RATES

End of Low Volatility Presents New Opportunities

This report is excerpted from the Second Quarter 2026 Fixed-Income Sector Views.

Geopolitical tensions and energy prices drive yields, creating opportunities in G10 sovereign bonds.

While fixed-income markets began 2026 on a robust note, the Middle East conflict and surging energy prices sharply repriced inflation expectations, pushing sovereign yields higher and flattening curves. We believe that a prolonged conflict will shift market focus from inflation to growth risks, supporting lower yields and resumed Fed easing. In this environment, we are opportunistically managing duration within trading ranges, targeting short-term Treasurys, and capitalizing on attractive relative value opportunities in G10 sovereign markets, including Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Sweden, Switzerland, the United Kingdom, and the United States.

Sector Commentary

- The first two months of 2026 started out strong with fixed-income returns of 1–2 percent, supported by subdued labor market growth, contained inflation expectations, and anticipated Fed easing all driving Treasury yields lower.
- In March, market focus quickly shifted to the outbreak of war in Iran. Surging energy prices followed the Strait of Hormuz closure and repriced short-term inflation expectations sharply higher.
- As energy prices skyrocketed, global sovereign yields surged higher, yield curves flattened, and central bank expectations pivoted from an easing regime to a potential tightening regime amid short-term inflation pressures.
- We believe that a prolonged conflict would see fixed-income markets shift focus from the short-term inflation impact to the longer-term negative growth impact, supporting lower Treasury yields and a resumption of Fed easing.

Investment Themes

- Treasury yields remain in a trading range, which allows us to opportunistically reduce duration when yields reach the lower end of the range and add duration as yields move to the higher end.
- We expect that the Fed will likely resume easing, but later than we previously forecast. Short-term Treasurys trading above the fed funds rate offer compelling value, in our opinion, and we will take advantage of this trading opportunity in various ways.
- The global selloff in sovereign bonds has created attractive relative value investment opportunities to own duration exposure in other G10 countries with strong fiscal positions.
- Interest rate volatility has surged, prompting investors to move to the sidelines. This volatility, combined with elevated yields, has made for attractive coupons in callable Agency bonds.

By Kris Dorr and Tad Nygren

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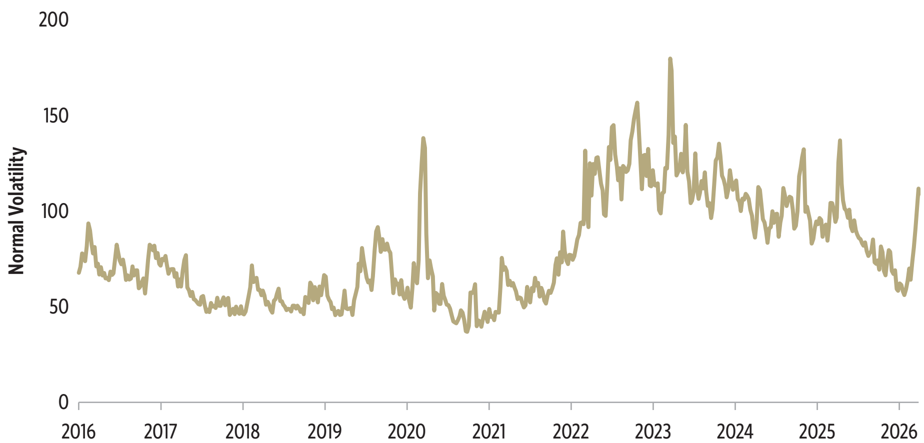
Increased Volatility and Elevated Yields Enhance Opportunities in Treasury Market

1-Month Implied Option Volatility on Interest Rate Swaps



Source: Guggenheim Investments, Bloomberg, BofA ICE MOVE Index. Data as of 3.29.2026.

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One **basis point** is equal to 0.01%.

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