

Fixed Income Focus

Summary

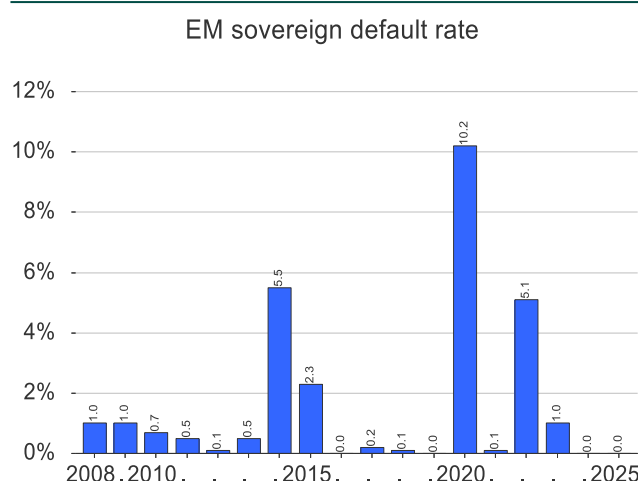
- 1. Policy divergence deepens: ECB holds, Fed cuts.** We expect the Fed to deliver two rate cuts in 2026, bringing the terminal rate to 3.25%, whilst the ECB remains on hold throughout the year with the first hike forecast for September 2027.
- 2. UK gilts stand out, US and German bonds fairly valued.** Our 12-month targets for 10-year yields are 2.75% for Germany, 4.25% for the US, and 4.30% for the UK. We maintain a Positive view on UK gilts. We remain Neutral on both US Treasuries and German bunds as both trade close to our targets.
- 3. Fed independence under unprecedented attack.** The Trump administration's attempts to remove Fed Governor Lisa Cook and investigate Chairman Powell have sparked global outrage. Whilst markets remain calm, the implications for Fed autonomy and the US sovereign rating warrant close attention.
- 4. Agency MBS: superior alternative to investment grade credit.** Given their similar yield (4.7%), lower duration and government guarantee, they offer an attractive option. Additionally, Trump's \$200 billion GSE purchase directive provides technical support, while IG corporates face significant supply pressures.
- 5. 2026 Top Conviction: EM local currency bonds offer compelling carry and FX upside.** EM local currency bonds offer compelling yields around 6%, rate cut potential exceeding market pricing and FX appreciation against the dollar. Euro-based investors should consider exposure with FX hedging. Technical support from under-ownership and strong fundamentals support our Positive view.
- 6. Where to find value:** We favour UK gilts, Emerging Markets local currency bonds, US Agency MBS, US TIPS, EUR/GBP investment grade corporate bonds.

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CHART OF THE MONTH: SECOND YEAR IN A ROW WITH NO DEFAULTS IN EMERGING MARKETS



Source: LSEG Datastream, JP Morgan, 15/01/2026

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Central banks

Policy divergence: ECB holds, Fed cuts

European Central Bank (ECB)

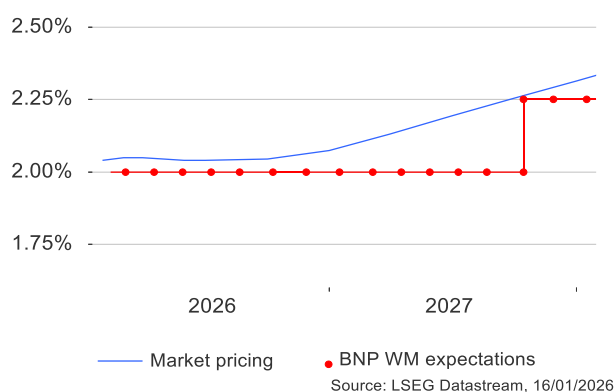
Data-driven restraint: Eurozone inflation stabilised near the ECB's 2% target in late 2025. The December staff projections forecast 1.9% average inflation in 2026 alongside 1.2% GDP growth, allowing policymakers to deem current rates "neutral".

ECB holds firm: Inflation is more likely to overshoot than undershoot the ECB's target at the end of 2026, in our view. The Governing Council's rhetoric underscores the lack of urgency for change, with French official Villeroy de Galhau dismissing 2026 hikes as "fanciful".

Steady through 2026: We expect policy rates to remain unchanged throughout the year. The market concurs, pricing out easing within the next 12 months. We forecast the first move (a rate hike) in September 2027, when growth and inflation should pick up thanks to German and EU fiscal plans.

WE SEE NO RATE CHANGE IN THE EUROZONE THIS YEAR, IN LINE WITH MARKETS

ECB pricing



US Federal Reserve (Fed)

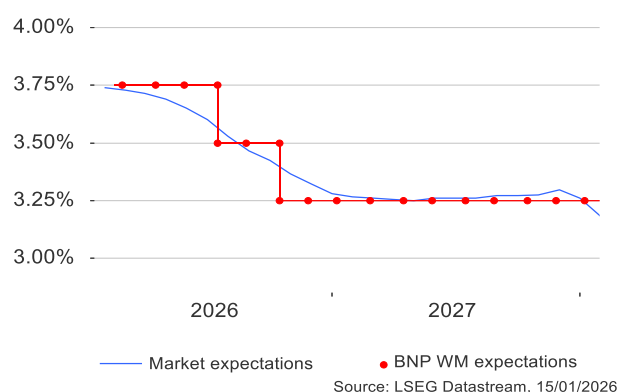
Sticky disinflation: December's CPI confirmed that headline inflation remained at 2.7% year on year. Alternative measures (trimmed mean, median, supercore) still point to a gentle rise, around 2.75% to 3.10%. We expect inflation to peak in the second quarter before easing modestly.

Cooling labour market: The latest jobs report shows the labour market is cooling in orderly fashion. The "low hire, low fire" trend persists and the unemployment rate has edged lower.

Our view: Some Fed officials still anticipate rate cuts citing weak payroll growth. Political pressure to lower rates has become intense (see the Topics section). The newly appointed Federal Reserve Chair will be compelled to cut rates at the June FOMC meeting, or he will be seen as a weak leader if he fails to persuade his colleagues to do so. We retain our forecast of two rate cuts this year, now scheduled for June and September, which will bring the terminal rate to 3.25%.

WE EXPECT TWO RATE CUTS IN THE US THIS YEAR, IN LINE WITH MARKETS

Fed pricing



INVESTMENT CONCLUSION

In our view, the Fed will cut rates twice this year to 3.25%, as we expect inflation to peak in Q2, payroll growth is weak, political pressure is intense, and the new Chair needs to demonstrate strong leadership by convincing colleagues to cut rates at the June FOMC meeting.

In the eurozone, inflation is on track and growth is gaining momentum. We predict the ECB will keep rates at 2% this year, with a potential hike in Q3 2026. The market now aligns with our forecasts.



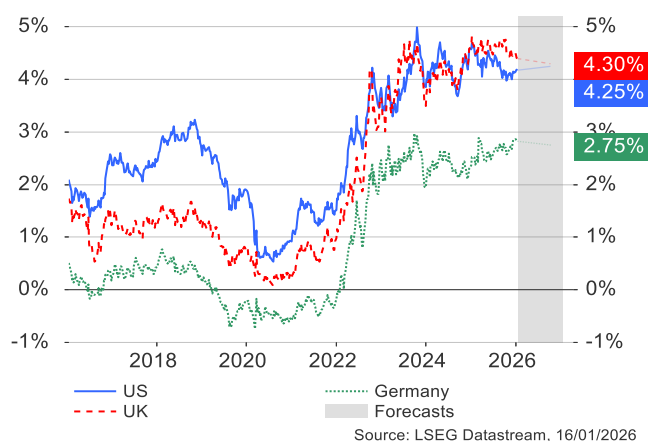
Bond yields

Differentiated opportunities

Divergent trajectories: Government bond yields have displayed contrasting dynamics in early 2026. US 10-year Treasuries remain range-bound around 4.17%, reflecting balanced inflation and fiscal concerns. German bunds hold steady near 2.82%, supported by expected bond issuance. UK gilts have seen the most pronounced moves, retreating from above 4.60% in early January to 4.40% as weaker-than-expected PMI data, softer wage figures and dovish BoE commentary eased inflation concerns.

Positioning for targets: Against our 12-month targets of 2.75% for Germany, 4.25% for the US and 4.30% for the UK, gilts offer some room for appreciation in addition to attractive carry. The recent dovish shift in BoE messaging, combined with softening growth momentum, supports our constructive view. Both Treasuries and bunds trade close to our forecasts, warranting a neutral stance. Market pricing now reflects more aggressive BoE easing than previously anticipated, which should underpin gilt performance over coming months.

10-YEAR RATES



	Maturity (years)	15/01/2025	3-month target	12-month target
USA	Policy rate	3.75	3.75	3.25
	2	3.57	3.60	3.60
	5	3.77	3.75	3.75
	10	4.17	4.10	4.25
	30	4.80	4.75	4.90
Germany	Policy rate	2.00	2.00	2.00
	2	2.11	2.00	2.00
	5	2.43	2.25	2.25
	10	2.82	2.75	2.75
	30	3.40	3.50	3.60
UK	Policy rate	3.75	3.50	3.50
	2	3.68	3.60	3.30
	5	3.87	3.80	3.75
	10	4.39	4.40	4.30
	30	5.13	5.20	5.10
Japan	Policy rate	0.50	0.75	1.25
	2	1.17	1.05	1.30
	5	1.63	1.40	1.60
	10	2.17	1.90	2.10
	30	3.47	3.35	3.50

Source: Refinitiv Datastream, BNP Paribas WM

INVESTMENT CONCLUSION

We maintain a Positive view on UK gilts, which offer the most attractive risk-reward at current levels, versus our 4.30% year-end target. We remain Neutral on both US Treasuries and German bunds, as both markets trade close to our 12-month forecasts of 4.25% and 2.75% respectively.



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Topics in Focus

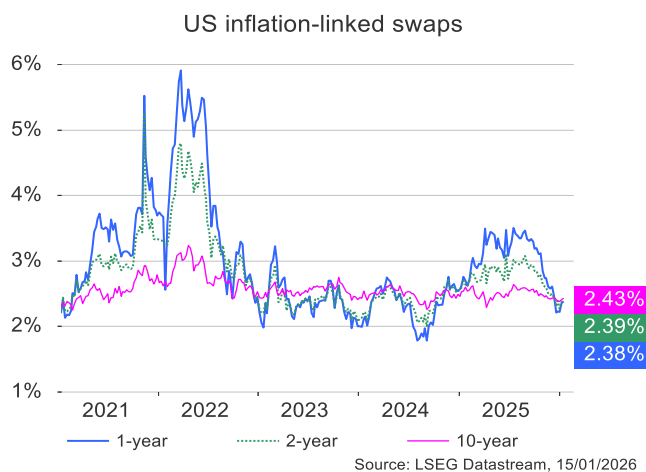
A step too far against the Fed independence

Under attack: The Fed's independence is facing unprecedented threats from the Trump administration. The attempted removal of Lisa Cook, a Fed governor, on dubious allegations of mortgage fraud sets a disturbing precedent. The Supreme Court hearing will be on 21 January, with a decision expected in June-July.

Outrage and backlash: A criminal investigation into Chairman Powell's testimony on the Fed building renovation has sparked widespread outrage and condemnation from politicians and central bankers worldwide. This move appears to be Trump's way of signalling to Powell and his successor that he expects compliance with his views on policy rates, and that those who disagree may face consequences.

Market implications: Fitch Ratings has warned that Fed independence is crucial for the US sovereign rating. Whilst markets have remained calm, with long-term inflation expectations and the 10-year term premium unchanged, the implications of this assault on the Fed's autonomy are far-reaching and warrant close attention.

NO MARKET REACTION FOLLOWING THE ATTACK ON THE FED'S INDEPENDENCE

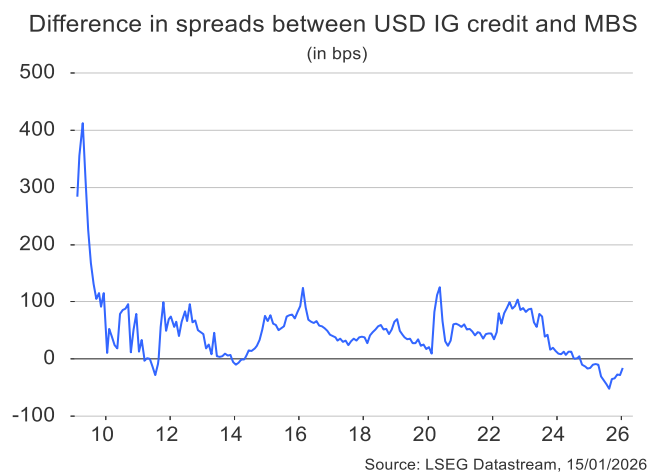


Agency MBS: A compelling alternative to USD investment grade credit

Attractive alternative to USD IG credit: Agency mortgage-backed securities offer yields comparable to USD investment grade corporates whilst presenting a superior risk profile and carrying implicit government guarantee. Current coupon MBS yield 4.7% versus IG corporates at 4.8%, with MBS duration at just 5.5 years compared to 6.9 years for corporates. This lower duration provides meaningful protection should yields rise whilst maintaining attractive income. From a valuation perspective, IG spreads are at the lowest in 20 years (0th percentile), whilst MBS spreads sit at the 7th percentile, offering better relative value.

Technical support builds: The MBS market benefits from President Trump's directive to GSEs to purchase \$200 billion in agency MBS, contrasting with the Fed's ongoing quantitative tightening at \$20 billion monthly. Meanwhile, IG corporate bonds face supply pressures close to \$2 trillion in 2026, driven by AI-related capital expenditure.

MBS SPREADS OFFER BETTER RELATIVE VALUE THAN USD IG CREDIT



INVESTMENT CONCLUSION

- Fed independence under attack: Markets have looked through the political noise so far.
- We favour exposure to Agency MBS over USD investment grade corporates. MBS offer similar yields with lower duration, government guarantee and technical support from the \$200 billion Trump administration purchase directive, and no large supply wave unlike USD IG.



2026 Top Conviction

Emerging Market Local Currency bonds: High yields meet improving fundamentals

Monetary policy tailwinds create carry opportunity:

Inflation in many EM economies has moderated significantly, giving central banks room to cut rates ahead of the Fed and creating an attractive carry and roll environment. With our policy targets, we expect more rate cuts than currently priced into markets for both 2026 and 2027. Colombia, Brazil, and Turkey's central banks stand out as having more cutting potential, in our view. The JPM GBI-EM index currently yields around 6%, whilst real yields remain well above developed market equivalents, providing attractive income and a cushion against volatility.

FX valuations attractive against the dollar:

We expect the dollar to weaken over our 12-month horizon, making EM currencies an attractive prospect. Many EM currencies are undervalued relative to fundamentals, offering potential for appreciation and an additional source of return beyond the carry component. While euro-based investors may want to consider hedging due to expected depreciation, USD investors can benefit from potential appreciation,

enhancing total returns. In our view, Eastern European countries offer the most significant upside against the USD

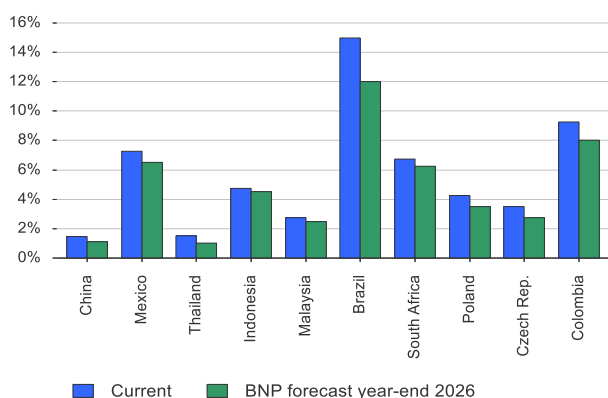
Stronger fundamentals: Several EM countries have taken steps to consolidate budgets and improve policy credibility. Debt-to-GDP ratios are under 60%, notably lower than the over 110% seen in advanced economies. There have been no defaults in 2025, for the second year in a row. In our view, Middle Eastern countries have the best fundamentals. This fiscal discipline has created a more stable investment environment than in previous EM cycles.

Technical support from under-ownership:

International investors remain underweight EM local bonds compared to historical allocations, leaving room for further inflows. Thailand, Malaysia, and Egypt are the most under-owned by funds and ETFs. Growing domestic institutional ownership from pension funds creates additional support. In addition, EM local bonds offer low correlation to US Treasuries, providing portfolio diversification.

WE SEE FURTHER MEANINGFUL EM RATE CUTS AHEAD

EM Policy rates with BNP forecasts



EM CURRENCIES ARE REBOUNDING AGAINST THE DOLLAR

Emerging Market Currency index
(JP Morgan index)



INVESTMENT CONCLUSION

EM local currency bonds offer compelling yields around 6%, rate cut potential exceeding market pricing and FX appreciation against the dollar. Euro-based investors should consider exposure with FX hedging. Technical support from under-ownership and strong fundamentals support our Positive view.



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Our Investment Recommendations

Asset class	Zone	Our opinion	
Government bonds	Germany	=	We turned Neutral from Positive on German sovereign bonds. Prefer 2-5 years maturities.
	Peripheral countries	=	Neutral on peripheral debt (Portugal, Italy, Spain, Greece).
	United Kingdom	+	Positive on UK government bonds.
	United States	=	We turned Neutral from Positive, prefer 2-5 years maturities. Positive on TIPS.
Corporate bonds Investment Grade (IG)	Eurozone United Kingdom United States	+	<ul style="list-style-type: none"> Positive on eurozone and UK IG corporate bonds, and Neutral on US corporate bonds. We prefer maturities up to 7 years in the eurozone and up to 5 years in the US. Positive on convertible bonds in the eurozone.
Corporate bonds High Yield (HY)	Eurozone and United States	=	<ul style="list-style-type: none"> Neutral on HY bonds. Positive on <i>fallen angels</i> and <i>rising stars</i>.
Emerging bonds	In hard currency	=	Neutral on EM hard currency bonds (sovereign and corporate).
	In local currency	+	Positive on EM local currency government bonds.

Market Data

	10-year rate (%)	Spread to bund (bp)	Spread change 1 month (bp)
United States	4.17	---	
Germany	2.82	---	
France	3.49	67	-4
Italy	3.41	59	-9
Spain	3.21	39	-5
Portugal	3.21	39	8
Greece	3.35	53	-8

15/01//2026
Source: Refinitiv Datastream

	Yield (%)	Spread (bp)	Spread change 1 month (bp)
Global	3.52	26	-3
Corporate bonds IG EUR	3.14	75	-1
Corporate bonds IG USD	4.81	76	-4
Corporate bonds HY EUR	4.90	266	-16
Corporate bonds HY USD	6.48	278	-26
Emerging government bonds in hard currency	6.59	229	-1
Emerging government bonds in local currency	5.87	210	-7

15/01/2026
Source: Refinitiv Datastream, Bloomberg

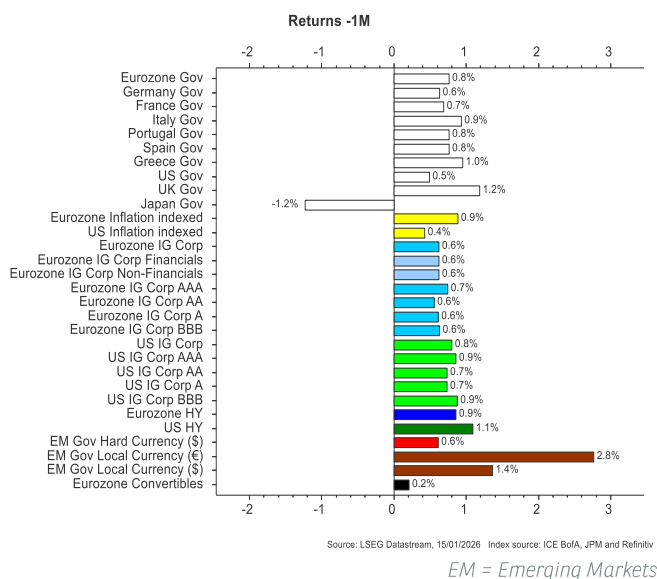


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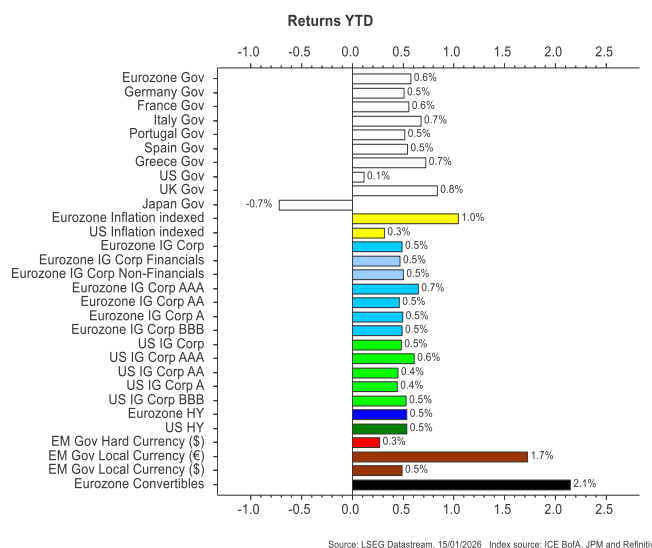
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Returns

OVER ONE MONTH



SINCE 01/01/2026



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Jean-Roland DESSARD

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Isabelle ENOS

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LUXEMBOURG

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