APRIL 2026

Active Fixed Income Perspectives Q2 2026:

Dispersion drives opportunity

Sara Devereux Global Head of Fixed Income Group

Chris Alwine, CFA Global Head of Credit

Roger Hallam, CFA Global Head of Rates

Kelly Gemmell, CFA Head of Fixed Income Product Specialism, Vanguard Europe

Contents

Key takeaways 2

Notable resilience 3

The flow of energy 4

Diverging policy paths 5

Portfolio positioning and strategy 6

Key takeaways

Performance recap

Coupon income helped support bond returns during a period of heightened market volatility. The sharp rise in energy prices shifted expectations for rate cuts towards the possibility of rate hikes in economies with inflation-focused central bank mandates and greater exposure to energy shocks. Global bond yields moved higher, albeit unevenly across regions, reflecting differences in perceived inflation risk and central bank reaction function. While the larger moves in rates were due to changing interest rate expectations, credit spreads also widened modestly from cycle lows, while performance across sectors became increasingly differentiated.

The big picture

The US economy entered the year on relatively strong footing with solid underlying momentum, although higher energy prices pose an increasing risk to both the growth and inflation outlook. So far, markets have not shown a broad or lasting negative reaction - but more persistent disruption to energy flows threatens greater downside risks.

Our approach

Attractive overall yields continue to draw a broad mix of investors, and increased price dispersion across the market is creating pockets of value within investment-grade credit and emerging markets. In government bonds, we continue to see selective opportunities in the euro area periphery, and we remain short Japan given local inflation dynamics and the extent of Japanese oil sourcing via the Strait of Hormuz.

Notable resilience

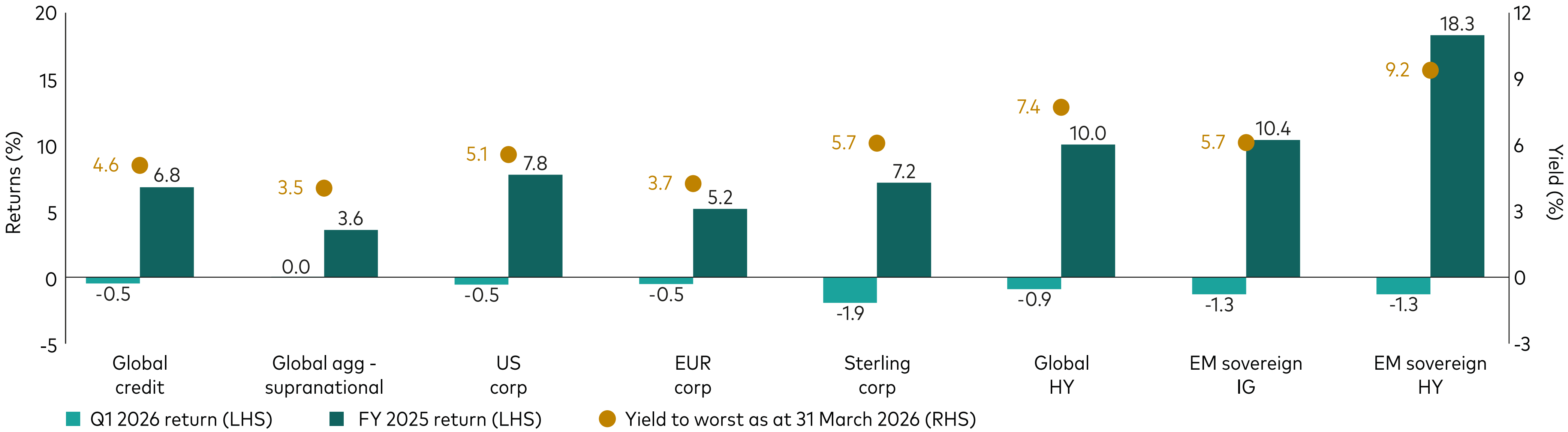
The bond market was pulled in multiple directions during the first quarter as investors navigated a rapid shift in the sources of uncertainty. Early in the quarter, government bond yields moved lower as markets priced in concerns that the pace and scale of AI-related investment could ultimately weigh on growth.

That dynamic shifted sharply in March, when the onset of the conflict in Iran and the resulting spike in energy prices pushed near-term inflation risks back into focus, driving yields higher globally - most notably in regions where central banks operate under inflation-focused mandates and economies are more sensitive to energy price shocks.

Even so, bond markets demonstrated notable resilience. The repricing was measured given the magnitude of the energy shock, with credit spreads widening only modestly from cycle lows towards the upper end of the ranges we had anticipated this year.

Importantly, strong starting yields across much of the market continued to support investor returns. Coupon income helped offset the impact of higher yields and wider spreads, leaving total returns for global bonds down 15 basis points for the quarter (in dollar terms)[1].

Fixed income sector returns and yields



Notes: Yield to worst represents the lowest yield possible for a security given the current price, considering both call dates and maturity.

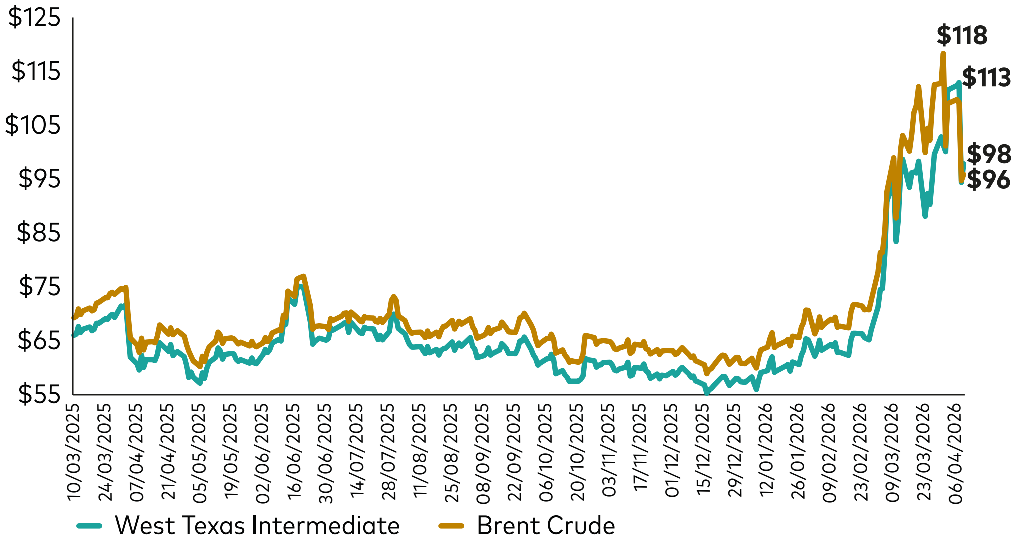
Sources: Bloomberg indices and the J.P. Morgan EMBI Global Diversified Index. Q1 2026 return data from 31 December 2025 to 31 March 2026. **Past performance is no guarantee of future returns. Performance is provided on a total return basis, in the base currency of the index, or for global indices, USD hedged.**

1 Source: Bloomberg Global Aggregate Index, as at 31 March 2026.

The flow of energy

In March, Brent crude prices surged, rising well above $100 a barrel after averaging roughly $66 over the previous 12 months. The magnitude of the move reflects the disruption to energy flows in the Middle East. Absent a resumption of normal transit, upward pressure on energy prices is likely to persist.

Oil price per barrel



Source: Bloomberg data as at 9 April 2026.

The economic impact of higher energy prices depends largely on the duration of the disruption. If the flow of traffic through the Strait of Hormuz is halted or limited as it has been, global volumes will continue to be constrained despite efforts to reroute oil and natural gas through alternative channels.

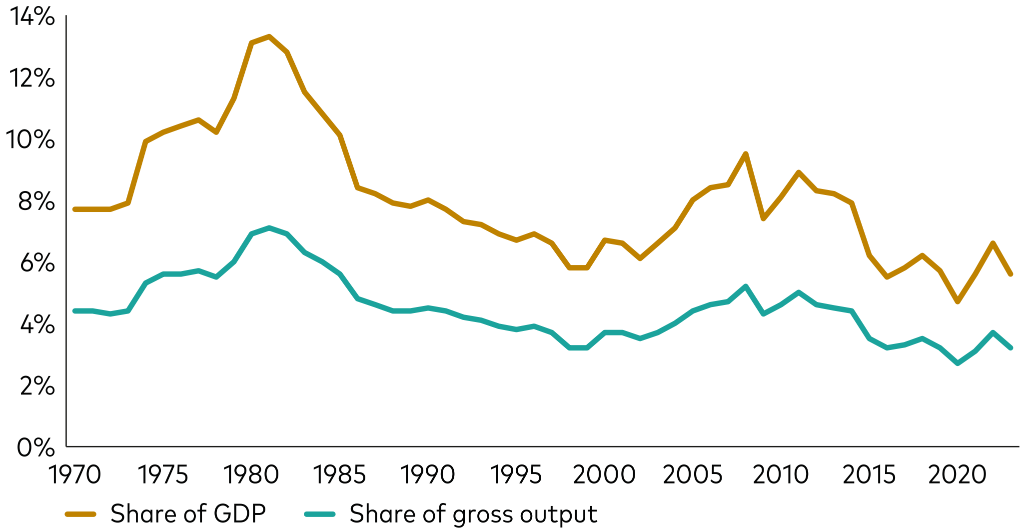
Higher energy prices most directly affect headline inflation. However, at sufficiently high levels or over longer periods, spillovers into core inflation and growth become more meaningful - raising the risk of broader macroeconomic consequences. We are assessing the potential impact to markets across three key scenarios.

Base-case path — If oil prices remain around $100 for one to two quarters, we do not expect a large impact to growth or medium-term inflation across regions.

Protracted scenario — If oil prices hold above $100 per barrel for several quarters, measurable effects are expected. In that scenario, we forecast a 40 basis-point decline in US growth and a further 30 basis-point rise in core inflation. The impact in Europe would be approximately double these figures.

Recession outcome — Should oil prices remain above $125 for 12 consecutive months, recessionary conditions are anticipated in the euro area and Japan. Sustained oil prices exceeding $200 for a year would produce comparable economic conditions in the US.

Energy expenditures as share of GDP and gross output (1970-2023)

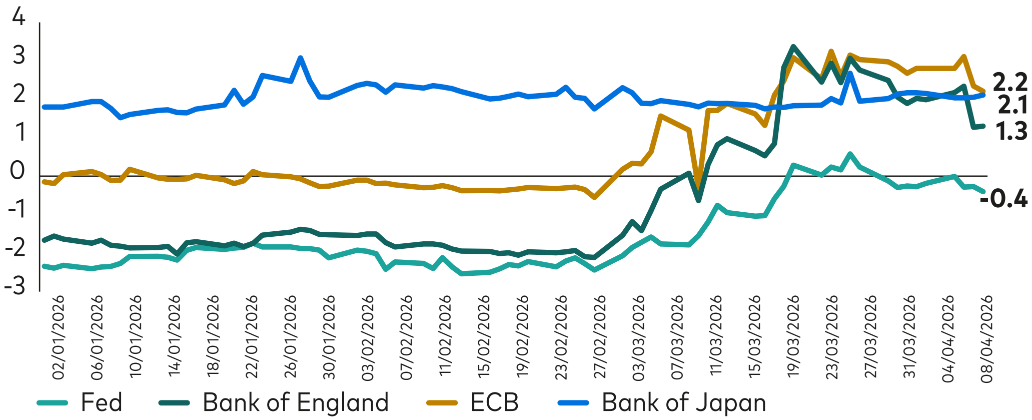


Source: U.S. Energy Information Administration, as at 26 March 2026.

Diverging policy paths

As energy prices surged, markets refocused on inflation risks and repriced expected policy paths across regions. In the most exposed economies—particularly where central banks operate under inflation focused mandates—expectations shifted from near term rate cuts or a pause, towards the possibility of rate hikes this year.

Central bank expectations for 2026 have repriced unevenly across regions
Hikes/cuts in 2026



Source: Macrobond as at 9 April 2026.

In practice, central banks have historically looked through energy-driven inflation shocks, recognising that monetary policy is ill-suited to address supply-side pressures and that premature tightening risks amplifying downside growth outcomes. However, the inflation experience of recent years has left policymakers more sensitive to the risk of higher inflation becoming entrenched. While short-term inflation expectations have moved higher, medium-term measures remain well anchored in the US and broadly within acceptable ranges across Europe and Japan.

In a more prolonged conflict scenario, inflation risks could gradually give way to growth concerns as higher input costs weigh on demand, prompting markets and policymakers to anticipate eventual easing. With the impact of the shock still uncertain, the US Federal Reserve (Fed) retains flexibility given its dual mandate, while the European Central Bank (ECB), Bank of England (BoE) and Bank of Japan have all shifted towards more hawkish stances - raising the likelihood of divergent policy paths as conditions evolve.

Trimming our outlook

The US economy entered this period from a position of strength. Business investment and consumer spending have continued to provide steady support, even as markets absorb supply-driven shocks. This resilience has been reinforced by strong corporate profitability and an ongoing investment cycle, particularly in technology.

Fiscal policy remains supportive, and the Fed retains flexibility should conditions weaken. As a net energy exporter, the US is also better positioned to absorb energy shocks than in past cycles. Moreover, economic growth is far less energy-intensive today than in previous decades - with measures of energy use per dollar of real GDP declining by more than half over the past 40 years.

Against this starting point, it remains difficult to construct a base-case recession scenario over the near term. While recent geopolitical developments have increased uncertainty, they have not materially altered our outlook for the US economy. Instead, we have modestly revised our forecasts, downgrading growth and upgrading inflation expectations. Even so, we continue to anticipate growth above 2% and inflation below 3% over the coming quarters.

Outside the US, we see greater risks and have more meaningfully raised our inflation views. In the euro area, we have revised our 2026 headline inflation forecast upwards to 2.5%, while lifting core inflation more modestly to 2.1%. The euro area remains particularly sensitive to energy shocks given its reliance on energy imports and the relatively large weight of energy in the regional inflation basket. Even so, inflation expectations remain broadly anchored, reflecting a more favourable starting point than during previous shocks.

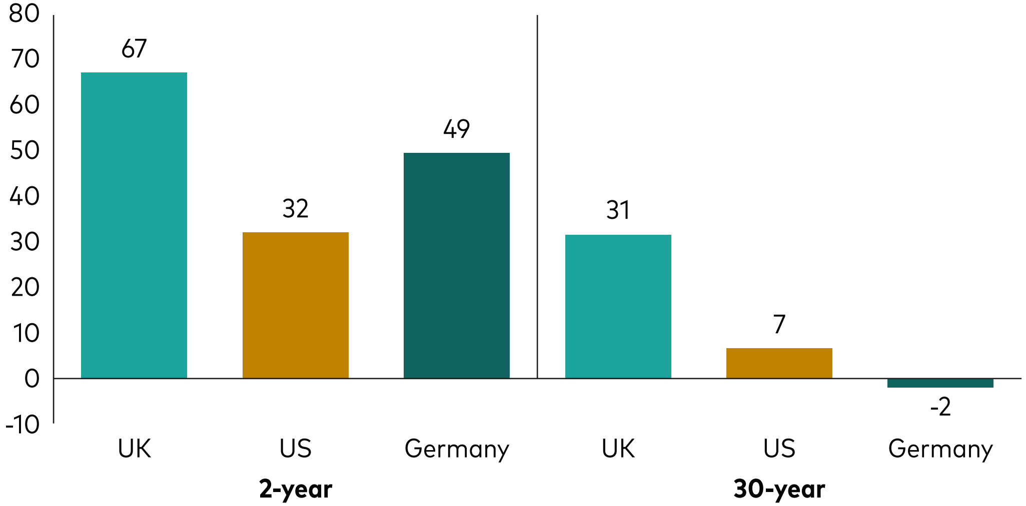
In the UK, we have raised our 2026 headline Consumer Prices Index (CPI) forecast by 0.6 percentage points to 2.8% and our forecast for core CPI, which excludes volatile food and energy prices, by 0.2 percentage points to 2.8%. In addition to second-round effects, regulated energy prices also add to inflation persistence - as highlighted during the 2022-23 energy crisis. In this context, we have revised our policy outlook and now expect the BoE to maintain its Bank Rate at 3.75%, rather than make two cuts in 2026. Our UK policy outlook contrasts with market expectations, with us pricing in higher interest rates before year-end.

Portfolio positioning and strategy

Rates outlook

Government bond yields moved higher across the curve in the first quarter, but the largest moves in yields occurred at the shorter end of the curve. The move reflected the market's expectation that central banks would need to follow a more hawkish path than previously anticipated.

Change in 2- and 30-year government bond yield (basis points)



Source: Bloomberg data, from 1 January 2026 to 31 March 2026.

US

We expect the Fed to remain cautious but to be prepared to look through short-term energy-related price increases as long as any increases in core inflation are moderate and inflation expectations remain anchored. We maintain our view of one US rate cut over the course of this year, dependent on clearer progress in inflation.

The reduced likelihood of near term Federal Open Market Committee (FOMC) easing has likely lifted our prior fair value range of 3.75%-4.25% on 10-year US Treasuries. That said, we continue to see 10-year Treasury yields above 4.25% as attractive levels at which to extend duration and build greater portfolio resilience against potential growth risks.

Europe

The policy outlook for the ECB and the BoE has shifted in response to sharply higher oil and gas prices. A sustained decline in energy prices would likely be required to prevent the ECB from initiating a modest tightening cycle. In the UK, we remain sceptical that the BoE will ultimately follow through with rate hikes given ongoing labour market weakness.

Japan

In Japan, our view of a gradual policy normalisation remains unchanged. Rising fiscal and monetary policy risks in Japan reinforce the case for higher Japanese government bond (JGB) yields and a flatter JGB curve. Middle East tensions have only strengthened this conviction given Japan's exposure to energy flowing via the Strait. We continue to view short duration positions in JGBs as warranted.

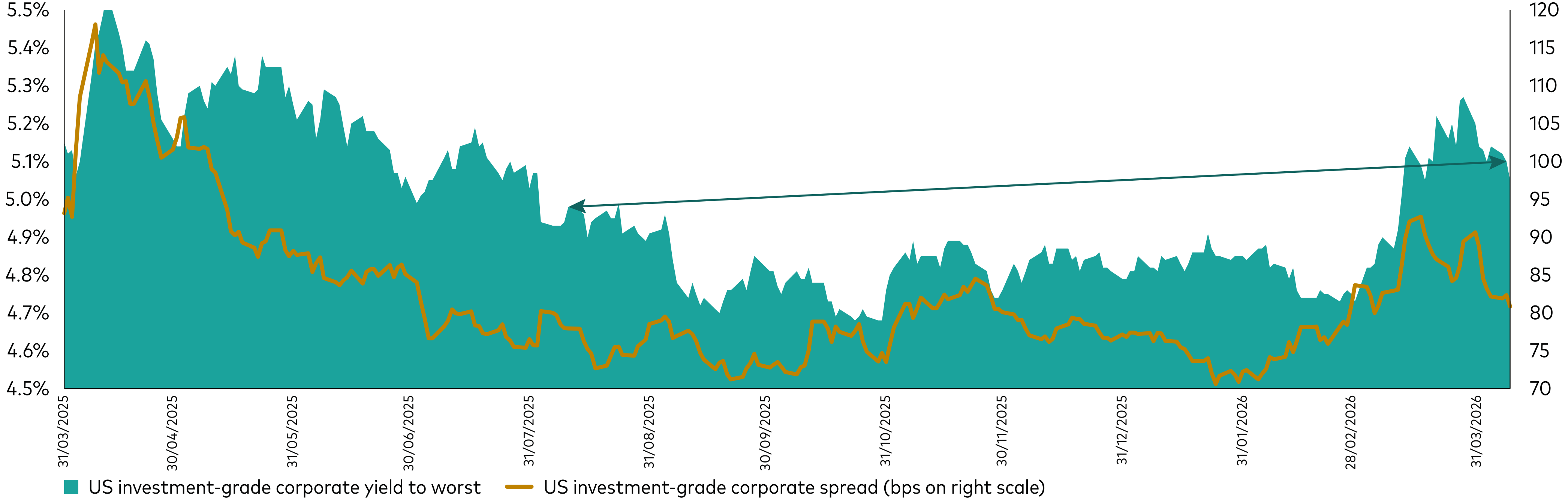
Credit outlook

In the first quarter, credit spread moves were mostly contained relative to the repricing in yields. As the quarter progressed, spreads moved wider in two stages, first when concerns around AI–related disruption weighed on sentiment, and then again with the onset of the conflict in Iran. So far, the reaction to the rise in geopolitical risk has been far more muted than prior macro shocks—including last year's tariff driven volatility—signalling the market's optimism that the risks are short-lived, and that the primary impact will be to inflation, not growth.

In addition to the rise in volatility, credit issuance volumes were expectedly strong in the first quarter. In the US, investment-grade companies set a record with roughly $775 billion in gross issuance fuelled by continued AI-related investment and rising merger and acquisition volumes. Perhaps a more important signal was that this surge in issuance was more than met by strong demand to absorb the new supply of bonds.

Investment-grade credit remains attractive in our view. Fundamentals are healthy, and the supply-demand backdrop continues to support spreads. With all in yields on US investment-grade bonds back above 5%, the bid for high-quality credit should remain strong from yield-focused buyers.

Round trip: Yields have bounced back to last year's levels



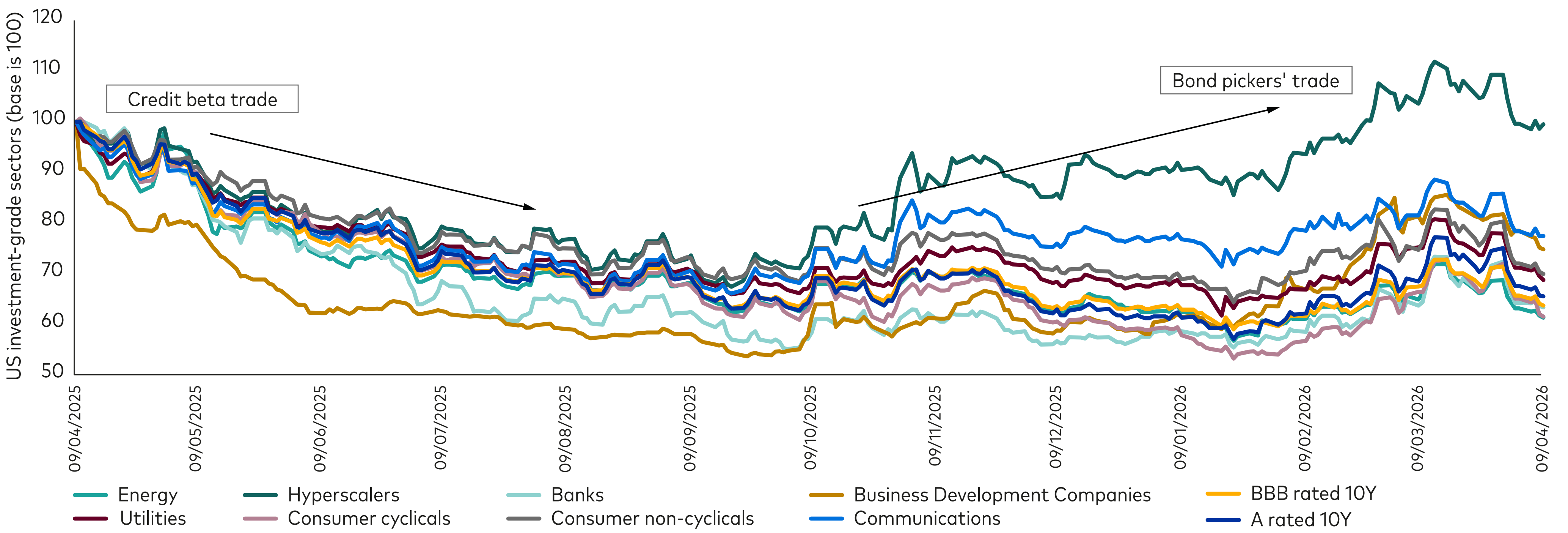
Source: Macrobond as at 9 April 2026.

Growing dispersion and opportunity in credit

Spreads now broadly reflect what we thought could transpire at the start of the year. Levels are near the middle of our forecasted ranges and within each segment we are seeing wider dispersion across subsectors and issuers. This has created opportunities to add exposure to issuers with resilient business models now trading at more attractive levels. While credit performance last year could be characterised as a rising tide that lifted all boats, this year it has been more of a bond pickers' market, as we expected.

Corporates have become increasingly resilient in the face of challenges in recent years, including Covid-19, Russia's invasion of Ukraine and, most recently, tariff announcements. In that context, we note the ability of high-quality corporates to, in general, manage supply chains and pass on inflation. However, given the recent Middle East tensions, and especially if concerns around growth rise, lower-quality credit is most exposed. We therefore prefer to maintain a quality bias and a disciplined, issuer-by-issuer approach.

Rising uncertainty is increasing dispersion and opportunity



Source: Macrobond as at 9 April 2026.

Emerging markets

The theme of dispersion was also reflected in emerging markets, with performance divergent between oil exporters and importers – as well as between countries which are more and less exposed to oil sourced through the Strait of Hormuz. We actively pivoted portfolios to capture opportunities as they evolved, but believe further opportunities remain.

Elsewhere, we remain long Hungarian bonds, after our expectations of a victory for the opposition party were realised in April's parliamentary elections. These developments increase the likelihood of Hungary having access to EU funds; they also potentially pave the way towards the country meeting the Maastricht criteria, which could ultimately make Hungary's adoption of the euro a possibility over time.

Factor	Strategy	Trades
Rates	• We have revised our likely training range for US 10yr rates higher to 4.0%-4.5%	• Short US vs Germany
	• Bank of Japan policy normalisation could move the yield curve higher and flatter	• Short 7-year Japanese government bonds
	• European growth outlook softer than the US	
Credit	• AI disruption, private credit risks and geopolitical tensions are potential headwinds but technicals and credit fundamentals remain strong	• Optimise carry for given market beta
		• Biased towards non-cyclicals vs cyclicals and financials vs non-financials

Investment risk information

The value of investments, and the income from them, may fall or rise and investors may get back less than they invested.

Past performance is not a reliable indicator of future results. The performance data does not take account of the commissions and costs incurred in the issue and redemption of shares.

For professional investors only (as defined under the MiFID II Directive) investing for their own account (including management companies (fund of funds) and professional clients investing on behalf of their discretionary clients). In Switzerland for professional investors only. Not to be distributed to the public.

The information contained herein is not to be regarded as an offer to buy or sell or the solicitation of any offer to buy or sell securities in any jurisdiction where such an offer or solicitation is against the law, or to anyone to whom it is unlawful to make such an offer or solicitation, or if the person making the offer or solicitation is not qualified to do so. The information does not constitute legal, tax, or investment advice. You must not, therefore, rely on it when making any investment decisions.

The information contained herein is for educational purposes only and is not a recommendation or solicitation to buy or sell investments.

BLOOMBERG® is a trademark and service mark of Bloomberg Finance L.P. Bloomberg Finance L.P. and its affiliates, including Bloomberg Index Services Limited ("BISL") (collectively, "Bloomberg"), or Bloomberg's licensors own all proprietary rights in the Bloomberg Indices.

The products are not sponsored, endorsed, issued, sold or promoted by "Bloomberg." Bloomberg makes no representation or warranty, express or implied, to the owners or purchasers of the products or any member of the public regarding the advisability of investing in securities generally or in the products particularly or the ability of the Bloomberg Indices to track general bond market performance. Bloomberg shall not pass on the legality or suitability of the products with respect to any person or entity. Bloomberg's only relationship to Vanguard and the products are the licensing of the Bloomberg Indices which are determined, composed and calculated by BISL without regard to Vanguard or the products or any owners or purchasers of the products. Bloomberg has no obligation to take the needs of the products or the owners of the products into consideration in determining, composing or calculating the Bloomberg Indices. Bloomberg shall not be responsible for and has not participated in the determination of the timing of, prices at, or quantities of the products to be issued. Bloomberg shall not have any obligation or liability in connection with the administration, marketing or trading of the products.

Issued by Vanguard Group (Ireland) Limited which is regulated in Ireland by the Central Bank of Ireland.

Issued in Switzerland by Vanguard Investments Switzerland GmbH.

Issued by Vanguard Asset Management, Limited which is authorised and regulated in the UK by the Financial Conduct Authority.

Connect with Vanguard©

global.vanguard.com

Vanguard®