

Global Bond Market Conditions May Demand an Active Management Approach

Experts from Schroders examine central-bank policy divergence, inflation risks, valuation dynamics, and emerging opportunities across global fixed-income markets.

As global fixed-income investors look toward 2026, the landscape is shaped by cycles that are increasingly out-of-sync across major economies, with the trajectories for inflation, monetary policy, and economic growth diverging across regions. The leaders of our fixed-income teams share their views on how these markets can be navigated in the new year.

Global Bonds: Desynchronized Cycles and Attractive Opportunities

Julien Houdain, PhD, Head of Global Unconstrained Fixed Income

2025 has been a year of differentiation in bond markets, with very large divergences in yield moves, both between geographies and at different maturities of the curve. We expect this to continue as we head into 2026.

Why? Simply because growth, labor market, and inflation outlooks are desynchronized by country, and major central banks are at different stages of their policy cycle. The US Federal Reserve (Fed) and Bank of England remain in the easing phase, the European Central Bank looks to be happily on hold, and the Bank of Japan is not yet done hiking rates.

This provides huge opportunity—but only to those who are active in their bond allocation and capable of taking advantage of fast-changing and disparate economic conditions globally. Passive management in this environment could leave portfolios overallocated to the relative “losers” as yield moves diverge, and that could lead to underwhelming returns and greater risks.

Insight from sub-adviser Schroders Investment Management



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Key Points

- Because central banks are at different stages of their policy cycles, there are significant opportunities for active managers who can adapt to fast-changing conditions.
- The US bond market has benefited from moderating inflation, fiscal stability, and resilient consumer demand. In 2026, we expect US fixed income to remain attractive, but selectivity matters.
- We expect emerging-market debt to continue to be supported by strong macroeconomic adjustments and favorable inflation trends. Improving liquidity and policy flexibility in key emerging markets may present attractive opportunities.

FIGURE 1

2025 Has Seen Desynchronized Yield Moves by Country and Maturity, and We Expect That to Continue in 2026

Year-To-Date Yield Moves Across Country and Curve (in Basis Points)



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We're optimistic about the outlook for the US economy in 2026 because of fiscal and monetary easing.

As of 10/28/2025. Current economic and market trends are not a guide to future results and may not continue. A basis point is a unit that is equal to 1/100th of 1% and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security. Data Sources: Macrobond, Bloomberg, and Schroders, 12/25.

Too Much of a Good Thing?

We're optimistic about the outlook for the US economy in 2026 with both fiscal (as the full impact of the One Big Beautiful Bill Act hits) and monetary easing (spurred by a softening labor market in mid-2025) working their way into the economy.

While we welcome the government and central-bank support to reduce the rising hard-landing risks we saw in the summer of 2025, we worry about policymakers overcooking it on stimulus. Too much of a good thing is a real possibility, in our view. We're watchful for signs that policy has become too stimulative, such as a re-tightening of the labor market or rising core inflation and wages.

After a period of outperformance for US bonds, we're seeing better opportunities emerge for global portfolios. We also believe having inexpensive inflation protection is prudent given a strong growth outlook, dovish policymaking, and the ongoing threat of weakened credibility of the Fed with the end of Jerome Powell's term in May 2026 and the appointment of a new chairperson.

Europe's economy has been slowly improving throughout 2025. We see this continuing into next year and expect German fiscal stimulus to be additive, but not a game changer to overall eurozone growth, in our view.

In the UK, however, a loosening labor market, combined with a budget that will tighten fiscal policy, will likely keep UK growth below trend early in the year. We think this could continue to create opportunities in gilts, the government bonds issued by the UK.

The Only Certainty Is Uncertainty

Whether it's concerns over concentrated AI-driven growth, inflated equity prices, volatile US policy, or other risks, the diversification benefits of fixed income as an asset class are increasing as global inflation pressures remain benign.

2026 Outlook Fixed Income

For investors still heavily invested in cash, the safety net is not as strong as it once was. With cash rates falling and unable to keep pace with inflation, bonds remain an attractive income opportunity.

Patience Is a Virtue

Corporate bonds have enjoyed another year of positive performance, but we see the valuation starting point as the key driver of forward-looking returns. The spread¹ earned for taking additional credit risk over government bonds is now at historically low levels. With these very tight spread levels, significant exposure here seems unwise.

Opportunities to add risk in credit will present themselves in 2026, as they generally do, though we never know in advance what's going to be the catalyst for change. Given our optimistic growth outlook, we believe the ability to deploy capital when these better opportunities arise is the most sensible approach. In the meantime, it's important to use rigorous fundamental research, look where other investors aren't, and continue to innovate to generate alpha² within corporate bonds.

This flexible approach to asset allocation also means taking advantage of better opportunities when they arise. We think agency mortgage-backed securities could be supported by attractive valuations and declining rate volatility. In Europe, we're also finding good opportunities in quasi-sovereign and covered bond issuers.

2026 will inevitably bring both risks and opportunities. As such, we think an agile and active approach to bond investing will be even more important for delivering investment performance.

US Bonds: A Strong Year—and Supportive Conditions Could Extend Into 2026

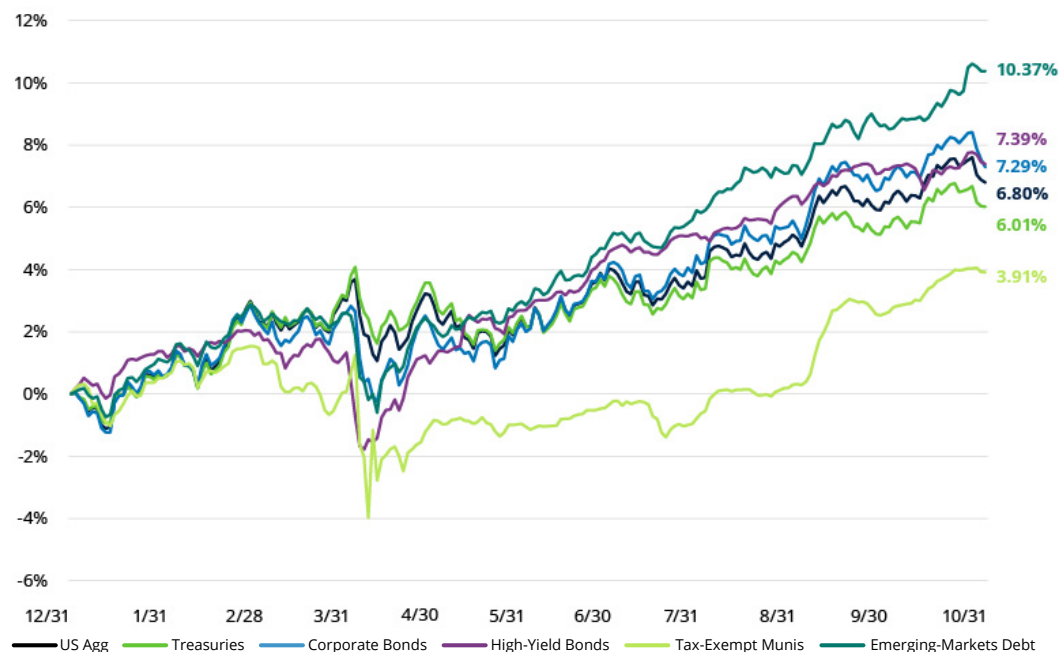
Lisa Hornby, CFA, Head of US Fixed Income

Despite early year pessimism, US fixed income posted solid performance across nearly all sectors. The strong and steady returns were driven by income earned from high coupons and further supported by price gains from lower Treasury rates and tighter spreads in the credit and mortgage-backed securities (MBS) sectors.

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FIGURE 2
Strong 2025 YTD Returns Across Most Sectors of the US Bond Market



As of 10/31/25. Past performance does not guarantee future results. US Agg represented by the Bloomberg US Aggregate Bond Index. Treasuries represented by the Bloomberg US Treasury Index. Corporate Bonds represented by the Bloomberg US Corporate Investment Grade Index. High-Yield Bonds represented by the Bloomberg US Corporate High Yield Index. Tax-Exempt Munis represented by the Bloomberg Municipal Bond Index. Emerging-Markets Debt represented by the Bloomberg EM USD Aggregate Index. Data Source: Bloomberg.

We believe today's benign economic conditions could persist and support US fixed-income performance in 2026. The US economy continues to absorb shocks effectively. The economy has settled into a mild mid-cycle environment, with growth moderating from last year's elevated pace but remaining positive, inflation trending toward a range in the Fed's comfort zone, and the labor market adjusting in a measured way. For fixed-income investors, this combination—slower growth without sharp contraction and contained inflation—has historically provided fertile ground for strong total returns.

Several factors could continue to support US bond markets in 2026. Notably, the inflation pass-through from tariffs remains limited, with companies absorbing more cost pressures through productivity gains and lower profit margins, thereby reducing the risk of an inflation spike. Provided this dynamic holds, there's room for interest rates to remain anchored or gradually decline further, and that could support further price appreciation for bonds.

Fiscal tailwinds from the One Big Beautiful Bill Act (OBBBA) are expected to persist into 2026, thereby potentially cushioning the economy from the effects of softer private sector demand for labor. Companies' immediate expensing of capital expenditures and increased federal investment commitments could continue to help steady nominal GDP growth, further boding well for credit quality.

The US consumer remains broadly healthy, supported by robust household balance sheets, although spending is increasingly concentrated among the top 10% of earners. This lends some fragility to growth, yet we think aggregate consumption is likely to remain resilient. This would provide a supportive backdrop for credit and structured products well into next year.

Such conditions—moderating inflation, fiscal stability, and a healthy consumer—would bode well for US fixed-income returns in 2026, from both attractive income and potential capital appreciation as yields adjust to an ongoing moderate central-bank policy and a backdrop of economic growth.

Risks to the Outlook Remain

Recent failures in less-regulated debt markets highlight the importance of transparency and liquidity—characteristics that will likely sustain interest in publicly regulated debt markets if volatility rises in 2026. Meanwhile, the rapid flow of capital into artificial intelligence (AI) ecosystems has increased interconnectedness in the technology sector. A valuation correction in one node of the AI supply chain could potentially trigger cascading effects across the entire ecosystem because of tightly woven financial relationships.

Positioning for Quality in a Higher-Yield World

We think the broader US fixed-income market continues to offer an attractive prospective return profile, especially as we look toward 2026. In our opinion, the current environment calls for greater selectivity across sectors. We see value in increasing exposures to high-quality duration³ assets such as tax-exempt municipals and securitized instruments, while avoiding generic credit beta⁴ that no longer offers sufficient spread premium. With yields already attractive, investors do not need to stretch for incremental income. We believe the focus should remain on securities and sectors where income is sustainable, and downside risks are limited.

Despite ongoing uncertainty, the core message remains: US fixed-income markets continue to benefit from moderating inflation, more stable fiscal dynamics, and a resilient—if slower—economy. In this environment, high-quality sectors such as agency MBS and long-dated tax-exempt municipals could remain well positioned in 2026. The strong performance in 2025 reinforces the thesis that starting yields matter, and investors who focus on quality and value could, in our view, be rewarded as supportive conditions carry into next year.



Moderating inflation, fiscal stability, and a healthy consumer would bode well for US fixed-income returns in 2026.

Emerging-Market Debt: The Stage Is Set for a New Reallocation Cycle

Abdallah Guezour, Head of Emerging Market Debt and Commodities

Emerging-market (EM) debt is on track to deliver a third consecutive year of strong returns, as markets continue to reward the macroeconomic adjustments experienced by key EM countries in the post-pandemic period. These adjustments—which broadly preserved fiscal and balance of payments sustainability and enhanced external buffers—explain the recent growth resilience of emerging markets in the face of the global trade and geopolitical dislocations. As global investors are now starting to recognize these achievements, a recovery in portfolio flows to EM fixed-income markets is underway. This capital reallocation cycle is still in its early stages and has further to go. Global asset allocators are still severely underinvested in the asset class despite its strong outperformance in recent years.

More Room for Monetary Easing

In our view, this recovery in capital flows will be supported by emerging markets' economic growth, which is expected to strengthen in 2026, thanks to improving domestic liquidity conditions as EM central banks regain room to ease monetary policy. This upturn in monetary and credit cycles is unfolding against the backdrop of already robust private-sector balance sheets, which could enhance the transmission of policy stimulus into real economic activity. Encouragingly, EM exports have also remained resilient despite the headwinds from recent US trade tariffs.

We expect these dynamics to keep the average EM growth premium over the US sufficient to warrant the recent renewed investors' appetite for EM assets. However, China's growth trajectory may remain subdued, as it could be constrained by persistent weakness in the property sector and the lingering risk of renewed trade or geopolitical tensions with the US. That said, continued calibrated policy support in China and a still-solid external position—including a healthy trade surplus and ample foreign-exchange reserves—could continue to provide a meaningful buffer against downside risks.

The global disinflation trend of the past two years remains intact, although the US may soon be an exception as tariff effects could start to feed through, thereby maintaining price pressures and potentially undermining the credibility of the Fed's current easing cycle. While this represents a risk for EM assets, we take comfort from the fact that EM inflation remains more benign, supported by subdued food and energy prices and China's ongoing export of deflation.

A Favorable Inflation Outlook

This disinflation emanating from China is particularly beneficial to EM economies with lower trade barriers and minimal export overlap with China, most notably the commodity-exporting nations in Latin America and Eastern Europe, the Middle East, and Africa. With this favorable inflation outlook, real rates across EM remain unnecessarily too high, in our view, and 10-year local government bond yields still offer appealing value. This appeal is reinforced by more favorable public-sector debt dynamics in EM, especially when compared with their developed-markets counterparts (FIGURE 3).

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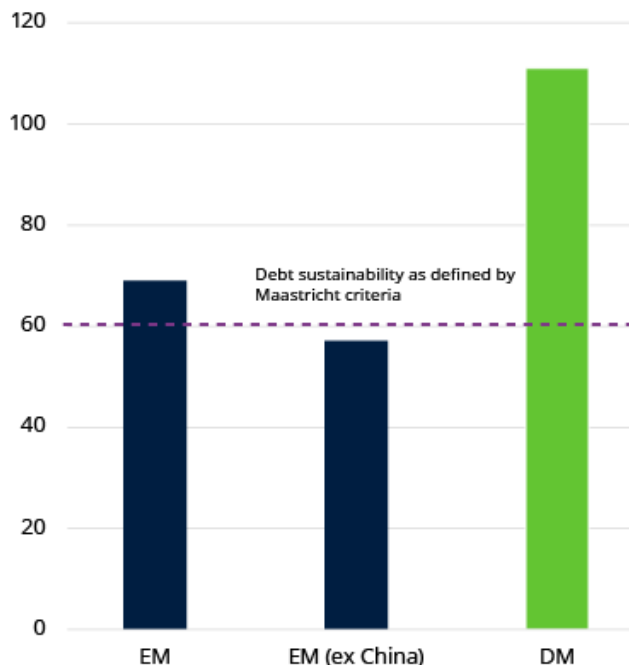
Global asset allocators are still severely underinvested in emerging-market debt despite its strong outperformance in recent years.

FIGURE 3

Debt Dynamics and Real Yields: EM and DM

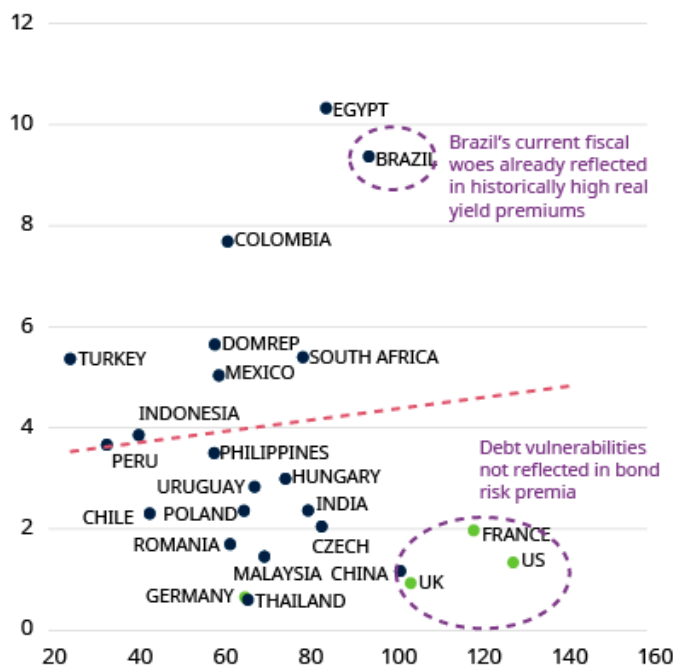
Average Government Debt/GDP %

DM Ratios Underestimate Real Level of Debt as They Exclude Unfunded Liabilities



Expected Inflation-Adjusted Yields vs. Gross Debt as a % of GDP

Real Yield (10y-12 Month Forward CPI) vs. Gross Debt



As of September 2025. Risk premia is the investment return an asset is expected to yield in excess of the risk-free rate of return. Maastricht criteria are a set of economic rules that European Union (EU) countries must meet to adopt the euro as their currency. Data Sources: IMF, Macrobond, and Schroders, 12/25.

A Currency Cycle That May Favor Non-US Assets

This favorable outlook could also be boosted further if the US dollar continues the cyclical downturn that began in 2025. While intermittent rebounds of the dollar may be expected and will require active currency risk hedging, various factors are likely to continue to put pressures on the greenback. Indeed, the dollar remains expensive on a real effective exchange-rate⁵ basis. It's also losing interest-rate support and is increasingly affected by the unsustainable accumulation of twin deficits—fiscal and current account. With the dollar having broken its 15-year uptrend this year, the currency cycle appears to be turning in favor of non-US asset outperformance. This environment, combined with abundant global financial liquidity, reinforces the relative attractiveness of EM debt, particularly in local currency segments. We continue to favor markets such as Brazil, Mexico, South Africa, India, and parts of Central Europe, in which valuations remain compelling and policy flexibility is high. While EM dollar-denominated debt spreads have already tightened substantially, this sector still offers attractive high-income opportunities, especially among selective high-yield sovereign and corporate issuers.

**To learn more about the opportunity in fixed income,
please talk to your financial professional.**

Bloomberg Emerging Markets Debt Index, an unmanaged index that tracks total returns for external-currency-denominated debt instruments of the emerging markets

Bloomberg Municipal Bond Index is designed to cover the USD-denominated long-term tax-exempt bond market.

Bloomberg US Aggregate Bond Index is composed of securities that cover the US investment-grade fixed-rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.

Bloomberg U.S. Corporate High-Yield Bond Index is an unmanaged broad-based market-value-weighted index that tracks the total return performance of non-investment grade, fixed-rate, publicly placed, dollar denominated and nonconvertible debt registered with the Securities and Exchange Commission.

Bloomberg US Corporate Investment Grade Bond Index covers all publicly issued, fixed rate, nonconvertible, investment grade debt.

Bloomberg Barclays US Treasury Index is an unmanaged index of prices of US Treasury bonds with maturities of one to 30 years.

¹ Spreads are the difference in yields between two fixed-income securities with the same maturity but originating from different investment sectors.

² Alpha is the measure of the performance of a portfolio after adjusting for risk. Alpha is the excess return of a portfolio over its benchmark.

³ Duration is a measure of the sensitivity of an investment's price to nominal interest-rate movement.

⁴ Beta is a measure of risk that indicates the price sensitivity of a security or a portfolio relative to a specified market index.

⁵ Real effective exchange rate measures the value of a country's currency compared to a basket of other major currencies, adjusted for inflation.

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