



Fixed Income Outlook

Q4 2026

BlackRock

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Contents

**U.S. fixed income:
Higher rates, increasingly
divergent effects**

04

**Systematic view:
Higher yields, for
good reason**

06

**European fixed income:
The broad opportunity is
income. Dispersion
rewards selectivity.**

09

**Emerging markets debt:
Outperforming in a
challenging global
environment**

11

**Asian fixed income:
A wider world of income**

13

Foreword



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More yield, more judgment

Higher yields have changed the fixed income conversation. The challenge is no longer simply finding income. It is understanding what risks investors are being paid to take.

That is an enviable problem to have. Today's yields allow more of a portfolio's potential return to come from income rather than relying on falling rates or further spread compression. But abundance does not make the choices easier. Stronger nominal growth, persistent inflation risks, geopolitical uncertainty and greater competition for capital are pulling markets in different directions. Even some of the diversification properties investors have traditionally expected from bonds are being tested.

The opportunity set is richer, but the choices within it matter more. Economic and policy cycles are diverging, valuations vary widely, and investments offering similar yields can carry very different underlying risks. That puts a greater premium on looking beneath the yield.

Income may be abundant, but it is not interchangeable. Assessing the risks behind that income may matter as much as the yield itself.

That is the perspective we bring to this quarter's Fixed Income Outlook: looking across global markets for resilient sources of income while remaining deliberate about where and how risk is taken.

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**Income may be abundant,
but it is not interchangeable;
similar yields can carry very
different risks.”**

Higher rates, increasingly divergent effects



Rick Rieder

Chief Investment Officer
of Global Fixed Income

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The more important question for policy is not simply how high inflation is, but how responsive it is to rates.

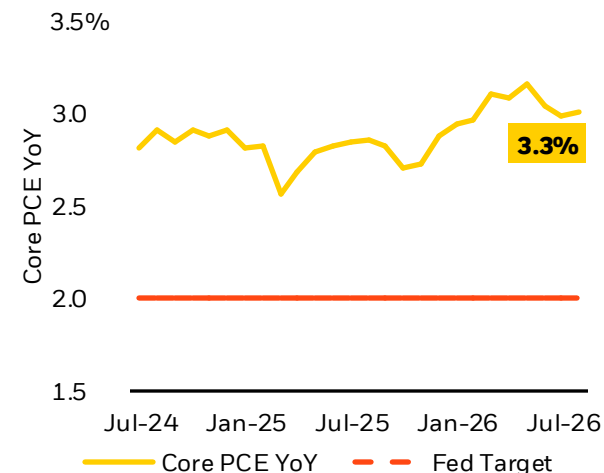
After initially waiting for greater clarity on inflation, the Federal Reserve (Fed) raised its policy rate by 25 basis points in September, to a range of 3.75% to 4.00%, amid stronger inflation and labor market data. The move was widely anticipated, with the Federal Open Market Committee citing inadequate progress on underlying inflation and seeking greater confidence that inflation will return to target. Chair Warsh also pointed to strong growth data in arguing that policy is not restrictive. We agree that the economy has been remarkably resilient overall and that modest further rate increases may not put aggregate growth at risk. But some parts of the economy are far more rate-sensitive than others.

Not all inflation responds to rates

Lower- and middle-income households are more reliant on credit than wealthier households, and with 90-day credit card delinquencies already at 12.9%, we worry that higher rates could add to their financial stress.¹ The Fed remains committed to returning inflation to its 2% target and wants to see greater progress. Core personal consumption expenditures (PCE) inflation has shown little recent progress toward that level, leaving the overnight policy rate as the Fed's primary tool to address it (see chart on the right).

The more important question for policy is not simply how high inflation is, but how responsive it is to rates. An analysis from the San Francisco Federal Reserve shows cyclical components are generally well behaved, while acyclical inflation remains harder to contain and less responsive to interest rates. Energy, insurance, health care and education are passing through higher costs, leaving the Fed to combat those pressures with a tool poorly suited to the task.

Core inflation remains above the Fed's target



Source: Bureau of Labor Statistics, as of September 2026.

¹ Federal Reserve Bank of New York, as of June 30, 2026.

Higher rates, increasingly divergent effects

Strong growth, narrow foundations

While growth appears strong overall, its drivers have become increasingly narrow and sector-specific. An artificial intelligence (AI) infrastructure buildout is driving a capital expenditure boom, alongside strong services consumption from higher-income households. These areas are relatively insensitive to rates, widening the divide with rate-sensitive parts of the economy, many of which are already in recession. We believe that divergence will increasingly complicate both monetary policy and investment decisions.

With both policy rates and longer-term yields moving higher, the critical question for investors is how much risk higher rates pose to rate-sensitive parts of the economy and the assets tied to them. Housing is a clear example: higher borrowing costs can weigh on activity and create stress in mortgage and real estate assets. That makes selectivity increasingly critical, along with deep, sector-specific research into which parts of the economy may benefit from these trends and which may be impaired by them.

Starting yield changes the equation

For all the debate about why interest rates are at current levels, the more useful question for investors is: what return can be generated from this starting point? The answer is compelling. What we believe makes today's opportunity unusually attractive is that investors do not need to reach far for that income. It is now possible to build a diversified fixed income portfolio yielding more than 7%, with less than three years of duration and an average credit rating of A-. That said, at these higher interest rate levels, rollover risk, or refinancing risk, is a meaningful worry for some segments of the fixed income market, which again suggests that selectivity and deep sector research is critical to managing where to most effectively attain yield for portfolios.

The combination of income, quality and limited interest-rate sensitivity is historically unusual. If inflation continues to move closer to the Fed's 2% target, that income becomes even more meaningful in real terms. While equities still matter for long-term growth, investors no longer need them to carry as much of the return burden. Built deliberately, that combination can create a portfolio that does not depend on the next payroll print, consumer price index (CPI) surprise or geopolitical headline.

Higher yields, for good reason



Tom Parker
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Jeffrey Rosenberg
Senior Portfolio
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Higher yields are a rational response to greater inflation risk, stronger nominal growth, competition for capital and diminished diversification value.

The Federal Open Market Committee's (FOMC) September rate hike confirmed a shift that had been building since July. Rising geopolitical risk and disruptions to crude shipping pushed international oil prices to their highest levels since the war in Iran began. More important for downstream inflation, distillate prices, particularly diesel, have risen well above earlier peaks, while crack spreads have reached record levels. Warsh cited these developments as contributing to the September hike, with the FOMC “dot plot” indicating further increases.

Oil's downstream passthrough to inflation is also showing up in its relationship with interest rates.

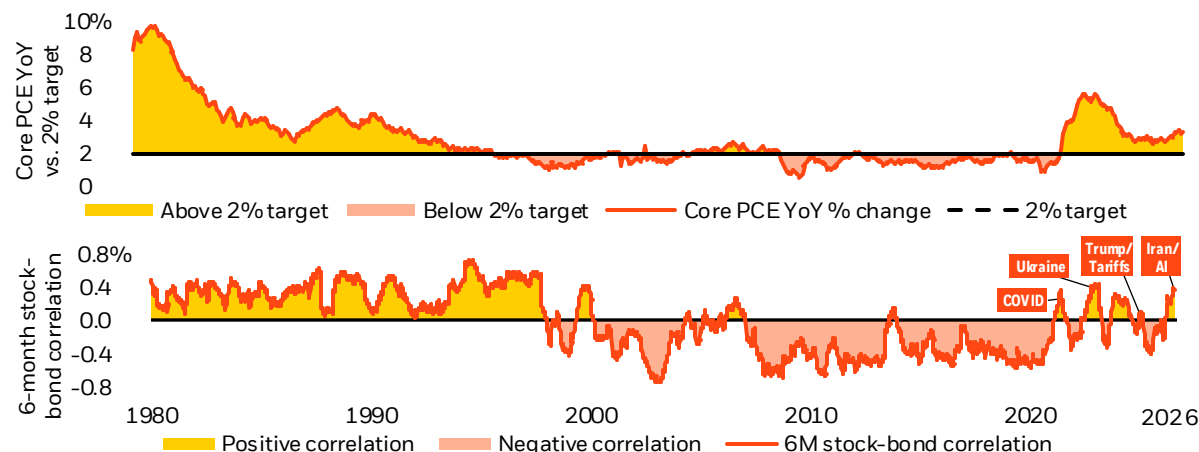
Historically, the correlation between oil and the US 10-year Treasury yield has averaged around 20%. Since the Iran war, that correlation has risen to roughly 80%.²

Geopolitics is one driver of higher long-term yields. Competition for capital and stronger global growth are two others. We would add a fourth: reduced demand for long-duration bonds as their diversification benefits diminish. Put simply, bonds don't hedge like they used to.

The chart below highlights this dynamic and its underlying driver: too little versus too much inflation.

Inflation changes the stock-bond relationship

Core PCE inflation versus the Fed's 2% target and six-month stock-bond return correlation



Sources: BlackRock Systematic, with data from FRED, Federal Reserve Bank of St. Louis, January 1980 through Sept. 4, 2026. Core PCE data through July 2026. Stock-bond correlation represents the rolling six-month correlation between the S&P 500 and U.S. Treasuries.

² Bloomberg, as of Sept. 30, 2026.

Higher yields, for good reason

When bonds hedge less

For roughly two decades before COVID, persistently negative stock-bond correlation coincided with a similarly persistent period of too little inflation. Repeated demand shocks, secular stagnation and a low natural rate of interest frequently pushed policy rates toward the effective lower bound, constraining the Fed's ability to respond to negative demand shocks.³ With inflation not constraining the Fed, markets came to expect rates to fall in response to negative demand shocks. Monetary accommodation could then support growth and inflation in the same direction, the so-called "divine coincidence." Falling rates therefore tended to cushion equity declines, contributing to negative stock-bond correlation.

Today's environment is different. With too much rather than too little inflation, the Fed faces tradeoffs between its objectives. Persistent inflation shocks can push bond yields higher even as stocks fall, producing

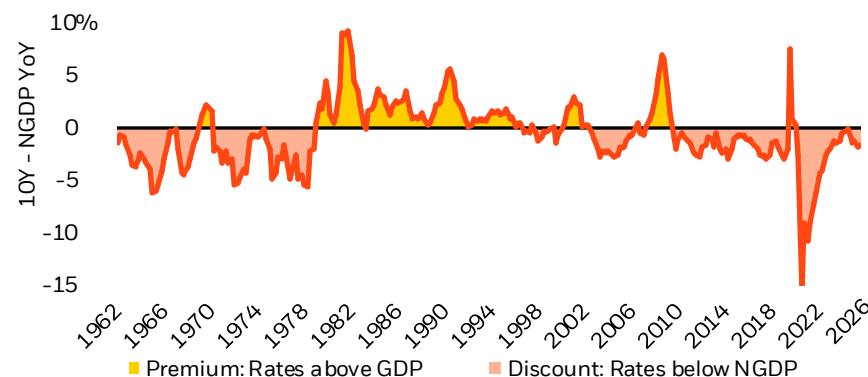
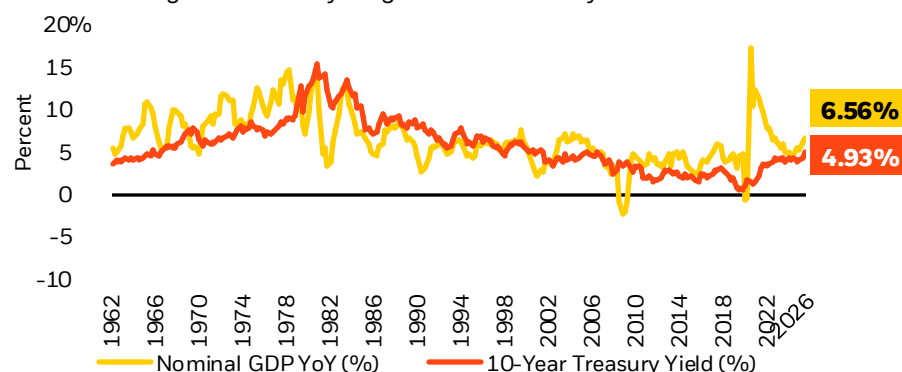
more frequent bouts of positive stock-bond correlation and weakening bonds' role as an equity hedge. More than five years of above-target inflation have been shaped by a sequence of supply-side shocks — from COVID and Ukraine to tariffs and, this year, the Iran conflict and AI investment boom. The resulting loss of diversification is itself a reason yields need to be higher: reduced demand for bonds requires greater income compensation to clear the market.

Competition for capital is rising

Nominal GDP provides a useful anchor for long-term interest rates, with nominal yields historically tracking nominal growth over time (see chart below). Whether yields trade above or below that anchor, however, also depends on the supply of and demand for investment capital. Before COVID, excess savings relative to investment demand produced a persistent discount of Treasury yields to nominal growth. Today, that balance is shifting.

Nominal growth provides an anchor for rates

Nominal GDP growth vs. 10-year government bond yields



Sources: BlackRock Systematic, with data from FRED, Federal Reserve Bank of St. Louis, 1962 through September 2026. Nominal GDP shown as year-over-year percent change. 10-year U.S. Treasury yields represented by the 10-Year Treasury Constant Maturity Rate. Discount/premium represents the 10-year U.S. Treasury yield less nominal GDP growth, in percentage points.

³ Mertens, Thomas M. and John C. Williams. 2019. "Monetary Policy Frameworks and the Effective Lower Bound on Interest Rates." *AEA Papers and Proceedings* 109: 427–432.

Higher yields, for good reason

AI is an important part of that shift. Rising expectations for agentic AI use cases are driving estimates of required capex higher, while more of that financing is migrating from banks and private markets into public bond markets. Treasury issuance therefore competes against growing private-sector financing needs for investor capital.

Recent rate moves also reflect this competition for capital, not simply higher inflation expectations. While the Fed remains focused on the inflationary effects of oil and distillates, breakeven inflation has largely looked through those pressures. The rise in longer-term yields has instead been driven more by higher real rates — consistent with investors demanding greater real compensation as investment demand rises.

What higher yields mean from here

The recent global move in rates broadly corresponds with stronger nominal growth expectations. Since the start of the year, 30-year government bond

yields across our sample have risen by roughly 50 basis points on average, alongside a similar increase in 2026 nominal GDP growth forecasts.⁴

What does that mean for rates going forward? Upgrades to nominal GDP forecasts reflect the strength, resilience and breadth of the AI capital expenditure wave alongside wealth-effect support for consumption. Higher oil and distillates prices contribute to a stickier global inflation outlook. Rates are adjusting upward to this configuration of strong growth and sticky inflation.

Absent further acceleration in either factor, that adjustment should eventually slow. But continued uncertainty around oil and signs of accelerating benefits from the AI boom could sustain upward pressure on global rates. Higher yields reinforce fixed income's traditional role as a source of income, even as persistent excess inflation challenges its role as a diversifier. That reinforces the need for new sources of diversification and a rethink of bond allocations built primarily around the diversification use case.

⁴ Bloomberg, as of Sept. 30, 2026.

The broad opportunity is income. Dispersion rewards selectivity.



James Turner

Head of Global
Fixed Income
in EMEA

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

European bond yields have risen sharply this year, with German Bund yields up nearly 100 basis points since the escalation of the Middle East conflict. Despite concerns about inflation and the impact of higher rates on portfolios, European bond markets have remained orderly, with rate volatility relatively contained. Growth has also proved more resilient than expected.

For investors, higher starting yields improve the return equation. For much of the previous decade, falling rates were an important contributor to bond returns. Today, higher starting yields mean more of the potential return can come from carry and coupon income rather than relying on further declines in rates. But attractive income is only

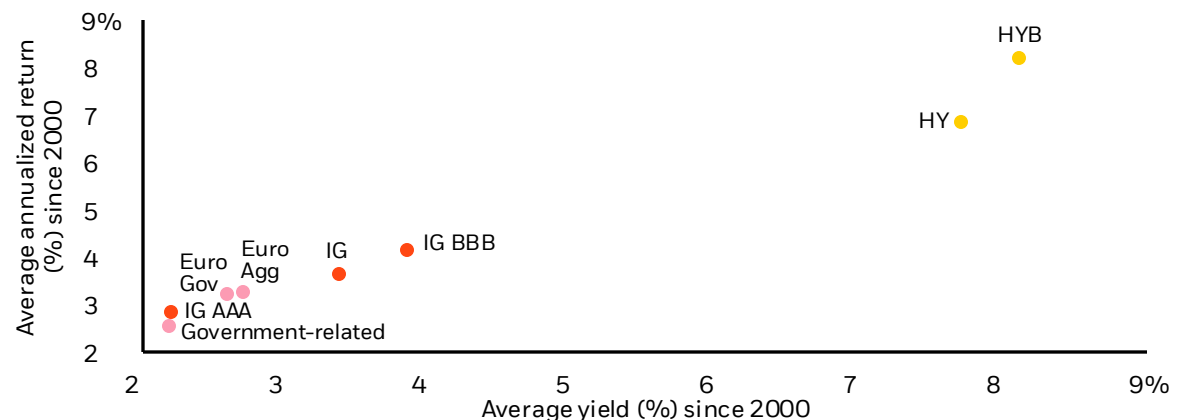
the starting point. With spreads tighter and valuations increasingly differentiated, we believe security selection and relative value will become increasingly important sources of return.

Beyond the benchmark in credit

When spreads are wide, broad market exposure can do more of the work. Today's tighter spreads raise the bar for selection. In investment-grade credit, we see relative value increasingly beneath the surface: between U.S. and European credit, across sectors and ratings and even within individual issuers' capital structures. The valuation gap between U.S. and European credit could also renew interest in reverse Yankees, adding another potential source of relative value.

Yield drives return for Europe

Starting yield vs realized annualized return, by Euro sector (since 2000)



Source: Bloomberg, as of Sept. 14, 2026.

The broad opportunity is income.

Dispersion rewards selectivity.

Within European credit, investors have increasingly favored defensive sectors amid concerns about higher energy prices and slower growth. But resilient consumers, fiscal support and improving corporate fundamentals could make periods of weakness in consumer-facing sectors an opportunity to add selectively. Dispersion is also evident within individual issuers: corporate hybrids in utilities, telecoms and energy have lagged the broader compression in spreads, creating relative value opportunities across capital structures. Meanwhile, renewed rating dispersion is creating greater scope for selection across the quality spectrum.

High yield offers another source of differentiation. Fiscal spending programs are beginning to support infrastructure, defense and transport, while valuations in cyclical sectors such as chemicals and industrials already reflect a challenging backdrop. If activity stabilizes, selected issuers in these sectors could benefit. We also see value in selected B-rated issuers, including in real estate, financials and services, where we believe fundamentals remain stronger than current pricing suggests.

Curve selection matters as well. Strong demand for fixed-maturity products has supported the front end, while the four- to seven-year segment continues to offer attractive carry and relative value. The strength of that demand is already evident in Italy, where bond funds have gathered approximately €100 billion since 2023, with 75% of inflows directed toward fixed-maturity products.

Political and fiscal paths diverge

The same principle applies to sovereigns, but for different reasons. Here, the dividing lines are increasingly political and fiscal. Higher yields have improved the income available from European government bonds, while diverging fiscal trajectories could create greater differentiation among countries. As elections approach, we expect investors to focus increasingly on fiscal sustainability, political stability and governments' capacity to deliver reform.

France is perhaps the clearest example. For bond investors, the important question is less the election outcome than whether the eventual government can deliver credible fiscal consolidation. More broadly, we expect fiscal trajectories, growth prospects and political risks to diverge across France, Italy and Spain. In this environment, we believe country selection and relative value could become increasingly important sources of return alongside duration.

Starting yields make the case for income. Dispersion makes the case for selectivity. In credit, the dividing lines run across sectors, issuers and capital structures; in sovereigns, they are increasingly fiscal and political. We believe this growing differentiation favors skilled active management, with security selection and relative value offering the potential to capture income while seeking additional alpha beyond broad benchmark exposure.

Outperforming in a challenging global environment



Michel Aubenas
Head of Emerging
Market Debt

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Returns from here should depend more on carry, country selection and currencies than on broad market direction.

Emerging markets debt (EMD) enters the fourth quarter on stronger fundamental footing, with resilient growth, healthy external balances and yields close to 7%.⁵ But with spreads in the bottom half of the last five years, we see less scope for another broad round of compression to drive returns. From here, we believe income, country selection and potential recovery in core rates should matter more.

Policy discipline provides the anchor

Across many emerging markets, policymakers have strengthened external resilience, maintained restrictive monetary policy to contain inflation and continued to consolidate fiscal accounts. That discipline is showing up in sovereign credit quality: 2026 marks a fourth consecutive year of net positive ratings upgrades, led particularly by lower-rated countries.⁶

Recent political shifts, that brought market friendly candidates winning in key elections (e.g., Hungary, Peru, Colombia, and Brazil) could add another source of differentiation, should promises of fiscal consolidation and structural reforms come to pass.

Starting yield does more of the work

Over longer horizons, starting yield can be an important driver of forward returns. For example, income cushion has helped offset the drag from higher Treasury yields this year. EM spreads have also tightened even as U.S. investment-grade and high-yield corporate spreads widened, consistent with the relative strength in EM fundamentals.

Flows to EMD have remained resilient despite higher U.S. real yields and greater duration supply elsewhere in fixed income. Global investors remain under allocated following the 2022–2024 outflows, potentially leaving room for allocations to rebuild.⁷ That shifts the return equation: with less room for broad spread compression, starting income should provide a larger share of potential returns, while dispersion creates opportunities to add value through country, currency and security selection.

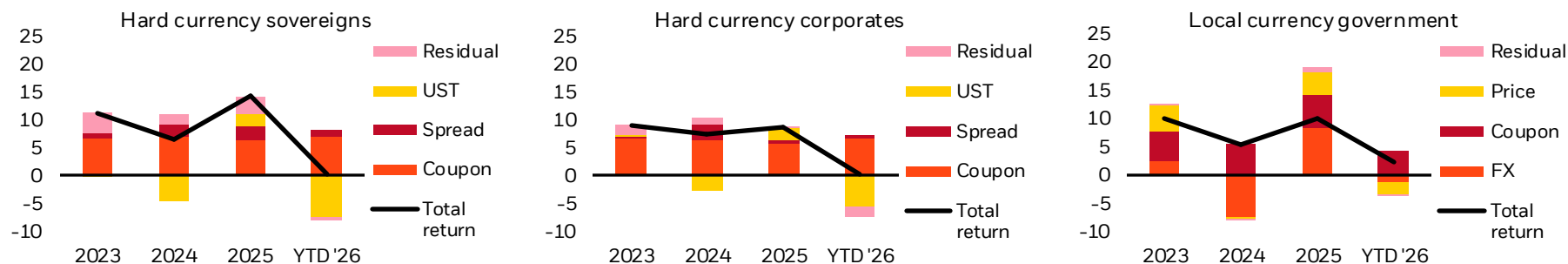
⁵ J.P. Morgan EMBI Global Diversified and GBI-EM Global Diversified indices, as of Oct. 2, 2026. ⁶ BlackRock on Bloomberg, S&P, Fitch and Moody's data, as of Sept. 18, 2026, Subject to change.

⁷ BlackRock, as of September 2026.

Outperforming in a challenging global environment

Income and selection have driven EM returns

Return decomposition across hard- and local-currency emerging markets debt



Source: Sovereigns (JPM EMBIGD Index), Local Currency Debt (JPM GBI-EMGD Index), Corporates (JPM CEMBI BD Index), as of Sept. 30, 2026.

Different markets, different return drivers

The opportunity is far from uniform across emerging markets, with wide dispersion across countries, currencies and sectors. This year, returns have been driven more by selection than broad index beta, reinforcing the importance of differentiating among markets from here.

For hard currency sovereigns, we continue to favor income over duration, with a preference for the intermediate part of the curve and a more cautious stance toward longer-dated bonds. Within credit, we favor high yield over investment grade, where tighter spreads provide less cushion against higher core rates. Within high yield, we see the most compelling opportunities in lower-rated sovereigns where fiscal adjustment, policy reform or improving fundamentals could support further credit-rating upgrades and selective capital appreciation.

Within EM corporates, attractive income with relatively lower duration than sovereign debt, supports a favorable income-to-volatility profile. We favor BB-rated issuers, where spreads can provide a buffer against global rates volatility while avoiding some of the credit risk further down the ratings spectrum. At the sector level, we see opportunities in metals and mining, supported by

higher commodity prices and stronger balance sheets, as well as Latin American telecoms, where consolidation and relatively resilient revenues are supportive.

In local currency debt, we remain cautious on broad directional duration as higher developed market rates continue to create a challenging backdrop, instead favoring bottom-up opportunities in markets offering attractive real yields and differentiated monetary-policy. In currencies, we retain a constructive medium-term view on EMFX but favor relative value and carry – e.g., Colombia 4% and Brazil 7.5% – over broad directional beta dynamics.

The risks to watch

Core duration is the first risk, where the speed of the move may matter more than the level. EM credit has absorbed elevated developed-market yields when the adjustment has been orderly, but history shows that a 50bps+ move within two months leads to EM spreads widening, while otherwise the beta from yields to spreads is negative. Second comes oil prices, with the forward curve remaining above roughly \$85 through mid-2027, higher energy costs could slow disinflation, leave central banks less room to cut rates and weigh on importers and consumers.⁸

⁸ BlackRock, Bloomberg, Sept. 30, 2026.

A wider world of income



Navin Saigal
Head of Global Fixed
Income, Asia Pacific

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The question is becoming less ‘How do I earn a high income?’ and more ‘Which risk do I want to underwrite?’

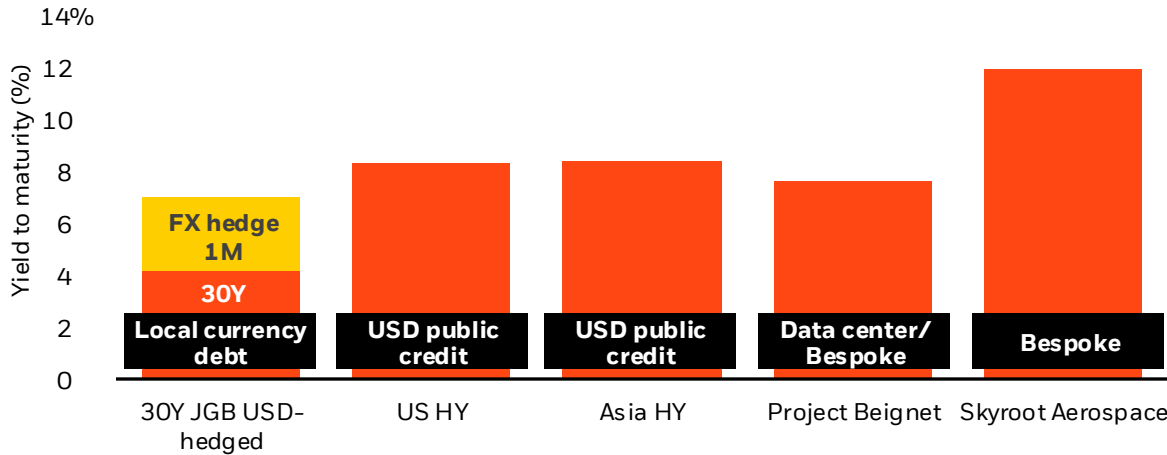
Income opportunities are plentiful today. Seven years ago, nearly \$17 trillion of debt traded at negative yields.⁹ Investors in Asia can now earn approximately 7% through distinctly different avenues: currency-hedged, long-dated Japanese government bonds, where duration is the primary risk; shorter-duration public high yield, where credit risk prevails; or bespoke credit, whose returns reflect contractual cash flows and structural protections and complexity. The question is shifting from “How do I earn a high income?” to “Which risk do I want to underwrite?”

Bringing these varied opportunities together can support a more diversified, resilient income stream. Instead of relying on one rate path, credit cycle or macroeconomic outcome, investors can combine multiple sources of income. Active management can consequently extend beyond traditional public-bond allocation to sourcing, underwriting and structuring investments outside conventional benchmarks.

Asia’s expansion of AI and digital infrastructure is generating fresh financing demand in public markets and bespoke transactions, widening the region’s fixed income opportunity set.

Similar yields can be built in different ways

Yield to maturity across selected public and bespoke credit opportunities



Sources: BlackRock, Bloomberg, as of Sept. 30, 2026. 30Y JGBUSD-hedged: Generic Japan 30Y Government Bond with Bloomberg USDJPY 1month hedging cost applied. US HY: ICE BofA U.S. High Yield Master II Index. Asia HY: iBoxx ChinaBond Asian High Yield USD Hedged Index.

⁹ Bloomberg, as of December 2019.

A wider world of income

Emerging anchors for diversification

For years, Japan provided a natural anchor for global bond yields. As Japanese rates normalize and long-end pressure returns to developed-market curves, we see Chinese government bonds emerging as a differentiated source of stability.

That contrast was evident last quarter: while U.S. Treasuries were volatile, China continued to chart its own path. Chinese government bond yields remained near year-to-date lows in August, with 10-year and 30-year yields around 1.68% and 2.16%, respectively.¹⁰

China's resilience stems from its distinct economic cycle, subdued inflation, ample domestic liquidity and accommodative policy backdrop. More broadly, we believe differentiated Asian rate cycles can provide valuable balance for global portfolios when the direction of developed-market yields remains uncertain.

AI is not just an equity story

AI has captured investors' attention largely through equities, but building the infrastructure behind it will require significant debt capital. Data centers, power generation, grid infrastructure and computing capacity are broadening the investment opportunity to those financing and enabling AI's growth.

Asia's story also differs from the U.S., where concerns have centered on heavy issuance from a small group of hyperscalers. Across Asia, financing demand spans a more diverse ecosystem of data-center operators, infrastructure owners and project financings, led by India and Malaysia, with Australia, Indonesia and Japan adding scale.

APAC ex-China data-center capacity is expected to grow from around 20 gigawatts (GW) today to more than 53 GW by 2030, requiring nearly US\$300 billion of cumulative capital expenditure.¹¹ Around US\$95 billion could be

funded through public bonds, equivalent to approximately US\$24 billion annually.¹² That would represent only about 10% of annual APAC investment-grade issuance. We believe this supply could broaden and diversify the regional credit universe rather than overwhelm the market.

The bigger opportunity may lie beyond public markets. If public bonds fund only US\$95 billion of the projected US\$300 billion required, a substantial financing gap remains. Banks are meeting much of that demand through construction loans and project finance, but the scale of the build-out will require other sources of long-term capital.

Beyond public markets

That gap is creating opportunities across loans, private credit, infrastructure debt and bespoke credit. We are seeing a growing opportunity to structure bespoke financing for borrowers whose needs fall between traditional public and private markets.

Our recent investments in Skyroot Aerospace and Adani Airports illustrate the expertise required to access these markets. Skyroot required an approach bridging traditional credit and venture equity, combining lender protections with participation in future growth, while Adani Airports required analysis of a complex infrastructure platform exposed to India's long-term growth in mobility, consumption and urbanization.

These investments are very different, but the philosophy is consistent: source through deep relationships, underwrite what others may find difficult and partner with companies as their financing needs evolve.

As we enter the fourth quarter, opportunity and discipline need to go hand in hand. Not every company exposed to AI will succeed, and not every structure will adequately compensate investors for its complexity. In our view, rigorous sourcing, underwriting and security selection will be critical to turning Asia's growing demand for capital into durable investment returns.

¹⁰ Bloomberg, as of August 2026. ¹¹ J.P. Morgan Research, as of August 2026. ¹² J.P. Morgan Research, as of August 2026.

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Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.

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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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