Vanguard

MARCH 2026

Active Fixed Income Perspectives—Monthly Pulse

Key takeaways

1. **Base case: We expect the U.S. economy to grow at a near-trend pace, supported by elevated capex, healthy consumer spending, supportive fiscal policy, and a less restrictive monetary policy backdrop.**
2. **With growth steady and labor conditions gradually improving, we expect inflation to remain sticky and modestly above target. This should keep the Fed cautious and deliberate around additional easing.**
3. **The emerging conflict in Iran is introducing more uncertainty into the global-growth backdrop, and labor-market risks remain skewed toward the downside if economic activity cools or AI-driven productivity reduces demand for labor.**
4. **Our base case is constructive for risk assets, but with tight valuations and emerging risks, we remain focused on selective carry and an up-in-quality bias.**

Outlook: Base case of near trend growth, but with rising geopolitical risks.

Our base case is for near-trend U.S. growth in 2026, supported by robust AI-related capex, strong consumer spending, supportive fiscal policy, and a less restrictive monetary policy backdrop. In this environment, we expect inflation to remain sticky and modestly above target, which is likely to keep the Fed cautious about additional easing.

AI-related capex and the labor market remain key drivers of the backdrop. Elevated investment spending is a strong contributor to our forecast for firm U.S. economic growth. The current "low hire, low fire" dynamic leaves the labor market fragile. While we expect conditions to gradually improve over the course of the year, we view the balance of risks as remaining skewed toward a weaker labor market.

The escalating conflict in Iran introduces additional uncertainty into the economic environment, with the early market impact most visible in energy and in issuers exposed to oil supply disruptions. Prolonged stress in the energy markets increases upside risks to inflation and downside risks to growth—a negative supply shock dynamic—reinforcing the need to frame the base case with clear acknowledgement of evolving risks.

Our active positioning: Balanced rate risk, selective carry in credit, and curve-driven value in municipals

Rates: Neutral duration while taking advantage of dispersion in global rates. In U.S. rates, we remain strategically neutral on duration and favor curve steepeners. In mortgages, we retain an overweight with an emphasis on sub-sectors that offer relative value. Outside the U.S., we maintain a short duration position with a flattening bias in Japan and a steepening bias in the Eurozone. In cross-market relative value, we are positioned short U.S. versus Germany and short Germany versus the UK. We have reduced our overweight to peripheral European sovereigns versus core EU nations.

Credit: Overweight but focused on higher-quality carry and security selection with dry powder to deploy. We expect corporate spreads to remain in a defined range through the first half of 2026, supporting an overweight focused on selective carry. Trend-like growth, strong corporate fundamentals, and a neutral-to-supportive Fed underpin a constructive outlook, but risks are rising that spreads could widen if geopolitical tension rises, growth slows, or inflation accelerates. Should spreads widen materially, we are maintaining dry powder to add exposure in credit. As always, security selection remains central to alpha generation, particularly in lower quality sectors like high yield and emerging markets.

Municipals: Steep curve and long-end value support carry/roll-down. The steepness of the muni curve continues to offer compelling return potential, with carry and roll-down particularly attractive inside 20 years. In addition, the long-end ratio of muni yields to Treasuries are standing out relative to historical norms versus the same ratio in the front end. We continue to hold a long muni duration position, in part as a hedge against our credit exposure, where spreads remain attractive versus history.

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