Goldman Sachs Asset Management

FIXED INCOME OUTLOOK 1Q2026

Finding Opportunity in Uncertainty

Kay Haigh

Co-CIO and Co-Head, Fixed Income and Liquidity Solutions

Whitney Watson

Co-CIO and Co-Head, Fixed Income and Liquidity Solutions

"Fiscal expansion, continued central bank policy divergence and the AI capital expenditure boom have created a rich backdrop for 2026. Carry and curve positioning remain key themes, while yields across many asset classes are attractive even in the middle of a Fed easing cycle. This environment presents an attractive opportunity to bolster portfolios with diverse and strategically managed fixed income allocations."

"While recognizing how fertile the fixed income environment is, we remain focused on trying to minimize downside risk, managing potential headwinds such as geopolitical tension, credit quality concerns and rising fiscal spending. Spreads remain tight, however we see pockets of opportunity in sectors including financials and securitized credit, underpinned by our bottom-up research."

CIO Perspectives

Fixed income markets ended 2025 in the main on a positive note, with several assets across credit, emerging markets, currencies and core government bonds achieving strong positive returns for the year. However, this broad-based bull-run belied the true nature of markets for the period, one marked by bouts of volatility and uncertainty. Looking ahead in 2026, many of the previous year's themes still resonate. Tariffs, are still having a real effect on corporate and country balance sheets, while the implication of rising government spending on growth and budgetary credibility remains a long-term question. Central bank divergence also continues, with many economies across the G10 at different stages of their respective cycles.

These have now been joined by a fresh set of factors for market participants to navigate. The AI boom for example has firmly become a fixed income story due to the billions of dollars' worth of issuance by large cloud service providers—also known as hyperscalers—while recent geopolitical events are a reminder of the wider uncertainty that can govern a multipolar world. With so many different variables receding, emerging and appearing on the horizon, how should investors decide where and what to focus on?

Choosing a suitable path necessitates a flexible and dynamic approach to fixed income. This allows investors to implement strategies and views across multiple debt and currency markets, and shift decisively when required. In Japan, for example, the new government's expansionary program and a hiking Bank of Japan (BoJ) keeps us cautious on Japanese government bonds, while in the UK we are overweight gilts, expressing our view that fiscal tightening and weak inflation could see them rally. We also continue to see value in emerging markets, which could benefit from falling US rates, solid fundamentals and their attractive carry profile. Spread sector opportunities are also apparent despite still-tight valuations, with segments of the high yield and securitized credit spaces in particular appealing as sources of income.

Managing portfolios with a vigilant mindset is critical in this environment, to appropriately express convictions while heeding potential pitfalls. In this context, we look to mitigate downside risk by balancing marrying credit exposures with select, high-quality core fixed income allocations.

The economic and market forecasts presented herein are for informational purposes as of the date of this document. There can be no assurance that the forecasts will be achieved. Please see additional disclosures at the end of this document.

Summary of Investment Views

	Underweight	Neutral	Overweight	Investment Perspectives
Sovereign Bonds				
US		●		We feel the near-term Fed meetings are fairly priced and are positioned for a steeper curve, which could potentially work in either a rally or sell-off environment.
Euro Area		●		The European Central Bank (ECB) is likely to be firmly on hold, but deteriorating supply/demand at the long end should put steepening pressure on the curve.
Japan	●			BoJ rate hikes are likely to exceed market expectations given robust underlying inflation, resilient growth, loose financial conditions, and expansionary fiscal.
UK			●	Underlying inflation pressures are much weaker than high headline numbers would suggest, while the labor market is loosening rapidly, and fiscal is turning more contractionary.
Other G10			●	The market is overestimating the probability of a pivot to rate hikes this year in Australia and New Zealand.
Currencies				
US Dollar		●		Slight overweight. Positive tailwinds include relative tech outperformance in equity markets, fiscal expansion without any risk premium, and relative productivity advantage. Unwind of AI optimism and weaker-than-expected labor market data are key risks to this view.
Euro		●		Neutral, responding to our currency signals.
Japanese Yen	●			Underweight on government spending concerns under Takaichi's premiership and BoJ policy divergence.
British Pound	●			Underweight on growing fiscal concerns.
Chinese Yuan		●		Signals are positive; however, the risk/reward profile is unfavorable.
EM (ELMI)		●		Currency signals are neutral. We are overweight select Asian currencies against the more-volatile EM basket, as well as the Czech koruna versus the Hungarian forint.
Fixed Income Spread Sectors				
IG Credit	●			Moderately underweight due to tight spreads. Fundamentals remain supportive but stretched valuations and AI-related supply dynamics are headwinds for forward returns.
HY Credit			●	Valuations are tight but offer better risk-adjusted carry than investment grade and fundamentals remain supportive especially in the BB and B cohorts.
Bank Loans			●	Income potential is attractive, but we are selective given potential stress among issuers with significant short-dated debt and low free cash flow cushions.
Agency MBS			●	Moderately overweight due to the potential for renewed investor demand amid wide spreads relative to other sectors, but we are alert to headwinds from higher rate volatility. Supply is expected to be muted as housing activity remains weak.
Securitized Credit			●	Risk-adjusted carry is attractive, and there is spread-tightening potential in select segments.
External EMD			●	Carry remains attractive, while the continued improvement in fundamentals is encouraging. The weaker US dollar remains a tailwind, but valuations are tight.
Local EMD			●	Tailwinds remain the continued grind lower in yields, helped by lower US Treasury yields, easing cycles from central banks on the back of recent policy orthodoxy as well as higher real yields.

Source: Goldman Sachs Asset Management. As of January 7 2025. Based on representative exposures in a global multi-sector fixed income portfolio. Currency Signals: We systematically derive investment signals based on analysis of carry prospects, macro fundamentals, and market sentiment. Our portfolio managers then exercise discretion to adjust or override these signals based on fundamental economic research, market intelligence and risk analysis, ensuring a risk-aware approach to optimizing returns.

Macro at a Glance

Growth: K-Shaped Recovery Takes Form in US

US growth in 2026 is likely to continue its positive trajectory, in our view. As the recent Q3 GDP release showed, household spending remains robust despite pressure on real incomes, with strength likely driven by higher-income consumers more sensitive to stock market wealth effects than labor market fragility. This dynamic could continue to be supported by expected additional stimulus, from both the One Big Beautiful Bill Act and falling interest rates. Easing drags from tariff uncertainty and continued tailwinds from AI capital expenditure (capex) should also help support growth.

The overall economy and Fed, however, remain sensitive to weakness in the labor market, and meaningful negative surprises in the nonfarm payrolls and unemployment rate now that data sources are less noisy post shutdown could alter that trajectory. Overall, however, we think that continued robust growth could curb the extent of any labor market softness, although we are mindful the current low-hire low-fire equilibrium is fragile and downside risks remain meaningful.

Among other major economies, we see upside and downside risks to European growth as finely balanced. In the short term, continued tensions over US trade and Chinese competition, as well as domestic political uncertainty, could potentially weigh on activity. However, the expected feeding through of increased fiscal spending, as well as robust activity driven by tourism and AI spending, could provide a catalyst to higher growth going forward. In the UK, meanwhile, a combination of risks point to the downside given subdued sentiment and ongoing labor market weakness, with recent GDP figures coming in well under Bank of England projections amid budget uncertainty.

In China, strong export performance in 2025 despite the increase in tariffs came as a surprise and provided a boost to growth, which we expect to be very close to the 5% target. On the other hand, domestic demand remained soft, with investment showing a year-on-year contraction for the first time. Looking ahead, we expect exports to continue to grow solidly in 2026 and be an important growth engine against still soft domestic demand. We see growth moderating overall but still remaining around 4.5%. The momentum of growth slowed into latter part of last year which combined with a high base means that achieving the growth target (likely to be set around or close to 5%) will require additional policy stimulus. We expect a modest easing of monetary policy (10-20 bps), additional liquidity support to facilitate government bond issuance, and a modestly supportive fiscal policy. The strong external performance would likely lead to a modest appreciation of the Chinese yuan, but a significant or rapid appreciation is unlikely as it exacerbates deflationary pressures.

Inflation: Cautious Optimism

The outlook for inflation in some areas of the world has improved after an uncertain 2025. In the US, for example, tariff passthrough has been slower and weaker than expected. While we expect further passthrough in 2026, with risks that firms opt to use start-of-year price resets to pass on costs, upward pressure on goods prices inflation should fade as the year progresses. Meanwhile, there continues to be progress on underlying inflation, reducing the risks of second-round effects. Inflation expectations are well anchored, wage growth has converged to target consistent levels and further disinflation in housing services is providing an offset to higher goods inflation.

In Europe, meanwhile, there is the potential for inflation to surprise slightly on the downside this year, driven by lower energy and core goods inflation. Services inflation could ease gradually due to high wage growth and a resilient economy. We anticipate headline inflation to remain below the 2% target for the next two years, before the introduction of the new carbon pricing system for fossil fuels and heating in 2028 pushes it back to target level.

In the UK, inflation will take a big step down in 2026 due to the cost-of-living measures of the budget, easing wage pressures and the fading impact of some one-off measures in 2025, such as national insurance contribution increases. Underlying inflation pressures in Japan meanwhile remain strong. A tight labor market and weak yen could well continue supporting price increases, even as headline inflation comes under downward pressure from incoming government subsidies on energy, education and childcare.

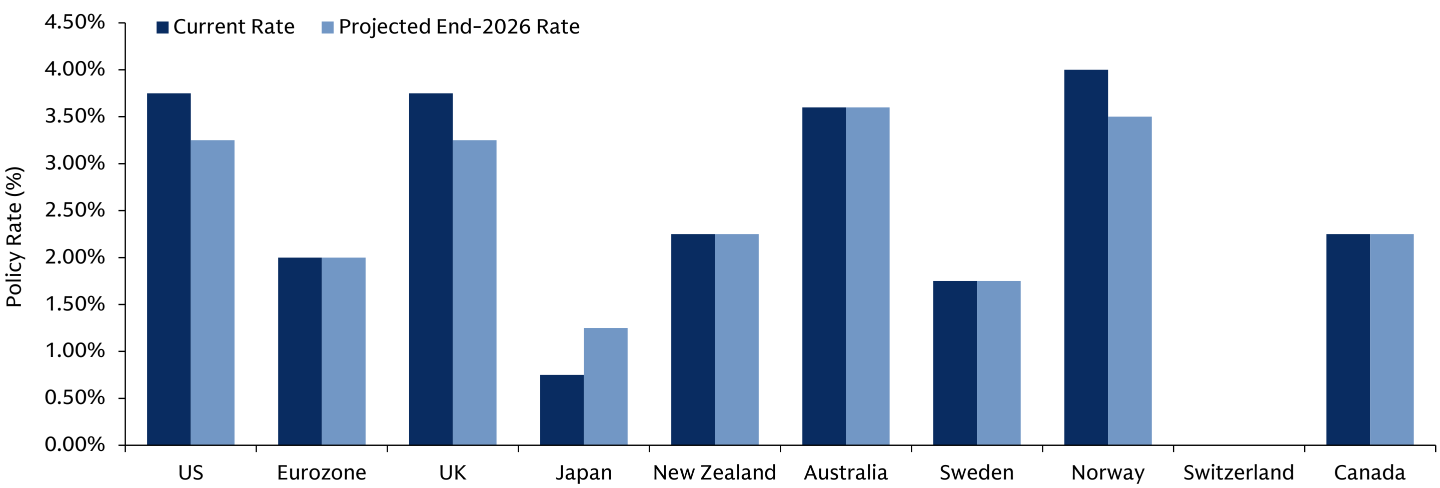
Policy Picture

The Fed appears to be on track to cut rates twice in 2026. Labor market risks continue to weigh on the mind of the Federal Open Market Committee, as expressed by the dovish tone of the December meeting. This easing bias will likely be continued with the arrival in May of a new Fed Chair, who is expected to be in the dovish camp. While the timing of further rate cuts remains uncertain, it would take significant upside surprises in labor market data and growth to push the Fed off its easing bias, in our view.

Other major central banks continue to enact policy on different paths. The ECB looks on course to stay on hold. The prospect of fiscal expansion driving hikes seems premature in 2026, in our view, while resilient growth and still-sticky services inflation have also reduced the chance of near-term cuts. The Bank of England could be in line to continue cutting rates twice in the first half of this year. Ongoing labor market weakness may add further downward pressure to rates, but the path towards the level rates settle at can be uncertain. In Japan, meanwhile, the pace of continued rate hikes likely depends on factors including yen strength and the upcoming Shunto wage negotiations at the turn of the first quarter. Weakness in the currency could see the BoJ hike faster than twice a year, and bring forward its hiking timetable to the first half of the year, possibly as early as April.

Policy divergence is also evident in other G10 markets. In Norway, we think the Norges Bank could overdeliver on its guidance of one rate cut this year in response to a better inflation profile and signs of softening economic activity, while the Riksbank in Sweden will likely hold rates instead until 2027. We also think Canada will keep policy steady this year, given signs that past easing is helping to support the economy. The Reserve Bank of Australia, meanwhile, has abandoned guidance for further cuts in the face of upside inflation pressure, and we now think there is a material risk that the next move for rates in the country could be higher. Across emerging markets, we expect easing to continue in many economies given continued downward pressure on US dollar and oil prices.

Exhibit 1: Global Policy Rates Continue to Move at Different Paces in Different Directions



Source: Goldman Sachs Asset Management. As of January 15, 2026.

Central Bank Snapshot

	INTEREST RATE POLICY	BALANCE SHEET POLICY	OUTLOOK	ACTIONS EXPECTED TO END OF 2026	OUR OUTLOOK VERSUS MARKET-IMPLIED PRICING
Fed	**Federal funds rate:** 3.50-3.75% **Last change:** December 2025 (-25bps) **Start of the cutting cycle:** September 2024 **Rate at the start of the cutting cycle:** 5.25-5.5%	Since December 1 the Fed has been fully reinvesting maturing Treasuries and rolling all MBS repayments into bills. In addition, the Fed stated reserve management purchases of bills on December 12.	Strong December unemployment data makes a near-term rate cut unlikely. The core of the FOMC, however, likely still supports taking rates back to neutral. We continue to see two cuts in 2026, now seeing them coming in June and July. **Expected rate at end-2026:** 3.0-3.25% **Neutral rate estimate:** 3.0%-3.75%	**Our outlook:** 2 cuts **Market-implied pricing:** 2-3 cuts	Neutral
ECB	**Deposit facility rate:** 2.0% **Last change:** June 2025 (- 25bps) **Start of the cutting cycle:** June 2024 **Rate at the start of the cutting cycle:** 4.0%	The ECB started reducing its balance sheet in March 2023 and ceased reinvestments from its APP in July 2023. The reinvestment of proceeds from maturing securities under the PEPP decreased, which started in July 2024 and concluded in December 2024.	We expect the ECB to stay on hold for the foreseeable future. Resilient growth and stronger inflation suggest the chances of further cuts are slimmer, but we also don't see hikes coming any time soon. **Expected rate at end-2026:** 2.0% **Neutral rate estimate:** 1.75%-2.25%	**Our outlook:** 0 cut **Market-implied pricing:** 0-1 cut	Neutral
BoE	**Bank Rate:** 3.75% **Last change:** December 2025 (-25bps) **Start of the cutting cycle:** July 2024 **Rate at the start of the cutting cycle:** 5.25%	The BoE has actively been reducing its balance sheet since November 2022. At the September 2025 meeting, the MPC voted to reduce the pace of gilt stock reduction to £70 billion. Given lower redemptions, this implies a slight increase in the pace of active sales.	Ongoing labor market weakness and falling inflation in 2026 should prompt the BoE to cut rates twice, quarterly, to 3.25%. The risks are tilted to the downside, but the path to the terminal rate may be slower due to a more gradual wage disinflation process. **Expected rate at end-2026:** 3.25% **Neutral rate estimate:** 2.25%-3.75%	**Our outlook:** 3 cuts **Market-implied pricing:** 2-3 cuts	Slightly Dovish
BoJ	**Policy deposit rate:** 0.75% **Last change:** December 2025 (+25bps) **Start of the hiking cycle:** March 2024 **Rate at start of the latest hiking cycle:** -0.1%	The gradual reduction plan for JGB purchases will be from around ¥6 trillion per month to around ¥3 trillion over 18 months. Reduced bond buying will initially concentrate on intermediate maturity bonds.	US tariff rebates, above-target inflation, a weak yen, labor market tightness and strong wage momentum should push the BoJ to hike at least every six months. **Expected rate at end-2026:** 1.25% **Neutral rate estimate:** 1.0%-2.5%	**Our outlook:** >2 hikes **Market-implied pricing:** 1-2 hikes	Hawkish

Source: Goldman Sachs Asset Management, Bloomberg for market-implied pricing. As of January 7, 2026. The neutral rate estimates come with a degree of uncertainty. They are derived from a combination of fundamental, market, and model-based assessments. The ranges for the Fed, BoE and BoJ reflect the diversity of these estimates. For the ECB, the range represents the spectrum of policymakers' estimates, which has been adjusted based on our discretionary perspective. The economic and market forecasts presented herein have been generated by Goldman Sachs Asset Management for informational purposes as of the date of this document. They are based on proprietary models and there can be no assurance that the forecasts will be achieved.

What We're Watching

Charting Europe's Path Ahead

Competing dynamics have made the outlook for eurozone growth in 2026 unclear. On one hand, the much-celebrated fiscal expansion announced last year has taken longer to deliver than anticipated, while increased competition from Chinese exporters is putting further pressure on the domestic manufacturing sector. Looking further ahead, the French presential election in 2027 could be an additional growth obstacle given ongoing political uncertainty in the country.

Several factors, however, could provide catalysts to European growth. The tourism sector remains strong, while peripheral eurozone economies—especially Ireland and Spain—have taken advantage of tariff front-loading and tax-haven status respectively to become significant drivers of growth. AI spending is also projected to boost activity, while the labor market's low employment and vacancy rates, as well as historically low levels of slack, point to a robust employment picture. This combination of headwinds and tailwinds, and whether one ends up dominating the other, will be a key determinant of whether the ECB will be shifted off its holding pattern earlier than we anticipate.

The Roadblocks That Could Stall the AI Buildout

Hyperscalers became increasingly willing to use debt markets to fund data center expansion in 2025. This broke from previous perceived wisdom that they would in the main finance these activities via their own cashflows, raising concerns about the sustainability of the AI-related debt boom. Most of these issuers remain in good financial health, in our view, however challenges could be on the horizon in terms of making adequate returns on investment and overcoming power generation bottlenecks.

Factors That Could Suggest a Turn in the Credit Cycle

Overall we believe these events, while concerning, are idiosyncratic, and do not speak to the health of the broader credit market. In terms of investment grade debt, robust earnings and a focus on balance sheet health indicate we are in the middle of the credit cycle; however, we remain on the lookout for behaviors that could suggest we are moving further on in the pattern, such as an increase in leveraged buyouts or a wider loosening of lending standards.

KEY 2026 NUMBERS AT A GLANCE

$700bn

Expected funding needs for data center buildout in 2026 alone, to be funded by hyperscaler cashflow and debt issuance. This could rise to more than $1.4 trillion in 2030.[1]

1.1%

Amount estimated that AI could boost European productivity over the next five years.[2]

$1.8tn

Amount of US investment-grade bond issuance forecasted for 2026, which would be the largest amount of annual gross supply on record.[3]

Source: [1]JP Morgan, as of 10 November 2025. [2]IMF, as of November 20 2025. [3]JP Morgan, as of 25 November 2025.

Asset Class Views: Our Outlook & Potential Opportunities

Interest Rates

Outlook

The Fed is on pause for now, in our view, waiting for any change in the balance of risks between inflation and employment before adjusting policy again. However, the relatively dovish nature of the FOMC's core, which has shown sensitivity to labor market weakness recently, suggests the bar to further cuts is low, while the arrival of a new Fed Governor in May—likely to adopt a dovish stance—also increases the case for further easing in 2026. The timing of these potential cuts remains unclear, however. In our view, the Fed could ease twice in the first half of the year should the labor market continue to show signs of deterioration, with their pace dependent on how severe the weakness is. A stabilizing labor market, however, could see 'normalization' cuts pushed back to a later date, under the auspices of the new Fed Chair.

The ECB meanwhile is firmly on hold, in our view, with the bar for both easing and tightening relatively high. Recent projection upgrades suggest the risk is for inflation to surprise to the downside; however, growth would need to significantly weaken for cuts to come into play. In the UK, much lower inflation should help the BoE continue cutting rates to neutral, and any downside surprises to growth expectations could see rates being cut further. Japan is on course to hike twice in 2026. The BoJ's timing, however, will likely depend on the outcome of wage negotiations and the direction of the yen.

Elsewhere in Europe, many easing cycles seen through 2025 are now at or nearing their end. In Sweden, for instance, the Riksbank is likely on hold for 2026, balancing a robust recovery with a relatively loose labor market. We see the bank starting a hiking cycle in the first quarter of 2027, although there is a risk of a cut in the second half of 2026 should its growth projections not materialize. The Swiss National Bank is likely to keep rates at zero this year, although could look to lift rates in 2027 if wider European growth prospects pick up, The Norges Bank, meanwhile, remains on course for two cuts this year in our view, with the economy continuing to gradually soften.

Across other G10 economies, Canada may keep rates steady for 2026 as it waits for unequivocal evidence that the recovery is taking hold. New Zealand and Australia interest rates also look set to be steady for 2026. However, we are cognizant that above-target inflation coupled with a cyclical recovery in both countries could see the Reserve Banks of Australia and New Zealand amongst the first DM central banks to pivot back to rate hikes.

Opportunities

Curve dynamics across the major DM bond markets are likely to be a major source of opportunity. Directionally, we are neutral on US Treasuries and European bonds, but hold a steepening bias across both. US steepeners could benefit in either a risk-off (labor market weakness causing front-end rates to fall) or risk-on (fiscal expansion supporting growth and pushing up long-term yields) scenario. In Europe, an additional catalyst for steepeners could come from selling by Dutch pension funds transitioning from defined benefit to defined contribution schemes, which could continue to weigh on longer-dated notes.

Elsewhere in DM, divergent central bank policy should continue to give active investors opportunities. In Japan, we are positioned underweight and in curve flatteners, as continued rate hikes could push up the short end of the curve. By contrast, we are overweight duration in the UK, with a focus on the short end of the curve, as a weak labor market and falling inflation could drive more central bank cuts than anticipated. And in Australia and New Zealand we believe the market is overestimating the probability of a pivot to rate hikes, instead seeing central banks on hold, and are thus positioned overweight.

Currencies

Outlook

Chair Powell's comments at the December Fed meeting suggested the FOMC has a low tolerance for labor market weakness, implying that the US dollar could fall further than markets expect if the upcoming unemployment and nonfarm payroll figures surprise on the downside.

By contrast, stronger-than-expected readings could remove that risk premium and provide support for the greenback, while continued AI-related capex may also be supportive. Overall, the dollar remains caught between several potential headwinds and tailwinds which could pull it in either direction. The Fed's increased focus on the labor market has most of our attention.

Opportunities

We have a balanced view of the US dollar given the pressure it faces in both directions. Fiscal expansion, AI-capex spending and a labor market that is cooling rather than deteriorating should cap the number of Fed rate cuts, in our view. However, the possibility of AI optimism waning, as well as weakness in upcoming labor market data, could prove detrimental to the dollar.

Elsewhere, we are cautious on the British pound given ongoing fiscal concerns, and hold a similar view on the Japanese yen given the Takaichi premiership's potential to increase government spending. In emerging markets, we hold select overweight positions in the South Korean won, Mexican peso and Czech koruna.

Investment Grade

Outlook

Investment-grade credit offers a compelling blend of income and relative stability in 2026 amid evolving economic conditions, in our view. Current tight spreads are largely justified by resilient corporate fundamentals and expectations for continued, albeit divergent, economic performance across key regions. Broad balance sheet strength remains; many non-financial corporations reported modest improvements in their third-quarter earnings in 2025, and steady debt growth has kept median gross leverage relatively stable. This fundamental stability underpins our expectation that spreads can remain range-bound. And while global growth is expected to remain steady, divergence in central bank policies could lead to tailwinds for all-in returns as yields continue to moderate. Strong demand has also been a key driver of tight spreads. While gross issuance is projected to rise in 2026, net issuance adjusted for coupon income is expected to remain manageable and below 2020 levels, supported by the sizable income component.

Opportunities vary across the investment grade market, with spreads near long-term averages and limited dispersion. This backdrop favors a nimble, bottom-up approach focused on selective positioning rather than taking excessive market risk at this point in the cycle.

Opportunities

Relatively high "all-in" yields remain a key draw for investors, offering attractive carry and a meaningful buffer against potential market shocks. Starting yields have historically been a strong indicator of total returns, and at their current level can provide additional support for investment grade credit in 2026, reinforcing the case for sustained demand and income generation.

While our base case is for spreads to remain range-bound, a slight widening is possible. This could be driven by increased M&A activity, higher AI-related capex, and idiosyncratic credit deterioration weighing on certain sectors. We are alert to the risk of more "fallen angels" (issuers downgraded from investment grade to high yield), though we expect conditions similar to 2025. Geopolitics, commodity prices, and AI-related sentiment will remain key factors to evaluate, with cyclical sectors such as energy and chemicals likely to face headwinds.

From a rating-bucket perspective, BBBs continue to offer relatively attractive carry compared to single-As, and we see scope for select BBB issuers that added leverage to repair balance sheets. Spreads between 10-year and 30-year notes remain tight, in our view, which reinforces our preference for overweight positions in short-end BBBs. This provides a defensive hedge should spreads widen materially, though this is not our base case.

Asset quality in the banking sector remains strong, and with expectations for further curve steepening, bank spreads concentrated in the short and intermediate parts of the curve look attractive versus more cyclical and supply-pressured sectors as we head into 2026. We favor senior debt from large, systemically important banks with robust capital buffers to withstand potential normalization in asset quality. We expect euro-denominated investment grade to modestly outperform US dollar-denominated investment grade as we head into 2026, consistent with historical trends prior to 2022. Key drivers include improving euro area growth supported by German fiscal measures, higher M&A and AI-related capex supply in US IG, and the larger share of financials combined with shorter duration in the European IG index.

High Yield Credit and Bank Loans

Outlook

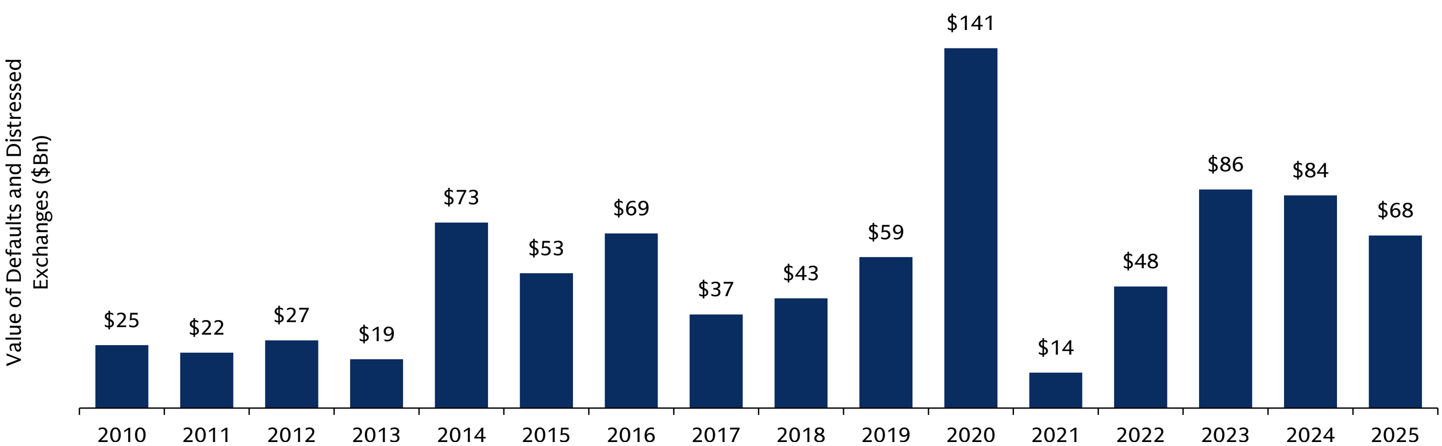
The setup for leveraged credit heading into 2026 has many of the same characteristics we saw one year ago, with one important difference. After a big move in valuations around Liberation Day, leveraged credit spreads across US and EU HY and credit spreads were essentially unchanged in the low 300bps mark over the course of 2025. Average leveraged loan spreads were fractionally higher at ~450 bps.[1]

Fundamentally, we believe the leveraged credit market remains in good shape overall as measured by average leverage and interest coverage ratios, with both just above 4.0x and in line with post-global financial crisis averages. We continue to see durable, low-single-digit growth in revenues in EBITDA for most issuers. Default rates, while higher for leveraged loans including distressed exchanges, are at manageable levels and our research team's recent survey across the US and European high yield and loan markets suggest a similar environment for 2026. Technically, we expect the high yield and leveraged loan markets to grow modestly in 2026 but traditional sources of demand, which include coupon reinvestment, collateralized loan obligation (CLO) formation, retail flows and crossover investment, should be more than sufficient to absorb new paper.

The difference to the setup as we enter 2026 is risk-free rates. The five-year US treasury yield has decreased by 65 bps to 3.75% over the past year while risk-free floating rates, as measured by SOFR, are now roughly (and coincidentally) 3.75% which is 75 bps lower than a year ago.

Positively, lower rates will aid issuer fundamentals, especially in the context of capital structures with floating rate debt which will see lower interest expense and better free cash flow all else equal. We believe that coupon-like returns are a reasonable base case expectation for leveraged credit investors in 2026. The positive blend of fundamental and technical factors discussed above provide substantial support for that view. While risk-free rates are clearly lower than one year ago, we think additional cooling of inflation data could enable duration to provide a tailwind for high yield market returns in 2026.

Exhibit 2: Combined Dollar Value of Defaults and Distressed Exchanges Among High Yield Bonds and Bank Loans



Source: JP Morgan, as of 6 January 2025.

Opportunities

Overall market discipline regarding underwriting standards generally remains good; however, we believe there will be opportunities for "inverse" credit picking. Avoiding credits that significantly underperform in this manner can have a positive impact on relative performance and will likely be a key feature of 2026 high yield investing. We also believe the capital intensity associated with

[1] JPM for USHY & LL, and Bloomberg for EUHY, as of 2025.

infrastructure around AI and energy will create attractive-yielding opportunities. In 2025, we saw $17 billion of high yield issuance from debut data center/AI-linked credits. Over the next two years, we estimate our market will see upwards of $40 billion incremental high yield AI infrastructure debt issuance.

Historically, M&A has been viewed as a credit risk in the leveraged finance market as management teams and sponsors often used covenant flexibility to make leveraging acquisitions which resulted in wider spreads and capital losses. Over the past two years, we have often seen M&A become a credit positive for the leveraged credit market. Investment grade companies have bought high yield issuers, while high yield issuers have been disciplined in financing structures. We expect the trend to continue and believe our fundamental, bottom-up approach to issuer research and portfolio construction will enable our team to identify and position opportunities in this arena.

Agency MBS

Outlook

We believe agency mortgage-backed securities' (MBS) strong performance in 2025 will continue into 1Q 2026, and we remain constructive on the asset class. Benign rate volatility and expected inflows from foreign investors and US banks should benefit the sector. On the housing front, the recent decline in mortgage rates and moderating home-price appreciation has resulted in housing affordability slightly improving.

Opportunities

Given these factors, we remain slightly overweight agency MBS basis. While spreads have reached their tightest since late March, they remain fair relative to historical levels and attractive relative to other risk assets. We continue to be positioned overweight par area and higher coupons as we expect prepayment speeds to slow down from the October peak. We also hold a small overweight to Ginnie Mae as we expect coming bank and overseas demand to be predominantly in Ginnies.[2] In specified pools, loan balance pools, Florida, and New York pools offer solid call protection compared to other stories, while also pairing well with our up-in-coupon trade.

Securitized Credit

Outlook

Risk-on sentiment driven by healthy fundamentals and robust technicals saw spreads broadly tighten across securitized sectors in 2025, and we expect this theme to continue in 2026, informing our broadly overweight stance to the asset class. While constructive on the sector, we remain observant for any decline in corporate fundamentals, consumer trends, and potential commercial real estate stress. Within commercial mortgage-backed securities (CMBS), we remain overweight Conduit and single asset, single borrower (SASB) CMBS, preferring senior tranches due to their sufficient credit protection. We still view the sector as well positioned during the Fed cutting cycle. Within SASB CMBS, we are focused on trophy office properties, reflective of their tariff insulation and work-in-office trends. CLO ETF demand remains robust, keeping CLO technicals supportive. With rate cuts in progress, tighter spreads and less loan coverage pressure should drive performance as well.

Opportunities

We continue to remain overweight CLOs, with a bias for AAAs given strong structural advantages and attractive carry. The ABS market also seeks to offer competitive valuations. Recent consumer data points to consumer resilience with strong Black Friday retail spending. Within ABS, we prefer senior tranches and remain overweight credit cards and auto loans. Lastly, we continue to maintain a favorable view on non-agency residential mortgage-backed securities. High levels of embedded home equity are supportive in a moderating home-price appreciation environment, and we prefer mezzanine credit risk transfer and AAA-rated non-qualified mortgages.

[2] Source: Goldman Sachs Asset Management, as of December 2025.

Emerging Market Debt

Outlook

We see multiple tailwinds that could support continued strength in 2026. Against a benign global growth backdrop and limited near-term risk events, we expect a supportive carry environment in which emerging markets compare favorably on yield. If a soft landing and a cutting cycle materialize, we see further room for spread tightening in select high yielders across sovereign and corporate issuers.

A benign inflation backdrop, still-elevated real policy rates, and projected additional US rate cuts create space for further easing in many EMs, especially high yielders. Where easing cycles near their end, fiscal divergence will become a more dominant factor. Even without further material USD depreciation versus G10, high-carry FX can still perform, and a low-volatility backdrop could add upside. U.S. rate cuts and dollar weakening have eased financial conditions, supporting growth. Faster-growing EMs offer diversification away from slower-growing developed markets; we believe the EM–DM growth differential to remain elevated at 2.4% in 2026.

Emerging market sovereigns and corporates also stand on solid footing. In Latin America, the election of market-preferred candidates in Brazil, Colombia, and Chile could catalyze pro-business policy and fiscal tightening. Sovereigns show strong nominal growth and healthy current account balances, though we note fiscal concerns in select pockets. Notably, emerging markets are increasingly characterized by improved macro stability, institutional credibility, and policy predictability, while in DMs investors are increasingly focused on issues traditionally associated with EM, such as rising fiscal deficits and central bank independence, blurring the traditional DM–EM boundary. Corporate default rates are likely to remain contained and concentrated in idiosyncratic cases rather than systemic trends.

Flow momentum has been positive since mid-2025 after a prolonged outflow period after the pandemic, leaving positioning in EMD still light. Overall, the combination of strong fundamentals, supportive technicals, and diversification benefits—including declining sensitivity to U.S. Treasuries—makes EM an attractive allocation in an increasingly multipolar world. Despite the positive backdrop, we remain vigilant to risks that could cause setbacks, including faster BoJ normalization and JPY appreciation, heavy U.S. AI-related debt issuance that could jeopardize EM IG spreads, and slower-than-expected Fed easing.

Opportunities

We view emerging market debt as an attractive source of carry and potential alpha, driven by high differentiation within the asset class. Carry makes the asset class particularly attractive versus other fixed income sectors. Local currency bonds come with additional FX risk, but high-carry emerging market FX can still perform even without another broad-based U.S. dollar decline, and additional rate cuts are in the pipeline for many emerging markets, especially high yielders, which could further support returns.

Emerging market corporates also offer potential opportunities for investors, as they have healthy balance sheets characterized by low debt levels and strategically hedged FX exposure. Net leverage for investment grade global EM corporates is also improving, having fallen to around 1.0x from more than 1.5x in 2013.[3] By contrast, European and US investment grade corporate net leverage has increased from the same level to almost 3.0x over the same period.

On the sovereign side, fundamental improvements, robust growth stories and structural reforms among sovereigns are helping improve the asset class's overall creditworthiness. This includes several rising stars in the emerging market debt universe, with Paraguay, Azerbaijan and Oman all earning IG status in 2025, while Morocco achieved its first IG rating. Looking ahead, we expect this broad-based trend to continue, as potential market-friendly electoral outcomes may act as a catalyst for fiscal consolidation and greater macroeconomic stability across many EMs.

For more, read '<u>Riding the Tide: The Strengthening Case for Emerging Market Debt</u>'

[3] Source: JP Morgan, as of December 2025.

Municipal Bonds

Outlook

We expect the muni market in 2026 to be shaped by three primary themes: attractive income generation, persistently elevated supply, and the increasing importance of credit selectivity. Investors can expect tax-exempt income to remain a compelling feature, particularly given the backdrop of potential market volatility influenced by Fed policy shifts and evolving economic data. The current elevated yields in the municipal market offer a significant buffer against market volatility, enhancing their appeal relative to other fixed-income assets. Despite these dynamics, municipal credit quality is expected to remain resilient. High-grade municipal credit demonstrated stability in 2025, even amidst challenges such as natural disasters and federal policy uncertainties. This resilience is underpinned by strong national economic performance and healthy reserve balances maintained by state and local governments. Furthermore, municipal debt growth has lagged economic indicators, leading to improved debt affordability compared to previous economic downturns. Elevated reserve levels are anticipated to support favorable budget cycles, contributing to overall credit stability.

Opportunities

The municipal yield curve is currently steeper than its 10-year historical average, notably the spread between shorter (2-year) and longer (30-year) maturities. Given the expected increased market volatility, opportunistically extending duration by adding longer-dated municipal bonds could enhance portfolio returns over the course of the year. Active management of this positioning will be crucial to capitalize on market movements. Increased supply also creates tactical opportunities for active managers, especially as factors like crossover investors, geopolitical events, and reduced dealer balance sheets amplify market fluctuations.

For more, read, '<u>What are the Key Themes for Munis in 2026?</u>'

Responsible Investing

Outlook

Despite ongoing geopolitical uncertainties, global markets are demonstrating resilience, propelled by widespread fiscal and monetary stimulus that is fueling economic growth, a trend we anticipate will extend into the first quarter of 2026. We forecast $500 billion in new global green bond supply in 2026, building on the record issuance seen in 2025. Activity should meaningfully accelerate in Europe in 2026, with the German fiscal stimulus starting to feed through into economic data but also the rest of Europe looking to spend more on defense and other associated infrastructure projects.

While new green bond issuance in Europe is expected to stabilize as its market matures, we foresee sustained growth in sectors like technology and chemicals, propelled by significant AI capex including advancements in chips and battery technologies. Utilities and grid operators may also experience substantial capex for expanding grid capacity, integrating renewables, and developing solar and wind power generation, which remain the fastest and cheapest ways to add capacity. Additionally, surging datacenter demand is driving increased capex from digital warehousing REITs. Although defense spending is not considered green or social, the associated fiscal stimulus will impact industrial value chains (e.g., chemicals, steel) and elevate power demand. In contrast, the automotive sector is likely to diminish in prominence due to the US moving away from Battery Electric Vehicle (BEV) production and relaxed EU emission targets. Furthermore, emerging market (EM) bond issuers are expected to continue to be significant drivers of the new supply forecast for 2026.

For context, ESG-labeled bonds now account for around 15% of new US dollar-denominated bond supply by EM issuers in Asia excluding Japan. We expect sustainability bond issuance to reach $250 billion in 2026 as blended green-social label structures have regained popularity post-pandemic. Social bond issuance is set to amount to $100 billion, slightly down compared to previous years as broader market focus has drifted towards more niche instruments such as blue bonds, water finance and nature-based solutions. Additionally, corporates are finding it challenging to locate social projects or assets that meet typical new bond issuance benchmark volumes, with most issuance driven by governments. We believe this brings our total green, social, and sustainability bonds issuance forecast to $850 billion for 2026, compared to just under $1 trillion in 2025.

Opportunities

Impact bonds, which include green, social, and sustainability bonds, consistently offer higher yields than conventional bonds, allowing investors to achieve greater income potential while contributing to sustainable objectives. Additionally, ongoing monetary easing cycles and the combination of monetary and fiscal stimulus, particularly in Europe where the green bond market features longer duration, are expected to further boost their performance relative to conventional bonds in 2026.

Moreover, the substantial issuance of emerging market green, social, and sustainability bonds seek to offer significant opportunities to capture new issue premia. This, coupled with the faster growth of the labelled bond market compared to the conventional fixed income market in emerging economies, is expected to positively drive the performance of dedicated labelled bond portfolios in these regions.

Liquidity Solutions

Outlook

Monetary policy adjustments remain a central focus for global money markets. The FOMC lowered policy rates twice in the fourth quarter by 25 bps at both the October and December meetings, while the federal funds target rate range closed 2025 at 3.50%-3.75%. The FOMC also announced the conclusion of the quantitative tightening program at the October meeting, and in December announced the start of Reserve Management Purchases (RMP). The RMP operations are focused on Treasury bills and Treasury securities with final maturities of three years or less (most purchases will be focused in the one- to four-month part of the Treasury bill curve), and are likely to total approximately $40 billion per month through the April tax collection period. The RMP program was announced to combat elevated funding market levels that were persistent throughout the fourth quarter as measured by the Secured Overnight Financing Rate (SOFR) printing closer to, if not above, the upper boundary of the target rate range. Heading into 2026, the federal funds futures market currently has two 25 bps cuts forecasted against a backdrop of the FOMC's Summary of Economic Projections indicating just one ease for the year. Our Liquidity Solutions team is more aligned with market pricing and views the potential for more easing in 2026 as the primary risk factor regarding monetary policy.

Moving to euro and sterling markets, policy divergence between the BoE and ECB has become increasingly evident. The ECB has held rates steady since June 2025, supported by headline inflation realizing near the 2% target and growth remaining resilient. President Lagarde continues to signal that policy is "in a good place," with only a material growth shock or persistent material inflation surprise likely to prompt a shift in rates. Meanwhile, UK inflation has proven stickier, its labor market has softened while growth remains subdued. These dynamics have led the BoE to maintain a quarterly rate-cutting cycle, which we expect to persist into 2026. Should disinflation accelerate or the labor market deteriorate further, the BoE could adopt an even more dovish stance. The UK gilt curve remains relatively flat versus European peers, but we expect gradual normalization over the coming year.

We anticipate continued balance sheet reduction from both the BoE and ECB through 2026, with liquidity declining via quantitative tightening and a shift toward a demand-driven reserve system. We are closely monitoring Dutch pension fund liquidity needs, as the implementation of the Future of Pensions Act is likely to reduce demand for long-duration assets and drive greater allocation to short- and medium-dated fixed income. Front-end credit spreads in euro and sterling corporate bonds (1–3yr) are at historically tight levels. We expect higher bond supply and potential volatility in 2026 to drive some widening in spreads.

Year-to-date, the offshore money market industry has grown by around $245 billion, led by inflows of roughly $105 billion into US dollar-denominated money market funds, $91 billion into euro-denominated money market funds, and $49 billion into sterling-denominated money market funds. We expect continued strong flows into them as cash investors seek daily liquidity and attractive yields.[4]

Opportunities

Money market funds continue to present an attractive option for investors seeking to mitigate near-term volatility while prioritizing stability and liquidity. For investors with the capacity to strategically segment their cash holdings, extending duration further along the yield curve through short-duration strategies offers a high-quality income generation source. This approach allows for potentially locking in attractive levels of current income and could be advantageous in a rate-cutting cycle. These strategies tend seek to offer a strategic balance between yield enhancement, capital preservation, and liquidity, bridging the gap between traditional fixed income and cash investments.

[4] Source: iMoneyNet, as of date for the data is December 12 2025.

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GLOSSARY

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ABBREVIATIONS

US Federal Reserve (Fed), European Central Bank (ECB), Bank of England (BoE), Bank of Japan (BoJ), Swiss National Bank (SNB), Central Bank of Sweden (Riksbank), Reserve Bank of New Zealand (RBNZ), Central Bank of Norway (Norges Bank), Bank of Canada (BoC), Reserve Bank of Australia (RBA).

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