



Global Fixed Income Strategy

FEBRUARY 2026

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2026 macro outlook

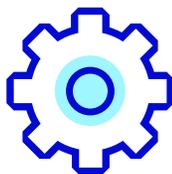
We've revised up our US growth outlook, but expect inflation to remain sticky in the first half of the year. The ECB is also forecasting better European growth momentum, but the UK may face softer conditions.



8 Rates and currency outlook

Major rates and currencies 3-month outlook

We are overweight UK and Australian rates, neutral on European, Chinese and Japanese rates and underweight US rates. We are overweight the euro, renminbi, yen and Australian dollar and underweight the US dollar and British pound.



12 Global credit strategy

2026 credit outlook

We share Invesco Fixed Income's global credit outlook for 2026 across investment grade, high yield, emerging markets and Asian credit.

Executive summary

US

- **Macro backdrop and policy outlook:** After the policy shocks and data disruptions of 2025, we expect the US economy to regain momentum in 2026, with stabilizing labor markets and modest tailwinds from easier financial conditions and fiscal support. Inflation remains sticky around 3%, leaving the Fed close to neutral. We assume two “compromise” rate cuts, driven more by political and institutional dynamics than economic necessity.
- **Recent data and baseline view:** Incoming data since the reopening of the government broadly support our baseline view: Labor market conditions have stabilized, with forward-looking indicators pointing to improving hiring, while inflation has surprised slightly to the downside but remains uncomfortably above target. Growth appears to be picking up without forcing near-term easing.
- **Revised growth and productivity view:** With modestly stronger productivity growth—partly reflecting early AI effects, labor reallocation, and business formation—and continued support from immigration and rising labor force participation in early 2026, the economy could grow around 2.8% without overheating. We view AI as a longer-term productivity catalyst, with gradual gains emerging over time rather than providing an immediate, economy-wide boost.

Europe

- **Macro backdrop and policy outlook:** The ECB has shifted its 2026 growth outlook toward stronger momentum, supported by German fiscal stimulus and higher defense spending, and views policy as neutral. However, we see downside risk to its inflation forecast, as alternative wage indicators suggest faster wage moderation than implied by the ECB’s preferred measure. This raises the chance that inflation falls more quickly, and marginally increases the likelihood of a rate cut in early 2026, even though our base case remains rates on hold.

UK

- **Macro backdrop and policy outlook:** UK data point to a more dovish outlook than the Bank of England’s November projections, with soft labor conditions and inflation set to fall faster than expected, supporting our base case of two rate cuts in 2026, with upside risk to a third cut if unemployment rises more sharply.

US

Recent months have been marked by a combination of policy-driven uncertainty, uneven data availability, and shifting market expectations. As delayed data releases resume and the economy moves beyond the policy shocks of 2025, it is increasingly important to separate signal from noise. The discussion below outlines our baseline macro outlook for 2026, reviews the incoming data since the beginning of the year, and assesses how these developments align with our baseline views and the adjustments they may warrant. We then present revisions to our projections, reflecting modest optimism about productivity gains and conclude with our framework for analyzing and interpreting the impact of artificial intelligence on productivity.

Setting the stage: baseline outlook and framework for 2026

In our baseline 2026 outlook, we expect the US economy to gain momentum after absorbing the policy shocks of 2025. With fewer headwinds, and some emerging tailwinds, particularly from easing financial conditions and modest fiscal stimulus, we expect growth and the labor market to strengthen in 2026.

Inflation, while coming in better than feared, remains sticky and above the Fed's target. At the same time, with growth accelerating, policy may already be close to neutral, and there may be little need for further rate cuts on macroeconomic grounds.

That said, we continue to pencil in two rate cuts—in June and July—primarily as a compromise shaped by political pressure and the differing views within the Federal Open Market Committee, rather than as a response to underlying economic conditions. The monetary policy reaction function is arguably more uncertain now than at any time in recent decades.

Summary of recent data releases

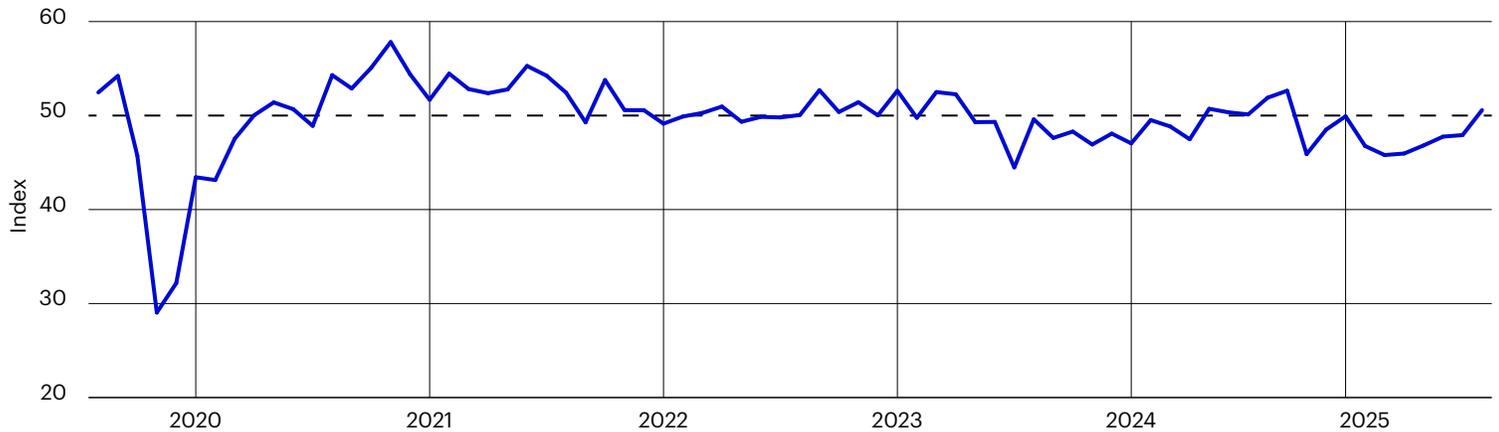
Since last month, statistical agencies have been catching up on delayed data releases following the reopening of government operations. As a result, the flow of data has increased, although, in some cases, data quality remains uneven, and revisions are still likely.

Labor market data have been relatively reliable and point to stabilization in hiring following the summer slowdown. The latest jobs report for December was on the soft side, with private-sector job creation coming in low. That said, conditions appear stable, and there are early signs of improvement in the labor market.

In particular, private-sector job creation measures have turned positive. Weekly data published by the human resources and payroll firm, ADP, have improved in recent weeks, and monthly indicators suggest that private-sector employment growth—as measured by the official US jobs report, ADP, and workforce analytics firm, Revelio Labs—is proceeding at a modest but positive pace. Moreover, forward-looking indicators, including the ISM Services Employment Index, Indeed job openings data, National Federation of Independent Business (NFIB) hiring intentions, and a broader set of labor market indicators that we track, suggest that firms may be becoming more inclined to hire this year.

Figure 1: The labor market has stabilized, and forward-looking indicators suggest that hiring may pick up in the coming months

ISM Surveys Labor Component

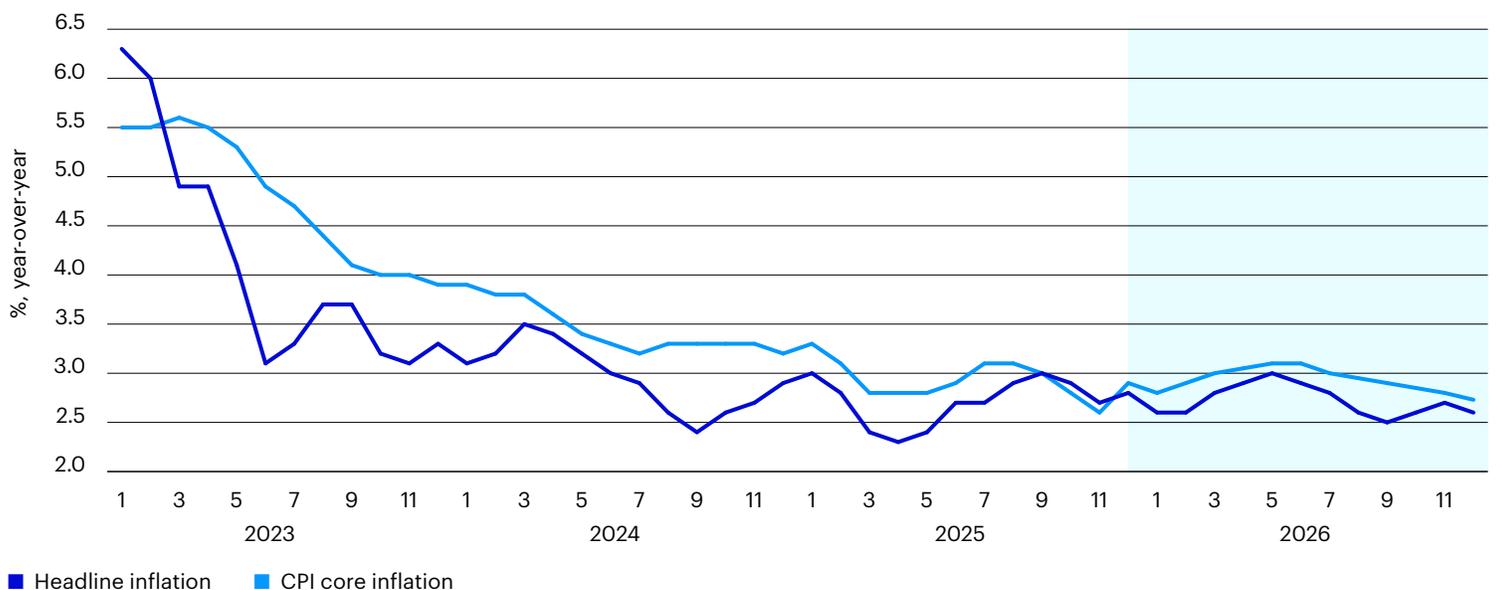


Source: ISM. Data from Jan. 31, 2020 to Dec. 31, 2025.

Turning to inflation, the latest data released in January delivered another downside surprise, driven primarily by the goods component. Some correction is likely, going forward, however, as recent inflation readings have been unusually noisy and may be biased downward in certain categories due to the government shutdown.

Overall, we continue to expect inflation to hover around three percent in 2026. Our tracking of core PCE inflation points to a rate near three percent in recent months, and we expect this pattern to persist in the period ahead. That is ultimately the bottom line: While tariff pass-through remains an important contributor to inflation, the overall level is still uncomfortably high. From a policy and communications standpoint, optics matter, and an inflation rate with a “three-handle” remains elevated. After several years of above-target inflation, stubbornly high levels give the Federal Reserve (Fed) ample reason to pause and take stock.

Figure 2: US inflation projection: We expect core inflation to rise to just over 3.1%, remain around 3% through the first half of the year, and then begin to decline, ending the year at 2.7%



Source: Bureau of Labor Statistics, Invesco projections. Data from Jan. 1, 2023 to Jan. 17, 2026. Forecasts thereafter.

Overall, recent data, including the jobs report released in early January, are broadly in line with our baseline. The labor market remains stable, and growth appears to be gaining some momentum. The Fed does not need to cut further at this stage, in our view, though we continue to pencil in two “compromise cuts” over the summer under the new Fed Chair, partially reflecting political pressure. It remains unclear whether renewed political pressure will alter that outlook, especially given ongoing legal and institutional uncertainties, such as the Supreme Court’s stance on Board Governor Lisa Cook and its ruling on the Trump administration tariffs.

Revised growth outlook: 2026 can hit 2.8% without overheating

In our 2026 projections, we assume modestly optimistic productivity gains, with productivity growth expected at close to 2.0%, compared to an average of 1.5% during the post-global financial crisis, pre-pandemic decade. Our upbeat outlook reflects the early impact of AI and other technological developments, though the full potential of AI has yet to be realized. Importantly, we believe the recent improvement in productivity has likely been driven by a range of other factors as well, such as labor reallocation and strong new business formation – which we discuss in the next section.

On the other component of potential growth—labor force dynamics—we believe its contribution to growth may eventually slow to zero, due to aging workers and reduced immigration. But this is not a story in the first half of 2026. For now, based on the latest data, immigration has slowed but remains positive. Deportations are broadly in line with historical norms – they are on the high side but not too elevated. This situation may change, but for now, we assume that the recent trend of roughly 400 thousand in net immigration per year will persist through the first one-to-two quarters of the year.

In addition, as growth picks up, labor force participation should improve, potentially lifting the labor force participation rate to 62.8%-63.0%. This could add 750,000 to one million workers to the labor force over the course of the year. Combined, these factors could contribute about 0.4% to potential growth in 2026. Looking ahead, we expect support from net immigration and participation to wane and it could even turn negative beyond 2026. As a result, we believe growth could accelerate to around 2.8% in 2026 without overheating the economy, which is our baseline assumption.

The role of AI in the US economic outlook

AI is emerging as a highly promising general-purpose technology, with massive investments already influencing the economy. In our 2026 outlook, we assume the following:

We are currently in the capital-deepening stage of AI investment— in other words, large-scale spending on infrastructure and technology that continues to support growth. However, broad-based productivity gains are not imminent. Much of the current impact is mechanical: building data centers and related infrastructure adds to economic activity. But overall investment is growing at a normal pace, suggesting that there is weakness outside AI. A concentrated group of tech firms drives most of this spending, so near-term productivity improvements will likely be limited to specific sectors and could be normal or even weak elsewhere. Moreover, there is typically a lag between investment and productivity gains.

Economic history shows that benefits from general-purpose technologies take time to materialize. Companies must adapt processes and redesign workflows to capture their full potential. AI could be different—unlike electricity or the internet, which required extensive infrastructure, AI tools are already widely accessible. Yet, arguably, most firms have not meaningfully changed workflows, so significant gains likely lie ahead, even if diffusion is faster this time. This underpins our modest optimism: we expect a slight pickup in productivity this year, as access is rapid, but more substantial improvements in the coming years, as there is need to change workflows. Many sectors, such as education, healthcare and hospitality, represent a large share of employment and output, and their adoption of AI may be slow.

Productivity is notoriously difficult to forecast in the short term—and AI makes it even harder. The best approach under such uncertainty, we believe, is to make clear assumptions and monitor data to adjust expectations as needed. For now, we expect

AI-driven gains to emerge gradually, with early signs at the sector level and more visible changes beyond 2026. This is a midway approach: incorporating some optimism over productivity gains, due partly to AI, but also from labor reallocation, strong new business formation, and a recovery from the disappointing productivity trends of the 2010s—in other words, we believe the current pickup in productivity is in part a normalization story and a shift toward mean reversion.

EUROPE and the UK

2025 was a difficult year for the eurozone and the UK - though for different reasons. The export-dependent eurozone faced structural headwinds with rising global competition and export tariffs, pushing policymakers toward a more assertive stance on defense spending and fiscal policy. In 2026, this policy shift, plus a series of European Central Bank (ECB) rate cuts, should help support the cyclical outlook, even though structural challenges persist.

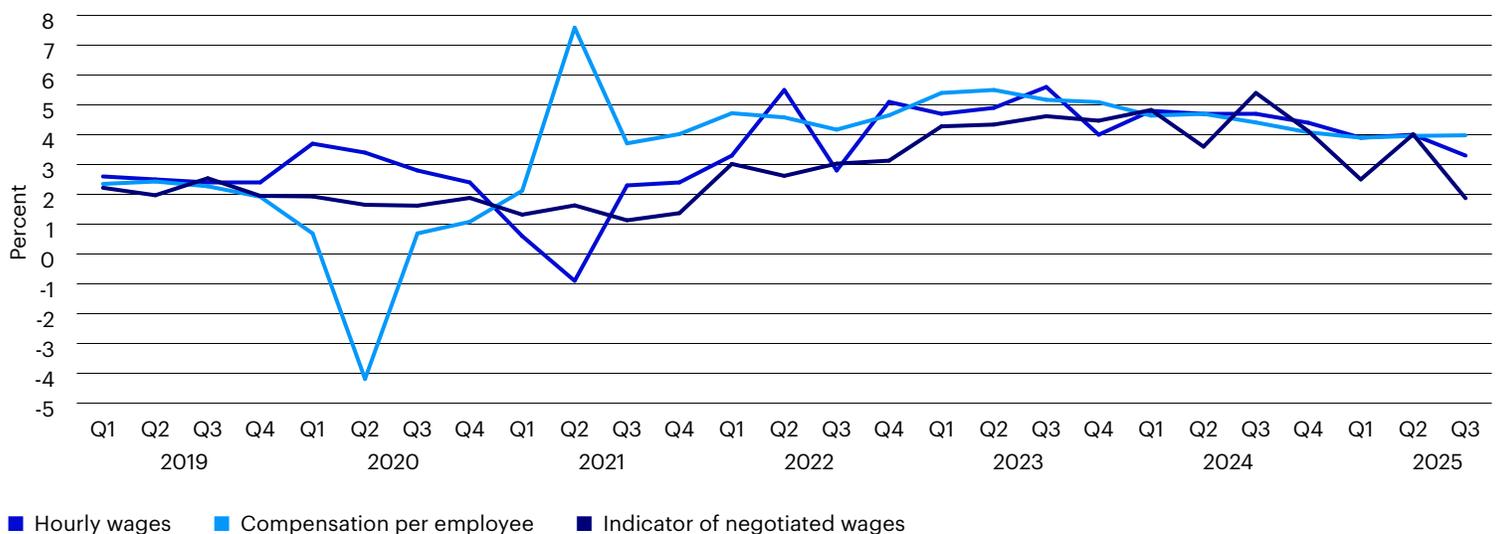
In the UK, inflation was elevated in 2025, partly driven by 2024 Budget decisions and ongoing fiscal concerns. We expect these pressures to ease in 2026: inflation should fall sharply in April, and fiscal worries should diminish following November's Budget. However, we are watching the labour market - its trajectory remains central to shaping the Bank of England's policy outlook.

Eurozone outlook

The ECB revised its growth and inflation outlooks in December, bringing its growth forecast more in line with our view and the broader market consensus. The ECB expects stronger cyclical growth in 2026, supported by German fiscal stimulus and increased defence spending across the eurozone. It believes that monetary policy is now in neutral territory and no longer restrictive.

We are less in line with the Bank's inflation revisions. The ECB raised its 2026 HICP (Harmonised Index of Consumer Prices) forecast from 1.7% to 1.9%, citing stickiness in its preferred wage metric, "Compensation per employee". However, we believe this measure may overstate underlying wage growth due to its composition - which includes bonus payments and additional hours worked (overtime) that have increased recently. Alternative indicators support our view that wage growth is softening, such as negotiated wages and hourly wages, which moderated more quickly in Q3 2025 (Figure 3).

Figure 3: Alternate measures of eurozone wage growth



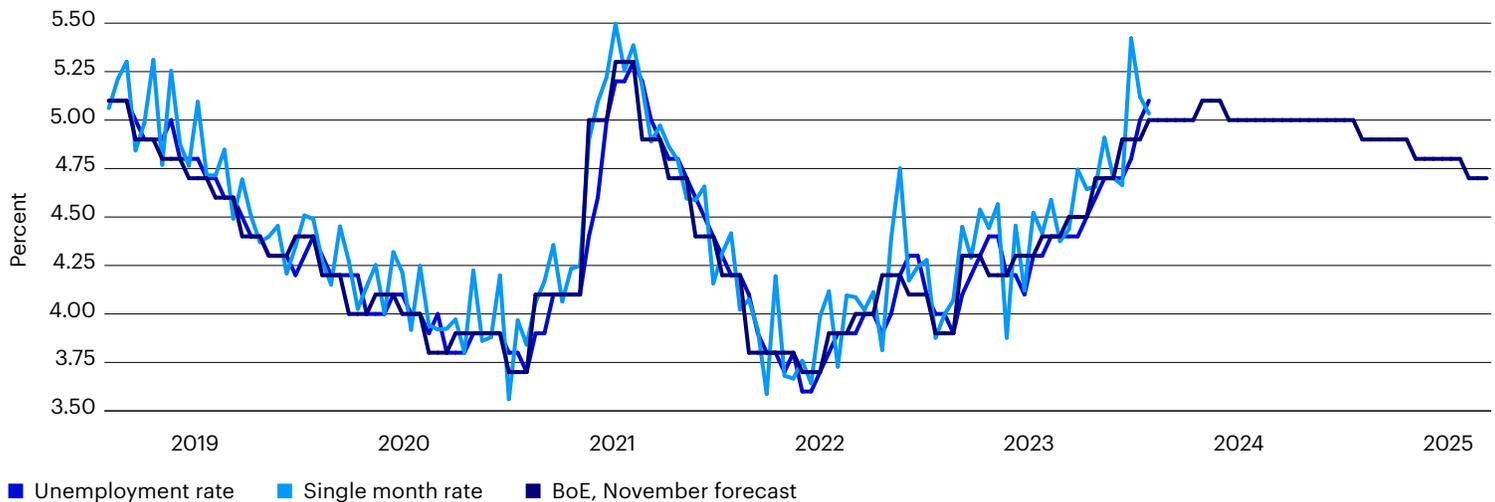
Source: ECB, Eurostat and Macrobond, Data from Jan. 1, 2019 to Sep. 30, 2025.

For this reason, we believe the ECB's near-term wage and services inflation profile is too high. Consequently, we see scope for headline inflation to fall faster than the ECB expects in the first half of 2026, increasing the possibility of a rate cut during that period. Our baseline view is still that interest rates will remain on hold through 2026. The ECB has emphasized that monetary policy is in a "good place," suggesting it would take a meaningful downside inflation surprise to cut - or a much stronger cyclical upswing to hike. Currently, neither scenario is our base case.

UK outlook

In the UK, we continue to see scope for dovish surprises compared to the Bank of England's (BoE) November forecasts, particularly on unemployment and inflation. While there are early signs of stabilization among the six leading employment indicators, they still point to flat-to-slightly-negative payroll growth. And, as labor supply improves through higher participation, we expect the unemployment rate to trend higher - contrary to the BoE's projection of stabilization at 5% (Figure 4).

Figure 4: UK unemployment measures



Source: Office of National Statistics, BoE and Macrobond, Data from Jan. 1, 2016 to Dec. 31, 2025. BoE forecast from Nov MPR.

Note: The main difference between the official rate and single-month estimates lies in the timeframe and data reliability:

- **Official Unemployment Rate (3-month average):** This is the "headline" figure published by the Office for National Statistics (ONS). It is based on a rolling three-month average from the Labour Force Survey (LFS) (e.g., August-October 2025). This is considered more accurate as it uses a larger sample size.
- **Single-Month Rate:** This is an 'experimental' estimate looking at just one specific month (e.g., October 2025). Single-month figures are more volatile, based on a smaller sample size, and are not considered as reliable for determining trends.

The BoE's inflation forecast also appears too high. This is partly due to the impact of inflation-fighting measures announced in the Autumn Budget, which were not incorporated into the BoE's latest forecast. Additionally, wholesale gas prices now imply a larger decline in the April energy price cap, which should drive a sharper fall in April inflation. As a result, we expect UK inflation to be within touching distance of the 2% target by April. Our baseline view remains that the BoE will cut rates twice in 2026, bringing the terminal rate to 3.25%. With inflation moving closer to target, we see the labor market as the key determinant of the BoE's policy path. A sharper-than-expected rise in unemployment could prompt an additional cut, whereas a rebound in hiring would likely argue for just one cut. At present, we think the former is more likely than the latter.

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Interest rate outlook

US: Underweight

We have downgraded our US rates view to underweight from neutral. We expect US growth to improve during the first half of 2026. Fourth quarter 2025 growth data have already surprised to the upside, and we expect the improvement to broaden into the employment data. We expect this to cause volatility in the expected number of Fed interest rate cuts priced by the market. In addition, global interest rate curves have been steepening, leading to higher risk premiums in the long end of the US market. For these reasons we expect US interest rates to rise modestly over the first half.

Europe: Neutral

Following a period of stronger economic performance, the ECB paused its easing cycle in 2025. This shift in policy stance prompted markets to price out further near-term rate cuts and to assign some probability to a rate increase in late 2026 or 2027. Public commentary from ECB officials appeared broadly consistent with this repricing, with more hawkish members expressing comfort with the view that the cutting cycle had concluded. In our assessment, this interpretation appears premature given the medium-term inflation outlook. Headline HICP inflation is expected to fall below the ECB's 2% target in January, reflecting favourable energy base effects and continued weakness in core goods pricing. Headline inflation is projected to remain below target through the end of 2027, driven by lower goods and food price inflation and outright deflation in energy prices. Core inflation is expected to remain close to target. If growth momentum softens and inflation expectations decline in line with headline developments, additional policy easing during the current cycle cannot be excluded. For now, however, the ECB appears content to remain on hold after having delivered cumulative cuts of 200 basis points. Over the next 12 months, we believe risks to policy remain skewed towards lower, rather than higher, interest rates.

China: Neutral

We maintain a neutral stance on onshore Chinese rates for the months ahead and continue to expect a steeper yield curve, especially at the long end. Local expectations that inflation may return to more positive territory in the coming year and more proactive asset reallocation by households may set a floor under onshore yields. On the other hand, the central bank's relatively loose monetary policy and proactive liquidity and funding cost management should help limit a move up in yields.

Japan: Neutral

We have upgraded our view on Japanese rates to neutral from underweight. Japanese government bond (JGB) yields have risen more than 30 basis points over the past month, driven by heightened fiscal and political uncertainty. The initial catalyst was Prime Minister Takaichi's surprise decision to dissolve parliament and adopt an opposition proposal to cut the consumption tax on food for two years. Coming on the heels of the sizeable easing package in the 2025 supplementary budget, the prospect of further fiscal stimulus unsettled markets. Global uncertainty around US Greenland policy and a weak January 20 auction compounded pressure at the super-long end of the curve. While yields have since retraced, markets are likely to remain cautious until election uncertainty clears and the 2026 budget is presented in the second quarter.

From a broader perspective, Japan's fiscal position is not especially acute. Stronger nominal growth has driven a surge in tax revenues, bringing the primary budget close to balance, which compares favorably to many developed peers. Public debt has declined relative to GDP, and interest costs remain manageable due to the long maturity profile of JGB issuance. Additional stimulus is likely to cost around 0.8% of GDP, which is meaningful, but its impact on JGB supply could be limited if issuance is concentrated at shorter maturities.

The market has now adjusted to a sustained 2% inflation environment, with long-dated JGBs offering internationally comparable real yields. Over time, repatriation flows and portfolio rebalancing by Japanese investors should provide some demand, though renewed buying will likely require greater political and fiscal clarity.

Japan's status as a net creditor nation differentiates it from countries where fiscal risks are more immediate. The Bank of Japan (BoJ) appears increasingly confident in the growth and inflation outlook, leaving open the possibility of a rate hike as early as April. Paradoxically, tighter policy could help stabilize long-end yields by reducing concerns about fiscal dominance and supporting the yen. While short-term rates likely need to move higher, this does not imply a material repricing of long forwards. We expect further curve flattening ahead.

UK: Overweight

UK gilts have been broadly stable over the past month but have outperformed US Treasuries and German bunds. Limited supply—particularly at the long end—along with signs of a softening labor market and easing inflation have supported performance. While these dynamics remain constructive, the market is pricing only around 35 basis points of Bank of England rate cuts over the next year.¹ Political risk is also resurfacing, as speculation grows about a potential leadership challenge to Prime Minister Starmer after May's local elections. Markets are concerned that a shift to a more left-leaning leadership could weaken an already backloaded fiscal consolidation path, a risk made more credible by low poll ratings and the rise of the Green party, though it is unclear how unorthodox the likely alternative candidates would be when faced with the realities of leadership. Ultimately, inflation and wage dynamics will likely be more decisive for gilts. Rising unemployment and falling private-sector wage growth should ease core inflation in the second quarter, though persistent above-target inflation and steady growth limit the scope for aggressive rate cuts.

Australia: Overweight

Australian interest rate markets have been range bound over the last month, modestly outperforming US Treasuries. Domestic growth data continue to point to a pickup in growth, and while recent inflation data haven't produced the string of upside surprises seen in the third quarter, they remain above the mid-point of the Reserve Bank of Australia's (RBA) target. The probability that the RBA would reverse the recent easing cycle has increased based on these recent data. However, market pricing, which implies close to 50 basis points of hikes this year, appears excessive given the benign trend in wages and the still soft employment picture. Long-end Australian forward rates are now priced at over 5%, which is attractive, in our view, on an outright and relative basis, given the likely trajectory of inflation and Australia's relatively favorable fiscal dynamics.²

1. Source: Bloomberg L.P. Data as of Jan. 23, 2026.

2. Source: All Australian rates data: Bloomberg L.P. Data as of Jan. 23, 2026.

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Currency outlook

USD: Underweight

We hold a long-term underweight view on the US dollar. Narrowing interest rate and growth differentials versus the rest of the world will likely continue to incrementally reduce the attractiveness of US dollar holdings. Additionally, increasing political influence over US institutions—including the Fed—has begun to erode perceptions of institutional independence, which has historically underpinned the dollar's role as the global reserve currency.

The sharp appreciation in gold prices further reflects a shift in investor sentiment, with institutional allocators increasingly seeking alternatives to the dollar. While the dollar's reserve status is not under immediate threat, we expect a continued and gradual diversification into other currencies and markets, exerting persistent downward pressure on the US dollar. We favor diversified longs including the euro, New Zealand dollar, Norwegian krone, and yen.

EUR: Overweight

We remain constructive on the euro, supported by our expectations of continued US dollar weakness and a near-term narrowing of interest rate differentials. The region stands to benefit from low interest rates and a supportive fiscal environment. We also anticipate a gradual reallocation by international investors away from US dollar denominated assets. In this context, the euro is well-positioned to benefit from these flows, in our view.

RMB: Overweight

We are overweight the renminbi over the medium term. We expect continued momentum in US dollar selling by exporters as the trade surplus reached around USD1.2 trillion in 2025 and further progress was made in the renminbi's internationalization process. The substantial growth in China's trade surplus, exporters' sizable holdings of foreign currency and the development of China's cross-border renminbi payment system are likely to support the renminbi's performance over the medium term. Recent actions by central banks and governments in other major markets are also likely to further support the renminbi's outperformance.

JPY: Overweight

The yen has continued to weaken against the US dollar and euro over the last month. Domestic political instability has combined with buoyant international risk sentiment and higher global bond yields to push the currency weaker. Significantly, the yen has decorrelated from interest rate differentials, with higher JGB yields not helping the currency. This might be because the jump in JGB yields is linked to questions about fiscal credibility and potential fiscal dominance of monetary policy, as there is a perception the BoJ will be hamstrung by Prime Minister Takaichi when it comes to hiking. The huge volatility in the JGB market is probably putting off domestic investors from repatriating funds. However, the cheapness of Japanese domestic assets will probably lead domestic investors to repatriate or re-hedge currency exposures, especially if the authorities start to intervene to support the yen, and bullishness about US asset returns is challenged.

GBP: Underweight

The British pound has appreciated on a trade weighted basis since the November budget, despite narrowing interest rate differentials with the US and Europe. Looking forward, the scope for continued outperformance looks relatively limited. Bank of England rate cuts have reduced the pound's carry advantage, particularly against the euro and yen. In addition, political uncertainty is set to rise ahead of the May local elections, after which a leadership challenge to Prime Minister Starmer is expected. The prospect of a more left wing prime minister could result in capital outflows - though a potential counter is if the new prime minister is more willing than Starmer to consider rejoining the European Union Customs Union. The UK's geopolitical vulnerability could

also be an issue for the pound; in April 2025 and in the brief risk-off period triggered by fears about US intentions in Greenland, the pound significantly underperformed the euro. This reflects the UK's weak balance of payments position and inability to be a significant independent geopolitical actor.

AUD: Overweight

The Australian dollar has lagged the repricing of interest rate differentials versus the US and Europe. If the RBA hikes rates, as markets currently expect, the Australian dollar is likely to reprice significantly stronger. Higher commodity prices and improving global growth sentiment should further support the Australian dollar. There is little evidence that superannuation schemes have raised the currency hedge ratio on their large foreign asset holdings, but changing relative interest rates and increased questions about US institutions and asset valuations could yet lift hedge ratios from record low levels at present. A shift in hedging behavior would likely reduce the Australian dollar's beta in the event of a global sell-off in risk assets.

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Global credit strategy

2026 credit outlook

Geopolitics are front and center as we look ahead into 2026. A year ago, tariff-related headlines created noise that began to fade relatively shortly after “Liberation Day”. More recent actions and signalling from the Trump administration are likely to have longer-term ramifications for the global order. This has not caused risk markets to wobble notably to date, and we see enough growth momentum to provide a cushion. But as we look across credit asset classes, the margin for error is small, which we believe advocates for active credit portfolio management strategies. From a volatility perspective, January was a big month, not least with Trump’s attendance at Davos and the move in Japanese government bonds. The quiet festive season already seems well in the past!

Against these challenges, we highlight Invesco Fixed Income’s credit outlook for 2026 across several global credit asset classes, including investment grade, high yield, emerging markets and Asian credit.

US investment grade

US investment grade credit enters 2026 on sound footing, anchored by macro strength, resilient corporate earnings and historically elevated yields. That said, 2026 should see record (or near-record) issuance. With valuations already near multi-decade tights, investors should expect wider trading ranges, sharper issuer and sector-level dispersion, and a market that rewards fundamentally-driven, high-conviction positioning.

Fundamentals remain strong, but sector divergence is accelerating - AI-linked issuers and “Mag 7-adjacent” businesses continue strengthening, while other sectors face greater fundamental discrepancies and rising event risk. Elevated supply, bifurcated trends between higher and lower income consumers, and increasing idiosyncratic risk reinforce one clear reality: 2026 is a bond picker’s market, demanding conviction, discipline, and deep fundamental credit analysis.

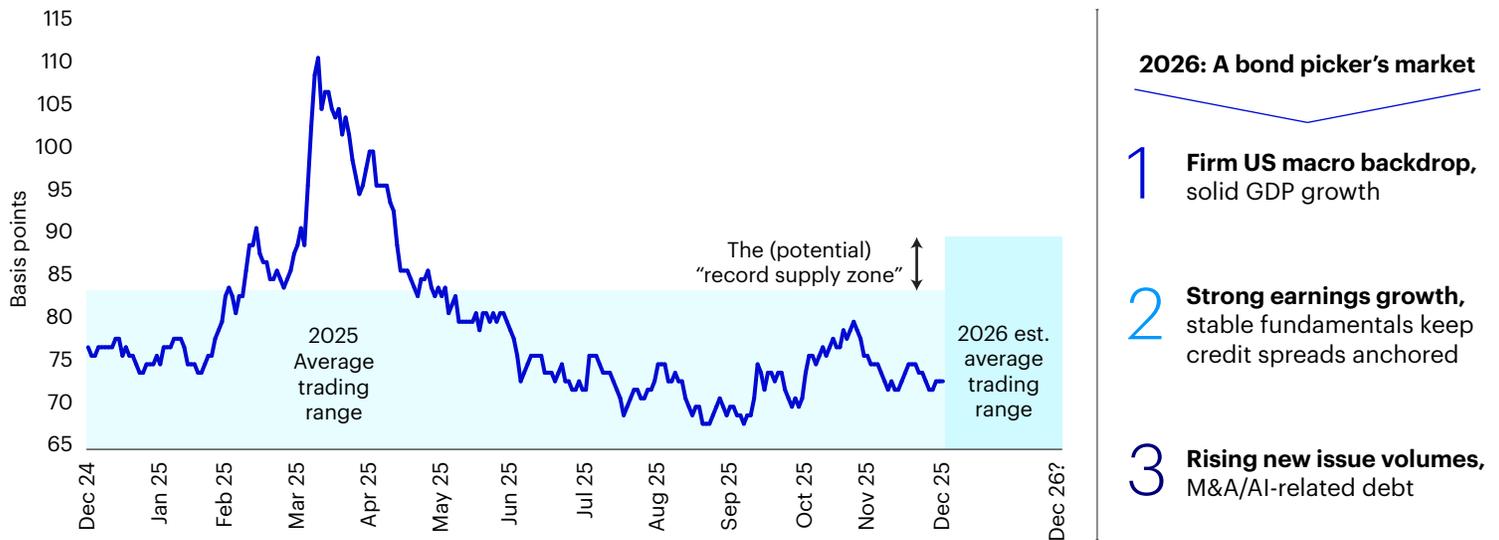
Top investable themes:

- **AI and tech credit:** Heavy AI-related issuance (public and private) creates both pressure and opportunity – we focus on high-quality tech and utility names that benefit from data center growth.
- **Mergers and acquisition (M&A) acceleration:** Rising deal flow introduces event-driven dislocations; in this environment, we favor high-risk leveraged buyout credits with change-of-control protection and selected M&A-related new issues with de-levering catalysts.
- **Financials:** We remain long banks. We are selective in business development companies (BDCs) with a bias toward high-quality, liquid platforms.
- **Energy:** Spreads are too tight for the underlying commodity price risk, in our view. We favor reducing exposure to exploration and production and prefer the durability of the midstream sector.
- **Utilities:** We favor beneficiaries of AI-related load growth, including floored hybrids of high-quality operators.

Bottom line: 2026 is a bond picker’s market. Positive growth, strong fundamentals, tight spreads, elevated yields and heavy issuance set the stage. As dispersion increases, high-conviction positioning, deep fundamental credit research and tactical capital deployment will likely drive outperformance in a complex, catalyst-rich market landscape.

Figure 1: A bond picker's market in US investment grade: supply waves and wider trading range in 2026

Supply surge will likely create opportunities for savvy active managers



Source: Invesco, Bloomberg L.P. Data from Dec. 31, 2024 to Dec. 31, 2025. Credit spread and index detail reflect Bloomberg US Investment Grade Credit Index OAS.

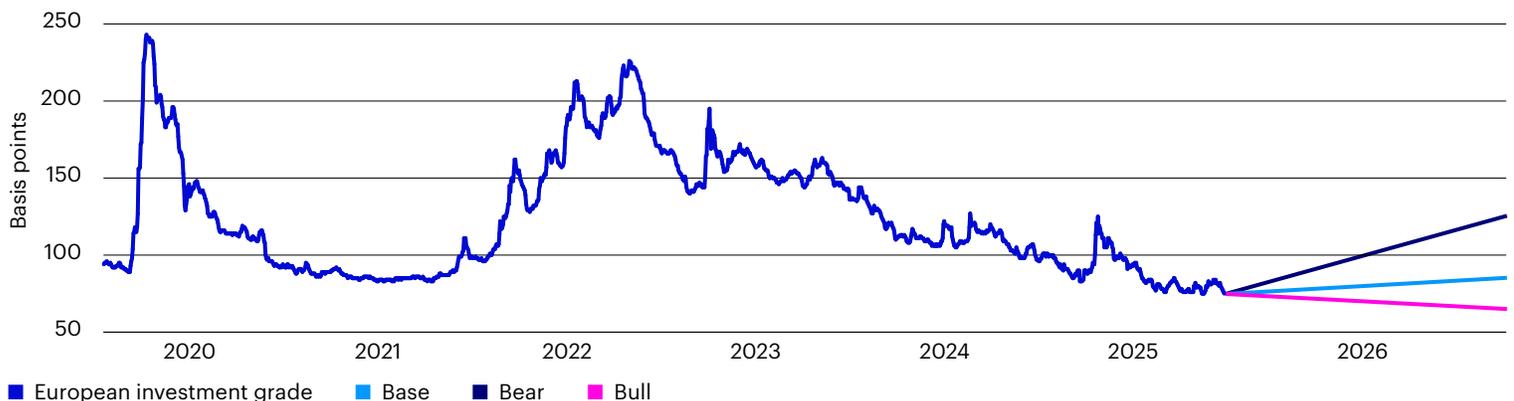
European investment grade

After impressive tightening in 2025, European investment grade spreads are now at the tight end of the post-global financial crisis trading range. We expect negligible default risk and limited rating migration to high yield this year, and European investment grade credit should deliver positive, though modest, excess returns in our central case.

Index yield levels slightly above 3% are likely to attract inflows that can absorb modest levels of net supply. However, reverse Yankee issuance is a concern, though it tends to be high quality.

Bottom line: We favor defensive positioning by sector, including reducing cyclicality and weaker BBBs, trimming overweight positions in financials and reducing subordinated debt exposure, such as to financial AT1s and corporate hybrids.

Figure 2: European investment grade - base, bull and bear case. Current spread levels just compensate for a reasonable outlook, but with downside risks



Bear (20% probability)

- The full impact of tariffs further hurts key European industries putting downward pressure on growth.
- AI investment increases leverage and leads to downwards rating pressure for high quality technology issuers.

Base (60% probability)

- Tariff uncertainty may weigh on key European industries
- Neutral ECB provides stability, but sovereigns must fund defense spending
- Geopolitical uncertainty could cause volatility that creates buying opportunities

Bull (20% probability)

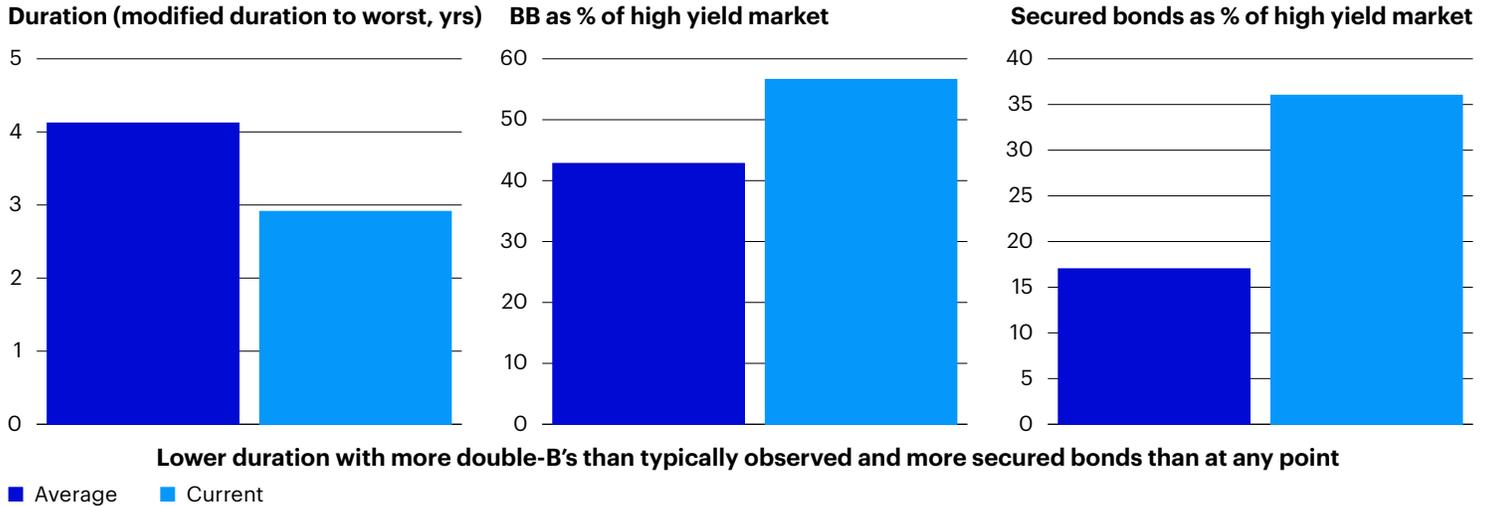
- Inflation is tamed and economic growth remains sufficiently buoyant
- Corporates maintain balance sheet discipline
- Geopolitical concerns abate and tariffs prove to be a one-off impact

US high yield

The backdrop to 2026 is similar to last year, with decent fundamentals, a benign default environment and a high up-in-quality skew among high yield issuers. Spreads have tightened, though, leaving less room for error. It seems the market's perception of economic health is increasingly influenced by the enormous investment in AI infrastructure and the returns generated by companies and industries related to it. This could be masking weakness elsewhere in the economy.

Figure 3: High yield composition

Shorter dated, higher quality market today



Source: BofA Global Research, ICE Data Indices LLC. Data as of Dec. 31, 2025. Duration and BB% data are monthly since 1996. Seniority is quarterly since 2000.

Our view of high yield sector fundamentals remains sanguine, but we are monitoring weakness in a few more industries than we were a year ago. That said, the huge sums being spent on AI and the tailwind of the One Big Beautiful Bill should be sufficient to drive good economic growth this year. Some incremental easing moves by the Fed will likely also help market sentiment.

Bottom line: With valuations quite tight across the board, we anticipate that this year's return will be driven by coupon, with modest spread widening forecasted. We remain constructive but cautious, looking to take advantage of any volatility events that occur this year.

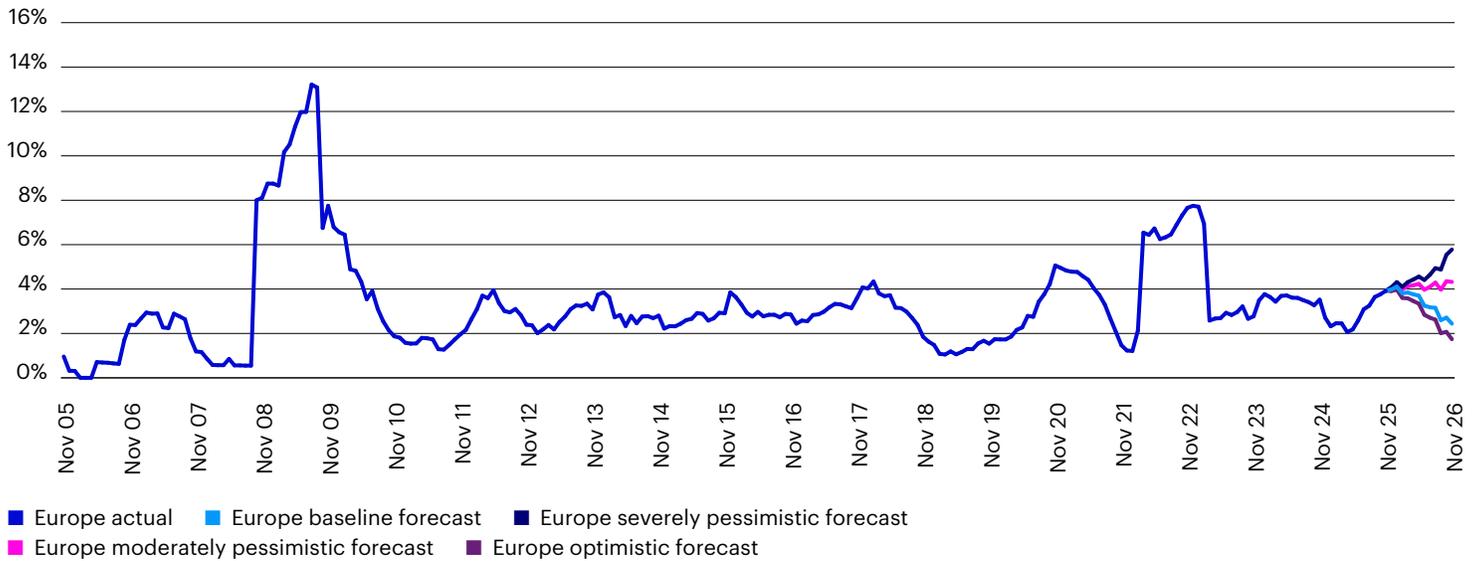
European high yield

2025 was another strong year for European high yield, as a supportive technical backdrop and resilient index-level fundamentals pushed credit spreads toward post-global financial crisis tights. Despite currently compressed spreads, yields remain attractive on a historical basis, in our view, which we expect to support continued inflows into the asset class in 2026.

Beneath the benign picture at the index level, however, a pronounced two-tier market has emerged. Certain cyclical sectors remain challenged, and, with limited visibility on the timing and pace of a recovery, investors have been less willing to underwrite risk in these areas. While this dynamic is likely to persist in the near term, valuations in these parts of the market are becoming harder to ignore.

Bottom line: Relying solely on higher quality risk will likely be insufficient to generate outperformance going forward. We expect returns in 2026 to be driven primarily by carry but, as always, the ability to identify attractive idiosyncratic opportunities will likely be critical. We expect most of these opportunities to be found within the single B rating category.

Figure 4: European high yield default rates



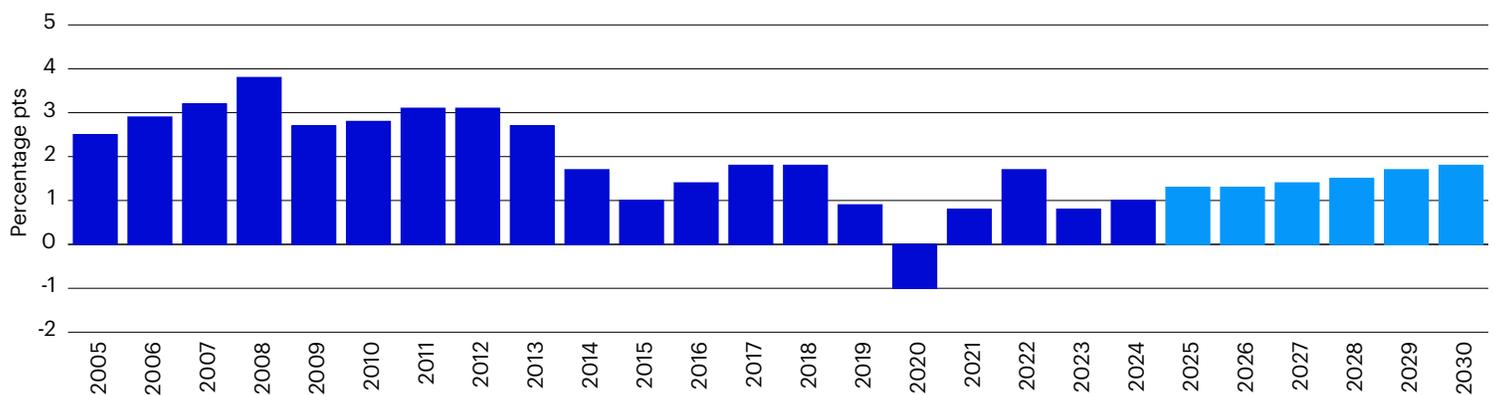
Source: Moody's Investors Service. Data from Nov. 30, 2005 to Nov. 30, 2025, forecasts thereafter. Forecasts are for illustrative purposes only.

Emerging markets – sovereign and corporate

We enter 2026 with a constructive but cautious outlook on emerging markets (EM). Geopolitics remain front and center following the US capture of Venezuelan president Nicolas Maduro, an event that has reinforced the Trump administration's willingness to take bold unilateral action and contributed to renewed US dollar weakness, a key tailwind for EM assets.

Despite spreads near historical tights, the macro setup is broadly supportive: EM growth continues to outpace developed markets (DM), underpinned by resilient domestic demand, improving external balances, easing inflation and a supportive global trade environment, driven in part by US AI-related investment and tariff exemptions that benefit EM supply chains. Monetary easing in several EM economies and the prospect of further Fed cuts add to the constructive backdrop.

Figure 5: IMF World Economic Outlook, real GDP growth, selected EMs less G2



Source: International Monetary Fund, World Economic Outlook, Jan. 19, 2026. Data from Dec. 31, 2005 to Dec. 31, 2024, IMF forecasts thereafter.

Bottom line: On the sovereign side, we maintain a neutral-to-positive stance. Heavy supply is being met with strong demand, which continues to draw inflows. While valuations are undeniably tight, improving credit quality – in the form of more rising stars than fallen angels - and better fiscal and external positions across EM support our outlook.

On the corporate side, we maintain a cautious stance. Fundamentals are solid but softening at the margin: leverage has ticked higher, interest coverage has slipped, and sector dispersion is growing. Valuations appear rich versus DM peers, with EM investment grade and high yield now offering only modest spread pickup. Technicals, on the other hand, are constructive: net issuance is expected to remain negative, inflows have stabilized and US dollar weakness provides support.

Asia corporate credit

Tight credit spreads leave Asian credit with a limited downside buffer in the case of significant risk-off events, but stable credit fundamentals and favorable market technicals provide good underlying support. Asian economies are generally in good shape with sound economic growth, controlled inflation and stable financial sector. Monetary and fiscal support are likely reserved for “emergency” events rather than to provide stimulus.

That said, swings in US national security strategy may have changed global geopolitical dynamics and potentially sped up regional geopolitical realignment in Asia, which may create increased volatility and opportunities in currencies, yield curves and the local currency bond market.

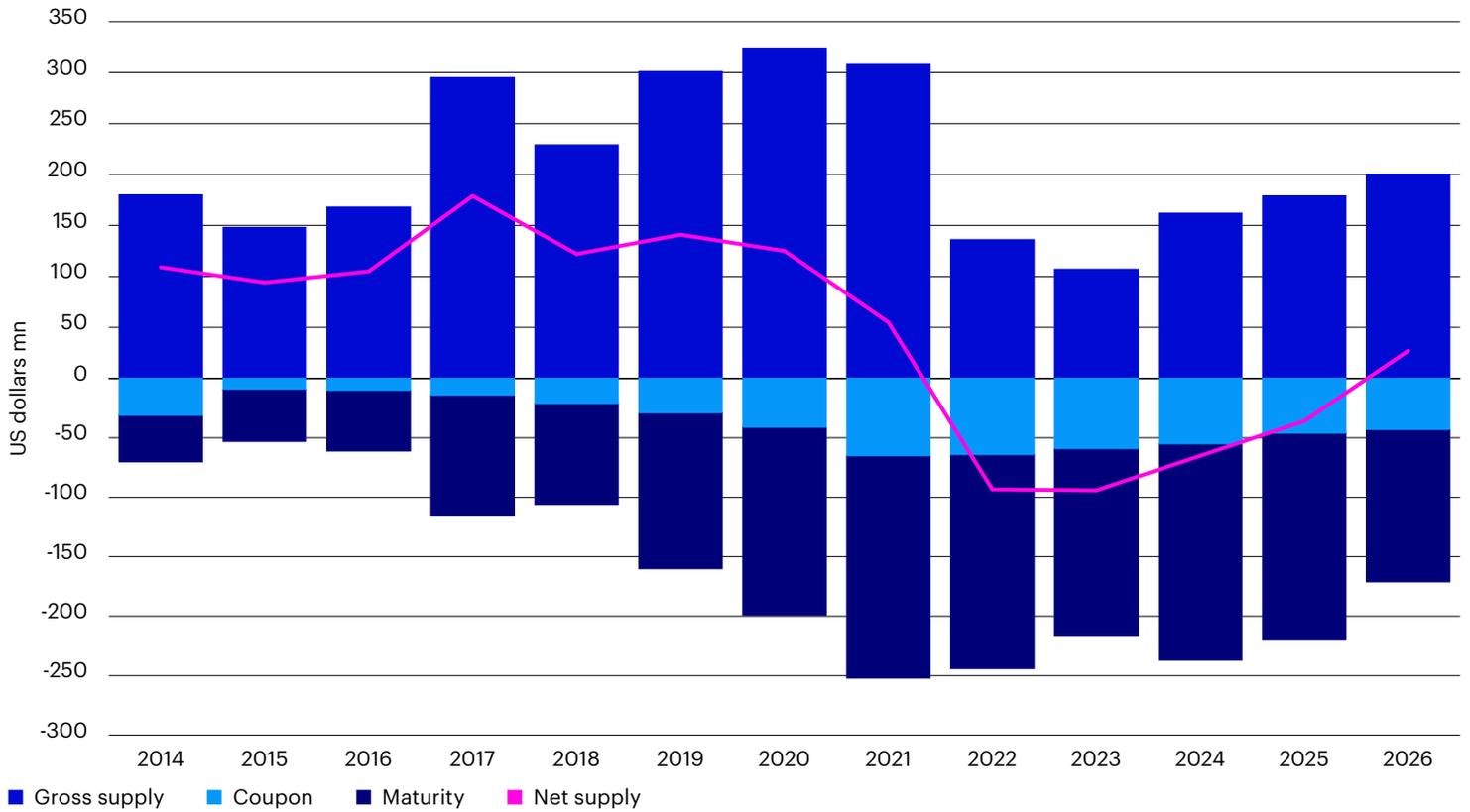
For example, geopolitical events may lead to short-term US dollar strength and US Treasury performance, while developments over the Fed chair and further substantial easing in the US could cause medium to long-term currency repricing and capital rotation away from US dollar assets.

Potential Asian currency outperformance against the US dollar, particularly the renminbi, could marginally reduce inflows into the Asian US dollar bond market. This scenario could cause credit spread repricing in 2026, but agile positioning along rates curves and tactical rotation across currencies could contribute more to total return than credit spread.

We expect new issuance to pick up in 2026, and net supply is likely to turn positive after four consecutive years of net redemptions starting in 2022. Japan, South Korea, India, and financials are likely to drive bond issuance growth this year but we expect higher levels of supply to be well absorbed.

Bottom line: Strong returns in the last three years have driven Asian credit spreads to historically tight levels. Stable credit fundamentals and strong technicals provide good underlying support, but tight spreads leave little cushion for significant risk-off events. We favor moving up in credit quality in each rating bucket, approaching high yield tactically, and issuers with improving credit trends in sectors including commodities, tech, consumer staples, financials and non-bank financial companies.

Figure 6: Asia net supply may turn positive in FY 2026



Source: JP Morgan, Bond Radar, Bloomberg L.P. Data from Dec. 31, 2014 to Dec. 31, 2025. Net redemption = gross supply – maturity – coupon. 2026 is an estimate.

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