

Full Discretion Team

Extra Credit

Q1 Round Up: Resilient Growth Amid Heightened Geopolitical Risk and Constrained Federal Reserve Policy

Heightened Geopolitical Risk & Solid Corporate Fundamentals

Market volatility during the first quarter was increasingly shaped by the emergence of geopolitical risk tied to the escalation of military conflict involving the United States, Israel, and Iran. The intensification of tensions in March marked a clear inflection point for markets, driving a sharp rise in energy prices, lifting inflation expectations, and reinforcing concerns around global supply chains, energy security, and regional stability. These developments compounded existing fiscal uncertainty in Washington, including a brief federal government shutdown from late January into early February and a subsequent, more targeted shutdown affecting the Department of Homeland Security that persisted through much of the quarter. Against this backdrop, U.S. Treasury yields moved higher, with the 10-year yield increasing from approximately 4.17% to 4.32%, reflecting heightened fiscal concerns and the risk that higher energy prices could reignite inflationary pressures. The market's initial response to the Iran conflict was relatively orderly across credit spreads and equities, suggesting that investors were not immediately pricing in a worst-case geopolitical outcome. However, near-term market dynamics remain highly dependent on whether the conflict evolves into a sustained oil supply shock. Key variables include potential damage to regional energy infrastructure, the duration and severity of any disruption to shipping routes through the Strait of Hormuz, and the degree to which shipping flows are selectively constrained. As a result, uncertainty remains elevated across growth, inflation, and central bank reaction functions, contributing to increased volatility across asset classes.

Looking ahead through 2026, we believe the U.S. economy will remain in the 'Expansion to Late Cycle' phase of the credit cycle, with the likelihood for slowing economic growth in the near-term and potential for re-acceleration later in the year. While geopolitical risks have risen meaningfully following the start of the Middle East conflict and the associated increase in energy prices, our base case calls for below-trend growth for the year rather than a recession. We believe corporate fundamentals remain solid, and consensus earnings growth expectations for 2026 are healthy across most regions. In our view, earnings growth remains the linchpin supporting investor demand across both equity and corporate credit markets.



Team Outlook

BASE CASE

CREDIT CYCLE	Expansion to Late Cycle
MACRO	Mid-Year Slowdown but Growth Remains Positive
INFLATION	Renewed Inflation Pressures
POLICY RATES	Middle East Conflict May Constrain Fed Policy
US RATES	Defensive on Long-End Yields
CORPORATE FUNDAMENTALS	Stable
FX	Potential Diversification Benefits
KEY RISKS	Conflict Escalates into an Oil Supply Shock

In the United States, positive wealth effects and solid consumer spending—particularly among mid-to-upper-income households—continue to support aggregate demand. Although labor market data has cooled modestly, we do not anticipate a widespread wave of layoffs as long as corporate profitability remains intact. Corporate balance sheets generally remain healthy, and profit margins have continued to strengthen despite higher input costs. In addition, substantial capital expenditures tied to artificial intelligence (AI), data centers, and related digital infrastructure are likely to support productivity gains and longer-term economic momentum. While AI adoption could eventually lead to labor displacement, we do not view this as a near-term risk and instead see investment-driven productivity as a constructive force through 2026. Outside the U.S., global economies are generally more exposed to energy price shocks, and we expect the rise in energy costs to lead to a modest slowdown in global growth. However, we are not anticipating a recessionary environment. Entering 2026, global growth appeared more synchronized, supported by interest rate cuts implemented in 2025, and many countries retain fiscal flexibility to support activity should conditions deteriorate. While external risks remain elevated amid heightened geopolitical tension, we believe the global economy is entering this energy shock with greater resilience than during the initial phase of the Russia-Ukraine war.

Global Uncertainty and Fiscal Pressures May Constrain Federal Reserve Policy

Our view on interest rates is grounded in the expectation that U.S. inflation will remain sticky in the near term, continuing to run above the Federal Reserve's 2% target. Structural forces—including persistent fiscal deficits, geopolitical fragmentation, higher defense spending, and ongoing supply-chain reconfiguration—continue to exert upward pressure on inflation. Cyclically, while recent data reflects the lagged easing of shelter inflation, we caution that fiscal stimulus from the One Big Beautiful Bill Act (OBBBA), elevated tax refunds, resilient consumer spending, and higher energy prices could contribute to renewed inflation pressure later in the year as costs pass through to goods prices. Against this backdrop, we now believe there is a very high bar for the Fed to hike versus cut given this could lead to a supply shock over which the Fed has no control. A great deal hinges on the balance between a softening labor market and the risk that energy-driven inflation constrains policy flexibility. New Fed leadership may lean toward a more forward-looking or accommodative bias, but more aggressive easing would likely require clearer evidence of accelerating disinflation and weaker employment data, in our view.

With respect to the U.S. fiscal deficit, we believe the imbalance is increasingly structural rather than cyclical, driven by large and growing nondiscretionary spending—primarily entitlements and defense—alongside rising debt-servicing costs as interest rates and the overall debt stock have increased. Elevated geopolitical risk, including the war in the Middle East, has reinforced upward

pressure on defense spending and contributed to higher energy prices, further complicating the inflation and fiscal outlook. In our view, the current deficit trajectory is unsustainable and risks stimulating inflation, which could push borrowing costs higher across the economy. Absent meaningfully stronger growth, material spending restraint, or the emergence of a durable new revenue source such as tariffs, we do not expect the deficit to stabilize in the near term. As a result, we see continued risk of upward pressure on long-term interest rates. We believe treasury supply is likely to remain a central market focus and likely places a floor under long-dated yields, particularly as foreign demand becomes more price sensitive. We estimate long-term fair value for the 10-year U.S. Treasury at approximately 4.00%–4.50%, based on a 1.75%–2.00% real rate and 2.25%–2.50% inflation breakeven. However, a combination of persistent fiscal expansion, higher term premia, and policy choices under the Trump administration—including tariffs and defense priorities—could push fair value modestly higher over time, in our view.

Credit Fundamentals Remain Stable

Within this environment of heightened uncertainty and volatility, our cycle-based investment process remains anchored to a long-term horizon. We continuously reassess value through our Risk Premium framework and Credit Health Index (CHIN), which continue to suggest that defaults and losses across both investment grade and high yield credit should remain below historical averages for this stage of the cycle. Bottom-up fundamentals have remained resilient despite modest weakening in leverage and interest-coverage metrics, as profit margins have strengthened and earnings growth expectations remain constructive. During the first quarter, credit spreads and risk premiums widened in response to heightened geopolitical uncertainty following the outbreak of conflict involving Iran. In our view, this repricing improved relative value across credit markets without signaling broad-based credit deterioration. We believe corporate balance sheets remain well positioned to absorb episodic macro volatility related to geopolitics, energy prices, and policy uncertainty.

Maintaining Flexibility as Volatility Could Create Potential Opportunities

In this context, we are preserving liquidity, selectively leaning into credit risk, and remaining prepared to redeploy capital should spreads widen meaningfully. We believe long-term value has returned to fixed income markets through a combination of discount-to-par pricing, positive convexity, and attractive all-in yields. Elevated volatility and evolving macro risks reinforce the importance of flexibility in managing both interest-rate and credit exposure, particularly when weighing the intermediate portion of the curve against the longer-term risks embedded in the long end. We remain selective across investment grade and high yield credit, bank loans, securitized assets and non-US dollar debt, where relative value opportunities continue to emerge. Lastly, convergence between public and private credit markets is accelerating, creating what we believe are additional opportunities for multi-sector investors.



Meet the Team

MATT EAGAN, CFA
Head of Full Discretion, Portfolio Manager

BRIAN KENNEDY
Portfolio Manager

PETER SHEEHAN
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ERIC WILLIAMS
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BRYAN HAZELTON, CFA
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DAVID ZIELINSKI, CFA
Investment Director

CHERYL STOBER
Investment Director

KRISTEN DOYLE
Associate Investment Director

MATTHEW GREEN
Associate Investment Director

About the Team

The Full Discretion team brings decades of expertise and collaboration to create tailored solutions for their clients.

23

Investment Professionals

22+

Years of Industry Experience
(Portfolio Management Team)

\$85.8

Team Assets Under Management
(Billion USD)

Team Philosophy

We have a legacy of independent thinking and leaning into the market when others may be pulling away. We take a deep-value, equity-like approach to credit selection across global fixed income markets. Our disciplined process helps give us confidence in seeking to identify macro trends, formulate a clear view on market sectors, and invest throughout the credit cycle.

For more than 40 years, we have been applying our distinctive style of bond picking to deliver portfolios designed to provide excess yield potential and have low correlations to traditional benchmark-focused fixed income strategies.

*Source: Loomis Sayles, as of 3/31/2026
Average years of expertise reflected at portfolio management level*

Important Disclosure:

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The Credit Health Index (CHIN) is a macro tool created by Loomis Sayles. The CHIN is currently managed by the Loomis Sayles Applied IQ team. It is a proprietary framework that utilizes a combination of macro, financial market and policy variables to project US corporate health.

Commodity, interest and derivative trading involves substantial risk of loss. Diversification does not ensure a profit or guarantee against a loss. Market conditions are extremely fluid and change frequently.

Any investment that has the possibility for profits also has the possibility of losses, including loss of principal. There is no guarantee that any investment objective will be realized, or that the strategy will be able to generate any positive or excess returns.

Past performance is no guarantee of future results.

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