



JULY 2026

Active Fixed Income
Perspectives Q3 2026:

Finding higher ground

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Key takeaways

Performance recap

Front-end yields rose and the yield curve flattened over the quarter as markets swung from pricing cuts to potential hikes. Strong economic growth and above-target inflation pushed up yields, while the Iran conflict added a temporary stagflationary risk premium that faded late in the quarter. Credit markets remained stable, supported by solid fundamentals, strong demand, and smooth absorption of elevated issuance. Municipal bonds performed well as a historically steep curve boosted demand and drove yields lower.

The big picture

We remain constructive on the fixed income outlook. While inflation remains above the Fed's target and geopolitical developments could create periods of volatility, higher yields provide stronger income potential and a greater cushion against uncertainty.

In taxable bonds, we see compelling opportunities in the front end and belly of the curve, where investors can benefit from income and ballast. Munis continue to offer better value at the long end of the curve. Overall, fixed income remains well positioned to deliver income and diversification benefits to portfolios.

Our approach

Income remains the anchor for returns, but active management will be critical in determining where that income is best sourced.

We have moved from a long to a neutral duration view. In credit, conditions remain favorable, but we are maintaining a selective approach. In municipals, we are focused on extracting value from convexity management and a steep curve.

Macro backdrop

From geopolitical risk to policy uncertainty

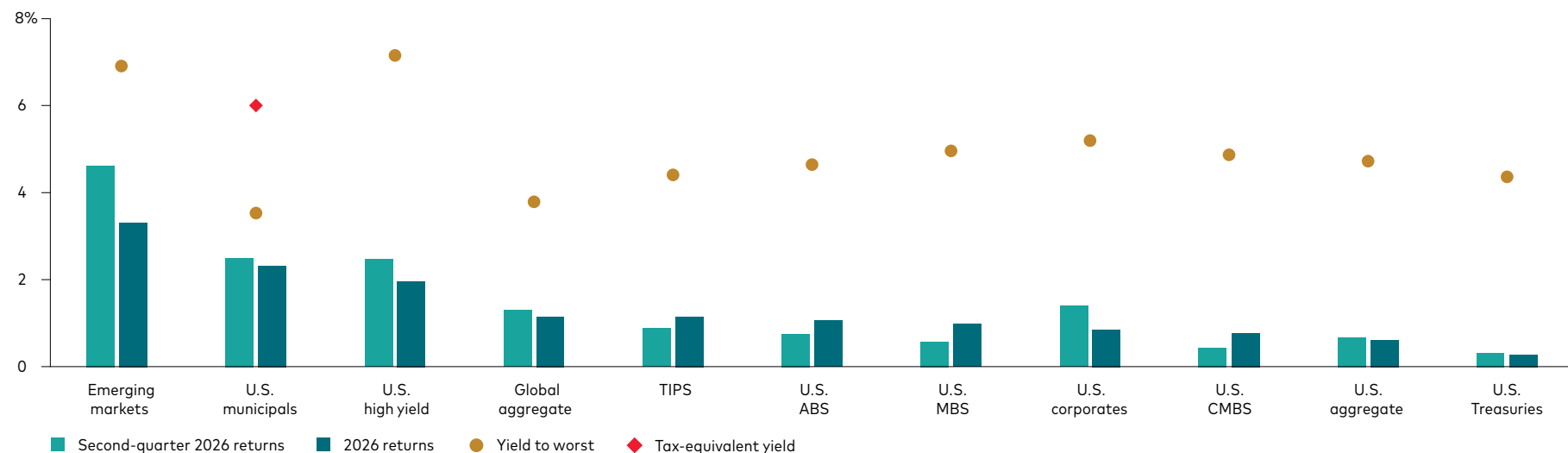
Three themes framed our outlook heading into 2026: the continuation of the AI-driven capital expenditure cycle, the implications of new Federal Reserve leadership, and signs of rising stress in private credit markets.

The most notable development since then has been the conflict in Iran, which increased concerns around energy prices, inflation, and global growth. While the initial reaction introduced a modest stagflation risk premium, the market impact proved more contained than feared as tensions began to relax.

When oil prices moved back down, inflation concerns eased and attention shifted back to domestic fundamentals. Geopolitics remains a risk, but the dominant driver of markets has shifted toward domestic factors, such as inflation, growth, and central bank policy.

That shift is important. Markets are increasingly focused on whether the current mix of resilient growth and persistent inflation requires tighter policy.

Fixed income sector returns and yields



Notes: The municipal tax-equivalent yield is calculated using a 40.8% tax bracket, which includes a 37.0% top federal marginal income tax rate and the 3.8% net investment income tax to fund Medicare. Yield to worst represents the lowest yield possible for a security given the current price, considering both call dates and maturity.

Indexes used in chart: The following indexes are represented in the sector returns and yields chart: J.P. Morgan EMBI Global Diversified Index, Bloomberg U.S. Corporate High Yield Index, Bloomberg U.S. Mortgage Backed Securities Index, Bloomberg U.S. Corporate Index, Bloomberg CMBS: Erisa Eligible Index, Bloomberg U.S. Aggregate Index, Bloomberg U.S. Treasury Inflation-Linked Bond Index (Series-L), Bloomberg U.S. Treasury Index, Bloomberg U.S. Asset-Backed Securities Index, Bloomberg Global Aggregate Index, and Bloomberg U.S. Municipal Index.

Sources: Bloomberg indexes and JPMorgan, as of June 30, 2026.

Past performance is no guarantee of future returns. The performance of an index is not an exact representation of any particular investment, as you cannot invest directly in an index.

A supportive mix

The U.S. economy remains on solid footing. Labor markets have been stable, corporate profits are at or near record levels, and AI-related investment continues to support demand. In the first quarter, for example, AI-related investment contributed more than half of U.S. GDP growth. We expect this investment cycle to remain an important contributor to growth over the next 12–18 months, with broader productivity benefits likely to materialize over a longer horizon.

Inflation remains above target, but the character of the risk has changed. The issue is less about energy-driven inflation shock and more about inflationary persistence in a growing economy. This can continue to be a supportive mix for risk assets, but a more nuanced environment for rates as recession risks remain low and the path back to lower inflation may be gradual.

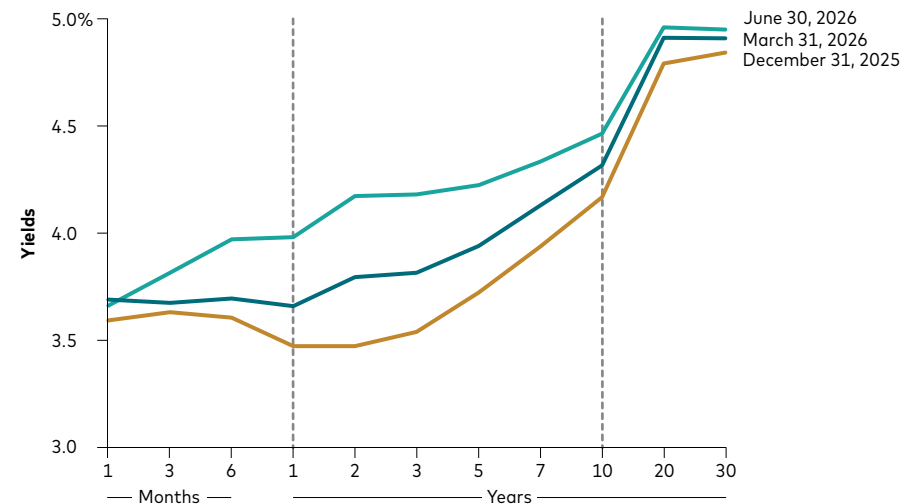
The labor market is the key swing factor. Recent job creation has been solid, while wage growth remains contained. We expect a gradual loosening over the back half of the year with monthly payroll gains slowing and the unemployment rate rising modestly.

A credible, reactive Fed

New Fed Chair Kevin Warsh is seeking to establish a quieter and more disciplined direction for policy. By reducing forward guidance, shortening the policy statement, and declining to submit a dot plot projection, the Fed has shifted toward a less transparent framework.

Markets interpreted the tone of the June meeting as more hawkish than expected, but the renewed emphasis on price stability has strengthened the Fed's credibility. The central bank appears willing to hike, if necessary, but it seems patient to wait for confirmation from incoming data rather than tighten preemptively. Our base case is that inflation and employment trends will soften, allowing the Fed to remain on hold. However, the bar for additional hikes has been lowered, leaving markets sensitive to incoming data and creating both volatility and opportunity.

Belly up: One- through ten-year U.S. Treasuries moved the most



Source: Bloomberg data, as of June 30, 2026.

Rates, markets, and strategy

A higher trading range

Over the quarter, U.S. yields pushed into a higher range as markets adjusted to stronger growth, persistent inflation, and a less dovish Fed. The largest repricing occurred at the front end of the curve, as expectations firmed up that one to two rate hikes may be delivered over the coming quarters. Higher yields continue to offer investors higher ground—providing meaningful income and helping strengthen portfolio resilience.

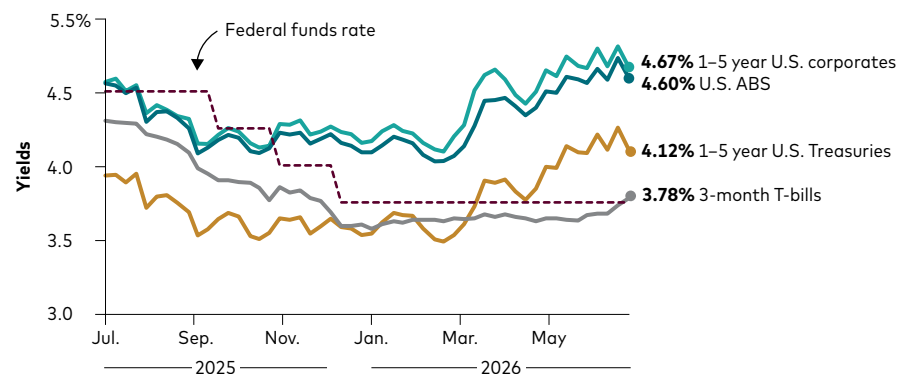
Late in the quarter, yields retraced from recent peaks as progress on Iran/U.S. negotiations led to a resumption of traffic through the Strait of Hormuz, significantly reducing stagflationary risks. Still, strong data and a more hawkish Fed bias suggest limited room for a sustained rally unless inflation declines more quickly or labor market data softens.

We expect the Federal Open Market Committee to hold steady in July and look to incoming data to determine whether policy action is warranted later this year. We continue to see the 10-year Treasury yield trading in a 4.25%–4.75% range in the near term, reflecting trend growth, inflation that remains above the Fed's comfort zone, and firm demand for fixed income at current yield levels.

For yields to break below our expected range, markets would likely be pricing a weaker growth outlook. Above it, investors would likely be anticipating a more aggressive tightening cycle.

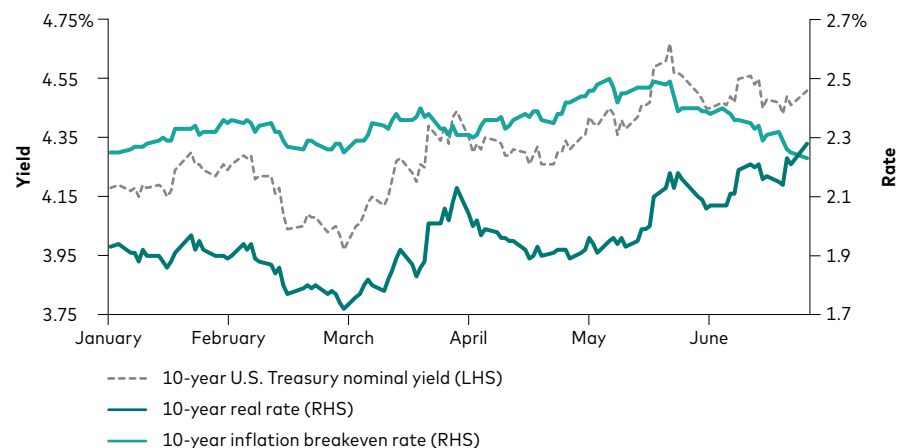
We are neutral duration and view market pricing of one to two hikes as justified by recent data, but not indicative of a fixed policy path, which remains highly data dependent.

Front-end yields have improved relative to cash



Source: Bloomberg data, as of June 30, 2026.

The rise in yields is a real-rate story



Source: Bloomberg, as of June 30, 2026.

Credit markets and strategy

Supported but increasingly selective

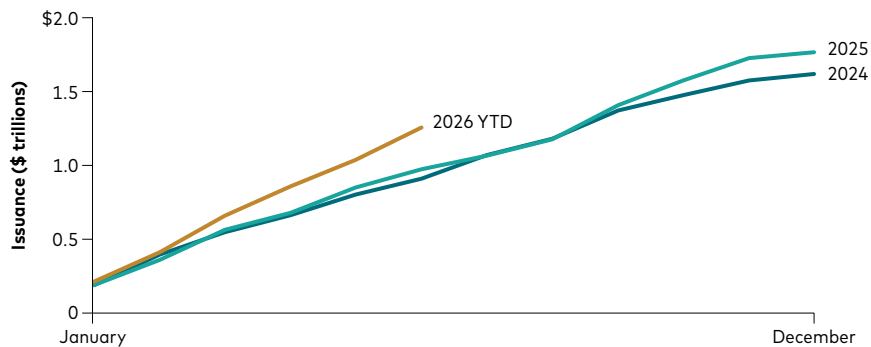
We remain overweight credit exposure across portfolios, as strong corporate fundamentals and resilient technical demand suggest outperformance versus government bonds through the second half of the year—even with spreads already tight.

Investment-grade companies, in particular, are in sound shape. Record profits and disciplined balance sheet management are supported by a sturdy labor market and continued consumer strength. Issuance over the first half of the year is on record pace, exceeding \$1.2 trillion, with roughly a quarter tied to AI-related investment. So far, strong investor demand has readily absorbed the higher supply, keeping spreads in a narrow range.

Hyperscalers such as Meta, Google, Microsoft, Amazon, Oracle, and even SpaceX are becoming large, frequent issuers as they fund the build-out of AI infrastructure. This year, investment-grade hyperscaler issuance accounted for 13% of corporate bond market issuance through June 30 and now represents 4% of the

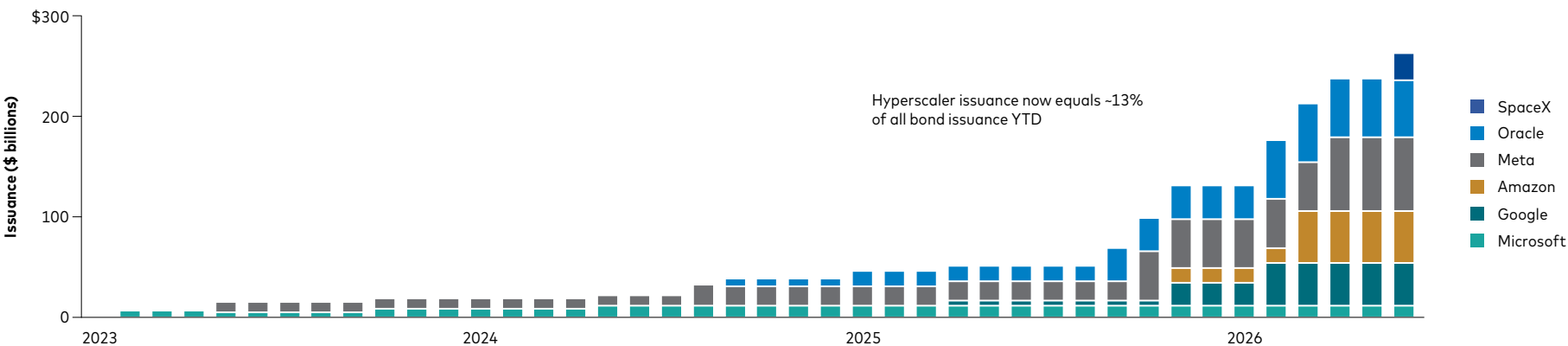
investment-grade corporate credit market. In many cases, we view this as an attractive addition from high-quality balance sheets that historically have been less represented in debt markets compared to their equity market footprints.

Cumulative investment-grade corporate issuance



Source: Bloomberg, as of June 30, 2026.

AI hyperscaler corporate debt issuance



Source: Bloomberg, as of June 30, 2026.

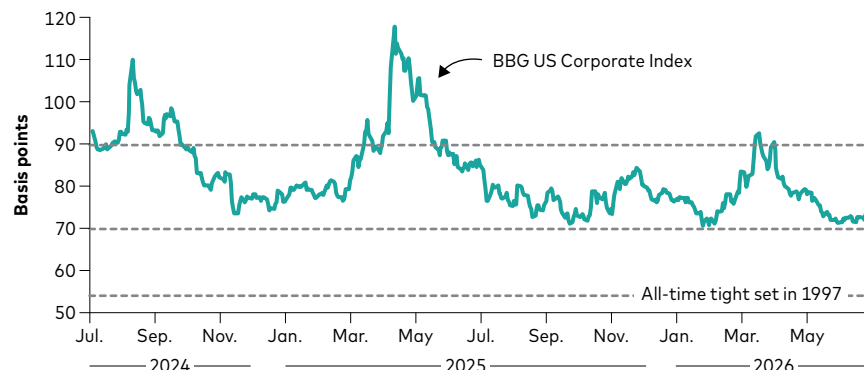
While these issuers grab most of the attention, we believe investors should not overlook the massive build-out of data centers enabling AI's computing capacity. Data center operators are issuing debt across fixed income markets, leveraging a diverse menu of bond features and a wider investor base. Data center proliferation is driving debt issuance across investment-grade corporate, high-yield corporate, and securitized credit markets. This creates attractive opportunities for managers able to compare the value and risks across markets, as they can vary significantly.

Beyond beta

If current conditions hold, any episodic widening in spreads is likely to be contained and short-lived. However, with spreads already pricing in a benign macro environment, the scope for further compression appears limited. As a result, credit returns are increasingly driven by carry and issuer selection rather than broad beta.

This dynamic reinforces our more selective approach to building credit exposure. While we do not see near-term catalysts for a broad-based repricing in wider spreads, we do expect dispersion within and across sectors to continue to increase. This creates a more differentiated opportunity set, where active management can add value by identifying resilient issuers and avoiding weaker credits.

U.S. corporate investment-grade spreads remain within our forecasted range



Note: Option-adjusted spread of the Bloomberg U.S. Corporate Index. The top two dotted lines represent the Fixed Income Group's current expected ranges for corporate credit spreads.

Source: Bloomberg, as of June 30, 2026.

Increasing bifurcation between higher quality and lower quality high-yield



Source: Bloomberg, as of June 30, 2026.

Taxable portfolio positioning

Rates

Exposure	View	Strategy
U.S. duration and curve	- Near-term, we expect 10-year yields to hold between 4.25% and 4.75%. - Strong data and a more hawkish Fed bias suggest limited room to rally without a weakening in the labor market.	- Neutral duration and curve positioning. - Long inflation breakeven exposure given attractive valuations and technicals.
Global duration and curve	Rising fiscal and monetary policy risks in Japan argue for higher JGB yields.	In Japan, we remain positioned short duration and in yield curve flatteners.
Mortgage-backed securities (MBS)/ agencies	We see MBS valuations as fair and the supply/demand outlook for the sector favorable.	- We remain overweight across portfolios. - Hybrid ARMs, select CMOs, and non-agency RMBS offer attractive relative value.

Credit

Exposure	View	Strategy
Investment-grade corporates	- Strong fundamentals—credit rating upgrades outpacing downgrades by a nearly 2:1 ratio. - Attractive all-in yields support investor demand—spreads likely range bound between 70 and 90 basis points.	- See attractive valuations in large U.S. and European banks. - Opportunities across companies supporting the AI build-out (for example, data center infrastructure, hardware, semiconductors, memory chips, and power generation).
High-yield corporates	- Broadly see positive fundamentals, supportive technicals, and valuations that are rich but provide good carry. - Performance dispersion is increasing, making issuer selection significantly more important than sector beta.	- Overweight the cable industry despite secular and cyclical challenges; we believe that markets have significantly overshot to the downside. - Other high conviction views in chemicals, autos, and airline sectors where we see improving fundamentals and clear deleveraging paths.
Emerging markets	- Country-level credit metrics are improving with declining budget deficits. - Lower-rated issuers have benefitted from strong investor demand. Credit selection is paramount.	- Front-end bonds offer attractive carry. - Remain cautious on lower-rated oil exporters that recently benefited from higher oil prices.
Structured products	- ABS supply remains heavy, keeping spreads attractive relative to investment-grade corporates. - CMBS offers more limited opportunities with light supply and tight spreads.	- We favor high-quality consumer risk, and selective commercial ABS exposure. - Prefer data center-backed bonds in tier 1 markets backed by long-term leases to high-quality hyperscalers. - Continue to favor AAA CLOs with limited software sector exposure.

Municipal bonds

Demand remains supportive, supply trends reinforce the long end

Longer-maturity municipal bonds have outperformed year-to-date, supported by steady inflows and evolving supply preferences.

Flows into municipal funds and ETFs approached \$60 billion through June, with demand notable for its consistency—positive net inflows in 23 of the first 26 weeks of 2026. This sustained demand contributed to spread compression and tighter municipal-to-taxable yield ratios.

Two effects have been particularly supportive in the long end of the curve. First, long-term municipal funds have captured a greater share of inflows than in prior years. The National Long category has accounted for roughly 17% of 2026 flows—nearly \$10 billion year-to-date—putting it on pace for a record year.

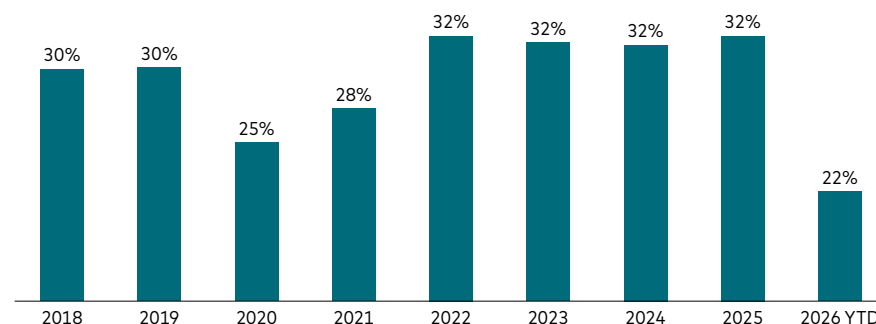
Second, issuance patterns have shifted. With a historically steep curve, issuers—particularly hospitals—have favored shorter maturities where financing costs are materially lower. This has resulted in lighter long-end issuance.

These market technicals have supported long-end performance. Even so, the curve remains steep, with approximately 180 basis points of yield pickup between 2- and 30-year AAA bonds—about 50 basis points above decade medians. Front-end, high-grade paper appears relatively rich, while longer maturities screen closer to fair value. But the steep curve further enhances roll-down potential in the 15–25 year segment, contributing to total return beyond headline yields in the long end.

This environment continues to support a barbell maturity profile within our municipal portfolios. This positioning allows us to maintain duration close to benchmarks while incorporating more long-end exposure where supply conditions, steady demand, and roll-down can further support relative return versus intermediate maturities.

At the same time, uncertainty around the Federal Reserve's policy path may contribute to continued rate volatility through year-end. With this backdrop, proactive convexity management via coupon selection remains an important tool for our municipal team. By avoiding bonds with yields priced close to their coupon levels, we can construct portfolios that will shorten in duration against benchmarks as yields rise and lengthen when yields fall.

Percentage of municipal bonds issuance that matures in 22 years or more



Source: Bloomberg total municipal issuance supply, as of June 30, 2026.

Flows and credit demand

Positive inflows have also supported credit markets, particularly in middle- and lower-rated segments where funds and ETFs are the primary buyers. Credit spreads have tightened—absent tobacco bonds which are facing fundamental challenges—to roughly their 25th percentiles, reflecting continued demand alongside more limited issuance of higher-yielding municipal securities.

Even with tighter spreads, lower-rated segments continue to offer relative value within the broader municipal market, particularly in the context of sustained inflows. Our allocations there remain modest and focused on selective opportunities where yield pickup is attractive relative to underlying credit risk. Areas of focus include retirement communities, charter schools, universities, and hospitals.

Prepaid energy bonds: A growing source of yield

Prepaid energy bonds represent an increasing component of the municipal market, particularly in short- and intermediate-maturity segments. Over the past two decades, the market has expanded to more than \$100 billion outstanding and become an established part of the municipal bond market for both issuers and investors.

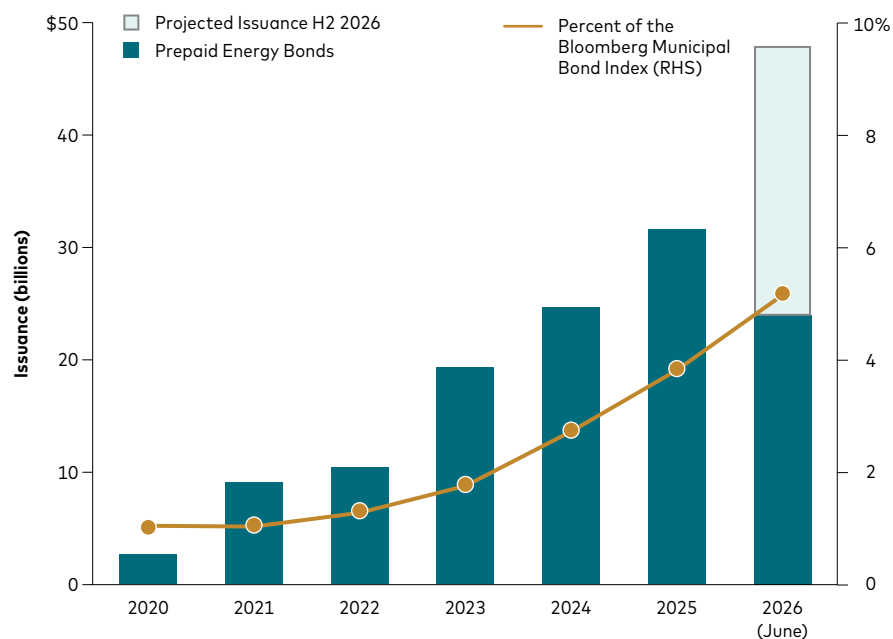
These bonds finance long-term gas or electricity supply agreements. Issuers use proceeds to prepay for energy, while participating utilities receive supply over time at discounted prices.

Although issued within the municipal framework—spanning across the credit spectrum—prepaid energy bonds differ from traditional municipals in their underlying exposures. Credit risk is typically linked to corporate counterparties—most commonly banks and insurance companies—which can result in performance characteristics more aligned with corporate credit. Prepaid energy bonds generally offer a yield premium, reflecting their exposure to corporate counterparties and the legal and structural complexity inherent in these transactions.

As issuance has expanded beyond its traditional base of financial institutions, we increasingly view prepaid energy as a structure that provides access to a range of corporate sectors rather than as a traditional standalone municipal sector.

At Vanguard, we have been active participants in the prepaid energy market for nearly two decades, leveraging our scale and market presence to help shape deal terms and preserve strong, standardized structures. Investment decisions in this sector require close collaboration between our municipal and corporate credit teams, combining analysis of the underlying credit with a detailed analysis of the transaction's structural features.

Prepaid energy bond issuance in the municipal market



Note: Projection for the rest of 2026 made by assuming the same amount as the first half of the year.

Source: Bloomberg Municipal Bond Index and Bloomberg Total Municipal Issuance Supply, as of June 30, 2026.

Tax-exempt portfolio positioning

Exposure	View	Strategy
Credit allocation	Lower-rated credit (single A and lower) valuations are on the richer side of "fair," but justified by strong fundamentals and supportive demand technicals.	- Maintain positions in lower-rated bonds with ample spread. - Selectively add exposures with a keen eye to value.
Structure	- A volatile yield curve places convexity management front and center on longer maturity strategies. - When properly utilized, the strategy can play both offense and defense, extending duration versus the benchmark in a rally and shortening duration in a sell-off.	- Augment coupon and call option exposures to maintain an advantageous benchmark-relative duration profile under various rate shift scenarios. - Avoid bonds trading near par, particularly those with near-term call dates.
Duration/ curve	- The yield curve remains historically steep beyond 15-year maturities. - Expect negative net supply in July and August as is typical during summer months. - Going forward, overall duration risks should be balanced if not favorable.	- Favor long-end yields and highly attractive carry-and-roll stemming from curve steepness. - Move slightly longer in duration given supportive summer technicals. - Implement slightly long overall duration as a hedge that pairs off against a credit overweight.

Vanguard active bond funds and ETFs

Vanguard active bond funds and ETFs		Ticker symbol	Expense ratio*
Treasury/Agency	GNMA*	VFIJX	0.11%
	Government Securities Active ETF	VGVT	0.10
	Inflation-Protected Securities	VIPIX	0.07
	Intermediate-Term Treasury	VFIUX	0.10
	Long-Term Treasury	VUSUX	0.10
	Short-Term Federal	VSGDX	0.10
	Short-Term Treasury	VFIRX	0.10
Investment-grade corporate	Core Bond	VCOBX	0.10%
	Core Bond ETF	VCRB	0.10
	Core-Plus Bond	VCPAX	0.20
	Core-Plus Bond ETF	VPLS	0.20
	Intermediate-Term Investment-Grade	VFIDX	0.09
	Long-Term Investment-Grade*	VWETX	0.10
	Multi-Sector Income Bond	VMSAX	0.30
	Multi-Sector Income Bond ETF	VGMS	0.30
	Short Duration Bond ETF	VSDB	0.15
	Short-Term Investment-Grade	VFSIX	0.07
	Ultra-Short-Term Bond	VUSFX	0.09
	Ultra-Short Bond ETF	VUSB	0.10
Below-investment-grade	High-Yield Corporate*	VWEAX	0.12%
	High-Yield Active ETF	VGHY	0.22
Global/International	Emerging Markets Bond	VEGBX	0.35%
	Global Credit Bond	VGCAx	0.25

Vanguard active municipal bond funds		Ticker symbol	Expense ratio*
National municipal	Core Tax-Exempt Bond ETF	VCRM	0.12%
	High-Yield Tax-Exempt	VWALX	0.09
	Intermediate-Term Tax-Exempt	VWIUX	0.09
	Limited-Term Tax-Exempt	VMLUX	0.09
	Long-Term Tax-Exempt	VWLUX	0.09
	Short Duration Tax-Exempt Bond ETF	VSDM	0.12
	Ultra-Short-Term Tax-Exempt	VWSUX	0.09
State municipal	California Intermediate-Term Tax-Exempt	VCADX	0.09%
	California Long-Term Tax-Exempt	VCLAX	0.09
	Massachusetts Tax-Exempt*	VMATX	0.09
	New Jersey Long-Term Tax-Exempt	VNJUX	0.09
	New York Long-Term Tax-Exempt	VNYUX	0.09
	Ohio Long-Term Tax-Exempt*	VOHIX	0.09
	Pennsylvania Long-Term Tax-Exempt	VPALX	0.09

* As reported in each fund's prospectus. A fund's current expense ratio may be higher or lower than the figure shown.

* Investment advisor: Wellington Management Company LLP.

* Investor Shares available only. There is no minimum investment required for advised clients.

Note: Data as of June 30, 2026.

Active fixed income at Vanguard

\$539B

Vanguard global active bond AUM

\$312B Vanguard global active taxable bond AUM

\$227B Vanguard global active municipal bond AUM

25+

Portfolio managers

35+

Traders

60+

Credit research analysts

130+

Dedicated team members

Note: Data as of June 30, 2026.

Active fixed income leadership team



Sara Devereux

CIO VCM, Global Head of Fixed Income

In industry since 1992



Chris Alwine, CFA

Global Head of Credit

In industry since 1990



Roger Hallam, CFA

Global Head of Rates

In industry since 2000



Justin Schwartz, CFA

Head of U.S. Municipals

In industry since 2004

For more information about active fixed income, speak with your representative.

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Vanguard ETF Shares are not redeemable with the issuing Fund other than in very large aggregations worth millions of dollars. Instead, investors must buy and sell Vanguard ETF Shares in the secondary market and hold those shares in a brokerage account. In doing so, the investor may incur brokerage commissions and may pay more than net asset value when buying and receive less than net asset value when selling.

Past performance is no guarantee of future results. All investing is subject to risk, including possible loss of principal. Diversification does not ensure a profit or protect against a loss.

Bonds of companies based in emerging markets are subject to national and regional political and economic risks and to the risk of currency fluctuations. These risks are especially high in emerging markets.

High-yield bonds generally have medium- and lower-range credit-quality ratings and are therefore subject to a higher level of credit risk than bonds with higher credit-quality ratings.

U.S. government backing of Treasury or agency securities applies only to the underlying securities and does not prevent share price fluctuations. Unlike stocks and bonds, U.S. Treasury bills are guaranteed as to the timely payment of principal and interest.

Bond funds are subject to interest rate risk, which is the chance bond prices overall will decline because of rising interest rates, and credit risk, which is the chance a bond issuer will fail to pay interest and principal in a timely manner or that negative perceptions of the issuer's ability to make such payments will cause the price of that bond to decline.

Investments in bonds issued by non-U.S. companies are subject to risks including country/regional risk and currency risk.

Municipal bond fund distributions, including any market discount recognized by the Fund's investments, may be taxable as ordinary income or capital gains. A majority of the income dividends that you receive from the Fund are expected to be exempt from federal income taxes. However, a portion of the Fund's distributions may be subject to federal, state, or local income taxes or the federal alternative minimum tax. You should consult your own tax advisor with respect to any particular U.S. or non-U.S. tax consequences of your investment in the Fund.

Be aware that fluctuations in the financial markets and other factors may cause declines in the value of your account. There is no guarantee that any particular asset allocation or mix of funds will meet your investment objectives or provide you with a given level of income.

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