Fixed Income asset class overview

February 2026

M&G Investments

Markets delivered strong performance over the month, supported by broadly positive macroeconomic data. US labour market indicators surprised on the upside, while core PCE inflation continued to appear sticky. Despite robust economic indicators, the technology and software sectors came under pressure, while further uncertainty was added by the US Supreme Court decision to strike down the administration's tariff implementation mechanism.

Month in review

In the US, January payrolls showed the largest monthly increase (+130K) since December 2024, after successive downward revisions of the monthly data in 2025. However, looking under the surface, around 90% of the jobs created at the start of this year were in healthcare and social assistance. Interestingly, looking back at the December 2025 figures, removing healthcare shows much weaker job growth in January 2026 -- so this is an area to monitor.

The ISM Manufacturing Index reached its highest level since 2022, according to data by brokerage house XTB, reflecting growing optimism amongst the sectors. Inflation continues to be sticky as core PCE inflation (3.0%) was marginally above market forecasts in December; in response, futures markets lowered the implied probability of a June rate cut to 64% from 87% earlier in the month. Interestingly, the Truflation index, which measures inflation in real time using extensive datasets rather than surveys and has historically had a very strong correlation with CPI, suggests that US inflation is more like 1.5%.

Although economic indicators were broadly robust, the technology and software sector came under pressure this month. Software companies led the selloff that later extended to some of the large US tech names, with the 'Magnificent 7' group falling by c. 7% in the equity market.

Credit spreads in these sectors widened, reflecting a range of factors including the major capex related to investment in AI, which has been partially funded by significant issuance in the bond market. Sectors such as software, legal and wealth management displayed concerns around the sustainability of their business models amid rapid advancements in AI.

Adding to the global uncertainty, the US Supreme Court struck down the administration's tariff implementation mechanism, prompting President Trump to announce a 10% blanket tariff on global imports, with signals that this could rise to 15%, under a different law. Markets are assessing what this means for inflation, supply chains and the potential response for global trading partners.

Japan's snap election delivered a strong majority for Prime Minister Sanae Takaichi. The clear outcome provided reassurance around policy continuity, which supported Japanese markets. Bond yields moved lower, with 10-year government bond yields falling for the first time in eight months.

While February market performance does not reflect the recent conflict involving the US, Israel, and Iran, it does include concerns about escalating tensions, which pushed oil prices higher in advance. Brent crude reached seven-month highs as investors weighed the possibility of supply chain disruptions.

Investment grade (IG) credit entered February at historically tight spread levels against a backdrop of high volatility. Concerns over an emerging AI-driven tech disruption and geopolitical tensions triggered a "risk-off" environment later in the month, causing government bond yields to fall while credit spreads widened modestly.

Regionally, UK IG experienced a 10 bps spread widening, but a strong gilt rally drove a 1.3% total return; issuance was notably heavy at around £10 billion, making it the busiest month since September 2024.

Euro IG and US IG saw slight spread drift from historically tight levels. Total returns were positive across the board, supported by falling government bond yields. IG displayed a strong number of issuances for the month, particularly euro IG where bond issuance reached c. €73 billion, a very high volume at the end of the month. Total returns were positive across the board, supported by falling government bond yields.

High yield (HY) had a mostly risk-off tone, set in part by tech and AI contagion concerns. The Global HY Index returned 0.3% for February. Regionally, EU HY outperformed US HY (0.4% versus 0.2%), supported by better technicals and lower direct exposure to the sectors facing the sharpest repricing. HY floating-rate notes (FRNs) were marginally negative (-0.2%), underperforming fixed-rate HY as technical pressures pushed spreads wider. However, FRNs continued to fare better than their closest peer group – leveraged loans, which fell 0.9% in February – largely due to the much heavier representation of software in the loan market. Technology was the standout underperformer, driven by the global software sector sell-off that accelerated in February amid concerns over newly released AI tools and softer fundamentals. For context, tech represents around 4% of the Global HY Index, with software accounting for just 2.5%, a much smaller footprint than in leveraged loans (13%) or in BDC (Business Development Companies -- publicly traded investment companies that lend money to small and mid-sized private companies) portfolios (22%), helping to contain the impact within HY.

Emerging market (EM) debt posted another month of gains, defying a choppy geopolitical backdrop and a late-month softening in risk appetite. Investors spent much of the period weighing steady macroeconomic fundamentals against rising geopolitical noise. Despite geopolitical concerns, EM assets remained broadly resilient, and local currency sovereigns once again outperformed their hard currency peers as EM FX held firm. The broad trend across the month is that sovereign bonds rallied while credit spreads widened, bar a few exceptions. Hard-currency sovereign bonds delivered a 1.4% return in February, with falling rates contributing +210 bps, while spreads widened modestly, detracting -70 bps.

The overall spread picture was softer, but pockets of country-specific strength persisted, led by Venezuela, Senegal and Bolivia. By contrast, Ethiopia, Mozambique and Gabon saw the sharpest widening, highlighting the ongoing dispersion beneath headline index moves. Hard currency corporate bonds continued to lag sovereigns, consistent with much of 2025. Their performance was driven by rates, which added +148 bps, while spreads shaved off -56 bps.

Developed market sovereigns

February was a strong month for government bonds, but with renewed divergence across developed sovereign markets (DM), driven by contrasting fiscal dynamics. Broadly, yield curves bull flattened over the month, with long end yields supported by safe-haven demand and the front end being anchored by cautious central banks. The US Supreme Court ruled the April 2025 "Liberation Day" tariffs illegal led to the EU pausing the process of finalising the trade deal agreed with the US last year.

Japanese government bonds (JGBs) were among the most volatile over the course of February. Prime Minister Takaichi's decisive victory in the 8 February snap election revived expectations of aggressive fiscal expansion. In spite of this, JGB yields fell as the market rebalanced following the aggressive selling seen in the first half of January. The 10-year JGB yield fell for the first time in eight months, with long-end JGB yields down markedly more sharply.

Markets were mostly closed on 28 February when the US and Israel began to strike Iran, so the subsequent reaction will be included in the March review. However, geopolitical concerns were priced in throughout the month, with Brent Crude up 2.5% and WTI up 2.8%. Precious metals continued their strong performance. Gold rose 7.9% and silver 10.1%.

US consumer price inflation fell to 2.4% in January, below expectations. It is possible that the threat of a resurgence in inflation in the US is being overstated.

US Treasuries posted a significant gain of 1.9% at an index level, and the 10-year yield fell by 30 bps to 3.9%, the biggest monthly decline for a year. The market feels like it is starting to price policy credibility risk, rather than near-term inflation risk.

In the euro area, sovereign bonds performed well with the German bund index returning a healthy 1.4% and the 10-year Bund yield experiencing its biggest decline since April 2025, falling 20 bps to 2.6%. Some of this was driven by increased strategic demand for euro assets as investors look to diversify away from the US dollar.

The European Central Bank (ECB) kept rates on hold at 2.0% in line with expectations. Very little movement in the ECB policy rate is priced in to the end of the year. However, with inflation looking stable, at just below target, and sluggish growth, perhaps this is being underpriced.

In the UK, inflation was 3.0% as expected. The Bank of England expects that CPI inflation will be back at target by late spring. Inflation falling towards target faster than expected and continued concerns around lagging growth led to a bull flattening of the curve.

There was political uncertainty over the month regarding Prime Minister Keir Starmer's position. This has led to caution over long end gilts, with any potential successor likely to be less friendly towards the bond market.

Gilts performed strongly over the month, returning 2.4% at index level.

Past performance is not a guide to future performance.

Government bond total returns (in local currency)

	10-year yield %	Total return % (1m)	Total return % (ytd)
Treasuries	3.9	1.9	1.9
Bunds	2.6	1.4	1.8
Gilts	4.2	2.4	2.3

Source: Bloomberg, 28 February 2026

Investment grade credit

Coming into February, IG credit spreads were around their tightest levels in decades. Against this starting point, February brought a burst of volatility. Concerns over an emerging AI-driven tech disruption and geopolitical tensions triggered a risk-off environment later in the month, causing government bond yields to fall while credit spreads widened modestly from their lows.

In US IG, a late-month flight-to-quality rally in Treasuries coincided with a modest widening of US IG credit spreads. Even so, the overall widening was limited – investment-grade credit outperformed riskier assets like loans and high-yield, which saw more pronounced selloffs. Strong inflows and the prior tightening cushion helped the market weather a flurry of new issuance and late-month volatility, with only a few basis points of spread widening into early March.

A major theme in Europe was heavy primary market activity. Euro-denominated IG bond issuance in February reached about €73 billion, a very high volume for the shortened month. Despite this influx of paper, the market absorbed deals relatively well – new issue concessions remained reasonable, though investors did demand slightly higher new issue premiums compared to January. Spreads are still near multi-year tight levels, supported by strong inflows and ECB tailwinds.

The sterling investment grade corporate market had a more challenging February relative to its euro and USD counterparts. Spreads widened by 10 bps in the month. However, thanks to a substantial rally in UK gilts, sterling IG delivered a strong total return of 1.3% for the month. February was exceptionally busy for sterling IG issuance. Approximately £10 billion of sterling IG bonds priced during the month, making it the busiest month for sterling IG supply since September 2024.

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Investment grade total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US IG	86	1.3	1.6
Euro IG	82	0.6	1.4
UK IG	90	1.3	1.6

Source: Bloomberg, 28 February 2026

High yield credit

It was an eventful month for HY with a mostly "risk-off" tone set, in part, by tech and AI contagion concerns. Technology was the standout underperformer, driven by the global software sector sell-off that accelerated in February amid concerns over newly released AI tools and softer fundamentals.

After the busiest January on record, primary market slowed in February with AI disruption fears weighing on issuance and risk appetite. Having said that, most deals continued to price at or inside the tight end of guidance.

Outlook

- Valuations remain fair in our view and are supported by a constructive macroeconomic backdrop, with HY spreads still at historically tight levels reflecting a broadly positive outlook – particularly in the US, where growth could potentially benefit from fiscal support and expectations of Fed easing.
- We believe the software sector impact is contained. Software is a very small component of the public HY universe in both the US and Europe, which has helped keep recent software sector volatility largely contained within HY credit. The more meaningful repercussions have been felt in leveraged loans, where exposure to software and SaaS (software as a service, usually accessed online via subscriptions) issuers is materially higher and the correction has resulted in more pronounced price moves and dispersion. We selectively added exposure to software during the sell-off – names we view as relatively defensive in the context of AI disruption
- Defaults are expected to remain benign. Default activity has ticked up modestly but is concentrated in isolated distressed exchanges. Broader distress levels remain low and consistent with a sub 3% default rate over the next 12–18 months, in our view supported by generally healthy corporate fundamentals. With spreads compressed, avoiding issuer-specific risk is paramount – an area where our analyst team continues to add significant value.
- Cautious, balanced positioning – we maintain disciplined stock selection. Valuations are not compelling enough for us to materially increase risk, but the constructive macroeconomic backdrop does not justify being underweight either, given the importance of carry. Key risks to monitor include any reacceleration in inflation driven by accommodative fiscal conditions and a more compliant Fed. Our risk stance remains anchored in fundamental, bottom-up, value-driven security selection, keeping us fully engaged while preserving flexibility to capitalise on market dislocations.

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High yield total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US HY	312	0.2	0.6
Euro HY	287	0.4	1.1

Source: Bloomberg, 28 February 2026

Emerging market bonds

EM debt posted another month of gains, defying a choppy geopolitical backdrop and a late-month softening in risk appetite. Investors spent much of the period weighing steady macroeconomic fundamentals against rising geopolitical noise, including mounting expectations of a US strike on Iran, an event that ultimately took place on the last day of the month. Adding to the global uncertainty, the US Supreme Court struck down the administration's tariff implementation mechanism, prompting President Trump to announce a 10% blanket tariff on global imports, with signals that this could rise to 15%. Despite these developments, EM assets remained broadly resilient, and local currency sovereigns once again outperformed their hard currency peers as EM FX held firm. The broad trend across the month, across the major indices, is that rates rallied whilst spreads stuttered, bar a few exceptions.

Hard currency sovereign bonds delivered a 1.4% return in February, with falling rates contributing 210 bps while spreads widened modestly, detracting 70 bps. The overall spread picture was softer, but pockets of country-specific strength persisted, led by Venezuela, Senegal and Bolivia. By contrast, Ethiopia, Mozambique and Gabon saw the sharpest widening, highlighting the ongoing dispersion beneath headline index moves. Hard currency corporate bonds continued to lag sovereigns, consistent with much of 2025, returning 0.9%. Their performance was driven by rates, which added 148 bps, while spreads shaved off 56 bps. Sector performance favoured oil & gas and industrials, both of which benefited from firmer commodity prices among markets beginning to take some price action ahead of expected escalation in Iran and the Middle East region.

Past performance is not a guide to future performance.

Emerging market bonds total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
Local currency government	n/a	1.3	3.5
Hard currency government	267	1.4	2.1
Hard currency corporate	242	0.9	1.7

Source: Bloomberg, 28 February 2026

Currencies

The US dollar staged a firmer performance over the month, with the DXY rising 0.64%, reversing part of January's softness. Early indications suggest this momentum is likely to extend into March, supported by the renewed bid for safe-haven assets. The strengthening, however, was far from uniform. Among G10 currencies, the US dollar appreciated notably against the Australian dollar, Norwegian krone and Swiss franc, but weakened against most others including the British pound, which strengthened 1.5%.

A similarly mixed pattern emerged across EMs: while the majority of EM currencies posted gains, particularly in Latin America and parts of Asia, where carry and improving domestic fundamentals continue to attract inflows, pockets of weakness persisted in markets more sensitive to geopolitical risk and higher energy prices. It was also a month when typically low yielders performed well, including the Chinese renminbi, Thai baht, and Taiwanese dollar. The Colombian peso saw the largest depreciation, followed by the Turkish lira.

Key currency pairs

	Change % (1m)	Change % (ytd)
GBP/USD	-1.5	0.1
GBP/EUR	-1.2	-0.5
EUR/USD	-0.3	0.6

Source: Bloomberg, 28 February 2026

The value of investments will fluctuate, which will cause prices to fall as well as rise and you may not get back the original amount you invested.

The views expressed in this document should not be taken as a recommendation, advice or forecast.

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