JANUARY 2026

US PENSIONWATCH

A review of Q4 2025 and investment outlook

Asset markets maintained a firm tone through the final quarter of 2025, supported by the Federal Reserve's renewed easing cycle. While this policy shift buoyed sentiment, markets continue to contend with the lingering effects of earlier tariff increases and an outlook clouded by persistent policy uncertainty and a clearly softening labor market.

Looking ahead, although economic indicators have shown resilience, we expect economic momentum to fade in 2026. Nevertheless, we do not anticipate a recession; the ongoing wave of AI-driven capital expenditure and Fed cuts should help offset labor market weakness.

In this quarterly, we provide an update on our pension indices and examine how surplus positions are reshaping strategies in our annual pension monitor. We review the 10 key themes that defined 2025, explore the credit opportunities emerging from increased AI-related capital expenditure, and discuss the importance of a disciplined approach to fixed income allocation. Finally, our educational section features new research on France, highlighting how recent fiscal developments may be steering the country toward an unsustainable path.

- **2025 – Ten themes that shaped the year:** Inflation pressures gradually eased, while labor markets weakened, with unemployment climbing to its highest level since 2021. AI-driven capital expenditure provided a critical boost to growth, offsetting broader softness. The Fed resumed its easing cycle with three rate cuts, but Treasury yields ended the year largely unchanged. Credit markets outperformed Treasuries, while equities endured a turbulent year, slumping after the tariff shock before recovering to post strong gains. The US dollar weakened sharply, and pension funded status improved alongside growth assets.
- **Pensions:** In our US Pension Monitor we highlight that corporate defined benefit (DB) pension plans have entered a new era, with average funding ratios surpassing 100%. As plans move deeper into decumulation, investment strategies are evolving – with a rotation from equities to fixed income, including private credit. However, rising payout ratios highlight liquidity challenges, making cashflow-driven investment solutions and surplus management strategies critical.
- **Credit markets:** The surge in financing for AI infrastructure presents a new opportunity in credit markets. Issuance from hyperscalers and other tech leaders offers access to highly rated debt from issuers that rarely tap the market – often at a yield premium to similarly rated corporate bonds.
- **Investment outlook:** We expect investment grade credit to remain supported by strong fundamentals in 2026, though higher issuance may widen spreads but create opportunities in primary markets. We believe demand for high yield will remain solid but that the asset class needs careful credit selection amid rising supply. Structured credit has the potential for income and diversification, while we favor barbell strategies in municipal bonds.
- **Key risks:** Rising uncertainty across policy, trade, and geopolitics is increasing risks for investors and policymakers. Forecasting is challenged by policy uncertainty, while there is a risk that the US economy tips into recession with negative consequences for risk assets.
- **Educational update:** France's fragmented politics and fiscal uncertainty pose risks for markets, with the 2027 election adding unpredictability and potential underperformance versus eurozone peers.

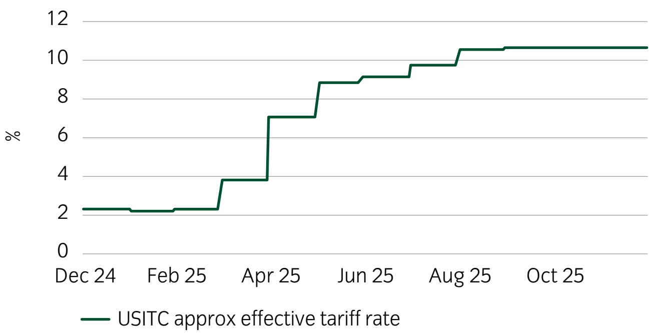
"It's not about how hard you hit. It's about how hard you can get hit and keep moving forward."
ROCKY BALBOA (2006)

2025: TEN THINGS THAT DEFINED THE YEAR

1. TARIFF RATES MEANINGFULLY INCREASED

In early April, the administration announced a 10% universal tariff on all imports and higher reciprocal tariffs on many major trading partners. After significant market turmoil, a 90-day pause was announced for tariffs above the 10% baseline (excluding China), providing a window for negotiations. This meant the effective tariff rate rose more gradually than initially anticipated (see Figure 1).

Figure 1: The effective tariff rate climbed gradually to over 10%[1]



2. INFLATION PRESSURES GRADUALLY EASED

The Fed's preferred gauge for inflation, the core personal consumption expenditures (PCE) price index, decelerated only marginally, from 3% year-on-year at the start of the year to 2.8% by the end of September. However, there have been encouraging signs that inflation pressures are broadly easing. For example, the Atlanta Fed's measure of core sticky inflation, which measures the price changes of goods that rarely change in price, decelerated from a year-on-year rate of 3.75% at the end of 2024 to 2.95% at the end of November 2025. If the effective tariff rate stabilizes at around 10%, then tariff-driven inflation should start to drop out of the data by mid-2026.

Figure 2: Inflation marginally eased[2]

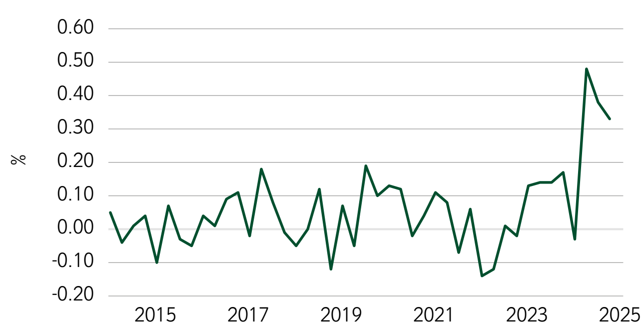
3. LABOR MARKETS WEAKENED

Nonfarm payroll growth decelerated sharply from monthly highs of between 100,000 to 150,000 earlier in the year to a net loss of 13,000 jobs in June after revisions. The unemployment rate steadily drifted upward from around 4.0% in January to 4.6% by November, the highest level since 2021. Meanwhile, forward-looking indicators such as the ISM Services Employment Index suggest corporations remain cautious while layoffs are trending upwards. These trends suggest the labor market has meaningfully weakened, with employers cautious about expanding their workforce, but largely holding onto current employees for now.

4. TECH CAPEX IS UNDERPINNING GROWTH

AI-related spending is increasingly influencing GDP growth statistics across four key areas: investment in equipment (such as semiconductors and IT hardware), structures (including data centres and power infrastructure), intellectual property (notably R&D and software), and net trade in AI-related goods and services. The effects of this investment wave are already visible in the data. According to Pantheon Economics, AI-related capex contributed approximately 0.5 percentage points to real US GDP growth in the first half of 2025. Without this boost, annualised growth would have been just 0.6%, compared to the reported 1.1%.

Figure 3: Contribution to US GDP from computers and peripheral equipment has surged[3]



[1, 2, 3] Source: Insight and Bloomberg. Data as of December 31, 2025.

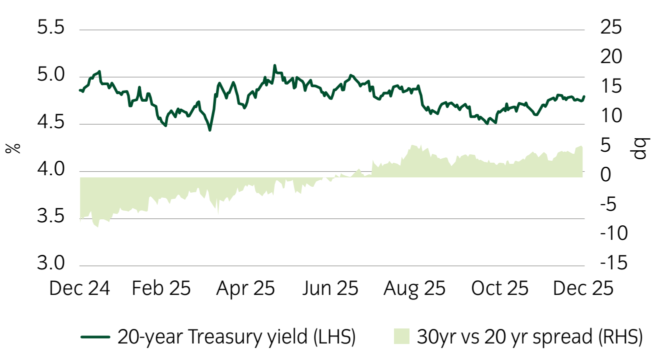
5. THE FED RESTARTED ITS EASING CYCLE

In September 2025, the Federal Reserve restarted its easing cycle, cutting the benchmark Federal Funds rate by 25 basis points and marking the first reduction since December 2024. This move was driven by mounting evidence of a softening labor market, with Chair Powell described the decision as a "risk management cut", with the Fed seeking to prevent a more meaningful economic slowdown. The Fed cut for a third time in December, taking the Fed Funds rate to a range of 3.5% to 3.75%. The "dot plot", which reflects the forecasts of members of the Federal Open Market Committee, suggests an expectation of one further cut in 2026. Three members of the committee dissented from the December cut, with two voting for no change and one voting for a 50bp cut.

6. BOND MARKETS TRENDED SIDEWAYS

US Treasury yields trended sideways through the year, with the yield of the 20-year Treasury starting the year at 4.86% and ending the year at 4.79%. However, the yield curve steepened between 20 and 30 years (see Figure 4), as markets started to question long-term US fiscal sustainability.

Figure 4: 20-year Treasury yields trended sideways, but the yield curve steepened[4]



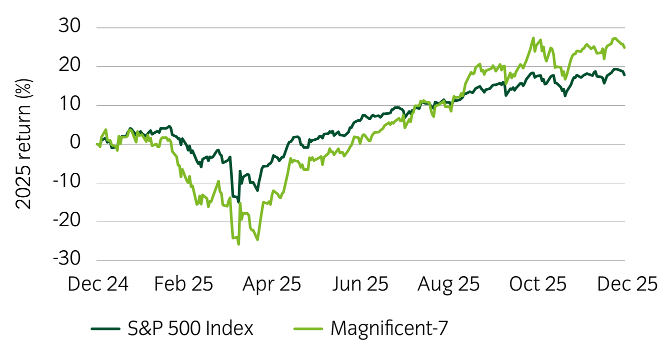
7. CREDIT OUTPERFORMED

Investment grade corporate credit spreads, as measured by the Bloomberg US IG Corporate Index ended the year at 78bp over Treasuries, tightening by 2bp over the year. The combination of higher income and tighter spreads led to the Bloomberg Corporate Index outperforming its Treasury equivalent by 1.19% in 2025[5]. High yield credit recorded strong gains, driven by very high levels of income and supported by a strong technical backdrop, which is expected to persist in 2025.

8. EQUITIES SLUMPED, THEN RECOVERED

The S&P 500 Index rose by close to 18% over the year on a total return basis but its performance was once again driven by a small group of companies, nicknamed the Magnificent Seven, which rose by close to 25%[6] (see Figure 5). This group of mega-cap tech stocks (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla[7]) experienced rapid earnings growth through the year and are expected to be some of the key beneficiaries of advances in artificial intelligence. It was a turbulent year for equities, marked by sharp swings in performance. The Magnificent Seven endured a steep 26% drawdown at its April low following the tariff shock, which rippled through broader markets and pulled the S&P 500 down by 15%. From there, sentiment gradually improved, paving the way for a steady recovery over the remainder of the year.

Figure 5: The Magnificent Seven dominated returns once again[8]



9. THE US DOLLAR DROPPED

The Federal Reserve's Trade Weighted Broad Dollar Index, which tracks the nominal value of the US dollar versus the currencies of its trading partners, declined by 7.6% by early July, recovered marginally, then declined again into year end. The index ended the year with a decline of 7.4%. Meanwhile, the US Dollar Index – a widely followed gauge of the dollar against major currencies – posted an even steeper drop of 9.4%.

10. PENSION FUNDED STATUS IMPROVED

Over 2025, the funded status of our two pension indices increased significantly. Please see our pension trends section on page 4 for further details.

[4] Source: Insight and Bloomberg. Data as of December 31, 2025.
[5] Source: Barclays. Data as of December 31, 2025.
[6] Source: Insight and Bloomberg. Data as of December 31, 2025.
[7] The mention of a specific security is not a recommendation to buy or sell such security.
[8] Source: Insight and Bloomberg. Data as of December 31, 2025. Bloomberg Magnificent Seven Index is equally weighted and rebalanced monthly. **Past performance is not indicative of future results. Investment in any strategy involves a risk of loss which may partly be due to exchange rate fluctuations.**

PENSION TRENDS

PENSION FUNDED STATUS UPDATE

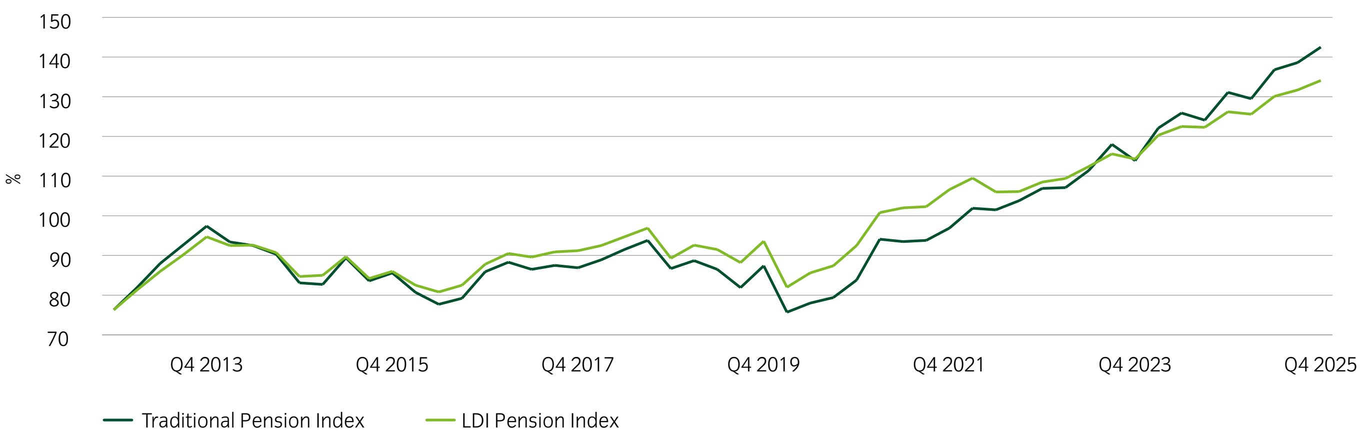
Insight maintains two model pension indices. The Traditional Pension Index aims to reflect those plans that have not yet adopted LDI. The LDI Pension Index aims to reflect those plans that have adopted LDI in the fixed income portion of their portfolio. Historically both have assumed a 60% allocation to growth assets and a 40% allocation to bonds, but since year end 2021 we have updated the LDI index to have a 50% allocation to bonds, reflecting higher levels of hedging in plans implementing LDI strategies.

Q4 funded status impact: Rates increased by 13bp over the quarter and spreads increased by 2bp, resulting in a 15bp increase in discount rates. Growth assets had a 2.1% return. Both of our pension indices saw an increase in funded status over the quarter, primarily driven by gains in growth assets.

The Traditional Index, which contains core fixed income, saw its funded status increase by 3.8% to 142.5%, while the LDI Index, which contains long duration fixed income, saw its funded status increase by 2.4% to 134.1%. The Traditional Index outperformed primarily due to its higher allocation to growth assets which outperformed fixed income.

Over 2025, the funded status of the Traditional Index increased by 11.4% and the LDI Index increased by 7.8%.

Figure 6: Pension funded status continued to improve in Q4[9]



[9] Source: Insight and Bloomberg. Data as of December 31, 2025. Note: Beginning in 2014, we introduced two indices to provide insight into the impact of rate and market movements on different types of pension plan investors. Traditional Pension Index: The index reflecting those pensions that have not yet adopted LDI. LDI Pension Index: The index reflecting those who have adopted LDI in the fixed income portion of their portfolio. Assumptions behind the Insight indices include 14-year typical pension liability duration, an aggregate 5% liability impact of updated mortality assumptions effective Q4 2014 and no external cashflows. WHERE MODEL OR SIMULATED RESULTS ARE PRESENTED, THEY HAVE MANY INHERENT LIMITATIONS. CLIENTS' ACTUAL RESULTS MAY BE MATERIALLY DIFFERENT THAN THE RESULTS PRESENTED. UNLIKE AN ACTUAL PERFORMANCE RECORD, MODEL RESULTS DO NOT REPRESENT ACTUAL TRADING AND MAY NOT REFLECT THE IMPACT THAT MATERIAL ECONOMIC AND MARKET FACTORS MIGHT HAVE HAD ON INSIGHT'S DECISION-MAKING IF ACTUAL CLIENT FUNDS WERE BEING MANAGED. ALSO, SINCE SUCH TRADES HAVE NOT BEEN EXECUTED, THE RESULTS MAY HAVE UNDER OR OVER-COMPENSATED FOR THE IMPACT, IN ANY, OF CERTAIN MARKET FACTORS, SUCH AS LACK OF LIQUIDITY. SIMULATED TRADING PROGRAMS IN GENERAL ARE ALSO SUBJECT TO THE FACT THAT THEY ARE DESIGNED WITH THE BENEFIT OF HINDSIGHT. MODEL RESULTS ARE ACHIEVED THROUGH THE RETROACTIVE APPLICATION OF A MODEL. MODEL RESULTS SHOWN DO NOT REFLECT MANAGEMENT FEES, TRANSACTION COSTS AND OTHER EXPENSES THAT WOULD REDUCE RETURNS. THIS IS A HYPOTHETICAL MODEL. THE QUOTED BENCHMARKS DO NOT REFLECT DEDUCTIONS FOR FEES, EXPENSES OR TAXES. THE BENCHMARKS ARE UNMANAGED AND DO NOT REFLECT ACTUAL TRADING. THERE COULD BE MATERIAL FACTORS RELEVANT TO ANY SUCH COMPARISON SUCH AS DIFFERENCES IN THE VOLATILITY, AND REGULATORY AND LEGAL RESTRICTIONS BETWEEN THE INDEXES SHOWN AND THE STRATEGY. INVESTORS CANNOT INVEST DIRECTLY IN ANY INDEX.

INSIGHT'S US PENSION MONITOR: SURPLUSES ARE CHANGING THE GAME

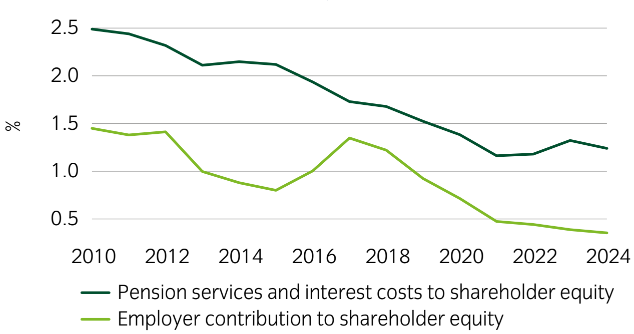
THE AVERAGE US CORPORATE DEFINED BENEFIT PLANS ARE IN SURPLUS

After decades of dealing with funding deficits, many US corporate DB pension plans have achieved surplus positions.

This improvement has partly been driven by rising discount rates (the average of which increased from 2.7% in 2020 to 5.2% in the 2024, the highest since 2010). Strong investment performance was the other major factor.

These improvements have helped ease pressure on corporate sponsors. Pension service and interest costs (as a share of shareholder equity) eased in 2024 after rising modestly following the disruption of the pandemic, due to smaller absolute accruals as well as improved valuations. The burden of employer contributions has also continued to ease over time (Figure 7) as funding positions subsequently rebounded but also from additional rounds of funding relief enacted in 2021.

Figure 7: Corporate sponsors are less burdened by their DB plans[10]

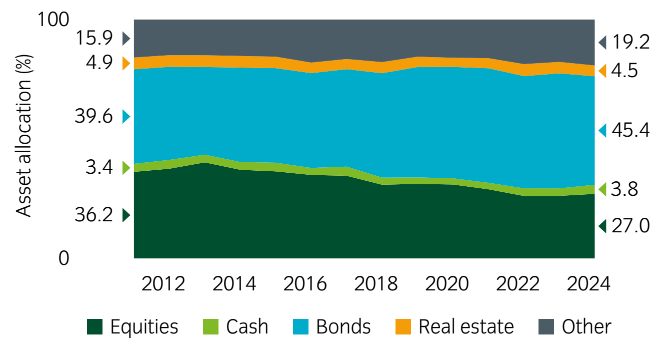


Globally, our study indicates that declining pension expense has contributed 15% of the improvement in global EBIT margins in 2024[11].

CORPORATE DB INVESTMENT STRATEGIES HAVE CHANGED ACCORDINGLY

As their funding positions have improved, US corporate DB asset allocations are changing in an effort to reduce funded status volatility and drawdown risk. Plans have been scaling back their equity exposure and increased their fixed income allocations. They have also increased their exposure to less liquid alternative asset classes such as private credit (Figure 8).

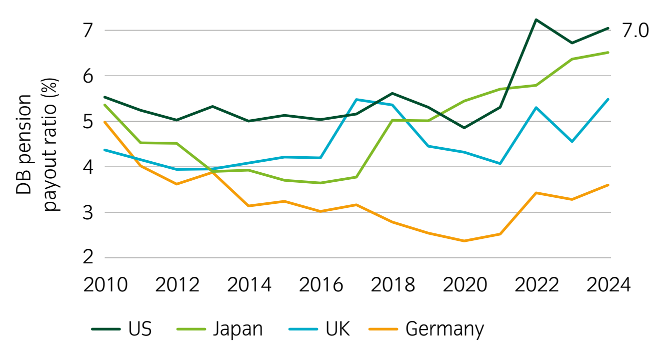
Figure 8: Plans have shifted their exposure toward fixed income[12]



LIQUIDITY CHALLENGES MAY BE AN UNDERAPPRECIATED RISK

Our study indicates that the US DB pension market has the largest average payout ratio in the world. It indicates the world's most mature pension market. It also implies growing risks from forced selling to meet benefit payments. During bouts of market volatility, forced selling of assets can incur high transaction costs, mean missing out on recovery rallies and heavily compromising growth potential.

Figure 9: The US market's payout ratio has been rising, indicating building cashflow risks[13]



[10] Source: Frankfurt School of Finance and Management, Bloomberg, Insight, December 2024. S&P 500 Index companies with defined benefit pension plans.
[11] Source: Frankfurt School of Finance and Management, Bloomberg, Insight. Based on companies in the S&P 500, FTSE 100, Nikkei 225 and Dax 40.
[12, 13] Source: Frankfurt School of Finance and Management, Bloomberg, Insight, December 2024. S&P 500 Index companies with defined benefit pension plans. Hedge ratio based on percentage change in assets and liabilities.

CONCLUSION: THE CHALLENGE FOR US DB PLANS IS EVOLVING

Plan sponsors are now considering how to manage their new funding status positions and their cashflow burdens. Insight is working with clients to help them adapt.

As pension plans move deeper along their glide paths into decumulation, we find that their needs change profoundly, and they increasingly value solutions that maximize precision and the certainty of achieving their objections. As part of this, we are discussing broadening the LDI toolkit to incorporate to incorporate overlays and cashflow-driven investment solutions.

We are discussing surplus-driven investing solutions, such as self-management as an alternative to rushing into a pension risk transfer, to deliver potential economic benefits to the sponsor and pension members alike. Overlays can manage the hedge with greater efficiency, precision and help address more complex liability risks. Cashflow-driven investment solutions aim to turn liquidity from a risk to a strategic advantage, by structuring portfolios to meet benefit payments through contractual income and maturity payments, without trading frictions while protecting residual growth assets from forced selling risks.

ECONOMICS AND MARKETS

KEY MARKET MOVEMENTS: Q4 2025

The yield curve steepened over the quarter as investors priced in Fed rate cuts, pushing short-term yields lower while longer-term yields edged higher. Overall, US Treasuries delivered positive returns; however, long-duration bonds lagged due to the steepening curve. Within the curve, intermediate maturities posted the strongest performance in 2025.

Wider spreads caused corporate credit to underperform Treasuries at the long end of the curve during the quarter, while outperforming in the intermediate segment. Over the full year, corporate credit outperformed across all maturities, with the intermediate area delivering the strongest performance. High yield outperformed over both the quarter and year as a whole.

Equity markets rallied over the quarter, with the S&P 500 Index generating a return of 2.6%. This took the year-to-date return to a solid 17.9%.

The US dollar, as measured by the dollar index, recovered by 0.5% over the quarter, bringing its year-to-date performance to -9.4%.

Table 1: Q4 2025 fixed income/equity index returns (%) and volatility index levels[14]

Index	Q4 2025 total return (%)	YTD total return (%)	Q4 2025 excess return (%)	YTD excess return (%)
Bloomberg US Treasury Index	0.90	6.32	-	-
Bloomberg US Intermediate Treasury Index	1.16	6.51	-	-
Bloomberg US Long Treasury Index	-0.05	5.59	-	-
Bloomberg US IG Corporate Index	0.84	7.77	-0.04	1.19
Bloomberg US Intermediate IG Corporate Index	1.29	7.95	0.13	1.31
Bloomberg US Long IG Corporate Index	-0.11	7.44	-0.39	1.04
ICE BofA US High Yield Index (H0A0)	1.35	8.50	0.45	2.19
S&P 500 Index	2.65	17.88	-	-
MSCI Emerging Markets Equity Index	4.73	33.57	-	-
Dollar Index	0.56	-9.37	-	-
VIX[15]	15	-	-	-
MOVE[15]	64	-	-	-

[14] Source: Bloomberg. Data as of December 31, 2025.
[15] VIX and MOVE are actual value at month end.

ECONOMICS

The global outlook remains subdued, with growth forecasts edging slightly higher over the quarter. Global real GDP is now expected to expand by 3.0% in 2025 and 2.9% in 2026, supported by modest upward revisions across developed markets. The US is projected to grow by 2.0% in both years, while the euro area and Japan are forecast at 1.4% and 1.2% in 2025, easing to 1.2% and 0.7% respectively in 2026. China continues to outperform expectations, with growth anticipated at 4.9% in 2025 before slowing to 4.5% in 2026. Inflation pressures are expected to ease globally, with consensus CPI forecasts declining by 0.2 percentage points in 2025 and 0.1 in 2026, bringing global inflation to 3.4% and 3.3% respectively. The US remains an exception, with inflation projected to hover near 2.8% through 2026, above the Fed's target, while Japan sees a notable uptick in 2025 before moderating. Overall, while growth revisions are positive, the pace remains modest, reinforcing expectations for a gradual disinflationary trend.

Table 2: Consensus GDP and CPI expectations[16]

Real GDP	Consensus*			Change over Q4	
	2024	2025F	2026F	2025F	2026F
United States	2.8	2.0	2.0	0.2	0.2
Euro area	0.7	1.4	1.2	0.2	0.1
Japan	0.1	1.2	0.7	0.2	0.0
China	5.0	4.9	4.5	0.1	0.3
Developed markets	1.9	1.7	1.7	0.2	0.1
Emerging markets	4.1	4.2	4.2	0.1	0.2
Global	**3.1**	**3.0**	**2.9**	**0.1**	**0.0**

CPI	Consensus*			Change over Q4	
	2024	2025F	2026F	2025F	2026F
United States	2.9	2.8	2.8	0.0	-0.1
Euro area	2.4	2.1	1.8	0.0	0.0
Japan	2.7	3.1	1.9	0.1	0.1
China	0.2	0.0	0.7	-0.1	-0.1
Developed markets	4.3	3.3	2.9	0.1	0.0
Emerging markets	6.5	3.0	2.7	0.0	0.0
Global	**4.4**	**3.4**	**3.3**	**-0.2**	**-0.1**

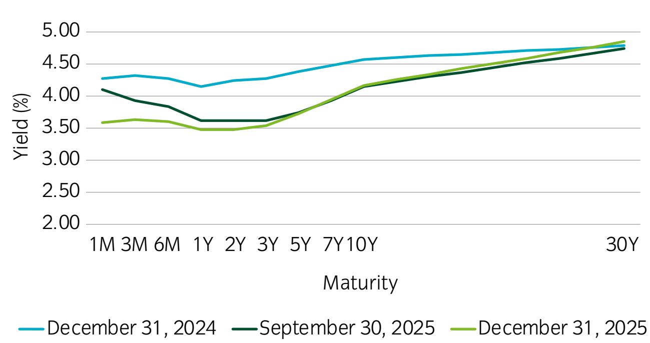
TREASURY MARKETS

The yield curve moved down and steepened

The Fed took a meaningful shift in Q4, reducing the Fed Funds rate by 25bp in October, and then a further 25bp in December – taking the policy rate to a range of between 3.50% and 3.75%. The Bank also officially ended its quantitative tightening program on December 1, citing concerns about tightening money-market liquidity and the strain on bank reserves. This shift was reinforced on December 10, with the Fed resuming Treasury bill purchases at a rate of $40bn per month to ensure ample reserve levels. Federal Open Market Committee minutes showed an unusually divided committee in December, with some members still concerned about inflation while others were more worried about the labor market. This saw three members dissent from the consensus, two voting for no cut and one voting for a 50bp cut. The Fed's dot plot suggests one further cut ahead in 2026.

The yield curve steepened over the quarter, as short-term yields declined in response to rate cuts, but longer maturity yields rose due to persistent concerns about long-term fiscal sustainability. By quarter-end, two-year yields had fallen 14 basis points to 3.47%, and 30-year yields were 11 basis points higher at 4.84%.

Figure 10: Treasury yield curve change[17]



[16] Source: Insight and Bloomberg. Data as of December 31, 2025. F=Forecast. * Bloomberg consensus forecast.
[17] Source: Bloomberg as of December 31, 2025.

No change in net borrowing ahead

At its October 2025 presentation, the US Treasury Borrowing Advisory Committee estimated that tax receipts for the 2025 financial year totaled $5,235 billion (+6% versus 2024). Total outlays were $7,010 billion (+4% versus 2024). On a year-on-year basis bills issuance has significantly declined, with a shift towards issuance in the two-to-five-year maturity bracket.

The median forecast of Primary Dealers was for net privately held marketable borrowing of $2.03 trillion in FY2026, $2.12 trillion in FY2027 and $2.12 trillion in FY2028.

It was noted that these forecasts had been adjusted for the effects of the One Big Beautiful Bill but not for tariff revenues, while uncertainty regarding future funding needs remains relatively high.

The US government shutdown officially ended the evening of November 12, 2025, after 43 days – making it the longest in US history – when President Trump signed a continuing resolution to fund federal operations through January 30, 2026.

Table 3: US Treasury net marketable borrowing[18]

Market ($bn)	2023 FY	2024 FY	2025 FY	Yr/Yr change
Bills issuance	1,616	744	392	-352
Floating rate issuance	-50	40	75	35
2-5yr Treasury issuance	-243	-38	409	446
5-10yr Treasury issuance	269	685	783	98
Over 10yr Treasury issuance	373	472	468	-3
5-10yr TIPS	15	42	19	-23
Over 10yr TIPS	20	17	-29	-46
Buybacks	0	-42	-185	-143
Total	**1,998**	**1,921**	**1,931**	**11**

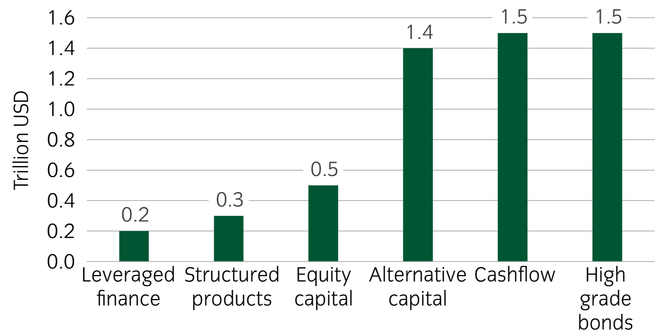
CREDIT MARKETS

Opportunity or risk? Investing in AI capex

Investment in AI-related infrastructure is booming, leading some observers to fear history may be repeating itself, drawing parallels to the dot-com boom of the late 1990s, which ultimately collapsed in 2000 after internet stock prices soared on growth expectations that proved vastly overstated.

In fixed income markets, we view the surge in financing for AI infrastructure as an opportunity to access attractive, low-risk debt from issuers that rarely come to market – or through structures typically offering a yield premium relative to similarly rated corporate bonds.

Figure 11: How AI capex will likely be funded to 2030[19]



Debt investors shouldn't fear an equity bubble

The dot-com bubble was defined by companies with weak balance sheets taking on excessive debt. In contrast, today's AI-related capital expenditure is largely driven by firms with exceptionally strong financial foundations. Across the US, corporate balance sheets and profitability remain healthy.

The largest US technology companies are underpinned by robust, diversified revenue streams – a critical distinction from the dot-com era. So, even if AI business plans disappoint, there is little reason to fear that these companies will have difficulty repaying their debts. Many hyperscalers generate substantial cash flows from existing businesses, and their credit ratings are anchored in these revenues rather than speculative AI income.

Three key questions for the AI funding boom

1. Can markets digest the volume of issuance?

The surge in issuance during Q4 is believed to be a key reason for why broader US credit spreads widened over the quarter, with markets struggling to absorb the unusually large volume of new debt. Ultimately, although an increase in issuance may impact spreads in the short term, we don't see it as a problem over longer time horizons. Spreads in US credit markets have tightened over 2025, driven by demand outpacing supply. With absolute yields remaining elevated, we see little reason for this dynamic to change – even with this increase in AI-related issuance.

2. Will spreads for hyperscalers widen?

Historically, hyperscalers have enjoyed a scarcity premium on their securities, thanks to strong profitability and limited reliance on debt financing. However, the recent shift toward large-scale issuance has eroded that premium, leading to some widening in spreads. The elevated level of issuance is likely to see these issuers trading in this new wider range going forward. From an investor perspective, concentration limits will naturally cap exposure to any single issuer, which we expect will encourage companies to tap different segments of the debt market to diversify their funding sources. Asset-backed markets are one area which we are closely monitoring to take advantage of this.

[18] Source: Insight and US Treasury. Data as of November 30, 2025. Yr/Yr change is November 30, 2025 versus November 30, 2024.
[19] Source: JP Morgan, 10 November. Data is a forecast. For illustrative purposes only.

3. Where can value be found?

This wave of issuance offers investors greater access to securities from highly rated companies. However, if supply becomes excessive, it could put further upward pressure on spreads. For active credit managers, a key task is assessing how future issuance may influence spreads and positioning accordingly. Each deal needs to be assessed on an individual basis to determine whether an investor is being adequately compensated – we have seen significant variations between deals in this respect.

CORPORATE PROFITS REBOUNDED

Data from Factset[20] indicates analysts expect Q4 earnings for the S&P 500 to rise 8.3% year-on-year, with revenues up 7.6%. For 2025, full-year forecasts point to earnings growth of 12.3% and revenue growth of 7.0%. In 2026, earnings are projected to increase by 15%, with revenues up 7.2% – both well above the 10-year averages of 8.6% and 5.3%, respectively. This strong growth is expected to be driven largely by the “Magnificent 7”, which are forecast to deliver earnings growth of 22.7%.

CREDIT MARKET PERFORMANCE

Credit spreads widened over the quarter in anticipation of a meaningful pickup in issuance in 2026. Aggregate US corporate spreads ended the quarter 4bp wider. The intermediate and long maturity components of the credit curve both performed in line with the aggregate index. BBB credit underperformed other rating categories on a spread basis in long maturities.

Table 4: Average spread (bp) of corporate bonds[21]

Bloomberg Index	Dec 31, 2024	Sep 30, 2025	Dec 31, 2025	Change QTD	Weight (%)
Corporate	80	74	78	4	100.0%
Intermediate	71	66	70	4	67.2%
Long	98	90	94	4	32.8%
– Long AAA	41	39	44	5	
– Long AA	64	58	67	9	
– Long A	79	73	76	3	
– Long BBB	121	113	119	6	

ISSUANCE BREAKDOWN

Gross investment grade credit issuance was 3.5% higher year-on-year in 2025, with issuance in Q4 35% higher than in Q4 2024. Gross issuance in high yield was 17.7% higher year-on-year, and up by 34% in Q4 2025 relative to Q4 2024.

Table 5: Gross new US bond issuance in $bn[21]

Market	2023 total	2024 total	2025 total	Yr/Yr change (%)
US investment grade	1,451	1,758	1,819	3.5%
US high yield	176	281	330	17.7%

In high yield, $33.8bn of issuance was upgraded to investment grade (rising stars) in 2025, while $45.1bn was downgraded from investment grade to high yield (fallen angels). Defaults picked up in Q4 to $8.5bn.

Table 6: High yield issuance breakdown in $bn[21]

Market	Q4 2025 ($bn)	2025 ($bn)
Downgraded to high yield	3.4	45.1
Called or falling below 12 months	39.8	156.6
Upgraded to investment grade	5.1	33.8
Defaults	8.5	15.7

[20] Source: https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_092625A.pdf

[21] Source: Barclays research. Data as of December 31, 2025.

MARKET
OUTLOOK

BE DELIBERATE WHEN CHOOSING FIXED INCOME

When evaluating the value of fixed income investments, it is important for investors to clearly define their objectives and intentionally select strategies that align with their specific needs. Investors should assess which aspects of their overall portfolio requirements fixed income can effectively address.

Typically, fixed income investors seek one or more of the following outcomes from their bond portfolios.

- **Income:** Bonds offer a predictable stream of interest payments. For investors prioritizing reliable income, a thoughtfully constructed portfolio designed to generate consistent cashflows may be appropriate.
- **Returns or growth:** Beyond income, bonds can deliver capital appreciation. Declining yield levels can increase bond prices, while credit investments may benefit from lower government bond yields or tighter credit spreads. Additionally, market-neutral strategies that exploit relative-value opportunities can generate incremental capital gains.
- **Diversification:** Fixed income can provide diversification benefits relative to equities. While economic factors such as strong growth and inflation may support equities but negatively affect government bonds, the correlation between equity and bond returns can vary in magnitude and volatility. Corporate bonds may benefit from favorable conditions affecting both equities (e.g. inflation supporting corporate pricing power and tighter credit spreads) and bonds (e.g. declining government yields).

The key consideration is that the risk-return profiles of these asset classes differ. Constructing a diversified portfolio combining equities and various fixed income sectors can enhance long-term risk-adjusted returns compared to investing in each asset class separately. Market-neutral fixed income strategies, which exhibit low or no correlation with other asset classes, can also contribute to diversification.

A disciplined approach to considering the role of fixed income in a portfolio – whether it is to generate income, returns, offer diversification, or a combination of the three – may enable investors to harness the distinct characteristics of fixed income to meet their objectives effectively.

Investment outlooks

Investment grade credit: Recent corporate earnings have reaffirmed our view of the strong corporate fundamentals, underpinned by resilient profit growth. However, a notable theme across corporate results has been rising capital expenditure. We expect 2026 to be affected by borrowing for capital expenditure and merger and acquisition activity, driving a significant increase in issuance, most notably from AI-related expenditure. While this supply dynamic is now well telegraphed and is unlikely to surprise markets, we anticipate that spreads could continue to edge wider and settle into a higher trading range early in the year as corporates return to the market in size. If supply disappoints and investor demand remains high, then spreads should grind tighter. New issuance often comes to market with yields above prevailing levels. These types of primary market opportunities could benefit managers capable of active participation, which may help offset any effects of wider spreads. One trend that we're closely monitoring is high-quality US corporates looking to issue euro-denominated debt seeking to take advantage of lower coupon rates. This may present opportunities for those with global mandates or flexibility to invest off benchmark. We believe investor demand will remain robust in 2026 as investment grade credit offers a meaningful yield pickup over cash, and in our view, spreads offer attractive returns when compared to fundamental default risks, so we expect demand to remain high, with a focus on security selection and relative-value trades.

High yield credit: 2025 was a strong year for high yield market performance, supported by a robust technical backdrop that we expect to persist into 2026. That said, we anticipate a pickup in supply across both US and European markets. While refinancing activity should dominate, we also see room for increased issuance linked to acquisitions and capital expenditure. In addition, AI infrastructure financing is likely to make its way into the high yield space in various forms. This rise in supply could exert some upward pressure on spreads, leading to slightly softer returns than seen in 2025. Default rates remain at the lower end of historical ranges, and we see little reason for this to change given the improving quality of public high yield issuers and the migration of weaker credits to private debt markets. Maintaining caution around highly leveraged cyclical names and keeping an underweight in CCC-rated credits should help further mitigate default risk. Credit selection will remain critical, and we expect meaningful opportunities to add value via active security selection throughout the year. On a positive note, many corporates will have learnt how to negotiate the new trade backdrop over the second half of 2025, putting them on a firmer footing going into 2026.

Structured credit: 2025 delivered solid, primarily income-driven returns, and we expect a similar outcome in 2026. A gradual reduction in US and UK interest rates should provide support for consumers in those markets, though it will also temper returns given the floating-rate nature of the asset class. This dynamic reinforces the importance of credit selection to capture the best opportunities. We see particular potential in the UK, where markets appear overly pessimistic about consumer prospects following negative headlines around tax increases. With the budget now behind us, we anticipate sentiment will normalize in the months ahead. Our approach remains active in primary markets, taking advantage of new-issue premiums while seeking relative value opportunities that offer compelling risk-reward profiles. We continue to favor transactions with seniority in the capital structure and robust deal features that redirect cash flow in the event of underperformance in the underlying asset pool. Strong underwriting and servicing standards should further help insulate investors should economic conditions weaken unexpectedly.

Municipal bonds: We see a broadly constructive outlook for municipal bonds in 2026, with taxable muni yields remaining attractive versus similarly rated corporate credit. Credit fundamentals are strong, supported by robust reserves and cash balances built up in recent years. With the economy expected to slow, we favor defensive sectors such as public power and water/sewer utilities for their essential nature and predictable cashflows, while maintaining an underweight in state and local general obligation bonds given their lower premium to Treasuries. We remain cautious on healthcare due to rising labor and equipment costs. Following significant curve steepening, we view the long end as compelling and prefer barbell strategies – combining short maturities to benefit from Fed easing with long maturities to lock in yields. Although spreads are tight by historical standards, they remain supported by solid credit fundamentals and steady investor demand.

KEY MARKET RISKS

FORECASTING UNCERTAINTY RAISES RISKS

A heightened level of policy uncertainty is making forecasting increasingly challenging, with significant implications for both investors and the Fed. While a softening labor market may offer the Fed some short-term flexibility, history provides few precedents for rate cuts when inflation remains well above target and fiscal deficits are so wide.

GROWTH SOFTENS MORE MEANINGFULLY THAN EXPECTED

Economic data remained resilient through 2025, but we anticipate a slowdown in 2026. While recession is not our base-case scenario, there is a risk that growth will decelerate more sharply than expected, which could lead to more adverse outcomes for credit markets than currently projected.

AN UNPREDICTABLE GEOPOLITICAL BACKDROP

Geopolitical tensions remain elevated, creating an unpredictable backdrop where events can quickly escalate or de-escalate, creating significant market volatility. The ongoing rivalry between the United States and China continues to dominate global affairs, with trade disputes, technological competition, and military posturing in the Indo-Pacific region intensifying.

EDUCATIONAL: FRANCE – STEPS TOWARDS A SECOND EUROZONE SOVEREIGN CRISIS

France's political landscape is highly fragmented, with a divided parliament and precarious governments fueling legislative gridlock and reliance on legal mechanisms to pass budgets, resulting in only temporary stability.

- The 2027 presidential election is expected to be highly unpredictable due to the splintered political field. The far-right National Rally (RN) are strongly positioned to reach the run-off, while polling suggests most run-off scenarios are extremely close.
- The election outcome will significantly impact France's fiscal and political stability; a moderate victory may aid fiscal reform, while an RN win without a stable majority could worsen gridlock and increase investor uncertainty
- The ongoing political and fiscal instability is a clear risk for French assets, with government bond and credit markets potentially vulnerable to further credit rating downgrades and deteriorating market sentiment. This could see French assets underperform eurozone peers, while contagion remains a concern for the wider region.
- While a French debt default or euro exit is highly unlikely, long-term buy-and hold investors may remain comfortable; however, active investors may prefer diversifying away from France until political and fiscal risks subside.

FURTHER READING

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The ICE BofA US Corporate Index measures market performance of USD-denominated investment grade corporate debt publicly issued in the U.S. domestic market.

The ICE BofA 15-Year+ US Corporate Index measures market performance of USD-denominated investment grade corporate debt publicly issued in the US domestic market with a remaining term to maturity above 15-years.

The Bloomberg US Corporate Investment Grade Index measures market performance of USD-denominated investment grade industrial corporate debt publicly issued in the US domestic market.

The Bloomberg US Long Corporate Bond Index measures market performance of USD-denominated investment grade corporate debt publicly issued in the US domestic market with a remaining term to maturity above 10-years.

The ICE BofA AAA US Corporate Index measures market performance of USD-denominated investment grade corporate debt publicly issued in the US domestic market with AAA ratings.

The ICE BofA AA US Corporate Index measures market performance of USD-denominated investment grade corporate debt publicly issued in the US domestic market with AA ratings.

The ICE BofA A US Corporate Index measures market performance of USD-denominated investment grade corporate debt publicly issued in the US domestic market with A ratings.

The ICE BofA BBB US Corporate Index measures market performance of USD-denominated investment grade corporate debt publicly issued in the US domestic market with BBB ratings.

The ICE BofA BB US High Yield Index measures market performance of USD-denominated high yield corporate debt publicly issued in the US domestic market with BB ratings.

The ICE BofA B US High Yield Index measures market performance of USD-denominated high yield corporate debt publicly issued in the US domestic market with B ratings.

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