

PIMCO Income Strategy Update: Managing Risk While Locking In Yield

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Higher starting yields help anchor portfolios as uncertainty across markets and the global economy rises.

KEY TAKEAWAYS

- Economic and market outcomes are increasingly diverging across regions and sectors, underscoring the importance of resilience in portfolio construction.
- Starting yields are meaningfully higher than in recent decades, providing a cushion for investors even if inflation stays elevated and policy paths diverge.
- Income Strategy is diversified across the global fixed income opportunity set with an up-in-quality, up-in-liquidity bias, maintaining flexibility to navigate volatility and capitalize on dislocations.

Fixed income markets are offering compelling income potential, even as investors navigate an uncertain macro and geopolitical backdrop. Here, Dan Ivascyn, manager of PIMCO Income Strategy with Alfred Murata and Josh Anderson, answers questions from Esteban Burbano, fixed income strategist. They discuss the current environment and how the team is positioning Income Strategy for resilience, flexibility, and opportunity.

Q: PIMCO's latest Cyclical Outlook, "Layered Uncertainty: Conflict, Credit Stress and AI," highlights intensified uncertainty and increasing divergence among regions and sectors. How are these factors influencing our high-level outlook for the next 6–12 months?

A: We started the year with significant uncertainty from a macro standpoint with policy shifts and ongoing disruption from AI. These factors are driving a "K-shaped"

economy: Stronger households, sectors, and countries with clear growth drivers are holding up well, while others more exposed to inflation, higher rates, or slowing demand are being left behind. That divergence remains a defining theme in our outlook.

What has changed is the scale of uncertainty driven by the Middle East conflict and the potential for a prolonged energy supply shock. In environments like this with elevated uncertainty and fatter tail risks, we are building portfolios with an emphasis on resiliency and liquidity.

Q: How are we thinking about growth, inflation, and the key risks over the next year or so?

A: Our base case is still positive global growth. In the U.S., we forecast 2026 growth in the high-1% to 2% range, assuming geopolitical tensions do not meaningfully escalate.

Inflation is the bigger uncertainty. The energy shock is likely to keep inflation elevated for longer, taking several quarters to fully return to its prior path even if we have a meaningful easing of oil supply concerns. This means we could see less central bank accommodation than many were expecting prior to the conflict (though perhaps not the hawkish shift some have predicted more recently, either), along with a more differentiated policy outlook across countries. Income Strategy also has the flexibility to incorporate inflation-linked bond investments where appropriate to mitigate inflationary risks.

We continue to monitor a potential stagflationary scenario – where inflation stays high long enough to begin weighing on growth. If central banks are forced to push back more aggressively, that could be negative for credit and equities. While our base case is that the economy and risk assets hold up, the range of outcomes is wider than normal, and portfolios should reflect that uncertainty.

Q: With geopolitical and political uncertainty so elevated, how are you managing overall portfolio risk?

A: We're currently leaning on three core ideas. First, stay up in quality. When the world is this uncertain and risk asset valuations still broadly look stretched, we don't think it's time to reach aggressively into the most economically sensitive parts of the credit markets.

Second, stay diversified across the global fixed income opportunity set. Income Strategy is as diversified as it's been in many years, and that matters when different countries are in different stages of growth, inflation, and policy cycles.

Third, maintain a focus on liquidity, because liquidity means future flexibility. We treat liquidity as an asset; it allows us to step in when others need liquidity and to look to take advantage of dislocations when they occur.

Speaking more broadly, it's very challenging to predict macroeconomic outcomes with any precision. A key foundation of our thinking – and the good news today – is that you don't necessarily have to make bold predictions about what central banks will do, what global leaders will do, or how geopolitical situations might unfold. Instead, you can simply look to take advantage of attractive absolute and relative valuations within higher-quality fixed income, and that's where Income Strategy is focused.

Q: How are you thinking about duration and yield curve positioning right now?

A: The overarching objective is to lock in today's attractive yields while maintaining flexibility. If geopolitical risks escalate and slow growth, interest rates could fall, which would likely benefit bonds, but reinvestment opportunities may be less compelling down the road. That makes capturing current elevated valuations particularly important.

With this in mind, we have modestly increased duration, focusing on markets that lagged and could benefit from stabilization, including Australia, the U.K., and in higher-quality emerging markets. Overall duration remains in line with the strategy's benchmark.

We've also remained active in curve positioning as recent volatility, particularly at the long end, has created opportunities to adjust exposure. We've shifted from a front-end-heavy stance toward a more balanced, neutral posture, and while we still generally favor the front end, positioning today is more diversified and flexible.

Q: The strategy maintains a meaningful overweight to U.S. agency mortgage-backed securities (MBS). Why does that still make sense today?

A: Agency mortgages performed very well over the past couple of years because they started extremely cheap and then benefited from spread tightening. Recently they underperformed a bit as rate volatility rose, but we continue to view them as modestly cheap and closer to fair value today.

That said, we still like them because "fair" looks attractive in a world where parts of lower-quality credit remain expensive. They also offer a favorable liquidity profile, which lets us trade actively to add value, and rotate into other areas when better opportunities emerge. Over time, as compelling credit opportunities appear with better risk profiles and incremental spread, we can rotate, but for now, agency mortgages remain a key holding.

Q: What are you seeing in asset-backed securities (ABS) and structured credit?

A: High quality consumer ABS tied to middle- and higher-income households still look attractive. Underwriting standards have generally stayed strong, households have benefited from years of income growth, and many homeowners hold record amounts of equity in their properties. That said, we are being selective, especially as we have observed that some managers have moved into riskier, higher-yielding, lower-quality corners of the market.

We are also taking a close look at collateralized loan obligations (CLOs). Historically we've avoided meaningful mezzanine exposure due to volatility and embedded leverage, but senior CLO risk – especially higher-quality tranches – has started to look more interesting on the margin.

Q: Corporate credit spreads have been tight. Where are we leaning in and where are we cautious?

A: We are cautious on lower-quality credit. Spreads are tighter than we would like given macro uncertainty and the potential for AI-driven disruption, which can create winners and losers across sectors. Private credit has some concentrated exposures in more sensitive areas, and we are seeing stress build.

Traditional high yield fundamentals look stronger than some areas of private credit, but are vulnerable if growth weakens, so the Income Strategy has remained cautious. Investment grade fundamentals appear generally solid, though valuations are not especially cheap, in our view.

What is encouraging is the increase in special situations where companies that once expected private buyers are returning to public markets. In many cases, they're offering more investor-friendly terms to get deals done. That creates potential opportunities for patient investors with liquidity to step in on attractive terms.

Q: How are you thinking about currencies?

A: Over the longer term, we expect modest U.S. dollar weakness, so we maintain a small underweight to the dollar in Income Strategy. But in the short term, conviction is lower because in periods of acute conflict or risk-off moves, capital often rushes into the dollar temporarily.

We also recently reduced some currency exposure, particularly within emerging markets. Our approach continues to be relative-value-oriented rather than a massive risk position.

Q: What's the key takeaway for Income Strategy investors now?

A: Starting yields are the most important consideration today, in our view. Today's yields are meaningfully higher than we've seen for much of the past two decades, creating a cushion for income-oriented investors. Even with inflation elevated in the near-term, high quality bonds are generally yielding well above inflation, which has historically been a favorable indicator of forward returns.

For investors with a three- to five-year horizon, those starting valuations matter. In a flexible portfolio like Income Strategy, yield can act as a long-term foundation, with the potential to add value over time through active shifts across sectors, the yield curve, and global markets as opportunities arise. We believe the current environment is a prime time for investors to consider recentering portfolios on high quality bonds to generate potential income, diversify risk, and hedge against downside macro scenarios.

Q: Any final thoughts?

A: Thank you for the trust and confidence you place in PIMCO's people and investment process. We remain deeply committed to navigating a world that is clearly challenging, but also one that offers meaningful opportunities for disciplined, active fixed income. As always, we're focused on seeking to deliver strong income and returns relative to passive strategies over time.

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