MACKENZIE
Investments

Mackenzie Fixed Income Team

Q3 quarterly report

The second quarter delivered a changing of the guard at the Federal Reserve, an interim peace with Iran, and a bond market that finally stopped pricing hope.

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Chief Fixed Income Strategist

Brent spent much of the quarter above $100 with the Strait of Hormuz closed, then fell roughly 21% in June on the interim agreement, but the damage was done, with headline CPI at 4.2% y/y in May, while growth never wobbled, helped again by AI capex. The Fed held in April and June, but June was the story as Kevin Warsh's first meeting as Chair delivered a sharply shorter statement, no forward guidance, and half the committee projecting at least one hike.

Canada spent the quarter debating whether it was in recession, with the Bank of Canada holding at 2.25% in April and June, with core inflation near 2% and little energy pass-through. April GDP rose 0.5% m/m, taking some air out of the recession narrative, although May's flash was just 0.1% m/m.

Looking into Q3 and beyond, the theme is divergence, with the AI capex buildout at the centre of it. As we have argued since last fall, the spend on data centres, power and chips is a large, persistent driver of US growth and inflation, and may be the key reason the US economy remains exceptional in the quarters ahead. That is why we now think the Fed hikes before year-end, probably 25 bps in September or the fourth quarter, and why markets still underestimate how blunt a Warsh Fed can be on inflation. Even with Brent back in the low $70s, 2.5% to 3.0% as the new 2% remains our framework, and the long end has to carry term premium, heavy issuance and fiscal drift. Call it a 4.30% to 4.65% range on US 10s, with the risk slightly skewed higher.

Canada is the other side of that trade, and we would view the April bounce as a correction, not a recovery. The labour market is soft, business investment keeps falling on tariff and USMCA uncertainty, the mortgage reset cycle grinds on, and core inflation gives the Bank room to ease. We continue to believe the Bank cuts before year-end, probably 25 bps.

Elsewhere, Europe is absorbing an energy import bill it did not need, leaving the ECB stuck between weak growth and imported inflation. The BOJ hiked to 1.0% in June with the yen at four-decade lows and more hikes coming, keeping pressure on global duration. Emerging markets remain a story of energy haves and have-nots, though carry still looks okay as long as the Fed does not become overly hawkish.

Put that all together and the Q3 playbook is understanding the inflation pass-through, patience on duration, selectivity across the curve and credit, and owning the Canada versus US divergence directly. As we thought in Q2, central banks are no longer moving as a pack, and that divergence, as well as the inflation reaction function, is where the opportunity sits.

Mackenzie Fixed Income Team views

	Significant underweight	Underweight	Neutral	Overweight	Significant overweight
Duration			○		
CAD duration			○		
USD duration			○		
EUR duration		● →	●		
Credit			○		
Investment grade credit				○	
High yield corporate		○			
Leverage loan			○		
Private credit				○	
Inflation linked bonds				○	
Emerging market local debt				○	
Currencies					
USD			●	← ●	
Emerging market currencies				○	

○ Indicates no change ← → Indicates change

Source: Mackenzie Investments. As at June 30, 2026.

Investment grade fixed income

The conflict in Iran was the driver of markets during the second quarter, feeding through into yields, currencies, risk assets and inflation readings and expectations. The quarter started with Brent crude close to $120 per barrel, a level again reached at the end of April. May and June saw a grinding decline as the conflict ebbed, news was more positive and market participants assumed the worst was over. Oil futures closed the quarter below $73 per barrel, barely above pre-conflict levels.

In the US, the second quarter saw the transition of Fed leadership from Jerome Powell to Kevin Warsh. Policy remained unchanged, with the Federal Funds Target Rate remaining at 3.50%–3.75%, although the market took Warsh's press conference as more hawkish, pushing up yields and flattening the curve. US yields (2s, 5s, 10s and 30s) rose 37.5 bps, 27 bps, 15 bps and 4 bps, respectively. The situation in Canada was markedly different, with weaker economic data driving yields lower by 8–12 bps across the curve.

Risk assets ignored the rise in yields, with equities continuing their resilience and focusing on the AI/hyperscaler/chip manufacturer trade. Similarly, investment-grade credit remains extremely tight by historical standards despite huge issuance across these industries, including a Canadian record issue by Alphabet that was then immediately eclipsed by Amazon. Attractive all-in yields and asset mix rebalancing, driven by strong equity markets, continue to support positive fund flows into both CAD and USD fixed income markets, helping the market absorb the massive bond supply year to date (H1 2026 supply in Canada and the US rose by about 33% and 58%, respectively, from H1 2025). If any crack were to appear, it would be in the long end of the credit curve, where hyperscalers tend to skew their jumbo issuance. CDX IG and HY spreads, which had started the quarter at the widest levels of the year due to the Middle East conflict, closed near their tightest points, with CDX IG at 51 bps and CDX HY at 305 bps.

With high geopolitical uncertainty, we remain cautious on risk. Duration and curve positioning are close to benchmark. Active risk is focused on carry positions that are more cyclical (high-yielding, Latin America-focused), as well as countries that can benefit from sustained higher oil and commodity prices (Norway, Brazil). We have added inflation-protected securities at the long end of the curve, with real yields at multi-decade highs, and would look to opportunistically add to this risk sleeve.

There are differing opinions in the market on whether the Fed is likely to raise rates over the coming months. Some participants are taking Warsh's hawkish comments as a signal, while others are assuming the hawkishness was inevitable to show his independence from a government that has been pushing for lower rates. The outlook for the Fed is therefore unclear. There is more consensus in Canada, where the weaker economy has begun to show some stabilization despite falling into a technical recession. The Bank of Canada is likely to be on hold into the first quarter of 2027, giving the economy time to recover from an improving geopolitical outlook.

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Global fixed income

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The second quarter of 2026 was defined by the partial reversal of the first-quarter energy shock and a hawkish repricing of global monetary policy. Oil prices and short-term inflation expectations retraced much of their March surge as supply concerns eased, but realized inflation remained firm and growth proved more resilient than expected. Global fixed income markets finished the quarter in positive territory, as carry and resilient credit markets offset substantial rate volatility.

In the US, hiring slowed without developing into a broad layoff cycle, keeping recession risk contained. Core PCE, the Fed's preferred measure of inflation, accelerated to 3.4% in May, reinforcing the view that disinflation had stalled. The Federal Reserve held the federal funds rate at 3.50%–3.75% in June, but its projections shifted higher, and market pricing moved from cuts to hikes. Higher real yields and persistent fiscal supply pressure kept the long end volatile and made curve selection more important than an outright duration call.

Across Europe, weak activity coexisted with renewed inflation pressure. The European Central Bank raised its deposit rate to 2.25% in June, while the Bank of England held Bank Rate at 3.75%, with a minority of policymakers voting for an increase. The energy shock faded more quickly in market prices than in inflation data, leaving policymakers cautious despite soft growth. In Japan, the Bank of Japan raised the overnight rate to 1.0%. JGB yields remained volatile, and the yen stayed weak, keeping both policy normalization and the risk of official intervention in focus.

Canada's macroeconomic picture improved from a weak starting point. April GDP rose 0.5%, employment rebounded in May, and unemployment fell to 6.6%. Headline CPI rose to 3.2%, largely because of energy and food, while the Bank of Canada's preferred core measures remained close to 2%. The BoC held its policy rate at 2.25% at both meetings. The data weakened the case for imminent aggressive easing, but labour-market slack, housing sensitivity and trade uncertainty continued to argue against a sustained hiking cycle.

Inflation markets showed a notable disconnect. Short-dated break-even rates followed oil lower, while realized core inflation and long-term real yields remained elevated. We viewed this divergence as an opportunity in inflation-protected securities and a reason to remain cautious on unhedged nominal duration.

Emerging market assets remained selective rather than uniformly strong. High real carry and commodity exposure supported several local markets, but currencies remained sensitive to US rate repricing and the dollar's mid-quarter strength. By quarter-end, the dollar rally appeared increasingly mature, creating more favourable asymmetry in selected emerging market currency positions.

Our US duration stance remained tactical and curve-specific. We began the quarter with a modest long-duration view, based on the risk that elevated oil prices would weaken growth, but reduced the position as markets remained focused on inflation and fiscal pressure. By quarter-end, aggregate US duration was close to neutral. We added long-dated US inflation-protected securities as a source of real carry and inflation protection.

In Canada, we held a tactical duration overweight, concentrated in the long end around index extension. We continue to believe that domestic slack and core inflation near target should limit the need for a sustained hiking cycle, while constrained long-bond supply and pension demand continue to support the back end.

We maintained underweight duration positions in the euro area and Japan. In Europe, the view reflected the ECB's renewed tightening bias, sensitivity to energy prices, and heavier fiscal and defence issuance, with a relative preference for the belly over the front and long ends. In Japan, continued policy normalization kept us underweight JGB duration. We paired this with a smaller long-yen position, recognizing the asymmetric risk of official action at weak exchange-rate levels.

After taking profits on Chilean exposure early in the quarter, currency positioning ended Q2 with a modest bearish US dollar bias. We expressed this mainly through a long Mexican peso position and Brazilian local-rate exposure, with the currency left unhedged. Mexico was treated as a currency rather than a duration position, and Brazil as a carry opportunity rather than a clean policy conviction. We also maintained a long Norwegian krone position against the Canadian dollar and remained underweight the Swedish krona.

Our credit posture remained defensive: overweight government bonds; underweight broad corporate and securitized credit, particularly investment grade; and selectively exposed to low-duration high-yield bonds and loans. That caution detracted as spreads remained firm, but current valuations do not justify abandoning protection against a late-cycle growth or funding shock.

As we enter the second half of 2026, global fixed income remains attractive from a carry perspective, but we do not see a clean case for broad duration risk. Oil prices and market-based inflation expectations have normalized faster than realized core inflation. The Fed, ECB and BoJ face pressure to remain restrictive or tighten further, while the BoC has more room to wait because domestic slack remains visible.

We therefore favour relative-value positions: Canadian duration over Europe and Japan, inflation-linked bonds over comparable nominal exposure, and selected high-carry emerging market currencies and local rates. The main risks are a renewed energy shock from geopolitical re-escalation, further term-premium pressure from fiscal supply, an adverse North American trade outcome, and a sharper slowdown that would challenge credit. We will keep overall duration controlled, preserve a defensive credit bias, and rely on curve, country and currency selection rather than a single global rates direction.

High yield bond markets

Q2 opened with US high yield and broader risk markets still absorbing the Iran War shock that had defined March: spiking oil, fears of global shortages, and rate-cut expectations being unwound in real time. However, the quarter closed in a very different place, as ceasefire headlines, an announced US-Iran framework, and the prospect of Hormuz reopening drove a sharp risk-on retrace. The US high yield market returned a solid ~2.5% for the quarter. Spreads tightened from 328 bps to 275 bps, closing just 13 bps off the intra-quarter lows and only 20 bps off their 10-year tights. The headline performance masks meaningful dispersion beneath, with single-name bond moves materially diverging from the index.

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Overall, for H1 2026, high yield bonds have returned 1.9%, with Single-Bs (+2.4%) outperforming BBs (+1.8%) and CCCs (+0.1%). Sector dispersion has been meaningful, with Chemicals (+4.4%) and Energy (+4.0%) leading, while paper/packaging (-0.8%) was a sharp laggard. Primary issuance accelerated from Q1 as the risk-on tone brought more deals to the market. YTD US high yield bond issuance totalled $186.9 billion, compared with $144.6 billion for the same period in 2025 (+29%).

As of June 30, the high yield mandates continue to carry a defensive posture. Historically tight valuations offer limited upside from current levels. We favour a high-quality bias, as the US High Yield market's current 195 bps pickup compared with US Investment Grade is very compressed, at only 30 bps off the one-year low of 165 bps and 73 bps inside the 10-year average of 268 bps. Given the narrow valuation gap, we are running with a higher investment-grade weighting compared with our benchmark.

Most issuer fundamentals remain strong, as many companies termed out maturities at attractive yields ahead of the hiking cycle, leaving leverage manageable and coverage ratios intact. For the higher-quality cohort with continued capital markets access, we see limited covenant, liquidity or refinancing risk. The picture is meaningfully different in the tier that missed the refinancing window or has underwhelming fundamentals, which is where we are cautious given elevated LME risk.

Private credit continues to make headlines, but our allocation is deliberately sized and concentrated with top-tier managers. Their limited software and technology exposure has kept them out of the pockets where impairments have surfaced, and performance has held up with minimal credit losses.

Looking ahead, we are broadly aligned with the market's sanguine tone. Spreads are tight, but a clear catalyst for materially wider levels is hard to identify. The market's shallow and short-lived reaction to a genuine geopolitical shock in the Middle East over the last several months is itself evidence of how resilient the technical bid has been. Private credit stress also remains contained, as redemption activity has stabilized and issuers are using open investment-grade markets to plug near-term liquidity needs, pushing out the point at which cracks would surface in liquid credit. Risk sentiment and contagion remain on our watch list, but in the absence of an identifiable trigger, dispersion rather than direction is likely to be the more useful lens, with lower-quality tiers continuing to trade wide of what index-level spreads imply.

Against this backdrop, we have been adding selectively to high yield exposure and reducing cash levels in the high yield mandates over the course of the quarter. We do not see a compelling case for materially tighter spreads from current levels, but absent a clear shock, it is also difficult to argue for a meaningful widening. As a result, we believe it makes sense to reduce cash drag while maintaining a disciplined, selective approach and a continued bias toward higher-quality exposure within high yield.

Leveraged loans

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The loan market entered the second quarter on a strong footing. Following the market developments in private credit, the software and tech dislocations from the impact of AI, and the war in Iran, the broad volatility and spread widening observed in the first quarter proved to be temporary. As of this writing, sentiment is recovering in conjunction with improving geopolitics in the Middle East, strong market technicals, and resilient macro data. Technicals remain very supportive, as they were in 2025. Despite retail outflows from the loan asset class continuing in 2026, CLO investor demand remains robust, supported by a significant warehouse build and continued issuance expectations, alongside low net new loan issuance and hefty loan repayments. The market has demonstrated a strong capacity to absorb both primary and secondary supply. The primary loan market continues to be driven by M&A/LBO activity and refinancings, with expectations for increased M&A/LBO issuance later in 2026 as financial conditions ease.

Corporate fundamentals remain resilient but are moderating, with positive (though slowing) revenue and EBITDA growth across the loan universe. Default expectations remain contained at the index level, but stress is increasingly concentrated in weaker issuers, particularly those with aggressive capital structures or exposure to structural disruption, such as software, technology and services. The market is becoming more bifurcated, with strong issuers accessing capital markets easily and refinancing opportunistically, while weaker credits face higher funding costs, liability management risk, and elevated default probability. As a result, 2026 is increasingly a security-selection, alpha-driven environment rather than a broad beta rally.

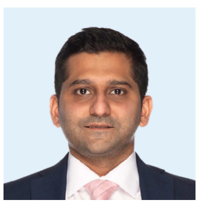
The portfolio remains positioned to benefit from carry opportunities in floating-rate credit markets, with a continued emphasis on non-benchmark loans. The fund continues to maintain very low interest-rate sensitivity, reflecting the portfolio's core objective of minimizing exposure to changes in government bond yields while generating income from credit spreads. The portfolio's average credit quality remained largely stable at BB-, indicating that risk-taking was measured and consistent with the strategy's mandate, with its largest exposures concentrated in Consumer Non-Cyclicals, Communications, Consumer Cyclicals, Industrials and Financials. The sector mix continues to reflect a preference for industries with resilient cash flows and relatively stable credit fundamentals while maintaining broad diversification across issuers and industries.

Despite modestly weaker CLO demand, the overall loan market remains well supported. We continue to expect bifurcation in the market to remain, with continued caution within distressed names and at-risk sectors (i.e., software and other potential AI-impacted names). Loans should continue to deliver attractive carry-driven returns, especially given the potential for rate hikes by year-end, which will help support demand for the asset class. However, tighter spreads and elevated dispersion emphasize a more selective approach. We would view periods of renewed volatility or spread widening as opportunities to add selectively.

The AAA CLO market entered the second half of 2026 on stable footing, with spreads largely unchanged year to date at around +120 bps and only modestly wider in recent weeks. Demand for high-quality CLO liabilities remains supportive, as evidenced by continued refinancing and reset activity, which has helped keep spreads contained despite elevated gross issuance. However, new-issue supply has slowed meaningfully versus last year, with issuance increasingly challenged by tight asset-side pricing and weaker arbitrage economics. The buyer base has also become more selective, with some large bank and institutional accounts pausing or reassessing the market backdrop, creating modest softness in AAA execution. As a result, while fundamentals and carry remain constructive, the market appears priced near perfection, and further tightening in AAA spreads will likely be needed to re-accelerate new-issue formation. Overall, the AAA CLO market remains well supported, but the balance of risk has shifted from broad spread compression toward more selective execution and relative-value opportunities.

We remain constructive on CLOs given supportive technicals. Supply is forecast to be lower year over year, as managers are focused on cleaning up existing portfolios, keeping net new supply muted. Against that backdrop, we expect prices to hold broadly stable. Should spreads be pushed wider because of increased volatility (i.e., Liberation Day), we would look to add on weakness, as CLOs have consistently retraced such moves quickly, and the technical backdrop leaves us comfortable underwriting the recovery.

Contributors



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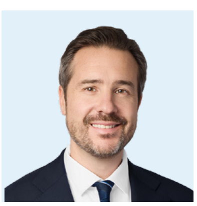

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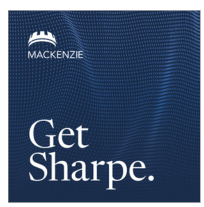

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