Fixed Income asset class overview

September 2026

M&G Investments

The dominant theme in September was the ongoing tensions between the US and Iran surrounding the Strait of Hormuz, which had a knock-on effect on oil and gas prices. Brent crude rose from around $90/bbl at the start of the month to above $100/bbl at various points during the period. Higher energy prices renewed concerns around inflation and stagflation, given their direct impact on inflation expectations.

Month in review

The fears surrounding the conflict in Iran were not reflected in broader economic data, which continued to demonstrate resilience across major economies. In the US, labour market conditions remained firm, consumer spending exceeded expectations and business activity indicators pointed to stronger growth momentum. Similar trends were evident across Europe, while in Japan, robust wage growth reinforced the view that economic conditions remained strong enough to support additional policy tightening. In contrast, the UK economy presented a mixed picture during the month. While some activity data showed pockets of resilience, labour market indicators softened and inflation remained a key concern, leaving the outlook uncertain.

September saw a large market sell off in developed market sovereign bonds globally. For all the sensationalist headlines describing a 'global bond crisis', we believe that this is simply a significant sell off. In historical context, yields are high, but still within the normal range. The 2010s period of rates around the zero bound was the unusual period. With yields at these levels, we believe that a lot of bad news has been priced in, unlike in credit and equity markets. We see this as a buying opportunity and a chance to lean into duration. All four major central banks had a policy meeting this month. The tone was hawkish: the Federal Reserve (Fed) hiked 25 bps to 4.0%, the European Central Bank (ECB) hiked 25 bps to 2.50%, the Bank of England (BoE) held hawkishly at 3.75%, and the Bank of Japan (BOJ) hiked 25 bps to 1.25% - the highest base rate since 1995.

It was also a difficult month for risk assets as volatility in government bond markets finally began to spill over into credit. While spreads remained relatively resilient, lower-rated credits, longer-dated bonds and more rate-sensitive sectors came under pressure. Market technicals remained supportive due to lower-than-expected issuance, helping to offset weaker fund flows. However, with valuations still appearing disconnected from broader macroeconomic and geopolitical risks, investors grew increasingly cautious towards month-end. US and European investment grade (IG) markets both weakened, particularly in BBB-rated issuers, while sterling credit proved relatively resilient against a more supportive supply backdrop.

This fed through into high yield (HY) markets with both US and European HY markets delivering negative returns, although European high yield outperformed its US counterpart as Treasury yields moved sharply higher. In contrast, floating-rate high yield demonstrated its defensive characteristics, benefiting from strong carry and limited interest rate sensitivity, and delivering positive returns despite broader weakness across fixed income markets. While spreads widened across regions, corporate fundamentals remained largely resilient, with negative returns driven primarily by higher government bond yields rather than any meaningful deterioration in credit quality. HY primary issuance was exceptionally active in both the US and Europe over September. The month saw the usual amount of refinancings, but the standout theme was a sizeable amount of M&A and capex driven financings keeping issuance levels heightened.

Emerging market (EM) debt faced a more challenging backdrop during September as higher oil prices, rising US Treasury yields and renewed geopolitical tensions weighed on sentiment. The dominant theme was the Middle East and its impact on energy markets. Escalating tensions involving Iran, the Strait of Hormuz and Saudi energy infrastructure repeatedly drove volatility in oil prices, while ongoing diplomatic efforts prevented investors from fully pricing in a worst-case scenario. This created a clear divergence across EM, with commodity exporters generally benefiting from stronger external accounts and fiscal support, while energy importers faced renewed inflation and balance-of-payments pressures. More broadly, the month reinforced the sensitivity of EM performance to energy markets despite improving domestic fundamentals across many countries.

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Developed market sovereigns

In September, yields were elevated across developed market (DM) sovereigns. We believe the current environment to be an attractive entry point into the asset class. Despite high levels of volatility in government bond markets over the last few years, we believe that the risk-reward dynamics in DM sovereigns are compelling. We are much closer to the ceiling than the floor in terms of where yields can go. Despite inflationary pressures, we do not foresee a 2022 inflation type scenario. Indeed, the moves in nominal yields have been driven by higher real yields with breakevens. Should growth come under serious pressure as a result of long term tight monetary policy, sovereign bonds may offer a good hedge to risk assets.

Over the month in the US, the August CPI came in line with expectations at 3.4%. Unemployment remained steady at 4.1%, but stronger than expected payrolls data led to real yields rising. The US economy is the hottest in the DM world at the moment, and this has contributed to the 10-year Treasury rising more than 50 bps over the month to 5.3%. Despite higher rates for a significant period, nothing seems to be cooling this economy at the moment.

There were also significant moves in the curve, with the flattening being led by front-end yields rising considerably. At its most extreme over the month, the 5s30s spread, the difference in yield between 5-year Treasuries and 30-year Treasuries, had flattened by c.30 bps. This led to many strategies moving out of the long-end into shorter-dated bonds given the move.

In the euro area, inflation seems to be ticking up. This was particularly marked in Spain where September flash numbers have reached 4.9%, Italy which jumped from 3.3% in August to 4.2% in September and increasing numbers in France and Germany. 10-year bund yields reached 3.57%, the highest level since 2009. France is under increasing fiscal and political pressure, with the spread over bunds widening from 80 bps to 117 bps in September.

In the UK, CPI rose from 3.1% to 3.3% in August. The Monetary Policy Committee (MPC) expects inflation of 3.75% in Q4 and for this to breach 4% in early 2027. Energy is the main driver behind this.

In September, the 10-year gilt hit 5.38%, the highest level since 2007, with the 30-year reaching 5.95%, the highest level since 1998. The curve flattened considerably driven by front-end yields selling off given the increased chance of the Bank of England (BoE) hiking.

The focus in October will be Chancellor Healey's first Budget.

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	5.3	-2.3	-2.7
Bunds	3.6	-1.2	-2.2
Gilts	5.4	-1.2	-2.5

Source: Bloomberg, 30 September 2026.

Investment grade credit

As for all risk assets September was a tricky month for investment grade (IG) credit. Spreads have remained resilient despite the volatility in rates. But not all sectors are equally resilient. Concerns were warranted with markets watching for any signs of spread curves steepening, rate sensitive sectors widening and lower rated credits decompressing. It feels like the cracks we have long anticipated have started to appear.

Perhaps one silver lining of the recent rates volatility is that September issuance is running below seasonal norms. Mutual fund flows have also turned marginally negative so the pull back in issuance helps support market technicals. Demand had outstripped supply fuelled by passive vehicles, thus forced buyers have stabilised credit markets and perhaps continue to do so. We have had widening over September, but nothing particularly significant versus history.

The market's concern is that credit funds seem mostly short, perhaps anticipating a reversal of the narrative discussed above and passives become forced sellers, starting a wave of widening. In a technically driven market (as IG credit has been for almost two years), and where pricing is just not reflective of market and geopolitical dynamics, you cannot but wonder when the rubber band breaks and things really start to move (as they have done in rates recently).

In the US IG market, September was a grind until the last week of the month. US IG spreads widened by 4 bps in the last week alone, resulting in an excess return of -0.3%. The credit curve saw broad based widening across all maturities with 3-5-years leading the underperformance, while BBBs underperformed across ratings. Media and Tech underperformed, while services and energy held in better. USD underperformed generally with the credit curve shape steeper and longer dated bonds suffering on duration as well as credit excess. This led to greater monthly declines.

Similarly to US, EUR credit was holding out until the last week of the month. EUR IG outperformed the US in the last week with spreads widening by 3 bps, leading to excess returns of -0.14%. The credit curve bear flattened, while BBBs underperformed slightly. Autos and leisure lagged, while energy and telecoms held up better. EUR IG funds reverted to inflows, rising to ~$1.3 billion (0.18% of AUM) following four consecutive weeks of net outflows. EUR slightly shorter-dated bonds and less aggressive long-end

moves provided a bit of protection relative to the US this month, but still produced negative returns over all.

September is usually a bumper month of issuance. The cost of credit hasn't changed but the cost of borrowing has, therefore GBP credit (thanks to a massive issuance form Amazon) has held up, whilst USD and EUR are dramatically lower versus history.

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Investment grade total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US IG	**84**	**-2.6**	**-2.8**
Euro IG	**89**	**-1.4**	**-1.2**
UK IG	**88**	**-1.3**	**-1.1**

Source: Bloomberg, 30 September 2026.

High yield credit

Global high yield (HY) returned -2.3% (USD hedged), US HY returned -2.5% and -1.6% (USD hedged) for European HY. Performance between major players has reversed over the month, with European HY outperforming its US counterpart. A more hawkish Fed outlook, resilient US economic data and renewed inflation concerns pushed Treasury yields sharply higher as markets increasingly priced a higher-for-longer policy path. The resulting sell off in government bonds weighed on US credit markets, with US HY spreads widening more than those in Europe. The Fed subsequently delivered its first rate hike since 2023, validating much of the repricing that had already taken place in markets.

Against this backdrop, floating rate high yield once again demonstrated its defensive characteristics with HY floating rate notes (FRNs) returning 0.1% over the month. The asset class continued to benefit from strong carry and minimal interest rate sensitivity, features which helped it deliver positive returns despite broader weakness across fixed income markets. The contrast between floating- and fixed-rate high yield was particularly evident during September as duration, rather than credit fundamentals, became the dominant driver of returns.

Inflation remained the defining theme of the month. Higher energy prices, ongoing geopolitical tensions and concerns around future central bank policy contributed to a broad risk off move across fixed income markets. While spreads widened across regions, corporate fundamentals remained largely resilient, with the negative returns driven primarily by higher government bond yields rather than any meaningful deterioration in credit quality.

Primary activity was exceptionally active in both the US and Europe over September. The month saw the usual amount of refinancings but the stand out theme was a sizeable amount of M&A and capex driven financings keeping issuance levels heightened.

HY FRNs – back in a sweet spot

Resilience through the rates sell-off: Rates have been under heavy pressure this year. Macro uncertainty, higher oil prices, supply-driven inflation fears and a hawkish repricing of central bank expectations have all pushed yields higher. The sell-off has hit fixed rate credit hard. Floating rate high yield has held up remarkably well, because its income resets with short-term rates rather than losing value as yields rise.

Highest yields in years, with a substantial cushion: The rates move has hurt fixed rate investors, but it has also lifted yields to multi-year highs. HY FRNs benefit most because they are anchored at the very front end of the curve. Running yields are close to 7.2% in EUR and 8.7% in USD, supported by high short-term rates and c.400 bps of spread. That income could absorb roughly a doubling of spreads before turning into a loss.

An effective diversifier: HY FRNs combine high income with virtually no interest rate sensitivity. That rare combination makes the asset class, in our opinion, an effective diversifier within a fixed income portfolio, particularly while the rates outlook stays uncertain.

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High yield total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
US HY	312	-2.5	0.0
Euro HY	311	-1.8	0.1

Source: Bloomberg, 30 September 2026.

Emerging market bonds

The dominant theme was the Middle East and its impact on energy markets. Escalating tensions involving Iran, the Strait of Hormuz and Saudi energy infrastructure repeatedly drove volatility in oil prices, while ongoing diplomatic efforts prevented investors from fully pricing in a worst-case scenario. This created a clear divergence across emerging markets, with commodity exporters generally benefiting from stronger external accounts and fiscal support, while energy importers faced renewed inflation and balance-of-payments pressures. More broadly, the month reinforced the sensitivity of EM performance to energy markets despite improving domestic fundamentals across many countries.

A second theme was the deterioration in the global rates backdrop. Strong US activity data, resilient inflation, and a

hawkish Fed pushed Treasury yields sharply higher through September. While stronger growth supported the broader risk environment, higher risk-free rates created a more difficult backdrop for EM credit, particularly in longer-duration assets. Investors' focus increasingly shifted towards carry, defensive positioning, and valuation discipline rather than broad beta exposure.

Geogrpahic differentiation became increasingly important. Investors continued to reward reform momentum, International Monetary Fund (IMF) engagement and fiscal adjustment while penalising political uncertainty and financing concerns. Senegal remained a major focus as discussions around debt treatment and IMF support evolved, while Colombia's fiscal consolidation plans attracted close scrutiny. Argentina's reform agenda remained broadly supportive, although investor enthusiasm moderated as political and implementation risks became more apparent. Across frontier markets, policy credibility increasingly drove performance outcomes.

Ultimately, September marked a shift towards a more selective market environment. While EM fundamentals remain broadly supportive, rising DM yields and geopolitical uncertainty have increased the importance of country selection. Investors appear increasingly focused on fiscal discipline, reform credibility and external resilience, suggesting active positioning rather than broad market exposure is likely to remain the key driver of returns into year-end.

Emerging market debt outlook

The outlook for emerging market (EM) debt remains broadly balanced with the asset class continuing to benefit from attractive all-in yields and generally supportive domestic fundamentals, but global macro headwinds are becoming increasingly influential in shaping performance.

A key risk is the shift in the US rates outlook. Stronger economic data, persistent inflation pressures, and a more hawkish Fed have increased the likelihood that interest rates remain higher for longer. This raises the prospect of a firmer US dollar and tighter global financial conditions, both of which have historically created a more challenging environment for EM.

Inflation also remains an important consideration. Elevated energy prices are likely to exert near-term pressure on inflation across many economies, while there is an increasing risk that higher food prices feed through into inflation over the medium term. This could slow the pace of policy easing in a number of countries and reduce some of the support markets had expected from lower interest rates.

That said, EM fundamentals remain relatively robust. Many central banks were ahead of developed market peers in responding to the post-pandemic inflation shock and continue to benefit from stronger policy credibility. Fiscal positions are generally healthier than in many developed economies, while external balances remain supportive across much of the opportunity set. EM economies also continue to exhibit stronger structural growth characteristics than most DMs.

As a result, we believe the key debate is less about EM fundamentals and more about the impact of an increasingly complex global environment. While higher US rates, a potentially stronger dollar and renewed inflation pressures may create periods of volatility, attractive yields and improving policy frameworks should continue to provide support. In this backdrop, country differentiation and active security selection are likely to become increasingly important drivers of returns.

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Emerging market bonds total returns

	Credit spread (bps)	Total return % (1m)	Total return % (ytd)
Local currency government	n/a	-2.1	0.6
Hard currency government	187	-3.3	-0.7
Hard currency corporate	171	-2.0	0.3

Source: Bloomberg, 30 September 2026.

Currencies

The USD has been strengthening in tandem with rising US Treasury yields, strengthening against most major currencies in September.

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Key currency pairs

	Change % (1m)	Change % (ytd)
GBP/USD	-2.1	-1.6
GBP/EUR	0.4	2.0
EUR/USD	-2.5	-3.5

Source: Bloomberg, 30 September 2026.



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