Investment Insights

Dynamic global fixed income: Investing across the cycle

January 2026

FOR PROFESSIONAL INVESTORS ONLY
Marketing communication

Dynamic global fixed income: Investing across the cycle

Manusha Samaraweera
Investment director

Jeremy Cunningham
Investment director

Key Takeaways

- As we head into 2026, uncertainty continues to dominate the investment landscape. Despite a year of numerous challenges, the global economy has been resilient and valuations across major asset classes remain elevated. Against this backdrop, some economic signals are indicating potential softness, which could challenge these stretched valuations.
- Government bonds are fundamental to providing portfolios with defensive ballast and diversification. However, with developed market government borrowing at record highs, and showing little sign of abating, they may no longer always be the optimal choice for defence. Other areas of the bond market could potentially enhance a portfolio's defensive characteristics.
- A flexible investment approach allows investors to dynamically diversify exposure across regions, sectors, and currencies, creating opportunities for non-traditional and contrarian sources of defence and return. For example, emerging markets debt has been an effective diversifier during periods of market stress during 2025.
- It's not just defence. Macroeconomic conditions have shifted, and today's structurally higher bond yields may provide the potential for capital appreciation as well as income accrual.

After the uncertainties of the past year, 2026 looks set to provide investors with another potentially challenging environment. In part, this reflects the changing structural backdrop we discuss in our wide-ranging thesis, ***The Great Global Restructuring***. This paper explored how growing trade and policy uncertainty, as well as diminishing consensus on rules-based institutions interconnect and impact outcomes for investors. While these forces are driving structural change, the cyclical backdrop also remains highly uncertain.

On one hand, the global economic backdrop remains robust, with its strength reflected in stretched valuations across asset classes, such as equities, gold, and credit spreads. On the other hand, economic signals are beginning to show signs of softness, which makes the expensiveness of risk assets potentially more vulnerable to corrections. For example, payroll growth in the United States has slowed further this year, even as asset prices have remained elevated.

Valuations at higher end of past 3-year ranges

Description	Cheap valuations (3Y period)	As of end-Dec 2025	Expensive valuations (3Y period)
US Equities (P/E ratio)	15.1		22.2
Global Equities (P/E ratio)	16.9		26.3
Bitcoin vs. USD (Spot Price)	16,540		125,261
Gold vs. USD (Spot Price)	1,811		4,533
Oil Index	840		1,182
Property Index	429		615
Global HY Corps (Spread, bps)	543		271
EM Hard Currency Debt (Spread, bps)	554		305

Source: Bloomberg. Data as at 31 December 2025

US Equities: S&P 500 Total Return Index, Global Equities: MSCI All Country World Total Return Index, Oil: Dow Jones Commodity Brent Crude Total Return Index, Property: S&P Global Property USD Total Return Index, Global HY Corps: Bloomberg Global High Yield Corporates, EM Hard Currency Debt: JPM EMBI Global Diversified Index. Note that the S&P Global Property Index serves as a proxy for global property price dynamics and reflects the returns of listed real estate securities, which may differ from valuations of direct physical real estate.

Payroll growth has slowed further this year

Source: Bloomberg. Data as at 31 December 2025

Faced with these potential contradictions, should investors stay invested and try to benefit from further positive growth momentum or exercise prudence and prepare for market corrections? In our view, a carefully constructed allocation to fixed income may allow investors to achieve elements of both.

Defence and diversification

Even if recession is not an investor's base case, holding some defensive ballast against future potential volatility has historically been considered a prudent way to maintain exposure to risk markets like equities.

The need for defensive ballast is one of the traditional reasons for holding core global bonds, and we think it remains as relevant as ever. Part of the reason core bonds are so effective as ballast is the low correlation they have historically had to equities. However, the abrupt sell-off of both bonds and equities in 2022 has led many investors to question the diversification merits of global bonds. This scepticism has driven a cohort of investors to seek diversification through other sources such as alternative assets. While such alternatives have their merits, we think there are some key reasons why investors should not overlook an allocation to core bonds.

1. 2022 stands out as a highly unusual period in the history of fixed income investing. Starting yields were ultra-low and in the preceding period, central banks had not needed to deal with higher inflation leaving them unprepared for the prevailing inflationary shock. Neither of these factors are true today.
2. As the macro-economic environment has "normalised", the old-world mechanics of bonds have also returned. Today's structurally higher yields restore the potential for capital appreciation when interest rates fall during risk-off events. This was mathematically difficult when rates were low prior to 2022.
3. Inflation is moderating. While the fight for lower inflation is certainly not over, the combination of an energy-related supply-side shock and strong post-pandemic demand that led to the surge in inflation in 2022, is no longer present.

In summary, we think the traditional rationale for holding global bonds, specifically to provide defence and diversification versus risk assets like equities, remains highly relevant. However, along with evolving markets, the way that investors achieve these investors should also evolve.

Rethinking traditional bond diversifiers: Are yesterday's stabilisers today's stressors?

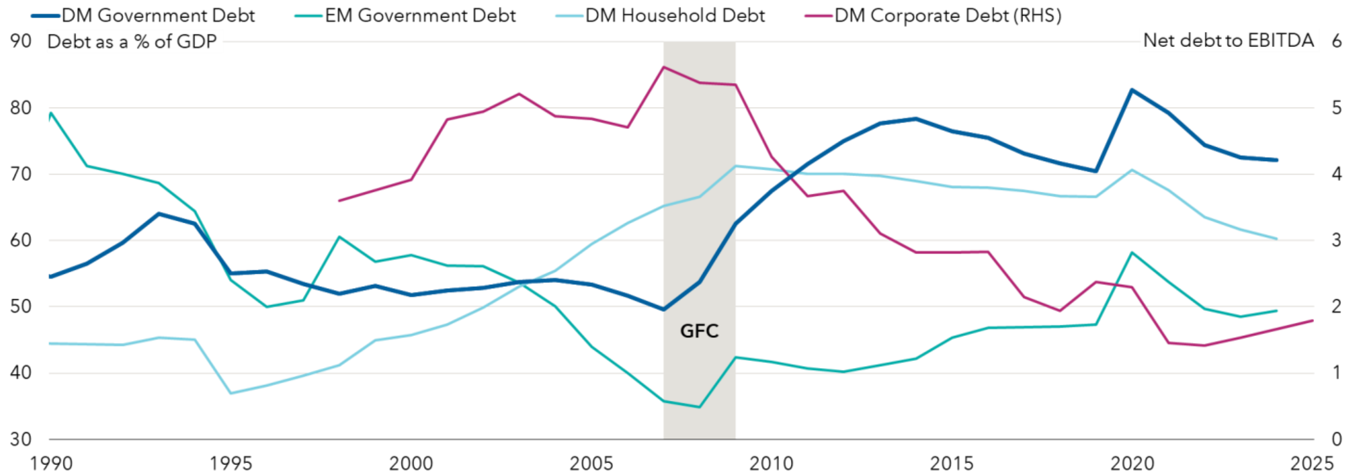
Historically, a simple core global bond portfolio grounded in developed market (DM) government bonds has been a core part of the risk-conscious investor's portfolio.

For instance, a portfolio that is long US dollars and long US Treasury exposure would be expected to provide a reliable source of defence in periods of market stress. The rationale underlying this assumption is simple, DM governments are generally seen as safe havens in times of stress due to their ability to pay back obligations when economies falter. Additionally, DM central banks have historically been seen as providing support to markets during periods of economic or markets stress.

Developments over the past 15 years, however, challenge these assumptions:

First, debt dynamics have shifted dramatically since the global financial crisis (GFC). DM governments have taken on significantly more debt. By contrast, emerging market governments, consumers, and corporates have generally reduced their borrowing. This trend is likely to persist if, as expected, fiscal deficits continue in developed economies. Ultimately, this could lead markets to question developed market governments' ability or willingness to be liquidity providers in economic downturns.

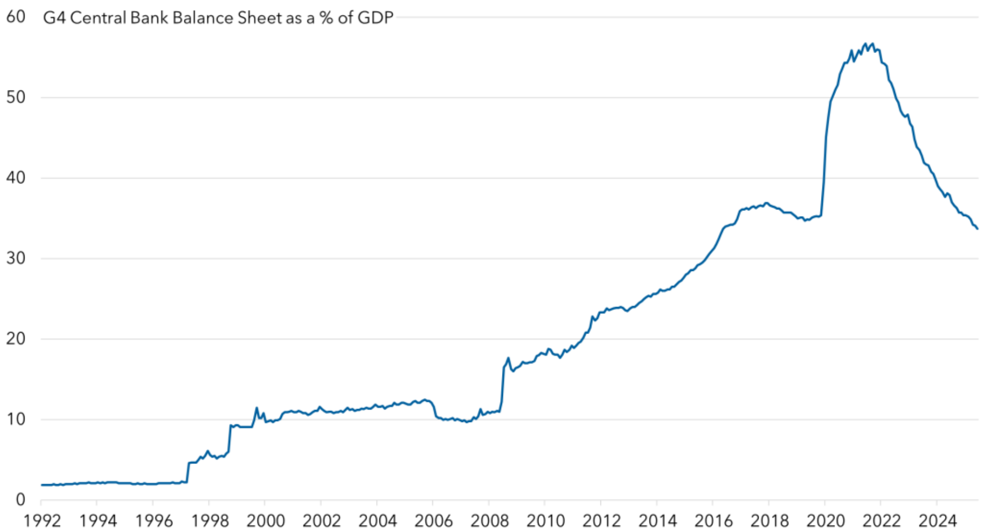
Global debt dynamics since the global financial crisis (GFC)



Source: LHS axis – IMF. Data as at 31 December 2024 for DM Government Debt, EM Government Debt and DM Household Debt. RHS Axis – Data as at 31 December 2025 for DM Corporate Debt, based on the net debt to EBITDA ratio of the MSCI World Index.

Second, central bank influence on markets could diminish over time. A growing willingness for balance sheet contraction (achieved through quantitative tightening) may mean less liquidity and a reduced ability to intervene in markets during periods of stress. Additionally, growing political pressures and questions about central bank independence potentially erode the central bank's authority and effectiveness.

Central bank balance sheets have declined since 2022



Source: Bloomberg. Data as at 30 September 2025

Together, these trends suggest that developed market governments and central banks may have less capacity to stabilise markets and influence asset prices in the future. In fact, the opposite may be true. The institutions and governments once relied upon for market stability could increasingly be sources of instability.

These developments do not suggest a complete departure from government bonds as a defensive anchor in portfolios; rather, we think they highlight that the traditional approach may no longer be sufficient. One potential option is to seek defence from across a broader array of sources and to extend diversification beyond traditional boundaries.

In practice, this might mean implementing a multi-faceted investment strategy to achieve the desired defensive risk position. For example, a traditionally defensive DM government bond allocation, such as US treasuries, could be combined with other sources of debt that have lower levels of borrowing, such as, higher quality emerging market sovereigns or investment grade corporate bonds. So that this does not add additional unwanted risk, the allocation can be paired with a relative value sector position or selective currency exposure. The successful implementation of a strategy of this kind requires high levels of flexibility that are reserved for a more dynamic approach to global bonds.

The Case for Dynamic Global Bond allocation

What is a Dynamic Global Bond strategy? *Generally speaking, an investment style that combines elements of benchmark-aware core global bonds (benchmarked to the Bloomberg Global Aggregate Index) with a more total return and flexible approach to achieve excess returns. It is an investment style that seeks to broadly replicate the same investment characteristics experienced in a core global bond allocation while aiming for higher active returns by enhancing active risk across diversified risk factors.*

Flexibility is a basic requirement for successful active investors. Arguably, it matters even more in a global multi-sector aggregate context. This is because a higher degree of flexibility not only enables investors to pivot towards areas where greater opportunity lies, but it also provides managers with the scope to mitigate and control investment risk to achieve balance within the portfolio.

Underpinning the ability to control risk is a deep understanding of the varying correlations and risk factors across global fixed income sectors. Correlations can be low, or at times even negative – for instance credit vs duration risk. Active global fixed income managers can use these uncorrelated assets to build well diversified and robust portfolios. However, correlations are not static and as relationships change, there are often environments when sectors can become less efficient hedges. Managers need to be aware of any such changes and be able to pivot to markets that can provide a more effective hedge.

A global bond allocation is not just about defence

Global bonds can be more than a purely a defensive strategy. Today, with the global bond market standing at approximately US$150 trillion[1], the asset class offers a rich source of potential capital appreciation and income opportunities.

Some key opportunities we believe a more dynamically minded active manager in global bonds can now exploit include:

- Global policy divergence: There is a high degree of divergence between monetary and fiscal policy expectations across DM and EM economies today. This creates potential opportunities for active managers to position for relative value exposures.
- Duration: the relatively high yields now offered by bond markets mean adding duration is now less expensive than it has been for much of the post GFC period.
- Emerging Markets: Opportunities exist within emerging markets, particularly in local rates and foreign exchange (FX). Some of these issuers benefit from robust economies and central banks that are ahead of the curve in fighting inflation and therefore have the flexibility to further ease policy.
- Spread dispersion: While headline spread levels are relatively tight across most credit sectors, valuation dispersion between issuers remains high. This

[1] Source SIFMA. Latest data from SIFMA showed that global bond markets reached US4145 trillion as of end 2024. With continued net supply and funding needs in 2025, the size of global bond markets is expected to have reached >US$150 trillion as of end 2025.

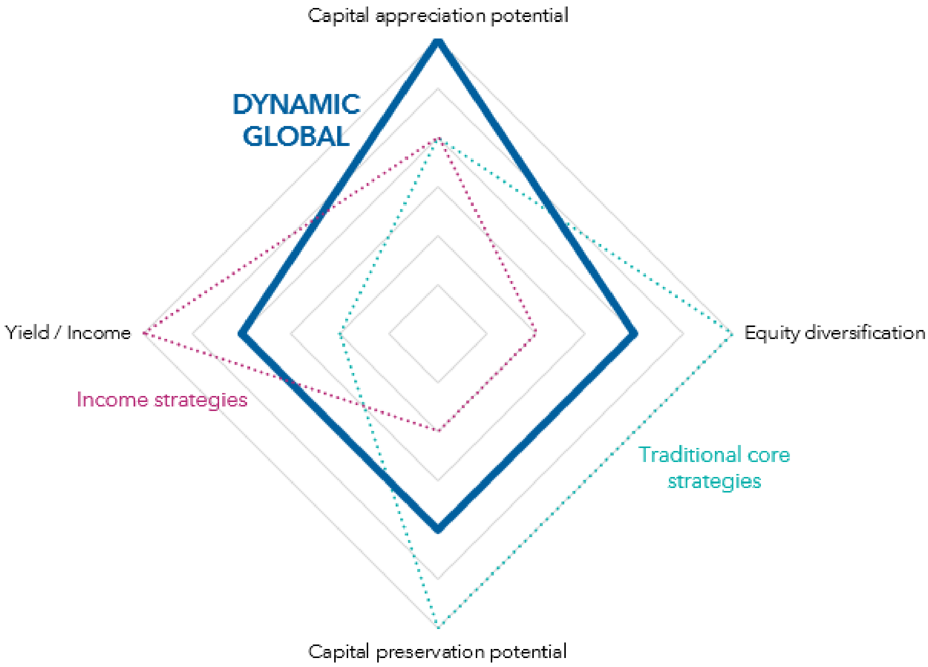
provides opportunities for fundamental research and bottom-up security selection to identify potential investments.

Balancing the benefits of fixed income

A dynamic global bond strategy is designed to balance the key benefits of fixed income: capital preservation, diversification, income, and capital appreciation. Maintaining exposure to high-quality assets may help mitigate against equity market volatility. Diversification can be further enhanced by having flexibility across geographies and sectors.

By having a dynamic exposure to credit sectors such as high yield, investment grade, emerging markets and securitised assets investors have the potential to access attractive yield opportunities without necessarily making significant compromises on quality. Actively managing this dynamic allocation with a total return orientation can enable investors to look beyond pure defence to pursue opportunities for capital appreciation.

A dynamic core-profile-balancing capital appreciation, income and diversification



Source: Capital Group.

Conclusion: Why now for Dynamic Global Bonds?

In an environment where volatility is likely to be elevated and the outlook somewhat uncertain, the ability to effectively adapt portfolio positioning can help strengthen defensive capabilities and capture potential investment opportunities. This is the core of a dynamic global bond approach with income, capital preservation, diversification and capital appreciation all balanced.

Manusha Samaraweera *is a fixed income investment director at Capital Group. He has 16 years of industry experience and has been with Capital Group for two years. He holds a double bachelor's degree in finance and law from the University of Sydney, Australia. He also holds the Chartered Financial Analyst® designation. Manusha is based in Singapore*

Jeremy Cunningham *is an investment director at Capital Group. He has 39 years of industry experience and has been with Capital Group for 10 years. He holds the Chartered Financial Analyst® designation. Jeremy is based in London.*