

## Mackenzie Fixed Income Team

# Quarterly report

## Neutral rates, diverging paths

The fourth quarter of 2025 marked a shift in what markets were responding to. Inflation continued to fade as the primary driver, but it was not replaced by a clean growth scare. Instead, attention moved back towards government policy, fiscal dynamics and the limits of central bank control late in the cycle. Risk assets held up well, credit remained orderly and duration stayed supported.

The US government shutdown played a meaningful role in shaping that backdrop. In real time, it weighed on activity through reduced federal spending and more cautious behaviour from affected households. More importantly, it disrupted the information flow. With key data delayed or unavailable, markets were forced to rely less on evidence and more on assumptions about how policymakers would behave.

The shutdown also mattered for liquidity. As outlays stalled, the US Treasury's cash balance rose sharply, pushing the Treasury General Account well above typical levels. Once the government reopened, those funds began flowing back into the economy through back pay and resumed spending. That mechanical reversal helped stabilize markets into year-end and helps explain why growth and financial conditions may look firmer in early 2026 than the late-2025 data would imply on its own.

The December FOMC meeting anchored those dynamics. The 25bps cut was expected but Powell's framing was not. Powell spent more time discussing neutral than he had earlier in the cycle, and with policy now at 3.50%–3.75%, that discussion became more realistic and less of an academic exercise. His comments aligned with a 3.50% neighbourhood as a reasonable estimate for neutral, and possibly the upper end, for some. From here, further cuts would not necessarily represent normalization; they would move into accommodative territory.



Dustin Reid  
Chief Fixed Income Strategist



By highlighting relatively modest average job growth and explicitly raising the likelihood of negative revisions, Powell acknowledged that payroll strength may be overstated. At the same time, inflation remains above target, and when the mandates conflict, Powell made clear that restraint is often the default. The message was not that the Fed is preparing to cut aggressively, but that it is positioning itself to wait while keeping optionality intact.

Canada entered year-end with a different mix of pressures but a similar tension between headlines and structure. The Bank of Canada held at 2.25%, the bottom end of its neutral range, while markets began

to price a late-2026 hiking narrative following a run of strong employment reports. We remain skeptical. Job gains continue to skew toward part-time work; labour force dynamics are doing some of the work in pulling the unemployment rate lower and final domestic demand has already softened. At the same time, Canada remains in the middle of a mortgage reset cycle, with housing and real estate still a critical macro transmission channel. Despite recent data surprises, we continue to see greater risk of easing than tightening over the coming quarters and expect the Bank of Canada to cut twice by mid-year.

## International

Outside North America, the global backdrop remains broadly supportive, but uneven. While German industrial data has shown some improvement, helped in part by increased domestic fiscal spending, Europe more broadly continues to struggle with weak underlying demand and limited policy flexibility given tighter budget constraints elsewhere. Inflation has cooled, but not enough to give policymakers a clean runway to ease aggressively.

In emerging markets (EM), the carry environment remains attractive, supported by relatively stable global financial conditions and high nominal yields, though the trade has become increasingly sensitive to shifts in global rates and funding dynamics. Japan, in particular, bears watching. A sustained move higher in the back end of the Japanese Government Bonds curve, whether driven by fiscal ambition or market structure, has the potential to disrupt global flow dynamics and challenge crowded carry positions. That risk is not our base case, but it represents an important tail risk for global risk assets and EM foreign exchange as we move through the first half of 2026. Against that backdrop, global rates remain increasingly sensitive to developments in the US, particularly at the long end of the curve.

Looking ahead, the first quarter of 2026 is increasingly about pricing out Fed rate cuts expected early in the year and above-expectations US growth. The market has largely settled on an easing outcome, but it may be misjudging when that easing occurs and under whose leadership. Roughly 50bps of Fed cuts are priced through the end of 2026, with close to

20bps priced through April. That front-loaded easing looks vulnerable.

The distinction between a Powell-led Fed and the post-Powell Fed matters. There are three meetings before Powell steps aside in May. With policy already near neutral and inflation still above target, the hurdle for additional cuts under this chair is high. Absent a material deterioration in the labour market, patience is the more likely outcome. In that context, pricing for an early-2026 cut may need to be unwound, even if the broader easing narrative remains intact later in the year.

At the same time, the growth backdrop argues against a sharp decline in long-end yields. US 10-year Treasury yields have spent most of the period since Labour Day oscillating within a broad 4.00% to 4.20% range. We continue to view that range as increasingly vulnerable to an upside move through the first half of 2026. In that environment, term premia look mispriced for a world of firmer growth, structurally higher inflation and sustained fiscal support.

US growth is a key component. Consensus expectations for 2026 anchor near 2%. Our conviction remains that growth in the first half of the year will be stronger, potentially in the 2.5% to 3.0% range. The consumer remains resilient and the softness associated with the shutdown should be viewed as a temporary interruption rather than a turning point. Measures of labour income, household cash flow and balance-sheet health continue to support aggregate demand. With policy rates close to nominal neutral, the current rate environment is not a meaningful constraint on spending for higher-income households.



Corporate investment adds another layer. AI-related capex remains in the early stages, and fixed business investment more broadly should remain firm into early 2026, even after a solid backdrop in 2025. Fiscal dynamics reinforce that view. The One Big Beautiful Bill Act legislation carries substantial spending into 2026, while associated tax relief has yet to be fully felt by lower and middle-income households. Those effects begin to materialize in early 2026 and are augmented by retroactive tax relief tied to 2025.

The shutdown also reinforced this setup. The subsequent drawdown in the Treasury General Account as payments resumed adds a short-term liquidity tailwind into early 2026. Tariffs add another layer. Even if the legal framework around the IEEPA mandate evolves, we do not expect tariff receipts to be reversed. The roughly \$300 billion annualized tariff run rate therefore remains stimulative and is likely to exert a larger impulse in 2026 than in 2025.

Inflation remains sticky. Headline and core measures continue to hover near 3%, and our view remains that a range from 2.5% to 3%, effectively becomes the “new 2%”. Post-pandemic structural changes and less integrated supply chains create a persistent floor under inflation. This regime argues for curves trading higher in absolute terms and relative to the prior decade, which was defined by an assumption of durable 2% inflation.

Finally, there is a non-trivial tail risk related to Fed leadership. While not the central driver of our long-end view, the market may judge some potential chairs as risks to inflation stability or independence. A Fed Chair perceived as willing to push policy well below neutral without clear macro justification would likely be interpreted as inflationary, and at worst as a policy error. In that scenario, the back end of the curve becomes the pressure point, and the existing range for 10-year yields becomes increasingly difficult to sustain.

## Mackenzie Fixed Income Team views

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

○ Indicates no change   ← → Indicates change

Source: Mackenzie Investments. As at December 31, 2025.



# Investment grade fixed income

The final quarter of 2025 unfolded amid a complex environment, heavily influenced by a US government shutdown that left a data-dependent Federal Reserve effectively “driving in the fog.” The absence of timely economic releases introduced significant uncertainty, which was only partially resolved when the shutdown ended in November. For markets more broadly, the quarter marked a pivotal moment as the monetary easing that had provided a tailwind for risk assets began to fade.

## US fixed income markets

In the United States, the Federal Reserve delivered its third consecutive 25 basis point rate cut at its December meeting, bringing the federal funds target range to 3.50%–3.75%, the lowest since 2022. The decision, however, highlighted a growing divide within the committee, with three members dissenting. Fed Chair Powell noted that policy is now in the range of “neutral,” suggesting a potential pause in the easing cycle as the central bank weighs risks to its dual mandate of maximum employment and price stability. Adding a dovish tilt to the meeting was the announcement of a significant increase in short-term Treasury purchases, with the Fed planning to add approximately \$160 billion in T-bills over the coming months. This move, seen by some as a toned-down form of quantitative easing (or “QE lite”), provided a tailwind for risk assets. The Fed also raised its growth forecasts for 2025 and 2026 while slightly lowering its inflation projections. Despite this, investors continue to price in two rate cuts for 2026, a more dovish stance than the single cut projected by most Fed officials.

The Treasury yield curve steepened during the quarter, with the 2-year yield falling by 14bps, while the 10-year and 30-year yields rose by 2bps and 11bps, respectively. Credit spreads remained well-behaved, with the US CDX IG Index ending the period at 50.0bps, down modestly from 52.1bps at the start. The Bloomberg US Aggregate Bond Total Return Index posted a gain of 1.10% for the quarter, finishing the year with a 7.30% return.



Mark Hamlin  
Portfolio Manager



Felix Wong  
Portfolio Manager



## Canadian fixed income markets

In Canada, the narrative was one of surprising economic strength. The Bank of Canada held its target overnight rate at 2.25% in December, signaling that the current policy rate was appropriate. This decision was supported by a string of robust data. Third-quarter GDP expanded at a solid 2.6% pace, while the labour market showed improvement. After a period of rising unemployment, the rate fell to 6.5% in November, its lowest level in 16 months, as the economy added over 50,000 jobs per month for three consecutive months.

With CPI inflation slowing to 2.2% in November, the Bank appears comfortable observing the impact of global uncertainty and trade-related pressures on the domestic economy. The Canadian yield curve also steepened, but more dramatically than in the US. Yields on 2-year, 10-year and 30-year government bonds rose by 12bps, 25bps and 23bps, respectively. The FTSE Canada Universe Bond Index recorded a modest loss of -0.32% in Q4, but still delivered a 2.64% return for the full year. Canadian corporate bonds outperformed, with the FTSE Canada All Corporate Bond Index returning 0.34% in the quarter and 4.48% year-to-date.

### Outlook

Looking ahead to 2026, we are maintaining a neutral duration stance, nuanced by our geographic views: overweight in Canada and Australia, and underweight in the US and Europe. In the US, we believe expectations for rate cuts may be too optimistic given underlying economic strength. Conversely, in Canada the potential for softer growth, primarily due to significantly lower immigration and housing weakness, suggest a path of least resistance characterized by prolonged policy accommodation. We remain cautious on the backend of the curve due to fiscal deficit concerns and therefore our Canadian exposure is concentrated in the front end of the curve ( $\leq 5$  years).

Within credit, our preference is for high-quality issuers and defensive sectors like utilities

and pipelines, which offer predictable cash flows. We are underweight sectors we believe have tight valuations and are more exposed to trade dynamics such as automotive and shipping/logistics. We anticipate that mergers and acquisitions will be a significant theme in 2026 and are positioning our portfolios toward well-capitalized companies that are likely to be consolidators.

In emerging markets, we exited positions in Peru and South Africa after reaching our targets. We reallocated capital to markets offering more attractive risk-adjusted returns, establishing and reinforcing long positions in Australia, Brazil and Mexico. We believe the emerging markets space offers good risk-adjusted carry and see it as an attractive opportunity for investment.



# High yield bond market

The high-yield market closed out 2025 on a positive note, delivering 3.5% gains in the fourth quarter. High yield bond yields have drifted lower since the Federal Reserve (the Fed) began raising interest rates. Investors welcomed a Fed decision that came across as less hawkish than expected, helping drive yields lower as credit spreads tightened to a three month low in December. This was supported by steady macroeconomic data that continued to point to stronger than anticipated economic growth.

Healthy market sentiment, active new issuance and ongoing inflows into high yield funds further reinforced demand for the asset class. This performance, however, masked a clear divergence in the market, with investors showing a strong preference for higher-quality debt. The higher-quality credits were the primary drivers of returns as split BB-rated bonds returned +1.95% during the quarter; in contrast, lower-quality CCC-rated bonds struggled, posting a return of -2.54%. This flight to quality was also reflected in sector performance; industries like broadcasting and telecommunications were top performers, while the retail sector lagged significantly. Default activity remained a key focus, with the par-weighted default rate ending the year at 1.88%.

## Positioning

As of December 31, the high yield market spread of 281 bps is near cycle lows, tightening from the start of the year and the peak spreads experienced during the “Liberation Day” selloff in April. The all-in yield-to-maturity has also compressed from 7.47% at the start of the year to a current 6.62% as a result of the significant rally in the government bond yields. The relatively tight spreads and yields can be rationalized by the quality of the high yield index that is higher than at almost any other time in history with 57% rated BB. Other important data points that are worth highlighting as follows:

- The yield on the high yield market was as low as 4.3% during 2021, but has risen to the high single-digit range and currently stands at 6.62% as of December 31, 2025. The current yield represents an attractive source of income after a long period of low yields (and even in some areas of the market negative yields).



Dan Cooper  
Head of Credit,  
Portfolio Manager



Ken Yip  
Portfolio Manager



- The average price of a high yield bond has declined from \$103.31 in 2022 to a current price of \$98.06. The majority of these bonds will continue to make their coupon payments and mature in the future at a price of \$100, representing an attractive capital gain opportunity for investors that are willing and able to do the deeper analysis required in the high yield market.
- The overall quality of the issuers in the index is higher than at almost any other time in history, with 57% rated BB, as a large portion of the index is represented by companies that were previously investment grade before being downgraded to the high yield market (known as fallen angels).
- The majority of the high yield market issuer fundamentals are strong, as companies were able to refinance debt and extend out maturities at attractive yield levels prior to the beginning of the rate hiking cycle. With reasonable leverage, and strong interest coverage ratios, we see limited risks related to covenants, liquidity or refinancing needs for higher quality companies that continue to have access to the capital markets.

The high yield default rate last peaked in 2020 at 6.8% and traded as low as 1% in the post-COVID-19 period. The default rate has since increased from those record lows and currently sits at 4.0% (including distressed exchanges), as the stress caused by the interest rate hiking cycle has been moderated by the Fed's shift to a rate cutting cycle. We expect default rates to remain elevated, given the current market dynamics and prominence of the LME (liability management exercise) backdrop, but stay below prior cycle peaks, given the relatively short time frame since the last default wave, the high quality of the index and the strong overall fundamentals of the issuers.

## Outlook

As we enter 2026, the backdrop for high yield in general has improved significantly due to a substantial influx of liquidity with nearly \$2.6 billion (USD) of inflows to high yield bonds in the last six weeks of 2025. This has made us more constructive on the broader high yield space, but with continued hesitation towards deeply stressed or distressed credits, who still face fundamental risks that have not been

resolved. As such, our team continues to prefer higher quality names which is represented by a credit rating higher than the benchmark. From a sector perspective, we see geopolitical tailwinds for the aerospace/defense, homebuilding and Canadian energy industries. We also have positive views on the services, healthcare, broadcasting and metals sectors.



# Global fixed income

Despite late-quarter volatility, the global bond market ended the year in firmly positive territory, posting a full-year return of more than 8%, even as it recorded a slight decline in Q4. The quarter was characterized by continued divergence in central bank policies and a growing focus on the interplay between fiscal stimulus, inflation risks and future monetary policy paths.



Hadiza Djataou  
Head of Macro,  
Portfolio Manager

In the US, the Federal Reserve (the Fed) delivered its third consecutive 25-basis-point (bps) rate cut in December, bringing the federal funds rate to a 3.50%–3.75% range. The decision, however, highlighted a growing divide within the committee, with three members dissenting. While Governor Stephen Miran advocated for a more aggressive 50bps cut, Austan Goolsbee and Jeffrey Schmid argued for a pause. The Fed's updated economic projections signaled a more resilient economy, with upward revisions to GDP growth for both 2025 and 2026. Our portfolios remain tactically short US duration, particularly in 10-year and 30-year maturities, reflecting our view that expectations may be over-optimistic on the extent of future easing.

Across the Atlantic, many central banks appeared to have concluded their easing cycles, with the notable exception of the Bank of England. In the UK, back-end gilt yields fell following the government's budget announcement, with 30-year yields dropping 30 basis points. Heading into the budget, the team was long the back-end as we believed the negative news on fiscal spending was priced in by the market. Our European duration positioning remains underweight, primarily expressed through German Bunds. We have maintained a preference for peripheral sovereign debt, such as Italy, where improving fiscal discipline has been recognized with credit upgrades, while avoiding exposure to France and Belgium due to deteriorating fundamentals.

The Bank of Japan took a significant step toward policy normalization, raising its policy rate by 25 basis points to 0.75% at its December meeting. The move was underpinned by policymakers' increasing confidence in achieving a sustainable cycle of moderate wage and price growth, reinforced by solid corporate profits and the new Prime Minister's plans for significant fiscal spending. We maintain our strategic underweight to Japanese government bonds, as we expect upward pressure on yields to persist.



In Canada, the narrative is distinctly different. The Bank of Canada held its policy rate at 2.25% in December after growth surprised to the upside in the third quarter. However, we anticipate a path of least resistance characterized by prolonged easing due to softer growth drivers, including lower immigration and housing market weakness. Our positioning is constructive on Canada but concentrated in the front end of the curve ( $\leq 5$  years). We remain cautious on longer-dated bonds, given concerns around term premiums and deficit overhangs.

## Inflation

A primary risk heading into 2026 is the possibility of inflation settling at a structurally higher rate. While inflation expectations as measured by break-evens remained contained, we believe the possibility remains that the market may be too complacent. A combination of looser monetary policy and renewed global fiscal stimulus could reinvigorate capital expenditures and hiring in the year, creating conditions for a potential wage-price spiral, particularly under a new Federal Reserve Chair. While the deflationary impulse from China is waning and commodity prices have softened, the risk that additional stimulus in an already strong economy could prove inflationary is noteworthy.

## Emerging market debt

Emerging market (EM) local currency debt performance was muted during the quarter but notably outperformed over the year, benefiting from a broadly stable-to-weaker US dollar. We believe the EM complex is underinvested and see opportunities for allocation, particularly into countries with strong fundamentals. Higher carry countries backed by policy credibility are particularly attractive in our view. We retain meaningful exposure to both Brazilian and Mexican local currency bonds. During the quarter, we took profits and exited our positions in Peru and South Africa, adhering to our trade discipline after achieving our targets.

## Outlook

Looking ahead to 2026, we expect the divergence in central bank policies, coupled with fiscal and political uncertainties, to maintain an elevated level of volatility across global fixed income markets. This environment, in our view, creates a fertile ground for active allocators to identify attractive opportunities. We believe expectations for US rate cuts could be too aggressive, as a firm domestic economy and persistent core inflation near 3% argue for a more cautious Fed. Our strategy remains flexible and nuanced, with tactical underweights in US Treasuries and German Bunds, and overweights in Canada and Australia.



# Leveraged loans

The fourth quarter of 2025 unfolded against a backdrop of strong technicals and generally stable fundamentals, capping a solid return environment for the leveraged loan market. Demand remained concentrated in performing benchmark and higher-quality loans, while dispersion widened across credit quality. Lower-rated and more cyclical issuers continued to lag, reinforcing a market increasingly driven by selectivity rather than broad beta exposure.



Movin Mokbel  
Portfolio Manager

Monetary policy remained a key influence during the quarter. The Federal Reserve (the Fed) continued its easing cycle into year-end, reducing short-term rates further after an initial cut in September. While lower base rates modestly reduced loan coupons, they proved supportive for the asset class by easing interest burdens for weaker borrowers and reinforcing credit stability. Floating-rate characteristics continued to insulate loans from duration risk, while still offering attractive income relative to other fixed income assets.

Market technicals were particularly strong throughout the quarter. Persistent demand from CLO managers continued to provide a powerful tailwind, outweighing ongoing retail outflows from loan funds. Issuer-friendly conditions remained in place, extending a trend that has defined the loan market for much of the past several years. Despite negative retail flows, the overall loan market continued to grow and reached a new record size by year-end, reflecting the depth and resilience of institutional demand.

Performance during the quarter was positive but lagged other risk assets. Returns were driven almost entirely by income, as price appreciation remained limited due to a large portion of the market trading near or above par. This dynamic constrained upside in higher-quality, performing loans, while contributing to underperformance in lower-quality segments. Cyclical sectors were among the weakest performers, while more defensive and service-oriented sectors held up better.

Credit quality trends improved modestly. Default activity continued to trend lower, driven in part by improved liquidity conditions and the growing use of liability management exercises as an alternative to traditional bankruptcy filings. While this has helped stabilize headline default rates, recoveries in distressed situations have deteriorated, reflecting more complex capital structures, looser documentation and the increasing prevalence of asset-light business models. Importantly, stress remained largely idiosyncratic, with limited evidence of broad-based deterioration across the market.



## Outlook

The loan market has entered 2026 with renewed momentum. After sentiment was rattled in late Q3 and early Q4 by high-profile defaults — most notably First Brands and Tricolor — early 2026 has seen a notable improvement in tone.

That said, the macro backdrop has become more complex. Geopolitical risks have escalated meaningfully, driven by renewed US expansionist rhetoric, heightened trade tensions and ongoing instability in energy markets stemming from developments in Iran. These risks introduce a higher degree of path dependency for the asset class, particularly as inflation concerns, which never fully dissipated, are once again resurfacing and threatening to dampen consumer demand and corporate investment.

Despite these uncertainties, many investors remain constructive on leveraged loans, viewing recent bouts of volatility as transitory and attractive entry points. Loans continue to offer compelling relative value, providing higher current yields than high yield bonds, supported by still-elevated benchmark rates and improving underlying credit quality. Notably, the quality gap between loans and high yield bonds has narrowed over the past two and a half years, as subdued leveraged buyout activity has limited the issuance of more aggressive, lower-quality loan structures.

Looking ahead, outcomes will be heavily influenced by whether the US economy avoids a recession. In a weaker growth scenario, additional Fed rate cuts would likely provide further support to credit markets, including loans, through reduced interest burdens.

Our base case remains that a deep recession can be avoided and that US growth, while slowing, will persist. Trade tensions are ultimately political in nature and therefore subject to resolution should policymakers choose to de-escalate. As such, we remain generally constructive on the loan asset class from an income perspective. For investors concerned about recession risk, we favour higher-quality loans and AAA-rated tranches of collateralized loan obligations (CLOs), which offer limited credit- and rate-risk. For those anticipating a more severe downturn accompanied by aggressive monetary easing, high-quality investment grade portfolios remain the most appropriate positioning.



## Contributors



**Rahul Vekaria**  
Investment Director,  
Fixed Income



**Frank Clyde**  
Investment Director,  
Fixed Income

## To engage with us and learn more be sure to check out the following:





**Konstantin Boehmer**  
Head of Fixed Income,  
Portfolio Manager

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