

Fixed Income Outlook

Q4 2025

BlackRock

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Foreword



Rick Rieder

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Gaining a little edge, a lot of times

After decades of refining our fixed income investment process, we have come to describe it as a method of ‘making a little bit of money a lot of times.’ This summer, the U.S. Open tennis tournament inspired us to draw a parallel with our approach. In tennis, winning a little over half the points gives players a significant edge over time. Rafael Nadal, one of the sport’s greatest of all time, won 112 of 115 matches he played at the French Open, conquering 14 titles in 17 years. How he achieved this seems counterintuitive: by winning 54% of the points! This was not a fluke. Between 1991 and 2016 the world’s top-ranked tennis player won just over half the points each year. The key to their success was winning disproportionately at pivotal moments in the match. The parallel with investing is that in markets, winning at critical pivot points can lead to successful portfolio outcomes.

The write-ups in this quarterly commentary identify and describe our views on those critical points playing out in markets today. Here are a few:

Desynchronization of the global economy.

This is leading to divergences in monetary policy direction and bond performance, broadening diversification opportunities across Asian and European countries. But these regions are not monolithic and with no single market able to rival U.S. fixed income in size and liquidity the trick is turning several small wins in these regions into bigger wins. Conversely, non-U.S. investors are increasingly realizing that the U.S. is simply too big a market to replace this core portfolio allocation. Managing diversification in a period of desynchronization could be regarded as a common goal for all investors, regardless of where they are in the world.

Disruptive technologies and innovation.

We are at the threshold of a significant innovation and productivity boom. At its core, artificial intelligence (AI) is creeping into all aspects of personal and business activities. AI tools are the new cost cutting, productivity boosting machines. They are helping companies navigate a period of declining sales growth, and in the process, getting better at it. AI tools are also facilitating collection of alternative data to better connect the dots and gain an investment edge. Recently, this gave us visibility into U.S. wage dynamics, later confirmed by traditional data sources.

Foreword

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In the U.S., the post-Covid era inflation remains elevated and complicates things for the Fed as the labor market is softening.

Monetary policy trajectory. A third, and related critical point, is the likely sea change in U.S. monetary policy and diverging trends in other areas, such as Asia. In the U.S. the post-Covid era inflation remains elevated and complicates things for the U.S. Federal reserve System (Fed) as the labor market is softening. A crucial point will be how quickly and to what extent innovation can deliver productivity gains that are good for profits but bad for jobs. The 50% of lower earners in the U.S. economy are most at risk, but their spending level is relatively low and thus this may be unlikely

to tilt the aggregate numbers. For now, those numbers remain solid, but social imbalances may reach a tipping point, and this is a risk we are monitoring. Following these dynamics, as well as the Fed's own reading on them, will be part of our homework ahead.

We hope you find the commentaries in this outlook insightful as we explore these themes and others in greater detail, highlighting the opportunities and risks we see playing out in coming months.

The Fed, technology, and the future of employment



Rick Rieder

Chief Investment Officer
of Global Fixed Income

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While some aspects of our economic and political landscape have generated uncertainties that can be unsettling, opportunities abound for those willing to do the work.

On an aggregate level, the U.S. economy continues to provide a solid growth backdrop, even with weakening labor market growth and still-elevated inflation that should continue to decline longer-term. What this backdrop masks, however, is the high level of dispersion embedded within the economy today. The fact is that many of the most resilient segments of the economy (be they corporations or households) are simply not terribly sensitive to elevated interest rates, as high levels of liquid assets and good cash flows make borrowing less necessary. At the same time, the lower 50% of America has far more non-mortgage debt than they do liquid assets. As such, when rates moved higher, they took on the stress from higher interest costs without benefitting from higher asset prices, or from the higher rate of return on cash. Meanwhile, they are also seeing weaker wage growth as the labor market comes under pressure. This pain, though, is largely masked in the aggregate numbers, as the lower 50% represents a more modest share of overall spending.

Additionally, the interest rate-sensitive housing market remains structurally challenged, impacting much of the population today — particularly the younger, low-to-medium income cohorts. It is for these reasons, and to support a labor market that has begun to display signs of weakness, that the Fed decided to cut policy rates at its mid-September meeting and why further cuts are likely in store in the months ahead. Moreover, while corporate sector leverage remains in good shape overall, this aggregate picture masks the greater interest rate sensitivity

(reliance on credit) of smaller-to-medium-sized businesses, which are a significant source of new job creation. If policy rates are likely heading lower in the shorter term, the Fed (and other global central banks) will also have to manage the possibility of anemic job growth due to technological and productivity gains in the medium term. Therefore, interest rate policy over the next decade could be quite different from a structural perspective than it was in the pre-Covid period. In fact, while the Fed previously struggled to elevate (the then-tame) inflation rate pre-Covid, we may transition to a place where the central bank struggles to elevate employment going forward.

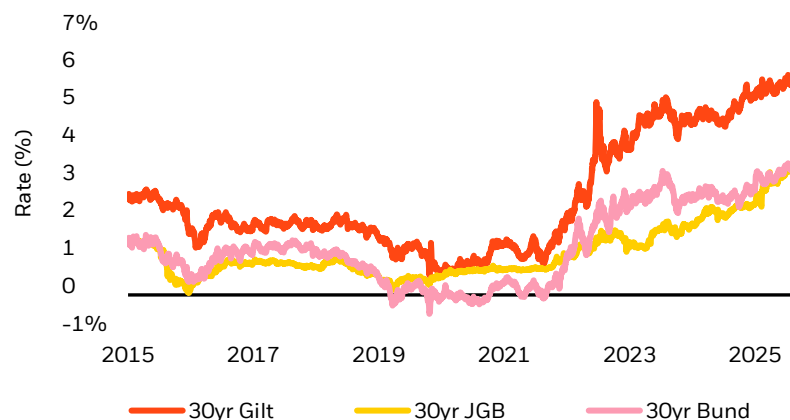
Given this economic context, how should one invest the fixed income segment of a portfolio? In recent years, we have witnessed the back-end of global interest rate markets behave in a less reliable and, at times, more erratic manner, as concerns surrounding different governmental fiscal trajectories are a global phenomenon. But today, some exposure to this part of the market makes sense as rates may decline from currently high levels (see chart, below). Moreover, we believe there are also opportunities to diversify globally, with select European sovereign issues as an attractive area to keep clipping yield (which appears quite attractive, particularly on a foreign-exchange-hedged basis). Given the potential secular change and orientation of the Fed, these real rates further out the curve now deserve at least some seat at the table.

The Fed, technology, and the future of employment

Still, in the U.S., we prefer to own more of our duration exposure in the front to belly of the yield curve, as correlations and hedge effectiveness have improved at the margin. This allows one to balance these bond allocations with risk assets of various types, providing ballast and generating income in a whole portfolio context (see chart, below). Overall, fixed income markets are still offering historically attractive levels of income, especially as evolving

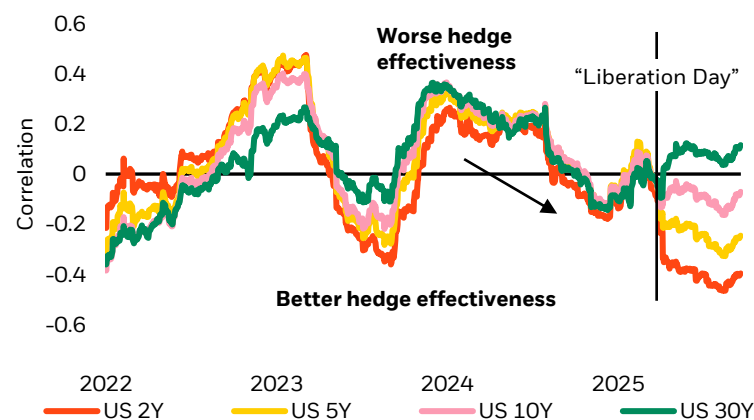
fundamentals and technical factors continue to be supportive of current spread levels. As we have argued previously, this is an extraordinarily exciting and interesting time to be an investor, and while some aspects of our economic and political landscape have generated uncertainties that can be unsettling, opportunities abound for those willing to do the work.

Global 30-year government bond yields



Source: Bloomberg, data as of September 5, 2025.

Rolling 6-month correlation of Treasuries vs. S&P 500



Data's evolving role in tracking macro shifts



Tom Parker
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While we often see broad correspondence between “traditional” and “alternative” data, the value of alternative data often lies in its timeliness – providing an earlier read on macro trends.

The rapid adoption of AI is reshaping how investors seek an edge in today's complex markets. Systematic strategies have long relied on data and advanced analytics, but the breadth and depth of models is now expanding faster than ever. In today's world of information abundance, the advantage lies not in just collecting data but in connecting the dots to unlock deeper investment insights.

Recent labor market dynamics illustrate this, with alternative data providing an additional layer of insight as revisions to official payroll data reshape the outlook. This integration of traditional and alternative sources is critical for identifying macroeconomic shifts amid heightened uncertainty.

Connecting the dots with alternative data

Revisions to payroll data have prompted markets to reassess the health of the U.S. labor market and the broader economy. From monthly payroll reports to the record preliminary estimate of annual benchmark revisions, these sharp adjustments have highlighted the limitations of traditional economic data amid structural changes in collection and response rates.

Response rates to establishment and household surveys have been declining for more than a decade, a trend accelerated by the Covid shock. One factor is technological change: telephone interviews remain central to survey design, yet the rise of “cell-only” households has made it easier to screen out survey calls. At the same time,

non-response bias has distorted results in certain periods. For example, in 2020 higher-income households were disproportionately represented, leaving survey-based income statistics biased upward.

While traditional economic statistics have faced mounting challenges, from Covid disruptions to technological shifts, these very forces have also accelerated the scope and availability of alternative data. The ease of purchasing through smartphones has enabled real-time tracking of consumption trends. Geo-tagging enables robust point of interest (POI) analysis for both consumer trends and supplier dependencies. Increasingly powerful AI tools used to process the massive amounts of “big data” resulting from these technological changes highlight that an information edge in investing today is no longer about collecting the dots, it's about connecting the dots.

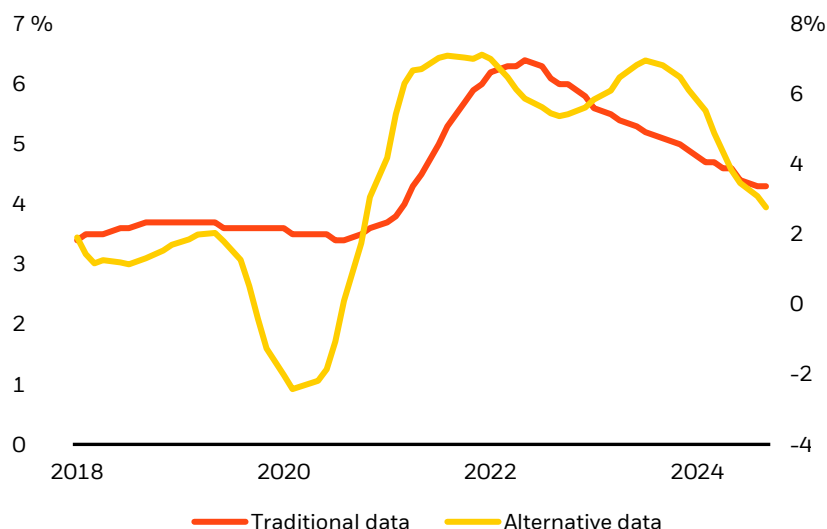
Getting ahead of macro shifts

Analysis of alternative data helps paint a clearer picture of economic trends as they unfold. The move towards online job postings (and away from traditional print newspaper ads) enables near real-time measurement of labor demand, providing an alternative to demand-side measures of payrolls such as the establishment survey. In addition, regulatory changes in many states requiring the posting of salary levels or ranges provide an additional alternative measure for wages. The chart on the next slide highlights the wage data we can extract from these alternative sources.

Data's evolving role in tracking macro shifts

A sharper lens on wages

U.S. wage growth: Traditional measures (Atlanta Fed wage tracker) vs. alternative measures (online job postings), 2018–2025



Source: BlackRock Systematic, Atlanta Fed. Alternative data from online job postings shows the 2nd quartile of income wage growth, 6-month average of monthly y/y % change as of July 31, 2025.

While we often see broad correspondence between “traditional” and “alternative” data, the value of alternative data often lies in its timeliness and its potential to deliver clearer, high-frequency insights into macro trends.

The post-Covid inflation surge made tracking wage inflation a critical part of assessing the labor market's contribution to the inflation outlook. The alternative data series on wage inflation derived from online job postings was especially effective at capturing the impact of labor market tightness, as wage inflation shot up rapidly before appearing in the more traditional Atlanta Fed wage tracker data.

The market's recent focus on labor market softening reflects a shift from inflation concerns toward growth concerns. Our alternative data captured a record pace of labor market easing, revealing the slowdown earlier and with greater accuracy than traditional measures. These signals were later reflected in sharp downward payroll revisions, underscoring how alternative data can provide both a timely and reliable view of labor trends.

Of course, the use of alternative data comes with its own challenges and shortcomings. Nothing can replicate the long time series of many premier macroeconomic indicators with their consistency and historical depth. Still, the rapid adoption of new technologies is generating alternative data with the potential to provide clearer, near real-time signals. These offer valuable complements to traditional measures, even if histories are shorter or evolve as the underlying technologies scale.

For investors, the takeaway is clear: alternative data is an additive form of information for investment applications. Rather than supplanting traditional data, it has become an increasingly important complement, helping investors spot shifts earlier and with greater clarity. In the current case of assessing the labor market, the shifting macro narrative driven by revisions to traditional data had already been signaled by the slowdown observed in alternative data. Ultimately, alternative data allows us to observe and infer what is happening—with more timeliness and, increasingly, with more accuracy.

Finding alpha in a market ‘priced for perfection’



Simon Blundell

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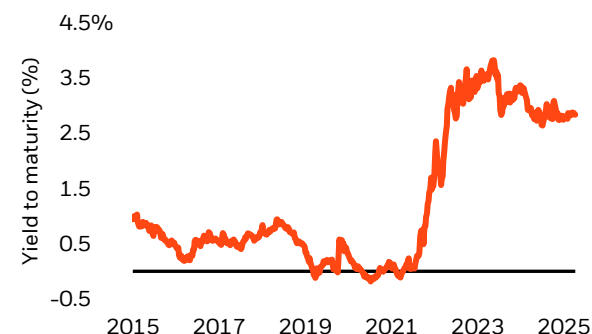
Bond yields across the region remain close to the 3% level, a historically elevated point of entry that is also supported by fundamentals.

European fixed income remains one of the most compelling opportunities for income-oriented investors. Bond yields across the region remain close to the 3% level,¹ a historically elevated point of entry that is also supported by fundamentals (see chart). Inflation expectations are broadly aligned with the European Central Bank target of 2% and growth prospects are rising from a low base. Flows into the asset class this year reached US\$121.5 billion through August 31,² and while interest remains elevated, we are wary of beta returns in a market that appears to be ‘priced for perfection.’

Tight credit spreads across sectors and the quality spectrum leave little margin for error in a potential risk event. Investment-grade spreads in the Euro area broke through a ten-year low of 78 basis points in July.³ In such a finely balanced environment, any adverse news — whether from geopolitics, ongoing tariff disputes, or fiscal headwinds in Europe and the U.S. — may trigger outsized market reactions. Investors’ tolerance for negative surprises is thin, making valuation discipline critical. But these can be positive conditions for alpha generation.

Sticky yields

Bloomberg Euro aggregate bond index, 2015-2025



Source: Bloomberg, as of September 9, 2025. **The figures shown relate to past performance. Past performance is not a reliable indicator of current or future results.** Index performance returns do not reflect any management fees, transaction costs or expenses. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any BlackRock fund. Indices are unmanaged and one cannot invest directly in an index.

¹ Source: Bloomberg referring the index BBG Euro Aggregate Bond Index. Yield at 2.82% as of August 9, 2025.

² U.S. Mutual Fund data includes Retail and Institutional. Data includes MMFs and excludes Closed-End Funds, FoFs etc. GBI iShares ETF data is global and includes Retail and Institutional. Data includes MMFs. Non-U.S. Domestic and Total Cross-Border MF data. Includes all investor types (retail, insti, dedicated), includes third-party and proprietary sourced assets, and MMFs. Excludes Closed-End Funds, FoFs. As of July 2025.

³ Source: Bloomberg as of July 31, 2025. Data referring to BBG Euro Aggregate Corporate Index.

Finding alpha in a market ‘priced for perfection’

The European fixed income market may be priced for perfection, but its robust income potential and improving macro trends leave room for active managers to identify asymmetric risk/reward situations and turn them into potential alpha-generating opportunities.

The compelling income levels suggest that more meaningful opportunities lie in sector allocation and security selection. We believe that stretching for yield in fragile areas cannot match finding resilient companies with strong balance sheets and corporate management teams capable of weathering volatility. In-depth fundamental research and direct engagement with issuers can uncover mispricings that lead to alpha generation, even if the broader market appears to be fully valued.

Winning the important points

Today’s uncertain environment offers limited upside for capital appreciation while downside risks remain elevated. In this environment, a static, bold, and yield-chasing allocation approach may struggle, while more nimble, selective approaches may have an edge harnessing attractive income through agility and flexibility. Portfolio managers will need to act decisively when volatility, mispricings, or idiosyncratic shocks open windows of opportunity. Conviction to size positions, often overlooked as a factor that can meaningfully contribute to alpha generation, will be equally important.

Tight spreads in European fixed income do not translate into lack of opportunity as much as the need to be highly selective. Both the investment and non-investment grade markets continue to offer compelling yield potential of 3.31% and 5.58%, respectively.⁴ Strong credit research and market access are the keys to unlock it.

We see the EU-U.S. tariff negotiations continuing, despite the recent agreement, and believe sector resiliency will be uneven. Steel and aluminum remain on shaky ground, while banks, utilities, and the technology, media, and telecommunications (TMT) sector appear less vulnerable to tariff shocks, albeit not insulated from idiosyncratic risks as evidenced by recent volatility in tech-related stocks.

High-quality collateralized loan obligations (CLOs) stand out within securitized assets, providing a meaningful spread premium over comparably rated corporate credit. CLOs deliver the added benefit of low correlation to traditional fixed income.⁵

Relatively tight credit spreads have made European government bonds also appear more attractive. Volatility in sovereign bonds is creating opportunities for investors seeking to lock the yields available without taking the credit risk of corporate bonds. Political instability in France has contributed but diverging growth outlooks between northern and southern countries compounds the potential for alpha generation. For now, clipping yields at the front end of the curve remain front and center, but the significant curve steepening throughout the year warrants keeping a close eye on longer-dated assets.

Ultimately, “winning the important points” in this market is about balancing resilience with agility: Securing attractive income, leaning on deep research to avoid pitfalls, and positioning portfolios to capture alpha whenever dislocations arise.

⁴ Bloomberg as of July 31, 2025. Data referring to BBG Euro Aggregate Corporate Index and Barclays Pan-European High Yield Index.

⁵ Source: Bloomberg, BlackRock, JP Morgan as of June 30, 2025. Analysis based on indices comparison. Indices used: Bloomberg Global Aggregate Corporate Index, Bloomberg Global Aggregate Government Index, Bloomberg Global Aggregate Securitized Index, Bloomberg Pan European High Yield Index, Bloomberg U.S. High Yield Corporate Index, JP Morgan CLO EUR AAA Index, JP Morgan CLO USD AAA Index. Hedging costs are based on annualized 1-month forward rates. Indices are unmanaged and one cannot invest directly in an index.

Yes, and yes – Asian bonds and active management



Navin Saigal

Head of Global Fixed
Income, Asia Pacific

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The U.S. bond market stands unmatched in scale and liquidity but viewing Asia-Pacific or global ex-U.S. bonds as regional blocs changes the conversation.

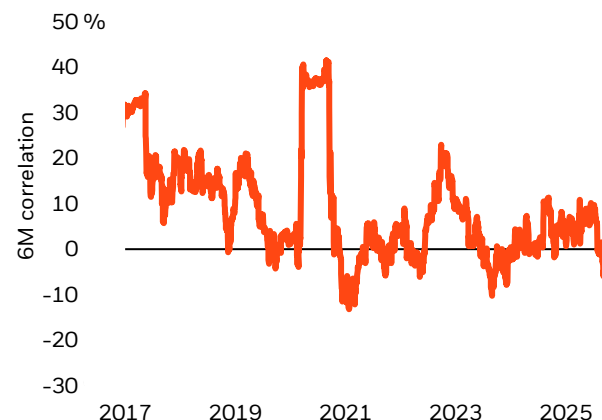
Identifying uncorrelated assets for portfolio construction has become increasingly challenging for investors. Historically, the negative correlation of developed market bonds to developed market equities meant that both assets were highly effective portfolio diversifiers. But recent shifts in monetary and fiscal policy have led to significantly higher correlations between stocks and bonds across developed markets. And while the U.S. dollar until recently maintained its safe-haven status by moving inversely to the typical “60/40” portfolio allocation, this relationship flipped to positive this year.

Asset allocators seeking uncorrelated assets have turned increasingly creative, adding gold, bitcoin, real estate, infrastructure, and private credit — “alternatives” whose place in portfolios have grown as the efficacy of traditional hedges has waned. Asian bonds are underrepresented in this mix. We believe they shouldn’t be.

An economic desynchronization is underway between the U.S. and Asia fueled by diverging paths in inflation, growth and fiscal and monetary policies that are also fueling divergence in their bond markets. The correlation between major Asian and U.S. bond indices has turned negative from 30%-40% in the earlier part of the last decade (see chart). Asian bonds used to trade with a beta to U.S. Treasuries but are now their own asset class.

Correlation breakdown

Emerging market vs. U.S. bonds, 2017-2025



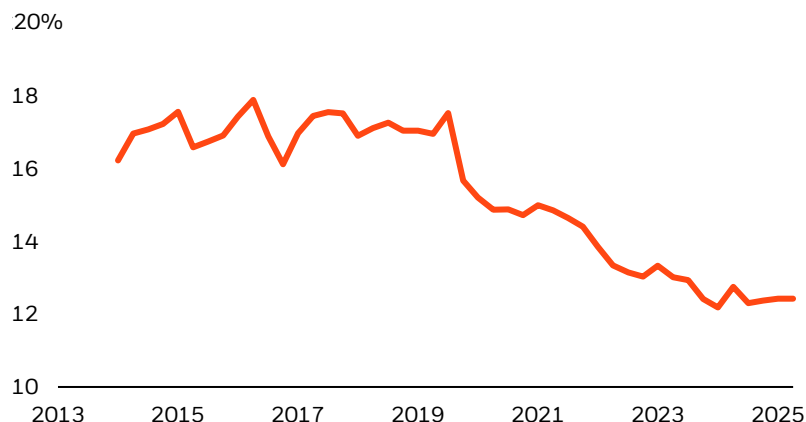
Source: Bank of Philippines as of April 10, 2025

Global investors are showing more interest in marginally reallocating funds to Asian and non-U.S. bonds while maintaining the U.S. bond market as their core allocation. For now, Asian bonds remain largely under-owned. Over the past five years, foreign ownership of Asian government bonds fell from 18% to 12% (see chart on next page).

Yes, and yes – Asian bonds and active management

Under-owned asset class

Foreign ownership of Asian bonds, 2014–2025



Source: Monetary Authority of Singapore as of April 13, 2025 .

Many money managers seeking diversification from long-dated Treasuries regard market size, liquidity, real yield, income and cost as significant impediments to acting materially. Any Asian bond market is indeed too small to be a viable diversifier from Treasuries. The size and trading volume of most non-U.S. markets resemble small segments of the U.S. corporate

market. For example, Singapore's sovereign bond market is about US\$235bn (as of June 2025),⁶ about half the size of the U.S. CMBS market.

The U.S. bond market stands unmatched in scale and liquidity but viewing Asia-Pacific or global ex-U.S. bonds as regional blocs changes the conversation. Implementation is another matter. In our view, threading a needle to balance theory and practical limits within a portfolio's risk and liquidity profile demands an active strategy rooted in strong local knowledge and an understanding of shifting global dynamics.

Beautiful divergence

This year's U.S.-Asian bond market divergence doesn't solely reflect tariff policy or investors drifting away from U.S. assets. We believe a more fundamental contributor has been the "Japanification" of Asia ex-Japan. Asia's manufacturing capacity outstrips domestic demand, and a large-scale fiscal stimulus that could change the equation hasn't materialized.

In the late 1980s, Japanese goods became pricier for U.S. consumers as the yen strengthened massively after the Plaza Accord, a policy aimed at addressing the rising U.S. trade deficit. Over the next 30 years, Japanese bond prices rose as deflation set in. Now, a different policy, U.S. tariff policy, is expected to be inflationary in the U.S. but deflationary in Asia due to lower U.S. demand and price pressure to clear inventories elsewhere. This is driving divergence in the respective bond markets.

⁶ Source: BlackRock, with data from JPMorgan and Bloomberg, U.S. CMBS market size as of March 31, 2025; Singapore market size as of May 7, 2025.

Yes, and yes – Asian bonds and active management

Inflation expectations remain high in the U.S., but some Asian central banks have adjusted their forecasts downward for 2025. The Bank of Philippines reduced its inflation projection from 3.5% to 2.3% and lowered interest rates this year. The Monetary Authority of Singapore loosened financial conditions and decreased both growth and inflation forecasts by 1%.

Asian interest rates, particularly real rates, are currently elevated relative to the region's low growth and low inflation conditions. In India and Indonesia, yields stand at approximately 6% while inflation remains around 3%,⁷ resulting in a notable margin of safety for investors. Central banks in these

countries have scope to reduce rates, which is good news for bond investors.

Amid persistent global uncertainty and high U.S. stock-bond correlations, Asian bonds stand out as under-owned, uncorrelated assets that can enhance portfolio diversification and resilience. The tricky part is managing the myriad regional complexities this entails. We believe the distinctive value of Asian bonds in a diversified portfolio is best unlocked through active management — enabling investors to dynamically navigate shifting conditions, seize emerging opportunities, and benefit from the resilient characteristics these markets offer.

⁷ Source: BlackRock, with data from Bloomberg, as of September 30, 2025.

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