

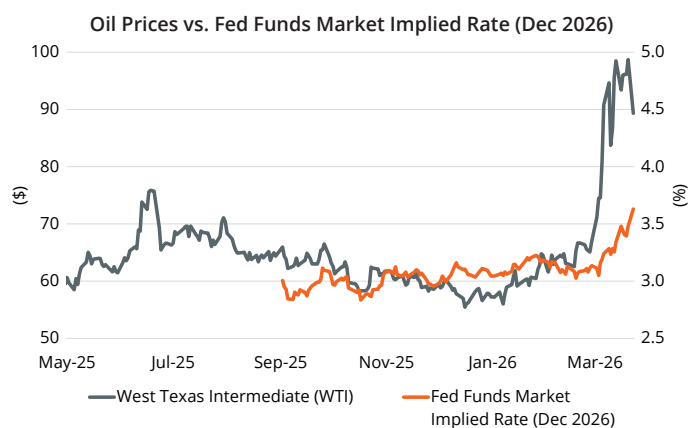
Fixed Income Review & Outlook

1Q 2026: Oil Shock Meets Bond Markets

- Rates moved higher in March as the Iran-driven energy shock revived inflation concerns.
- The Fed remained on hold, openly acknowledging inflation risks tied to oil and tariffs.
- Credit spreads stayed tight, suggesting investors expect limited economic fallout from the Iran conflict.
- Signs of stress emerged in private credit markets as investors sought liquidity.

For fixed income markets, the first quarter of 2026 had two distinct acts. Coming into the year, investors were focused on a gradual cooling in the labor market, moderating inflation, and a general sense that the Federal Reserve (Fed) was on its way to at least two additional rate cuts. Equity volatility was elevated, but the questions on investors' minds centered around familiar themes: whether investments in AI will drive productivity and profit growth; how trade policies will evolve and impact bottom lines; and the viability and sustainability of private credit markets. Interest rates steadily drifted lower through February.

That entire backdrop shifted almost instantly when the U.S. and Israel initiated joint strikes on Iran on February 28. With the Strait of Hormuz effectively shut down and roughly one-fifth of the world's energy supply offline, markets quickly repriced a meaningful inflation shock. Interest rates rose sharply as the expectation for additional rate cuts vanished.



Source: Bloomberg, Madison Investments

Note: The Dec 2026 Market Implied Rate is derived from the CME 3-Month SOFR Dec 2026 futures contract. This rate is a proxy that reflects market expectations for the Fed Funds Rate.

Inflation Back in the Spotlight

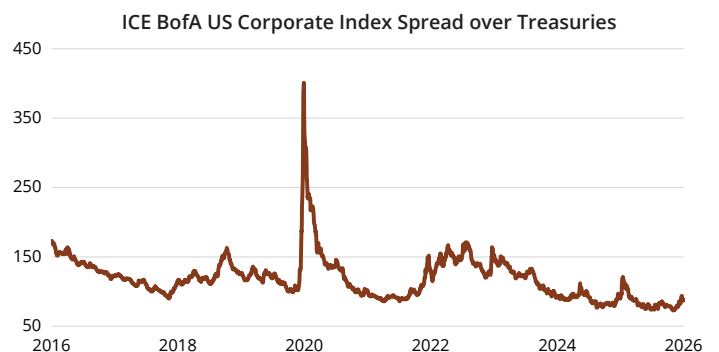
The February Consumer Price Index offered encouraging signs of progress toward the Fed's 2% inflation target, but market reaction was negligible as the report reflected conditions *before* the conflict. At its March meeting, Fed Chair Powell recognized continued upward pressure, particularly on goods inflation, as tariffs and an energy price shock make their way through the system. February's Producer Price Index came in hotter than expected as well, another potential concern as the Iran conflict goes on.

With the spike in oil prices since February 28, the bar for rate cuts has risen. In fact, with the Fed now squarely focused on inflation, investors must entertain the possibility of a rate hike.

For now, the market is treating this as a straightforward price shock: higher energy prices → inflation rises → central banks on hold. This may be the correct starting point, but far from the whole story. If disruption persists and users of energy-intensive inputs are forced to pull back, the impact may shift from inflationary shock to recessionary. Historically, that is when interest rates can fall sharply, and credit spreads widen. We do not believe the credit markets are appreciating this risk.

Credit Markets

Credit spreads have remained near the historically tight levels we have become accustomed to over the past twelve months. Markets appear to be pricing a scenario where: a) the conflict ends soon; b) energy flows normalize quickly; and c) the global economy absorbs the shock with minimal damage. This is possible, but not guaranteed. It is the hope, but not the basis of our current portfolio positioning. Given the elevated uncertainty, we do not feel this is the time to stretch for yield when we aren't being compensated for the added risk.



Within the opaque and less-regulated world of private credit, we began to see signs of stress in the first quarter. Redemption requests have compounded, and while many vehicles are gating withdrawals, several publicly-listed business development companies (BDCs) now trade at roughly 80% of their reported NAVs. This gap reflects investor skepticism about stated valuations and liquidity, an important reminder that liquidity risk can be amplified in times of elevated stress. It is likely that the attractive yields of many of these vehicles are compensating for more than just a liquidity premium. Investors and their advisors should also pay attention to the quality of the underlying assets.

Outlook

The outlook for fixed income hinges on the duration and severity of the energy disruption. A quick resolution would allow inflation to ease and the Fed to resume discussions about normalization. A prolonged shutdown

would eventually feed through to slower growth and widening credit spreads. The volatility injected into interest rates is a function of a wide range of potential economic environments. Conviction on the direction of rates is low, but our conviction on volatility is high. Oil at \$150-\$200 is plausible if the conflict worsens, which would push rates higher. A sharp global slowdown is also plausible, pushing rates lower.

Regardless of the path, the first quarter was a strong reminder that risk and return are linked. Preservation of capital is perhaps the most critical role bonds can play in a portfolio amidst volatility and uncertainty. As always, our focus is on quality securities, active management of fixed income risks, and capitalizing on opportunities when the return (yield) is appropriate for the risk taken.

Bond Concepts: Liquidity Risk

Picture this: you're in a bustling room filled with people, and there's only one exit. Now, imagine if all these people suddenly needed to leave at once. Those near the exit would manage fine, but it would be a chaotic struggle for everyone else. Think of bond liquidity as the number of available exits in the room. When a security is highly liquid, investors can come and go without a hitch. When liquidity tightens, it's like a crowd of investors attempting to squeeze through a single door.

Unlike equities, where trading is centralized and continuous, bond liquidity varies widely by sector, structure, and even individual CUSIP. When markets are stressed, bid-ask spreads widen, dealers step back, and securities with limited natural buyers can behave like a crowded room with too few exits.

The rise of private credit adds another layer. These loans may offer attractive yields, but many are idiosyncratic, thinly traded, and rely on periodic marks rather than observable

trading levels. In a risk-off environment, that can delay price discovery and compress optionality at precisely the wrong time. Not only does the room have too few exits, but now it's going to cost you extra when you do find the exit.

For advisors and investors, the key is recognizing that liquidity risk isn't just theoretical. It can have a meaningful impact on returns if timed improperly. To assess liquidity, ask yourself:

- **How easily can you sell or redeem?** Public markets offer varying degrees of liquidity; private credit is intentionally less liquid to prevent forced selling.
- **What drives liquidity in this sector?** Assess market size, homogeneity of structures, and the dependence on dealer balance sheets or valuation marks.
- **Are you being compensated for the risk?** A higher liquidity premium doesn't automatically equate to better value.





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In addition to the ongoing market risk applicable to portfolio securities, bonds are subject to interest rate risk, credit risk and inflation risk. When interest rates rise, bond prices fall; generally, the longer a bond's maturity, the more sensitive it is to this risk. Credit risk is the possibility that the issuer of a security will be unable to make interest payments and repay the principal on its debt. Bonds may also be subject to call risk, which allows the issuer to retain the right to redeem the debt, fully or partially, before the scheduled maturity date. Proceeds from sales prior to maturity may be more or less than originally invested due to changes in market conditions or changes in the credit quality of the issuer.

Diversification does not assure a profit or protect against loss in a declining market.

Bond ratings are grades given to bonds that indicates their credit quality as determined by a private independent rating service such as (Standard & Poor's or Moody's, etc.) The firm evaluates a bond issuer's financial strength, or its ability to pay a bond's principal and interest in a timely fashion. Ratings can be expressed as letters ranging from 'AAA', which is the highest grade, to 'D', which is the lowest grade.

Basis point: one-hundredth of a percent.

Bond Spread: the difference between yields on differing debt instruments of varying maturities, credit ratings, and risk, calculated by deducting the yield of one instrument from another.

Duration: a measure of the sensitivity of the price of a bond or other debt instrument to a change in interest rates. Duration measures how long it takes, in years, for an investor to be repaid the bond's price by the bond's total cash flows.

Federal funds rate: the target interest rate range set by the Federal Open Market Committee (FOMC) for banks to lend or borrow excess reserves overnight. It influences monetary and financial conditions, short-term interest rates, and the stock market.

Volatility: the degree of variation of returns for a given security or market index.

Bid-Ask Spread: The difference between the price a buyer will pay (bid) and the price a seller will accept (ask) for a security.

Yield Curve: A graph showing the various yields of similar types of securities that vary in their maturity dates. A flat yield curve is one in which short-term bonds have yields similar to longer bonds.

Consumer Price Index (CPI): a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services.

Producer Price Index (PPI): a family of indexes that measures the average change over time in selling prices received by domestic producers of goods and services.

Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only, and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance.

ICE BofA US Corporate Index: tracks the performance of USD-denominated investment grade rated corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P, and Fitch), a fixed coupon, and greater than 1 year of remaining maturity.

The CME Group 3-Month SOFR Dec 2026 futures contract: a quarterly interest rate futures contract that represents the market's expectation of the average secured overnight financing rate over a specific three-month period.

