FIXED INCOME MARKET COMMENTARY

1ST QUARTER 2026

Chris Sebald, CFA
Portfolio Manager,
Income Investments

Entering 2026, fixed-income and credit markets appeared to be on a strong footing. The yield curve steepened, central banks signaled forthcoming rate cuts, employment and growth remained solid, and credit spreads tightened. However, this supportive backdrop shifted abruptly in March, when war broke out in Iran, triggering a broad selloff across bonds, stocks, credit, and even gold. Markets quickly pivoted from anticipating multiple Fed rate cuts to pricing in higher yields.

Surging oil and gasoline prices, along with the specter of a prolonged energy shock, heightened inflation risk for both households and the broader economy. Even though the U.S. has substantially reduced its energy intensity over recent decades, oil and natural gas prices continue to exert a meaningful influence on the broader cost of goods and services. Energy inflation extends well beyond the gas pump, rippling through shipping, transportation, and petrochemicals, the foundational inputs for roughly 95% of manufactured goods. Against this backdrop, the Middle East conflict and closure of the Strait of Hormuz disrupted energy supplies, reigniting inflationary pressures and pushing interest rates higher.

For the quarter, the Bloomberg Aggregate Bond Index returned 0.0%, the Bloomberg Municipal Bond Index declined 0.2%, and the S&P 500 declined 4.4%.

Within the Treasury market, longer-term inflation expectations remained remarkably stable, as evidenced by steady 10-year TIPS breakeven inflation rates. Yet the yield curve steepened noticeably: the 2-year yield rose from 3.5% to 3.8%, while the 10-year yield climbed from 4.2% to 4.3%.

This rapid repricing erased earlier expectations of two or three 25-basis-point Fed cuts in 2026. By quarter end, markets had shifted to pricing the next Fed move as a potential rate hike rather than a cut.

For now, markets are still betting on a relatively short conflict with Iran. Futures curves price WTI crude—currently around $102—to retreat near pre-war levels by the end of 2026. However, should war drag on and energy prices stay elevated, the resulting impact on growth could alter the calculus, elevating recession risks and potentially reopening the door for Fed rate cuts to support employment.

Credit markets, which had been notably sanguine early in the year, began pricing in higher risks as the quarter evolved. Spreads on corporate investment grade and high-yield bonds, and leveraged loans widened by 11, 51, and 55 basis points, respectively (according to Bloomberg and S&P indices), reflecting war-related uncertainty and renewed concerns about liquidity and software loan exposures in private markets. Though we do not view these issues as systemic threats as portrayed in some media reports, they are adding pressure on already-stressed investors. These investors are navigating a lengthy list of challenges, including tariff and immigration uncertainty, government shutdown risk, persistently elevated inflation, rising unemployment concerns, and rapid technological change.

Despite heightened credit concerns, underlying corporate fundamentals remain supportive. Corporate debt levels have continued to decline relative to GDP since the COVID-19 pandemic, and the average company now carries lower debt and interest expense relative to cash flow.

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Amid the quarter's uncertainty, fixed income delivered stable returns. This resilience underscores why bonds remain a cornerstone of diversified portfolios, providing ballast during volatile periods and helping investors stay on track to meet their long-term objectives.

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