

Market commentary

Market volatility intensified in March as the escalation of the Iran conflict and disruptions to Middle Eastern oil supply reignited inflation concerns. The sharp sell off in rates eclipsed the growth slowdown narrative that had dominated the early part of 2026. Over the quarter, U.S. 10-year Treasury yield rose 15 basis points (bps) to end the quarter at 4.32%, driven by the 38bps rise that took place in March on the back of inflation fears. The yield curve flattened as front end rates bore the brunt of near term inflation fears, with the 2s10s spread narrowing by -17bps to 52bps.

Asia investment grade credit markets remained resilient during the quarter despite elevated geopolitical risks linked to the Iran conflict. Spreads widened modestly by 8bps to 110bps in March, reflecting heightened risk aversion rather than a broad based deterioration in underlying credit fundamentals. The primary regional risk relates to potential energy supply disruptions, given Asia's reliance on oil and gas flows through the Straits of Hormuz. Early signs of pressure emerged through energy related policy responses, including fuel rationing measures in select countries, which could weigh on regional growth prospects and credit profiles if sustained.

Across investment grade sectors, idiosyncratic news continued to be the driver of credit events. Moody's and Fitch revised Indonesia's sovereign outlook to negative, citing concerns around policy credibility, rising fiscal risks, external buffers, and investor sentiment, with these pressures extending to certain quasi sovereign issuers. In India, two public sector non bank financial companies announced a proposed merger aimed at improving scale and operational efficiency, which may support medium term credit strength. In China, rating agencies maintained a cautious stance on a delivery services company within the technology, media, and telecommunications (TMT) sector due to ongoing profitability pressures, weaker cash generation, and margin compression. Separately, an investment grade Chinese property developer also faces fallen angel risk after S&P revised its BBB outlook to negative, reflecting slower than expected deleveraging. Moody's upgraded several offshore Chinese financial leasing companies, supported by expectations of strong parental and government backing. However, S&P placed one China leasing company at BBB- credit watch negative following a profit warning from its subsidiary. In Korea, S&P downgraded a steel producer on concerns that elevated capital expenditure and subdued operating conditions will constrain free cash flow, while outlooks on a battery manufacturer and a chemical company were revised to negative amid weaker electric vehicle demand and a prolonged chemicals downturn.

Conversely, S&P upgraded a Korean memory chip manufacturer to BBB+ with a positive outlook, underpinned by robust earnings and cash flow driven by strong AI related demand.

Asian non-investment grade US dollar remained resilient overall amid heightened geopolitical tensions, though performance continued to be shaped by issuer- and country-specific developments. Within China, the Middle East conflict has not materially affected consumer sentiment or Macau gaming activity, with a modest recovery evident in gaming revenues. However, issuer-specific risks remain elevated, underscored by weakness in a Chinese industrial issuer after China's National Financial Regulatory Administration advised onshore insurers to limit exposure to the company. In Japan, credit differentiation persisted, with a NAND flash memory producer positioned for a potential upgrade on the back of strong earnings momentum, while a Japanese investment company was placed on negative outlook due to balance sheet risks. At the sovereign level, Sri Lanka and Pakistan experienced significant bond sell-offs, driven primarily by inflation concerns linked to higher oil prices following the Iran conflict, which have weighed on expectations for central bank rate cuts and increased fiscal pressures for these energy-importing economies.

Performance review – Asian Credit

The Asian Credit portfolio underperformed its benchmark in 1Q26:

Positive contributors:	Negative contributors:
<ul style="list-style-type: none">• Underweight in Indonesia and Philippine sovereign bonds• Security selection within China investment grade bonds• Security selection in Asian financial sector bonds	<ul style="list-style-type: none">• Overweight in Indonesian quasi-sovereign bonds• Overweight exposure in Australian government bond• Currency positioning, particularly overweight in the Japanese yen, euro, and Australian dollar

Strategy positioning

The strategy maintained a cautious approach, keeping an underweight in credit spreads relative to its benchmark. In credit markets, holdings in China technology, media, and telecommunications issuers were reduced following a period of spread tightening. Japanese credit exposure was also scaled back amid increased volatility in Japanese government bonds, while exposure to the Middle East was further trimmed in response to elevated geopolitical uncertainty.

In rates positioning, the strategy was initially overweight U.S. duration. However, following heightened geopolitical tensions in March, U.S. duration exposure was shifted from overweight to underweight. At the same time, the Japanese rates position was reduced from overweight to neutral due to rising inflation expectations, while a modest exposure to Australian rates was maintained. In addition, the portfolio retained a small allocation to euro-denominated credit, with euro exposure hedged back to the US Dollar during March. The strategy maintained its Japanese yen exposure and increased its Australian dollar exposure over the quarter.

Performance review - Rates and Currency

The Rates and Currency portfolio underperformed its benchmark in 1Q26:

Positive contributors:	Negative contributors:
<ul style="list-style-type: none"> Reduced overweight in US rates 	<ul style="list-style-type: none"> Overweight in Australian government bond and the Australian dollar Overweight in Japanese government bond and the yen Underweight in Chinese government bond and the yuan Overweight in emerging market currencies, such as the Brazilian real and Malaysian ringgit

Strategy positioning

Amid a turbulent geopolitical backdrop, the rates strategy adopted a more tactical stance in US Treasuries, reducing its overweight position ahead of rising inflation concerns. An overweight position was initiated in UK gilts, reflecting expectations of a weakening domestic economy.

In currency positioning, the strategy maintained an underweight exposure to the US dollar, while adopting a tactical approach to position sizing as geopolitical developments drove heightened volatility. Exposure to the Australian dollar was increased, while euro exposure was reduced. Positioning in the Japanese yen was maintained, reflecting its long term undervaluation.

Performance review – Asian Total Return

The Asian Total Return portfolio delivered negative performance in 1Q26:

Positive contributors:	Negative contributors:
<ul style="list-style-type: none"> Allocation in China Real Estate Allocation in Asia convertible bonds Allocation to Asia financials bonds 	<ul style="list-style-type: none"> Long position in the Japanese government bond Long position in Australian government bond Currency positioning, particularly overweight in the Japanese yen, euro, and Australian dollar

Strategy positioning

Amid heightened geopolitical uncertainty and a more cautious outlook for global growth, the strategy adopted a more defensive stance during the quarter. We continued to focus on the potential impact of elevated oil prices on inflation and policy expectations, recognising that sustained energy price pressures could limit the scope for near term monetary easing in the U.S.

Portfolio credit quality was meaningfully improved, with the average portfolio rating rising from BBB+ to A-, reflecting a deliberate shift toward higher quality issuers with resilient cash flows and attractive income. Exposure to the Middle East was further reduced amid elevated geopolitical risks, alongside trims to China high yield positions with weakening fundamentals and Japanese credit amid increased government bond volatility. The strategy continues to selectively allocate to Asian convertible bonds, which offer a balanced risk return profile.

In rates, U.S. and Japanese duration exposures were reduced as inflation expectations rose, while positions in Australian government bonds were maintained given attractive valuations. In foreign exchange, exposure to the Australian dollar was increased, supported by Australia’s commodity exporter profile, while euro exposure was reduced amid weaker growth dynamics and elevated inflation pressures as a net energy importer. A long position in the Japanese yen was maintained as a potential hedge against global risk off conditions.

Q2 2026 Outlook

Global / US

Even before the latest escalation in the Middle East, the U.S. economy had begun to exhibit signs of fatigue beneath otherwise resilient headline growth figures. Labor market indicators have softened noticeably, and consumption strength is increasingly concentrated among higher income cohorts rather than the middle income households that typically underpin broad based demand. With pandemic era savings exhausted and fiscal transfers now normalized, households no longer possess the buffers that previously supported elevated spending.

Our core view of a slowing U.S. growth trajectory remains unchanged, and energydriven price pressures are likely to cause a bigger drag on consumer sentiment and growth. Prior to the conflict, we expected roughly 100 basis points (bps) of additional the federal reserve (Fed) cuts in 2026. However, the inflation risk from a prolonged geopolitical shock could keep the Fed on hold for longer, and in a tailrisk scenario even raise the possibility of rate hikes if inflation expectations become unanchored.

Even if tensions ease, we do not expect sentiment to swing sharply toward optimism in a sustained manner. As such, U.S. rate dynamics will ultimately depend on the interplay between conflict related inflation risks and ongoing domestic growth deterioration. At the long end, fiscal concerns and inflation fear may keep yields elevated, though weaker growth should exert some anchoring pressure. At the front end, the government’s policy response to inflation concerns will remain the dominant driver, reinforcing the need for a more tactical approach.

Equity valuations have become more fragile and risk sentiments oscillate headline to headline on geopolitical news. We still see the risk of renewed sell offs should the conflict escalate meaningfully. For fixed income investors, this environment reinforces the importance of disciplined credit allocation - focusing on quality and steering clear of stretched segments.

Asia

For the Bank of Japan, rising oil prices paired with an undervalued yen adds more certainty to its path of monetary policy normalization. We continue to expect policy rates to move toward 1.5–2%, with 10year Japanese Government bonds(JGBs) likely settling between 2–2.5%. Notably, 30year JGBs remain attractively valued, as Japan maintains the steepest yield curve among developedmarket rates. In our view, the case for continued policy normalization remains intact, despite domestic political uncertainties, as currency weakness increasingly fuels imported inflation.

China's recovery, while gaining traction, remains uneven and fragile. Growth momentum is still weak, employment subdued, and deflationary pressures present. With U.S.–China trade tensions persisting, expectations for further fiscal stimulus continue to build, given that monetary easing alone has not been sufficient to reinvigorate activity. We believe additional fiscal measures will be essential to stabilizing growth.

More broadly, Asian markets appear resilient enough to withstand the initial geopolitical shock, with near term fundamentals largely intact. However, the longer term implications are harder to ignore. Asia is the world's largest recipient of crude flows through the Strait of Hormuz - a chokepoint that becomes even more critical in conflict periods. Strategic reserves will help cushion disruptions, but can only slow - not prevent - the inflationary impact on living costs. Economies such as Thailand, India, and the Philippines are particularly vulnerable to sustained energy price increases; even moderate but persistent rises could push inflation higher from currently benign levels.

In this context, fiscal strength becomes an important buffer. Countries with healthier balance sheets and enough flexibility to deploy targeted subsidies or temporary support measures will be better equipped to soften the transmission of higher energy costs to households and businesses. These steps cannot fully remove inflationary pressures, but they can meaningfully mitigate them.

Credit

After a strong start to 2026 for Asian credit spreads, the recent geopolitical shock reminds us of underlying fragilities. We continue to see the risk reward profile as asymmetric, with heightened geopolitical tensions increasing the likelihood of abrupt risk off episodes. Although Asian credits overall remain resilient and carry remains the dominant driver of returns, pockets of the market exposed to oil prices and the middle east have become increasingly vulnerable to near term volatility.

In this environment, we remain highly selective - reducing exposure to weaker segments while favouring idiosyncratic issuers with robust fundamentals that can better withstand external shocks. Such issuers are still capable of delivering compelling risk adjusted returns, even as the broader geopolitical landscape becomes more unsettled.

Currencies

A stronger U.S. dollar is likely to remain the dominant theme as long as geopolitical tensions run high, with the currency's path continuing to depend on the length and severity of the conflict in the Middle East. Should tensions ease, however, we expect the USD to weaken as underlying economic softness becomes more visible beneath the resilient headline figures. Political preference also matters: Trump's inclination toward a weaker dollar reinforces this bias.

The euro stands to benefit most if U.S. outflows accelerate, supported by Europe's commitment to fiscal expansion. While our long term view remains that the USD is structurally overvalued, we remain tactical in the near term on the back of near-term market volatility.

The Japanese yen presents a more nuanced outlook. While its recent weakness reflects Japan's heavy reliance on imported energy, the currency proved relatively resilient during March's risk-off environment, emerging as the strongest-performing G10 currency against the US dollar. A further unwinding of yen-funded carry trades – which have exerted sustained downward pressure on the currency – would be supportive of yen appreciation. Taken together, these dynamics suggest scope for a stronger yen over the longer term.

Source: First Sentier Group as at 31 March 2026.

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