

From Oil Shock to Rate Shock: Fixed Income Strategy in an Uncertain 2026

Fixed Income Markets Q1 2026 Commentary



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The first quarter of 2026 marked a fundamental change in the bond market, and global monetary policy driven by the war in Iran. The Middle East conflict has led to a functional closure of the Strait of Hormuz, disrupting not only the flows of oil and liquefied natural gas (LNG) but also other critical commodities such as fertilizers and sulfur. Vessels traveling through the strait have dropped from a daily average of more than 100 before the beginning of the war, to only 2 to 4 per day over the past month. The reverberation of this disruption has sent the price of crude oil from the mid \$60s in the beginning of the year to over \$110 at the end of the first quarter of 2026. The shipping crisis in the Gulf is now the longest supply chain disruption in the history of the global oil market.¹

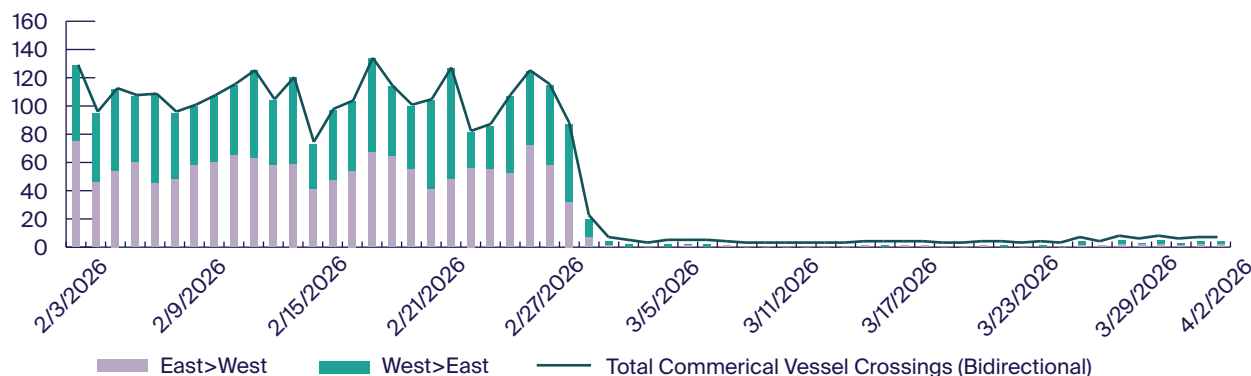
Beyond oil, natural gas is a key input in the production of nitrogen-based fertilizers. The Strait plays a critical role in global agricultural supply chains, with 20 to 30% of globally traded fertilizers transiting through.^{2,3} Additionally, Qatar accounts for a third of the world's helium supply, and the effects are already rippling through global technology supply chains as helium plays a critical role in semiconductor manufacturing. Furthermore, half of all seaborne sulphur trade passes through the Strait as well, an important input to battery chemistry and fertilizers. This broad-based supply shock—spanning energy, agriculture, and industrial inputs—has materially shifted inflation expectations higher, forcing central banks to reassess what had been a synchronized easing cycle.

Key Market Takeaways

- 1 The Iran war and effective closure of the Strait of Hormuz triggered a broad supply shock in energy, fertilizers, and industrial inputs, **pushing global inflation expectations higher and upending the expected rate-cut cycle.**
- 2 **Central banks have shifted to a more hawkish stance**, leading to rising yields, bear-flattening of G7 curves, and renewed pressure on longer-duration bonds, while Saturna's conservative duration positioning helped limit rate sensitivity.
- 3 GCC sukuk and bond issuers have shown resilience despite growth risks, and **Saturna continues to emphasize capital preservation by focusing on high-quality credits with strong balance sheets** and financial flexibility

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Hormuz commercial vessel crossings



Source: Saturna Capital Research

Monetary Policy – The Pivot

Going into 2026, global central banks were aligned around a soft-landing narrative. The Federal Reserve had penciled in two rate cuts for the year, with markets pricing 2.6 cuts by year-end. The European Central Bank (ECB) had moved ahead of the Fed, cutting their policy rate eight times from 4% to 2%, and by June 2025, their cutting cycle was complete. Similarly, the Bank of England was on track to continue reducing rates to 3.25% in 2026.

This consensus was upended within days of the war's onset, driven by fears of the conflict's ability to spur a global inflationary shock to the economy. The Fed held at 3.50 to 3.75% for the second consecutive meeting and removed anticipated cuts from its consensus economic projections. Personal Consumption Expenditures (PCE) inflation expectations were revised up to 2.7% for 2026, and the Atlanta Fed placed an approximately 20% probability on a hike – a figure that would have been unthinkable in January.⁴ Fed Chair Powell acknowledged the dilemma clearly: the tendency is to “look through” a supply shock, but only if inflation expectations remain anchored.⁵

Eurozone inflation has moved up from 1.9% in February to 2.5% in March, a particularly staggering rise resulting from the region's reliance on foreign energy imports.⁶ This large move brings the economy closer to the ECB's adverse scenario, and above the bank's 2% target, increasing the probability for an interest rate hike.⁷ The Bank of England unanimously decided to

hold rates at 3.75% – a complete reversal from its prior cutting path – with markets pricing in a 60% probability of a hike in June, with two possible by the end of the year.

Bond Market

Monetary policy

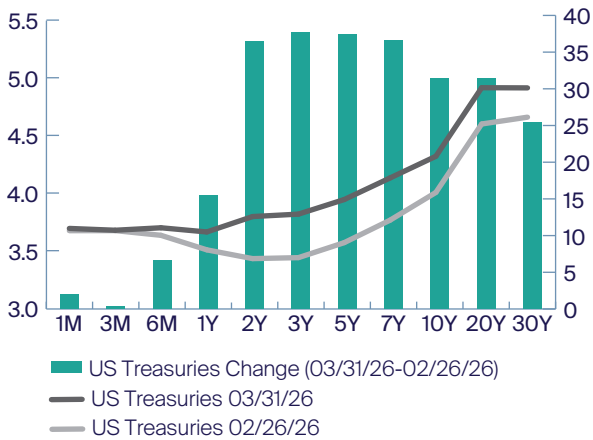
Changing inflationary dynamics and resulting shift in monetary policy fed directly into the bond markets. The defining feature of this quarter for bond portfolio managers was the failure of the safe-haven trade. Typically, geopolitical shocks send investors into sovereign bonds, pushing yields down. However, rather than rallying, inflation fears from the oil spike drove a global bond selloff, marking a clear departure from historical safe-haven dynamics. From just before the start of the war to quarter end, the US 10-year Treasury yield surged from 4% to 4.32%, 10-year German Bunds moved from 2.69% to ~3.0%, and UK 2-year Gilt yields rose more than 85-basis points. The curve dynamic across most G7 markets was bear flattening – short-end yields rising faster than the long end, reflecting hawkish monetary policy repricing.

Market Dynamics

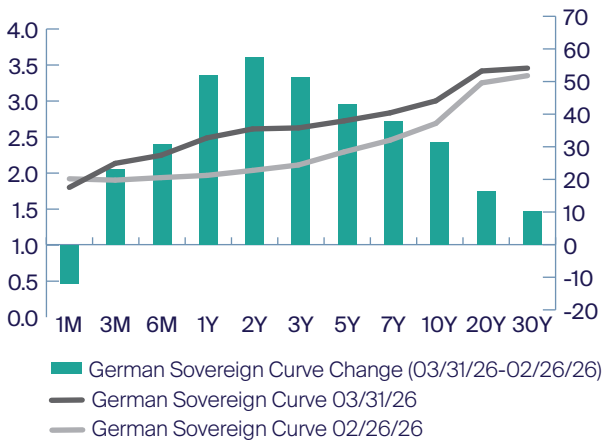
Duration performance dynamics shifted from last year which saw the belly of the curve, particularly the 5-7 year maturities, drive performance. The first quarter of 2026 went back to the dynamics seen in years' prior where long duration saw more negative impact, and shorter bonds outperformed. While we did see

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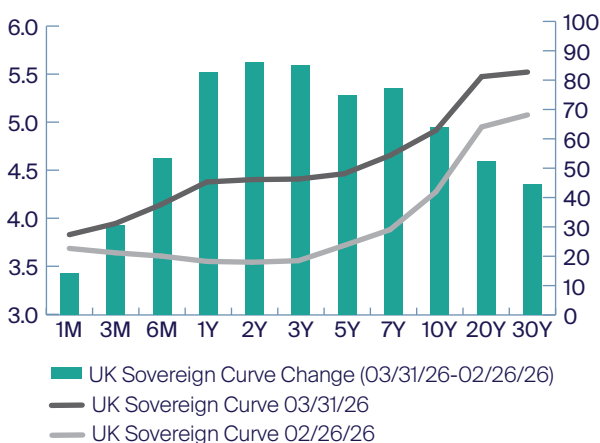
US Treasury Curve



German Sovereign Curve



UK Sovereign Curve

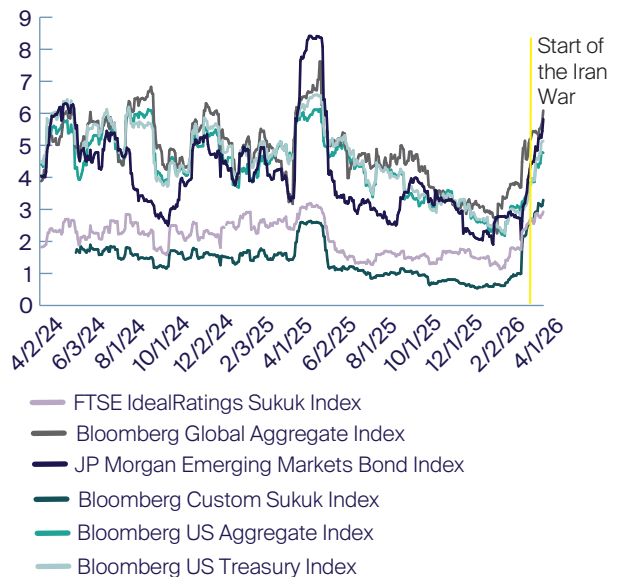


Source: Saturna Capital Research

an uptick in volatility and broadly rising interest rates across fixed income, Saturna maintained conservative duration positioning across fixed income funds, to minimize sensitivity to interest rates and the long-end underperformance.

As represented by the chart below, bond market volatility ticked up after the start of the Iran war, but still not to the levels seen last year after Liberation Day. The sukuk market, represented by the Bloomberg Custom Sukuk Index (approximately 200 US dollar sukuk issuers), and the FTSE IdealRatings Sukuk Index has held its low relative volatility seen historically. This emphasizes that despite the conflict, sukuk issuers, particularly in the GCC have shown resilience underpinned by strong credit and financial flexibility.

Rolling 30 Day Volatility



Source: Saturna Capital Research

The GCC bond and sukuk market face counteracting forces. According to an analysis done by the UN Development Program,⁸ we could see GDP contractions of 3 to 5% for Saudi Arabia and UAE, and up to 14% for Kuwait and Qatar,⁹ if the Strait remains closed – despite these countries being the world’s primary oil exporters. The core paradox is that Hormuz closure makes export of oil more difficult, which counteracts to some extent the high oil prices. Saudi Arabia has more flexibility due to their east-west

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pipeline which opens some oil exports despite the Strait closure. The UAE also has more flexibility with only 30% of GDP coming from oil, and access to the Abu Dhabi Crude Oil Pipeline which also bypasses the Strait.^{10,11} Many GCC issuers in the sukuk market have demonstrated exceptional financial flexibility, low debt levels, and strong governance. Going forward, we expect to see more infrastructure investment, diversification, and vulnerability mitigation. We also note that no Fitch-rated GCC sukuk has defaulted, and 84% remain investment-grade. The asset class has proven its relative value credentials under stress.¹²

The same supply-driven inflation dynamics are playing out unevenly across emerging markets. Latin America for example, entered 2026 mid-easing cycle and has been forcibly reversed. Brazil faces a compound shock: it is the world's largest fertilizer importer, with approximately 50% of supply transiting Hormuz, threatening its status as the producer of 60% of global soy exports. Colombia hiked rates twice in three months – first due to a 23% minimum wage shock, then compounded by war – with rates reaching 11.25% by quarter end.¹³ The Colombian peso has been one of the strongest currency performers relative to the USD, appreciating more than 2.4% since February 26, 2026. Mexico surprised with a cut to 6.75% despite the Consumer Price Index (CPI) at 4.63%, prioritizing a weaker growth outlook, though the peso has since slipped past 18 US dollars. For Colombia and Brazil, the benefit of being a net oil exporter is largely countered by rising fertilizer import costs, US dollar strength, and tighter global financial conditions, creating an uncertain path ahead.



Going Forward

We remain vigilant to the changing global market dynamics. The duration of the closure of the Strait of Hormuz and the Iran war will drive economic outcomes, inflation expectations and consequently monetary policy. Saturna continues to navigate stormy markets by prioritizing our fixed income funds' primary objective of capital preservation. In addition to extensive credit diligence, and conservative duration profile, we maintain positioning in issuers able to have the financial flexibility to weather economic cycles.

End Notes

- ¹ Geldard, Rebecca. "Beyond Oil: 9 Commodities Impacted by the Strait of Hormuz Crisis." World Economic Forum, April 1, 2026. <https://www.weforum.org/stories/2026/04/beyond-oil-9-commodities-impacted-closure-hormuz-strait/>
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- ⁵ Cox, Jeff. "Powell Sees Inflation Outlook in Check, No Wider Crisis Yet in Private Credit." CNBC, March 30, 2026. <https://www.cnbc.com/2026/03/30/powell-sees-inflation-outlook-in-check-no-wider-crisis-yet-in-private-credit.html>
- ⁶ Ellyatt, Holly. "Euro Zone Inflation Smashes Through ECB Target to 2.5% in March as Energy Costs Soar." CNBC. March 31, 2026. <https://www.cnbc.com/2026/03/31/euro-zone-inflation-smashes-through-ecb-target-to-2point5percent-.html>
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- ⁹ "Arab Nations May Lose \$200 Billion From Iran War, UN Says." Bloomberg, March 31, 2026. <https://www.bloomberg.com/news/articles/2026-03-31/arab-nations-may-lose-200-billion-from-iran-war-un-study-finds>.
- ¹⁰ U.S. Department of Commerce. "Energy Resource Guide – United Arab Emirates – Oil and Gas." International Trade Administration, April 22, 2021. <https://www.trade.gov/energy-resource-guide-united-arab-emirates-oil-and-gas>.
- ¹¹ "Saudi, UAE, Iraq: Can Three Pipelines Help Oil Escape Strait of Hormuz?" Al Jazeera, March 27, 2026. <https://www.aljazeera.com/economy/2026/3/27/saudi-uae-iraq-can-three-pipelines-help-oil-escape-strait-of-hormuz>.
- ¹² GCC DCM Spreads at Five-Year High on Iran War; Below Pandemic Levels." Fitch Ratings, March 30, 2026. <https://www.fitchratings.com/research/non-bank-financial-institutions/gcc-dcm-spreads-at-five-year-high-on-iran-war-below-pandemic-levels-30-03-2026>.
- ¹³ Bocanegra, Nelson, and Carlos Vargas. "Colombia Government Withdraws from Central Bank Board, Finance Minister Says." Reuters, March 31, 2026. <https://www.reuters.com/world/americas/colombia-government-withdraws-from-central-bank-board-finance-minister-says-2026-03-31/>

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