MACKENZIE Investments



## Mackenzie Fixed Income Team

# Quarterly report

**The third quarter of 2025 was defined by the market's focus shifting away from inflation and toward a weakening US labour market, with a more deliberate pivot back toward the Federal Reserve as the dominant market driver. Risk assets have continued to perform well and, in many ways, this is the market the Fed built, one that seemingly will be there to provide ample liquidity at any hint of a crisis or downturn, almost regardless of inflation.**

Dustin Reid
Chief Fixed Income Strategist

The Fed's late-summer rhetoric marked a notable turning point. Chair Jerome Powell's Jackson Hole speech signaled a clear acknowledgment that the labour market was slowing, breaking from the long-held line that employment was "in balance." Before and since, a string of softer nonfarm payrolls and private employment reports has confirmed that view. By September, the breakeven job creation rate in the US had slowed to roughly 25,000-50,000 per month, a remarkable deceleration for an economy still showing resilience elsewhere. The market responded swiftly: two-year yields fell through 3.50%, and term structure steepened as traders began to price a faster pace of cuts into 2026.

Adding intrigue was the appointment of Stephen Miran to the Fed Board of Governors. His projection for policy rates below 3% by the end of 2025 effectively implied a sequence of 50bps cuts through year-end — far faster than either the market consensus or the Fed's median guidance. While few took those numbers literally, Miran's inclusion underscored the political undertone now pressing the Fed. The administration has made no secret of its preference for looser financial conditions, and the market remains keenly aware of that tension.

Through most of the third quarter, US duration was consistently bid. Ten-year Treasury yields peaked near 4.50% in mid-July and settled closer to 4.00% by early September, while Fed funds futures briefly dipped below 2.85% for the end of 2026 before retracing. The combination of softer data and policy recalibration supported a broad set of risk assets. Risk markets have digested this transition well, suggesting confidence that the easing cycle will remain gradual rather than reactive.

The Canadian bond market largely followed the global trend but with a more muted tone. The US rally outpaced Canada's, narrowing the 10-year US/Canada spread from nearly -95bps at the start of Q3 to around -77bps by late August before widening again into quarter-end. Canada's story remains challenging, with fiscal pressures rising, the housing market continuing to soften and labour market cracks that are clearly getting larger. Yet the Bank of Canada (BoC) has stayed cautious, and the market has so far been accepting of that view.

We continue to think the risks in Canada lean toward additional policy accommodation in 2026. Population growth is slowing, joblessness remains elevated and the consumer backdrop looks fragile. For now, the short end of the Canadian sovereign curve offers opportunity, particularly if the market remains reluctant to price in a more dovish BoC path but opts to at a later date.

As of this writing, the US government shutdown has frozen several key data series, including NFP, CPI and PPI. The absence of those indicators complicates life for policymakers and markets alike. If the shutdown persists beyond mid-October, the Fed will have little choice but to lean on its dovish bias at the upcoming October FOMC meeting, likely delivering another 25bps cut. We expect a further 50bps in total cuts by year-end, one in October and another in December, but believe markets are too aggressive in discounting an additional 50–60bps worth of cuts in 2026.

The US economy remains broadly resilient. Consumer spending continues to surprise to the upside, corporate credit conditions are healthy, and while housing activity has cooled, it hasn't collapsed. Inflation risks are skewed modestly higher into early 2026, particularly as fiscal policy stays loose and the "K-shaped" nature of the recovery deepens. We continue to see too much easing priced into 2026 and expect some retracement there as growth stabilizes.

Globally, carry trades have remained one of the year's most durable themes. With the USD softer, US yields stable and global liquidity ample, high-carry strategies have extended their run, though the risk-reward has started to compress partially due to underlying macro conditions and partially due to price action. If the market begins to reprice 2026 Fed cuts, we may see a pause in this trade into year-end, especially in EM FX and higher-beta G10 crosses.

Another evolving theme is the growing political appetite for fiscal expansion. From Ottawa to Washington to London and Tokyo, policymakers are showing a willingness to deploy fiscal tools alongside monetary easing. In Europe, fiscal discipline has already given way to stabilization efforts, while in Japan, budget spending remains the policy anchor. The implication is straightforward; fiscal stimulus, while supportive for growth, risks prolonging inflation volatility. This has not been lost on investors, gold and base metals remain exceptionally well-bid, and duration at the back end of global curves faces growing risk as a result.

For Canada and the US, the message is similar. Fiscal support remains strong, but the line between supportive and excessive is murky in our view and there is little room for error from the Carney or Trump governments. Should markets start to doubt policymakers' restraint, bond vigilantes could reemerge. For now, we don't see that scenario as imminent and recent moves such as the Supplementary Leverage Ratio (SLR) adjustment, stablecoin regulation and ongoing Fed balance sheet management in the US suggest policymakers are aware of the risks. As we go to print awaiting the Canadian budget, we are expecting something spendy, but the question remains balancing that with needed long-term infrastructure projects; the investment versus operating lines in the budget will be key.

We like a "box trade" setup in Canada and the US, expecting Canadian curves to steepen and the US curve to flatten into year-end. We've also initiated tactical USD/CAD longs to lift hedge ratios across portfolios, capitalizing on near-term rate divergence while maintaining longer-term optionality through USD shorts against EUR and AUD. As global investors rebalance and hedge more of their US exposure post-"Liberation Day", we expect continued USD softness into early 2026.

As we noted in our previous quarterly commentary, we are undergoing a shift back to when markets are taking more of their cues from the Fed. We expect that theme to continue for the duration of the year and potentially into 2026.

# 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 September 30, 2025.

# Investment grade fixed income

Mark Hamlin
Portfolio Manager

Felix Wong
Portfolio Manager

**The third quarter of 2025 unfolded against a backdrop of evolving macroeconomic conditions, shifting policy expectations and recalibrated investor sentiment. While the period began with a relatively constructive tone in risk markets, the narrative shifted as downward revisions to labour market data, central bank actions and geopolitical developments introduced new layers of uncertainty.**

The most notable development in the US was the Federal Reserve's decision to cut the federal funds rate by 25bps at its September meeting, bringing the target range to 4.00%–4.25%. This marked the first rate cut since December 2024 and came amid growing evidence of labour market softening. The July employment report revealed historic downward revisions to prior payroll data — May and June job gains were revised down by a combined 258,000, significantly altering the near-term assessment of labour market strength. This deterioration, coupled with stable core personal consumption expenditures (PCE) inflation, provided the Fed with cover to initiate a so-called "insurance cut," though debate remains about the appropriateness of further easing. Market pricing now reflects expectations for an additional 50bps of cuts by year-end, with additional cuts in 2026. The divergence of views within the Federal Open Market Committee (FOMC) was on full display in the latest meeting as newly appointed Governor Stephen Miran dissented, favouring a more aggressive 50bps cut.

US Treasury yields were mixed over the quarter. The two-year yield fell 11bps, while the 10-year and 30-year yields declined by 8bps and 4bps, respectively. The curve remains steep relative to earlier in the year, reflecting both easing expectations and a reassessment of long-term inflation risks. The US CDX IG index ended the quarter at 52.1bps, down modestly from 54bps at the start, with spreads remaining resilient despite macro volatility.

The Bank of Canada cut interest rates in September, which was largely expected by market participants. With the domestic economy showing signs of softness, the case for additional easing continues to build. Unemployment in Canada continued to move higher hitting the highest level in four years at 7.1%. Canadian yields generally declined across the curve, with the two-year falling 12bps, the five-year down 8bps, and the 10-year lower by 9bps. The 30-year yield, however, rose 7bps, reflecting concerns around long-term fiscal sustainability. The spread between Canadian and US 10-year yields remained compressed, trading in a tight range around 97bps, down from the highs of 150bps earlier in the year. Credit markets in Canada remained well bid as investment grade spreads tightened further. The FTSE Canada Universe Bond Index returned 1.51% in Q3, bringing the year-to-date return to 2.98%.

During the period we increased our duration in line with benchmarks in our core plus strategies. We continue to take a nuanced approach to duration management, focusing on the relative cheapness and expensiveness of G7 countries' yield curves. Despite credit spreads grinding tighter, all-in yields remain attractive, reinforcing the importance of credit selection at this point in the cycle. During the quarter, we exited our New Zealand exposure. In Latin America, we continue to favour Mexico which offers an attractive yield and is poised for a favourable policy backdrop.

## Outlook

Looking ahead, we remain cautious. The market continues to price in a benign outcome — moderating inflation and gradual policy easing. However, we are mindful of fragilities, particularly around labour market visibility and the potential for policy missteps. In Canada, the convergence of yields with the US remains a theme we are watching closely and are positioned for, especially as fiscal dynamics diverge.

Credit remains expensive relative to historical norms, but high all-in yields and positive fund flow continue to support tight spreads. In our view, valuations appear stretched, particularly in an environment where fundamentals have deteriorated over the course of the year. We are maintaining a disciplined approach to credit selection, focusing on higher-quality issuers and more defensive sectors such as utilities and pipelines. These sectors offer more predictable cash flows and benefit from regulatory tailwinds, resulting in more attractive risk/return profiles. Finally, we have also been underweighting the automotive and shipping/logistics sectors, where we believe the impact of trade dynamics are likely to be more pronounced.

# Global fixed income

**The third quarter saw a continued trend of decorrelation across G10 rates, extending the divergence observed in Q2. Global bond markets extended their positive momentum from previous quarters, pushing global fixed income markets further into positive territory.**

Hadiza Djataou
Portfolio Manager

In the US, the Federal Reserve's September rate cut of 25bps — its first since December — was widely anticipated, bringing the Fed funds rate to the 4.00%–4.25% range. However, the decision was not unanimous, with newly appointed Governor Stephen Miran advocating for a more aggressive 50bps cut. US duration positioning was tactically adjusted over the quarter but generally long as historic downward revisions to May and June payrolls — amounting to a net loss of 258,000 jobs — shifted sentiment, raising concerns about economic visibility and reinforcing the Fed's cautious stance.

In Europe, German bunds continued to diverge from the US, while the European Central Bank (ECB) kept interest rates unchanged at its latest meeting. The Governing Council outlined an improving of underlying inflation outlook yet stopped short of pre-committing to a particular rate path. Tariff risks and political uncertainty — particularly around France's sovereign downgrade by Fitch — have added complexity. Eurozone duration was tactically managed but ultimately reduced and remained underweight, given the upward pressure on global yields.

UK gilts experienced a sharp sell-off following political instability tied to the Labour Party's welfare policy reversal and speculation around Chancellor Rachel Reeves's position. The yield on 10-year gilts rose by 20bps in a single day — its largest move since the October 2022 mini-budget crisis— prompting a reassessment of UK duration exposure.

Japanese government bonds remain a strategic underweight, with upward yield pressure expected to persist amid gradual policy normalization. Meanwhile, New Zealand duration was fully exited during the quarter. The initial thesis — centered on aggressive rate cuts due to economic sensitivity — played out, and global yield dynamics have since overtaken local idiosyncratic drivers.

Canada remains a relative underweight versus the US at the long end of the curve, due to greater fiscal concerns surrounding the former compared to the latter. The Bank of Canada resumed its rate cutting cycle bringing its interest rate to 2.5% at its September meeting following consecutive holds leading up to the decision. Canada's GDP contracted 1.6% and exports faced headwinds as the shift in the country's approach to immigration and challenges around trade weighed on the labour market and economy.

# Inflation

Inflation trends varied across developed and emerging markets. In the US, core inflation remains sticky, with consumer price index (CPI) and personal consumption expenditures (PCE) readings broadly in line with expectations. The August PCE price index rose 0.3% month-over-month, while core PCE, which excludes energy and food, increased 0.2%. On a year-over-year basis, PCE prices increased from 2.6% in the previous month to 2.7% and core PCE increased by 2.9% from the previous year. Tariff risks remain a key upside factor for US inflation, particularly in goods categories. While typically viewed as transitory, the current fiscal and immigration policy backdrop could amplify their persistence.

In the eurozone, inflation dynamics are more benign, with currency appreciation offering a modest disinflationary impulse. Estimates suggest a sustained 10% rise in the euro could reduce inflation by 0.2% annually over three years.

Elsewhere, inflation moderated in Japan and Australia and held steady in the UK. In Latin American, inflation eased during the period in Brazil and steadied in Mexico. Inflation-linked instruments, particularly US TIPS, continue to offer attractive real yields and remain a core allocation within global portfolios.

# Emerging market debt

Emerging market debt remained a focal point, with monetary policy developments in Latin America, an easing US dollar year-to-date, and disinflationary pressures providing a tailwind. In Mexico, the central bank cut rates by 25bps, bringing policy to 7.5% and closer to its estimated neutral rate. Market pricing suggests a neutral level near 7%, and forward guidance from the central bank will be key in shaping expectations going forward. Our portfolios maintain meaningful exposure to Mexican 10-year bonds across global and core-plus strategies, reflecting confidence in the country's disinflation trajectory and policy credibility.

In Brazil, September inflation prints came in softer than expected, reinforcing market expectations for a gradual easing cycle. While only 25bps of cuts are priced over the next six months, the longer-term path suggests more than 150bps over the next year, contingent on inflation dynamics and political stability. The carry trade remains attractive and our exposure is unchanged for now. We continue to monitor the timing of Brazil's potential rate cuts, with some market participants anticipating a December start to the easing cycle.

Finally, South Africa remains relatively attractive as the country benefits from an advanced disinflation process that enhances policy flexibility.

## Outlook

Looking ahead, global fixed income markets are expected to remain volatile, shaped by divergent central bank policies, fiscal dynamics and geopolitical developments. In our view, this presents a particularly attractive environment as active allocators in the global fixed income markets to find opportunities. Risks are skewed toward inflation uncertainty, questions around fiscal discipline, elevated rate volatility, and the implications of a prolonged US government shutdown. These conditions warrant a selective and tactical approach to duration and risk allocation.

We continue to monitor labour market trends, inflation data and central bank communications closely. While the Fed's September cut aligns with market expectations, further easing will likely depend on labour market deterioration and stable inflation. In this environment, flexibility in portfolio construction remains paramount.

# High-yield corporate fixed income

**The third quarter of 2025 marked another resilient period for high-yield credit, with the asset class delivering its twelfth consecutive quarterly gain, returning +2.4% and bringing year-to-date performance to +7.06%.**

Dan Cooper
Head of Credit, Portfolio Manager

Ken Yip
Portfolio Manager

This strength was underpinned by robust technicals and supportive macro conditions. High-yield bond yields and spreads declined in the quarter by 30bps and 16bps, settling at 7.06% and 280bps, respectively, near multi-year lows. The Fed's insurance cut and expectations of further easing have added a tailwind to risk assets. Investor appetite remained strong, evidenced by a $5 billion inflow for Q3 and $14.9 billion YTD. Taken together, strong market conditions led to a wave of primary market activity, with quarterly issuance volumes hitting their highest since 2021 issuers capitalized on historically low yields and strong investor demand with Q3 gross issuance totalling $122 billion, up 12% year-over-year, while net issuance surged 40% year-over-year to $75 billion. September was an especially high watermark, with $59 billion of issuance making it the third busiest month on record. Credit fundamentals remain stable. The par-weighted high-yield default rate declined to 1.39%, well below long-term averages, while distressed exchanges hit a multi-year low. Notably, CCC spreads widened 76bps YTD, reflecting selective risk repricing, though overall dispersion remains contained.

## Positioning

As of September 30, the high-yield market spread of 280bps has tightened compared to the start of the year and the peak spreads experienced during the "Liberation Day" selloff in April and are now trading near cycle tights. The all-in yield-to-maturity has also compressed from 7.47% at the start of the year to a current 6.73% due to 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 over 50% 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 6.73% as of September 30, 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).

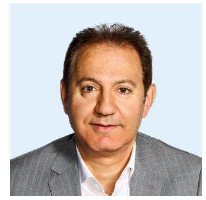
- The average price of a high-yield bond has declined from $103.31 in 2022 to a current price of $98.08. The majority of these bonds will continue to make their coupon payments and mature in the future at a price of $100, representing an attractive capital gain opportunity for who are willing and able 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 over 50% 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).
- Fundamentals are strong for the majority of the high-yield issuers, 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 end of the spectrum.
- The high-yield default rate last peaked in 2020 at 6.8% and traded as low as 1% in the post-COVID period. The default rate has since increased from those record lows and currently sits at 3.3% (including distressed exchanges), as the stress caused by the interest rate hiking cycle has moderated as the Fed has shifted to a rate cutting cycle. We expect default rates to remain elevated given the current market dynamics and prominence of the liability management exercise (LME) backdrop, but stay below prior cycle peaks given the relatively short timeframe since the last default wave, the high quality of the index and the strong overall fundamentals of the issuers.

## Outlook

Looking into Q4, we're paying close attention to a few different themes. In particular, many of the riskier credits in the space that spent the last several years without meaningful credit improvement appear to be losing access to capital markets liquidity. Following a wave of LMEs in 2024, investors' appetite to kick the can down the road further is being tested by a combination of high cost of capital, ongoing margin pressure from tariffs in many sectors and signs of consumer slowdown. Absent credit improvement and/or incremental liquidity for these types of credits, we expect further deterioration in certain lower quality segments of the high-yield market and have de-risked accordingly into Q4. As such, our team continues to have a preference for higher quality which is represented by a credit rating that is higher than the benchmark. Rather than reaching for yield in the syndicated high-yield bond market, our team has found attractive opportunities in other areas of the fixed income market that we feel may offer attractive risk-return characteristic and enhanced diversification. We expect that credit selection will grow in importance over the next couple of quarters as the market digests the various risks present in the current environment despite the tight spreads that are inadequately priced for these risks.

# Leveraged loans

**The third quarter of 2025 unfolded against a backdrop of stable credit conditions and healthy market fundamentals, although sentiment weakened late in the period following a sharp price decline in automotive aftermarket supplier First Brands. This idiosyncratic event weighed on performance in September but did not materially alter the overall constructive view on the loan market.**



Movin Mokbel
Portfolio Manager

The key macro development in the quarter was the Federal Reserve's 25bps rate cut on September 17, marking its first reduction since February. While the move trimmed loan coupons modestly, it provided meaningful support to weaker borrowers — particularly single-B-low and CCC-rated issuers — and reinforced the view that monetary policy is shifting toward accommodation. Overall, the rate cut was broadly seen as positive for the loan market.

Technicals remained exceptionally strong through the quarter, supported by sustained CLO demand. New CLO formation totaled $52 billion in Q3, bringing the year-to-date issuance to $153 billion, roughly 7% above the same period last year. The prior year, 2024, marked a record for new CLO issuance with $202 billion priced, underscoring the continued depth and resilience of loan market demand.

Primary issuance was robust, driven by active deal flow in July and September, resulting in record quarterly issuance of $404 billion. The loan market expanded by $10.6 billion in September alone, bringing total outstanding to US$1.509 trillion — a new high. Year-to-date, market growth reached $91 billion, underscoring the sector's expansion.

Valuations remain supportive: 37% of the LSTA Index traded at or above par by month-end (down from 41% in August), while 81% of loans traded at 98 or higher. The share of loans priced below 80 remained steady at 2.9%, with those below 70 comprising 2.2% of the index — signaling minimal stress within the market.

Defaults remained contained through the quarter. The Chapter 11 trailing 12-month default rate finished September at 1.47% by both principal and borrower count, effectively unchanged from August. Importantly, this excludes liability management exercises (LMEs), which have become increasingly prevalent, now accounting for roughly two-thirds of all defaults. This trend underscores issuers' preference for flexible, non-court restructurings that preserve equity and limit costs.

Recovery rates remain under pressure, reflecting structural market changes: a higher share of LMEs, the shift toward asset-light business models, the prevalence of loan-only capital structures and continued covenant-light issuance. Together, these dynamics have contributed to historically low recoveries across the loan universe.

## Outlook

As the fourth quarter began, market tone turned more cautious. The defaults of First Brands and Tricolor (subprime auto lender) reverberated across credit markets, contributing to a modest ¼ to ½ point decline in loan prices month-to-date in October. While these events tested sentiment, technical conditions remain firm with over $200 billion in open CLO warehouses, suggesting strong reinvestment demand.

Despite near-term volatility, loans continue to offer attractive relative value versus high-yield bonds given their higher current income and limited duration exposure. The credit quality differential between loans and high-yield has narrowed in recent quarters, reflecting more conservative underwriting and a slowdown in aggressive LBO issuance since 2023.

Looking ahead, the outlook remains path-dependent, contingent on the trajectory of trade tensions and the broader US economic backdrop. While inflation concerns persist, a potential slowdown in growth could prompt additional rate cuts, which would be supportive for credit markets.

Over the past three years, loans have performed well on a risk-adjusted basis, benefitting from elevated coupons and resilient fundamentals. While defaults are trending higher, many of the weaker credits have already been marked down, mitigating potential downside risk. Absent a deep recession, we continue to view the loan asset class as an attractive income opportunity, supported by yields near 8.5% and trading levels below par.

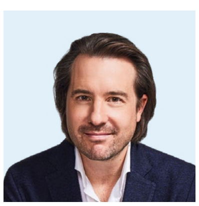
For investors seeking lower credit risk, high-quality loans and AAA-rated CLO tranches remain preferred exposures. Conversely, for those anticipating a more severe downturn, a shift toward investment-grade credit may be warranted.

## Contributors

Rahul Vekaria,
Investment Director, Fixed Income

Frank Clyke,
Investment Director, Fixed Income

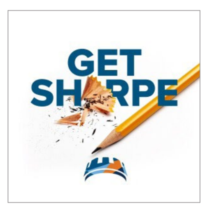
## To engage with us and learn more be sure to check out the following:



### Konstantin Boehmer

Head of Fixed Income,
Portfolio Manager

Connect on LinkedIn




### Mackenzie Investments

"Get Sharpe" Podcast Series

Listen on Apple

Listen on Spotify



5155150 11/25