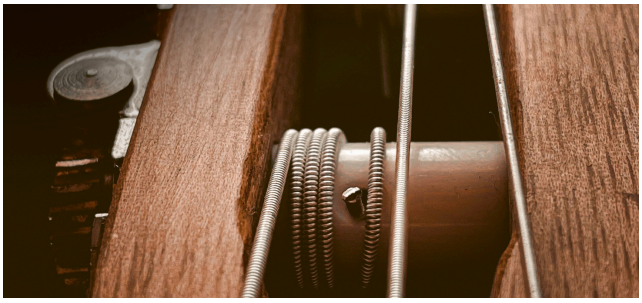
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Rebalance into fixed income

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- **Why?** 1) Fixed income can provide a reliable source of portfolio income. 2) Quality bonds can diversify equity exposure and strengthen portfolio resilience if growth weakens or financial instability rises. 3) Emerging market and high yield bonds can complement quality bonds with additional income and return potential.
- **Why now?** 1) Elevated starting yields offer attractive prospective returns and can cushion the impact of moderate price declines. 2) If inflation moderates as we expect, falling yields could generate capital gains alongside coupon income. 3) Investors can capture these opportunities while managing fiscal and term premium risks by focusing primarily on maturities of around two to 10 years.



Attractive starting yields reinforce the case for adding to fixed income allocations in 2027, with quality bonds offering portfolio resilience. Source: Pexels_Avishek Sengupta

Quality bonds

Our base case is supportive for bonds. Geopolitical and fiscal uncertainty could keep yields volatile in the near term. But if inflation moderates as we expect, yields should decline modestly, allowing investors to earn coupon income and capital appreciation.

Quality bonds can also strengthen portfolio resilience. In our "AI bust" scenario, weaker capital expenditure and monetary easing would lower yields and support bond prices as equities decline. Bonds could also benefit if financial instability prompted policy intervention.

Even if yields do not decline as expected, elevated starting yields provide a substantial income cushion. This carry can offset some of the price impact of a moderate rise in yields, especially in short- and intermediate-maturity bonds.

Maturity exposure should reflect investor objectives. Shorter maturities offer attractive income with less sensitivity to fiscal and term premium risks, while quality bonds can extend toward the longer end of our preferred two- to 10-year range, providing greater portfolio diversification as they benefit more if yields fall. We would extend beyond 10 years only selectively, given heavy expected issuance and fiscal uncertainty.

Favor EM and high yield

We favor emerging market (EM) and high yield bonds on a relative basis. EM sovereign and corporate bonds yield around 7.1% and 7.0%, respectively (J.P. Morgan EMBI and CEMBI indices), while US high yield offers around 8.3% (ICE BofA US High Yield index). These elevated yields provide a meaningful income cushion and should support attractive returns over the next 12 months in our base case of resilient economic growth.

EM fundamentals are stronger than in previous cycles. Higher foreign exchange reserves, improved current account positions, manageable fiscal deficits, and fewer distressed sovereigns support creditworthiness. Corporate fundamentals have improved, while differences in growth, monetary policy, currencies, and commodity exposure can diversify returns.

US high yield also enters 2027 on a relatively sound footing. Around 60% of the US market is now rated BB, compared with about 40% a decade ago. We expect defaults to remain around 2%, supported by generally sound fundamentals and a light near-term maturity schedule: Only

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about 3% of the US market matures over the next year. Recent spread widening has been concentrated among a small number of capital-intensive or structurally challenged borrowers, rather than signaling broad macroeconomic stress.

We favor well-diversified exposure across countries, sectors, currencies, and issuers. Within EM, investors should focus on external balances, fiscal credibility, and political stability. Within high yield, we favor maturities toward the shorter end of our preferred range and issuers with sustainable cash flows, manageable leverage, and limited refinancing needs, while limiting exposure to the weakest borrowers.

A sharp global slowdown, renewed dollar strength, prolonged monetary tightening, or wider credit spreads would challenge the outlook. In an AI-led investment downturn, weaker growth and wider spreads would weigh on both markets, particularly high yield. Overall, elevated income and supportive fundamentals leave EM and high yield bonds well placed to outperform cash and complement quality developed market bonds in our base case.

CHF investors: Broaden income sources

Although global bond yields have risen materially, yields in CHF have not increased enough to make domestic government bonds a compelling standalone income source. Swiss inflation and policy rates remain relatively low, limiting the income available in francs.

High-quality Swiss issuers can provide incremental yield without adding currency risk. We favor companies with strong cash flows, manageable refinancing needs, and conservative leverage. But investors seeking higher portfolio cash flows therefore need to look beyond Swiss investment grade credit.

One area is foreign currency bonds, which may offer substantially higher nominal yields. But they introduce currency volatility that can overwhelm bond returns. Investors should therefore retain currency exposure selectively, where the prospective carry and currency outlook justify the risk.

Outside of bonds, Swiss dividend-paying equities currently yield around 3.1%, compared with a 2.4% average since 2004, and dividends have contributed more than half of the SMI's total return over the past three decades.

Investors able to accept additional risk can also sell options or use structured yield strategies to generate premiums. This can complement bond and dividend income. However, it is important to note that with such strategies, income may be conditional, upside may be capped, and losses can be significant. We therefore favor diversified underlyings, staggered maturities, and disciplined position sizing.

Investors should combine bond coupons, credit spreads, dividends, and option premiums without allowing any single currency, issuer, or market risk to dominate.

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 and commonly known indices, House View scenarios, and analyst convictions over the next 12 months.
Absolute view
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.
Note: For equities, we have a five-tier rating system with two additional preferences. When equities are included with the other asset classes in the three-tier rating system, we collapse "Most Attractive" with "Attractive" and "Least Attractive" with "Unattractive."
Most Attractive: We consider this asset class to be among the most attractive. Investors should seek opportunities to add exposure.
Least Attractive: We consider this asset class to be among the least attractive. Seek more favorable alternatives opportunities.
Relative preferences
For the multi asset view, we also include relative preferences to help investors compare between items.
Preferred: We view this item more favorably than others within its asset class.*
In line: We see this item similarly to others within its asset class.*
Least preferred: We view this item less favorably than others within its asset class.*
*In the case of cross-asset, compared to other asset classes.
Note: 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.

Appendix

Risk information
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