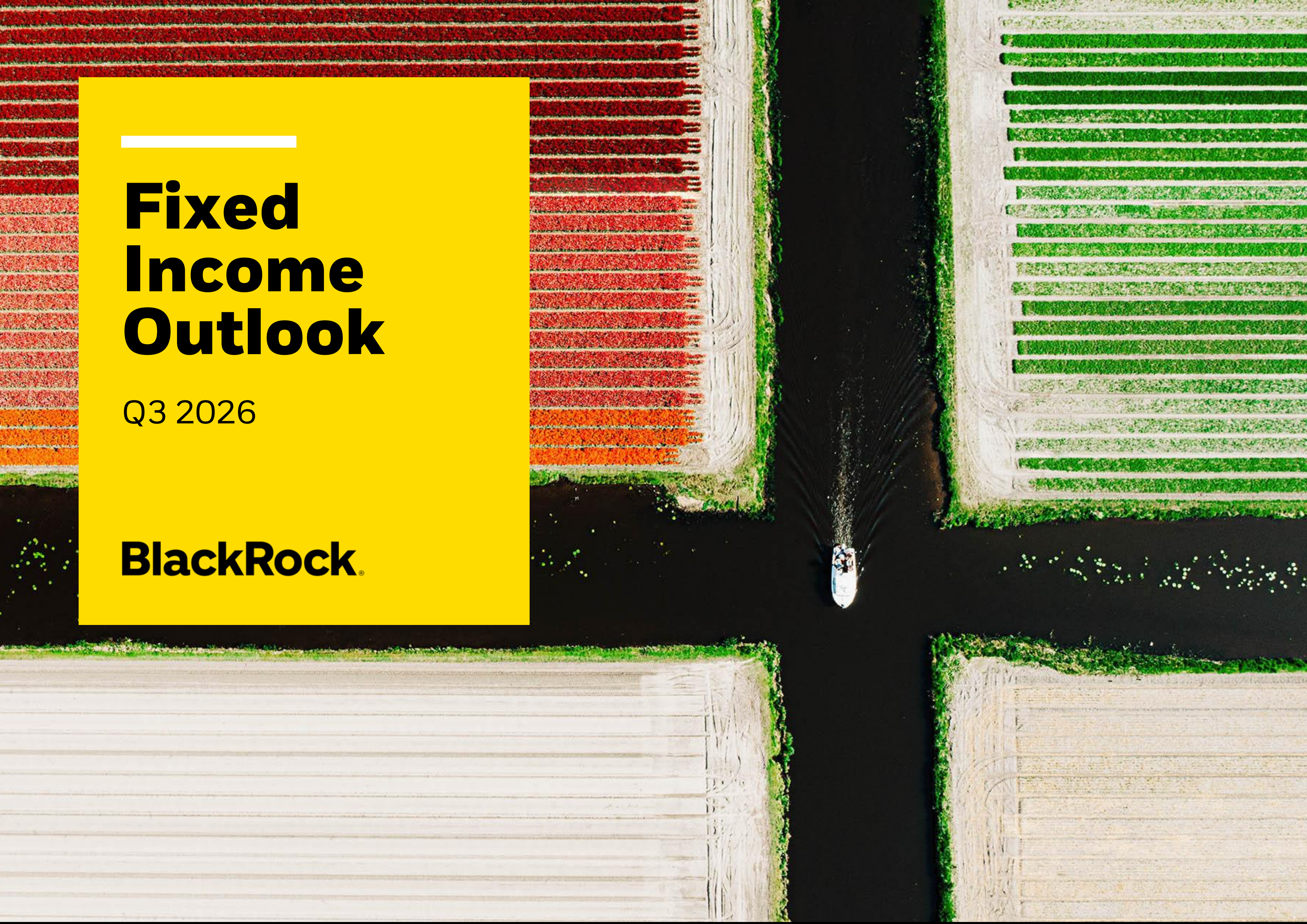
Fixed Income Outlook

Q3 2026

BlackRock



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Foreword

Rick Rieder
Chief Investment Officer
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Tom Parker
Chief Investment Officer
of Systematic Fixed Income

Old assumptions, new markets

For much of recent history, fixed income investors have operated within a familiar policy framework. Central banks anchored markets, forward guidance often mattered more than the data itself, and understanding the U.S. Federal Reserve's (Fed) reaction function became almost as important as understanding economic fundamentals. That framework is beginning to give way to a new regime.

Economic growth has remained resilient, supported by investment in artificial intelligence (AI), healthy corporate balance sheets and robust capital spending. But growth is becoming more narrowly driven, policymakers face more complex trade-offs, and the Fed is entering a new chapter under new leadership.
As central bank communication becomes less prescriptive, investors may need to spend less time anticipating policy moves and more time assessing the underlying economic and market forces shaping investment outcomes.

Today's yields continue to make a compelling case for fixed income. What has changed is not the opportunity, but how investors should think about capturing it.

The margin for error has narrowed. Investment outcomes depend less on how much risk investors take and more on where, and how selectively, they choose to take it. In this environment, judgment becomes increasingly valuable.

That is the perspective we bring to this quarter's Fixed Income Outlook. Our global active fixed income investment teams bring together insights from across markets to examine the forces shaping today's fixed income landscape and explain how we are positioning portfolios for a market defined by new realities rather than old assumptions.

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Global fixed income: A time to get more serious

Rick Rieder
Chief Investment Officer
of Global Fixed Income

Growth remains positive, but the drivers of growth, earnings and employment are becoming more concentrated.

The path of the U.S. economy and markets has been strikingly uneven over the past year, but despite the volatility, the underlying picture remains broadly constructive. It is easy to forget that in early 2025, markets priced nearly 70% odds of a recession by year-end.[1] Instead, recession fears faded and economic activity proved far more resilient than expected.

A key driver of that resilience has been the AI investment boom. Hyper-scaler capital expenditures have grown nearly 80% year over year, fueling economic growth, corporate earnings and market returns.[2] Nonresidential investment has expanded at an exceptional pace, helping support GDP growth even as higher interest rates continued to weigh on housing and other rate-sensitive sectors.

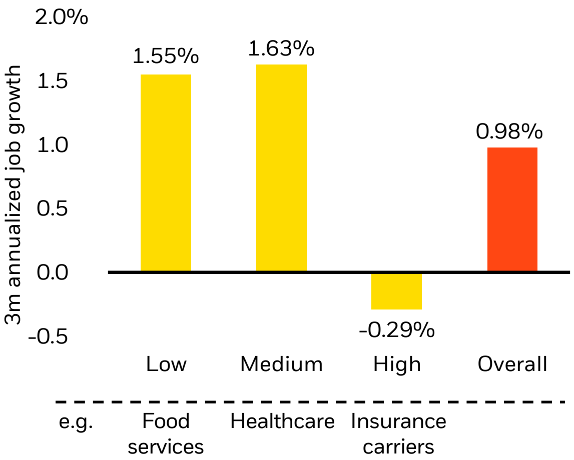
The long-term implications of AI remain powerful, but the near-term investment story is becoming more nuanced. The level of spending can remain high even as the growth rate cools, and markets tend to price that shift before the data confirms it. AI-driven disruption is also starting a much longer process of labor reallocation that is likely to create winners and losers across industries, even as headline economic data remains healthy.

Growth remains resilient, but narrower

Recent employment reports have been encouraging, but much of the hiring strength remains concentrated in a handful of sectors, while signs of softness are beginning to emerge elsewhere (see chart at right).

At the same time, inflation has remained elevated due in part to the energy shock associated with the conflict in Iran. While both labor market and inflation pressures warrant respect, we believe they are likely to moderate over time.

Three-month annualized job growth by level of AI exposure



Sources: Bureau of Labor Statistics, BlackRock analysis; as of May 31, 2026.

Growth remains positive, but the drivers of growth, earnings and employment are becoming more concentrated. Markets have benefited enormously from a narrow set of powerful themes, particularly around AI investment, but the next phase is likely to require greater precision in how risk is allocated and where opportunities are sourced.

1 Polymarket, as of Dec. 31, 2025.
2 Bloomberg, as of June 2026.

Global fixed income:
A time to get more serious

A new era for monetary policy

These crosscurrents create a difficult backdrop for policymakers, which is why we are encouraged by recent developments at the Federal Reserve. In our view, the arrival of Chairman Kevin Warsh signals the beginning of a new era in monetary policymaking.

We expect less reliance on traditional forward guidance and a reduced emphasis on strict "data dependence." Rather than reacting solely to backward-looking indicators, policymakers are likely to place greater emphasis on where inflation, employment and growth are headed, using broader analytical frameworks and real-time information to assess the economy.

Importantly, we also believe the Fed will utilize a wider panoply of policy tools than investors have grown accustomed to over the past decade. That may include greater attention to the balance sheet, liquidity conditions, money supply dynamics and longer-term interest rates, rather than relying predominantly on the overnight federal funds rate as the primary mechanism for influencing economic activity.

We are also encouraged by efforts to incorporate perspectives from across the public and private sectors. In a rapidly evolving economy, a more modern policy framework requires a wider range of expertise, data and analysis.

While this approach may imply less certainty around the precise path of policy, we believe it can improve the Fed's ability to respond to a rapidly changing economy and build confidence in its long-term objectives around inflation and employment.

Income still does the heavy lifting

For investors, this reinforces the importance of staying focused on income rather than trying to predict every move in rates. We remain respectful of the possibility that the Fed could tighten further if inflation proves persistent, but additional hikes are not a foregone conclusion.

We continue to favor an income-first approach rather than taking large directional duration positions until the data more clearly validates a turn.

Today's yield levels provide a meaningful cushion against volatility and remain one of the most compelling features of the fixed income market. Some investors may view this new policy framework as a source of greater uncertainty. We see it somewhat differently. Periods of uncertainty and elevated volatility can create opportunities, particularly when markets overreact to changing expectations. In that environment, we continue to see value in selectively selling volatility when opportunities present themselves, while remaining focused on resilient income streams and long-term return potential.

Why selectivity matters more now

At the same time, we believe investors should avoid relying on broad market exposures alone. Risk premia across many markets have compressed meaningfully, and opportunities are becoming more selective.

In our view, this environment favors active decision-making, flexible portfolio construction and a willingness to look beyond traditional benchmark exposures. Global fixed income markets continue to offer a broad opportunity set across sectors, regions and asset types, creating opportunities to build diversified streams of income and pursue attractive risk-adjusted outcomes.

The bottom line is that growth remains resilient, but the market environment is becoming more complex. We believe investors should stay invested, focus on income, remain flexible and be increasingly deliberate about where risk is taken. As we move into the second half of the year, it is time to get more serious about portfolio construction.

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Systematic view:
Regime change for the Fed, and for investors

Tom Parker
Chief Investment Officer, Systematic Fixed Income

Jeffrey Rosenberg
Senior Portfolio Manager, Systematic Fixed Income

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The process of unwinding the central role of central banks in the price-setting process might restore investors to making direct assessments of data, policy and risk premia.

Kevin Warsh's first Federal Open Market Committee (FOMC) meeting signals a consequential change coming for the Federal Reserve and, along with it, broader financial markets.

Communications, Credibility, and Composition were among the key themes from the meeting. But the fourth "C" is likely the most important: Consequential. Since the Global Financial Crisis (GFC) of 2008 ushered in "unconventional" monetary policy, those measures have become institutionalized. What was initially proposed as temporary became entrenched and, by some readings — including those of Warsh and Treasury Secretary Bessent — metastasized into a "gain-of-function" institution that strayed from its long-established mission to the detriment of achieving it. Warsh's five task forces on Fed processes highlight the ambitious agenda for regime change ahead and the need for investors to adapt.

Communications

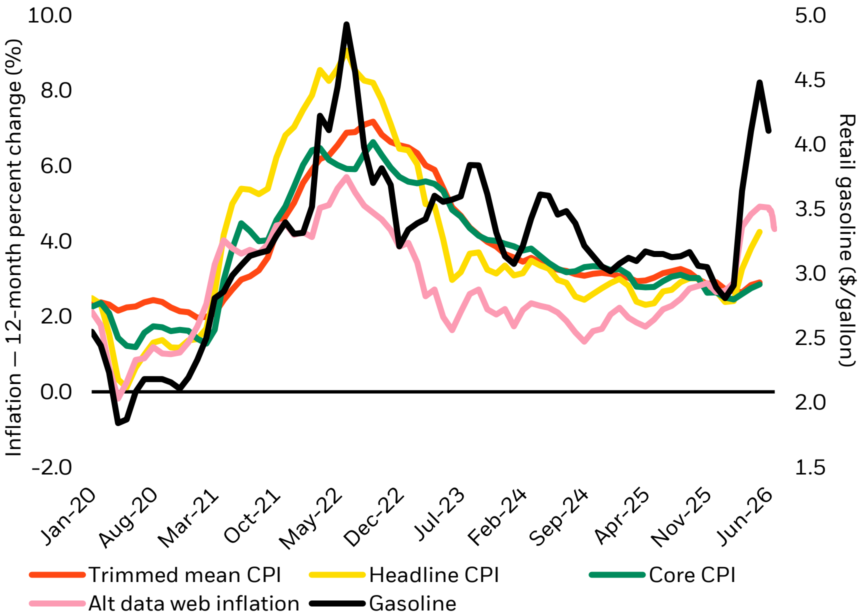
Changing the Fed's communications is the first of Warsh's task forces, and he delivered the first change right out of the gate. By reducing the statement from its average length of more than 200 words to fewer than 100, he harkened back to its origin story: Then-Chairman Greenspan's first FOMC statement in February 1994. Over time, innovations such as policy bias and forward guidance became standard monetary policy tools. In Warsh's assessment, however, those tools were "not well-suited to the current policy conjuncture." As a result, "that statement just gives you the facts, as best we can judge it."

Credibility

In the press conference, Warsh acknowledged the Fed's failure to deliver on price stability since the pandemic. With inflation running above target for more than five years, he recommitted the Federal Reserve to restoring price stability as its primary objective and dispensed with any notion of backing away from the 2% inflation target. In doing so, he recognized that credibility remains the central bank's most powerful policy tool. Those words will ultimately need to be backed by actions — or by moderating inflation, which recent data suggest may already be underway. As shown in the chart (on the next page), retail gasoline prices, along with web-scraped product prices that provide a real-time alternative data proxy for goods inflation, reflect price pressures coming off recent highs.

Systematic view:
Regime change for the Fed, and for investors

Easing goods price pressures and lower gasoline prices point to moderating inflation
Headline, core and trimmed mean CPI, web-based goods inflation and retail gasoline prices



Sources: Cleveland Fed (headline, core and trimmed mean CPI), U.S. Energy Information Administration via FRED (retail gasoline prices), and PriceStats (web-based goods inflation). CPI data through May 2026; retail gasoline prices and web-based goods inflation through June 23, 2026.

And on this measure, his task force focused on evaluating how new information sources may bring the Fed closer in line to private market participants' use of alternative data sources such as the ones cited above, potentially increasing their importance for forecasting.

Composition

In the second task force, focused on the balance sheet, Warsh surprisingly put the ample reserves regime on the table for review. The task force will examine "the benefits and risks of the current ample reserves regime, and the composition of the Fed's balance sheet" and "assess alternative frameworks for the conduct and operation of monetary policy." Can the Fed unscramble the egg? With Fed holdings still large amid much higher indebtedness, the implicit debt monetization of the past two decades seems difficult, if not impossible, to unwind without significant fiscal consequences. But the composition, if not the size, of the balance sheet may be more amenable to change. Changes here could have the greatest consequences for investors.

Consequential

Taken together, these efforts point to one of the most consequential developments for investors, whether systematic or fundamental. Warsh suggested that financial markets perform best when they react to incoming data rather than asking: How will the Fed react to that information? He explained that when markets are merely "reflecting back what we've said," policymakers become blind to what he described as "the most important source of information." The goal, he suggested, is to create a system in which "those blinders come off."

Systematic view:
Regime change for the Fed, and for investors

The Fed's credible use of its communications and balance sheet policies since the GFC has brought us to this point. A critical turning point in this post-GFC era of central bank dominance in the price-setting process came during the Eurozone crisis of 2011–2012. Mario Draghi, then President of the European Central Bank (ECB), addressed a group of investors and sought to calm concerns over the crisis with a promise of unlimited use of the central bank balance sheet in what would become "Outright Monetary Transactions," saying, "The ECB is ready to do whatever it takes to preserve the euro. And believe me, it will be enough."

The credible threat of unlimited use of the balance sheet fundamentally shifted the balance of power between markets and central banks. Warsh's own intellectual break with the Fed in 2011 over the use of the balance sheet may now come full circle as the task force reviews its role. Some may recall James Carville's famous observation that he would "like to come back as the bond market" because "you can intimidate everybody." That reflected the pre-GFC era of "bond market vigilantism," when investor price signals provided policymakers with feedback on the debt and inflationary consequences of their policy choices. The U.K. under Liz Truss faced similar constraints more recently. Many view the current state of fiscal excesses across developed markets as, in part, a consequence of central banks' implicit debt monetization schemes mitigating these price signals. Unwinding such a regime may prove too expensive from a fiscal perspective, if it is possible at all.

But the process of unwinding the central role of central banks in the price-setting process might restore investors to making direct assessments of data, policy and risk premia, rather than first filtering them through the lens of the central bank reaction function. For investors of all stripes, whether fundamental or systematic, that means rethinking how information is processed, perhaps reducing the role of the "reaction function" and increasing the role of data, both traditional and increasingly alternative, in forecasting interest rates.

Two shifts, three implications

Chi Chen
Senior Portfolio Manager
in Global Fixed Income

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A more flexible approach can help investors access a broader opportunity set and enhance income while maintaining the high-quality characteristics of core fixed income.

As we move into the second half of the year, we see two important shifts shaping fixed income markets. First, inflation and growth are likely to moderate from their first-half pace. Second, we expect greater dispersion across sectors, issuers and regions as evolving economic conditions and the uneven impact of AI innovation reshape industries, capital needs and issuer fundamentals.

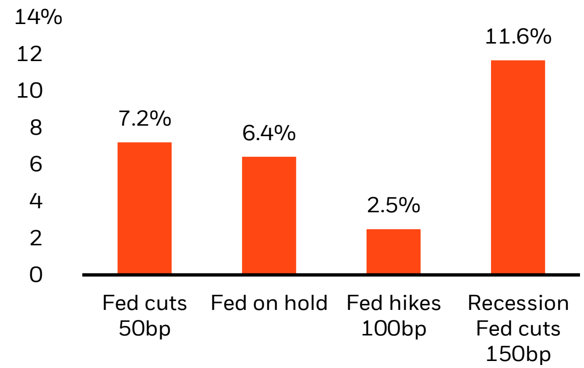
Together, those shifts have important implications for investors and create a richer opportunity set in fixed income. The challenge is capturing it with greater precision.

Higher real yields may offer a better starting valuation in U.S. rates

Much of the "3-highs" narrative of high growth, high inflation and high deficits is now reflected in Treasury yields. Markets are pricing a more hawkish path for Fed policy than we expect. With U.S. real yields above 2% across most tenors and 30-year real yields near their highest level since 2003, valuation has become increasingly compelling to lock in these yields.

Our forward-looking return scenarios point to a favorable asymmetry in U.S. Treasuries, with positive expected returns across a wide range of plausible macro scenarios (see chart at right). Current yield levels provide a substantial cushion against further rate selloff. In fact, 10-year Treasury yields would need to rise roughly 70 basis points from current levels before generating negative total returns over a one-year horizon. While income remains the primary driver of fixed income returns, investors are beginning to get better compensated for taking some duration risk as well. In our view, the risk-reward in rates has improved.

Improved return asymmetry in U.S. rates across macro scenarios
U.S. Treasury AGG: Estimated return scenarios over the next 1 year



Sources: Bloomberg, BlackRock, as of July 6, 2026.

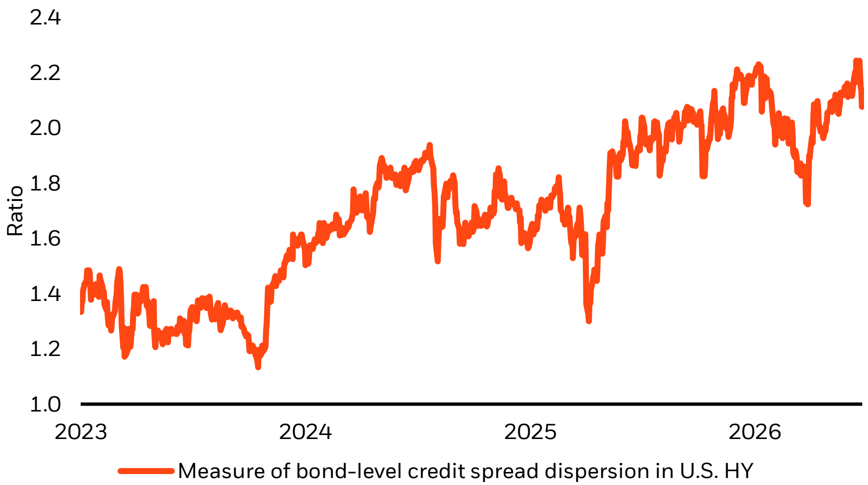
Still a carry-friendly backdrop, but precision matters

The backdrop remains supportive for carry. Strong nominal growth, a sixth consecutive quarter of double-digit corporate earnings growth, attractive all-in yields, and elevated cash in the system to be invested continue to support markets. However, spread valuations across many areas of credit remain relatively tight, limiting the scope for broad-based spread compression.

Two shifts, three implications

As a result, future returns are likely to depend less on spread tightening and more on earning and compounding income over time as well as capturing alpha from rising dispersion. In our view, investors are likely to be rewarded for careful underwriting, disciplined security selection and identifying resilient sources of income rather than simply chasing broad market exposure.

Rising dispersion in credit
Dispersion in U.S. high yield corporate spreads



Sources: Barclays, Bloomberg, as of June 29, 2026.

We continue to see attractive opportunities in securitized assets, where valuations remain compelling on a quality-adjusted basis and where security selection, structural analysis and origination alpha can create meaningful differentiation. In addition to attractive income potential, these sectors can provide valuable diversification benefits.

Regime calls for modernizing core fixed income allocations

Today's market calls for a fresh look at traditional core allocations. The Bloomberg U.S. Aggregate Bond Index remains an important foundation for core fixed income portfolios, but it represents only about half of today's investable fixed income universe and provides limited exposure to many attractive sources of income and alpha.

Greater dispersion across sectors, issuers and regions is creating a stronger backdrop for active sector allocation and security selection. A more flexible, multisector approach can help investors access a broader opportunity set and enhance income while maintaining the high-quality characteristics investors expect from core fixed income.

The opportunity set has evolved. The implementation of core fixed income should evolve with it.

European fixed income: Time to get serious about European credit

James Turner
Head of Global Fixed Income in EMEA

Jose Aguilar
Head of European Credit

Higher policy rates have restored income as a meaningful source of return, shifting the conversation from spreads to yields.

From patience to income

The first half of 2026 was marked by geopolitical, inflation and policy developments that created an uneven path for markets. Despite persistent headline risk, European fixed income delivered positive total returns. Dynamic patience remained our guiding principle: Harvesting income, managing risk and maintaining the flexibility to capture opportunities. As we move into the second half of the year, many of these themes remain in place. The focus now shifts from navigating uncertainty to selectively taking risk and capturing income in a resilient market.

The ECB's June rate hike to 2.25% reflected the complex backdrop facing policymakers. While the move was well telegraphed, it came at a time when higher energy prices were pushing up near-term inflation,
even as business and consumer surveys pointed to moderation.

However, we see limited evidence of second-round effects at this stage, and the current energy shock remains less severe than that experienced in 2022. As a result, we view a prolonged hiking cycle into deeply restrictive territory (>3% ECB rate) as unlikely. Markets appear to be pricing a slowdown rather than a recession, with growth expected to remain positive, albeit below trend.

In this environment, higher rates continue to support attractive income opportunities, allowing investors to earn compelling yields without significantly extending duration. We continue to favor European credit, as corporate fundamentals as a whole remain healthy in the region, with issuers reducing leverage and improving balance sheets.

European credit: Yield matters more than spread?

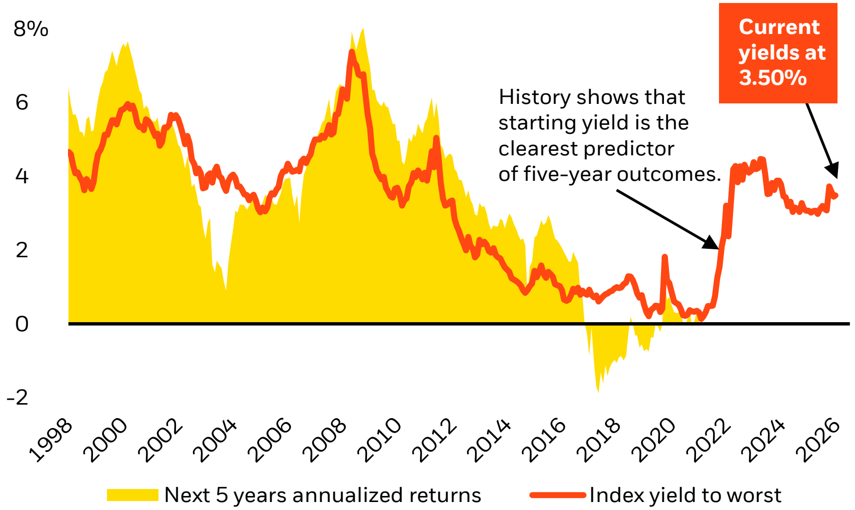
For much of the post-GFC and negative-rate era, the investment case for European credit was largely a spread story. With government bond yields close to zero, investors focused on relative value and spread compression as key drivers of returns. Today, the landscape looks very different; more than 80% of the global bond market is yielding above 4%. Higher policy rates have restored income as a meaningful source of return, shifting the conversation from spreads to yields.

As the chart on the following page shows, European credit currently yields around 3.5%. With starting yields, historically the clearest predictor of subsequent five-year returns, today's environment provides a compelling foundation for long-term performance. Even with spreads near historical tights, we believe European investment grade credit continues to offer attractive returns, allowing investors to lock in income, compound carry and maintain a cushion against market volatility.

European fixed income:
Time to get serious about European credit

Starting yield matters

Current yield to worst and annualized 5-year returns



Index used BBG Euro Agg Corporate Index. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results. Indices are unmanaged and one cannot invest directly in an index.** Source: Bloomberg, as of June 22, 2026.

Unlike the low-rate environment of the past decade, we believe today's yield levels allow investors to generate attractive returns without relying heavily on further spread compression.

Selectivity matters more now

Market volatility during the first half of the year increased dispersion across issuers, reinforcing the value of security selection. We continue to favor resilient, non-cyclical sectors with stable, asset-heavy business models, including regulated utilities, telecoms, infrastructure and select healthcare names. These sectors combine cash flows and reasonable valuations with limited exposure to AI-related disruption, while in some cases benefiting from the investment required to support the AI buildout. We expect favorable technicals to remain supportive through the second half of the year, with strong demand from yield buyers supporting credit.

Where are we focused?

Within financials, we continue to see attractive opportunities across the capital structure. European banks remain supported by strong capital, solid profitability and a supportive regulatory backdrop, with returns increasingly driven by carry rather than spread compression.

- Short-call AT1s, offering attractive income through elevated reset spreads and strong issuer fundamentals.
- Senior debt, particularly in primary market were we still see some new issue premium being offered.
- Insurance subordinated debt, across Tier 2 and Restricted Tier 1 structures, where strong credit quality and supportive regulatory frameworks underpin the sector, yet valuations have lagged bank capital.

We also continue to like AAA-rated European collateralized loan obligations, which offer high-quality credit exposure, structural protection and compelling floating-rate income. They provide a meaningful yield premium over similarly rated corporate and sovereign debt, making them an attractive risk-adjusted income source.

Finally, fixed maturity strategies remain compelling. By locking in elevated yields and providing greater certainty around future cash flows, we believe they allow investors to secure attractive income without relying on further spread tightening to generate returns.

European fixed income: Time to get serious about European credit

What to watch for

Despite comfortable overall credit fundamentals, dispersion across sectors and issuers has increased. Cyclical sectors such as autos and chemicals are facing greater pressure, while technological disruption, including AI, is likely to widen the gap between winners and losers. Investors must navigate a backdrop of geopolitical uncertainty, shifting inflation dynamics and an interconnected global economy.

As a result, active management is becoming increasingly important. Rather than relying solely on traditional core bonds, investors should draw on the full fixed income toolkit, dynamically managing credit and rate risk to capture income.

Emerging markets debt: Carry and resilient fundamentals

Michel Aubenas
Head of Emerging Market Debt

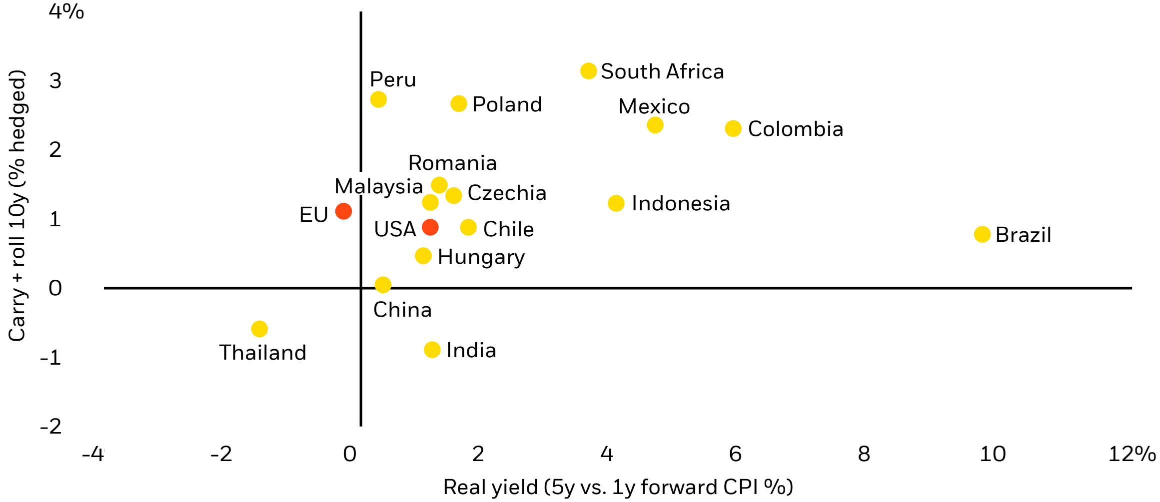
Elevated dispersion across emerging markets continues to create opportunities for active and selective positioning.

We remain constructive on emerging markets (EM) debt as fundamentals remained resilient despite recent geopolitical tensions. As energy supply disruptions start to be resolved, lower oil prices should support a broadening of global growth, give central banks greater scope to look through lingering inflation pressures and improve risk sentiment for emerging markets assets.

Within this context, EM local markets appear particularly well positioned. As global policy expectations gradually shift away from a precautionary hawkish stance, duration is likely to move from a headwind to a source of return, especially in markets where real yields remain attractive. We see selective opportunities across regions, with parts of Latin America and Central and Eastern Europe, the Middle East and Africa standing out in a more benign global rates environment.

We also see attractive opportunities in EM currencies. In our view, several Asian currencies, including the Indian rupee, Taiwan dollar, Korean won and Philippine peso, appear undervalued following the recent period of volatility and should benefit from a stabilization in global conditions. In Latin America, higher-yielding currencies continue to offer compelling carry where policy frameworks remain credible**.**

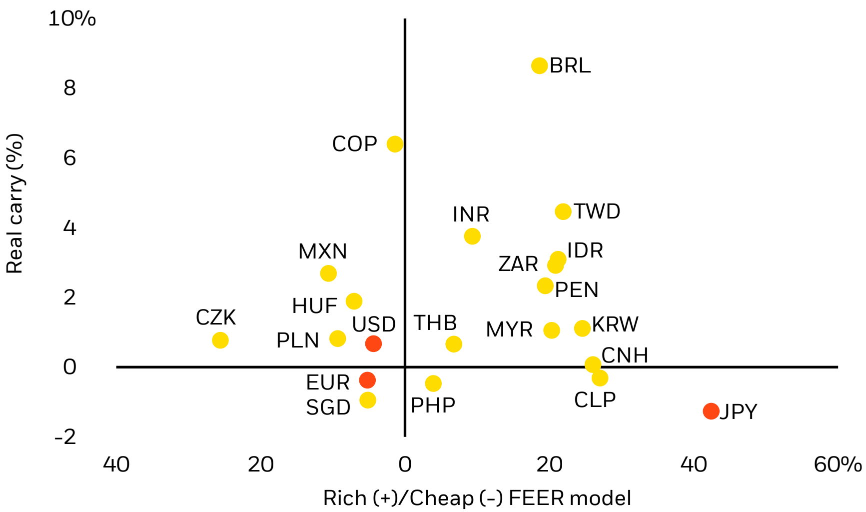
Several EM local markets combine attractive real yields and carry + roll



Source: BlackRock, as of June 2026.

Emerging markets debt: Carry and resilient fundamentals

Several EM currencies combine attractive valuations with high real yields



Source: BlackRock, as of June 2026.

We also see opportunities in hard currency sovereign debt. We have adjusted our stance toward oil-importing economies, which should benefit from improved external balances and easing inflation pressures as energy prices normalize. More broadly, elevated dispersion across emerging markets continues to create opportunities for active and selective positioning.

Why we remain constructive

Our outlook is supported by the resilience demonstrated by the global economy throughout the recent geopolitical shock. Despite continued uncertainty surrounding the Iran conflict, the resulting surge in energy prices and the broad repricing across global markets, underlying demand remained strong and investment trends, including AI-related capital expenditure, continued to support growth. That resilience helped anchor EM through the period of volatility and provides a solid foundation for the next phase of the cycle.

We continue to expect energy markets to normalize. If broader disruptions to supply remain limited, oil prices are expected to move lower, removing an important inflationary tail risk and reversing some of the terms-of-trade shock created by the conflict. As a result, markets should increasingly shift from managing energy-related risks toward improving macroeconomic fundamentals.

We also expect global growth to become more broadly distributed. Regions such as Europe, the Gulf Cooperation Council (GCC), Central and Eastern Europe and parts of the Association of Southeast Asian Nations, which were more exposed to elevated energy costs, are likely to benefit disproportionately from lower prices. Reconstruction efforts are likely to become growth-positive for the GCC. Given their relatively open and trade-linked economic structures, a recovery in these regions should have meaningful positive spillovers for EM. Rather than a sharp rotation in growth leadership, we anticipate a more balanced global expansion with a wider set of contributors supporting EM demand.

In our view, the normalization of energy prices should help ease pressure on central banks. During the energy shock, policymakers adopted a more cautious stance as inflation risks increased and markets repriced toward a more hawkish policy path. As energy-related inflation pressures recede, central banks are likely to remain data-dependent but increasingly willing to look through residual oil-driven price effects. This is also true for the U.S. Federal Reserve, beyond refocusing on the inflation target by Chair Kevin Warsh, a lot is in the price already. Overall, a more stable policy backdrop across both developed and emerging markets should help reduce global volatility and support investor appetite for emerging market risk.

Differentiated cycles and emerging anchors in Asian fixed income

Navin Saigal
Head of Global Fixed Income, Asia Pacific

In a fragmenting global bond market, Asia is carving out its own cycles and anchor points.

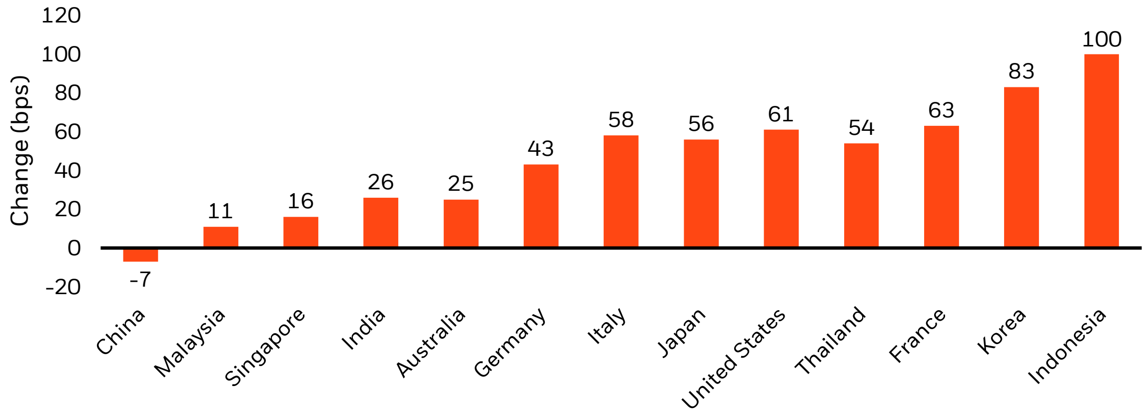
The global bond market is no longer moving in lockstep. Government yields are diverging as fiscal paths, inflation pressures and central bank responses desynchronize, making the fragmentation across markets difficult to ignore.

Nowhere is this clearer than in Asia. Local bond markets are trading on domestic fundamentals rather than global duration, reframing Asia from a peripheral allocation into a source of structural diversification. In our view, higher yields, differentiated policy cycles and lower correlations with developed markets are strengthening Asian fixed income's role in global portfolios.

Anchors of stability in a fragmenting global market

In a fragmented landscape, a small number of markets are acting as anchors, defining the range within which others trade. Chinese government bonds (CGBs) have emerged as a clear low-volatility anchor amid global turbulence. While U.S. and European yields have faced upward pressure, CGBs have remained resilient, supported by the People’s Bank of China's accommodative policy stance, ample domestic liquidity and an economic cycle decoupled from the West. China’s sizeable current account surplus, alongside tighter controls on unofficial capital outflows, further supports gradual renminbi appreciation.

Global 10-year government bond yields diverged following the Middle East escalation



Source: Bloomberg, as of June 12, 2026.

Differentiated cycles and emerging anchors in Asian fixed income

Most other Asian bond markets trade along a spectrum defined by two poles: U.S. Treasuries, with their pull on global duration, and China's largely independent rate cycle. Together they create a continuum rather than a single reference point. While Asian markets still respond to global yields, outcomes are increasingly shaped by local inflation, fiscal positions and policy choices. The result is growing dispersion across curves, currencies and carry, giving investors a broader menu of yields and regimes rather than a single global beta.

Unlocking the region's potential beyond the index

Traditional bond benchmarks such as the Global Aggregate Index still treat fixed income as a largely homogeneous asset class dominated by developed markets. Yet looking beneath the headline weight reveals significant concentration. Nearly 85% of APAC index exposure sits in China and Japan, with around 74% allocated to sovereign bonds.[3] As a result, passive investors remain concentrated in a relatively narrow set of markets despite the region's broader opportunity set.

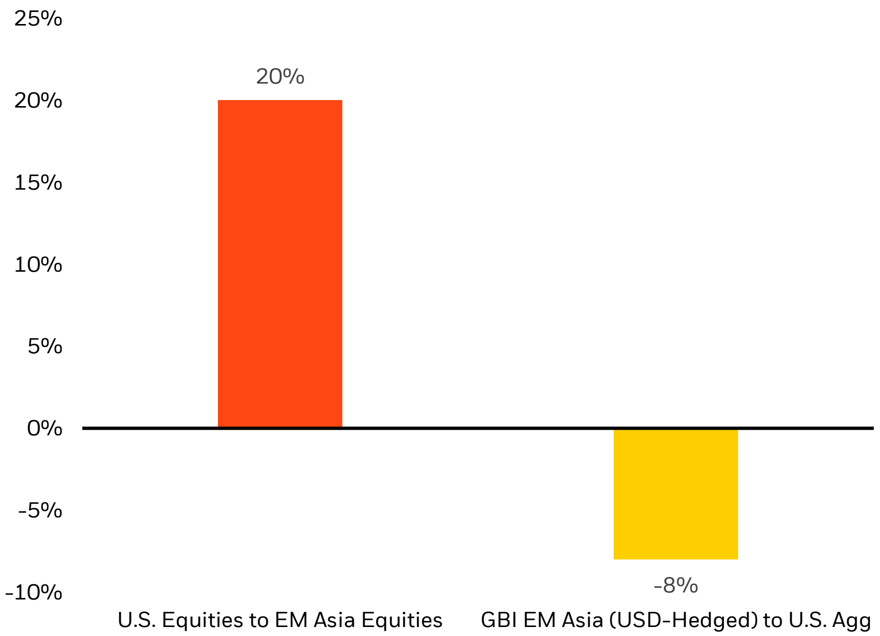
For active, unconstrained investors, that concentration creates opportunity. Moving beyond benchmark weights provides access to underrepresented sources of income and diversification, including Indian government bonds. Continued improvements in market access and foreign exchange (FX) infrastructure are reducing frictions for overseas investors, creating opportunities for unconstrained strategies to exploit gaps left by standardized global allocations.

Diversification matters more in fixed income

Diversification becomes more valuable as policy paths diverge and external shocks become more frequent. Unlike equities, where a small number of companies can drive index returns, fixed income offers limited upside beyond income and roll-down. Concentration therefore introduces asymmetry: issuer- or country-specific stress is not offset by comparable upside.

As global bond markets fragment, broader issuer and country diversification can improve resilience while reducing idiosyncratic and policy risk. For fixed income investors, diversification has become an important source of stability.

Five-year correlation: Equities vs. fixed income



US equities represented by S&P Index, EM Asia Equities by MSCI EM Asia Index, US Agg by Bloomberg US Aggregate TRI, EM Asia GBI by JP Morgan Government Bond Index - Emerging Markets EM Asia (USD-Hedged). Source: Bloomberg, as of June 23, 2026.

3 BlackRock, Bloomberg Global Aggregate USD Hedged Index, as of May 2026.

Differentiated cycles and emerging anchors in Asian fixed income

Policy action as a circuit breaker

Asian policymakers have taken different approaches to currency stabilization following FX pressures from the Middle East conflict. Indonesia hiked rates by a cumulative 100 basis points, prioritizing currency defense and containing imported inflation. India instead relied on targeted FX measures, encouraging inflows, improving onshore dollar liquidity and easing hedging stress while retaining greater monetary flexibility.

Early and credible policy action reduces the risk of disorderly currency adjustment. With central banks acting as effective circuit breakers, we believe regional FX volatility should moderate absent a renewed external shock, such as a sustained spike in oil prices.

Oil remains the swing factor

Oil prices remain the key swing factor for Asia's net energy importers. If prices remain range-bound, as our baseline assumes, the inflation impulse should stay contained, leaving many Asian bond yields near cyclical peaks and carry as the primary return driver.

The main tail risk remains a prolonged escalation in the Middle East. Net importers with tighter external constraints, including the Philippines, Indonesia and Thailand, appear more vulnerable to a renewed oil surge. By contrast, economies with greater policy autonomy and lower oil sensitivity, notably China, are better positioned as defensive anchors during periods of geopolitical stress.

Taken together, we believe Asian fixed income is becoming more idiosyncratic and diversifying. In a fragmenting global bond market, Asia is carving out its own cycles and anchor points. For global fixed income portfolios, this offers a compelling combination of income, diversification and lower correlation to developed markets.

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Emerging markets are generally more sensitive to economic and political conditions than developed markets. Other factors include greater 'Liquidity Risk', restrictions on investment or transfer of assets, failed/delayed delivery of securities or payments and sustainability-related risks.

Fixed income securities issued or guaranteed by government entities in emerging markets generally experience higher 'Credit Risk' than developed economies.

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