



Stay the Course

From Global Fixed Income

Executive summary

- The war in Iran represents a broad-based supply shock that is likely to slow global growth and push inflation higher, though the direct impact on the U.S. economy should remain manageable.
- Against a backdrop of elevated inflation and moderating growth, the Federal Reserve is likely to remain on hold, as policymakers balance upside risks to inflation against a gradual softening in activity.
- For fixed income markets, higher yields, increased volatility, and modest spread widening have improved forward return potential, with income remaining the primary driver of returns.
- We maintain a neutral to modestly long duration stance, favor intermediate maturities, and emphasize higher-quality credit and securitized assets, as dispersion across sectors reinforces the importance of selectivity and disciplined portfolio construction.

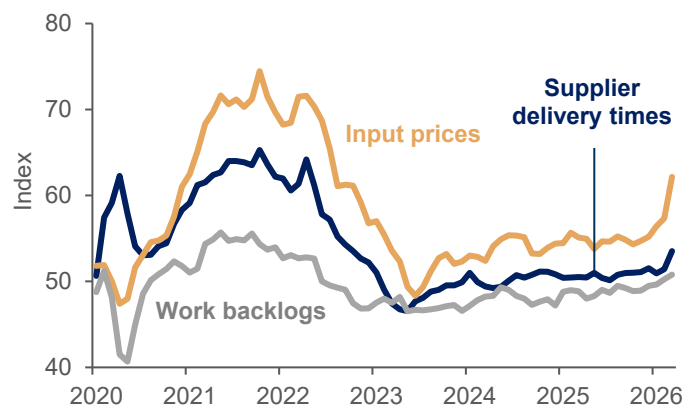
Macroeconomic outlook

The war in Iran poses meaningful downside risks to the global economy, particularly for oil-importing economies in Asia and Europe that are most vulnerable to disruptions in flows through the Strait of Hormuz. Beyond energy markets, the conflict represents a broader supply shock with potential

spillovers into key industrial inputs, including fertilizer, plastics, aluminum and segments of the semiconductor supply chain. While the scale of disruption is unlikely to approach that seen during the pandemic, the war nonetheless introduces a stagflationary impulse, constraining output while placing upward pressure on global prices.

For the U.S. economy, the macroeconomic impact should remain manageable provided the conflict does not escalate further and shipping through the Strait begins to normalize in

Figure 1: Global manufacturing PMIs are already reflecting increased supply chain stresses



Source: S&P Global. Readings above 50 indicate that a greater share of responding firms report rising input prices, longer supplier delivery times, or increasing backlogs of work.

the coming weeks. Recent developments on this front have been mixed, however, and pricing in prediction markets reflects expectations that a return to more typical vessel traffic may not occur until early summer. Against this backdrop, we have lowered our US growth forecast for this year by 50 basis points, to two percent. The revision reflects both higher energy prices and the drag from tighter global supply conditions. The state of the U.S. consumer also factors into this adjustment. Compared with the 2022 energy price spike, household resilience appears more limited, with a softer labor market, higher debt servicing burdens, and reduced savings all suggesting less capacity to absorb an external shock.

While the impact on headline inflation is likely to be meaningful, the effect on core inflation should be more limited and mainly reflecting higher transportation costs, increased input prices for goods such as plastics, and broader supply chain frictions. Assuming inflation expectations remain anchored, we expect core PCE inflation to end the year roughly where it began, at around three percent, for a second consecutive year. (see Figure 2)

We continue to expect monetary policy to remain on hold this year. While markets have at times priced in the possibility of a rate hike by year-end, we remain skeptical of such an outcome. As long as inflation expectations remain contained, policymakers are likely to look through a temporary energy-driven increase in inflation, particularly given the associated drag on growth and labor demand. We expect incoming Fed Chair Kevin Warsh to take a similar approach, remaining focused on underlying inflation dynamics and requiring clearer evidence of second-round effects before considering any tightening of policy.

Figure 2: Beyond the next year, inflation expectations remain anchored



Source: Barclays

Market and portfolio implications

A macroeconomic backdrop characterized by slowing growth, persistent inflation near three percent, and a Federal Reserve on hold creates an environment in which fixed income returns are increasingly driven by income, selectivity, and careful sector allocation than in recent years. The stagflationary nature of the current shock, combined with elevated uncertainty, has contributed to higher volatility and a more uneven performance across sectors. At the same time, higher starting yields and recent spread widening have improved forward return potential, reinforcing the role of fixed income as both an income-generating and diversifying asset class. In this environment, carry may continue to be a significant driver of returns, while episodic volatility may create opportunities for selective positioning.

Rates outlook: rangebound with a mild steepening bias

We expect the 10-year Treasury to remain in a relatively broad range of roughly 4.0% to 4.5% in the near term. Slower growth and the potential for eventual policy easing once inflation stabilizes may limit upward pressure on yields, while elevated fiscal deficits and Treasury supply concerns argue for continued caution around the long end of the curve. In this environment, duration is unlikely to be the primary source of return, and we favor intermediate maturities and curve positioning over aggressive long-end exposure.

Return profile: income still dominates

The first quarter reinforced a simple but important point: in a higher-rate world, fixed income does not need a large rally to generate attractive returns. Income remains the foundation of the asset class. At the same time, the market weakness late in the quarter improved the entry point in several sectors, increasing the potential for capital appreciation.

This is also an environment in which dispersion is increasing. Broad market exposure is less attractive than it was when spreads were tighter and volatility was lower. In our view, returns from here are more likely to come from careful sector selection, structural advantages, and security-specific opportunities than from broad beta exposure alone.

Credit outlook

Corporate credit fundamentals remain broadly stable, but the picture is becoming more uneven. In investment grade, balance sheets are still generally healthy, and all-in yields remain attractive. However, margins are no longer improving across the board, and weaker credits are beginning to show more strain than stronger issuers. That argues for maintaining a quality bias, particularly within BBB-rated credit and more cyclical industries.

In high yield, higher-quality segments continue to offer a more attractive risk-reward tradeoff than lower-quality credit. Wider spreads have improved compensation, but not all parts of the market have repriced equally. We continue to favor the upper tier of high yield, where carry remains compelling and refinancing risk is more manageable.

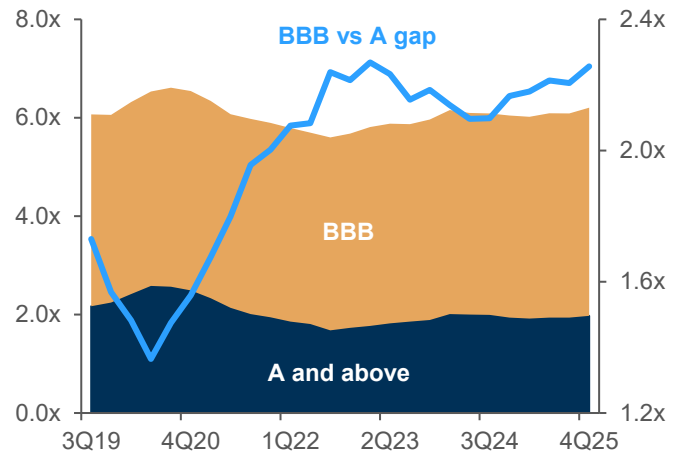
We remain more cautious on leveraged loans. Their floating-rate structure provided relative support in the quarter, but that same feature continues to pressure weaker borrowers. In our view, loans remain more vulnerable in a slowing growth environment, especially where issuers face margin pressure, elevated leverage, or business-model uncertainty. That caution extends to parts of the market adjacent to private credit, where transparency, valuation discipline, and refinancing flexibility may prove increasingly important as the year progresses.

While a sharp deterioration in credit is not our base case, spread widening risk has increased, particularly in lower-quality segments and in sectors where refinancing needs are rising into a still-restrictive funding backdrop.

Conclusion

The first quarter of 2026 did not undermine the case for fixed income. It refined it. The environment remains

Figure 3: Rising leverage gap between AAA-a and BBB issuers | gross leverage



Source: JP Morgan

favorable for income generation, but the path forward is likely to be less forgiving for lower-quality credits and broad beta exposure. In our view, public fixed income has regained its role as a meaningful source of income and portfolio diversification, but the market is increasingly rewarding selectivity, liquidity, and balance-sheet strength. Accordingly, we believe that maintaining a focus on income, quality, and liquidity remains critical as markets navigate a more uncertain macroeconomic and policy landscape.

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