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Seek diversified income

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- **Why?** 1) A diversified approach to yield generation is essential, given tight credit spreads and uncertainty around government debt. 2) This should include a mix of investment grade, select high yield, and emerging market bonds to balance risk and enhance returns. 3) Select exposure to direct lending can also provide strong long-term potential for under-allocated investors, with yields above those in public fixed income markets.
- **Why now?** 1) As the Fed continues rate cuts and rates remain low across Europe and Switzerland, income opportunities are becoming scarce. 2) Medium-duration quality bonds are expected to deliver mid-single-digit returns, outperforming cash, especially in adverse scenarios. 3) Equity income and yield-generating structures can further enhance income streams in the current environment.

Given tight credit spreads, ongoing uncertainty over government debt, and rising stresses in credit markets, we advocate for a diversified approach to generating yield. Source: Pexels

Video: Seek diversified income

Quality bonds

We believe quality bonds—specifically high grade government and investment grade corporate bonds—have an important role as a source of yield and diversification in 2026. We expect medium-duration quality bonds (four to seven years) to deliver mid-single-digit returns from a mix of yield and capital appreciation as the Fed cuts rates. We expect quality bond returns to exceed cash rates, especially in adverse scenarios where bond prices rise as rate expectations fall. Investors in economies with low or zero interest rates may not derive much income from quality bonds but should remember their portfolio diversification benefits as a reason to hold them.

Diversified fixed income strategies

We are more cautious about riskier parts of fixed income like high yield given very tight spreads. Nonetheless, we see merit in diversified fixed income strategies for investors looking to earn higher returns from fixed income. By combining investment grade bonds, and select high yield and emerging market debt in a risk-controlled way, investors can enhance yield while managing credit and duration risks.

Select direct lending

Private credit has attracted significant inflows in recent years as investors seek higher returns. We believe the asset class offers strong long-term income potential. However, tight spreads—where lenders earn only modest compensation for the risks borne— as well as pockets of financial stress necessitate careful selection. We recommend limiting excessive exposure in the lower middle-market segment (smaller companies), where risks are rising. We like sponsor backed loans (to private equity-owned firms) and senior loans (with repayment priority) and believe investors should focus on larger companies and sectors that are less sensitive to economic swings and carry less debt.

Equity income

Income-seeking investors in markets where bond yields are low, or credit spreads are tight may find better income generation opportunities in equity strategies, including both dividends and options strategies. Our preferred markets

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for dividend strategies are Switzerland, where high-quality dividend stocks yield about 4%, well above local bonds; and Southeast Asia, where average dividend yields also stand north of 4%. Equity income strategies that combine dividend strategies with systematic option-selling could generate even higher yields, enhance diversification of returns, and offer a more resilient income stream across cycles.

Yield-generating structured investments

We believe investors should also consider yield-generating structured investments, especially as interest rates drop. These structures—such as equity-linked notes—offer a yield in exchange for the obligation to buy an instrument at a predefined lower price. Lower rates make these structures relatively more attractive, although low volatility can mean option premiums and yields are reduced. We recommend careful attention to liquidity, issuer, and market risks within a diversified portfolio.

Global asset class preferences definitions
The asset class preferences provide high-level guidance to make investment decisions. The preferences reflect the collective judgement of the members of the House View meeting, primarily based on assessments of expected total returns on liquid, commonly known stock indexes, House View scenarios, and analyst convictions over the next 12 months. Note that the tactical asset allocation (TAA) positioning of our different investment strategies may differ from these views due to factors including portfolio construction, concentration, and borrowing constraints.
Most attractive – We consider this asset class to be among the most attractive. Investors should seek opportunities to add exposure.
Attractive – We consider this asset class to be attractive. Consider opportunities in this asset class.
Neutral – We do not expect outsized returns or losses. Hold longer-term exposure.
Unattractive – We consider this asset class to be unattractive. Consider alternative opportunities.
Least attractive – We consider this asset class to be among the least attractive. Seek more favorable alternative opportunities.

Appendix

Risk information
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