Mackenzie Fixed Income Team

Q2 quarterly report

The first quarter of 2026 forced markets to absorb a more uncomfortable reality: disinflation was slowing, growth was not breaking and easier policy was no longer close at hand.

Dustin Reid
Chief Fixed Income Strategist

The year began with investors still leaning into early rate cuts from the US Federal Reserve (the Fed) and a benign rangebound long end. What followed was not a growth scare or an inflation relapse. US activity stayed firm, inflation stopped improving fast enough and the long end had to absorb a world in which fiscal policy remained loose, capex stayed strong and the bar for easing rose materially. Hostilities involving Iran late in the quarter then widened the distribution again by reintroducing the risk of an energy shock just as markets were still repricing the front end. Our base case is that the energy complex remains higher for longer.

The Fed helped define that shift. In both January and March, the Federal Open Market Committee (FOMC) held the federal funds (fed funds) rate at 3.50% to 3.75% and kept describing activity as expanding at a solid pace while noting that inflation remained somewhat elevated. The March projections also pointed to a gentler easing path than markets had wanted to imagine. The hurdle for cuts has changed: Q1 was less about whether easing was ever possible and more about whether the market had brought it too far forward.

That repricing made sense because US aggregate demand, although slowing moderately, never really rolled over. The consumer remained more resilient than the consensus expectation, helped by decent income growth and healthy balance sheets among upper income households. AI related capex also remained a meaningful support to activity. The labour market lost some shine, but it did not break and the weekly jobless claims data continued to push back on the idea of an imminent labour market disaster. The unemployment rate drifted in a 4.3% to 4.4% range, federal employment continued to decline and hiring breadth looked softer than the headline consumer story implied. And while that is enough to keep the Fed attentive, it is not enough to force its hand while inflation is still too hot.

Inflation is the more important part of the story and markets have traded it as such. The easy phase of disinflation is now clearly behind us. US headline CPI accelerated to 3.3% year over year in March, while the personal consumption expenditures (PCE) index was still running at 2.8% in February. The consumer price index (CPI) energy subindex was up 12.5% year over year in March. Those numbers aren't consistent with a central bank rushing to ease while growth remains intact. More importantly, the composition of the inflation problem is changing. Goods deflation is less helpful than it once was. Supply chains are less integrated. Tariffs, industrial policy and a more fragmented geopolitical backdrop are all pushing the system toward a higher floor. Add a higher oil backdrop through the Iran channel, and the argument that 2.5% to 3.0% is the new 2% looks even more persuasive now than it did at the start of the year, not less.

That's why we continue to believe the market is too eager to imagine a rapid return to lower yields and easier policy. The better way to think about the second quarter is that the US is moving deeper into a late cycle phase where the front end is constrained by sticky inflation and the long end is pressured by term premia, fiscal drift and supply concerns. That doesn't mean yields move in a straight line higher. It does mean the old reflex of buying duration on every growth wobble is less reliable. Our base case is that the Fed doesn't cut until September at the earliest, and even that may prove too early. One 25-basis-point (bps) cut in 2026 remains more plausible than the more generous easing path markets have periodically wanted to price. The labour market is the variable that could eventually unlock easing, but it will likely require a more convincing weakening in hiring, wages and confidence than Q1 delivered. In that scenario, US 10-year Treasury yields are more likely to spend the next quarter in a 4.20% to 4.40% range than revisit the lower range investors were hoping for earlier in the year.

Canada still sits in a different stage in the cycle, even if that divergence hasn't always shown cleanly in the headlines. The Bank of Canada held at 2.25% in January and again in March. Yet the underlying structure still looks weaker than the market narrative implies. Employment data have flattered to deceive more than once. Job creation still leans too heavily on part time work, the mortgage reset cycle is ongoing, housing remains the key transmission channel and final domestic demand looks softer than the labour headlines suggest. Canada's base case is still a housing-led slowdown. We remain more dovish than the market on Canada and continue to see greater odds of Bank of Canada easing than renewed tightening over the coming quarters.

Outside North America, the global picture remains uneven. Europe is less bad than it was, particularly with Germany offering a somewhat better fiscal impulse, but it's still not strong enough to carry global growth. China and parts of North Asia continue to benefit from export resilience and technology demand, though the quality of that growth remains uneven. Emerging markets entered the year with a supportive carry backdrop. That support hasn't disappeared, but the next stage is clearly more selective. Higher oil is an added cost for importers, a support for exporters and a complication for any market relying on lower volatility, a benign Fed and a calm dollar.

If energy prices remain higher for longer, the risk is that it isn't just an inflation story and that it becomes a growth story and eventually a consumer story. The US household sector enters this phase from a stronger starting point than most of the rest of the world, with income growth still decent and the labour market still firm enough to limit immediate damage. But the longer the shock lasts, the more it behaves like a surcharge on real income through gasoline, transport and broader input costs. Europe, and particularly the UK, is more exposed. Energy-importing emerging markets are also more exposed. Canada is more complicated — it benefits through the commodity channel, but many households remain extremely sensitive to both rates and cash flow.

Fiscal risk also remains in the background. In the US, the financing mix is more likely to lean on bills than on a dramatic step up in coupon supply, which should temper the pure duration shock. Still, large deficits continue to matter through term premia and through the market's willingness to trust that monetary restraint will not be asked to do all the work alone. Globally, fiscal policy is no longer reliably disinflationary, and that leaves long-end markets more exposed to shifts in supply, inflation expectations and policy credibility than they were for much of the last decade. Fed leadership remains a background risk too, but for now it's secondary to the more immediate energy and inflation problem.

The broad message for Q2 and beyond is the US remains firmer than many expected, even as the labour market gradually cools. Canada remains softer beneath the surface. Europe is stabilizing, not accelerating. Emerging markets remain opportunity rich, but less forgiving, with increasingly clear energy haves and have-nots. A more hostile energy backdrop has also raised the cost of policy mistakes and increased cross-asset volatility. That's a world in which central banks cut less, long-end yields stay higher and fixed income has to be approached with more selectivity and more patience than the market currently believes.

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 March 31, 2026.

Investment grade fixed income

The first quarter of 2026 was defined by a volatile mix of persistent geopolitical friction in the Middle East and a robust, technology-driven growth narrative in the US. While the period began with optimism following the resolution of the US federal shutdown, market sentiment was quickly recalibrated as tensions between the US and Iran escalated. This introduction of headline risk required a nimbler approach to duration and credit, as investors weighed the inflationary pressures of energy price volatility against the deflationary potential of a global growth shock.

Mark Hamlin
Portfolio Manager

Felix Wong
Portfolio Manager

US fixed income markets

In the US, the Fed maintained the fed funds rate at the 3.50%–3.75% target range for the second consecutive meeting in March. While the decision was widely anticipated, the narrative around projections revealed a central bank grappling with conflicting signals. On one hand, the "AI capital expenditure" theme has become a structural pillar of the domestic economy as the four largest tech titans are forecasted to spend more than $600 billion on capex this year.

On the other hand, the implications of the conflict in the Middle East remain a significant blind spot. Despite a brief suspension of hostilities in February, markets remained skeptical of a long-term diplomatic resolution. Consequently, inflation expectations were adjusted higher, with both PCE and core PCE now projected at 2.7% for the year. The Treasury yield curve experienced volatility during the quarter as yields declined before rising later in the quarter. The two-year yield rose by 32bps, while the 10-year and 30-year yields increased by 15bps and 7bps, respectively. Credit spreads also reflected this heightened uncertainty, as the US CDX IG Index widened to 58.8bps from 50.0bps at the start of the year. The Bloomberg US Aggregate Bond Total Return Index finished the quarter essentially flat at -0.05%.

Canadian fixed income markets

The Canadian narrative diverged from the US as domestic economic fragilities became more pronounced. The Bank of Canada (BoC) held its overnight rate steady at 2.25% in March, but the tone of policymakers shifted towards caution. Recent data confirmed that the Canadian economy contracted by 0.6% in the final quarter of 2025, and the labour market showed signs of cooling as the unemployment rate ticked up to 6.7% in February.

Despite this underlying softness, Canadian yields were generally pulled higher. The 10-year government bond yield rose towards 3.6%, reaching its highest level since mid-2025. Supply-side pressures also emerged following the release of the 2026-27 fiscal estimates, which included $48.4 billion for national defense and a widening deficit in Ontario due to increased health spending and housing-related tax holidays. The FTSE Canada Universe Bond Index returned 0.23% during the period.

Outlook

Looking ahead, we're maintaining a long front-end bias in Canada. Our thesis remains that Canada is entering a housing-led downturn, where a combination of falling rents and tighter financing will prompt the Bank of Canada to initiate rate cuts by 25–50 bps towards mid-year. In the US, our positioning was more tactical. We began the year underweight duration but moved to neutral as the Middle East conflict escalated. In mid-March, we selectively added long duration in 10-year and 30-year Treasuries as a hedge against an escalation-driven growth shock, though we remain mindful that core PCE resilience may limit the Fed's ability to ease policy in the near term.

Within credit, we're maintaining an overweight stance in investment grade. In high yield, we continue to express a high conviction in the aerospace and defense sectors. In an environment of remilitarization and increased fiscal defense outlays, companies in these sectors offer attractive risk-adjusted profiles. Conversely, we're underweight the automotive and airline sectors, citing execution risks and the direct impact of higher jet fuel costs on capacity. In the energy space, we believe the geopolitical stability of western Canadian infrastructure provides a structural advantage as insurance and shipping costs rise in more volatile regions.

Finally, our emerging markets exposure remains focused on local debt in Mexico and Chile. We added to our Chilean positions, viewing the Chilean peso as a primary beneficiary of the AI-led electrification trend and the resulting structural upswing in copper demand. As we move into the second quarter, we remain disciplined, prioritizing quality as the market continues to navigate this period of heightened geopolitical and fiscal uncertainty.

High yield bond markets

Dan Cooper
Head of Credit,
Portfolio Manager

Ken Yip
Portfolio Manager

The US high yield market had a volatile start to 2026. The strong technical backdrop in January moved to a more risk-averse tone by quarter-end, as early optimism around resilient growth and supportive earnings gave way to concerns over AI-driven disruption, rising Treasury yields and geopolitical uncertainty in the Middle East. High yield spreads briefly touched a post-Global Financial Crisis low of 264bps in late January before widening to 328bps by the end of March, while yields rose from 6.62% to 7.44%, leaving valuations meaningfully cheaper than where we started the year.

After gains in January and a small advance in February, the market weakened sharply in March, resulting in a first-quarter total return of -0.55% for high yield bonds. Performance became increasingly quality-driven as volatility rose, with BBs and Bs both outperforming lower-rated segments and ending the quarter down only -0.38%, versus -0.97% for CCCs. The main drivers of dispersion were the repricing of technology and software risk tied to AI concerns, higher rates and sustained retail outflows, although constructive earnings and still-active capital markets helped cushion the drawdown.

Sector dispersion was elevated and contributions were concentrated in energy, chemicals and telecom, which finished the quarter in positive territory, while paper and packaging, and housing were the weakest areas. Technology lagged earlier in the quarter before stabilizing in March. Primary issuance remained healthy at nearly $80 billion YTD and defaults, while drifting higher to 2.07%, remained manageable, though stress stayed concentrated in sectors such as technology, chemicals, and paper and packaging.

Positioning

As of March 31, the high yield mandates continue to have a defensive posture reflective of an uncertain backdrop and relatively tight historical valuations. Supporting datapoints to our high-quality high yield posture is 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 7.44% as of March 31, 2026. The current yield represents an attractive source of income after a long period of low yields (and even negative yields in some markets).
- The average price of a high yield bond has declined from $103.31 in 2022 to a current price of $96.18. 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 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 59% 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 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.
- Although private credit continues to make headlines, we're confident in our relatively small allocation to top-tier managers that have maintained discipline and differentiation versus their peers, generating strong performance with limited impairments given the low software/technology exposure.

Outlook

Looking ahead, two of the main risk-off themes we had been focused on have eased in the near term: Iran-related geopolitical risk and private credit stress. Geopolitical tensions have de-escalated, while in private credit, incremental liquidity and renewed transaction activity are helping contain stress and delay the emergence of broader cracks. While we still have concerns related to risk sentiment and contagion, investors are increasingly focused on the absence of an imminent catalyst for dislocations to occur.

Against this backdrop, we've been adding selectively to high yield exposure and reducing cash levels in the high yield funds. We don't see a compelling case for materially tighter spreads from current levels, but absent a clear shock, it's 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.

Global fixed income

Hadiza Djataou
Head of Macro,
Portfolio Manager

The first quarter of 2026 was shaped by a sharp shift in market narrative: what began as a continuation of the disinflation trend and a largely economy-driven market backdrop ended in a more volatile, supply-shock environment dominated by geopolitical instability. Against this backdrop, global fixed income markets navigated a choppy quarter and ultimately finished in slightly negative territory. The ICE BofA Global Broad Market Index (USD) returned -0.36%. The initial weeks were characterized by expectations of easing from the Fed, as growth moderated and labour-market conditions softened at the margin. However, this sentiment was abruptly displaced in the second half of the quarter by an escalation in Middle Eastern conflict. The resulting oil and energy price shock and repricing of global interest rate paths led to a tactical reassessment of duration and risk across our portfolios.

In the US, the Federal Reserve maintained the fed funds rate at the target range of 3.50%–3.75% at its March meeting. While the labour market showed signs of cooling, with unemployment at 4.4%, policymakers pointed to a persistent growth narrative supported by resilient consumer spending and continued business fixed investment. Our duration positioning in the US was dynamic: we entered the year underweight the back end, but transitioned to neutral in February as the geopolitical conflict intensified. While we briefly moved to a long position in 10-year and 30-year Treasuries in mid-March to hedge against a potential growth shock, we have since returned to a neutral stance as inflation risks became the primary market driver.

The euro zone and UK faced significant headwinds as inflation risk triggered a pronounced rate sell-off. European markets remained particularly sensitive to cost of imported energy following the spike in Brent crude. We maintained our underweight duration bias in Europe, given the direct energy-price shock especially LNG. Similarly, Japanese Government Bonds (JGBs) remained a strategic underweight for much of the quarter. The Bank of Japan held its policy rate at 0.75% in March, but the dissenting opinion from Board member Takata Hajime in favour of raising the policy rate to 1.0%, together with the Board's warnings regarding energy-driven inflation, suggest that the path towards normalization is still very much in play.

Canada emerged as a focal point for our non-consensus views. The Bank of Canada (BoC) held its target rate steady at 2.25% in March, yet we believe the market is underestimating the depth of the domestic economic slowdown. Following a 0.2% quarter-over-quarter GDP contraction in Q4 2025 (or -0.6% annualized, if using the Bank of Canada convention) and unemployment rising to 6.7% in February, our thesis remains centered on a housing-led downturn. We anticipate that falling rents and tighter financing will drive a sharp deleveraging cycle, necessitating earlier and deeper cuts than the current consensus suggests. Consequently, we maintain a constructive view on Canada, expressed through a long position in the front end of the curve.

Inflation

Inflation dynamics during the quarter were heavily influenced by the Middle East conflict, leading to a notable divergence in market expectations. Short-term inflation break-even rates surged, reflecting the immediate shock of higher energy and trade-related costs. Conversely, long-term break-evens remained relatively anchored, suggesting that market participants view the current inflationary impulse as a temporary disruption rather than a permanent structural shift.

In the US, core PCE remains sticky and above target, limiting the Fed's flexibility. While higher oil prices provide a headline shock, the US economy's lower sensitivity to energy prices relative to its G7 peers offers some insulation. In Canada, however, the combination of energy volatility and trade cost pressures is expected to push CPI higher in the coming months, even as headline CPI eased to 1.8% in February and the Bank of Canada's preferred core measures remained close to 2.3%. We remain neutral on inflation-linked instruments, as current valuations largely capture these conflicting forces.

Emerging markets debt

Emerging markets (EM) assets experienced a mixed quarter. The asset class started the year with a robust rally, supported by a stable US dollar and strong growth in Asia. However, the shock of strikes and retaliations in the Middle East, including restrictions on the Strait of Hormuz, reversed many of these gains in March. Despite this, we remain overweight EM local currency debt, but with a preference for markets combining policy credibility, attractive real carry and resilience to higher imported energy costs and tighter external financing conditions.

Chile has become a core conviction for the team. Rated "A" and supported by conservative fiscal governance, Chile is well-positioned given policy credibility, solid institutional strength and high beta to copper demand. We added to our Chilean positions during the quarter, viewing it as both an attractive rate and currency play. In contrast, we reduced our exposure to Mexico, transitioning the trade from a duration play to a pure currency play. Brazil remains a tactical opportunity, though we're mindful of fiscal credibility concerns and continue to treat it as a carry opportunity rather than a clean duration conviction.

Outlook

As we move further into 2026, we expect the environment for global fixed income to remain attractive for active managers. The divergence in central bank responses to stagflationary risks, coupled with the ongoing support from US business investment, including substantial AI capex expectations and fiscal shifts toward defense in Europe, creates significant relative value opportunities. In our view, the lack of visibility regarding Middle East negotiations necessitates a disciplined and tactical approach to portfolio management identifying the right opportunities, while monitoring and hedging risks. We remain prepared to adjust duration and risk allocations as we navigate the path forward.

Leveraged loans

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 on 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, investor demand for collateralized loan obligations (CLOs) remains robust, supported by a significant warehouse build and continued issuance expectations, alongside low net new loan issue 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 mergers and acquisitions (M&A) and leveraged buyout (LBO) activity, as well as refinancings, with expectations for increased M&A/LBO issuance later in 2026 as financial conditions ease.

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Credit fundamentals and risks

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 in software, tech 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.

Positioning

For constructive base-case investors, loans remain attractive as a carry asset, but portfolios should emphasize issuer quality, sector selection and avoidance of credits prone to liability management exercises. For investors concerned about downside risks, favour higher-quality loans (BBB/BB/strong single-B) and AAA CLO tranches (defensive carry, minimal credit risk, floating-rate exposure). For investors expecting a more material slowdown and aggressive Fed easing, consider shifting toward higher-quality fixed income/investment-grade exposure, where duration becomes a tailwind.

In summary, loans remain attractive, but returns will be driven more by carry and credit selection than by market direction.

Outlook

The macro outlook remains constructive but not clean. Growth is slowing but still positive, with a broad consensus that a recession isn't the base case, supported by less restrictive monetary policy and ongoing fiscal support. Inflation concerns haven't fully dissipated and remain a source of uncertainty. Sticky inflation and ongoing or returning geopolitical risks could pressure consumer demand and corporate margins, reinforcing a more cautious forward view. The outlook remains path-dependent, particularly on geopolitical developments, the inflation trajectory and central bank response, and the evolution of trade tensions and global supply chains. In a downside scenario, a material growth slowdown or recession would likely trigger Fed easing, which would be supportive for credit markets broadly, though lower base rates would reduce income for loans.

We remain constructive on loans and continue to view periods of price drops and spread widening as buying opportunities, particularly given strong carry and technical support. Loans continue to offer attractive relative value versus high-yield bonds, driven by higher all-in yields supported by still-elevated base rates, their floating-rate structure in an environment where inflation remains somewhat sticky and the rate path is uncertain. Notably, the quality gap between loans and high yield bonds has narrowed modestly given the absence of aggressive LBO supply in recent years (unlike what we saw during and post the COVID-19 issuance wave). Absent a recession, loans continue to present an attractive return opportunity, with yields in the ~8% area and prices still below par in many segments, supporting carry-driven returns. However, spread compression has largely played out, and forward returns are expected to be driven primarily by income rather than large price appreciation. While technicals remain strong, tight valuations increase vulnerability to volatility, particularly if macro or geopolitical risks return or materialize.

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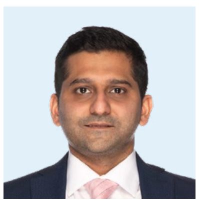

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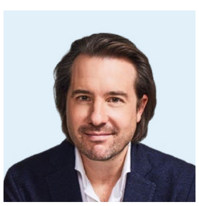

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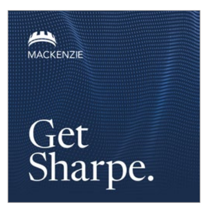

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