Marketing Communication
July 2026

Fixed income Outlook H2 2026:

Alpha Trumps Beta

see money differently

Palomar Fixed-Income

H1 2026 review: Alpha trumps beta

Since inception net returns (US$)[1]: Fund 5.73% p.a. | Bloomberg Global Aggregate (US$ hedged): 4.09 % p.a. | Bloomberg Global Aggregate ex China (US$ hedged): 3.77 % p.a.

What we said six months ago

1. **Fed independence could cause market upset.**
2. **Sticky inflation could cause yields to fall less than thought.**
3. **AI supply would be huge.**
4. **Intra-market volatility would be important for fund returns.**
5. **Interest rate curves would be directional.**

What happened in H1 2026

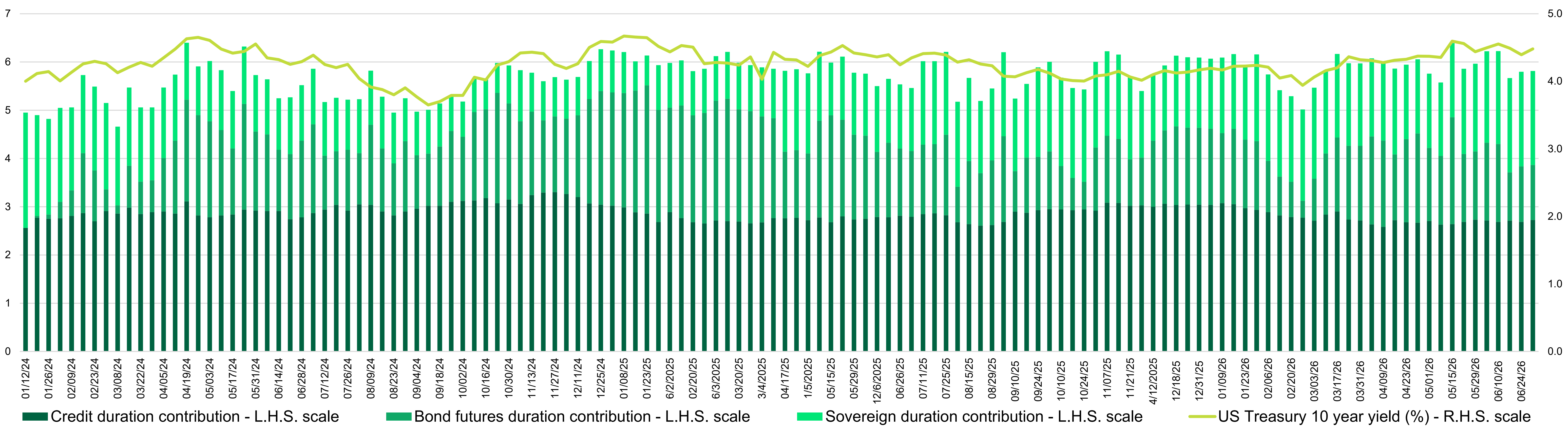
H1 2026 net returns (US$):

Fund 1.53% | Bloomberg Global Aggregate (US$ hedged): 1.15 % p.a.

Bloomberg Global Aggregate ex China (US$ hedged): 0.93 % p.a.

Being nimble and value-driven through market volatility

Portfolio duration (years) by sector versus bond yields



We didn't see the Iran attack coming. I'm not sure many did. Prior to March, yields had fallen, with most investors anticipating a series of G7 rate cuts. We didn't think those cuts were warranted so entered Q2 with materially less duration than the global bond index. Surging energy prices meant any safe-haven status for G7 bonds was quickly forgotten in favour of inflation fears. Good relative performance allowed us to add duration into the sell-off in early April, and we've remained close to index neutral (around 6 years) since.

Credit, in similar vein to equity did a bit more than wobble. Having ignored economic danger signs for nearly two years, spreads did really well in Q1. Oil at $110 per barrel reversed that trend. However, similar to Liberation Day 2025, they quickly recovered al the lost ground. Indeed, from April onward, credit markets were largely becalmed.

One area of weakness was anything AI-related. Even bonds issued by the hyperscalers struggled. This probably owed more to supply indigestion than to any real long-term fear of balance sheet destruction. That may come, although with the Mag 7 continuing to throw of huge amounts of cash, default and downgrade is likely more the province of second tier players, data centre structured finance and their lenders. Along with further private credit fallout, this looks more like an issue for H2 2026 and beyond than it did for the past six months.

Our weighting to investment grade and high yield bonds remained stable over the period. We guide toward 20-30% high yield and have generally been running closer to 15%. That's largely a value call – yes, there are some great individual opportunities, but the broader market looks expensive to us. Against that, balance sheets remain strong and public high yield quality is still boosted thanks to lower quality names funding in private markets.

We note the rising tide of gated or partially closed private credit funds – especially concentrated in a handful of market segments. Although we have no direct exposure, we remain concerned that any major liquidity event will spill into public markets. Hence, we kept our weighting low.

Investment grade too raised valuation concerns. Our exposure was primarily in shorter-dated bonds. That, plus our aversion to the wall of hyperscaler supply meant we avoided the plunges in price associated with ultra long bonds from the likes of Oracle and SpaceX.

To balance overall portfolio risk, we invested in longer dated sovereign debt, from Japan to the UK. By and large this worked well, and ,at the time of writing we wait for concrete news from Japan to back up official chatter suggesting a new era of yield targeting could be upon us.

The main event was, of course, the Middle East conflict. No escaping that. At quarter end a tentative cease fire had been agreed. Conflict one day, talks the next, has been a recipe for market volatility. In rates markets, we stayed close to home over the period – initially underweight and quickly closing that as yields surged with energy prices. Heightened uncertainty gave good tactical opportunity. Strategically, we like bonds at current levels. However given the nature of our mandate and current geopolitical uncertainty, we preferred to play markets with many smaller tactical positions, which fits well with our process.

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[1] 9 Jan 2024 to 30 June 2026.
Fund results based on NIF Global Strategic Bond Fund Class D in US$ and index results based on
Chart data from 9 January 2024 to 30 June 2026. Credit is a combination of investment grade and high yield. . Source: Nedgroup Investments, Bloomberg

Rates outlook: A new man at the helm

We need to talk about Kevin

Six months ago, we talked about central bank divergence. The ECB and Bank of England would cut, the Fed would probably do nothing, and the Bank of Japan would hike. We knew there would be pressure on Chairman Warsh to cut rates. All of that was overtaken by events.

Warsh already appears more hawkish than Trump would like. However, as June ended, oil was still up around 20% year to date and CPI remained uncomfortably above 3%. As a result, his and other central bankers' bias towards hikes rather than cuts seemed sensible.

It's a mug's game trying to second-guess the politics of conflict. The best we can do is weigh the probabilities.

What's priced in?

To that end, around two rate hikes are currently expected by major bond markets. That is likely to change regularly in the coming months. To see a proper tightening cycle (four or more hikes) and significantly higher market yields, we would likely need G7 employment and equity market resilience, combined with oil at $90–100 per barrel for several months.

At current levels, with yields well above medium-term inflation projections, bonds offer material protection against a prolonged energy-price squeeze. Bonds will generate a high level of income in H2 2026, meaning capital losses would need to be significant to produce negative total returns.

That's not a ringing endorsement or a reason to be maximum long. It is, however, a very attractive starting point for long-term investors.

Portfolio implications

On the upside

- Yields remain high, offering compensation for inflation pressures.
- G7 central banks are expected to raise rates, any volte face offers capital gain potential.
- Investors generally remain nervous and a little underweight, if that changes demand will push prices higher.

On the downside

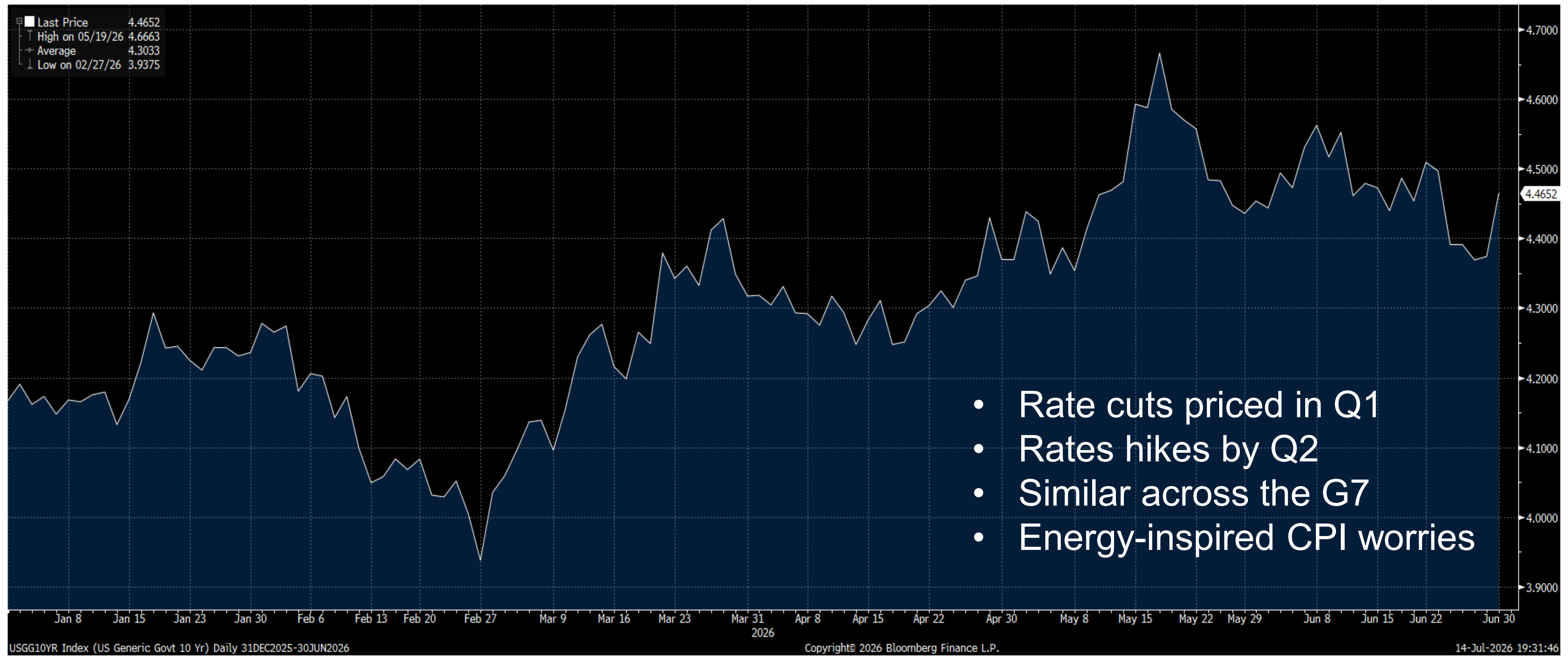
- Middle East conflict continues, with attendant energy price worries.
- There's a new man at the Fed, experienced enough for normal markets, perhaps not in a crisis.
- AI-related mega supply potentially "crowds out" sovereign issue, pushing yields up.

Fund positioning

- Duration: G7 yields rose in H1, we've adopted a "don't be underweight" stance with bonds offering good long- term value. We flip to being "long" when markets sell off.
- Curve: Directional. When yields rise, curves flatten and vice versa, so avoid doubling up of positions and focus on outright duration.
- Geography: Europe and Australia were H1 leaders although the former proved higher beta, more correlated to energy. Japan will be worth looking at eventually, not least because 99% of investors seem to be short.

Yields rose in H1, providing a decent base for constructive H2

10-year US Government Bonds: Too expensive in March, too cheap in May



Credit outlook: A tightrope of outcomes

Late-cycle expansion phase

Spreads are effectively unchanged from the start of the year, meaning excess carry has done all the heavy lifting. With spreads close to their tightest levels since before the financial crisis, there is little room for anything other than a continuation of excess returns through carry, or enough spread widening to erase those excess returns. It's a tightrope of outcomes.

Credit markets have turned into a low-beta asset class, generally trading within a very narrow range despite the geopolitical backdrop. There are fundamentally good reasons for this. We remain in Goldilocks territory: credit conditions are neutral, balance sheets remain relatively strong, and comparatively high all-in yields continue to support demand.

The risk is that we are moving into a late-cycle expansion phase, triggered by excessive AI-related borrowing that causes leverage to rise and technicals to be overwhelmed by issuance. Hyperscalers have issued over $200bn of debt year to date. Whilst we expect the primary market to slow in the second half of the year, beyond 2026 issuance is likely to remain elevated given capex forecasts across the hyperscalers of close to $1trn next year.

Secondly, whilst company results have been impressive, earnings projections remain high and continue to be upgraded. That implies much of the growth still needs to happen in the second half of the year, a view that looks optimistic given growth remains subdued outside AI-related investment. Equity valuations also look vulnerable and, whilst credit markets can ignore noise, they cannot ignore an equity market correction.

None of this is priced into the markets however, for now, fundamental risk remains low and credit conditions are still easy. But with such tight valuations we believe we need to remain relatively defensively positioned within credit markets and invest for carry, seeking out extra yield through mainly short-dated bond exposure.

With limited scope for spread tightening, credit selection is key and impacted more by what you don't own than what you do. Avoiding names that post disappointing earnings and fall into value traps should help protect performance.

A final note on liquidity. We expect the second half of 2026 to continue to show stress in private markets as default rates rise alongside withdrawal requests. Liquidity premiums in public markets still do not reflect possible spill-over effects and consequently we maintain our overall positioning in liquid credits.

Coming to the end of a European overweight?

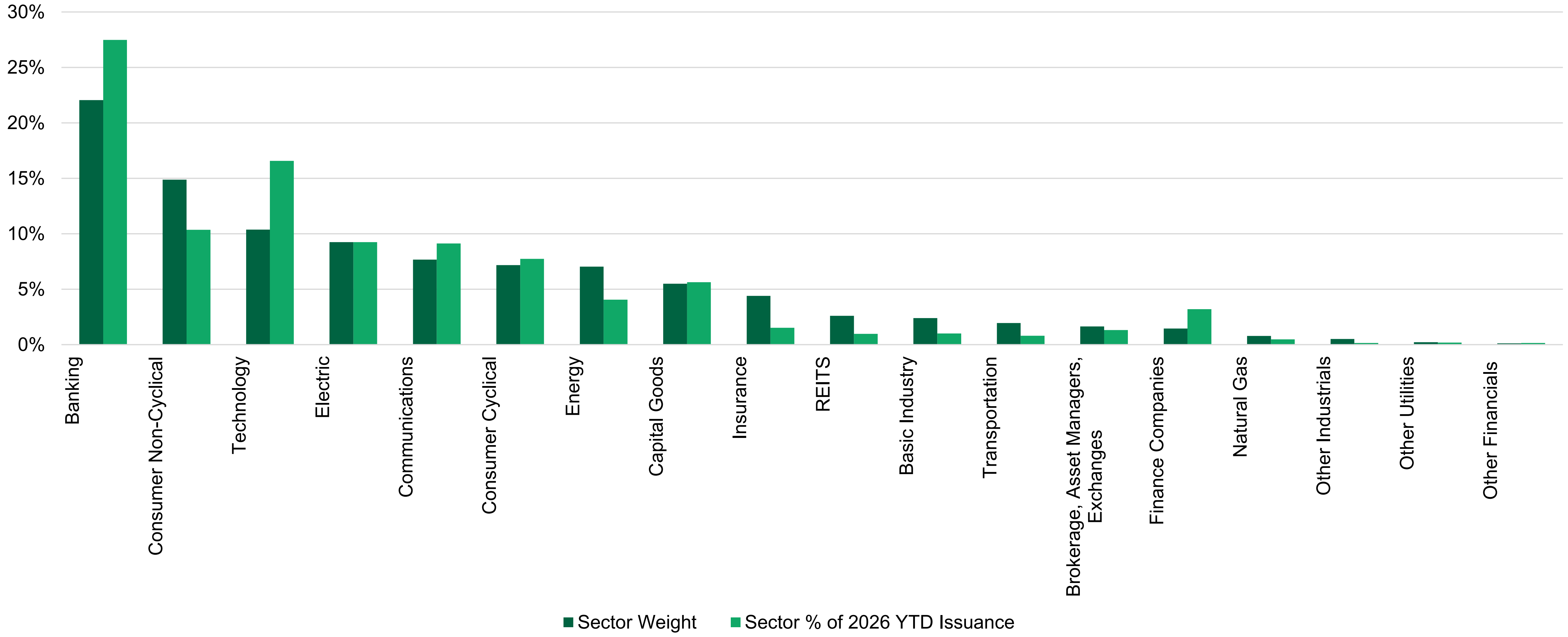
Since the fund launched, we have run an overweight in European vs US credit. This allocation has worked as spreads have compressed between the two regions thanks to value and technicals surrounding AI issuance. European credit hedged back into dollars is starting to look expensive however. We have cut our European exposure down, and where we had some 15%+ more in Europe than US, we now only have just over 3%. We believe there will be further opportunities in the coming months to switch more as individual value arises.

Portfolio implications

- We have cut European credit exposure as valuations are starting to look stretched.
- Continued preference for the belly of the credit curve (5-7 years) and short-dated as valuations and issuance weighs on longer dated bonds.
- We maintain minimal exposure to AI due to technical and fundamental reasons but the second half of the year may generate value in hyperscalers, whose balance sheets are supported by other cashflows.
- Maintain a liquid portfolio as private credit risk looms large over public markets.

Can the credit market absorb AI issuance?

Tech: An increasing part of the US corporate bond index



Biographies

Alex Ralph

Co-Portfolio Manager of Global Strategic Bond strategy

Alex Ralph is a fixed-income investor with over two decades of experience in the industry. She is widely recognized for her strong track record and considered one of the leading fixed-income investors of her generation.

Alex was previously a partner at Artemis Investment Management where she helped set up the bond desk, launched Artemis Strategic Bond Fund and was appointed lead fund manager on the Artemis High Income Fund. The desk managed some £3 billion in credit by the end of her tenure. Alex holds a BSc in Economics from London School of Economics and is a CFA Charter holder.

Alex joined Nedgroup Investments as Senior Fund Manager in 2023 to set up a Fixed Income boutique.

David Roberts

Co-Portfolio Manager of Global Strategic Bond strategy

David Roberts is a fixed income investor with over 30 years' experience in the industry. He was previously partner and head of global fixed income at Liontrust until late 2022. Prior to that, he was head of fixed income for Kames Capital and a member of the executive committee. Earlier in his career, he held roles at Britannia Investment Managers and Lloyds Bank. David holds a joint Honours degree in Economics and Industrial Relations as well as an MSc in Investment Analysis.

David joined Nedgroup Investments as Head of Fixed Income in 2023 to set up a Fixed Income boutique.

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