

Fixed Income Asset Allocation Insights

Geopolitical Uncertainty and Selective Risk Opportunities

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Fixed income markets posted largely negative returns in the first quarter of 2026, driven by a notable selloff in rates during March amid renewed inflation concerns. The market narrative was dominated by the escalating conflict in the Middle East, which introduced significant uncertainty regarding energy supply disruptions and their potential impact on the delicate balance between inflation and growth. Compared with past shocks, such as the “Liberation Day” tariff announcements last April, the current environment appears more complex and less contained, prompting a measured but broad-based repricing as investors reassess the duration and severity of the disruption.

The Federal Reserve left policy rates unchanged at a target range of 3.50%-3.75%, signaling a cautious stance while maintaining expectations for just one rate cut in 2026, according to the updated dot plot. Policymakers raised their inflation forecasts for the year, citing persistent core services inflation and upside risks from elevated energy prices linked to ongoing geopolitical tensions. Treasury yields moved higher through March as investors scaled back expectations for near-term easing, reflecting growing concern that inflation could remain stubbornly above target for longer than anticipated.

The eurozone economy is expected to face a more material drag on growth, estimated between 2 and 3 percentage points, due to its heavy reliance on energy imports compared to the US, which remains a net exporter. Asia is also experiencing early signs of demand destruction as trade through the Strait of Hormuz remains disrupted. The energy price shock has driven safe-haven demand for the US dollar; and, although the euro is sensitive to rising gas prices, it is expected to remain rangebound. The ECB is likely to avoid rate hikes unless the energy situation worsens significantly.

Overall, the credit market is characterized by widening spreads and rich valuations, though fundamentals in areas like leveraged finance remain decent despite consumer-led pressures. Technicals are still generally supportive, bolstered by strong demand for new issues and potential regulatory changes that could make mortgages more favorable for domestic banks. Our base case remains a stabilization scenario over the next 12 months, assuming conflict-related disruption is measured in weeks rather than months. While we maintain a slight tilt toward risk, we are currently on hold, looking for selective buying opportunities as volatility plays out.

About This Report

Fixed Income Asset Allocation Insights is a quarterly publication that brings together the cross-sector fixed income views of PineBridge Investments. Our global team of investment professionals convenes in a live forum to evaluate, debate, and establish top-down guidance for the fixed income universe. Using our independent analysis and research, organized by our fundamentals, valuations, and technicals framework, we take the pulse of each segment of the global fixed income market.

Our Asset Class Outlooks

Investment Grade Credit

We are adopting a wait-and-see approach to developments in the Middle East. Thus far, markets have remained orderly; while rates have moved higher and credit spreads have widened, these shifts have been relatively contained. A prolonged conflict, however, could sustain upward pressure on energy prices, lift inflation expectations, dampen growth prospects, and trigger a broader risk-off tone. In the meantime, we continue to evaluate relative-value opportunities in the primary market, particularly in segments of the curve where we remain underweight, such as intermediate maturities.

Securitized Products

Recent spread widening appears driven more by interest rate volatility and curve flattening than by geopolitical developments. Unlike “Liberation Day,” which delivered an immediate shock, the current conflict has unfolded gradually – more a “death by a thousand cuts” – allowing the sector to hold up comparatively well. A notable positive is Fed Governor Michelle Bowman’s advocacy for regulatory changes that could make mortgage holdings more attractive for domestic banks. Overall, we remain constructive on MBS spreads.

Leveraged Finance

Fundamentals remain broadly sound, though signs of strain are emerging in consumer-driven sectors such as housing and autos. The US’s relative energy independence continues to provide a cushion against external shocks. High yield credit has widened by roughly 30 to 50 basis points (bps), creating more attractive return profiles. While “alarm stories” around private credit are gaining attention, we do not see meaningful spillover risks or systemic contagion. For investors with a year-end horizon, current market conditions could present selective buying opportunities, albeit with elevated volatility.

Emerging Markets

Emerging market spreads have been remarkably resilient, widening by only about 10 basis points. Underlying fundamentals remain solid, and we expect market access to improve once the current issuance pause subsides. Some higher-yielding sovereigns are beginning to price in renewed rate hikes, which we view as premature; in our view, central banks are more likely to delay, rather than reverse, their easing cycles. We continue to favor rotating risk toward oil-importing countries that have built strong external buffers.

Non-US-Dollar Currency

We expect FX markets to remain largely range-bound within a low-volatility, carry-friendly environment. While short-term energy and risk-aversion dynamics support the US dollar, a cooling US economy and potential Fed cuts in the second half should cap sustained dollar strength. Elevated oil prices may persist in the near term but are likely to stabilize later this year, easing inflation pressures. The euro remains vulnerable to higher gas prices and weaker growth momentum, which could limit its upside versus the dollar.

Segment Snapshots

Using our independent analysis and research, organized by our fundamentals, valuations, and technicals framework, we take the pulse of each segment of the global fixed income market.

Investment Grade Credit

US Dollar Investment Grade Credit

Dana Burns, Portfolio Manager, US Dollar Investment Grade Fixed Income

Fundamentals

Fundamentals remain firm, with good balance sheet strength and leverage metrics. Capex and merger and acquisition (M&A) activity are expected to increase in 2026.

Valuations

Credit spreads have bounced off multi-decade tightness. All-in yields remain attractive to investors. The primary market has offered select opportunities.

Technicals

Negative broker/dealer inventories greater than five years and the search for quality credit continue to offer support. Attractive all-in-yields have driven foreign demand as well as domestic demand from insurers. AI-related supply has been strong year-to-date (YTD) and is expected to pause for awhile.

Non-US-Dollar Investment Grade Credit

Roberto Coronado, Portfolio Manager, Non-US-Dollar Investment Grade Credit

Fundamentals

Neutral. Companies in general continue to post decent results while balance sheets remain healthy and M&A activity remains low. Management teams however are providing cautious outlooks, citing limited visibility into future sales/margins as the economic outlook and tariff impact remain uncertain.

Valuations

Neutral. We see credit spreads at or through fair value and expect the index to trade within a range in the coming weeks and months. We see a low probability of a large index move in either direction. For that reason, sector and security selection will be key to outperformance.

Technicals

Positive. Flows into euro corporates have been strong for the past 12 months, while supply has been well absorbed. Investors continue to be better buyers of credit, and new issues are performing well.

Securitized Products

Andrew Budres, Portfolio Manager, Securitized Products

Fundamentals

Worries about the war and its impact on inflation have exacerbated the notion that the Fed will execute fewer rate cuts. This has caused the yield curve to flatten and for mortgage-backed securities (MBS) valuations to come under pressure during flatteners, all else equal.

Valuations

Any widening of spreads from war-induced increases in forward implied volatility should be considered contained if indeed the government-sponsored enterprises (GSEs) will buy MBS throughout the year.

Technicals

Besides the potential GSE buying in 2026, Fed member Bowman is going to great lengths to make it more accommodative to banks to hold more MBS on their balance sheets.

Leveraged Finance

John Yovanovic, CFA, Head of High Yield Portfolio Management

Fundamentals

Fourth-quarter 2025 earnings and 2026 outlooks are complete for most issuers (mainly public and some private). Results overall were in line with recent quarters. Continued weakness was noted in the building products sector as interest rates remain stubbornly high. Last-12-month par-weighted default rates in high yield increased slightly, to 2.06%/1.17%.

Valuations

The US high yield spread-to-worst is now at 345 (BB 227, B 377, CCC 698), 40 bps wider month-over-month. The yield-to-worst is at 7.24%, 62 bps wider month-over-month. The widening has been driven by war concerns and some earnings season disappointments. Loan market spreads widened to S+ 438 on 16 March, up 15 bps from S+423 on 18 February, but spreads have actually tightened 20 bps from the intra-month low of S+458 on 3 March. Year-to-date pressure on loan spreads can be attributed to AI concerns, with limited impact more broadly at the index level from the conflict in Iran month-to-date.

Technicals

US high yield new issuance totaled \$28.7 billion in February, roughly in line with average 2024-2025 levels. Low-quality issuance was 8.8% of the total, versus 6.2% for 2023-2025. Fund flows were a headwind in February at -\$0.7 billion, continuing the trend we saw in January, though we note that inflows were very strong in 2025. With loans still trading near AI-driven risk-off lows and geopolitical uncertainty clouding the outlook, a meaningful pickup in net loan supply appears unlikely in the near term.

Emerging Markets

Sovereigns

Sam McDonald, Sovereign Analyst, Emerging Markets Fixed Income

Fundamentals

The global growth environment is expected to remain favorable overall for emerging markets (EM) in 2026, with the US tech cycle continuing to support EM trade, particularly in Asia. Given the strong disinflation backdrop in 2025, inflation is expected to move more sideways this year but will be increasingly differentiated across regions. However, there is still room for rate cuts, with EM high-yielders taking the lead as many low-yielders' cutting cycles have largely finished. These high yield issuers also tend to have better fiscal trajectories, which could support yield-curve flattening. Market access has been extended to almost all current sovereigns in the index, and we also expect improvements in the external sector, with our commodity outlook remaining supportive.

Valuations

Spreads remain near their historical tightness. However, changes in country weights and the inclusion of several recently restructured defaulters make historical comparisons difficult. We expect EM spreads to remain supported by positive external and domestic backdrops. At 253 bps, the EMBI is 23 bps wider month-over-month and 16 bps wider year-to-date. Within the index, EMBI HY is 41 bps wider month-over-month, while IG spreads are 7 bps wider.

Technicals

February saw record monthly issuance at almost \$24 billion, with the YTD level at around \$83 billion – predominantly driven by investment grade (IG) names. However, given that spreads are at historical tightness, lower-rated issuers have come to the market, including Benin and Ecuador. Nonetheless, we expect net supply to be materially lower this year versus 2025, when net supply totaled \$100 billion. For 2026, on the flow side, expectations are for around US\$40 billion-US\$50 billion to enter the market via dedicated EM bonds, creating a positive technical.

Corporates

Kim Keong, Trader, Emerging Markets Fixed Income

Fundamentals

As we are currently in the middle of the second-quarter earnings We remain in the fourth-quarter 2025 earnings season, with results broadly in line with expectations and a modest positive skew to earnings beats. Credit rating momentum has normalized following a strongly positive year, with recent downgrades largely concentrated in Latin America, particularly Brazil. The default rate for 2026 has recently been revised higher to 4.3% from 3.0%, driven by two large Latin American issuers. These defaults

appear idiosyncratic in nature and do not signal a broad-based deterioration in underlying credit fundamentals. Our view is that the balance sheet is still strong and will remain resilient during the volatile period.

Valuations

Over the past month, the CEMBI BD spread to worst widened by 9 bps, with IG (+2 bps) outperforming HY (+21 bps). As expected, CEEMEA (+16 bps in IG+ and +38 bps in HY+) underperformed the rest, while LatAm was the outperformer in IG+ (-35 bps) and HY+ (+9 bps). The main underperformers since the conflict started were Gulf Cooperation Council (GCC) real estate and airlines, whereas the oil and gas credits have outperformed. Over the month, EM credits tightened against their developed market peers in both IG (-13 bps) and HY (-17 bps).

Technicals

Primary market activity in February slowed to \$24 billion, the lowest total for the month in almost a decade. The net financing for the month concluded at -\$12 billion. The expected supply in March is \$33 billion. However, with the ongoing conflict in the Middle East, we expect muted issuance. Month-to-date, gross issuance is \$5 billion, and with the scheduled cash flows of \$29 billion, we expect another month of net negative financing. We have not heard of material outflows in the EM space (yet), other than ETF selling, while locals and US investors are looking to buy the dip.

Non-US-Dollar Currency

Anders Faergemann, Senior Portfolio Manager, Emerging Markets Fixed Income

Fundamentals

The US dollar has strengthened on safe-haven demand amid geopolitical uncertainty, but this strength is likely to be temporary. A more persistent energy risk premium in Europe suggests the EUR/USD has likely peaked for the year, even if broader dollar upside is capped.

Valuations

We are keeping our 12-month EUR/USD forecast at 1.1900 despite the increased market uncertainty premium. We are keeping our 12-month USD/JPY forecast at 147.50, reflecting the new political regime in Japan, a more hawkish central bank, and misalignment between US/Japan rate differentials and USD/JPY.

Technicals

According to J.P. Morgan as of 13 March, euro length has been pared back. Over the prior week, we saw a 2.1-sigma reduction of euro longs in the futures space. One-month momentum shows a clear bias lower for EUR/USD for the first time since the first quarter of 2025.

Disclosure

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