Frontier International

Credit where credit's due – active management in global fixed income

September 2026

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Frontier Advisors
Forefront Thinking

About us

Frontier Advisors has been at the forefront of institutional investment advice in Australia for over thirty years and provides advice on $920 billion of assets across the superannuation, charity, public sector, insurance and university sectors.

Our purpose is to empower our clients to advance prosperity for their beneficiaries through knowledge sharing; customisation; technology; and an alignment and focus that is unconstrained by any product conflicts.

Iain McMahon

Head of Defensives & Alternatives

Iain McMahon joined Frontier Advisors in 2019 and is the Head of Defensives & Alternatives. Iain is responsible for investment strategy, portfolio construction, derivatives advice and manager research across debt, currency, alternatives and multi-asset derivatives. Prior to joining Frontier, Iain spent eight years at J.P. Morgan in a range of investment functions. Four of these years were based in London providing quantitative and qualitative portfolio analysis as a Market Risk Manager. He holds a Bachelor of Commerce (Finance) and a Bachelor of Science (Statistics) from the University of Melbourne. He is also a CFA® charterholder and a certified Financial Risk Manager (FRM).

Atharv Seth

Consultant

Atharv Seth is an Investment Consultant at Frontier Advisors, where he works across the defensives, alternatives research, and client consulting teams. Atharv has over four years of experience in financial markets. Before joining Frontier in August 2025, he worked as an equity analyst covering ASX-listed stocks for institutional investors. Before that, he was an Investment Analyst at Zenith Investment Partners, specialising in fund manager research across Australian and Global equity strategies. Atharv holds a Bachelor of Commerce (Finance) from the University of Melbourne and is a CFA® charterholder.

Introduction

In May, Frontier's defensive and private markets team members, Iain McMahon and Andrew Kemp, met with fund managers across London, New York, Boston, Charlotte and Los Angeles.

The trip came at an important time for liquid investment-grade fixed income. All-in yields have risen materially, but inflation remains uncertain, geopolitical risks are abundant and investment-grade credit spreads are near historical lows. The level of artificial intelligence related debt issuance has also accelerated rapidly.

This creates a better starting point for bond investors, but also a more complex risk environment. Higher income is helpful, but the margin of safety from credit spreads appears limited.

The consistent message from managers was that income and carry, rather than large directional duration positions, are likely to be the more reliable return drivers in this environment. However, the income cushion does not remove the need for selectivity while credit spreads remain tight.

Against this backdrop, the trip explored how active managers are positioning portfolios, how to balance improving fundamentals versus deteriorating valuations, where the balance of risks and opportunities lies and whether investors' expectations for excess return should be tempered.

This paper examines the key return drivers for Frontier's Liquid Core Fixed Income Peer Group and considers whether active management is more conducive to investors seeking resilient fixed income outcomes.

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Part 1: The passive investor

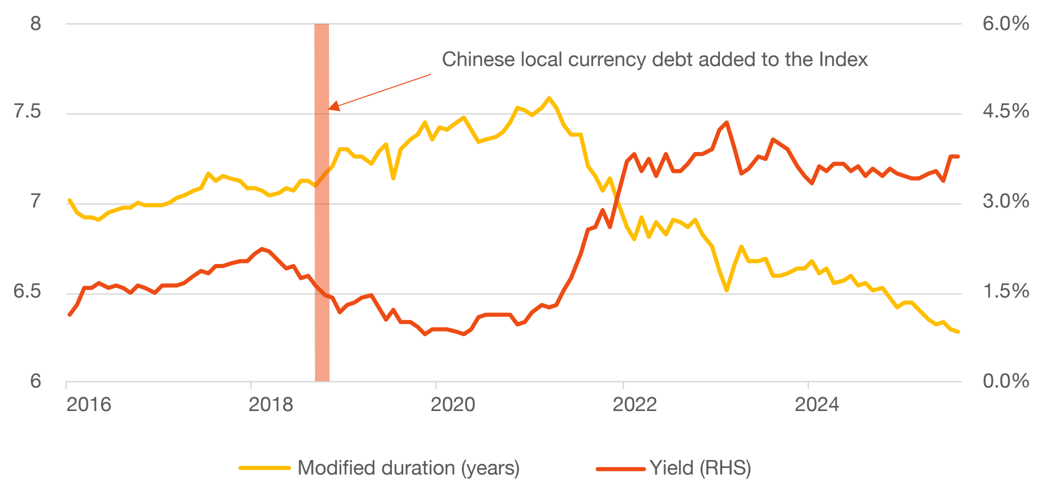
After years of near zero yields, bonds are again offering meaningful income.

The Bloomberg Global Aggregate Index remains the main benchmark for global investment-grade bond markets and, for many passive investors, the core building block of fixed income exposure.

One notable change over the past decade was the inclusion of China's renminbi-denominated government bonds, completed over the 20 months to November 2020.

As Chart 1 shows, index yields are now near ten-year highs, while modified duration, a measure of sensitivity to yield changes, has gradually declined.

Chart 1: Bloomberg Global Aggregate Index – yield versus duration

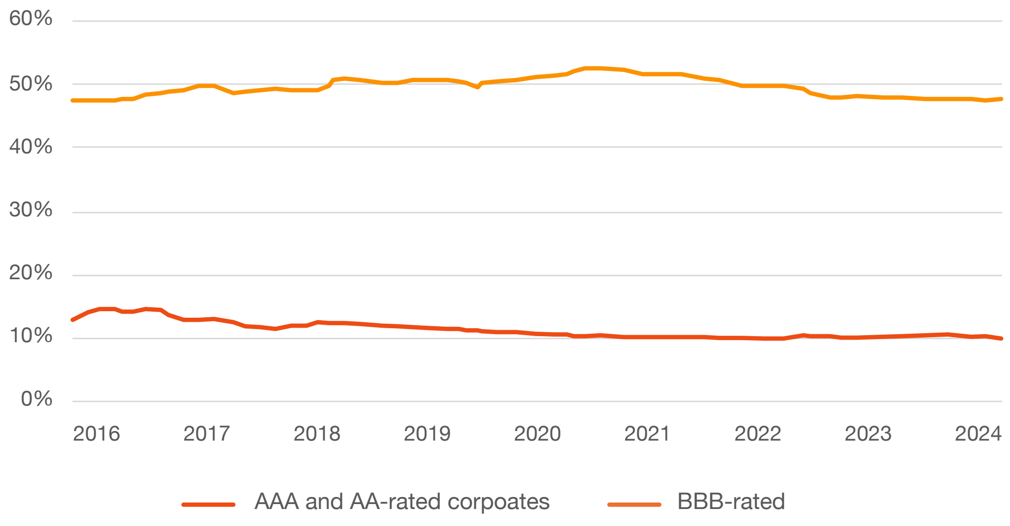


Source: Frontier Advisors, Bloomberg, data as of May 2026

Investors are therefore being paid more income for each unit of interest rate risk than they have received for much of the past decade.

Importantly, higher yields have not come at the expense of benchmark credit quality. As Chart 2 shows, the overall credit quality mix has remained broadly stable over the same period.

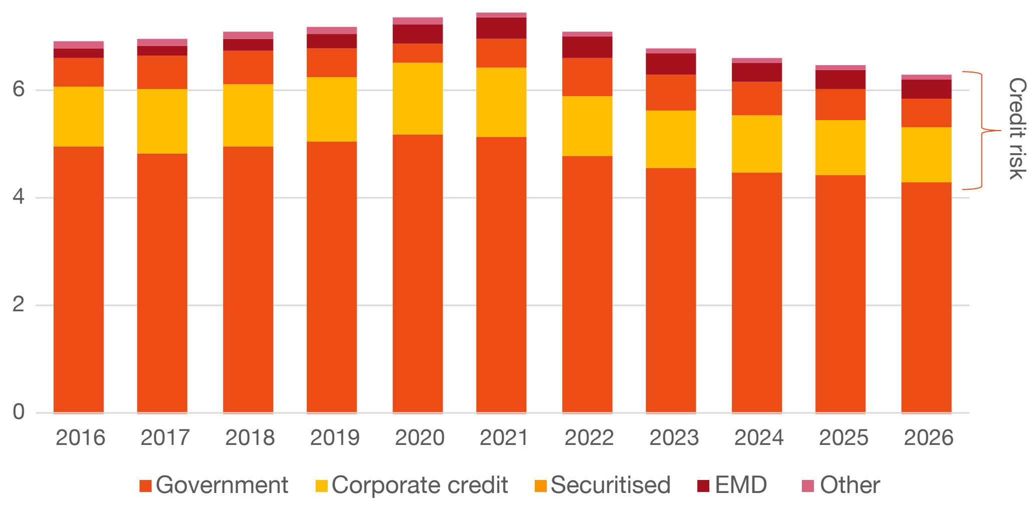
Chart 2: Bloomberg Global Aggregate Index – credit quality



Source: Frontier Advisors, Bloomberg, data as of December 2025

Nor has the yield uplift been driven by a material extension in credit spread duration, which has remained broadly stable over the past decade, as shown in Chart 3.

Chart 3: Bloomberg Global Aggregate Index – contribution to modified duration (years)



Source: Frontier Advisors, Bloomberg, data as of January 2026

These trends are positive, but there is an important caveat – the rise in all-in yields has been driven entirely by higher government bond yields. Credit spreads remain near decade lows, despite broadly stable credit risk at the index level, as shown in Chart 4.

Chart 4: Bloomberg Global Aggregate – credit spread (bps)

Source: Frontier Advisors, Bloomberg, data as of June 2026

The key risk from here is a normalisation in credit spreads, which would erode some of the higher yield investors are now receiving. For passive investors, this risk is concentrated in investment-grade corporate credit, the largest contributor to benchmark credit risk.

Frontier also asked active managers whether the Bloomberg Global Aggregate Index has become increasingly inefficient. The main concern was the growing concentration of US dollar-denominated debt.

Managers generally viewed this concentration as an active opportunity rather than simply a benchmark risk. Most expected the US component to lag the rest of the benchmark and were seeking relative value across countries, curves and sectors rather than relying on a broad duration position.

We have summarised some of the managers responses below.

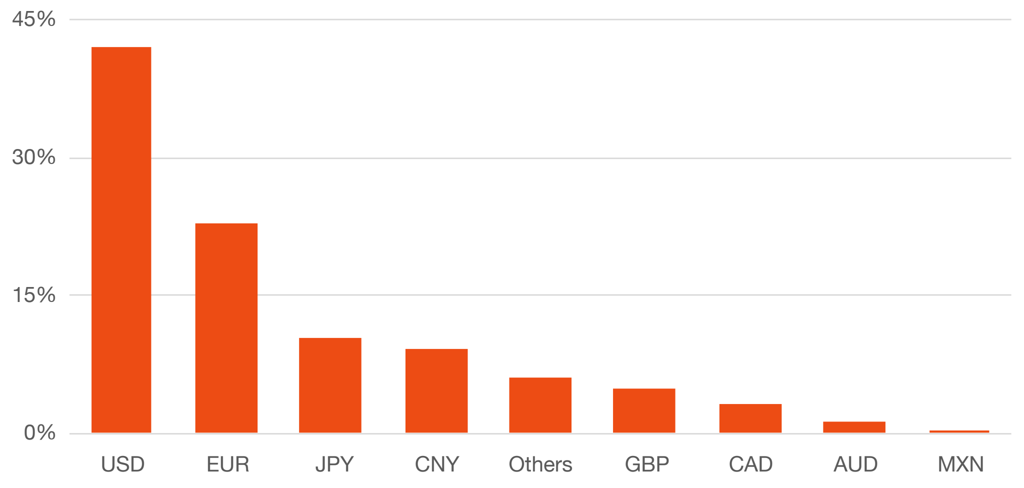
> Emerging markets now represent nearly 30% of global bond markets (up from ~8% in 2003) yet remain underrepresented at around 10% of global aggregate indices, with China accounting for almost two-thirds of that share. The Index reflects today's debt structure, but not the full breadth of opportunities across regions, sectors, or issuers.

> Market-cap weighting hands the largest weights to the most indebted sovereigns — the US, the clearest example, as fiscal deficits mechanically increase Treasury issuance and index weight exactly as the risk/reward of that duration deteriorates. Rising G3 sovereign concentration is crowding out the diversification benefit the index originally offered.

> The Index's makeup has drifted: US Treasuries now carry a larger weight, while mortgage-backed securities (MBS) have seen their share decline.

For passive investors, this is another key risk. As shown in Chart 5, US dollar-denominated debt now accounts for approximately 40% of benchmark duration risk, meaning outcomes are increasingly tied to the US economy and its rising debt burden.

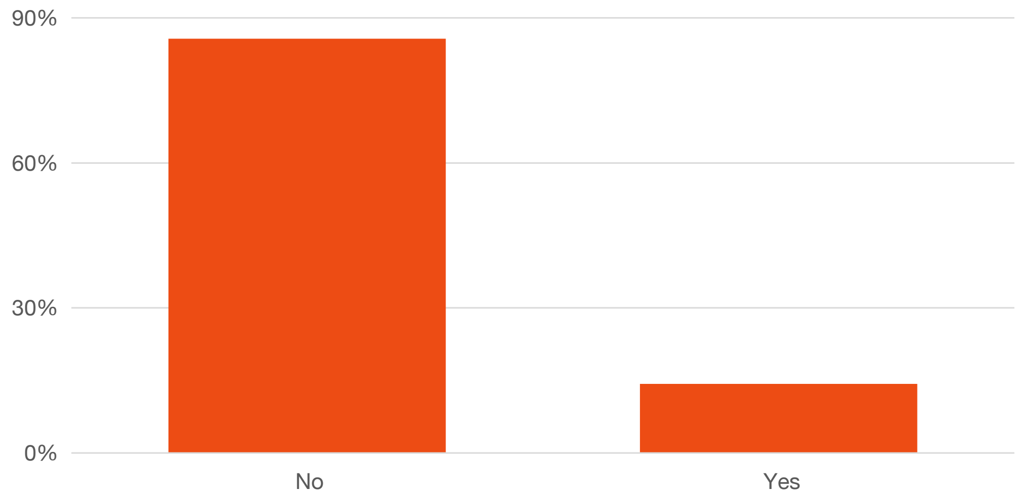
Chart 5: Bloomberg Global Aggregate – regional contribution to modified duration



Source: Frontier Advisors, JPMAM, data as of December 2025

Most active managers surveyed expect the US component of the Global Aggregate Index to underperform the rest of the benchmark over the next 12 months, as shown in Chart 6.

Chart 6: Will the US Aggregate Index (US$ hedged) outperform the Global Aggregate (US$ hedged) over the next 12 months?



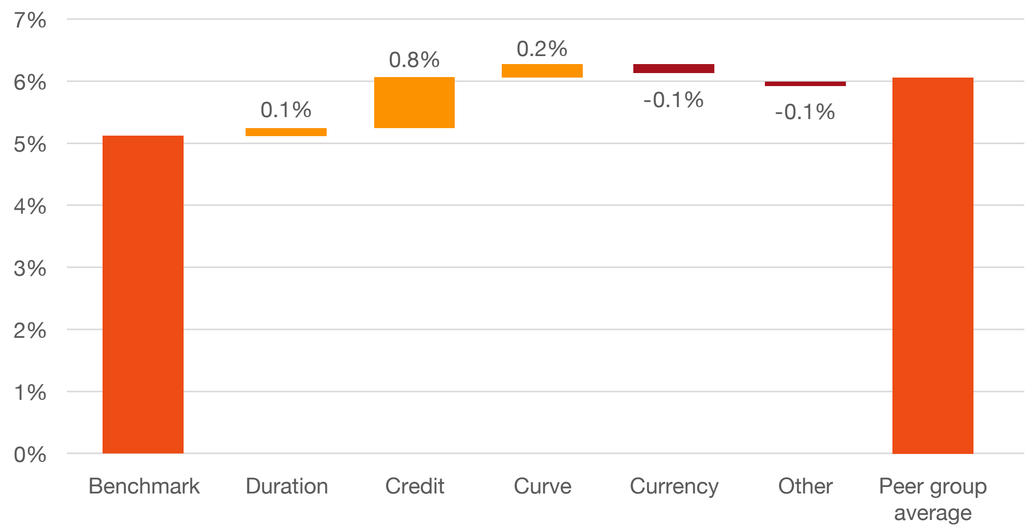
Source: Frontier Advisors, data as of June 2026

Part 2: The active investor

What has this environment meant for active global bond managers?

The average manager in Frontier's peer group has outperformed the Bloomberg Global Aggregate Index by around 100 basis points over the most recent three-year period. As Chart 7 shows, most of this excess return came from credit selection and allocation.

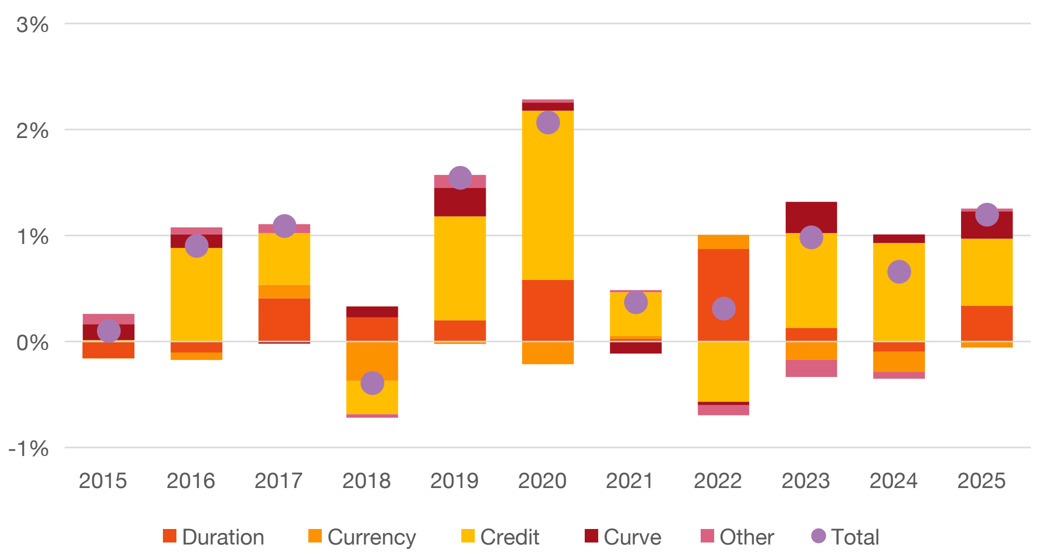
Chart 7: Average manager – three-year performance attribution



Source: Frontier Advisors, fund managers. Benchmark: Bloomberg Global Aggregate (US$ hedged), data as of 31 December 2025

The longer-term pattern is similar. Since 2015, the average manager has outperformed the benchmark in every calendar year except one, with excess returns driven almost entirely by credit selection, as shown in Chart 8.

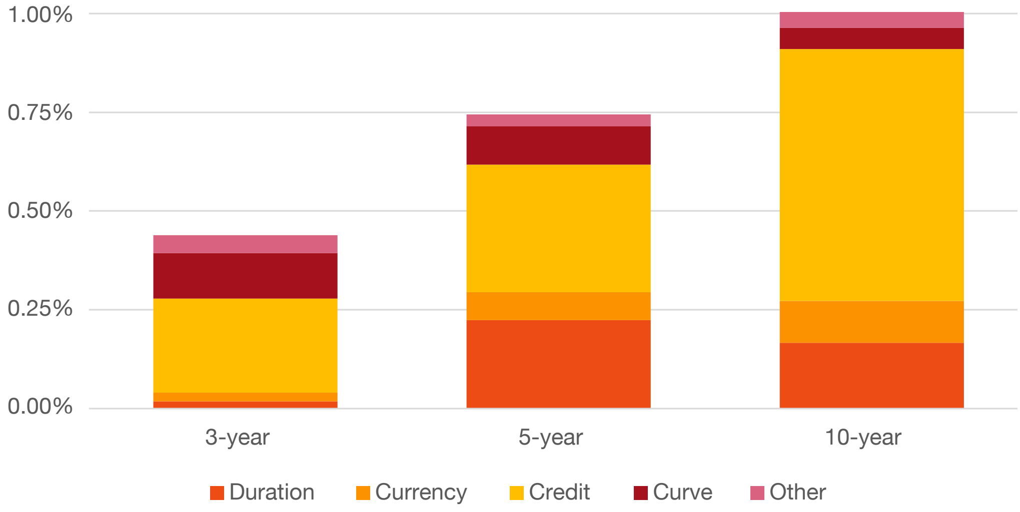
Chart 8: Excess return drivers for average global aggregate manager



Source: Frontier Advisors, fund managers. Benchmark: Bloomberg Global Aggregate (US$ hedged).
Manager count 9 as of December 2025

This reflects where managers take active risk. As Chart 9 shows, most active risk has come from credit, with credit accounting for an even larger share over the most recent three-year period.

Chart 9: Sources of tracking error for average global aggregate manager

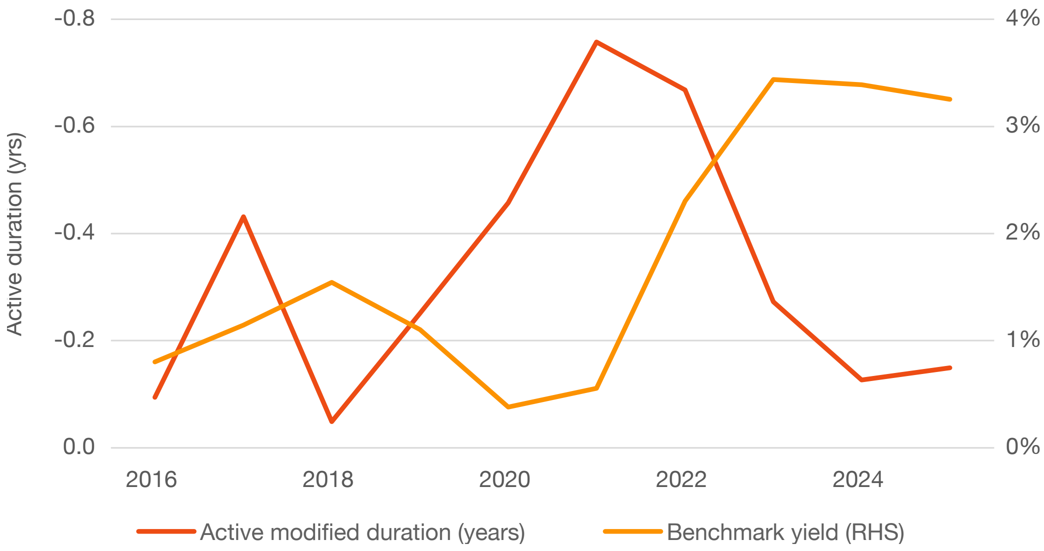


Source: Frontier Advisors, fund managers. Benchmark: Bloomberg Global Aggregate (US$ hedged), data as of December 2025

Managers have also reduced their active duration underweight, which reached roughly one year in 2022 and has since moved back toward neutral, as shown in Chart 10. This has reduced the deviation from benchmark returns.

This was consistent with the discussions held during the trip. Managers were less willing to rely on a single directional rates view and instead emphasised carry, curve positioning and smaller, higher-conviction duration trades.

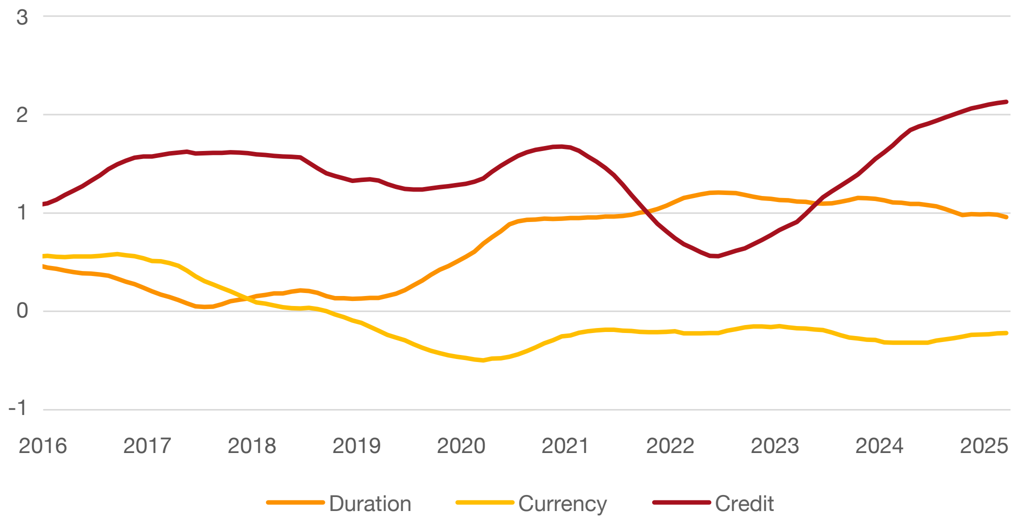
Chart 10: Active duration (years) for Frontier Global Aggregate Manager Peer Group versus benchmark yields



Source: Frontier Advisors, data as of December 2025

The average global aggregate manager has also reduced active currency risk. This reframing has coincided with the recent US dollar inflection and historically delivered weaker risk-adjusted returns, as shown in Chart 11.

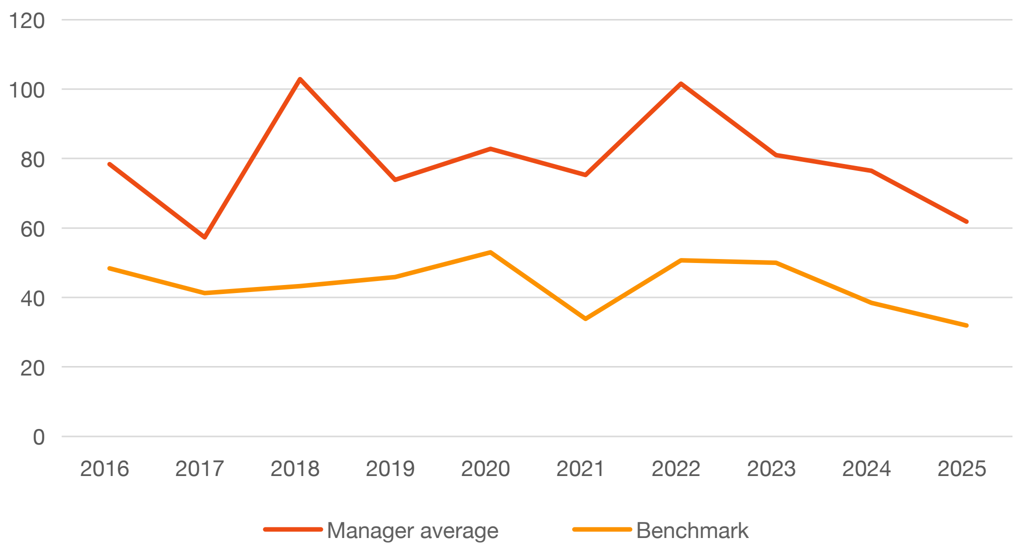
Chart 11: Average manager – rolling five year information ratio



Source: Frontier Advisors, fund managers. IR calculated on a standalone basis

Active risk has also declined over the longer term, with credit contributing most to the fall in tracking error. However, this appears to reflect lower credit spread volatility rather than a meaningful reduction in credit positioning. As Chart 12 shows, the average option-adjusted credit spread above the benchmark for active global bond managers has remained broadly stable over the past decade, despite tighter market-wide credit spreads.

Chart 12: Frontier Global Aggregate Peer Group versus benchmark – option-adjusted spread (bps)

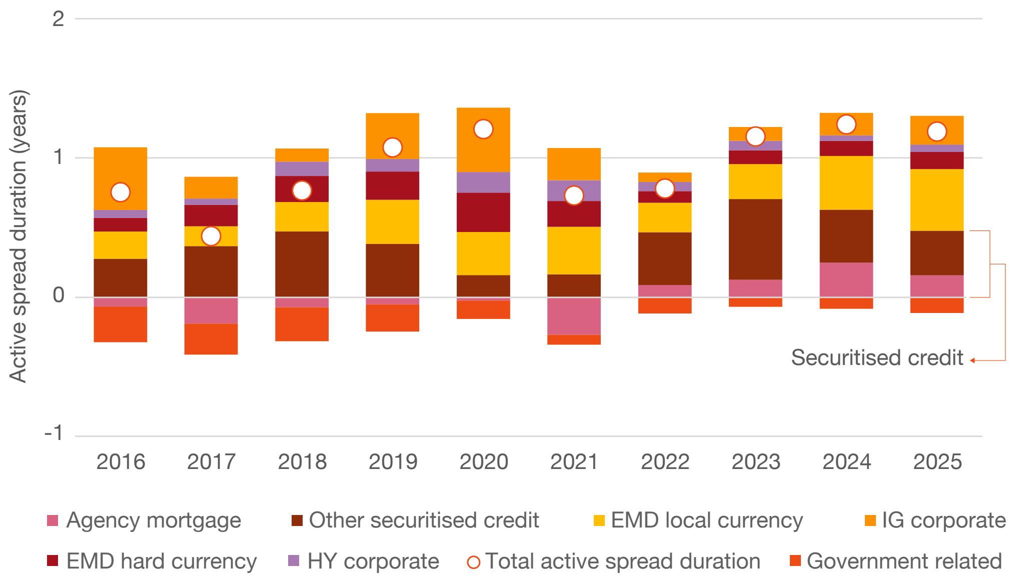


Source: Frontier Advisors, fund managers. Benchmark: Bloomberg Global Aggregate (US$ hedged), data as of December 2025

While the average spread above the benchmark has remained broadly stable, the credit positioning of the average active manager has changed materially. This reflects the change in sectors from which managers source active credit risk. Compared with 2016, managers are now sourcing more active risk from securitised credit and local currency emerging markets debt.

Chart 13 illustrates the composition of active credit risk for the Frontier Global Aggregate Manager Peer Group.

Chart 13: Average manager – active credit risk composition



Source: Frontier Advisors, fund managers. Annual data as of December 2025

Many active managers appear to have balanced valuation discipline with supportive credit fundamentals. They have also rotated portfolios toward sectors where valuations look more attractive, such as emerging market debt, and away from areas where spreads are tighter, such as corporate bonds.

The common theme was not a broad preference for credit at any price. Managers focused on contractual income and sectors with stronger relative value, while retaining liquidity and the capacity to add risk when dislocations emerge.

In our view, this balance between fundamentals, valuations and sector rotation has been the key driver of excess returns and an important source of differentiation between top- and bottom-quartile active managers.

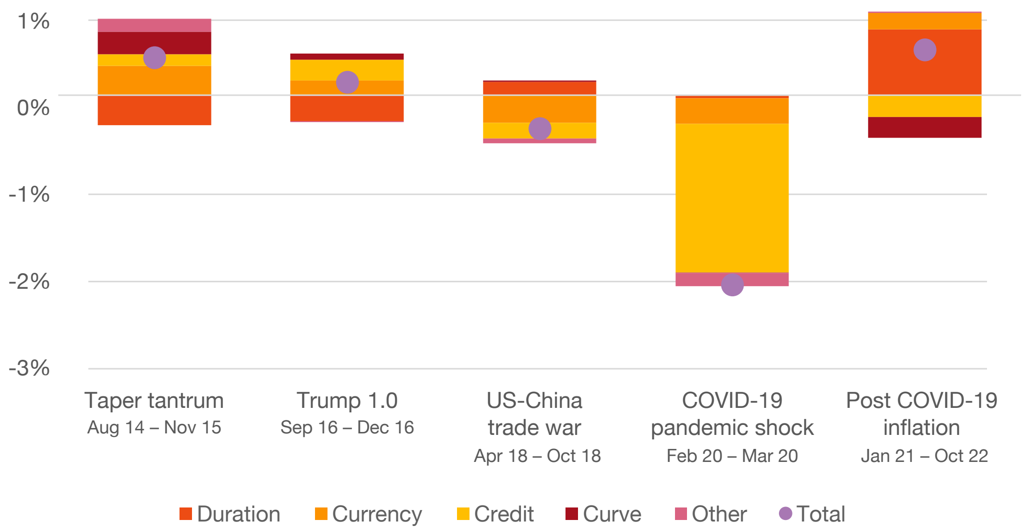
Overall, the average manager has delivered consistent out performance, primarily through credit selection. Credit has also contributed meaningfully on a risk-adjusted basis, with a standalone information ratio above 1x over the past ten years.

This is positive, but it raises an important question: what does it mean for downside protection? Credit risk typically moves with equity risk, reducing its defensive value when equities sell off. During the trip we noted a reduced concern over this aspect particularly given the bulk of the new debt issuance was from the government sector, an area most managers were prudently minimising allocations toward. Furthermore, even with higher credit exposure, the average manager has remained reasonably anchored to the benchmark during most periods of equity stress. COVID-19 was a notable exception, highlighting that the speed and severity of each sell-off can materially affect active returns.

We generally perceive the credit risk premia to be an additive and reliable source of alpha. This tailwind is widely utilised by active managers and has generally been suitably managed throughout periods of market stress (mitigating material downside and liquidity imposts). The successful management of active credit is inherent in using other sources of alpha for diversification. This is another hallmark of Frontier's perceived top quartile managers.

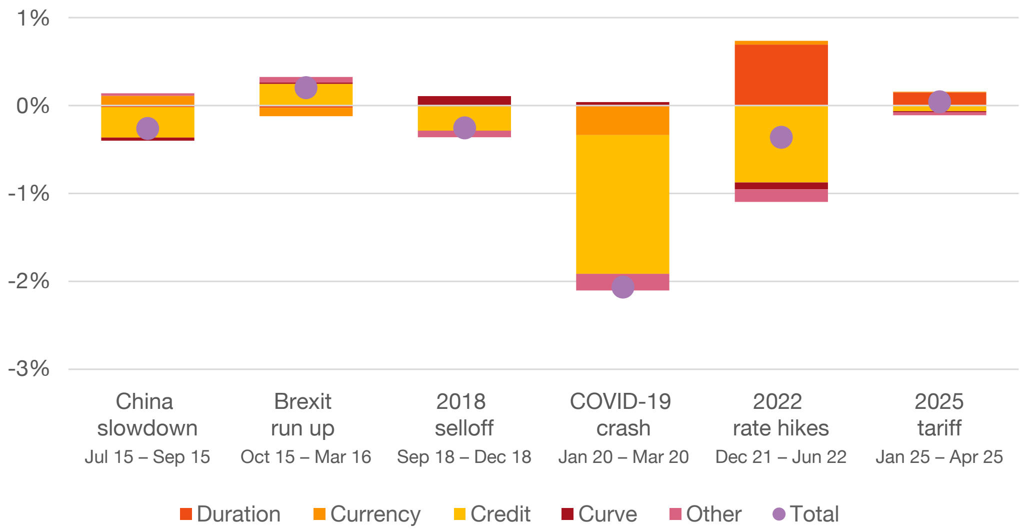
As Charts 14 and 15 show, the average active global aggregate manager has generally outperformed during bond market drawdowns but added less value during equity-led selloffs.

Chart 14: Average manager – excess returns during global bond market stress



Source: Frontier Advisors, fund managers. Bond market stress periods are defined as episodes with a drawdown exceeding 2%, measured from peak to trough

Chart 15: Average manager – excess returns during global equity market stress



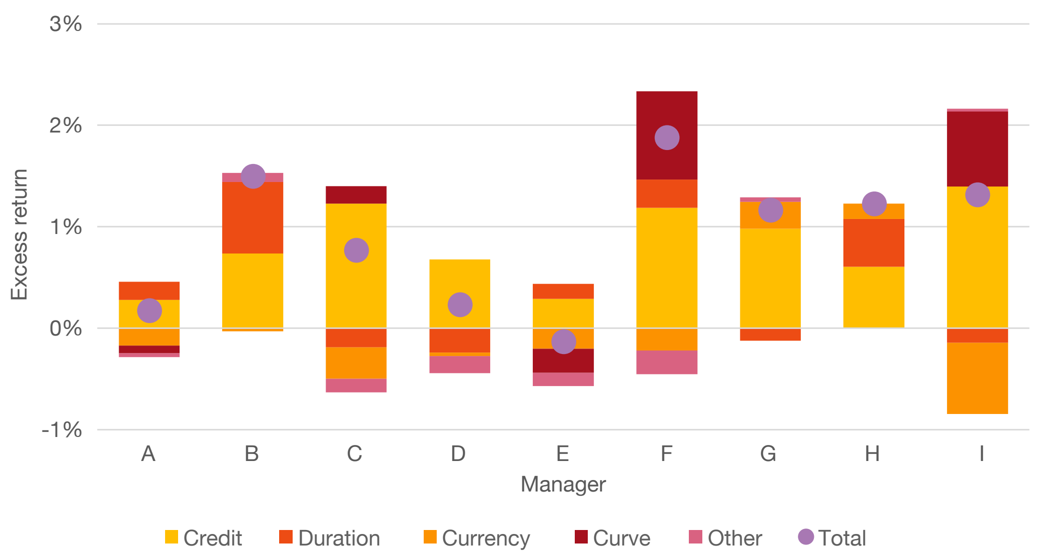
Source: Frontier Advisors, fund managers. Equity market stress periods are defined as episodes with a drawdown exceeding 5%, measured from peak to trough

Part 3: What differentiates the best from the rest?

The analysis so far has focused on the average outcome across Frontier's Active Global Bond Manager Peer Group.

Credit selection has been the dominant driver of excess returns for almost all managers over the most recent three-year period. In other words, the average result is not masking wide dispersion across managers, as shown in Chart 16.

Chart 16: Frontier Global Aggregate Peer Group – three year excess return drivers



Source: Frontier Advisors, fund managers. Benchmark: Bloomberg Global Aggregate (US$ hedged), data as of December 2025

Top quartile managers have also added value through curve trades and duration decisions. However, fewer generated positive excess returns from active currency positioning, highlighting the difficulty of using it as a consistent source of returns.

This raises an important question: if managers are generating excess returns from similar sources, mainly credit selection, what is the benefit of holding more than one manager in a core fixed income portfolio? Put differently, does appointing multiple managers duplicate the same active exposures?

This doesn't appear to be the case, with the median pairwise correlation of excess returns across Frontier's peer group being 0.3, with correlations ranging from -0.5 to 0.7. This suggests multi-manager global bond portfolios can still provide diversification benefits. Some manager pairings also have negative correlations, which can improve risk-adjusted returns. Table 1 shows the full correlation matrix.

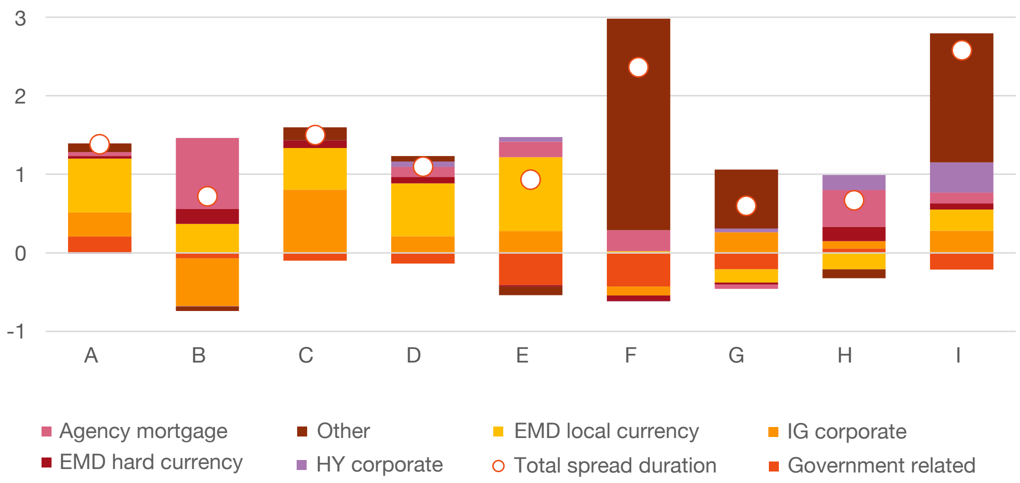
Table 1: Pairwise correlations between Frontier's Active Global Bond Manager Peer Group

	A	B	C	D	E	F	G	H	I
A	1.00	0.19	0.04	0.26	-0.17	-0.01	0.09	0.35	0.22
B	0.19	1.00	0.42	0.56	0.08	0.44	0.18	0.22	0.61
C	0.04	0.42	1.00	0.39	0.59	0.41	0.35	-0.16	0.73
D	0.26	0.56	0.39	1.00	0.15	0.36	0.09	0.07	0.40
E	-0.17	0.08	0.59	0.15	1.00	0.56	0.57	-0.50	0.39
F	-0.01	0.44	0.41	0.36	0.56	1.00	0.66	-0.24	0.45
G	0.09	0.18	0.35	0.09	0.57	0.66	1.00	-0.31	0.26
H	0.35	0.22	-0.16	0.07	-0.50	-0.24	-0.31	1.00	-0.25
I	0.22	0.61	0.73	0.40	0.39	0.45	0.26	-0.25	1.00

Reading the matrix: orange shading indicates a positive correlation and blue a negative correlation; deeper shading reflects a stronger relationship. Values range from –1.00 to 1.00. Three year, monthly returns, as of December 2025

This partly reflects how managers source active credit risk. Chart 17 shows the sectors from which managers derive their active credit spread duration.

Chart 17: Frontier Global Aggregate Peer Group – sector contribution to active spread duration (years)



Source: Frontier Advisors, fund managers. Benchmark: Bloomberg Global Aggregate (US$ hedged). Three year average spread duration. Data as of 31 December 2025

While most managers were similarly positioned on overall credit spread duration, the underlying sources of active risk differed materially across the peer group. Diversification (and balance) of active risk remains a critical feature of Frontier's preferred active fixed income managers.

Manager discussions also reinforced that quantitative tools are generally supporting, rather than replacing, fundamental judgement. The stronger processes combined common macro and valuation inputs with clear portfolio manager accountability for security selection and portfolio construction.

Manager perspectives: Consensus and contrarian market themes

The discussions included active global aggregate managers and specialists in global credit, private credit, asset-based finance and real estate.

The specialist views provide broader market context but are not representative of Frontier's Global Aggregate Peer Group.

The main consensus was that higher yields favour income and carry, while tight corporate spreads require greater selectivity. Macro views generally favoured moderate growth and broadly stable policy rates, but managers also identified slowing activity, consumer and employment risks, fiscal pressure and uneven lower-quality credit outcomes. Several considered geopolitical risk to be underpriced, supporting liquidity and capacity to add risk after dislocations.

Global aggregate managers were generally less reliant on large duration positions, preferring country, curve and relative-value trades. They also identified opportunities outside rich corporate credit, including securitised assets, agency mortgage-backed securities and local currency emerging markets debt. Concern about the growing US dollar concentration of the benchmark was another recurring theme.

Outside liquid investment grade fixed income, private credit was not generally viewed as a systemic risk, although managers expected wider dispersion across vintages and greater pressure from leverage, payment-in-kind income and refinancing. Asset based financing (ABF) managers emphasised secured, contractual cash flows and control over origination, while acknowledging competition may compress returns. Real estate views were selectively constructive due to constrained supply and price dislocation, particularly through residential and commercial real estate debt.

The main contrarian view was that government bond yields are attractive enough to justify longer duration, particularly in Europe relative to the US, alongside lower spread exposure and greater agency mortgage-backed securities exposure. Some managers also viewed selected emerging market issuers as fundamentally stronger than similarly rated developed market issuers.

The final word

For many investors, the Bloomberg Global Aggregate Index remains the core building block for global investment-grade fixed income exposure.

For investors considering reducing growth-asset risk, passive exposure to the Global Aggregate Index is more attractive than it has been for much of the past decade. All-in yields are higher, interest-rate risk is lower and benchmark credit quality has remained broadly stable.

However, the rise in yields has been driven mainly by higher government bond yields. With credit spreads near historical lows and benchmark duration risk increasingly concentrated in US dollar-denominated debt, passive investors are being paid more income but are also carrying a more concentrated set of risks.

This is where active management can play an important role. Frontier's Active Global Bond Manager Peer Group has delivered consistent excess returns relative to the Bloomberg Global Aggregate Index, with credit selection and allocation the main sources of value. The key implication for investors is not simply that active managers have taken more credit risk, but that better managers have been more selective about where they take it, rotating toward sectors with more attractive valuations and managing downside risk through diversification.

The paper also shows that multi-manager portfolios can still add value. While many managers generate returns from similar headline sources, the underlying exposures can differ materially. Moderate correlations across managers and different sources of active credit risk suggest investors can improve portfolio resilience by combining complementary managers rather than simply appointing multiple managers with similar exposures.

Overall, the case for active management in global fixed income is strongest when investors are clear about the role bonds are expected to play. Higher yields make the asset class more compelling, but tight spreads, benchmark concentration and uneven downside protection mean manager selection remains critical. In Frontier's view, investors should favour active fixed income managers with disciplined credit selection, diversified sources of alpha and a demonstrated ability to balance income generation with portfolio resilience.

Learn more

If you are interested in learning more, please reach out to your consultant or a member of the Defensive Assets and Alternatives Team.

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