensitive domestic money managers and the savings of U.S. households by extension. Term premium, the compensation U.S. investors require to hold Treasuries, has been rising and this trend could easily continue if large debt sales are increasingly dependent on a narrower investor base (see panel 4).

Panel 4:

Term Premium Has Been Rising



* Based on the New York Fed's Adrian, Crump, and Moench Treasury Term Premia Model.

Third, and perhaps most comforting, the Administration appears sensitive to market reactions. In the week following the April 2nd announcement, the S&P 500 index fell by as much as 15%, the VIX index – the measure of expected equity market volatility – more than doubled, and bond prices plunged. In response, the Administration moved to de-escalate the trade war and has since continued with exemptions, delays, and a steady news flow about potential trade negotiations. The flexibility shown by the President and his advisors confirms that they are not indifferent to turmoil in markets.

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Endnotes

1. *A labor diffusion index is a metric that measures the dispersion of employment changes across industries, indicating whether employment growth is widespread or concentrated in specific sectors. An index reading of 50 represents an equal balance between 250 private-sector industries with increasing and decreasing employment.*
2. *That said, firms also appear reluctant to reduce current staff.*
3. *The Conference Board's Consumer Confidence Index dropped to 86.0 in April, a reading that rivals the pandemic lows as consumers across all age groups keep growing increasingly anxious about their financial situation.*
4. *According to the Bloomberg U.S. Mortgage-Backed Security Index.*