LM CAPITAL GROUP

GLOBAL FIXED INCOME MANAGEMENT

LM Capital Group Perspectives

Investment Insights
1Q 2026

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A New Conflict Arises

It's been a volatile ride so far this year for investors as markets were thrashed by a number of continued cross currents. Attention turned to tariffs once again after the U.S. Supreme Court ruled against Trump's use of the International Economic Emergency Powers Act (IEEPA) to justify the "reciprocal" tariffs announced in 2025. The administration quickly implemented a flat 10% tariff on all imports in response to which markets took relatively in stride.

More importantly, geopolitical tensions ratcheted higher with the war in Iran significantly impacting oil and gas supply, with particular focus on the 21-mile wide Strait of Hormuz. Yields across the curve ended higher, though they spent all of February trending down about 30bps, as markets focused on upside inflation risks than downside risks to growth. Trades that had been popular prior to the conflict unwound, most notably with gold and emerging markets falling while the Dollar rallied.

The Federal Reserve's inflation model approximates every $10 increase in oil prices pushes inflation up by 0.35%. Using that as a roadmap, a conflict ranging three to six months that pushes oil to $100 per barrel would bring further inflationary pressure to the economy of +1.4%. The longer the conflict, the higher the oil prices and the more direct readthrough into inflation. It can take time to affect consumer behavior and trickle into the data, which means if the disruption is brief, the impact can be limited. The good news is, as a net energy exporter, the U.S. is somewhat more insulated from the spike in energy prices than its European and Asian counterparts.

(If you missed our two short white papers on these issues, you can find them here: Research Write Up: Oil and Conflict, Conflict and Natural Gas)

WTI

Source: Bloomberg

The cooling US labor market should also help to keep price pressures at bay. Following a strong January print, non-farm payrolls shrunk by -92,000 in February (vs. consensus expectations for a 60,000 increase). In March, the Federal Open Market Committee (FOMC) left the Fed funds rate unchanged but maintained its outlook for one rate cut this year as we approach the onset of Chairman Powell's exit.

Sector Recap

The US dollar gained 1.67% this quarter, its third straight positive quarter after a rough start to 2025. The U.S. Treasury (-0.04%), Mortgage-Backed Securities (+0.40%) and Government Agency (+0.23%) sectors beat the benchmarks total return of -0.05% this quarter. The US Corporate (-0.54%), Emerging Market Debt (-1.35%), High Yield (-0.50%) and Non-Dollar (-1.87%) all lagged the benchmarks return.

Market Outlook

The focus of the fixed-income market has shifted from the Federal Reserve to the Middle East. Investors have plenty to worry about, including long-lasting damage to energy and industrial facilities. Curtailed supplies of crude oil, refined products, and LNG are the obvious concerns, but shortages of sulfuric acid and helium will prove to be headaches to some key industries. One of the more complex issues to analyze is the impact of increased energy prices on agricultural planting, and in turn, on global inflation.

By most accounts, any US inflation from the Middle East problems will be considered transitory by the Fed. US energy production appears to largely insulate the US economy from major energy supply shortages, aside from diesel fuel. So, no rate hikes will be needed to rein in that inflation. The market is leaning towards "rate hikes or cuts someday, but not anytime soon".

In the long-term, we remain concerned about weaker demand for the US dollar from international investors. However, the US should largely be spared from the headwinds facing much of the rest of the world. For a time, worries over international currency flows should abate.

We continue to worry about the impairment of purchasing power in the US from the Middle East spillover to US inflation. The US economy appears to be strong, but not too strong. Spending on data centers and the reshoring of manufacturing facilities should support continued US growth. And in the back of many minds, there is concern about continued changes in tariffs and about potential delays to the confirmation of Kevin Warsh as the new Federal Reserve Chair.

For April, we are maintaining our cautious stance, with portfolio durations close to those of the benchmark indices. Durations are generally 1-2% shorter than the benchmark indices, and, where appropriate, we remain underweight in long-duration credit exposure by favoring U.S. Agency MBS sector exposure instead. We are positioned for a yield curve steepening as the spread between short-term and long-term rates widens. We continue to maintain non-dollar-denominated debt in accounts that include that sector in their mandates, despite temporary headwinds facing many international currencies.

We expect positive fixed income returns for 2026, dominated by coupon clipping. If there is a whiff of fear in credit markets, we expect it to be largely offset by lower rates in the US Treasury market. We believe that the risk of a sudden change in market sentiment is relatively high. US Treasury rates and credit spreads have been range-bound with a lack of fear in the markets. We are biased towards adding credit on significant spread widening and changing our key rate duration weightings as the US Treasury market moves.

Pablo Barrientos

Senior Credit Analyst

Emerging Markets 1Q 2026 Review

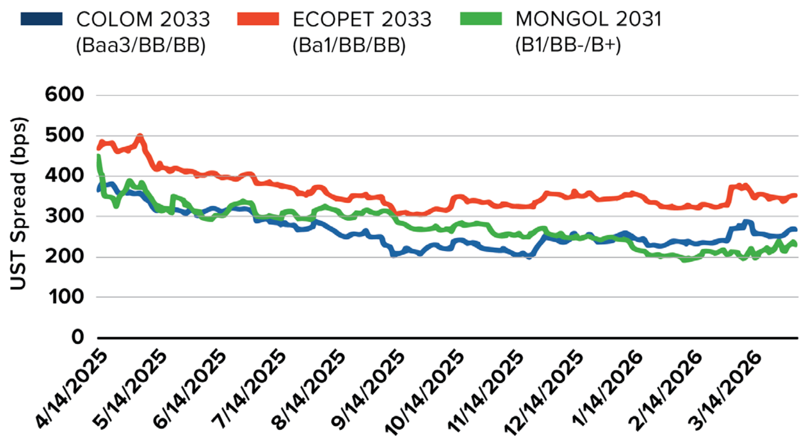
Emerging market debt markets faced a challenging backdrop in the first quarter of 2026. Major fixed-income indexes posted negative total returns, pressured by rising global yields, episodic risk-off sentiment, and volatility stemming from geopolitical tensions around Iran. Against this headwind, a clear theme of differentiation emerged: surging oil prices delivered a powerful tailwind to producers and net energy exporters, while weighing on importers and higher-beta credits more sensitive to inflation and funding costs.

This commodity-driven divergence shaped our positioning and created selective opportunities. Colombia was the quarter's primary focus ahead of the May presidential election. We increased exposure to the sovereign and select oil-linked corporates, drawn by compelling valuations and supportive signals from center-right candidates in polls and betting markets.

Although local-currency debt underperformed during the quarter amid rising US Treasury yields and weaker EM currencies, Colombia proved a notable exception. Persistent inflation pressures prompted the central bank to hike rates by 200 basis points during the quarter, pushing real yields higher and allowing us to add exposure to the Colombian peso at attractive levels.

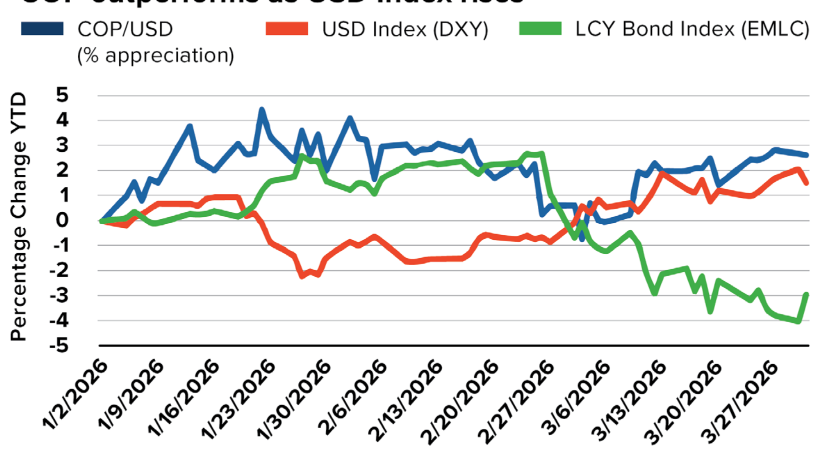
In the Middle East, we selectively reduced exposure to certain sovereign credits while maintaining positions in regional corporates with a focus on energy transmission infrastructure and those benefiting from diversified global operations. This adjustment reflects our preference for credits with resilient cash flows less directly tied to fiscal or geopolitical volatility.

Colombia spreads remain relatively wide ahead of presidential elections



Source: Bloomberg

COP outperforms as USD Index rises



Source: Bloomberg

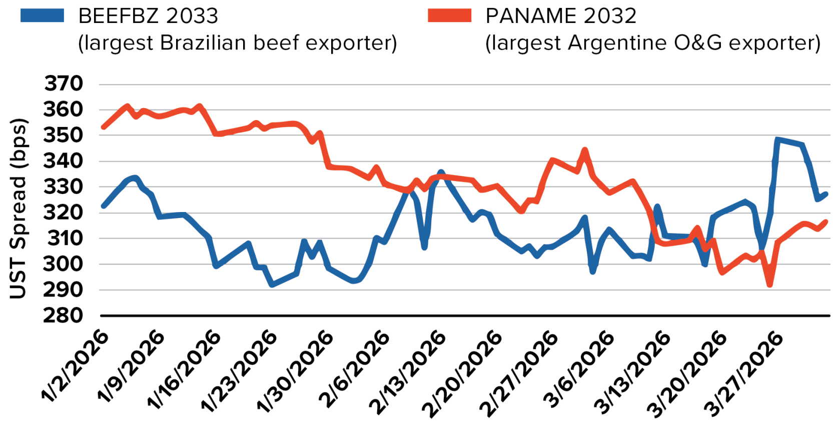
Trade policy provided additional undercurrents. The US-India trade deal helped stabilize tariff expectations for select India-linked exposures. In Mexico, the official launch of USMCA review discussions introduced a new layer of uncertainty while simultaneously opening selective opportunities. In South America, the EU-Mercosur agreement—signed and scheduled for provisional application from May 1—should support greater cross-border flows for regional exporters, with particular benefits expected for Brazilian and Argentine corporates.

Political continuity further bolstered investor sentiment in several markets. In Chile, President José Antonio Kast was inaugurated in March, extending the region's conservative policy shift and reinforcing our constructive view on Chilean assets. In Costa Rica, the ruling party's electoral victory preserved a right-wing, business-friendly policy framework.

China's macro environment remained soft, with investment and consumption subdued despite additional government incentives. Tourism spending showed a modest rebound around Lunar New Year, but we continue to access China-related exposure indirectly through commodity exporters rather than taking direct risk.

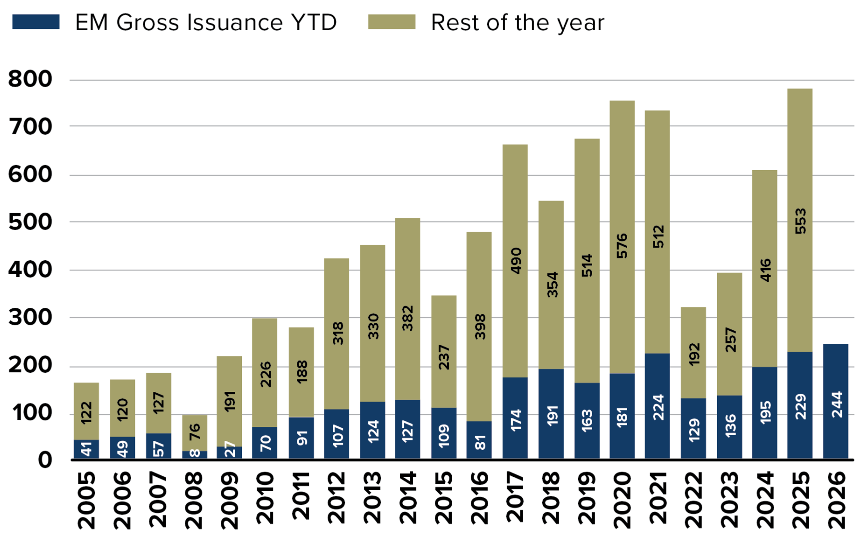
Liability-management activity remained brisk, with several bonds called or tendered during the quarter. This contributed to EM primary issuance reaching a new record for a first quarter. In Latin America, sovereign issuers were particularly active, opportunistically extending near-term maturities at attractive spread levels amid an uncertain interest rate outlook.

Leading exporters trading at attractive spreads



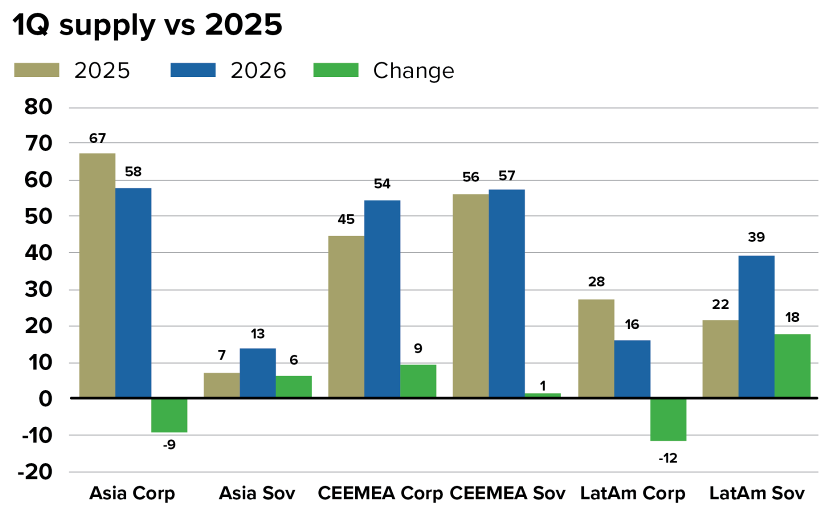
Source: Bloomberg

Record EMD issuance despite market volatility



Source: Bloomberg, Bond Radar

As we move into the second quarter, Colombia's presidential election, the evolution of USMCA negotiations, and developments surrounding the Iran conflict will remain the dominant catalysts. We anticipate continued volatility but expect further opportunities to add to fundamentally resilient, commodity-exposed credits at attractive levels. Our bias remains tilted toward high-conviction, oil-linked producers and jurisdictions demonstrating policy continuity or tangible reform momentum.



Source: Bloomberg, Bond Radar

LM Capital Group Spotlight

This month, LM Capital Group was proud to participate in a panel Delta Sigma Pi at University of San Diego.

Pablo did a fantastic job representing LM as part of a panel of professionals discussing their experiences working in business as minorities and growing a minority-owned firm. He also shared valuable advice with students and recent graduates as they prepare to enter the workforce.

Thank you, Pablo, for representing LM Capital Group so well!

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