

# 360°

H1 2026

Fixed Income Report

[www.hermes-investment.com](http://www.hermes-investment.com)

For professional investors only

**Federated  
Hermes**   
Limited

# Authors



**Mitch Reznick, CFA**

Group Head of Fixed Income – London &  
Global Head of Sustainable Fixed Income



**Nachu Chockalingam, CFA**

Head of London Credit



**Filippo Maria Alloatti**

Head of Financials



**Vincent Benguigui**

Senior Portfolio Manager



**Tom Steabler**

Senior Investment Analyst



**Andrew Lennox**

Senior Portfolio Manager



# Contents

Click the text on the right to navigate to each section and use the menu at the bottom of the page throughout the report to go between sections easily.

**Introduction/Commentary** **2**

**Spotlight** **4**

**Fundamentals** **8**

**Credit relative value** **10**



Introduction/Commentary

Spotlight

Fundamentals

Credit relative value

# Introduction



Introduction/Commentary

Spotlight

Fundamentals

Credit relative value



**Mitch Reznick, CFA**

Group Head of Fixed Income – London & Global Head of Sustainable Fixed Income

# Commentary

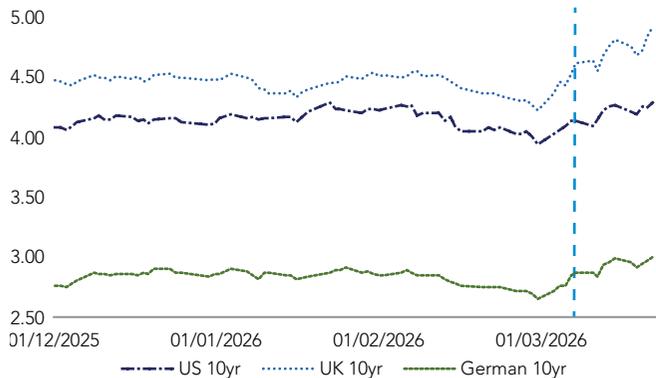
## Is this what it sounds like when doves cry?

Typically, when we see elevated geopolitical risks, the flight to quality includes government bonds. As a result, front-end interest rates rally. This did not happen following the Israeli-US attacks on Iran.

So, what has happened... and what does it mean for credit markets?

First, the price of fossil fuels spiked... and then spiked again. Within hours of the attacks, inflation forecasts reversed entirely. The market pivoted from expectations of disinflation to fears of inflation as the price of oil rose more than 50% within days, continuing an upward trajectory that began before the onset of the latest conflict.

**Figure 1:** Dotted line demarcates the launch of the attacks on Iran



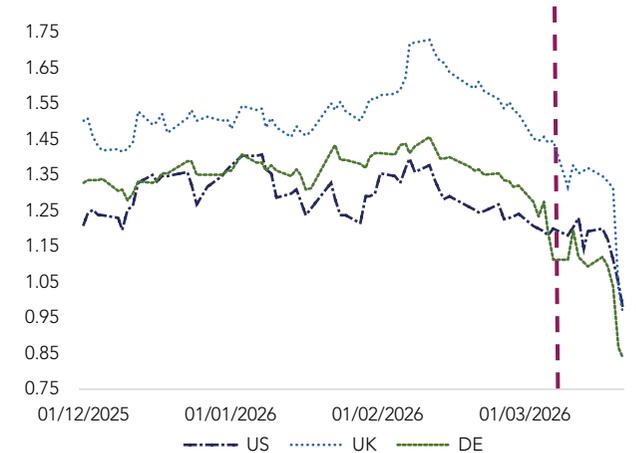
Source: Bloomberg, Federated Hermes, Ltd. March 19, 2026.

Second, the reversal in inflation expectations triggered a sell-off in rates, as the prospects of dovish central bank policy this year—predicated on ongoing disinflation—evaporated. The sharpest sell-off was in UK gilts, where a 90% market expectation of a spring rate cut by the Bank of England collapsed to zero.<sup>1</sup> Meanwhile, central bank activity during the week of 16 March pushed expectations even further in the same direction.

Markets are now expecting as many as three rate hikes from the Bank of England (BoE) and the European Central Bank (ECB), and one from the Fed by year-end. This is a remarkable turn of events in just a matter of weeks.

The sell-off in the front end of the curve has caused dramatic bear flattening, accelerating the twist in rates curves. In the space of just over a month, we have seen more than 85 basis points (bps) of flattening in the two-year/30-year gilt curve from peak to trough, and dramatic flattening in others as well (Figure 2).

**Figure 2:** Rate curves do the twist



Source: Bloomberg, Federated Hermes, Ltd. March 19, 2026.

Concerns about inflation and, as a consequence, central bank rate activity, appear to have eclipsed worries about the effects of rising geopolitical risks on the back of the US military's "little excursion" into Iran.<sup>2</sup> This speaks volumes about the market's belief that the current conflict can be contained. Elevated oil prices in the near term appear likely.

The extent to which the price of oil can be contained remains an open question. What is clear is that rates markets have made a rapid U-turn from the dovish consensus-led rally this year (until 2 March). This suggests that markets now see central banks lifting rates to tame inflation, which, in turn, has caused the pronounced moves in credit markets.

<sup>1</sup> World Interest Rate Probabilities (WIRP), Bloomberg.

<sup>2</sup> Trump calls U.S. operations in Iran 'a little excursion'. March 11, 2026.



# Spotlight



Introduction/Commentary

**Spotlight**

Fundamentals

Credit relative value



Mitch Reznick, CFA

Group Head of Fixed Income – London &  
Global Head of Sustainable Fixed Income

# Spotlight

## From disinflation to reflation to stagflation?

'Discrete' financial markets do not operate in a vacuum; they are inexorably linked. The month-to-date period for March<sup>3</sup> shows volatility in certain pockets of credit markets, particularly those that are most sensitive to rate moves. Other pockets appear calmer.

On a total return basis, sterling credit was among the worst performing asset classes at the time of writing in late-March. If we distil this underperformance into total returns versus excess returns – the returns associated with changes in credit risk premia – we can see that the vast majority of this performance is rates-driven. Of the -3.3% return in the month-to-date period, 17bps came from the credit risk component. The rest can be attributed to the rate move.

Returns in US high yield are largely driven by rates, with 30bps explaining the -1.2% performance in March coming from credit risk. Global rates moves are affecting returns in investment grade (IG) markets (Figure 3). Of the -1.8% return in this segment, only 13 basis points has been driven by changes in credit spread.

The one outlier in this analysis is European credit. In Figure 3, we can see that spread moves explain a large part of the change in total return in the month-to-date period. Though not to the same degree, this pattern is also replicated in the market for banks' contingent capital securities, or CoCos. These securities are largely issued by European banks.

**Figure 3:** Credit market returns

|                      | Total Return YTD (%) | Total Return MTD (%) | Change in spread MTD (bps) | Excess Returns MTD (%) |
|----------------------|----------------------|----------------------|----------------------------|------------------------|
| Global High Yield    | -0.354               | -1.374               | 22                         | -0.418                 |
| Global IG            | -0.208               | -1.813               | 5                          | -0.133                 |
| Euro High Yield      | -0.595               | -1.874               | 36                         | -0.808                 |
| US High Yield        | -0.512               | -1.151               | 15                         | -0.302                 |
| EM Credit            | -0.213               | -1.766               | 12                         | -0.357                 |
| EM High Yield Credit | 0.481                | -1.635               | 30                         | -0.479                 |
| Euro IG              | -0.149               | -1.757               | 7                          | -0.218                 |
| US IG                | -0.216               | -1.816               | 4                          | -0.089                 |
| Sterling Credit      | -1.811               | -3.292               | 5                          | -0.174                 |
| CoCo Markets         | -0.186               | -1.931               | 20                         | -0.65                  |
| USHY BB              | -0.294               | -1.29                | 13                         | -0.386                 |
| USHY B               | -0.531               | -0.947               | 16                         | -0.183                 |
| USHY CCC             | -1.842               | -1.003               | 24                         | -0.202                 |
| EHY BB               | -0.355               | -1.776               | 25                         | -0.652                 |
| EHY B                | -1.207               | -2.133               | 62                         | -1.232                 |

Source: ICE BofA, Federated Hermes. As at March 19, 2026.

**Past performance is not a reliable indicator of future performance.**

On the face of it, year-to-date performance shows some fairly benign moves. For example, looking at US high yield versus European high yield, we see similar total returns. In the year-to-date period until the attack on Iran, non-US credit had been outperforming US credit. Since the attack on Iran, this dynamic has flipped.

In the case of sterling credit, we can see that the move is largely driven by rates. However, for European credit and emerging market (EM) credit, it's not all about rates for the more spread-sensitive markets. European high yield and lower quality EM credit underperformance can also be explained by spread-widening.

We think this is the result of a number of factors. First, it could be down to a reversal in credit markets that had rallied for several months as part of a 'hedge the US' rotation trade. Perhaps more concerning, this could also reflect a change in expectations for the macro environment. Whereas the US is a net exporter of energy, Europe imports about 60% of its energy needs from abroad, with oil comprising 70% of that.<sup>4</sup> The combination of the supply-shock-driven spike in inflation and an increase in interest rates raises the spectre of stagflation in Europe. As such, it would make sense to see a sell-off in markets that had performed so well in the previous context of clear macro visibility.

<sup>3</sup> ICE BofA Indices. March 19, 2026.

<sup>4</sup> U.S. energy facts – imports and exports – U.S. Energy Information Administration (EIA); Energy in Europe: imports dependency – News articles – Eurostat.



# Spotlight

## From disinflation to reflation to stagflation?

We suspect that the spectre of stagflation exists in the UK as well. It's hard to see how a prolonged increase in borrowing costs and fuel prices would not put some degree of pressure on consumers and corporates.

### Contained credit spreads on the sidelines

If the conflict continues, we will likely see extended pressure on the global economy. The longer the effects of this supply shock last, the greater the potential for realised demand destruction. That is a credit-negative.

While this remains a concern, we do need to place the current geopolitical risks and supply shock in the context of the current macroeconomic and valuations. Spread moves have been relatively contained against a backdrop of almost historical tightness. As such, we'd have to see some spread-widening given the rupture to a supportive narrative for credit. This has been despite the risk of the Iran conflict affecting a wide circle outside the region economically, and potentially militarily.

We attribute this relatively contained reaction to three potential factors:

- First, macroeconomic conditions and solid corporate fundamentals were supportive of credit markets ahead of the attack.

- Second, there is less leverage in the financial ecosystem than there was ahead of the 2008–09 global financial crisis (GFC), largely due to enhanced regulatory supervision.<sup>5</sup>
- Third, the banking system is in decent condition, even as rating agency Moody's reports that US banks have exposure of approximately US\$300bn to providers of private credit—just under 3% of their loan book.<sup>6</sup>

While the risks attached to private credit and other non-bank financial institutions – at about 10% – are meaningful, they do look manageable. According to a separate report from Moody's, the vast majority of the US\$2tn in private credit sits with US institutional investors such as pension funds, endowments, foundations and family offices.<sup>7</sup> The extent to which this exposure is linked to systemic risks could act as a compounding factor, rather than a leading one. In the meantime, credit markets are functioning in an orderly manner and – with 'hyperscalers'<sup>8</sup> hitting the market with huge deals – remain open for business.

One interpretation of all of this is that credit markets are siding with the prospect of a shorter conflict over a prolonged campaign. We have seen only modest spread-widening across global credit markets as shown in Figure 3. Although we have seen a return of new issue premiums, for

higher quality credits, the markets are open. Online retailer Amazon, for instance, has issued over US\$50bn in corporate bonds in the midst of the current uncertainty, including a €14.5bn tranche. Collectively this was the largest corporate bond ever issued.<sup>9</sup> In global high yield, Electronic Arts issued US\$8bn in bonds across the US and Europe on 24 March.

So, what are the potential catalysts for more pronounced pressure on credit markets?

It's likely that the main driver for credit spreads rallying in 2025 – market technicals, or the balance of supply and demand of credit risk – will be the main driver of credit spreads in 2026.

If institutional investors start cutting their strategic asset allocation to credit, then we could see some proper selling, and more material widening. On the one hand, all-in yields are looking even more attractive. This could actually see institutional investors adding to credit.

As for the supply side, JP Morgan is predicting approximately US\$600bn of capital expenditure (capex) spend by the hyperscalers in 2026 and about the same for 2027.<sup>10</sup> This could put pressure on investment grade spreads as this capex financing will be drawn from debt capital markets.

<sup>5</sup> [WWW.KANSASCITYFED.ORG/RESEARCH/BANK-CAPITAL-ANALYSIS](http://WWW.KANSASCITYFED.ORG/RESEARCH/BANK-CAPITAL-ANALYSIS); Citi Velocity.

<sup>6</sup> [US banks' private credit loan exposure nears \\$300 billion.](#)

<sup>7</sup> <https://www.economy.com/getfile?app=download&q=2107637A-C535-4AFF-83BC-6CBA1AD1FAB9>

<sup>8</sup> [Financing the AI infrastructure boom: on- and off-balance sheet borrowing.](#)

<sup>9</sup> [Amazon makes market history with largest corporate bond sale ever | IFR](#)

<sup>10</sup> JP Morgan. Email to clients: "Everything Hyperscalers: Issuance Expectations / Fundamental Views / RV". February 13, 2026.



# Spotlight

## From disinflation to reflation to stagflation?

The extent to which the US and Israel continue their military excursion into Iran remains to be seen. With one eye on the US mid-term elections in November, and the other on public opinion,<sup>11</sup> US President Donald Trump may seek to de-escalate the conflict sooner rather than later. That being said, the price of crude is not entirely under Washington's control and we could very likely be in a 'higher for longer' oil price scenario. This is our base case.

### Trade headlines to your peril

Headlines have been plentiful, inconsistent and erratic. Away from the tragic humanitarian fallout from the war, there has been so much speculation about the conflict that the flow of news has become almost banal. In this environment, investors could lose ground almost instantly for taking a tactical position, while crossing bid-offer spreads could consume performance from rapid trading, given the contained market moves in spreads.

From a strategic perspective, we are reluctant to degrade our higher-quality credit book until we have more clarity on market technicals and to what extent, and for how long, oil remains above US\$80 a barrel. The market is functioning fairly well considering that the lifeblood of the global economy – oil – has been put in a chokehold.

That being said, we are disinclined to chase default risk for its value should credit markets shut their doors and those in need of refinancing be left out in the cold. We have taken some profits on our credit options book where those specific options have reached their maximum efficiency, while those options with attractive gamma profiles remain in place. To some extent, we hope we won't need them.

<sup>11</sup> [Just one in four Americans say they back US strikes on Iran, Reuters/Ipsos poll finds | Reuters](#)



# Fundamentals



Introduction/Commentary

Spotlight

**Fundamentals**

Credit relative value

# Fundamentals

## The outlook for credit in the context of a supply shock to the system

The Multi-Asset Credit Strategy Meeting (MACSM) committee modestly downgraded its outlook for the macro backdrop and for corporate fundamentals at its last outing. We had been slightly constructive on both factors for credit. However, concerns over the prospects for demand destruction; a weaker consumer and higher costs for capital pushed us in the other direction.

The committee also became more cautious on technicals. Although the investment grade (IG) market is open and functional, recent outflows from high yield could lead to some selling (though this has not been the case so far). The absorption of new issues shows that technicals are still sound.

Even so, it's fair to say technicals have degraded somewhat compared to the strength of 2025. Sentiment has also clearly deteriorated to some degree as well. However, the value

proposition of credit has become more attractive with the gap in all-in yields, which has led to an increase in the score for valuations despite the increase in geopolitical risk. In pulling all of these factors together, the committee modestly downgraded its overall score for credit.

We will remain fully invested in higher quality credit. We will, however, resist chasing yield with the belief that lower-quality credit would be vulnerable to rising costs of capital and in the case that primary credit markets become more challenging.

Investors are increasingly pricing in a protracted conflict in the Middle East that looks set to cause extensive economic damage. Given the absence of any concrete signs of de-escalation, oil prices are staying elevated – which, in turn, has raised the risk of a broader stagflationary shock. It's also looking less likely that the disruption to shipping and energy

infrastructure will prove only temporary. The longer the oil spike persists, the higher the downside risks to global growth and, ultimately, corporate earnings and fundamentals.

Risk premia have increased across the board but credit markets have arguably been more sanguine than equity and rates markets. In terms of the latter, the US has held up much better than Europe and emerging markets (EM), which tend to be more energy sensitive.

At the same time, credit markets remain principally open and functional. This supply shock event is unfolding in the context of a constructive macro backdrop and relatively low financial leverage in the financial system, preventing the transmission of geopolitical risk to systematic risk. Most importantly, the conflict is still somewhat regulated.



# Credit relative value



Introduction/Commentary

Spotlight

Fundamentals

**Credit relative value**

# Credit relative value

## Credit

Government bonds have not served as safe havens as the war skews the shock toward inflation and wider budget deficits. We are currently sticking with our defensive playbook across credit, favouring quality, and US dollar-denominated risk assets (both at the issuer and security level).

In terms of sectors, we find that Energy, Utilities and Healthcare tend to do well during stagflationary episodes, while Financials, technology, media, telecommunications and consumer goods do not. It makes sense, therefore, to be moderately underweight risk overall but agile until we have more clarity on the longevity and severity of the conflict, as we think there is likely to be more downside risk which is currently not priced in.

## Financials

March has been a challenging month for subordinated financials.<sup>12</sup> The impact of the conflict on Europe (which is vulnerable to oil price spikes) and the rates sell-off have pushed the perpetual part of the capital structure wider, unwinding year-to-date performance.

There has been a sharp correction in bank equity, but some of these shares have doubled in value over the last 12 months. The Additional Tier 1 (AT1) primary market also remains accessible, as demonstrated by the recent HSBC<sup>13</sup> and Danske Bank<sup>14</sup> transactions which attracted healthy demand.

Sector fundamentals remain positive. In this month-to-date widening, we do not see anything untoward from an idiosyncratic perspective. Rather, we see the move in subordinated financials as a correction on an otherwise robust two-year period in Europe.

## Asset-backed securities (ABS)

ABS has remained steady in the face of heightened volatility following geopolitical developments. AAAs have softened only marginally, with a little more widening in mezzanine but the moves have been limited and contained by significant demand from investors. An allocation to ABS in multi-asset portfolios is potentially positive for returns in periods of volatility.

Looking ahead, the outlook has changed somewhat since the beginning of the year. The AI disruption story will persist as developments in the technology continue and we uncover pockets of vulnerability. At the same time, the current geopolitical uncertainties are giving rise to higher inflation and higher rates concerns along with the potential for slower growth. Any uptick in unemployment and rates will be a knock to the consumer and we could see deterioration in the performance of ABS transactions as a result.

However, as a mitigant, savings ratios across Europe and the UK have remained elevated, post pandemic, suggesting the consumer has a buffer to see them through some of that potential downturn.

## Collateralised loan obligations (CLOs)

In the first quarter of 2026, CLOs (along with leveraged loans) have led the way wider in credit markets. Even before the conflict in the Middle East, leveraged loans were showing signs of weakness, particularly in credits believed to be most at risk from artificial intelligence (AI) replacement. The software sector took the brunt of the sell-off, but the ripples of uncertainty around AI disruption could be felt in other sectors in the leveraged loan space as well.

CLOs, as the largest buyer of leveraged loans, also repriced wider over the quarter, having started 2026 in bullish territory that took us to multi-year tightness across tranches.

While loans and CLOs repriced, there was much less of this widening seen in investment-grade and high-yield corporate credit until after the beginning of the conflict.

The sell-off in loans results in deterioration of the credit metrics of existing CLO portfolios. However, at the same time, it can benefit those CLOs looking to ramp up assets and print new deals with loans now being bought at lower cash prices.

<sup>12</sup> Tier 2 capital

<sup>13</sup> [HSBC launches US\\$2.5 billion AT1 bond issue in Hong Kong after market standstill | South China Morning Post](#)

<sup>14</sup> [Debt issues](#)



**The value of investments and income from them may go down as well as up, and you may not get back the original amount invested. Past performance is not a reliable indicator of future results.**

**This is a marketing communication.** The views and opinions contained herein are as of the date indicated above, are those of author(s) noted above, and may not necessarily represent views expressed or reflected in other communications, strategies or products. These views are as of the date indicated above and are subject to change based on market conditions and other factors. The information herein is believed to be reliable, but Federated Hermes and its subsidiaries, does not warrant its completeness or accuracy. No responsibility can be accepted for errors of fact or opinion. This material is not intended to provide and should not be relied on for accounting, legal or tax advice, or investment recommendations. This document has no regard to the specific investment objectives, financial situation or particular needs of any specific recipient.

This document is published solely for informational purposes and is not to be construed as a solicitation or an offer to buy or sell any securities, related financial instruments or advisory services. Figures, unless otherwise indicated, are sourced from Federated Hermes. Federated Hermes has attempted to ensure the accuracy of the data it is reporting, however, it

makes no representations or warranties, expressed or implied, as to the accuracy or completeness of the information reported. The data contained in this document is for informational purposes only, and should not be relied upon to make investment decisions.

Federated Hermes shall not be liable for any loss or damage resulting from the use of any information contained on this document. This document is not investment research and is available to any investment firm wishing to receive it. The distribution of the information contained in this document in certain jurisdictions may be restricted and, accordingly, persons into whose possession this document comes are required to make themselves aware of and to observe such restrictions.

**United Kingdom: For Professional investors only.**

Distributed in the UK by Hermes Investment Management Limited ("HIML") which is authorised and regulated by the Financial Conduct Authority. Registered address: Sixth Floor, 150 Cheapside, London EC2V 6ET. HIML is also a registered investment adviser with the United States Securities and Exchange Commission ("SEC").

**European Union: For Professional investors only.**

Distributed in the EU by Hermes Fund Managers Ireland Limited which is authorised and regulated by the Central Bank of Ireland. Registered address: 7/8 Upper Mount Street, Dublin 2, Ireland, DO2 FT59.

**Australia:** This document is for Wholesale Investors only. Distributed by Federated Investors Australia Services Ltd. ACN 161 230 637 (FIAS). HIML does not hold an Australian financial services licence (AFS licence) under the Corporations Act 2001 (Cth) ("Corporations Act"). HIML operates under the relevant class order relief from the Australian Securities and Investments Commission (ASIC) while FIAS holds an AFS licence (Licence Number – 433831).

**Japan:** This document is for Professional Investors only. Distributed in Japan by Federated Hermes Japan Ltd which is registered as a Financial Instruments Business Operator in Japan (Registration Number: Director General of the Kanto Local Finance Bureau (Kinsho) No. 3327), and conducting the Investment Advisory and Agency Business as defined in Article 28 (3) of the Financial Instruments and Exchange Act ("FIEA").

**Singapore:** This document is for Accredited and Institutional Investors only. Distributed in Singapore by Hermes GPE (Singapore) Pte. Ltd ("HGPE Singapore"). HGPE Singapore is regulated by the Monetary Authority of Singapore.

BD017432 0019965 02/26