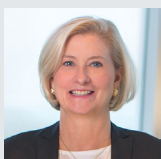


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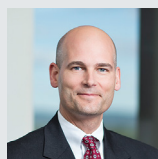
GLOBAL FIXED INCOME: THEMES TO WATCH IN 2026

Tight spreads meet elevated all-in yields as policy uncertainty, AI capex, and uneven growth set the stage. We see selective opportunities across High Yield, CLOs, IG Credit and EM Debt—with 2026 shaping up as a year for rigorous credit picking.

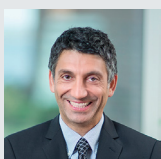
INSIGHTS



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2026 is shaping up to be a year defined by divergence: a corporate investment boom fueled by AI and infrastructure spending versus a labor market that has softened to levels not seen in a number of years; equity markets near historic highs even as parts of the consumer economy struggle; and a Federal Reserve navigating dissent on both sides of the policy spectrum.

Beneath the headlines, investors face a market where spreads are compressed across most sectors, yet all-in yields remain historically attractive thanks to higher base rates. This combination—tight valuations but elevated income—demands nuance. It is not a beta market; it is a market for precision: security selection, curve positioning, and risk budgeting. Against this backdrop, we explore four key segments—high yield, collateralized loan obligations (CLOs), investment grade credit, and emerging markets (EM) debt—where opportunities exist, but success depends on separating durable signals from transient noise.

High Yield: Quality Up, Spread Duration Down

High yield bond market enters 2026 amid a structural evolution that often goes underappreciated. While headline spreads hover near historical tights, the composition of the market has shifted dramatically since the global financial crisis. Back then, roughly 20% of the market was rated CCC or below; today, that figure is closer to 10%.¹ Meanwhile, BBs now represent about 60% of the index, up from 40% a decade ago.² This quality migration matters: it reduces aggregate credit risk and partially justifies tighter spreads.

Another critical metric is spread duration, which measures price sensitivity to changes in spreads. In 2022, spread duration in high yield was around 4.5 years; today, it is closer to three years.³ That decline means less price impact on the back of spread widening, improving the return-per-unit-of-volatility profile and bolstering the overall durability of the market. At the same time, all-in coupons remain fairly high, hovering near post-GFC averages thanks largely to elevated risk-free rates. Together, these three factors—a high-quality market, very low spread duration, and strong income—support a constructive outlook, even in an environment of compressed spreads.

DISPERSION IN THE MARKET

Still, risks remain. Economic divergences could amplify dispersion within the market. Consumer stress is concentrated in lower-income cohorts, while wealthier households—which drive roughly half of U.S. consumption—remain supported by equity gains. This dynamic makes equity markets a critical transmission channel for high yield fundamentals. A sharp correction in stocks or housing could ripple through credit more quickly than in prior cycles.

1. Source: ICE BofA. As of September 30, 2025.

2. Source: ICE BofA. As of September 30, 2025.

3. Source: ICE BofA. As of September 30, 2025.

Beyond macro linkages, sector specific vulnerabilities are emerging. Companies tied to discretionary spending, cyclical manufacturing, and lower tier retail may face margin pressure if wage growth slows or unemployment ticks higher. At the same time, technological disruption—particularly accelerated AI adoption—could challenge business models in service-heavy industries such as call centers and outsourced operations. These risks are not systemic today, but they underscore the importance of granular credit work. Distress cases such as Tricolor and First Brands illustrate this point and highlight how idiosyncratic risk can surface quickly. In First Brands’ case, opaque ownership structures, questionable working-capital ratios, and non-standard accounting practices raised red flags well before the company’s rapid deterioration. These examples reinforce that even in a higher-quality market, governance and transparency matter—and that active managers with deep credit research capabilities can avoid pitfalls others may miss.

ONE FINAL THOUGHT

Even with spreads near historical tights, structural improvements in market quality and lower spread duration provide resilience—but idiosyncratic risks underscore the need for disciplined credit selection.

CLOs: A Runway for Innovation

CLOs enter 2026 with structural tailwinds driven by innovation and evolving investor demand. On the innovation front, **European middle market CLOs**—virtually nonexistent two years ago—are now gaining traction, with reinvesting and multicurrency structures adding complexity and opportunity. For investors, middle market CLOs offer exposure to less trafficked credits with potentially higher spreads, while maintaining the structural protections of the CLO format. **Infrastructure CLOs** are another frontier, reflecting surging demand for capital tied to, among other areas, data centers, energy grids and transportation networks. CLO structures provide one of the most efficient ways for investors to gain access to diversified pools of high-quality assets with long term growth drivers at the risk and return profile of their preference.

CAPITAL STRUCTURE DYNAMICS

CLO performance and demand differ across the capital structure. **Equity investors** are focused on locking in today’s historically tight liability spreads. With AAA tranches near post-GFC tights, equity buyers see an opportunity to secure low-cost financing for the next 5–7 years.⁴ This allows them to reinvest into loans at spreads that, even if modestly compressed, still offer positive arbitrage. For **debt investors**, the calculus is different. All-in yields on CLO tranches have tightened significantly, especially in AAA and mezzanine tranches. For example, the spread differential between a BB CLO tranche and a BB corporate loan is roughly 250 bps—a gap that some investors view as insufficient compensation for structural complexity.⁵ As a result, demand at the debt level is increasingly selective, with investors scrutinizing tranche pricing relative to comparable risk in the loan market. Still, CLO debt offers diversification and structural protections that appeal to insurers, banks and pensions.

4. Source: JPM CLOIE index. As of 30 November 2025.

5. Source: Barings. As of October 2025.

The investor ecosystem also continues to broaden. Insurers remain anchor buyers at the top of the capital structure, drawn by favorable NAIC treatment and stable spreads. Banks, both money-center and regional, are increasingly active in AAA tranches, while pensions are viewing mezzanine and equity as diversifiers within alternatives buckets. Retail access is growing rapidly as well through ETFs, which have scaled from near-zero to roughly \$40 billion of AUM in just two years.⁶ This democratization of CLO exposure adds marginal demand that has contributed to the spread tightening environment, reinforcing the need for disciplined credit selection.

COLLATERAL ALPHA

With liability costs locked in and spreads at generational tights, the next leg of returns will not come from structural arbitrage—it will come from collateral alpha, or incremental returns generated through active credit selection and trading within the underlying loan pool. Managers will have to navigate idiosyncratic risks in leveraged loans, where dispersion is rising amid uneven consumer trends and technological disruption. Active trading, rigorous underwriting, and workout capabilities will undoubtedly define performance in 2026.

ONE FINAL THOUGHT

Innovation will continue to expand the CLO opportunity set, but 2026 will reward managers who excel at credit selection and active collateral management.

Investment Grade Credit: Barbell Curve, Select Niches

Investment grade corporates enter 2026 with a compelling mix of strong fundamentals and nuanced risks. Balance sheets remain robust, liquidity is ample, and management teams have demonstrated resilience through multiple shocks—from pandemic disruptions to supply-chain volatility. These characteristics underpin the asset class's role as a stabilizer in portfolios, even as spreads hover near generational tights.

One of the most striking themes today is the debate over whether top-tier corporates could trade inside U.S. Treasuries. Historically, Treasuries have been considered “risk-free,” but persistent fiscal deficits and questions around market liquidity have sparked comparisons: would you rather own a 10-year Treasury or a 10-year Microsoft bond? While the government can tax and print money, its debt-to-GDP trajectory and widening deficits contrast sharply with corporate issuers that often have negative net debt and cash reserves sufficient to retire all outstanding obligations. In a stress scenario, some AA and AAA corporates could see spreads compress to—or even through—Treasury levels, as has occurred in Europe and briefly in the U.S. before.

6. Source: ICE BofA. As of 3 October 2025.

THREE FOCUS POINTS FOR 2026

1. **Curve Strategy:** With spreads tight and volatility subdued, portfolio strategy matters. For relative-return investors, a barbell approach—overweighting risk in the short end for carry while underweighting long-end spread exposure—can help outperform benchmarks without sacrificing flexibility. Pull-to-par dynamics in short maturities provide a natural cushion against spread widening, while limiting exposure to long-end beta mitigates downside if volatility resurfaces.
2. **Niche opportunities:** Beyond mainstream benchmarks, select value persists in preferred securities of high-quality issuers, particularly those offering structural protections and spreads that compensate for subordination. Smaller insurance companies and well-structured BDCs also present opportunities, provided underwriting standards and portfolio composition skew toward first-lien exposure.
3. **The ripple effects of AI:** The AI investment boom is reshaping issuance patterns. Large-cap tech firms can self-fund data center expansion, but second-order beneficiaries—regulated utilities upgrading grids, capital-goods manufacturers scaling production—are likely to tap debt markets aggressively. These credits offer potential upside but carry execution and regulatory risks that warrant close monitoring.

ONE FINAL THOUGHT

2026 will be a year of contrasts—tight spreads may persist early, but volatility could return, creating opportunities for active positioning and relative-value trades.

Emerging Markets Debt: Carry, Curves & Currencies

EM Debt offers one of the broadest and most diverse opportunity sets in global fixed income. Even with spreads near historical tightness, compensation for default risk remains adequate at the index level, and all-in yields are near the upper end of their historical range. This combination supports the case for staying invested despite compressed valuations.

WHY INVESTORS ARE ENGAGING

Institutional interest in EM debt has been rising, driven by mandates to diversify away from developed-market concentration and capture higher real yields. While hard-currency sovereigns remain a core allocation for many, local markets are increasingly viewed as a source of alpha—particularly where inflation-adjusted yields are restrictive and policy credibility is strong. Select frontier allocations offer compelling opportunities but require rigorous analysis, a discerning process, judicious positioning and liquidity planning to capture value while avoiding losses.

LOCAL DEBT: RATES & CURRENCIES

Rates

Real yields remain elevated in several large markets, creating scope for policy normalization and yield compression as inflation stabilizes. Mexico, for example, entered 2025 with nominal yields near 8%. Similar dynamics exist in Brazil, Colombia, and South Africa, where nominal yields are in the double-digit range. Frontier local currency markets add another layer of potential, with countries like Uganda offering nominal yields near 17%, despite inflation rates below 4%—though liquidity and governance risks require careful sizing.⁷

Currencies

Balance of payments fundamentals in many EM economies are stronger than in prior cycles, and diversification flows away from U.S. centric exposures could provide incremental support. Credible policy frameworks and external buffers make select EM currencies attractive, particularly in a scenario where U.S. growth slows and the dollar weakens. For investors seeking diversification, local currency exposure can complement hard-currency sovereigns and local rates, adding an additional source of return.

ONE FINAL THOUGHT

Appetite for EM debt is strengthening as investors seek diversification and higher nominal yields. With potential for spreads to tighten further, disciplined country selection and liquidity management will be key to capturing value.

Conclusion

Across global fixed income, 2026 looks less like a beta trade and more like a dispersion driven market. Spreads are tight, but carry remains attractive. The challenge—and the opportunity—lies in separating structural signals from cyclical noise.

WE EXPECT

- **High Yield bond** to deliver reasonable returns through quality carry and disciplined risk management, despite compressed spreads
- **CLOs** to benefit from continued innovation while rewarding managers who can generate collateral alpha in an environment of tight liability costs
- **Investment Grade Credit** to offer durable income, with selective upside in niches and curve strategies
- **Emerging Markets Debt** to provide compelling real yields and currency optionality, particularly in local markets with credible policy frameworks

In short: 2026 will be a year to lean into credit selection and keep risk budgets flexible for volatility that could reset entry points without requiring wholesale changes to the macro thesis. Active management will not just add value—it will be essential.

7. Source: J.P. Morgan; Barings. As of October 2025.

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