Monthly Fixed Income Market Update

VICTORY income investors®
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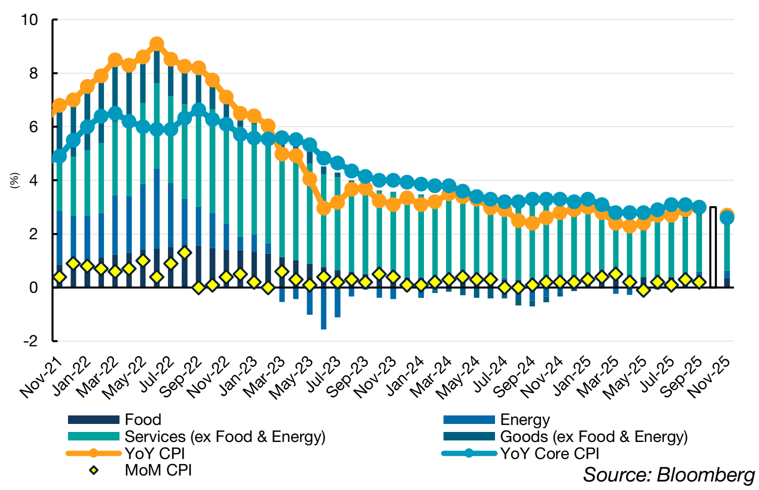
As of December 31, 2025

Key Takeaways

1. The Federal Reserve cut rates in December, but the lack of data following the government shutdown and division within the Federal Open Market Committee (FOMC) have driven uncertainty. The 10-year yield rose and ended the month at 4.17%, up from November's 4.02%.
2. Fixed income experienced negative performance in December, driven by rising yields across the majority of the Treasury curve. Corporate credit spreads continue to hold below long-term averages with minimal widening mid-month.
3. What does 2026 hold for fixed income? We explore some of the contradictory narratives.

The Month in Charts

November's CPI report, published in mid-December after the Federal Reserve's (the Fed) rate setting meeting, was one of the first reports to cover the period of the government shutdown. November CPI declined to 2.7% year-over-year, and Core CPI declined to 2.6% year-over-year. Given the lack of data collection throughout the shutdown there is some investor skepticism surrounding the inflation measure, leading to a lack of meaningful conclusions on inflation despite the decline. The Fed reduced rates once more in December, by 25 basis points. Chair Powell noted, however, that the pace of rate cuts is likely to slow in 2026 and 2027. The absence of data fueled additional dissent within the voting members of the FOMC, with two members calling for no cuts and one member calling for a jumbo cut. At the end of the month markets were more hesitant to price future cuts, with only some degree of confidence that it will come in the middle of the year.



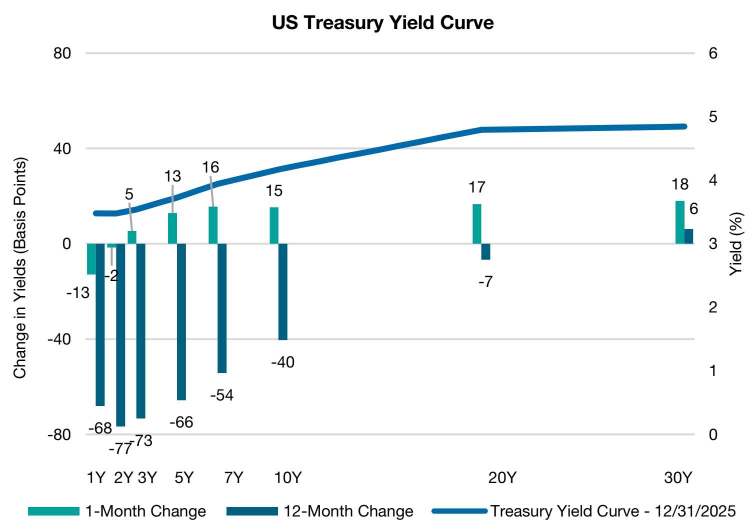
Source: Bloomberg

Most credit spreads tightened slightly month-over-month. Investment grade corporate credit spreads tightened 3 basis points and high yield corporate credit spreads tightened 7 basis points.

				Quarter		Change			Trailing 10 yr avg
Asset Class	Yield	Spread	Trend	Tight	Wide	MoM	QoQ	YoY	
U.S. Treasury	3.89								
U.S. MBS	4.63	22		20	31	-8	-9	-21	38
U.S. Corporate	4.82	77		72	85	-3	4	-2	118
U.S. Corporate High Yield	7.06	268		265	306	-7	-2	-19	405
CMBS	4.43	75		74	78	-2	-1	-6	90
ABS	4.09	52		50	55	-2	5	9	55
A	4.68	65		61	71	-2	2	-5	96
BBB	5.03	99		92	107	-4	6	-2	152
BB	5.92	163		158	195	4	-4	-16	265

Source: Bloomberg; Asset Classes represented by: ICE BofA US Treasury & Agency Index, Bloomberg US MBS Index, Bloomberg US Agg Total Return Value Unhedged USD, ICE BofA US High Yield Index, ICE BofA US Fixed Rate CMBS Index, ICE BofA US Fixed Rate Asset Backed Securities Index, Bloomberg US Agg A Total Ret Index, Bloomberg US Agg Baa Total Ret Index, Bloomberg Ba US High Yield TR Index. MoM/QoQ/YoY as of 12/31/2025

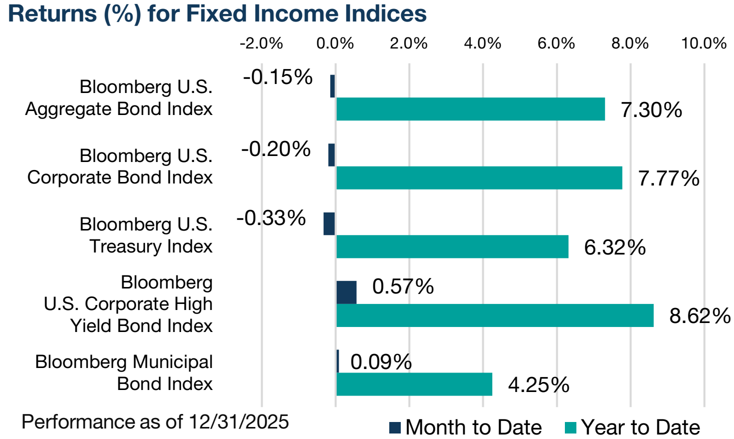
The Treasury yields generally ended December higher month over month despite the interest rate cut earlier in the month. While shorter-term yields did decline in response to the 25bps cut, concerns surrounding fiscal policy and inflation drove longer-dated Treasury yields up.



Source: Bloomberg

Performance was negative across fixed income in December aside from high yield corporate bonds and municipal bonds. Yields rose in response to the uncertain economic outlook, geopolitical risk and government spending, impacting fixed income performance. Year-to-date performance was positive across fixed income asset classes.

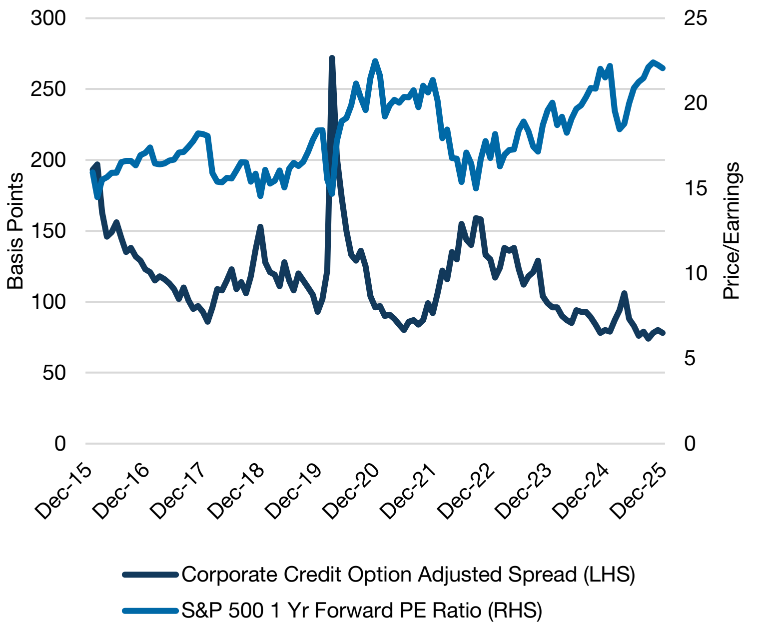
Returns (%) for Fixed Income Indices

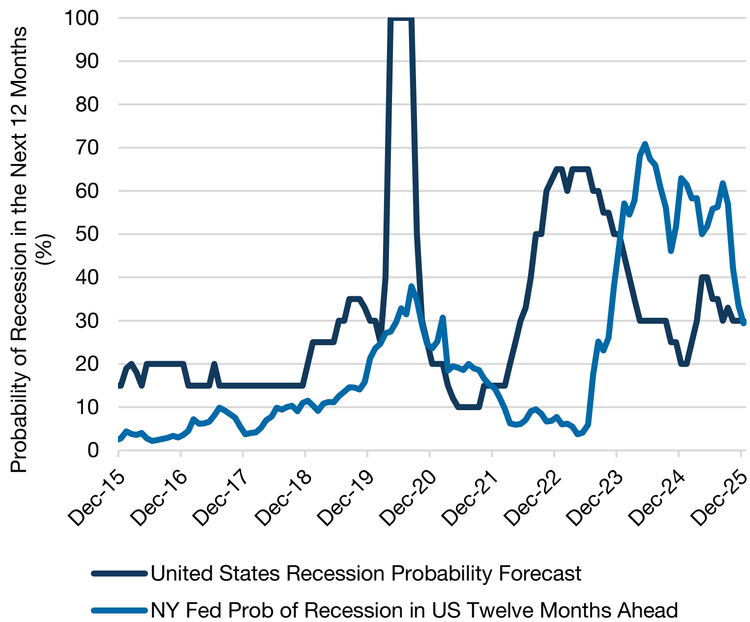


Past performance is no guarantee of future results. *Source: Bloomberg*

Frequently Asked Questions

Investors once again have found themselves in an uncertain environment – prompted by seemingly conflicting economic data. While economic growth and consumer resilience have continued to surprise to the upside, there is a consistent undercurrent of concern. This conundrum is laid out by the chart below showing recession probability forecasting steadily above long-term averages, but risk assets (such as stocks and bonds) are priced to perfection. The steady rise in equities and low credit spreads indicate a generally positive market, with optimistic expectations.





The contradictory nature of the above data is not the only example and as we kick off 2026, we recognize there may be more questions than answers on the economy. That being said, a central part of our investment process and philosophy is our focus on fundamentals-driven, repeatable fixed income management that avoids forecasting and, we believe, leads to consistent results through uncertain times. Looking ahead, despite the noise, we believe fixed income still presents an attractive opportunity for investors. On an absolute basis, real yields, which are yields in excess of inflation, are positive and elevated relative to history. On a relative basis, the yield of a 10-year Treasury bond exceeded the dividend yield of the S&P 500 at the end of December.

What We'll Be Watching in the Month Ahead

- **January 9th, Change in Nonfarm Payrolls and Unemployment Rate:** These will provide insight into the status of the labor market, an important consideration for the FOMC.
- **January 13th, December's CPI Report:** This report will provide insight into past inflation and whether it is still moderating toward the Fed's 2% inflation target.
- **January 12-20th, October PCE Report and Associated Data:** This report will provide insight into inflation during the government shutdown as data agencies work to catch up.
- **January 28th, the next FOMC Rate Decision:** The market largely does not expect a cut at this meeting due to the language Chair Powell used in his press conference at the December meeting. We expect January's press conference to provide more insight into the future of monetary policy.

Basis point "bps" is 1/100th of a percentage point. **Credit spread** is the difference in yield between a U.S. Treasury bond and another debt security of the same maturity but different credit quality. Credit spreads are the additional compensation that investors require to hold securities that are not as safe and liquid as those issued by the US Treasury. **The Treasury Yield Curve** shows the relationship between the US bond yield and the time to maturity. Yield and price have an inverse relationship. As the yield curve lowers, the price of bonds increase. **Core CPI:** CPI excluding food and energy. **Consumer Price Index (CPI),** a popular measure of inflation and deflation calculated by the Bureau of Labor Statistics, measures the monthly change in prices paid by U.S. consumers. **Personal Consumption Expenditure Price Index** is a measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services and is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior. The **Bloomberg 1-3 Month U.S. Treasury Bill Index** is designed to measure the performance of US-dollar-denominated, fixed-rate, investment-grade public obligations of the U.S. Treasury that have a remaining maturity 1 month to 3 months. The Index is market capitalization weighted, with securities held in the Federal Reserve System Open Market Account deducted from the total amount outstanding. The **Bloomberg U.S. Aggregate 1-3 Year Index** measures the performance of investment grade, USD-denominated, fixed-rate taxable bond market securities with maturities of 1-3 years, including Treasuries, government-related and corporate securities, mortgage-backed securities (MBS; agency fixed-rate and hybrid ARM pass-throughs), asset backed securities, and commercial MBS. The **Bloomberg U.S. Aggregate Bond Index** measures the investment grade, USD-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS, ABS and CMBS.

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