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Active Fixed Income
Perspectives Q2 2026:

Dispersion drives opportunity

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Key takeaways

Performance recap

Coupon income supported bond returns during a period of heightened market volatility. The sharp rise in energy prices shifted expectations for rate cuts toward the possibility of rate hikes in economies with inflation-focused central bank mandates and greater exposure to energy shocks. Global bond yields moved higher, albeit unevenly, across regions, reflecting differences in perceived inflation risk. Credit spreads widened modestly from cycle lows, and performance across sectors became increasingly differentiated.

The big picture

The U.S. economy entered the year with solid underlying momentum; however, higher energy prices pose an increasing risk to both the growth and inflation outlook. So far, markets have not shown a broad or lasting negative reaction, but if the disruption to energy flows persists, growth fears will become more broad-based, putting downside pressure on yields and upside pressure on credit spreads.

Our approach

Attractive overall yields continue to draw a broad mix of investors, and increased price dispersion across the market is creating pockets of value. We are maintaining an up-in-quality bias in credit focused on diversified sources of yield and have increased duration exposure as a portfolio hedge against downside scenarios. Higher yield volatility brings increased opportunity for tax-exempt portfolios to add value through coupon and call structure management.

Notable resilience

The bond market was pulled in multiple directions during the first quarter as investors navigated the uncertainty of rapidly shifting conditions. Early in the quarter, government bond yields moved lower as markets priced in concerns that the pace and scale of artificial-intelligence-related investment could ultimately weigh on growth.

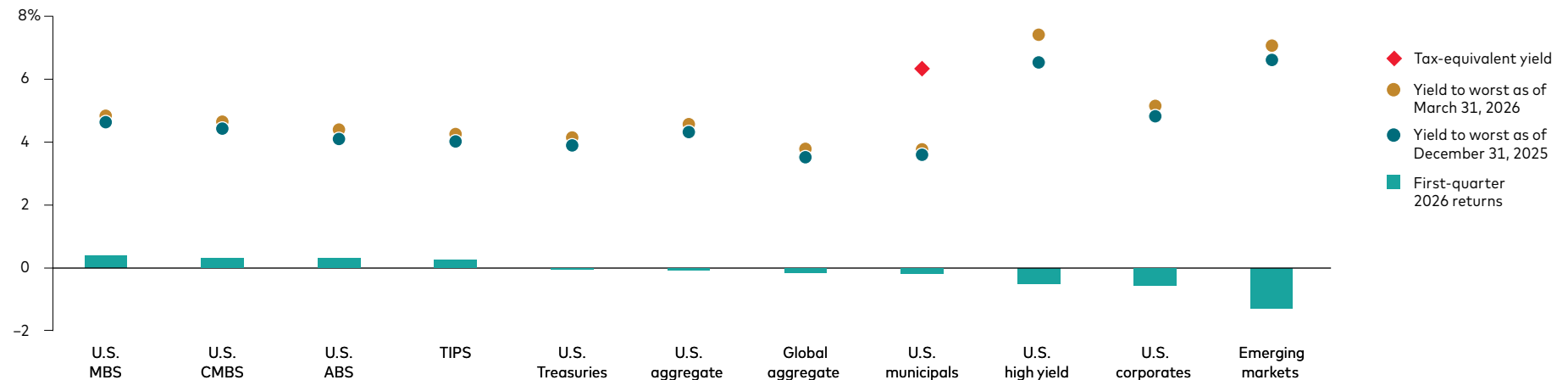
That dynamic shifted sharply in March, when the onset of the conflict in Iran and the resulting spike in energy prices pushed near-term inflation risks back into focus, driving yields higher globally—most notably in regions where central banks operate under inflation-focused mandates and economies are more sensitive to energy price shocks.

Even so, bond markets demonstrated notable resilience. The repricing was measured given the magnitude of the energy shock, with credit spreads widening only modestly from cycle lows toward the upper end of the ranges we had anticipated this year.

Importantly, strong starting yields—near or above 4% across much of the market—continued to support investor returns. Coupon income helped offset the impact of higher yields and wider spreads, leaving total returns for the U.S. Aggregate Index flat for the quarter.

As clarity around energy markets improves, we see a more stable to constructive path for rates, and we used the period of volatility to selectively add duration at more attractive levels and increase exposure to credit opportunities where risk compensation improved.

Fixed income sector returns and yields



Notes: The municipal tax-equivalent yield is calculated using a 40.8% tax bracket, which includes a 37.0% top federal marginal income tax rate and the 3.8% net investment income tax to fund Medicare. Yield to worst represents the lowest yield possible for a security given the current price, considering both call dates and maturity.

Indexes used in chart: The following indexes are represented in the sector returns and yields chart: J.P. Morgan EMBI Global Diversified Index, Bloomberg U.S. Corporate High Yield Index, Bloomberg U.S. Mortgage Backed Securities Index, Bloomberg U.S. Corporate Index, Bloomberg CMBS: Erisa Eligible Index, Bloomberg U.S. Aggregate Index, Bloomberg U.S. Treasury Inflation-Linked Bond Index (Series-L), Bloomberg U.S. Treasury Index, Bloomberg U.S. Asset-Backed Securities Index, Bloomberg Global Aggregate Index, and Bloomberg U.S. Municipal Index.

Sources: Bloomberg indexes and JPMorgan, as of March 31, 2026.

Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

The flow of energy

In March, Brent crude prices surged well above \$100 per barrel after averaging roughly \$66 over the prior 12 months. The magnitude of the move reflects the disruption to energy flows in the Middle East. Absent a resumption of normal transit, upward pressure on energy prices is likely to persist.

The economic impact of higher energy prices depends largely on the duration of the disruption. If the flow of traffic through the Strait of Hormuz is halted or limited as it has been, global volumes will be constrained despite efforts to reroute oil and natural gas through alternative channels.

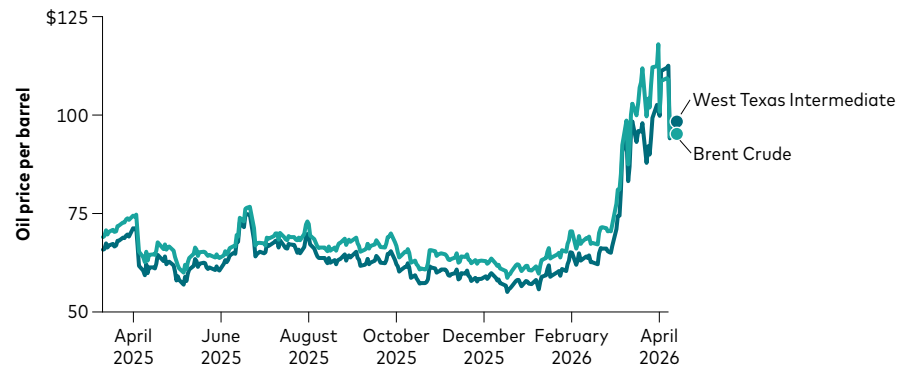
Higher energy prices most directly affect headline inflation. However, at sufficiently high levels or over longer periods, spillovers into core inflation and growth become more meaningful—raising the risk of broader macroeconomic consequences. We are assessing the potential impact to markets across three key scenarios.

Base case path—Progress toward resolution with broader terms that include a reinstatement of normal transit levels through Hormuz. If oil prices remain around \$100 for one to two quarters, we do not expect a large impact to growth or medium-term inflation across regions.

Protracted scenario—Progress stalls and the conflict continues. If oil prices hold above \$100 per barrel for several quarters, measurable effects are expected. In that scenario, we forecast a 40-basis-point decline in U.S. growth and a further 30-basis-point rise in core inflation. The impact in Europe would be approximately double these figures.

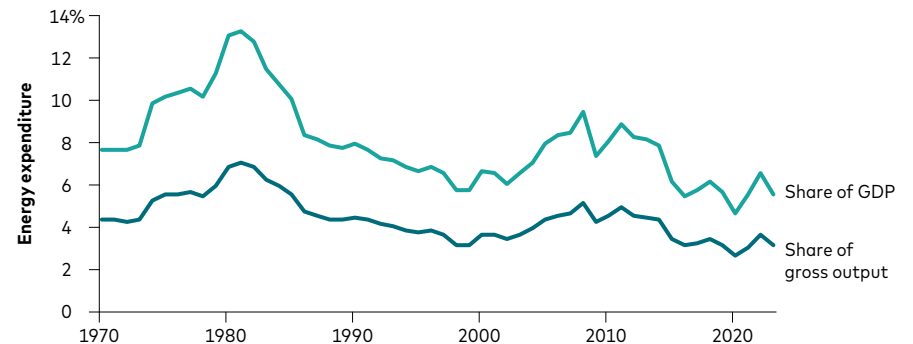
Recession outcome—Should oil prices remain above \$125 for twelve consecutive months, recessionary conditions are anticipated in the Euro area and Japan. Sustained oil prices exceeding \$200 for a year would produce comparable economic conditions in the United States.

Oil price per barrel



Source: Bloomberg data as of April 9, 2026.

Energy expenditures decline as a share of GDP and gross output (1970–2023)



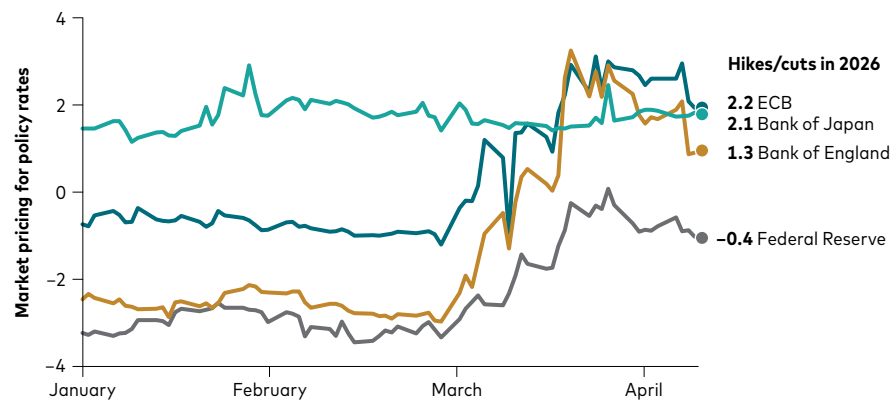
Source: U.S. Energy Information Administration as of March 26, 2026.

Diverging policy paths

As energy prices jumped, markets refocused on inflation risks and repriced expected policy paths across regions. In the most exposed economies—particularly where central banks operate under inflation-focused mandates—expectations shifted from near-term rate cuts toward the possibility of rate hikes this year.

Central banks have historically looked through energy-driven inflation shocks, recognizing that monetary policy is ill-suited to address supply-side pressures and that premature tightening risks amplify downside growth outcomes. However, the inflation experience of recent years has left policymakers more sensitive to the possibility of higher inflation becoming entrenched. While short-term inflation expectations moved higher, medium-term measures remain well anchored in the United States and broadly within acceptable ranges across Europe and Japan.

Central bank expectations for 2026 have repriced unevenly across regions



Source: Macrobond as of April 9, 2026.

In a more prolonged conflict scenario, inflation risks could gradually give way to growth concerns as higher input costs weigh on demand, prompting markets and policymakers to anticipate eventual easing. With the duration and magnitude of the shock still uncertain, the Federal Reserve retains flexibility given its dual mandate, while the ECB, Bank of England, and Bank of Japan have shifted toward a more hawkish stance—raising the likelihood of divergent policy paths as conditions evolve.

Trimming our outlook

The U.S. economy entered this period from a position of strength. Business investment and consumer spending have provided steady support, even as markets absorb supply-driven shocks tied to energy, tariffs, and labor. This resilience has been reinforced by strong corporate profitability and an ongoing investment cycle, particularly in technology.

Fiscal policy remains supportive, and the Federal Reserve retains flexibility should conditions weaken. As a net energy exporter, the U.S. is also better positioned to absorb energy shocks than in past cycles. Moreover, economic growth is far less energy-intensive today than in prior decades—measures of energy use per dollar of real GDP have declined by more than half over the past 40 years.

Against this starting point, it remains difficult to construct a base case recession scenario over the near term. While recent geopolitical developments have increased uncertainty, they have not materially altered our outlook for the U.S. economy. Instead, we have modestly revised our forecasts, downgrading growth and upgrading inflation expectations. Even so, we continue to anticipate growth above 2% and inflation below 3% over the coming quarters.

Outside the U.S., we see greater risks and have more meaningfully lowered our growth projections and raised our inflation views. In the months ahead, we are prepared for a wider range of outcomes and continue to emphasize active positioning, quality bias, and valuation discipline.

Portfolio positioning and strategy

U.S. rates and yield curve

U.S. Treasury yields moved higher across the curve in the first quarter, but the majority of the repricing occurred between two- and five-year maturities. The move reflected the market's expectation that the Fed would not be able to deliver on the two cuts previously priced in for 2026.

We anticipate the Federal Reserve to remain cautious but prepared to look through short-term energy-related price increases as long as core inflation increases remain moderate and inflation expectations remain anchored near 2%. We maintain our view of one policy rate cut over the course of this year, dependent on clearer progress in inflation.

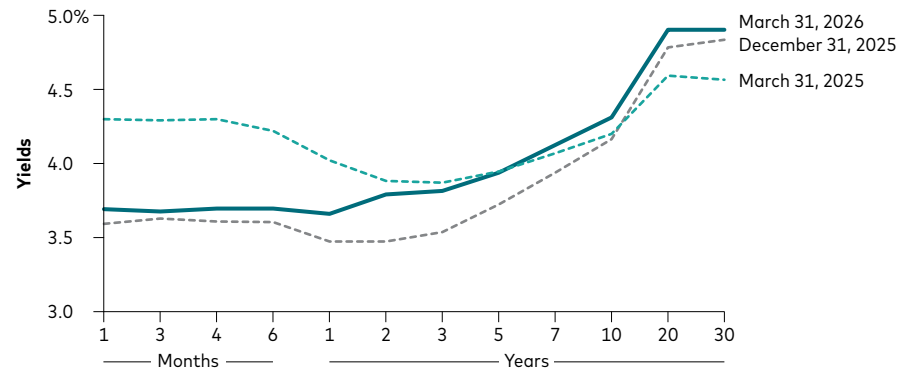
As 10-year Treasury yields moved above our prior fair-value range of 3.75% to 4.25%, we viewed the increase as an opportunity to add duration. While we acknowledge that the reduced likelihood of near-term FOMC easing has likely lifted the fair-value range somewhat, we continue to see yields above 4.25% as attractive levels to extend duration and build greater portfolio resilience against potential growth risks.

Outside the United States, the policy outlook for the European Central Bank and the Bank of England has shifted. A sustained decline in energy prices would likely be required to prevent the ECB from initiating a modest tightening cycle, while we remain skeptical the BoE will ultimately follow through with rate hikes given ongoing labor-market weakness.

In Japan, our view of a gradual normalization remains unchanged. Stronger relative growth prospects in the U.S. support our continued preference for long Germany versus short U.S. cross

market relative value positions, while rising fiscal and monetary policy risks in Japan reinforce the case for higher and flatter JGB yields. Despite added uncertainty from Middle East tensions, we continue to view short-duration positions in JGBs as warranted.

U.S. Treasury yields



Source: Bloomberg data as of March 31, 2026.

Daily U.S. Treasury Par Real Yield Curve Rates

Date	5 Year	7 Year	10 Year	20 Year	30 Year
March 31, 2026	1.38%	1.70%	2.00%	2.46%	2.69%
April 15, 2026	1.29%	1.61%	1.90%	2.38%	2.63%

Source: Federal Reserve, as of April 15, 2026.

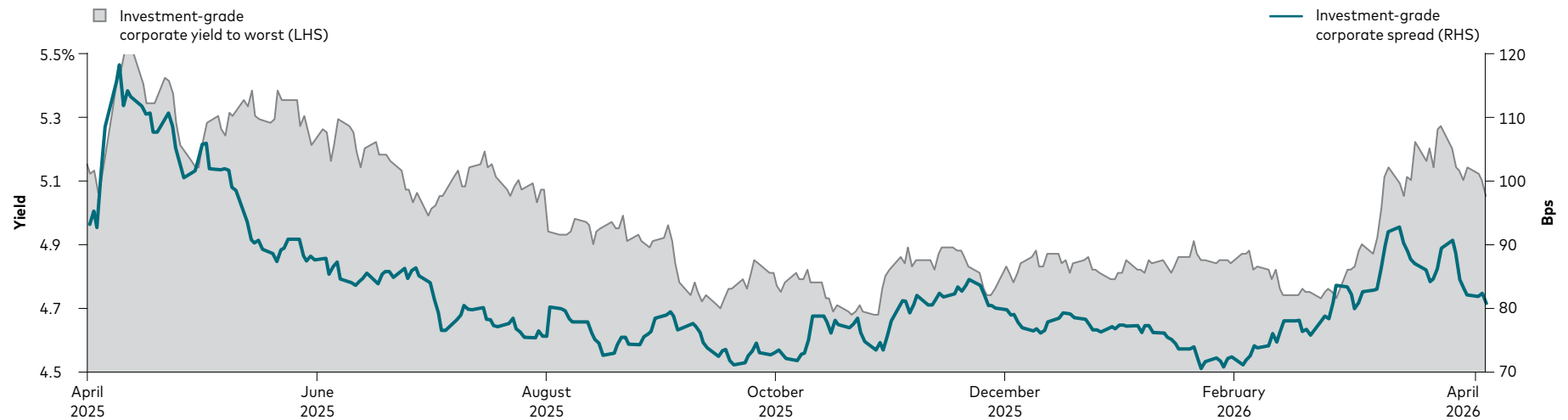
Credit outlook

In the first quarter, credit spread moves were mostly contained relative to the repricing in yields. As the quarter progressed, spreads moved wider in two stages, first when concerns around AI-related disruption weighed on sentiment and then again with the onset of the conflict in Iran. So far, the reaction to the rise in geopolitical risk has been far more muted than prior macro shocks, including last year's tariff-driven volatility, signaling the market's optimism that the risks are short-lived.

In addition to the rise in volatility, credit issuance volumes were expectedly strong in the first quarter. In the U.S., investment grade companies set a record with roughly \$775 billion in gross issuance fueled by continued AI-related investment and rising merger and acquisition volumes. Perhaps a more important signal was that increase in issuance was more than met by strong demand to absorb the new supply of bonds.

Investment-grade credit remains particularly attractive. Fundamentals are healthy, and the supply-demand backdrop continues to support spreads. With all-in yields back above 5%, the bid for high quality credit should remain strong from yield-focused buyers.

Round trip: Yields have bounced back to last year's levels



Source: Macrobond as of April 8, 2026.

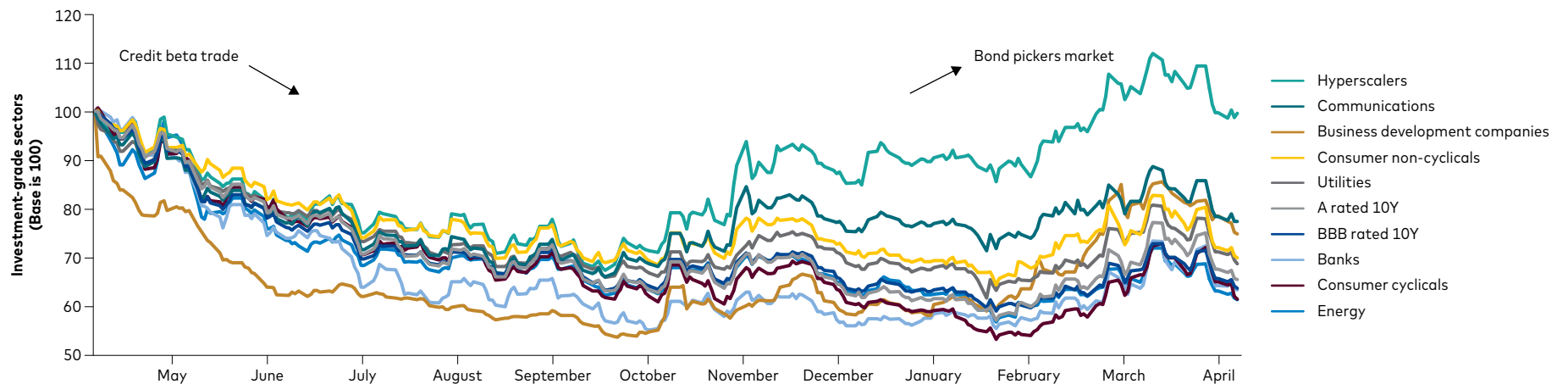
Broadly, spreads now reflect what we thought could transpire at the start of the year. Levels rose to the middle of our forecasted ranges, and within each segment, we are seeing wider dispersion across subsectors and issuers. This has created opportunities to add exposure to issuers with resilient business models trading at more attractive levels. While credit performance last year was better defined as a rising tide that lifted all boats, this year has been more of a bond-picker's market, as we expected.

Our outlook for credit performance remains constructive, but the war in Iran and corresponding disruption in the flow of energy presents notable downside risks that we continue to assess.

The longer the conflict lasts, the greater the implications for credit performance. As that occurs, the concerns over inflation will turn to concerns over growth, causing a more sustained widening in spreads.

If our base case holds and there is a near-term resolution in the Middle East where traffic through Hormuz resumes, we would expect economic conditions to be supportive for performance. If concerns around growth rise, lower-quality credit is most exposed, so we prefer to maintain a quality bias and a disciplined, issuer-by-issuer approach.

Rising uncertainty is increasing dispersion and opportunity



Source: Macrobond as of April 9, 2026.

Vanguard active bond funds and ETFs

Vanguard active bond funds and ETFs		Admiral™ Shares or ETF ticker symbol	Expense ratio*
Treasury/Agency	Government Securities Active ETF	VGVT	0.10
Investment-grade corporate	Core Bond ETF	VCRB	0.10
	Core-Plus Bond ETF	VPLS	0.20
	Multi-Sector Income Bond ETF	VGMS	0.30
	Ultra-Short Bond ETF	VUSB	0.10
Below- investment-grade	High-Yield Active ETF	VGHY	0.22

* As reported in each fund's prospectus. A fund's current expense ratio may be higher or lower than the figure shown.

† Investment advisor: Wellington Management Company LLP.

* Investor Shares available only. There is no minimum investment required for advised clients.

Note: Data as of March 31, 2026.

Active fixed income at Vanguard

\$479B

Vanguard global active bond AUM

\$285B Vanguard global active taxable bond AUM

\$194B Vanguard global active municipal bond AUM

25+

Portfolio managers

35+

Traders

60+

Credit research analysts

130+

Dedicated team members

Note: Data as of March 31, 2026.

Active fixed income leadership team



Sara Devereux

CIO VCM, Global Head of Fixed Income

In industry since 1992



Chris Alwine, CFA

Global Head of Credit

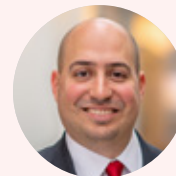
In industry since 1990



Roger Hallam, CFA

Global Head of Rates

In industry since 2000



Paul Malloy, CFA

Head of U.S. Municipals

In industry since 2005

For more information about active fixed income, speak with your financial advisor.

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