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Royal London Asset Management Market Review and Outlook

Quarterly Overview

31 March 2026

Overview

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The first quarter of 2026 was dominated by a sudden regime shift as geopolitics moved to the centre of the macro picture. Escalating tensions in the Gulf region came to a head in late February with the US-Israel offensive against Iran. The escalation added an additional layer of uncertainty and triggered concerns over oil and gas supplies, energy prices and near-term inflation risks. Brent crude hit more than 105 US dollars per barrel at the end of March as supply through the Strait of Hormuz was restricted and gas prices also surged, leading to a quickly deteriorating risk sentiment.

In the US, the spike in oil prices was a headwind, but the economy's energy sensitivity proved lower than in past shocks and the US benefits from being a major producer, helping US equities show relative resilience even as the quarter ended weakly. Investors also had to digest policy uncertainty after legal constraints changed the scope for tariffs announced in April 2025 and new tariff proposals reintroduced volatility, complicating the outlook for inflation and limiting the Federal Reserve's room to cut rates. Markets weighed the risk of a prolonged energy shock elevating recession likelihood later in 2026, even if the base case remained for a modest growth hit and higher near-term inflation.

As a net importer and more exposed to gas prices, the eurozone faced a tougher growth–inflation trade-off, even as incoming data still pointed to modest expansion and easing headline inflation. The ECB kept its policy unchanged with the deposit rate at 2%, but the broader oil and gas price shock pushed markets to reassess the path of European rates.

In the UK, the macro backdrop was similarly shaped by the energy price shock, but equities proved comparatively more defensive than some global peers, echoing patterns seen in prior commodity-driven events. In sterling credit, spreads that had tightened through 2025 began to widen in early 2026, with concerns over US private credit having a greater influence than Iran developments, while higher underlying gilt yields further lifted all-in yields. Primary markets were active over the first quarter, particularly during February. Credit performance was supported by areas such as structured bonds and financials, even as investors became more sensitive to inflation risk and the direction of policy rates.

Government bond markets bore the brunt of the repricing. Front end yields jumped, and curves reset higher as investors moved from expecting rate cuts to pricing fewer cuts, or even hikes, with higher energy costs seen as an inflationary impulse that central banks could not ignore. Moves in short dated yields were especially pronounced as markets tried to map the oil shock into policy reaction functions, while longer dated yields also swung as markets attempted to price the risks of any or all of higher inflation, lower growth and even potentially larger government borrowing. UK 10-year gilt yields shot up to 4.92%, up from 4.48% at the end of December and surpassing their highest levels seen last year (4.89% in January 2025). In the US, 10-year treasury yields rose to 4.31% in March from 4.14% at the end of December. The German 10-year bund yield was 2.98% at the end of the first quarter, rising from 2.82% three months prior.

The sterling investment grade credit market (iBoxx non-gilt index) returned -1.62% over the period under review. Spreads ended the quarter at 0.85% (iBoxx), compared to 0.77% (iBoxx) at the end of 2025. Sector returns were negative across the board, with more defensive areas such as covered bonds and supranationals less affected than areas with longer duration such as consumer services, telecoms and utilities.

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Global and UK Government Bonds

During the first quarter, UK 10-year gilt yields shot up to end at 4.92%, up from 4.48% at the end of December and surpassing their highest levels seen last year (4.89% in January 2025). In the US, 10-year treasury yields rose to 4.31% to end March from 4.14% at the end of December. The German 10-year bund yield was 2.98% at the end of the first quarter, rising from 2.82% three months prior.

At the start of the year, gilts performed well on both an outright and relative basis. Markets continued to price in multiple interest rate cuts from the Bank of England, supported by softer growth data and confidence that inflation would trend back towards target later in the year. In addition, the UK Debt Management Office (DMO) continued to starve the gilt market of long-end supply, with little to no long-end supply until April 2026 at the earliest. These factors contributed to falling gilt yields through January and February, reinforced by a more dovish-than-expected Bank of England meeting in February, where policymakers highlighted a cooling labour market and projected inflation at or below target for much of the forecast period.

Conditions changed materially in March following the escalation of conflict in the Middle East and the surge in oil & gas prices. Concerns around energy supply disruptions raised renewed inflation risks, prompting markets to reassess the expected pace and extent of monetary easing globally and driving bond yields higher.

Gilt markets, at their peak, moved to price in as many as four interest rate hikes from the BoE. While these expectations later tempered, the focus remains on how central banks would balance near-term inflation pressures against weakening growth and labour market conditions.

Global Credit and High Yield

The first two months of the year were not quiet, by any means, but the quarter was overshadowed by events in March. Prior to the escalating conflict in Iran, January saw the US remove the president of Venezuela, President Trump double down on his intention for the US to annex Greenland, (not ruling out the use of military force if necessary, and impose punitive tariffs on those European nations that objected), and, initially, threaten to take direct action on Iran should they crack down on domestic protests by Iranian citizens against the incumbent regime.

Despite this backdrop, the high yield market saw positive returns with the fund also producing positive returns. Spreads widened in February, however, as the market began to pay attention to a brewing conflict between the US and Iran.

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Global Credit and High Yield continued

The picture changed in March, with financial markets dominated by the war in the Middle East. Having had a strong start to the year, bond markets gave back all these gains, and more, in March as markets focused on the inflationary pulse arising from the increase in oil and gas prices, and the likely actions required by central banks to address this. The pricing of future interest rate moves by all central banks shifted dramatically over the course of the month. Global high yield markets faced an increasingly challenging backdrop as risk sentiment deteriorated.

As expectations for rate cuts were pushed further out, higher government bond yields weighed on returns and contributed to wider credit spreads. Market activity became increasingly headline-driven, with periods of volatility punctuated by brief rallies on signs of potential de-escalation. Investors grew more cautious, favouring higher quality and the more liquid parts of the market, while dispersion increased, and risk appetite became more selective despite primary markets remaining open for stronger issuers.

Default rates stayed exceptionally low, and companies generally managed cost pressures effectively, helping to sustain investor confidence. Overall, the asset class remained anchored by stable fundamentals, allowing it to absorb external uncertainties with limited disruption. The global high yield default rate inched above 2.0% in March, moving above 2.0% for the first time since August 2024.

In the high yield market, the ICE BofAML (BB-B) Global Non-Financial High Yield Index (sterling hedged) benchmark returned -0.46% in the first quarter with spreads ending the three-month period at 297bps, widening from 245bps at the start of the quarter. At the end of the period, the index's yield-to-worst stood at 7.29%, up over the quarter. In the broader-based high yield index, which includes CCC rated bonds, widened to 358bps from 304bps.

UK Credit

The sterling investment grade credit market (iBoxx non-gilt index) returned -1.62% over the period under review. Spreads ended the quarter at 0.85% (iBoxx), compared to 0.77% (iBoxx) at the end of 2025. Sector returns were negative across the board, with more defensive areas such as covered bonds and supranationals less affected than areas with longer duration such as consumer services, telecoms and utilities.

Sterling credit markets modestly outperformed gilts during the first quarter, helped by shorter duration and the higher income. Spreads remain relatively tight compared to the past two decades, but as we pointed out at the start of the year, when looking at a company level, defaults are low, company balance sheets are generally healthy, and investors continue to look for yield.

At a fundamental level, we still believe that credit spreads over-compensate investors for default risk, and that the all-in yield on sterling credit remains attractive. Furthermore, we continue to find attractive investment opportunities, partly through the new issue market but also by focusing on exploiting market inefficiencies. By focusing on bottom-up analysis, we continue to build overall portfolios that we believe offer attractive risk / return profiles with above-market yields.

Overview

Equities and Commodities

Global equities made a steady start to the year as investors focused on the path of disinflation, the timing of policy easing, and the resilience of economic activity. However, all this was upended in March. Risk sentiment deteriorated late in the quarter amid an escalation in geopolitical risk and a sharp move higher in energy prices, which revived inflation concerns and weighed on equities. March was the worst month for global equities since the start of the Ukraine conflict in 2022, which more than wiped out the previous two months' gains. A sharp rise in energy prices reignited inflation concerns, resulting in a market sell off.

The US was one of the weakest performing markets, as expectations for early interest rate cuts were pushed further out by a renewed bout of inflation anxiety linked to higher oil prices. Large technology stocks were a notable drag on performance, having already come under pressure earlier in the quarter due to valuation concerns and uncertainty around the impact of new AI capabilities on software business models. As volatility increased, investors rotated away from last year's technology leaders toward a broader mix of sectors, including more defensive and value oriented stocks.

European equities also gave back January and February's gains as rising energy prices led to concerns that inflation could remain above target. Markets in the region had previously benefited from falling inflation, raising hopes that European policy rates are near their peak. Energy and defence stocks provided pockets of relative strength during March. This helped to support the UK market, which was slightly more resilient.

Asia has been one of the strongest regions year to date but sold off the most in March due to the extent of its dependence on Middle Eastern energy imports. This particularly hurt Taiwanese and Korean stocks which had delivered double digit returns before the conflict broke out as key beneficiaries of the continued AI infrastructure build out and memory shortages. Japan was one of the few markets to finish the quarter higher, benefiting from yen weakness and expectations of increased fiscal support following the ruling Liberal Democratic Party's decisive victory in February's snap election.

Cash Markets

The first quarter of 2026 can be split into two distinct periods: before the breakout of war in the Middle East and the fallout stemming from sharply increased commodity prices, in particular oil afterwards. The conditions in January and February were supportive for strong performance while March then lagged on the heightened geopolitical volatility and the lack of a clear end in sight due to mixed messaging from the US administration.

Money market rates ended the quarter higher. While SONIA was unchanged – reflecting unchanged Bank of England interest rates – short-dated rates on CDs and similar money market instruments were trending lower early in the quarter on expectations of interest rate cuts. The outbreak of conflict in Iran, and the forecast increase in inflation, led to a sharp increase in money market rates.

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