Fixed income focus

Views from our Alpha Pods

January 2026

Macroeconomic outlook

The Federal Reserve has lowered its target federal funds rate into the wide range perceived as neutral.

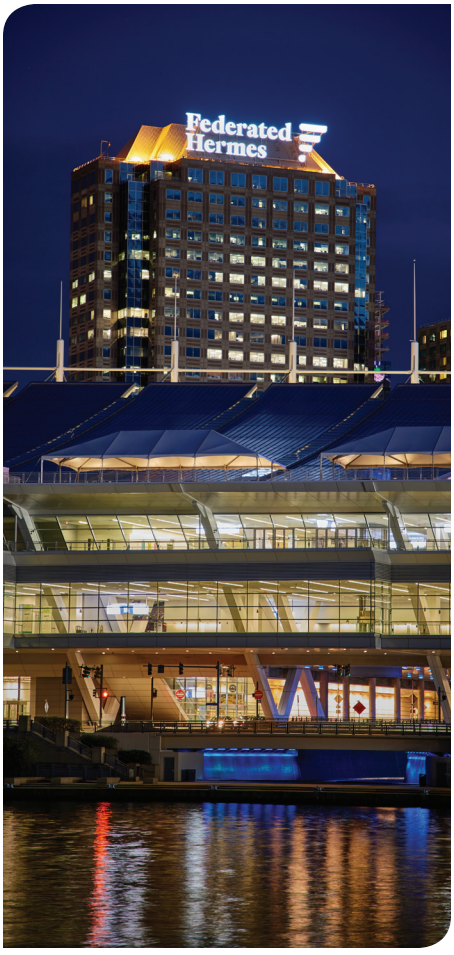
The Fed has mostly signaled a near-term intent to step to the sidelines. While inflation has leveled off, it remains stubbornly above the Fed's 2% target, and tariffs continue to seep through various product and service categories amid continued above-trend US economic growth that could reinforce inflation, adding to the Fed's caution. The re-escalation of the administration's pressuring of Chair Powell may have an opposite than intended effect, and the Fed will remain data dependent, likely not wanting to appear to be swayed.

Financial conditions are accommodative with credit spreads historically tight and stock prices at record highs.

The related financial wealth effect is supporting consumer spending by upper income households, while lower income households struggle amid weak job creation, higher price levels, and elevated mortgage rates. One risk to the bond market is that a continued rally in stocks supports the wealth effect on higher-income consumer spending, while monetary and fiscal stimulus keep GDP growth above potential, causing inflation to move up instead of down. Stickiness at the long end of the yield curve reflects this concern.

The Administration would like to see mortgage rates lower.

In an attempt to shepherd that mission along, President Trump announced that Fannie Mae and Freddie Mac would be purchasing $200 billion in mortgages. While we don't expect this to change the overall shape of the US treasury yield curve, as the agencies will likely hedge their duration to limit exposure there, MBS spreads did tighten. This makes other areas of fixed income more attractive for investors on a relative basis—namely investment grade corporate bonds.



By the numbers

Key fixed income stats and our directional expectations for the next 3 to 6 months.

	Prior data	Current data	Directional change from prior period	Our expectations
Unemployement rate*	4.60%	4.40%	▼	▲
Inflation (Core PCE YOY)**	2.90%	2.80%	▼	▲
Real US GDP Growth***	3.80%	4.30%	▲	▼
Federal Funds rate range upper bound******	4.00%	3.75%	▼	–
2-year Treasury yield******	3.47%	3.47%	–	▼
10-year Treasury yield******	4.02%	4.18%	▲	–

*Bloomberg current as of 12/31/25, prior as of 11/30/25.

**Bloomberg current as of 9/30/25, prior as of 8/31/25.

***Bloomberg current as of 9/30/25, prior as of 6/30/25.

****Bloomberg current as of 12/31/25, prior as of 11/30/25.

PCE is Personal Consumption Expenditures.

Past performance is no guarantee of future results.

Alpha Pod overview

Federated Hermes' fixed income investment committees, the Alpha Pods, guide our firm's bond market views and positioning.

- Four independent pods (Duration, Sector, Yield Curve, Currency)
- Consists of portfolio managers, analysts and traders
- Monthly meetings with votes and recommendations
- Aimed at generating alpha from active management
- Security selection by portfolio managers combines bottom-up analysis with the top-down Alpha Pod input

Opportunities in fixed income

There is a range of return opportunities within fixed income that can be sourced from a variety of risk exposures such as sector, duration and quality. Fixed income investors vary with respect to risk tolerances, investment goals and time horizons.

Summary investment views

Based on lively committee discussions, the below themes summarize the views our Alpha Pods are using when making investment decisions.

Duration	Sector	Yield curve	Currency
Maintained neutral as directional forces on yields are balanced	We continue to be sensitive to value as spreads across many sectors are within striking distance of historically tight levels	While we expect the curve to be steeper by year end, the pace has moderated in the early days of trading this year	The US dollar continues to be under pressure. We continue to hold few currency trades as we wait for trends away from the US Dollar to emerge

Overall, fixed income continued to deliver steady returns and fulfill its role within diversified portfolios. Our guidance remains unchanged: active management and valuation are paramount. High-grade, liquid instruments have met expectations—an attractive outcome for fixed income across any time period.

Alpha Pod positioning and rationale

Portfolio construction and management are the responsibility of portfolio management teams; however, the Pods provide tactical direction to each team. The below reflects the Pods' positioning following their regularly scheduled meetings, occasionally the Pods change positioning intra-meeting.

Duration management Maintained neutral (100%)	The Pod maintained a neutral duration stance as Treasury yields are trapped in a narrow range, with volatility at four-year lows and a broad mix of unresolved macro forces—including muted and still evolving macroeconomic data influenced still by the government shutdown, a neutral-tilting Fed, stubborn inflation, a fragile labor market, and pending tariff and geopolitical developments—providing no decisive directional signal.
Sector allocation Overweight: Treasurys Neutral: MBS Underweight: IG; HY; CMBS; EMD	The Pod remains constructive on economic fundamentals but continues to focus on the lack of value across most sectors, with spreads to UST remaining toward historically tight levels. With potential catalysts for spread widening, notably significant new issue supply, we remain disciplined toward valuation but poised to move. Our active positioning in MBS, IG, HY, EMD, and CMBS leaves a residual overweight in Treasurys and agencies, which serves as funding for attractive out-of-index opportunities in our most flexible fixed income strategies..
Yield curve analysis Moved to neutral	The Yield Curve Pod recommends exiting the 0.2 KRD 2/30 steepener and returning to neutral. While several factors could support curve steepening this year—including uncertainty around Federal Reserve policy and broader fiscal dynamics—the group sees risk given the administration's growing focus on affordability where changes to Treasury issuance patterns, debt management policy, or fiscal-program funding needs could put downward pressure on longer maturity yields resulting in curve flattening.
Currency management Underweight: USD	The Pod remains underweight to the USD as most committee members view the dollar as likely to decline over the coming year. Positioning is muted currently as the group anticipates that new trends and themes emerge in the early days of the trading year.

As of 1/15/26.

Mortgage-backed securities (MBS). Emerging markets debt (EMD). Investment-grade corporates (IG). High yield (HY). Commercial mortgage-backed securities (CMBS).

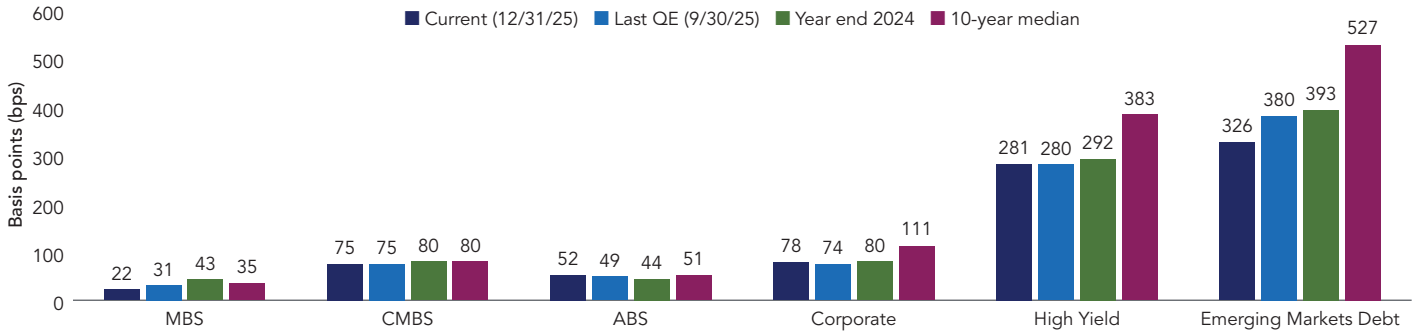
Sector snapshot

Spreads

MBS rallied hard into year end as the steepening yield curve pulled in more buyers. ABS continued to perform well, but spreads ended the year wider than they started. We are looking forward to potential opportunities in IG as more supply forecasted in 2026 could restore value given the continued solid fundamentals.

Spread levels by sector (bps)

Compared to similar maturity US Treasurys



Source: Bloomberg indices (MBS, CMBS, ABS, Corporate EMD), ICE BofA (High Yield).

A deeper dive

The Sector Pod focuses primarily on the sectors included in the Bloomberg US Universal Index. Additionally, underlying teams and portfolio managers weigh in on out of index sectors that could be used. The below provides some additional context to our overall views.

MBS

Neutral: We maintain our neutral position to MBS with valuations being tight, similar to other sectors. Buyers that drove tightness in 2025 included money managers, Government-Sponsored Enterprises and REITs. Supply was limited given lack of rate refinancing and housing market challenges. Nominal and option-adjusted spreads (OAS) have reached the lowest levels since 2022 and declining volatility fell to multi-year lows.

CMBS

Underweight: We maintain our underweight positioning due to overall weak Commercial Real Estate (CRE) fundamentals, weakness in the office sector, and tight valuations. The troubled office market vacancy rate seems to have peaked at 14%. A more dovish Federal Reserve is constructive for CRE financings and transactions but a weak labor market is a headwind for CRE rent growth. In December, the CMBS Index OAS declined by +1 bps.

Treasurys

Residual overweight: The process of our active sector decisions imply a suggested overweight to US Treasurys. In practice, this allocation serves as a funding source for out of index sector holdings such as trade finance, Treasury Inflation-Protected Securities (TIPS), asset backed securities and more in our most flexible strategies. Treasury yield curves steepened considerably into year end 2025.

IG

Underweight: We maintain our underweight to IG with a healthy discussion on what would prompt moving to neutral. We are seeing robust and increasingly broad-based revenue and earnings growth. There is strong demand for new issues with deals multiple times oversubscribed. However, valuations remain stretched and several industries (like office REITS, retails, etc) are dealing with issues. Consumer confidence is mixed to improving and holiday sales seemed solid.

HY

Underweight: We maintain an underweight primarily on valuation concerns. December was a solid month for HY as spreads to Treasurys moved tighter from 307 to 296 bps.* Other than a "Liberation Day" blip, spreads traded in a narrow range all of 2025. Spreads are not showing any interest in moving materially higher, shrugging off idiosyncratic credit and geopolitical events as credit quality remains okay. Recent headline defaults in the less liquid areas of speculative credit (bank loans/private credit) could prompt a risk off environment that negatively impacts HY.

EMD

Underweight: Given the current geopolitical climate, we maintain our EMD underweight. Latin America's political map is shifting. For investors, the recent action in Venezuela matters less as a standalone event and more as a signal about spheres of influence. Markets are increasingly pricing geopolitics through a common lens, however, EM currencies have performed strongly recently despite the Venezuela risk. We saw solid returns in December with local markets outperforming.

Overweight/underweight calls are relative to Bloomberg US Universal Index. Mortgage-backed securities (MBS). Emerging markets debt (EMD). Investment-grade corporates (IG). High yield (HY). Commercial mortgage-backed securities (CMBS). Asset-backed securities (ABS).

*Bloomberg as of 1/6/26.

Fixed income focus

Federated Hermes

Our leadership in fixed income

more than
55 years
managing fixed income products

team of over
100
fixed income professionals

our portfolio managers average
28 years
in the investment industry

our portfolio managers average
20 years
at Federated Hermes

Alpha Pods are chaired by seasoned leaders

Duration management	Sector allocation	Yield curve strategy	Currency management
11 voting members including Chair	10 voting members including Chair	10 voting members including Chair	7 voting members including Chair
Chaired by: **R.J. Gallo** *Deputy Chief Investment Officer, Global Fixed Income*	Chaired by: **Mark Durbiano** *Co-Head of Domestic High Yield Group*	Chaired by: **Donald Ellenberger** *Head of Muli-Sector Strategies Group*	Chaired by: **Ihab Salib** *Head of International Fixed Income Group*
Outlook based on: Business cycle analysis, Valuation indicators, Global attractiveness	Outlook based on: Historical spread analysis, volatility analysis	Outlook based on: Federal Reserve policy, inflation expectations, proprietary multi-factor model	Outlook based on: US current account/fiscal conditions, interest rate differential, expectations for growth

For dedicated municipal bond or short duration thought leadership from our team, reach out to your Federated Hermes representative.

Forward-looking statements or projections are subject to certain risks and uncertainties. Actual results may differ from those expressed or implied.

Views are as of the date above and are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector. Material has been prepared using sources of information generally believed to be reliable, but its accuracy is not guaranteed.

Bond prices are sensitive to changes in interest rates, and a rise in interest rates can cause a decline in their prices.

High-yield, lower-rated securities generally entail greater market, credit/default and liquidity risks, and may be more volatile than investment grade securities.

International investing involves special risks including currency risk, increased volatility, political risks, and differences in auditing and other financial standards. Prices of emerging markets securities can be significantly more volatile than the prices of securities in developed countries and currency risk and political risks are accentuated in emerging markets.

The value of some mortgage-backed securities and asset-backed securities may be particularly sensitive to changes in prevailing interest rates, and although the securities are generally supported by some form of government or private insurance, there is no assurance that private guarantors or insurers will meet their obligations.

Investment-grade securities are securities that are rated at least "BBB" or unrated securities of a comparable quality. Non-investment-grade securities are securities that are not rated at least "BBB" or unrated securities of a comparable quality. Credit ratings are an indication of the risk that a security will default. They do not protect a security from credit risk. Lower-rated bonds typically offer higher yields to help compensate investors for the increased risk associated with them. Among these risks are lower creditworthiness, greater price volatility, more risk to principal and income than with higher-rated securities and increased possibilities of default.

2s/10s and 5s/30s spread: The difference in yield between the 2-year and 10-year and the 5-year and 30-year Treasury bonds, respectively, is a measure of yield curve steepness.

2s/30s steepener: Refers to the environment or expectation that the difference between 2-year Treasury and 30-year Treasury yields is widening. Investors employing this strategy aim to benefit from their expectation that the 30-year rate will rise more than the 2-year rate or that the 2-year rate will fall more than the 30-year rate.

Alpha: Measures the excess returns of a fund relative to the return of a benchmark index.

Duration: A measure of a security's price sensitivity to changes in interest rates. Securities with longer durations are more sensitive to changes in interest rates than securities of shorter durations.

Key Rate Duration (KRD): A measure of the sensitivity of a security or the value of a portfolio to a 1% change in yield for a given maturity.

Yield Curve: Graph showing the comparative yields of securities in a particular class according to maturity. Securities on the long end of the yield curve have longer maturities.

Yield Spread: The difference between the quoted rate of return on different debt instruments.

Yield to Maturity (YTM): Used to determine the rate of return an investor would receive if a long-term, interest-bearing investment, such as a bond, is held to its maturity date. It takes into account purchase price, redemption value, time to maturity, coupon yield and the time between interest payments.

Bloomberg US Aggregate Bond Index: Is an unmanaged index composed of securities from the Bloomberg Government/Corporate Bond Index, Mortgage-Backed Securities Index and the Asset-Backed Securities Index. Total return comprises price appreciation/depreciation and income as a percentage of the original investment. Indices are rebalanced monthly by market capitalization.

Bloomberg US Universal Index: Is an index that represents the union of the US Aggregate Index, US Corporate High-Yield, Investment-Grade 144A Index, Eurodollar Index, US Emerging Markets Index and the non-ERISA eligible portion of the CMBS Index. The index covers USD-denominated, taxable bonds that are rated either investment grade or below investment grade.

Indexes are unmanaged and cannot be invested in directly.

Past performance is no guarantee of future results.

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Federated Securities Corp.