

First quarter 2026 outlook

After a banner year for bonds, strategic opportunities emerge



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Last year delivered strong returns across fixed income markets. As we enter 2026, structural shifts – from fiscal policy dominance to blurring developed/emerging markets distinctions – will reshape opportunities. While credit spreads remain tight, selective positioning across diverse credit sectors may enhance income and portfolio resilience in this evolving landscape.

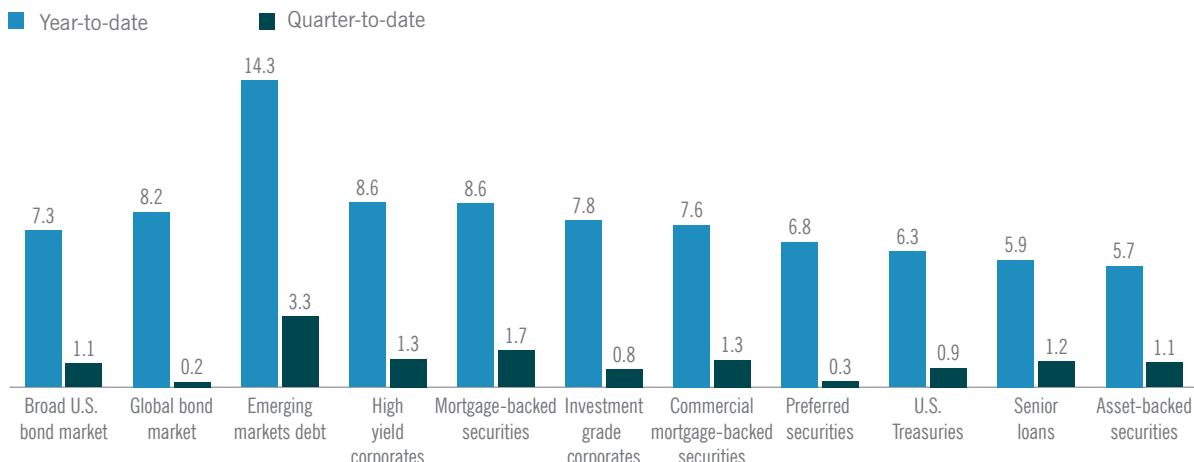
KEY TAKEAWAYS:

- Fiscal policy now drives markets as government spending overtakes central bank actions in shaping yield curves.
- Economic resilience supports credit despite tight valuations; focus on higher-quality below-investment-grade sectors for enhanced income.
- Extending beyond traditional corporate bonds may add more attractive opportunities and diversify risk exposures.
- Emerging and developed markets distinctions are blurring, favoring sectors isolated from sovereign volatility.

2025 PERFORMANCE SETS A STRONG FOUNDATION

Despite early concerns over tariffs, 2025 proved exceptional for bonds. Falling rates and tightening spreads drove all major categories above 5% returns, with emerging markets leading at 14.3%. Fourth quarter gains were more modest but broadly positive, setting a solid foundation for the year ahead.

Figure 1: 2025 delivered strong returns across bond markets



Data source: Morningstar Direct, 31 Dec 2025. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: **broad U.S. bond market**: Bloomberg U.S. Aggregate Index; **global bond market**: Bloomberg Global Aggregate Index; **emerging markets debt**: JPM EMBI Global Diversified Index; **high yield corporates**: Bloomberg U.S. Corporate High Yield of 2% Issuer Capped Index; **mortgage-backed securities**: Bloomberg U.S. Mortgage-Backed Securities Index; **investment grade corporates**: Bloomberg U.S. Corporate Index; **commercial mortgage-backed securities (CMBS)**: Bloomberg CMBS ERISA Eligible Index; **preferred securities**: ICE BofA U.S. All Capital Securities Index; **U.S. Treasuries**: Bloomberg U.S. Treasury Index; **senior loans**: S&P UBS Leveraged Loan Index; **asset-backed securities**: Bloomberg Asset-Backed Securities Index.

FOUR THEMES ARE SHAPING OUR APPROACH

Four distinct forces are reshaping fixed income markets. The table below summarizes how we're translating each theme into actionable portfolio strategy.

Time for a takeover: Fiscal over monetary

Central banks are nearing the end of rate-cutting cycles, and fiscal policy now dominates. Elevated deficits, demographic pressures, defense spending, industrial policy and green energy commitments

Figure 2: Investment themes for 2026

	What's happening?	Market implications	Portfolio positioning
Time for a takeover: Fiscal over monetary	Government spending dominates as central bank rate-cutting cycles end	Longer-term rates likely remain elevated despite policy easing	Favor positioning for a steeper yield curve over aggressive duration extension
Economic resilience: Tight spreads, but room for credit risk	Cooling inflation, technology investment, productivity gains, and strong corporate fundamentals underpin 2026 growth rebound	Spreads can remain compressed for extended periods during steady growth; premature derisking sacrifices income	Focus on higher-quality segments within below-investment-grade sectors, like high yield corporates, preferreds and senior loans
Digging deeper for diversification: Look beyond traditional credit	Historically tight credit spreads have reduced income potential of traditional bond investments	Less-traded credit sectors provide wider spreads and different risk exposures than traditional corporates	Capture incremental yield by moving into emerging markets debt, CMBS, preferreds, senior loans, CLOs and municipals
New playbook: Developed and emerging markets converge	Political and institutional risks now affect developed markets while emerging markets have strengthened fundamentals	Traditional analytical boundaries between developed and emerging markets are dissolving	Emphasize sectors insulated from sovereign risk (securitized credit, municipals); raise strategic allocation to high-quality emerging markets debt

will influence growth, inflation and yield curves across developed markets.

Large-scale government borrowing risks can push longer-term rates higher, particularly given already-elevated debt levels. Rather than extending portfolio duration aggressively, we favor positioning for moderately steeper yield curves by underweighting longer-duration bonds.

Economic resilience: Spreads tight, but room for credit risk

Our constructive global growth outlook remains intact – no recession is expected medium-term. Across developed markets, we expect faster growth in 2026 than 2025. We forecast U.S. GDP growth of 1.5% in 2025 (better than earlier estimates due to slower pass-through of tariffs) and 2.0% in 2026. Core PCE inflation moderates to 2.5%. Technology spending, accounting for roughly 20% of 2025

GDP growth, stays elevated as AI adoption boosts productivity. Supported by healthy balance sheets, corporate fundamentals remain strong.

However, valuations are rich. Credit spreads – measuring extra income for credit risk – sit near historical lows. Spreads have remained below average for extended periods since 2012, interrupted only by brief volatility spikes (Figure 3). Derisking prematurely may sacrifice the income advantage credit sectors provide.

We balance tight valuations against income needs by favoring higher-quality segments of below-investment-grade markets: BB and B rated high yield corporates, senior loans and preferred securities. This approach captures enhanced yield while maintaining moderate overall risk, avoiding the most vulnerable CCC rated segments.

Figure 3: Credit spreads often remain compressed for extended periods

Corporate bond spreads (bps)



Data source: Bloomberg, L.P., 31 Dec 2025. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: **investment grade corporates**: Bloomberg U.S. Corporate Investment Grade Index; **high yield corporates**: Bloomberg U.S. Corporate Investment Grade Index; **high yield corporates**: Bloomberg U.S. Corporate High Yield 2% Issuer Capped Index.

Digging deeper for diversification: Look beyond traditional credit

Strong inflows into fixed income markets have tightened credit spreads in conventional credit markets. We see better opportunities in lesser-known sectors. These areas offer higher yield potential to compensate for different risk exposures and less active trading than in traditional sectors.

Commercial mortgage-backed securities (CMBS) – Backed by income-producing properties like medical offices, retail centers and multifamily housing.

Senior loans – Asset-secured corporate lending at the top of the capital structure, with floating-rate coupons reducing interest rate sensitivity.

Collateralized loan obligations (CLOs) – Pooled senior loans creating securities with varying risk levels.

Emerging markets debt – Government and corporate issuance from developing economies, offering higher-growth exposure with lower correlation to developed markets.

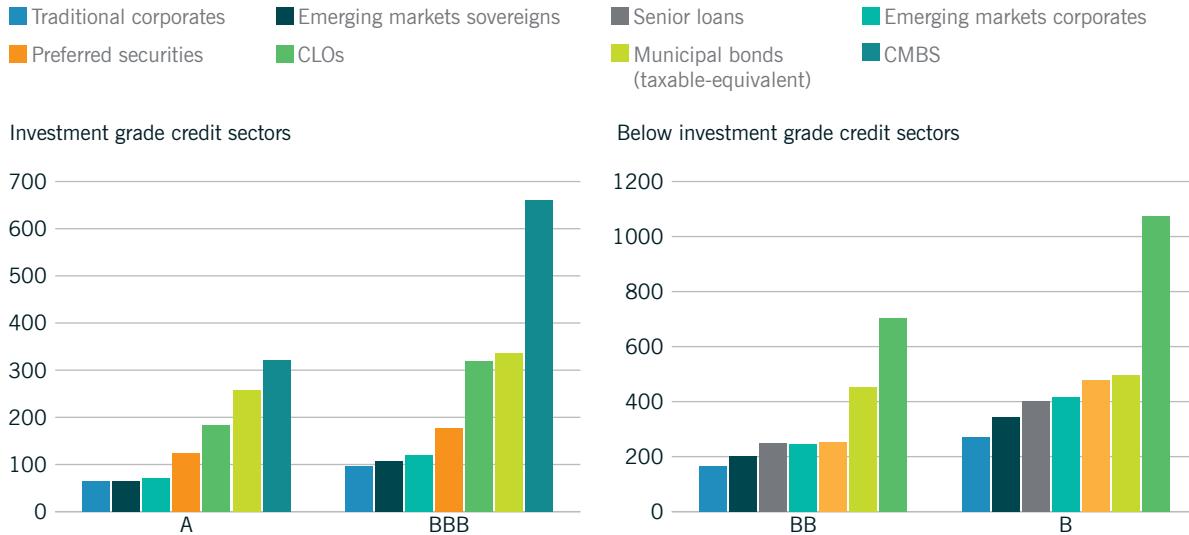
Preferred securities – Middle-tier corporate capital structure exposure, typically underrepresented in traditional fixed income portfolios.

Municipal bonds – Tax-exempt state and local obligations offering after-tax yield advantages for investors in higher tax brackets.

These extended sectors offer wider spreads than traditional corporates at comparable quality ratings (Figure 4). Their specialized nature makes them best accessed through professionally managed, diversified funds.

Figure 4: Extending credit sectors reveals more attractive opportunities across the ratings spectrum

Option-adjusted spread (bps)



Data source: Bloomberg, L.P., JPMorgan, Standard & Poor's, Factset, 31 Dec 2025. Performance data shown represents past performance and does not predict or guarantee future results. Representative indexes: **corporate A** & **BBB rated**: Bloomberg U.S. Corporate Index; **corporate BB & B rated**: Bloomberg U.S. High Yield Index; **emerging markets sovereigns**: JPM CEMBI Global Diversified Index; **senior loans**: S&P UBS Leveraged Loan Index; **emerging markets corporates**: JPM CEMBI Broad Diversified Index; **preferred securities**: ICE BofA U.S. All Capital Securities Index; **collateralized loan obligations (CLO)**: JPM U.S. CLO Index; **municipal bonds**: Bloomberg Municipal Bond Index (taxable-equivalent calculation assumes 37% federal income tax and 3.8% Medicare surtax rate); **commercial mortgage-backed securities (CMBS)**: Bloomberg CMBS ERISA Eligible Index.

New playbook: Developed and emerging markets converge

Traditional distinctions between developed and emerging markets are dissolving. Political uncertainty, central bank independence questions and government stability concerns – once associated only with emerging economies – now apply to major developed markets.

Meanwhile, many emerging markets have strengthened fundamentals. Earlier and more aggressive inflation control, reduced debt burdens and more credible policy frameworks allow them to enter 2026 from a position of relative strength.

This convergence demands applying emerging-markets analytical rigor to developed-market exposures — assessing political and institutional risks alongside traditional credit, rate, and currency factors. Active managers with robust emerging markets research capabilities are well-positioned for this integrated approach.

This shift has practical implications for portfolio construction: Favor sectors insulated from sovereign volatility. Securitized investments (MBS, ABS, CMBS) derive value from underlying collateral pools rather than government creditworthiness. Municipal bonds depend on state and local fiscal strength, providing separation from national political risk. High-quality emerging markets debt may now offer the diversification benefits developed markets traditionally provided, warranting higher strategic allocations.

TRANSLATING THEMES INTO PORTFOLIO STRATEGY

Multisector fixed income strategies efficiently capture these themes within a single portfolio, using fundamental research to uncover opportunities across extended credit sectors and the full ratings spectrum while dynamically adjusting to evolving conditions.

- **Multisector bond funds** invest across the broadest range — investment grade through below investment grade — offering enhanced income potential and reduced interest rate sensitivity. They provide maximum flexibility to access the complete credit opportunity set: securitized sectors, senior loans, CLOs, preferreds and emerging markets debt. This latitude allows managers to dig deeper for diversification and include sizable allocations to many non-traditional credit sectors and emerging markets debt.
- **Core plus funds** maintain a traditional fixed income foundation while allocating up to 30% in higher-yielding plus sectors like high yield and emerging markets debt. This structure can deliver diversification and return enhancement while preserving moderate overall risk. Its risk profile allows ample opportunity to include the higher-quality segments of the below investment grade markets to take advantage of economic resilience.
- **Core bond funds** invest broadly across investment grade sectors — Treasuries, securitized and investment grade corporates. Those with flexibility for modest plus-sector allocations can capitalize on opportunistic credit exposures.

OUTLOOK

Securitized markets and emerging markets present opportunities

Entering 2026, we expect U.S. real gross domestic product (GDP) growth to improve to 2.0%, a modest improvement from 2025's expected pace. With stronger growth, the labor market should stabilize with unemployment near current levels. Inflation may face near-term upside risk from pending tariffs but should moderate to around 2.5% core by year-end.

We expect the Fed to slow its pace of rate reductions but deliver an additional 50 bps of cuts through 2026. That would take the policy rate to 3.00%-3.25%, near our estimate of the "neutral" level. The European Central Bank should remain on hold before hiking rates in the second half of the year, while the Bank of Japan should raise rates at least once more this year.

We continue to modestly favor spread sectors and credit risk, with an up-in-quality bias. Credit spreads will likely remain volatile in the coming months, potentially creating more attractive entry points for risk taking. That said, we currently see opportunities in securitized markets — including commercial mortgage-backed securities and collateralized loan obligations — and in bonds from emerging markets economies poised to benefit from new trade policy. We expect Treasury yields to decline modestly and the yield curve to steepen throughout 2026.

For more information, please visit us at nuveen.com.

Endnotes

Inflation: U.S. Bureau of Labor Statistics Consumer Price Index for All Consumers. **Employment:** Bloomberg, L.P., Bureau of Labor Statistics, Peterson Institute, Nuveen. **Global debt and yields:** Bloomberg, L.P.

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