Fixed Income in 2026: Reclaiming Its Place at the Core of Portfolios

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From the Desk of the Fixed Income Team
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At a Glance:

- Fixed income posted strong performance for the third year in a row in 2025, supported by moderating inflation, stable macroeconomic conditions, and renewed investor confidence
- Elevated yields and healthy corporate fundamentals position core bonds to play a stabilizing, income-generating role in 2026 portfolios
- Active management, selectivity in credit, and gradually reallocating from excess cash are key opportunities for investors

A Year Defined by Resilience and Renewal

The fixed income landscape enters 2026 from a position of strength. Following several years of volatility—characterized by inflation shocks, rapid policy tightening, and challenging return dynamics—2025 extended the positive momentum that began when interest rates peaked in late 2023. Since then, the asset class has delivered strong, yield-driven performance, a trend we expect to continue into 2026. With equities and precious metals reaching new highs and economic conditions proving surprisingly resilient, fixed income quietly delivered its third consecutive year of gains, reinforcing that its role in diversified portfolios is not merely intact but remains essential.

This revived performance comes at a time when the macroeconomic backdrop is shifting in constructive ways. Inflation pressures have meaningfully moderated, labour markets remain sturdy, and global central banks—once sharply divergent—appear poised to move in closer alignment. The Bank of Canada's earlier and more aggressive easing cycle—beginning with substantial rate cuts in 2024 and followed by additional cuts in 2025—was a defining feature of the period. In the U.S., stronger than expected economic data initially delayed cuts, but signs now point toward a period of policy convergence in 2026 as both countries find themselves balancing stable inflation progress with the need to support growth.

This steadier macroeconomic foundation, combined with the enduring power of elevated yields, sets the stage for a compelling fixed income environment in the year ahead.

A Strong Finish to 2025: Performance That Reinforces Confidence

Performance across key fixed income strategies at TDAM was notable in 2025 **(Exhibit 1).** Core Canadian bond strategies delivered solid returns, a testament to disciplined duration management and high quality credit exposure. Corporate bond strategies were standouts, with the TD Canadian Corporate Bond Fund posting strong performance over one and three year periods. High yield also played an important role, with performance supported by resilient corporate fundamentals and healthy interest coverage ratios.

Exhibit 1: TDAM's Core Fixed Income Fund Performance

F- Series Returns as of December 31, 2025	1 yr	3 yrs	5 yrs	10 yrs	Since Inception	Since Inception Date
TD Short-Term Bond Fund	3.74%	4.67%	1.48%	1.75%	2.64%	November 1, 2004
TD Canadian Bond Fund	2.55%	4.70%	0.50%	1.82%	4.21%	November 1, 2000
TD Canadian Corporate Bond Fund	4.69%	6.44%	1.70%	N/A	2.71%	March 1, 2016
TD High Yield Bond Fund	6.46%	7.55%	4.46%	5.47%	5.05%	December 1, 2003
TD Global Income Fund	5.68%	5.75%	1.06%	n/a	2.24%	September 12, 2017
TD Fixed Income Pool	3.15%	4.46%	-0.26%	n/a	1.96%	January 29, 2019

Source: TD Asset Management Inc. As of December 31, 2025.

This strength is even more striking when viewed against the broader investment landscape. Investors grappled with the discomfort of seeing risk assets climb amid global uncertainty. The fact that bonds nevertheless continued their positive trajectory underscores the central theme heading into 2026: yield has returned as the primary driver of fixed income returns, and income—finally—does the heavy lifting.

Macroeconomic and Credit Outlook: Policy Convergence and an Economy Balanced “Not Too Hot, Not Too Cold”

As policy paths draw closer, fixed income valuations will increasingly be anchored by economic fundamentals rather than rate surprises. In Canada, economic data across labour, consumer spending, and Gross Domestic Product ("GDP") largely exceeded expectations in 2025. Growth is slowing, but gently – and when paired with stimulative monetary and fiscal policy the environment feels balanced rather than recessionary. Elevated yields and a steady macroeconomic backdrop provide fixed income with a solid foundation for the year ahead.

Tight but Supported Credit Spreads: Credit valuations remain tight, but this tightness is largely grounded in fundamentals rather than complacency. Balance sheets remain healthy, leverage is reasonable, earnings are stable, and interest coverage ratios remain comfortably above long-term averages. Tight spreads do not imply imminent stress; instead, they reflect a corporate sector that has broadly managed higher rates with discipline.

Modest spread widening is possible in 2026—particularly as U.S. companies continue to deploy capital into large scale artificial intelligence related Capital Expenditure ("CapEx") and Mergers and Acquisitions—but in our view, conditions for a disorderly repricing simply are not in place.

Stress indicators, such as problem loan ratios and charge off levels in the U.S. financial system, remain well below historical stress periods. Consumer behaviour also remains resilient.

In our opinion, the implication is clear: selectivity, not caution, is the priority. Active credit managers with strong research capabilities are well positioned to navigate issuer level dispersion and exploit pricing dislocations when they occur.

Two Key Investor Scenarios: Opportunities to Unlock Value

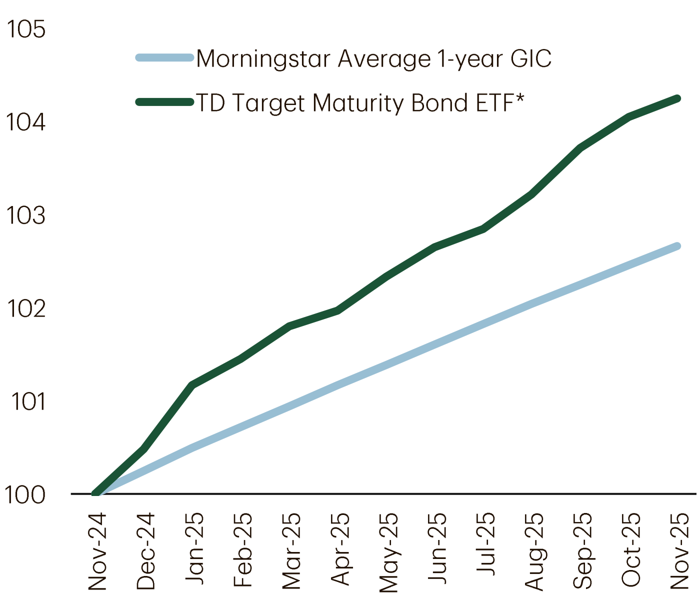
Actively managed fixed income funds at TDAM are managed with a nimble, tactical approach. This allows our investment teams to adjust allocations in response to exaggerated market moves and, more importantly, to protect capital during sell-offs. The ability to pivot quickly is a critical defense mechanism, especially for retirees who cannot afford significant losses. Following a strategic redesign, our funds now include a greater allocation to high-quality private alternatives that are less vulnerable to traditional market factors. This enhances resilience, as these components help diversify sources of return and provide additional protection against market volatility. The funds are particularly useful for equity investors seeking to reduce risk without exiting the market and for fixed income investors aiming to improve returns in a risk-managed way.

1. Investors Holding Excess Cash

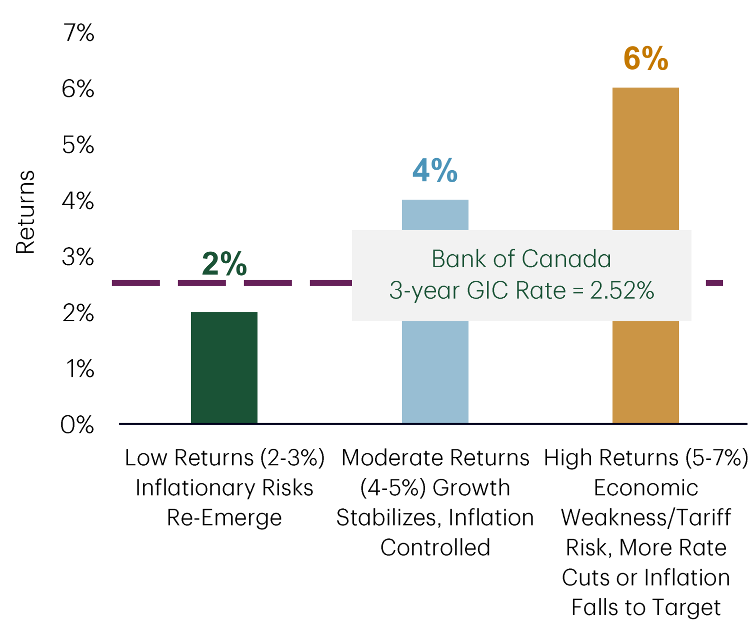
One of the most common challenges for investors today is holding too much cash or GICs in their investment portfolios. While this positioning may have made sense during the rate hiking cycle, it now represents meaningful opportunity cost. In 2025, short duration corporate bonds significantly outperformed the average one-year GIC **(Exhibit 2).** With reinvestment risk now dominating cash returns, even gradually reallocating into short-term fixed income strategies can help investors capture materially higher yields without taking on unnecessary duration risk. This shift could position investors to achieve bond outperformance over GICs again in 2026 while maintaining ample liquidity.

Exhibit 2: GIC vs. Canadian Corporate Bonds - Which one wins?

What $100 Earned in GIC vs. Bonds Past Year



What Could $100 Earn in GIC vs. Bonds in 2026?[1]



*TD Target Maturity Bond ETF Return is average of 2026 & 2027 Maturities.
[1]For a 5-year Canadian IG Corp Bond.
Note: TD Asset Management projections based on different assumptions on rates and spreads moves. GIC = Guaranteed Investment Certificate.
Source: TD Asset Management Inc, Morningstar®. As of Dec 30, 2025

2. Investors with non-traditional fixed income allocations

Another frequent scenario involves investors who are avoiding traditional bond exposure through structured products, fixed income hedge funds or higher risk credit strategies. Such exposure can introduce unintended bets and more importantly leave portfolios void of the portfolio role high-quality bond portfolios are designed to fulfill.

For investors seeking pure corporate exposure, high-quality Canadian corporate bond strategies offer strong performance, lower volatility, and the support of a deeply resourced credit research team—an area in which TDAM has a long and proven history. In 2025, this approach proved its value: consistent income, lower sensitivity to rate shocks, and strong security selection combined to deliver solid results.

Reestablishing the Role of Core Bonds

Core fixed income has reclaimed its foundational position. It provides ballast, diversification, and a reliable source of income—three attributes that matter deeply in a world where policy shifts, geopolitical tensions, and economic cross currents can reintroduce volatility without warning.

With Canadian 10-year yields still at elevated levels relative to recent history, core strategies offer attractive long-term entry points, helping investor portfolios withstand macroeconomic shocks and complement the growth orientation of equities. Actively managed core bond strategies can also assure investors that when credit spreads do widen, their core bond manager will capitalize on additional corporate bond exposure to increase returns.

Looking Ahead: What to Leave Behind, What to Embrace

With performance rebounding and the interest-rate environment increasingly supportive, fixed income is once again positioned to deliver strong risk-adjusted outcomes over the next 12 to 18 months.

The focus now should be on:

- Embracing elevated yields
- Maintaining high quality corporate exposure
- Using core bonds to stabilize portfolios
- Transitioning from cash into strategic fixed income
- Leveraging active management to navigate spread dispersion

With markets entering 2026 on relatively solid footing, investment management teams at TDAM are ready to help—leveraging disciplined, research-driven fixed income solutions designed to navigate today's elevated-yield environment and support investor's long-term financial goals.

For further information, please contact your investment professional.

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