Morgan Stanley
INVESTMENT MANAGEMENT

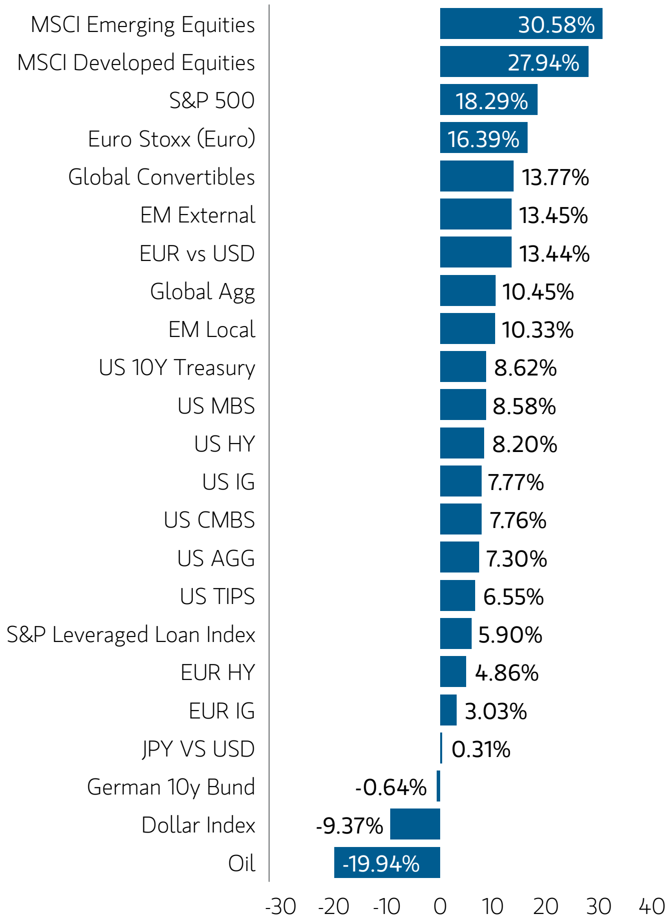
Global Fixed Income Bulletin

A Holiday Reset

MACRO INSIGHT | BROAD MARKETS FIXED INCOME TEAM | January 2026

Fixed income markets closed the year with a broad repricing of rate expectations, as central bank actions and communication reinforced a more cautious policy outlook. Across developed markets, yields moved higher and curves steepened as investors pushed out expectations for future rate cuts and assigned greater weight to rising term premia. In the U.S., the Federal Reserve delivered a 25 basis point (bp) rate cut, but guidance emphasized data dependence, anchoring front-end yields while higher global yields pushed longer maturities higher. In Europe, the European Central Bank held rates steady but struck a more hawkish tone, driving a near-20 bp sell-off in 10-year Bunds, while policy divergence remained evident elsewhere, including a rate hike by the Bank of Japan and a hawkishly interpreted cut by the Bank of England. In foreign exchange, the U.S. dollar weakened modestly on the month, with the Swedish krona and Canadian dollar outperforming and the Japanese yen lagging.

DISPLAY 1
Asset Performance Year-to-Date



Note: USD-based performance. Source: Bloomberg. Data as of December 31, 2025. The indexes are provided for illustrative purposes only and are not meant to depict the performance of a specific investment. **Past performance is no guarantee of future results.** See pages 5-7 for index definitions.

Despite higher government bond yields, credit markets ended the year on a constructive note. Investment grade (IG) spreads tightened modestly, supported by strong year-end inflows, limited primary issuance, and continued demand for carry, with European credit outperforming the U.S. high yield (HY) posted its strongest month of the fourth quarter, benefiting from improving risk appetite, supportive technicals, and a benign default

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backdrop, while convertible bonds underperformed amid renewed volatility in crypto-linked equities despite robust primary issuance.

Securitized markets were among the strongest performers in December. Agency Mortgage Backed Securities (MBS) spreads tightened meaningfully as the yield curve steepened and valuations remained attractive relative to other core fixed income sectors. Demand from money managers remained strong, and early signs of stabilization emerged in bank balance sheet participation as the Fed's balance sheet runoff continued at a measured pace. Issuance across asset-backed securities (ABS), non-agency residential mortgage-backed securities (RMBS), and commercial mortgage-backed securities (CMBS) was steady,[1] capping a solid year of supply and reinforcing the sector's role as a high-carry, shorter-duration alternative within fixed income portfolios.

Global Asset Allocation and Outlook

DEVELOPED MARKET RATE/FOREIGN CURRENCY

(Neutral duration, curve steepeners and USD underweight)

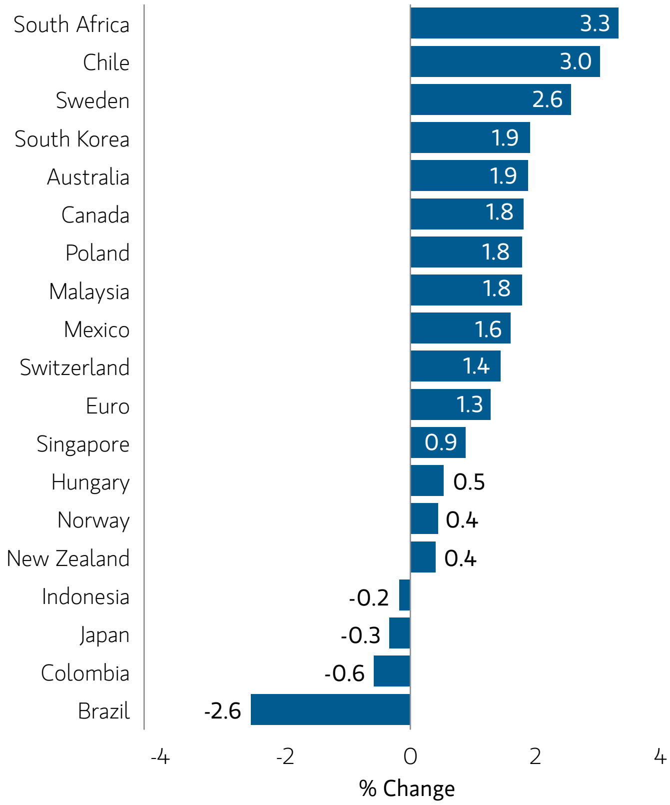
Following the recent repricing of dovish expectations, we maintain a neutral duration stance across developed markets, complemented by targeted regional expressions. We remain long duration outside of Japan, with positions in UK gilts, euro area rates, and the Canadian front end. In the U.S., we are neutral on outright Treasury duration and continue to express our views through curve steepeners. We also hold steepeners in Germany and France, primarily in the 5s–30s and 10s–30s segments, reflecting our expectation that term premia will continue to rise alongside persistent fiscal deficits and higher-for-longer issuance dynamics. Steepening structures in the U.S., UK, and Australia offer attractive risk-reward in an environment where carry is likely to remain the dominant driver of returns.

We remain short Japanese duration, reflecting rising term premia and expectations for further policy normalization by the Bank of Japan, though we have reduced the position as valuations have become more attractive. In inflation-linked markets, we took profits on long Japanese breakevens while maintaining a constructive stance on U.S. Treasury Inflation-Protected Securities (TIPS).

DISPLAY 2

Currency Monthly Changes versus USD

(+ = appreciation)



Note: Positive change means appreciation of the currency against the USD. Source: Bloomberg. Data as December 31, 2025.

In foreign exchange, we increased exposure to a basket of higher-beta currencies versus the U.S. dollar, reintroducing the New Zealand dollar and rotating from the Hungarian forint into the Polish zloty based on relative central bank dynamics. Looking into 2026, currency opportunities are becoming increasingly compelling. The U.S. dollar remains overvalued by historical standards, and we expect gradual depreciation as Fed easing progresses and global capital flows rebalance. This backdrop supports selective exposure to high-carry currencies and those underpinned by improving growth fundamentals, while remaining mindful of policy and geopolitical risks.

[1] Source: Bloomberg, as of December 31, 2025.

DISPLAY 3

Major Monthly Changes in 10-Year Yields and Spreads

COUNTRY	10-YR YIELD LEVEL (%)	MONTH CHANGE (BPS)	10-YR SPREAD (BPS)	MONTH CHANGE (BPS)
			(SPREAD OVER USTS)	
United States	4.17	15		
United Kingdom	4.48	4	31	-11
Germany	2.86	17	-131	1
Japan	2.07	25	-210	10
Australia	4.74	23	57	7
Canada	3.43	29	-73	13
New Zealand	4.40	14	23	-1
EUROPE			(SPREAD OVER BUNDS)	
France	3.56	16	71	-1
Greece	3.44	15	59	-1
Italy	3.55	15	70	-1
Portugal	3.15	15	30	-2
Spain	3.29	12	43	-4
EM	**10-YR LOCAL YIELD (%)**	**MTD CHANGE (BPS)**	**SPREAD (BPS)**	**MTD CHANGE (BPS)**
EM External Spreads			231	-13
EM Corporate Spreads			188	-14
EM Local Yields	5.86	-2		
			(SPREAD OVER USTS)	
Brazil	13.73	33	957	17
Colombia	12.64	12	848	-3
Hungary	6.77	-23	260	-38
Indonesia	6.05	-25	188	-40
Malaysia	3.50	4	-66	-11
Mexico	9.11	20	494	5
Peru	5.78	-13	162	-29
Poland	5.16	2	99	-13
South Africa	8.19	-30	403	-45
CREDIT			**SPREAD (BPS)**	**MTD CHANGE (BPS)**
U.S. IG			78	-2
EUR IG			78	-5
U.S. HY			266	-3
EUR HY			265	-7
SECURITIZED				
Agency MBS			110	-14
U.S. BBB CMBS			593	-10

Positive Neutral Negative

Source: Bloomberg, JPMorgan. Data as of December 31, 2025.

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EMERGING MARKET DEBT

(Overweight)

Emerging market (EM) sovereign and corporate debt remains a standout opportunity for 2026. Lower inflation, elevated real yields, and credible reform momentum across several countries underpin a supportive macro backdrop. Valuations—particularly in local markets—remain attractive, and many EM currencies are undervalued relative to the U.S. dollar. While the opportunity set is broad, dispersion is high, making country selection and policy discipline critical. We favor markets with credible monetary frameworks, improving fundamentals, and attractive real yield differentials versus developed markets.

CORPORATE CREDIT

(Underweight IG, small overweight HY)

We remain underweight investment grade credit, reflecting tight valuations, weakening technicals, and peaking fundamentals. While IG balance sheets remain healthy—characterized by strong liquidity, low downgrade risk, and conservative leverage—spreads are tight by historical standards, leaving little margin for error. Elevated issuance of long-dated debt to fund AI-related capital expenditure, alongside an active M&A pipeline, further challenges the technical backdrop. At current levels, modest spread widening could materially erode excess carry.

Regionally, we prefer Europe over the U.S., supported by more balanced supply dynamics. From a sector perspective, we favor financials—particularly banks—given strong capital positions, resilient earnings, and limited net supply. We are underweight single-A non-financials, where M&A risk is more acute.

We maintain a modest overweight to select high-yield issuers in both the U.S. and Europe. Fundamentals remain supportive, with improved average credit quality, low default rates, and manageable leverage. Although spreads are near post-crisis lows, the higher yield carry, shorter spread duration, and greater issuer dispersion create attractive opportunities for security selection. Defaults are expected to rise modestly but remain contained, supporting continued investor demand.

LEVERAGED LOANS

(Underweight)

We expect heavier net supply and rising dispersion in leveraged loans. While Collateralized Loan Obligation (CLO) demand remains a key technical support, economically sensitive sectors are showing signs of strain, contrasting with strength in software and technology-linked issuers. Given expectations for Fed rate cuts, we prefer fixed-rate exposure over floating-rate assets and remain underweight the asset class.

SECURITIZED PRODUCTS

(Overweight)

Agency mortgage-backed securities and non-agency residential mortgage-backed securities remain our highest-conviction overweight for 2026. Our overweight to agency MBS delivered strong absolute, excess, and relative returns in 2025, supported by a bull steepening of the yield curve, a compression in implied volatility to post-2021 lows, and a gradual but persistent improvement in market technicals. Looking ahead, we believe agency MBS continue to offer an attractive spread pickup relative to both historical levels and other core fixed income sectors, providing compelling relative value versus investment grade corporates and cash alternatives.

We expect demand for agency MBS to strengthen further as regulatory constraints ease, short-term rates decline, and bank balance sheets become more flexible. In addition, money managers remain attracted to the sector's combination of carry and high-quality collateral. The Federal Reserve's supportive policy stance, alongside the continued but measured runoff of Fed-held MBS, should provide an additional tailwind by limiting supply pressure and supporting market liquidity.

Non-agency RMBS also offers an attractive opportunity set, underpinned by stable home prices, low loan-to-value ratios, and historically low delinquency rates. Supply-demand dynamics remain favorable, with limited new issuance and minimal refinancing risk given the high proportion of borrowers locked into low mortgage rates. These factors, combined with the slow unwind of Fed-held positions, continue to support the sector's resilient credit profile.

Within CMBS, fundamentals remain resilient, particularly in higher-quality segments. We see attractive opportunities in hospitality—especially luxury and trophy properties—where demand trends and cash flows have stabilized. Office CMBS also presents selective value, supported by improving occupancy rates and a more stable interest rate environment. We continue to favor exposure to logistics, storage, and high-quality multifamily assets, where operating performance remains robust. While CMBS remains a high-conviction allocation, dispersion across property types and geographies is increasing, making selectivity critical. Our exposure is therefore focused on the single-asset, single-borrower (SASB) market, which allows for greater transparency and control over underlying cash flows.

Lastly, we remain constructive on Danish covered bonds. The market's depth, strong legal framework, and backing by a politically stable economy and resilient housing market support its defensive characteristics. Valuations remain compelling for high-quality assets, and the steep Danish government curve continues to offer attractive USD-hedged yields for global investors.

DEFINITIONS

Basis point (bp): One basis point = 0.01%.

INDEX DEFINITIONS

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The **Bloomberg Euro Aggregate Corporate Index (Bloomberg Euro IG Corporate)** is an index designed to reflect the performance of the euro-denominated investment-grade corporate bond market.

The **Bloomberg Global Aggregate Corporate Index** is the corporate component of the Bloomberg Global Aggregate index, which provides a broad-based measure of the global investment-grade fixed income markets.

The **Bloomberg US Corporate High Yield Index** measures the market of USD-denominated, non-investment grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below. The index excludes emerging market debt.

The **Bloomberg US Corporate Index** is a broad-based benchmark that measures the investment grade, fixed-rate, taxable, corporate bond market.

The **Bloomberg US Mortgage-Backed Securities (MBS) Index** tracks agency mortgage-backed pass-through securities (both fixed-rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA) and Freddie Mac (FHLMC). The index is constructed by grouping individual TBA-deliverable MBS pools into aggregates or generics based on program, coupon, and vintage. Introduced in 1985, the GNMA, FHLMC and FNMA fixed-rate indexes for 30- and 15-year securities were backdated to January 1976, May 1977, and November 1982, respectively. In April 2007, agency hybrid adjustable-rate mortgage (ARM) pass-through securities were added to the index.

Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food, and medical care.

Euro vs. USD—Euro total return versus U.S. dollar.

German 10YR bonds—Germany Benchmark 10-Year Datastream Government Index; **Japan 10YR government bonds**—Japan Benchmark 10-Year Datastream Government Index; and **10YR US Treasury**—US Benchmark 10-Year Datastream Government Index.

The **ICE BofAML European Currency High-Yield Constrained Index (ICE BofAML Euro HY constrained)** is designed to track the performance of euro- and British pound sterling-denominated below investment-grade corporate debt publicly issued in the Eurobond, sterling.

The **ICE BofAML US Mortgage-Backed Securities (ICE BofAML US Mortgage Master) Index** tracks the performance of US dollar-denominated, fixed-rate and hybrid residential mortgage pass-through securities publicly issued by US agencies in the US domestic market.

The **ICE BofAML US High Yield Master II Constrained Index (ICE BofAML US High Yield)** is a market value-weighted index of all domestic and Yankee high-yield bonds, including deferred-interest bonds and payment-in-kind securities. Its securities have maturities of one year or more and a credit rating lower than BBB-/Baa3 but are not in default.

The **ISM Manufacturing Index** is based on surveys of more than 300 manufacturing firms by the Institute of Supply Management. The ISM Manufacturing Index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

Italy 10-Year Government Bonds—Italy Benchmark 10-Year Datastream Government Index.

The **JP Morgan CEMBI Broad Diversified Index** is a global, liquid corporate emerging markets benchmark that tracks US-denominated corporate bonds issued by emerging markets entities.

The **JPMorgan Government Bond Index**—emerging markets (**JPM local EM debt**) tracks local currency bonds issued by emerging market governments. The index is positioned as the investable benchmark that includes only those countries that are accessible by most of the international investor base (excludes China and India as of September 2013).

The **JPMorgan Government Bond Index Emerging Markets (JPM External EM Debt)** tracks local currency bonds issued by emerging market governments. The index is positioned as the investable benchmark that includes only those countries that are accessible by most of the international investor base (excludes China and India as of September 2013).

The **JP Morgan Emerging Markets Bond Index Global (EMBI Global)** tracks total returns for traded external debt instruments in the emerging markets and is an expanded version of the EMBI+. As with the EMBI+, the EMBI Global includes US dollar-denominated Brady bonds, loans, and Eurobonds with an outstanding face value of at least $500 million.

The **JP Morgan GBI-EM Global Diversified Index** is a market-capitalization weighted, liquid global benchmark for US-dollar corporate emerging market bonds representing Asia, Latin America, Europe, and the Middle East/Africa.

JPY vs. USD—Japanese yen total return versus US dollar.

The **Markit ITraxx Europe Index** comprises 125 equally weighted credit default swaps on investment grade European corporate entities, distributed among 4 sub-indices: Financials (Senior & Subordinated), Non-Financials and HiVol.

The **Nikkei 225 Index (Japan Nikkei 225)** is a price-weighted index of Japan's top 225 blue-chip companies on the Tokyo Stock Exchange.

The **MSCI AC Asia ex-Japan Index (MSCI Asia ex-Japan)** captures large- and mid-cap representation across two of three developed markets countries (excluding Japan) and eight emerging markets countries in Asia.

The **MSCI All Country World Index (ACWI, MSCI global equities)** is a free float-adjusted market capitalization weighted index designed to measure the equity market performance of developed and emerging markets. The term "free float" represents the portion of shares outstanding that are deemed to be available for purchase in the public equity markets by investors. The performance of the Index is listed in US dollars and assumes reinvestment of net dividends.

MSCI Emerging Markets Index (MSCI emerging equities) captures large- and mid-cap representation across 23 emerging markets (EM) countries.

The **MSCI World Index (MSCI developed equities)** captures large and mid-cap representation across 23 developed market (DM) countries.

Purchasing Managers Index (PMI) is an indicator of the economic health of the manufacturing sector.

The **Refinitiv Convertible Global Focus USD Hedged Index** is a market weighted index with a minimum size for inclusion of $500 million (US), 200 million (Europe), 22 billion Yen, and $275 million (Other) of Convertible Bonds with an Equity Link.

The **Russell 2000® Index** is an index that measures the performance of the 2,000 smallest companies in the Russell 3000 Index.

The **S&P 500® Index (US S&P 500)** measures the performance of the large-cap segment of the US equities market, covering approximately 75 percent of the US equities market. The index includes 500 leading companies in leading industries of the U.S. economy.

S&P CoreLogic Case-Shiller US National Home Price NSA Index seeks to measure the value of residential real estate in 20 major US metropolitan areas: Atlanta, Boston, Charlotte, Chicago, Cleveland, Dallas, Denver, Detroit, Las Vegas, Los Angeles, Miami, Minneapolis, New York, Phoenix, Portland, San Diego, San Francisco, Seattle, Tampa and Washington, D.C.

The **S&P/LSTA US Leveraged Loan 100 Index (S&P/LSTA Leveraged Loan Index)** is designed to reflect the performance of the largest facilities in the leveraged loan market.

The **S&P GSCI Copper Index (Copper)**, a sub-index of the S&P GSCI, provides investors with a reliable and publicly available benchmark for investment performance in the copper commodity market.

The **S&P GSCI Softs (GSCI soft commodities) Index** is a sub-index of the S&P GSCI that measures the performance of only the soft commodities, weighted on a world production basis. In 2012, the S&P GSCI Softs Index included the following commodities: coffee, sugar, cocoa, and cotton.

Spain 10-Year Government Bonds—Spain Benchmark 10-Year Datastream Government Index.

The **Thomson Reuters Convertible Global Focus USD Hedged Index** is a market weighted index with a minimum size for inclusion of $500 million (US), 200 million euro (Europe), 22 billion yen, and $275 million (Other) of convertible bonds with an equity link.

U.K. 10YR government bonds—U.K. Benchmark 10-Year Datastream Government Index. For the following Datastream government bond indexes, benchmark indexes are based on single bonds. The bond chosen for each series is the most representative bond available for the given maturity band at each point in time. Benchmarks are selected according to the accepted conventions within each market. Generally, the benchmark bond is the latest issue within the given maturity band; consideration is also given to yield, liquidity, issue size and coupon.

The **US Dollar Index (DXY)** is an index of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of US trade partners' currencies.

The **Chicago Board Options Exchange (CBOE) Market Volatility (VIX) Index** shows the market's expectation of 30-day volatility.

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