THE ROLES FIXED INCOME CAN PLAY IN YOUR PORTFOLIO

January 2026

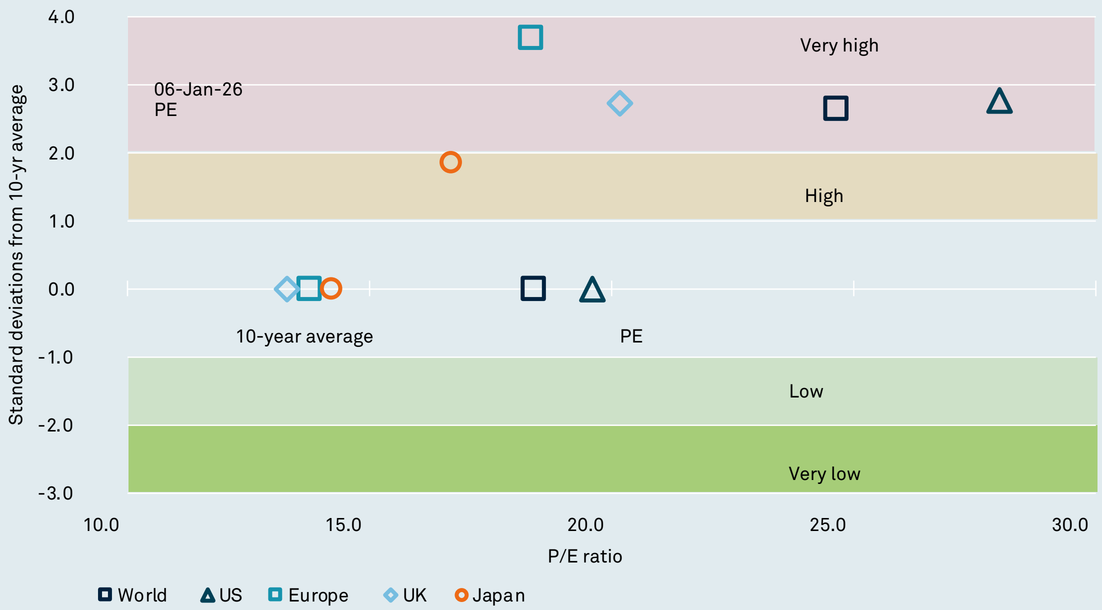
We believe investors should be deliberate and intentional when considering how to incorporate fixed income into their broad portfolios. Here, we consider the prevailing market backdrop and some of the common fixed income approaches.

Bond approach	Goal: Return	Income	Alpha	Diversification	Low duration options
Absolute return			✓	✓	
Total return[1]	✓	✓	✓		
Investment grade[2]				✓	
Short dated high yield	✓				✓
Systematic fixed income				✓	
Floating rate credit	✓				✓
Securitised	✓				✓

Source: Insight. For illustrative purposes only. Ticks reflect the primary objective(s) of each approach. [1] Including High income. [2] Short and long duration.

As investors evaluate opportunities in global markets, many face concerns regarding the potential returns and volatility associated with equities. Figure 1 shows price/earnings (P/E) ratios at country level against their 10-year averages, with most major markets at very high levels relative to history.

FIGURE 1: P/E RATIOS FOR EQUITIES APPEAR HIGH OR VERY HIGH



Source: Insight, World P/E Ratio. As at 06 January 2026. World = MSCI World Index, US = S&P 500 Index, Europe = FTSE Developed Europe All Cap Index, UK = MSCI UK Index, Japan = MSCI Japan Index,

While fixed income markets also face challenges, we believe yield trumps spread, meaning bond markets continue to offer appealing yields even if spreads are tight relative to history. When considering how to allocate assets across broader portfolios, we believe investors should:

- Recognise the current elevated equity valuations, slowing economic growth, and evolving interest rate dynamics, all warranting a deliberate approach to fixed income allocation.
- Define clear investment objectives for their fixed income allocation – whether income generation, capital appreciation, or diversification – to align their strategy with their needs.
- Consider a disciplined, intentional fixed income strategy to harness its distinct characteristics and support long-term risk-adjusted portfolio performance.

Be deliberate when choosing fixed income

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

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

- **Income:** Bonds offer a stream of interest payments. For investors prioritising 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 favourable 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.

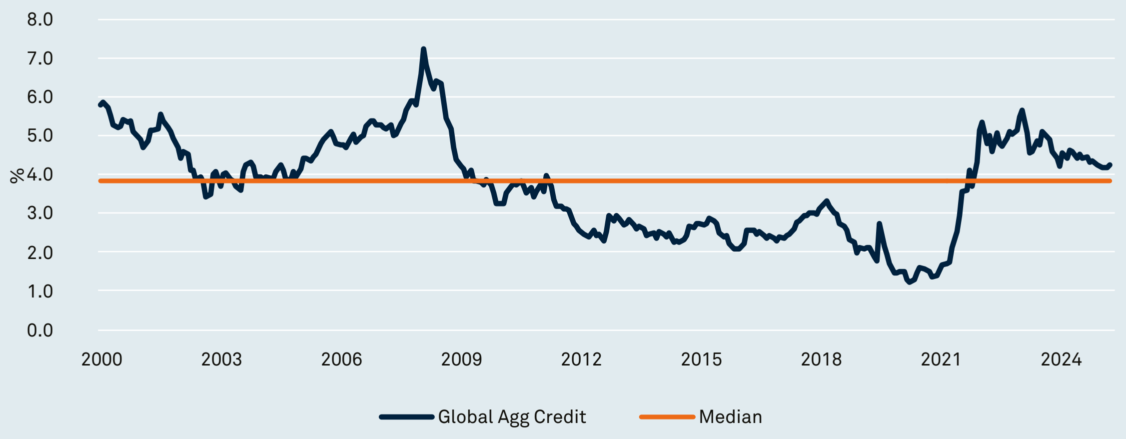
A disciplined approach to considering the role of fixed income in a portfolio – whether it is to generate income, returns, offer diversification, or a combination of the three – may enable investors to harness the distinct characteristics of fixed income to meet their objectives effectively.

Generating income

Official short-term interest rates in developed markets outside Japan are gradually approaching the lows of the current easing cycle but remain elevated compared to much of the previous decade. Consequently, achieving an attractive income level remains a feasible objective for investors.

Yields on longer-dated government bonds and credit instruments continue to hover near their highest levels in nearly 25 years, significantly exceeding the average since 2000.

FIGURE 2: YIELD ON GLOBAL CREDIT REMAINS ABOVE AVERAGE



Source: Insight, Bloomberg. As at 31 December 2025. Bloomberg Global Aggregate Credit Index yield to worst.

A strategy involving a carefully constructed portfolio of credit and government bonds, designed to generate a reliable and consistent income stream, may be appealing to investors.

Even in a low interest-rate environment, floating rate notes, asset-backed securities, and other secured finance instruments can offer income streams that substantially outperform cash deposits. Additionally, their limited interest-rate sensitivity (duration) results in lower price volatility compared to fixed-rate bonds, as they are less affected by yield fluctuations.

An income-focused strategy can be built using any of these asset classes individually or through a combination approach such as multi-sector credit income, targeting securities that provide desired cashflow streams via high interest payments. Alternatively, a buy-and-maintain approach may be attractive, offering structural exposure to credit markets while prioritising the delivery of required cashflows.

Capturing returns

Potential for attractive returns is not exclusive to equities, nor is fixed income solely limited to generating income streams. In today's market environment, investors may consider expressing views on market direction by evaluating whether they expect yields to decline – favouring long-duration positions as bond values rise – or to increase, which would favour short-duration strategies as bond values fall. Successful positioning can generate gains not only through managing overall risk but also by targeting specific maturities along the yield curve where yields are anticipated to move most favourably.

Alternatively, gains may be realised without taking active directional market risk. Equity and credit markets currently exhibit valuations that may be stretched, limiting the potential for positive market beta, especially amid rising recession risks. In this context, holding relative-value positions – such as active preferences across asset classes, countries, sectors, or individual issuers – can offer opportunities to add incremental value beyond the underlying beta of a strategy.

An absolute return approach, which might aim to deliver positive returns on a rolling basis (such as 12 months), rather than to outperform a bond index – or a total return approach which actively allocates across fixed income asset classes (with a long bias) without being constrained by a benchmark – may provide a pathway to growth through active management.

Enhancing diversification

Incorporating a fixed income component can help mitigate return volatility within a diversified portfolio. Typically, risk assets such as equities and corporate credit have performed well during periods of robust economic growth and strong corporate profitability, while government bonds may underperform. Conversely, periods of slower economic growth have tended to negatively impact equities and credit, while government bonds have often benefited from declining yields and short-term interest rates.

Although this inverse relationship may not always hold due to various factors influencing asset prices, fixed income investments are generally expected to contribute positively to portfolio diversification over the long term.

To further enhance diversification, investors might consider absolute return strategies. These strategies can be expected to exhibit low correlation with major asset classes, as rather than relying on broad market beta exposure, they typically focus on generating alpha through other means such as relative-value positioning in bonds or credit.

Additionally, short-dated high yield or floating rate credit strategies can offer a low-volatility fixed income approach while providing potential for attractive income generation.

Goal	Bond Approach
Total Return	Absolute return bond
Income and Diversification	Government bonds, investment grade, municipal bonds, global aggregate
Income	Global credit (investment grade rated), asset-backed securities
Income and growth	Strategic bond, multi-sector credit
Growth	Global high yield, emerging markets, secured finance

Glossary

Asset-backed securities (ABS): Pools of loans packaged and sold as securities – a process known as "securitisation". Typically, the assets backing these are home mortgages or credit card receivables.

Absolute return: Aims to achieve a positive return over a set timeframe and in all market conditions, although this is never guaranteed

Floating rate credit: Fixed income securities whose interest (income) payments are periodically adjusted depending on the change in a reference interest rate.

Global Aggregate Credit Index: The Bloomberg Global Aggregate Bond Index is a comprehensive measure of the global investment-grade fixed-income market, encompassing government, corporate, and securitized bonds from various regions. It includes securities rated investment grade (Baa3/BBB-/BBB- or higher) and is divided into several sub-indices based on geography, sector, currency, and credit quality.

Investment grade: Fixed income securities with a medium or high credit rating that are considered to be at lower risk from default than those issued with lower credit ratings.

P/E ratio: A financial metric that measures a company's current share price relative to its earnings per share (EPS).

Securitised bonds: Securitisation is the financial practice of pooling various types of contractual debt such as residential mortgages, commercial mortgages, auto loans or credit card debt obligations and selling their related cash flows to third party investors as securities.

Short-dated high yield: Below investment grade bonds with short maturities, typically issued by companies with higher credit risk and offering higher yield to compensate investors.

Standard deviation: A statistical measure that quantifies the amount of variation or dispersion in a set of values, calculated using the square root of that variance.

Systematic fixed income: An investment approach that aims to outperform bond markets by investing around factors linked to differences in expected returns, typically focused on security selection and risk control.

Total return: The term for the gain or loss derived from an investment over a particular period. Total return includes income (in the form of interest or dividend payments) and capital gains.

Yield-to-worst: The lowest potential yield that can be received on a bond without the issuer defaulting. This metric is used to evaluate the worst-case scenario for yield to help investors manage risks and ensure that specific income requirements will still be met even in the worst scenarios.

DISCLAIMER

No investment strategy or risk management technique can guarantee returns or eliminate risk in any market environment.

RISKS

Asset class comparisons such as comparing equities to bonds have limitations because different asset classes may have characteristics that materially differ from each other. Because of these differences, comparisons should not be relied upon solely as a measure when evaluating an investment for any particular portfolio. Comparisons are provided for illustrative purposes only. Although stocks have greater potential for growth than bonds, they also have much higher levels of risk. With stocks, the prices can rise and fall for a variety of reasons, including factors outside of the company's control. Bonds may be considered relatively safer. Because they're a debt security, they function as an IOU. The company pays interest to the bondholder, and once the bond matures, the bondholder receives the principal bank. Bonds aren't completely risk-free; there is the possibility of the issuer defaulting on its bonds, and if sold prior to maturity the market value may be higher or lower than the purchase value. But compared to stocks, historically there's been less volatility.

Bonds are subject to **interest rate, credit, liquidity, call and market risks**, to varying degrees. Generally, all other factors being equal, bond prices are inversely related to interest-rate changes and rate increases can cause price declines. High yield bonds involve increased **credit and liquidity risk** than higher rated bonds and are considered speculative in terms of the issuer's ability to pay interest and repay principal on a timely basis.

The information contained herein reflects general views and is provided for informational purposes only. This material is not intended as investment advice nor is it a recommendation to adopt any investment strategy.

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