

Fixed Income Weekly



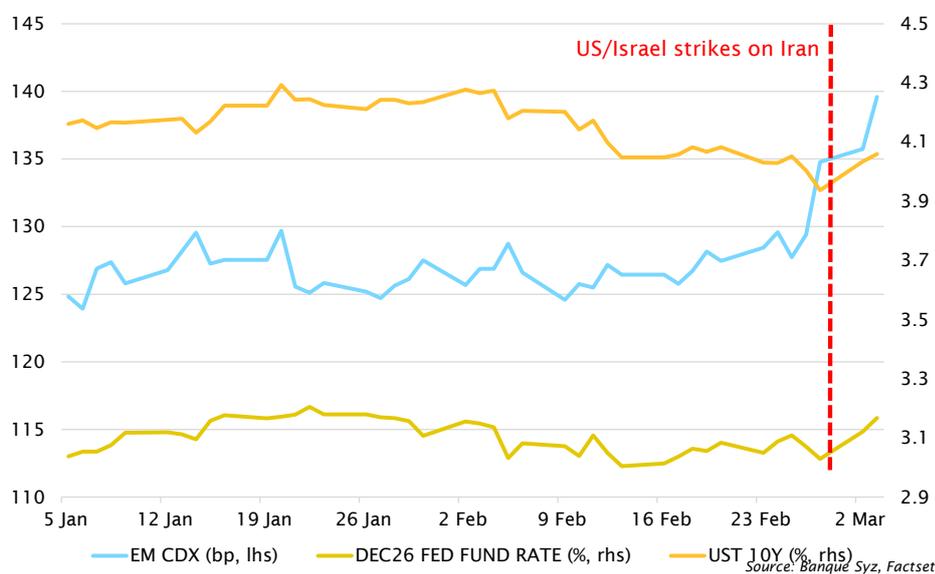
Bond markets moved in Risk off mood as the Middle East enters a highly uncertain phase

Syz Fixed Income Research – Week from 23 to 27 February 2026

USD rates fell ahead of the week-end's strikes on Iran, while credit and Emerging Market spreads reflected rising concerns on the situation in the Middle East.

The Chart of the Week

The imminence and then beginning of strikes on Iran has sent shockwaves on bond markets



It had been in the air all week; over the weekend, it became reality: the United States and Israel struck Iran, triggering a highly uncertain and destabilizing new phase in the Middle East.

Bond markets reacted swiftly. Emerging market and credit spreads widened markedly from previously compressed levels. Rising uncertainty, increased risk aversion, and concerns about the economic impact of higher oil prices logically justify a higher risk premium. This repricing has been particularly visible in bonds issued by corporates and sovereigns in GCC countries, as well as in neighboring economies such as Turkey and Egypt. However, the move has not been confined to the region; European issuers and broader credit markets have also come under pressure.

More surprising has been the reaction of US Treasury markets. Fears that surging oil prices could reignite inflation have pushed US yields higher and prompted futures markets to scale back expectations of Federal Reserve rate cuts this year. In the initial phase of the crisis, US Treasuries have not acted as a traditional safe haven; instead, they have declined alongside equities.

At this stage, market moves appear driven primarily by sentiment and flows rather than by a clear reassessment of fundamentals. The ultimate impact of these developments on credit quality and the interest rate outlook remains highly uncertain and, for now, difficult to quantify.

What happened last week?

Central banks

While there were no major developments or meetings among major central banks last week, central bankers took this opportunity to share their views in various speeches, underscoring a data-dependent and increasingly nuanced policy landscape.

At the Federal Reserve, Governor Christopher Waller described his March rate decision as a “coin flip,” hinging on February labor data. A renewed softening would justify the 25bp cut he favored in January; continued strength would argue for holding steady, assuming inflation remains near 2%. Chicago Fed President Austan Goolsbee echoed the need for clearer disinflation before easing further, while noting tariff uncertainty could both damp hiring and relieve price pressures. Richmond’s Tom Barkin cautioned against using rates to offset AI-driven “creative destruction,” as Kansas City’s Jeff Schmid highlighted productivity gains. St. Louis Fed President Alberto Musalem judged policy near neutral, with balanced risks. Governor Stephen Miran, by contrast, still favors earlier and deeper cuts in 2026.

In Europe, European Central Bank President Christine Lagarde signaled agility but little urgency to move, citing inflation near target and balanced risks, while stressing vigilance on AI’s labor impact and euro strength. Governing Council members Boris Vujcic and Joachim Nagel emphasized optionality amid asset-valuation and currency concerns.

At the Bank of England, Governor Andrew Bailey sees scope for gradual easing as inflation returns to target, though colleagues including Huw Pill and Megan Greene urge caution.

Rates

Sovereign bonds rallied decisively last week as broader risk caution and softer macro signals pulled yields lower across core markets. In the US, 10-year Treasury yields declined 14.4bps to 3.94% (-6.4bps on Friday alone), their lowest level since October 2024. The move was led by the belly of the curve, with 5-year yields down 15bps to 3.50%, while 2-year yields fell 10bps to 3.37% and 30-year yields dropped 11bps to 4.61%. The decline in long-end yields reflected both lower real rates and softer inflation expectations: 10-year real yields fell 11bps to 1.68%, while breakevens narrowed modestly by 4bps to 2.26%.

European rates followed suit. German 10-year Bund yields fell 9.4bps to 2.64%, marking their largest weekly decline since last April’s Liberation Day volatility. Moves were broad-based across the curve, with the 5-year down 10bps and the 2-year down 6bps. Peripheral spreads were broadly stable as France (-8bps), Italy (-7bps), Spain (-9bps), Portugal (-8bps) and Ireland (-8bps) all rallied in tandem. UK 10-year Gilts outperformed, with yields down 12bps to 4.23%, while Japan was unchanged.

Duration exposure was rewarded: iShares Treasury 20y+ gained 1.58%, with gains increasing along the curve. In Europe, 10–15 year government bond ETFs rose 0.84%, underscoring renewed demand for high-quality duration.

Credit

Credit spreads widened on Monday following the outbreak of US–Iran war, though the move was more contained than feared. Investment grade credit in both the US and Europe held up relatively well, supported by a flight-to-quality phenomenon. Nevertheless, total returns were broadly negative across markets, except in US high yield segment. largely due to the rise in US Treasury yields.

In fact, markets had already begun to price in geopolitical risk. Credit spreads had started to widen and oil prices had spiked in the preceding week as the significant US military buildup around Iran ultimately escalated into direct strikes.

At the current juncture, energy-driven commodity inflation is more likely to weigh on growth than trigger a sustained inflation shock. Current oil prices reflect an implicit market assumption of a short-lived conflict of around four-weeks. Moreover, the U.S. is now largely energy self-sufficient.

Primary market activity has almost come to a standstill after an exceptionally strong start to 2026.

OpenAI raised \$110 billion, valuing the company at \$730 billion pre-money (up from \$500 billion valuation in October) and \$840 billion post-money. Amazon will invest \$50 billion, while SoftBank Group and Nvidia each committed \$30 billion.

The current elevated uncertainty argues for diversification and a long-term investment mindset, rather than reactive portfolio changes.

Emerging market

The widening in EM spreads so far signals investor caution rather than panic. Markets appear to be pricing in near-term uncertainty without anticipating an immediate deterioration in GCC's (Gulf Cooperation Council) credit profiles.

GCC corporates have historically exhibited very low default rates and generally conservative leverage levels. UAE banks, for example, maintain strong capitalisation, with an average CET1 ratio of 14.4%, well above the 7% regulatory minimum (CET1: Common Equity Tier 1). In addition, the governments of the UAE, Qatar, and Saudi Arabia have consistently demonstrated a willingness to support state-owned and strategically important companies and banks during periods of market stress. In addition, many GCC countries benefit from multi-year liquidity buffers.

A prolonged conflict combined with elevated oil prices could weigh on Turkey and Egypt, which are net oil importers. Nevertheless, both countries enter this period with stronger foreign-exchange reserves than in the past. The Central Bank of Turkey has also shown a willingness to respond rapidly to financial-stability risks, including through decisive monetary tightening when necessary. Fitch's Positive Outlook on Turkey in January 2026 highlighted the country's progress in reducing external vulnerabilities, with debt-to-GDP expected to be only 25% next year.

For Latin America, the geographical distance and the structure of economic linkages imply limited first-order effects from the conflict. The primary transmission channel is through oil and commodity prices. Brazil and Colombia are net oil exporters. However, a prolonged conflict and a

more challenging external environment could reduce the scope for anticipated rate cuts by central banks in Brazil (-50 basis points), Chile (-25bp), and Mexico (-25bp) for this year.

From a performance perspective, EM local-currency sovereign bonds (the J.P. Morgan EM Local Currency Bond ETF) were the biggest loser, declining by 1.1% during Monday's session, driven by stronger USD. The U.S. has become a net oil exporter in this conflict. EM sovereign USD bonds and EM corporate USD bonds (iShares benchmarks) fell 0.3% and 0.4%, respectively.

Given the ongoing developments in the Middle East, refraining from adding risk exposure to GCC, Egypt and Turkey will be prudent at this stage.

Our view on fixed income

Rates

NEGATIVE in current environment

We maintain a Negative stance on government bonds. Positive global growth dynamics, price pressures in the US and profligate fiscal policies reduce the attractiveness of long-term government bonds as a potential hedge for economic downturn and increase the risk of higher long-term yields. Limited prospects of further central banks' rate cuts and unattractive yield curve slopes at the front-end also reduce the attractiveness of government bonds on short-to-medium term maturities.

High Yield

NEUTRAL, favor short maturities

We like High Yield bonds with short maturity for their attractive combination of yield and low sensitivity to interest rate movements. HY spreads have tightened, signaling economic stability and contained default risk in the short run. However, those tight spreads are not attractive for medium-to-long term maturities as they do not compensate adequately for a potential deterioration in the economic environment. As such, we hold a Neutral view for High Yield in an allocation, with a clear preference for short-duration investments. We continue to find value in subordinated debt.

Investment Grade

NEUTRAL, harvest the carry

We find Investment Grade corporate bonds attractive in the current environment, given their yield level and our constructive economic scenario. However, tight credit spreads reduced the margin for safety in credit and make the asset class expensive from a valuation standpoint. As a result, we keep a Neutral stance on Investment Grade credit from an asset allocation perspective. The credit market's overall health is supported by robust demand and strategic maturity management.

EM

NEUTRAL, with opportunities

We advocate for a careful selection of issuers to benefit from attractive absolute yields. Global growth dynamic, a weaker US dollar, contained public debt & corporate leverage along with strong flows are supportive for EM debt. However, risks persist, with rich valuations and unpredictable Trump's trade policies. Idiosyncratic risks also remain, notably in Brazil and India. Given this backdrop, we stay selective, favoring short and medium-duration opportunities while remaining Neutral on the broad EM debt asset class in a multi-asset portfolio context.

Disclaimer

This marketing document has been issued by Bank Syz Ltd. It is not intended for distribution to, publication, provision or use by individuals or legal entities that are citizens of or reside in a state, country or jurisdiction in which applicable laws and regulations prohibit its distribution, publication, provision or use. It is not directed to any person or entity to whom it would be illegal to send such marketing material. This document is intended for informational purposes only and should not be construed as an offer, solicitation or recommendation for the subscription, purchase, sale or safekeeping of any security or financial instrument or for the engagement in any other transaction, as the provision of any investment advice or service, or as a contractual document. Nothing in this document constitutes an investment, legal, tax or accounting advice or a representation that any investment or strategy is suitable or appropriate for an investor's particular and individual circumstances, nor does it constitute a personalized investment advice for any investor. This document reflects the information, opinions and comments of Bank Syz Ltd. as of the date of its publication, which are subject to change without notice. The opinions and comments of the authors in this document reflect their current views and may not coincide with those of other Syz Group entities or third parties, which may have reached different conclusions. The market valuations, terms and calculations contained herein are estimates only. The information provided comes from sources deemed reliable, but Bank Syz Ltd. does not guarantee its completeness, accuracy, reliability and actuality. Past performance gives no indication of nor guarantees current or future results. Bank Syz Ltd. accepts no liability for any loss arising from the use of this document.

Welcome to Syzerland®
