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Fixed Income YTD 2026

Geopolitical Volatility Creates New Opportunities in Fixed Income

Executive Summary

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Fixed Income

After a promising start to the year for fixed income investors, the escalation of tensions in the Middle East has triggered a significant repricing across global bond markets. Government bond yields have risen sharply, rate volatility has surged, and inflation concerns have once again become a key driver of market sentiment.

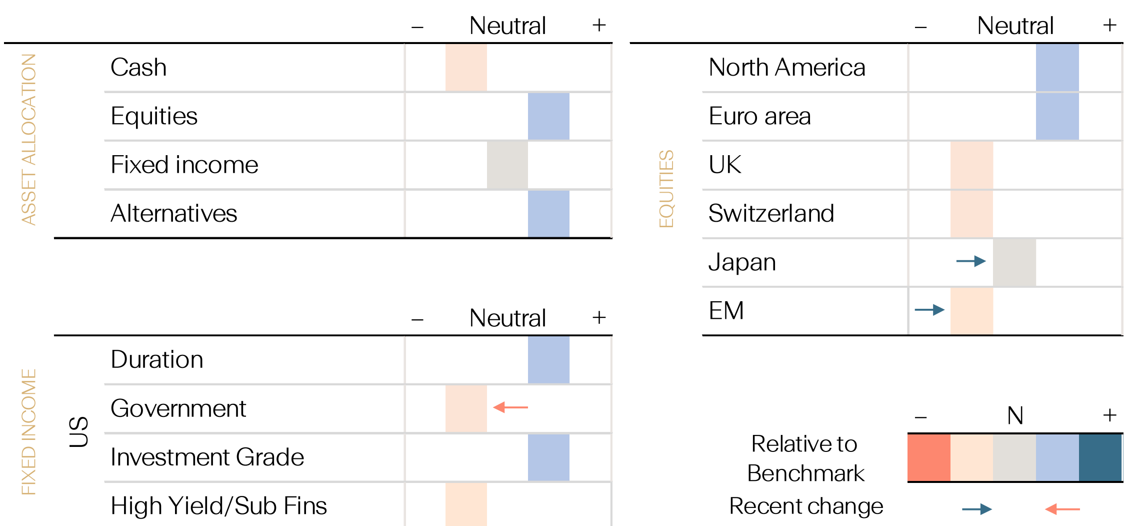
The immediate catalyst has been the disruption of global energy supply chains, particularly through the Strait of Hormuz, resulting in a sharp increase in oil prices and renewed concerns about inflation. Markets have rapidly revised their expectations for monetary policy, leading to a significant upward repricing of both short- and long-term interest rates.

While recent developments inevitably draw comparisons with the inflation shock of 2022, we believe the current environment differs in several important respects. Unlike the post-pandemic period, today's inflationary pressures stem primarily from a supply-side shock rather than a combination of supply constraints and exceptionally strong demand. Furthermore, policy rates are already significantly higher, central bank balance sheets have largely normalized, and inflation expectations remain better anchored.

As a result, although volatility is likely to remain elevated, we do not expect a repeat of the severe bond market losses experienced in 2022.

Our base case assumes a gradual normalization of energy markets over the coming quarters. Under this scenario, current yield levels offer an attractive entry point for investors willing to tolerate short-term volatility. We continue to favour a balanced fixed income allocation combining duration exposure, inflation-linked bonds and selective short-duration credit carry strategies.

Novum's "Investment Mosaic"



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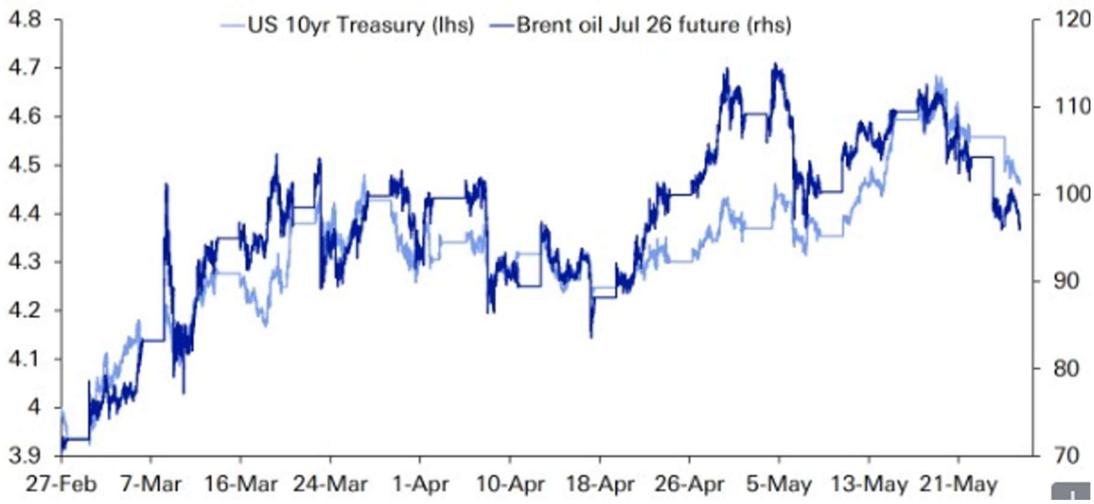
1. Geopolitics Has Revived Bond Market Volatility

After a constructive start to the year, bond markets experienced a sharp reversal following the escalation of geopolitical tensions in the Middle East.

	2Y			5Y			10Y		
	28-Feb-26	31-May-26	Spread	28-Feb-26	31-May-26	Spread	28-Feb-26	31-May-26	Spread
US Treas	3.37%	4.00%	0.63%	3.50%	4.14%	0.64%	3.94%	4.44%	0.50%
Bund	2.00%	2.53%	0.53%	2.24%	2.64%	0.40%	2.64%	2.94%	0.30%
OAT	2.12%	2.68%	0.56%	2.53%	2.96%	0.43%	3.22%	3.55%	0.33%
BTP	2.16%	2.68%	0.52%	2.58%	3.03%	0.45%	3.27%	3.65%	0.38%
Gilt	3.53%	4.21%	0.68%	3.68%	4.35%	0.67%	4.23%	4.81%	0.58%
JGB	1.25%	1.39%	0.14%	1.59%	1.92%	0.33%	2.13%	2.66%	0.53%
SWISS	-0.13%	0.09%	0.22%	0.05%	0.23%	0.19%	0.21%	0.46%	0.25%

Interest rate volatility rose dramatically, with the MOVE index increasing from approximately 65 to 115, while government bond yields across the G7 moved significantly higher. Credit spreads widened temporarily before quickly retracing most of the move, highlighting that investors viewed the shock primarily as an inflation and rates event rather than a systemic credit crisis.

The main transmission mechanism has been the sharp increase in energy prices following disruptions to global supply routes. Higher oil prices have rapidly translated into higher inflation expectations and a reassessment of future central bank policy paths.



Beyond the immediate impact on fuel prices, investors are increasingly focused on three potential second-round effects:

- The transmission of higher energy costs into broader goods and services inflation.
- Fiscal support measures aimed at offsetting higher energy prices for households and businesses.
- The emergence of wage-price dynamics that could make inflation more persistent and require further monetary tightening.

The market reaction has therefore reflected not only the current inflation shock but also uncertainty regarding its potential persistence.

2. Why This Is Not 2022

	2022	Today
Inflation	10+	4-5%
Demand	Very High	Moderate
Central Bank rates	Extremely low	Already high
Quantitaive Easing	Very High	Moderate
FI risk	Very High	Limited

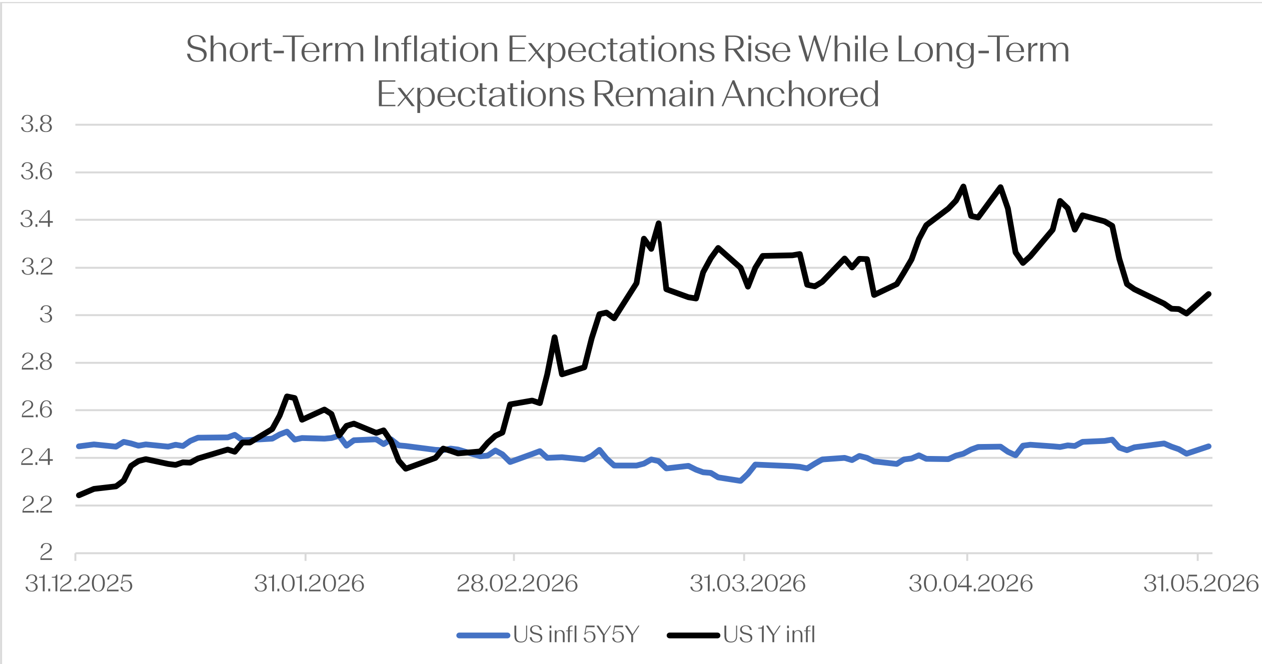
The current environment naturally recalls the inflation shock of 2022, when energy prices surged following the outbreak of the Russia-Ukraine conflict.

However, we believe there are several important differences.

First, the post-pandemic period was characterized by a combination of supply-side disruptions and exceptionally strong demand, supported by unprecedented fiscal and monetary stimulus. Today, the shock is primarily supply-driven.

Second, bond markets entered 2022 with historically low nominal yields and deeply negative real yields. Investors were therefore highly exposed to a repricing of inflation and monetary policy expectations. Today, yields have already normalized significantly and offer a much stronger carry buffer.

Third, central banks were widely perceived as being behind the curve in 2022. By contrast, inflation expectations remain relatively well anchored today, reflecting stronger confidence in policymakers' commitment to price stability.



While current market conditions remain challenging, the starting point for fixed income investors is significantly more favourable than it was in 2022.

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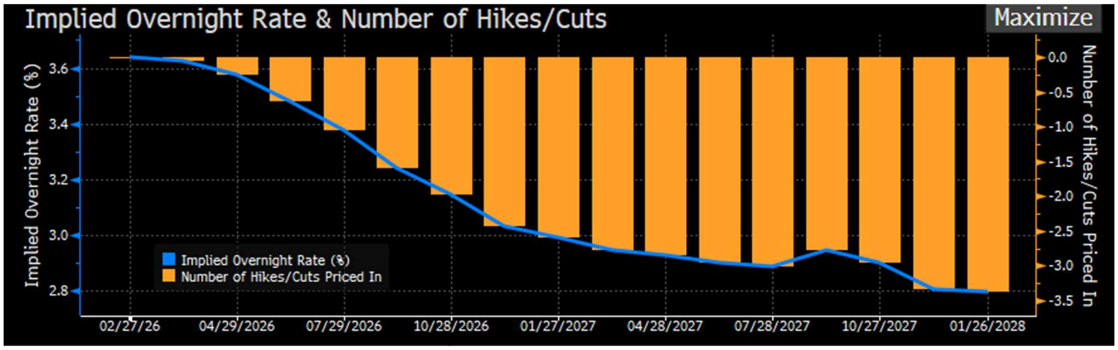
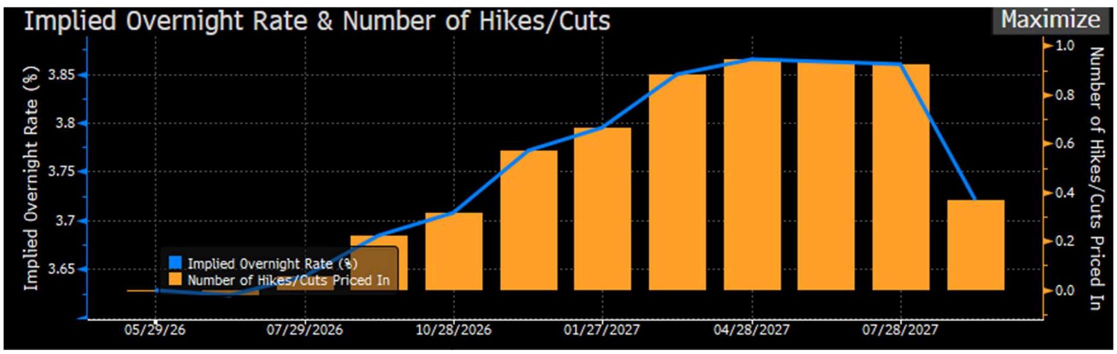
3. What Is the Market Pricing Today?

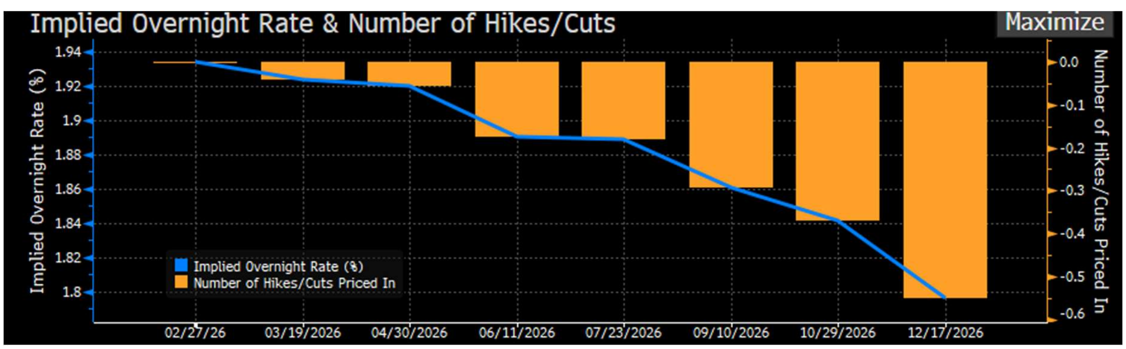
The recent repricing has been particularly visible in interest rate expectations.

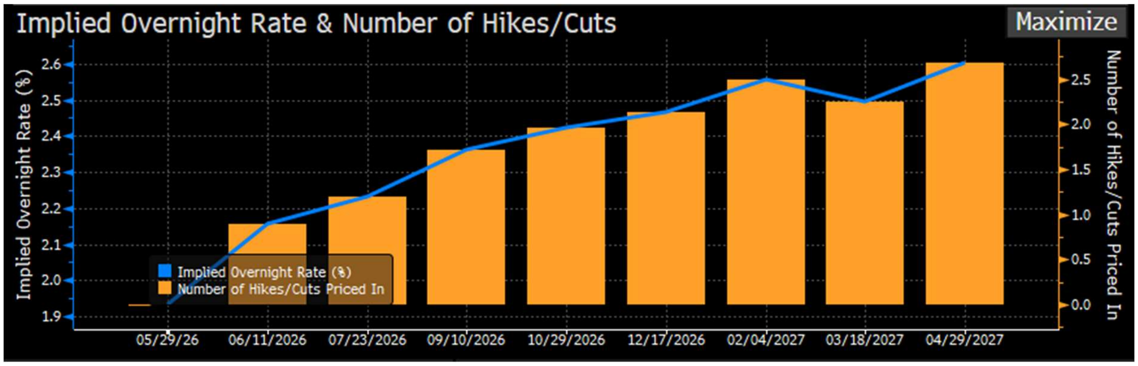
Markets have significantly reduced expectations for policy easing in both the United States and Europe. In the US, expectations for rate cuts in 2026 have largely disappeared as investors reassess the resilience of economic activity and the inflationary consequences of higher energy prices.





In Europe, markets have also moved aggressively to price a more restrictive path for monetary policy, although we believe economic fundamentals remain considerably weaker than in the United States.





The key question for investors is whether current market pricing accurately reflects the likely medium-term economic outcome.

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4. Outlook for Rates: United States and Europe

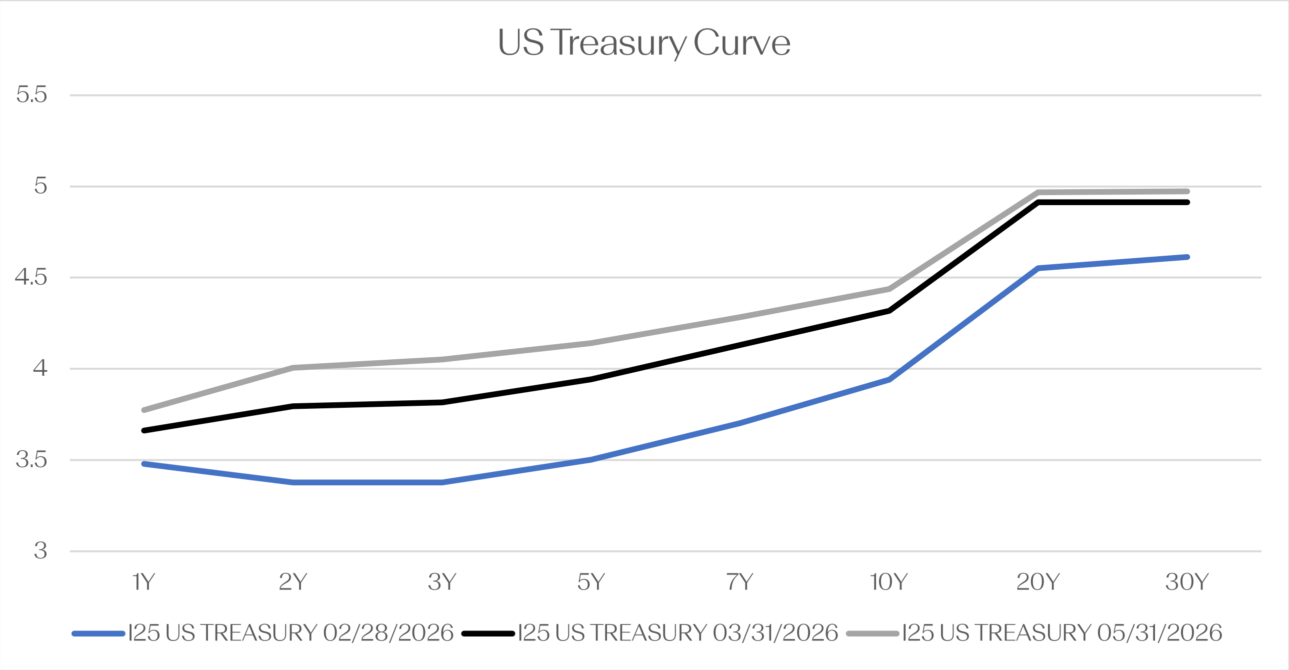
United States

The US economy continues to demonstrate remarkable resilience despite tighter financial conditions.

We expect inflation to rise further in the coming quarters, potentially reaching levels around 5% before gradually moderating. However, long-term inflation expectations remain relatively well anchored, suggesting that investors continue to trust the Federal Reserve's ability to restore price stability.

The recent increase in long-term Treasury yields appears justified given the inflation outlook. However, current yield levels increasingly incorporate a substantial risk premium that may prove excessive should energy markets gradually normalize.

Our central scenario therefore anticipates some retracement in Treasury yields by year-end, with a more dovish monetary environment emerging over the medium term as inflation pressures eventually subside.



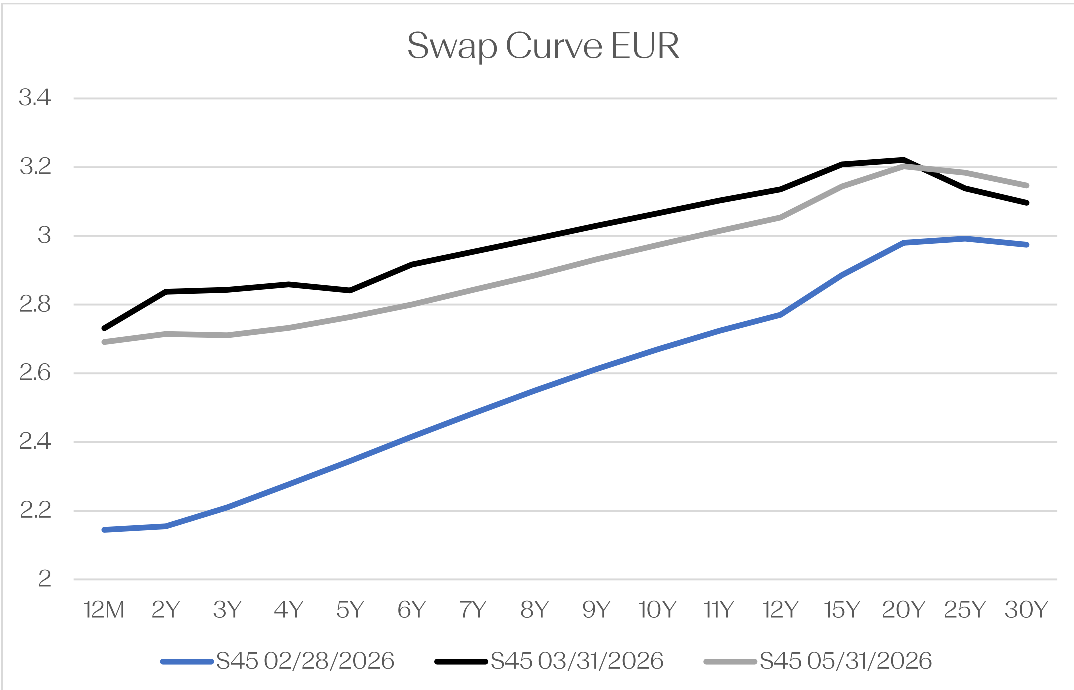
Euro Area

The repricing has been even more pronounced in Europe.

The ECB remains highly sensitive to inflation risks, reflecting the lessons learned during the 2022 energy crisis. Nevertheless, recent communications suggest a growing recognition that excessive tightening could further weaken an already fragile growth outlook.

While markets currently anticipate additional tightening, we believe the ECB is likely to adopt a more cautious wait-and-see approach.

Europe's structural growth challenges remain significant, and we continue to expect that weaker economic momentum will eventually require a return to a more accommodative monetary stance. Under this scenario, Bund yields are unlikely to remain sustainably near current levels and could gradually move back towards 2.5%.



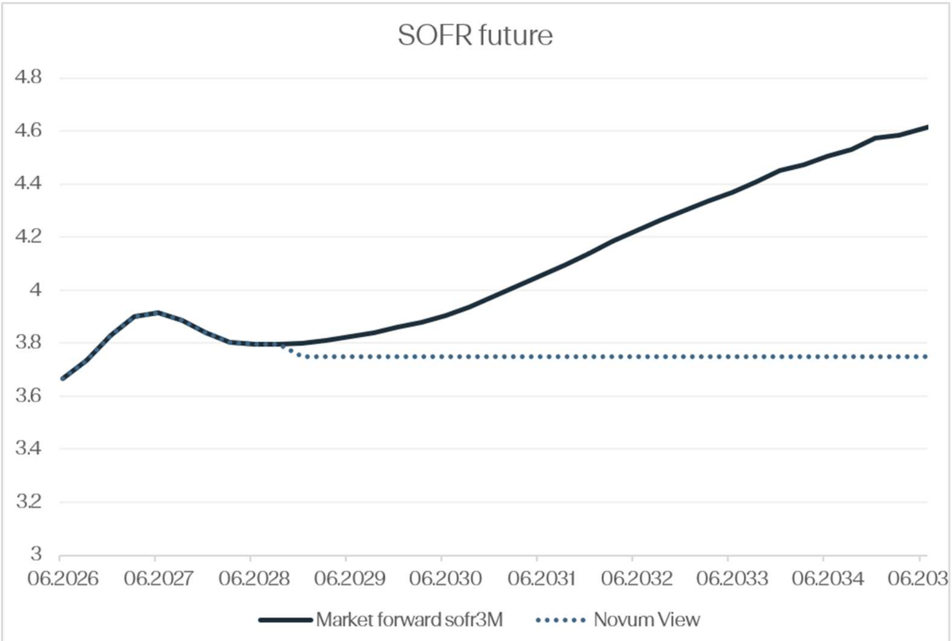
5. Investment Implications

Although geopolitical uncertainty is likely to remain elevated, current market conditions create several attractive opportunities within fixed income.

Duration

We believe investors should gradually increase duration exposure.

Current yield levels provide an attractive entry point and compensate investors more effectively for interest rate risk than at any time in recent years. Our central scenario of gradual energy market normalization should support lower long-term yields over time.



SOFR future
4.8
4.6
4.4
4.2
4
3.8
3.6
3.4
3.2
3
06.2026
06.2027
06.2028
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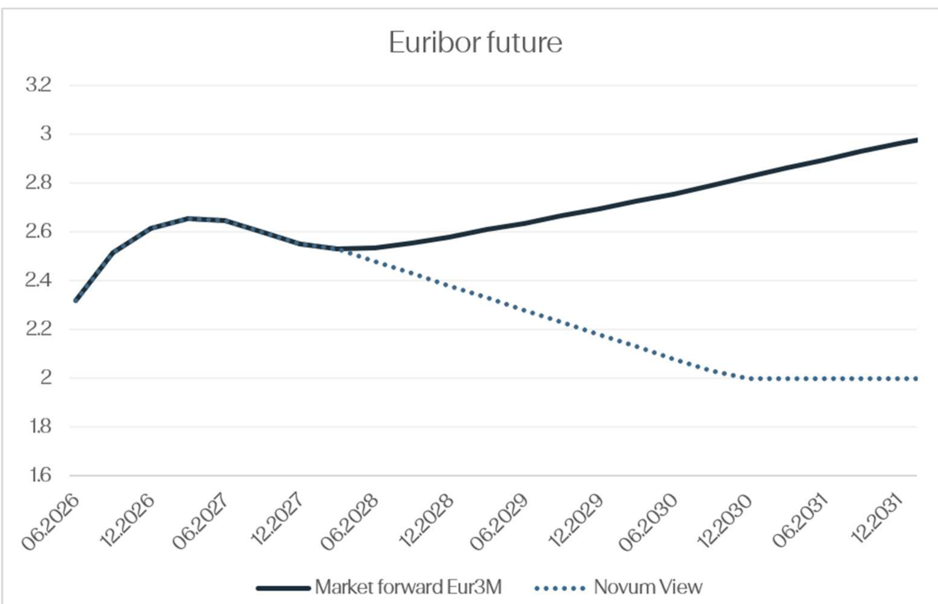
Market forward sofr3M
Novum View



Euribor future
3.2
3
2.8
2.6
2.4
2.2
2
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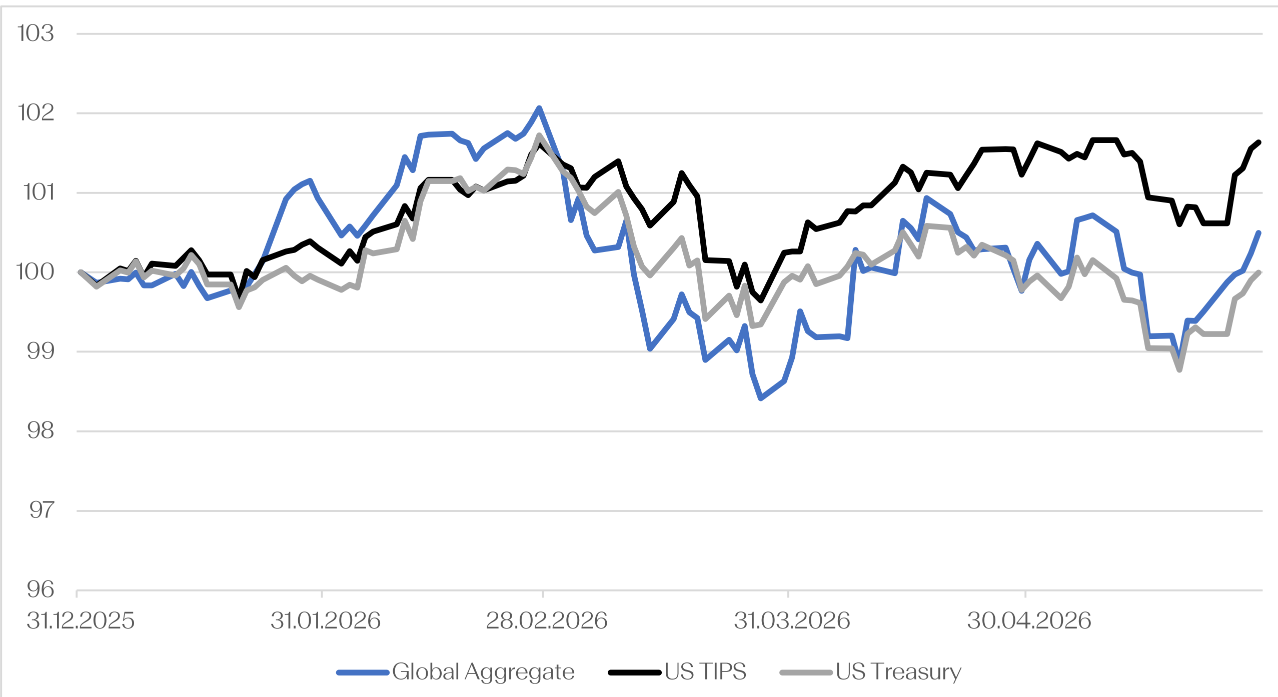
1.6
06.2026
12.2026
06.2027
12.2027
06.2028
12.2028
06.2029
12.2029
06.2030
12.2030
06.2031
12.2031
Market forward Eur3M
Novum View

Inflation-Linked Bonds

Inflation-linked bonds remain an attractive hedge against the principal risk to our outlook: a more persistent inflation shock.

They provide protection against a scenario where energy inflation spreads more broadly through the economy and eventually feeds into wages.



Credit

Credit spreads remain relatively contained and do not currently indicate significant systemic stress.

We continue to favour short-duration carry strategies that offer attractive income while limiting sensitivity to further rate volatility.

6. Expected Returns Through Year-End

FI asset	Average Yield 2015-2021	Today	End of Year Exp
US Treasury	1.95%	4.44%	4.15%
Bund	0.07%	2.94%	2.54%
IG Credit $	3.05%	5.13%	4.80%

Under our central scenario:

USD Fixed Income

- Portfolio yield: approximately 5%
- Duration: approximately 5 years
- Treasury yield decline: 30bps

Expected total return over six months:

~4.0%

(approximately 8% annualized)

EUR Fixed Income

- Portfolio yield: approximately 3.8%
- Duration: approximately 4.75 years
- Bund yield decline: 40bps

Expected total return over six months:

~3.8%

(approximately 7.6% annualized)

Conclusion

The recent geopolitical shock has reintroduced significant volatility into global bond markets. However, unlike in 2022, today's fixed income markets begin from a much stronger position, characterized by higher yields, more attractive valuations and better anchored inflation expectations.

While short-term market movements will continue to be heavily influenced by geopolitical developments, current yield levels offer investors a meaningful source of carry and a significantly improved risk-reward profile.

In our view, the current environment should be seen not as a repeat of the 2022 bond market crisis, but rather as an opportunity to rebuild strategic fixed income exposure at substantially more attractive levels. The combination of duration exposure, inflation protection and selective carry strategies should allow investors to navigate ongoing uncertainty while capturing the renewed return potential of the asset class.

Novum's Trade History

From 31.12.2023 to 22.05.2026