



# The strategic power of security-selection alpha

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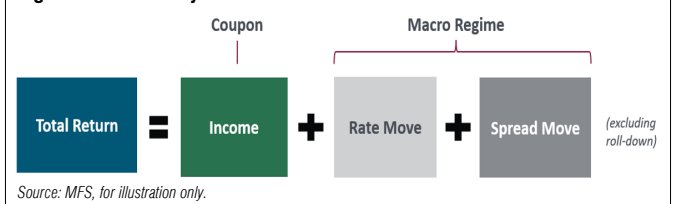
**W**e expect alpha to play a much bigger role in fixed income returns this year. While beta should remain supportive in 2026, it is no longer exceptional. In this environment, security-selection alpha appears particularly attractive, offering both style diversification and stronger potential for excess returns relative to other alpha sources.

In our view, fixed income expected returns are lining up to be quite decent in 2026 but are no longer remarkable, primarily because the ‘Goldilocks’ macro regime is over. Indeed, the current macro and market environment is less supportive of fixed income, in large part due to a more complicated duration landscape and a challenging spread valuation backdrop.

In many parts of the world, central banks are no longer easing. Even in the US, the bar is fairly high for the Fed to deliver more cuts than are currently priced in by the rates market. In the absence of aggressive policy easing, duration is therefore unlikely to be a major contributor to total returns. In addition, credit spreads are tight in many markets.

As a result, we believe that there is limited space for further spread compression, though we are not necessarily calling for a spread correction in the period ahead. In fact, our baseline scenario calls for stable spreads, helped by a robust macro backdrop and solid credit fundamentals, though we do not expect this alone to drive total returns.

Figure 1. Income may be a main driver of fixed income beta in 2026



This leaves us with income as a main driver of global fixed income returns, supported by total yields that remain attractive by historical standards (see Figure 1). Looking at the Bloomberg Global Aggregate Index (Global Agg), its yield is currently around 3.45%, producing a 10-year z-score<sup>1</sup> of 1.05 in our valuation analysis—a level that is quite attractive relative to history.

From a portfolio-construction perspective, this shift matters because the ‘easy’ sources of beta are becoming less reliable at the margin. When policy rates are no longer trending steadily lower, the distribution of outcomes for duration widens and rate volatility can potentially rise. Indeed, modest changes in inflation momentum, fiscal expectations, or term premium can translate into meaningful rate moves. At the same time, when spreads are already tight, carry remains appealing but the cushion against idiosyncratic shocks is thinner, making downside asymmetry more relevant.

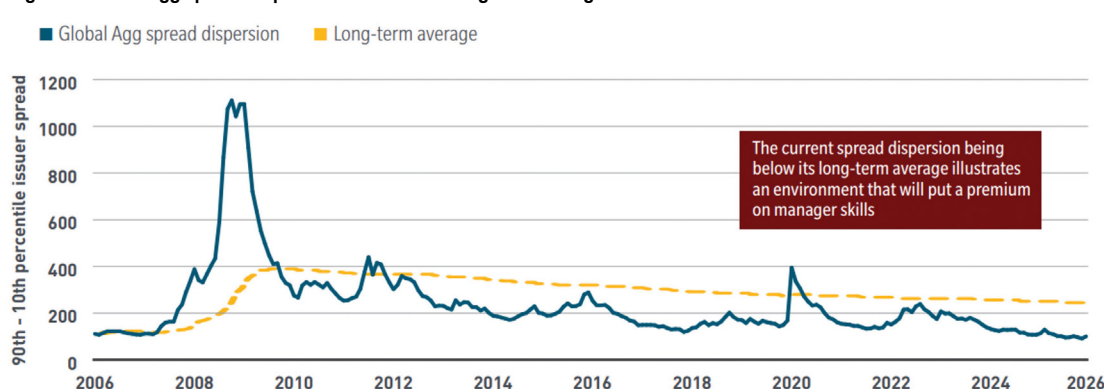
This combination tends to reward disciplined risk budgeting and

**Figure 2. Average three-year rolling excess return of global fixed income unhedged strategies versus Global Agg**



Source: eVestment Alliance, LLC. The eVestment All Global Fixed Income universe was screened for active managers using an unhedged approach and benchmarked to the Global Agg. The excess returns are calculated on an average three-year rolling basis. Specifically, the data for December 2025 reflect the January 2023 to December 2025 period. Returns are gross of fees and in USD. Monthly data from December 2024 to December 2025. The dotted line represents the long-term average. Past performance is no guarantee of future results.

**Figure 3. Global Agg spread dispersion is well below long-term average**



Source: Bloomberg. Global Agg spread = difference between the 90th and 10th issuer spreads. Long-term average is calculated using an expanding window. Monthly data from March 2006 to February 2026.

careful security selection prioritising bonds where investors are being paid for specific, identifiable risks (liquidity, structure, sector, or issuer fundamentals) rather than relying on broad market repricing. Put differently, as macro uncertainty rises and valuations look less forgiving, the value of being selective increases because small differences in entry point, credit quality, and balance-sheet resilience can have an outsized impact on realised returns.

As fixed income beta returns diminish, alpha may play a bigger role in generating returns. In recent months, we have seen the alpha generated by active asset managers rise above the Global Agg’s long-term average of 91 basis points (see Figure 2). The current market environment of complexity and macro volatility, along with a focus on diversification and risk management, is creating opportunities for active asset managers to potentially generate higher excess returns. In turn, this alpha is likely to represent a larger share of total returns.

Together, factors such as fundamental mispricing, greater

differentiation, and the emergence of ‘winners’ and ‘losers’ create a more favourable market environment for active managers. The spread dispersion within the Global Agg is the tightest it has been in many years, which means that there is a greater premium on the quality of the active manager, especially when it comes to security selection (see Figure 3).

**Strategically, security-selection alpha appears to offer attractive characteristics**

For a start, selecting a global active manager that primarily relies on security selection may offer some style diversification. Based on eVestment data, we have identified two distinct global fixed income peer groups. The first is active managers that cite security selection as their largest source of alpha (peer group 1). The second is the rest, that is, those whose self-reported largest source of alpha is not security selection (peer group 2).

What is striking is that peer group 1 represents a minority in the community of active Global Agg mandates.



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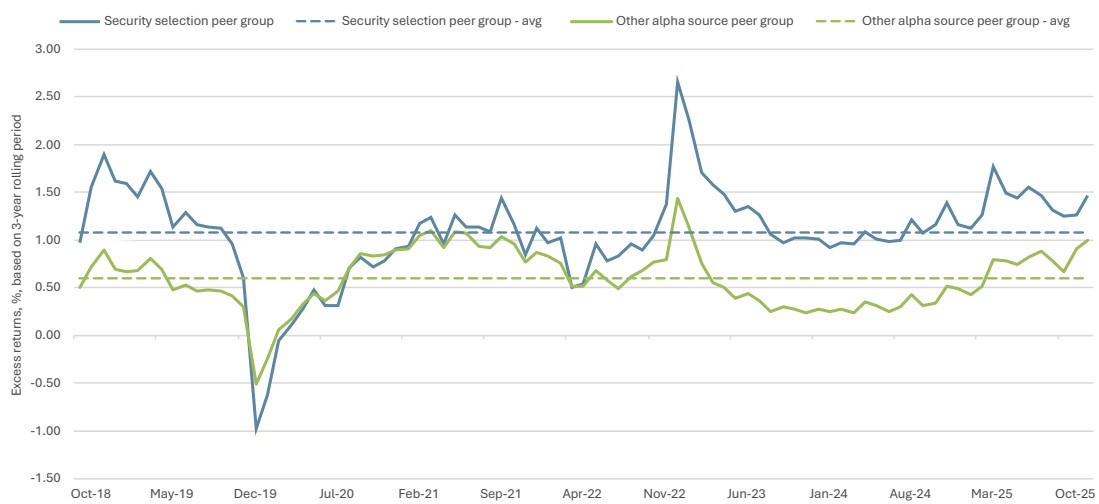
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### The quote

*When policy rates are no longer trending steadily lower, the distribution of outcomes for duration widens and rate volatility can potentially rise.*

**Figure 4. Global Agg active managers: Excess returns per peer group**



Source: eVestment, monthly data up to December 2025. Excess returns are calculated on a three-year rolling basis. The last period shown captures January 2023 to December 2025. Peer group 1 comprises active managers that self-reported security selection as their largest source of alpha. Peer group 2 comprises active managers that self-reported a source other than security selection as their largest source of alpha. The reference benchmark is the Global Agg. Returns are gross and in USD. Past performance is no guarantee of future results.

Indeed, in our data sample, peer group 1 is only 17 managers compared with 45 managers in peer group 2. This suggests that security selection may offer some style diversification. In fact, the most popular self-reported source of alpha across all respondents is asset allocation.

Empirical evidence shows that security selection may help generate higher excess returns. Looking at the past seven years—the longest time window for which data are available—excess returns generated by peer group 1 have been higher, averaging 1.08% annually against 0.60% for peer group 2 (see Figure 4). In our view, this 48-basis-point annual average outperformance is significant.

In addition, it is worth noting that peer group 1 excess returns beat peer group 2 excess returns 86% of the time, suggesting robust outperformance consistency. Finally, when factoring in the volatility of alpha, it is worth pointing out that peer group 1 generated 0.76% of expected returns per unit of risk over the whole period, as opposed to 0.44% for peer group 2. In other words, this suggests that security selection may help generate more attractive risk-adjusted returns.

In practice, security-selection alpha in global aggregate portfolios often comes from a thorough credit research process. For instance, this can include favouring issuers with improving fundamentals ahead of rating actions, avoiding bonds with weaker credit profiles, and exploiting relative-value discrepancies across an issuer's curve, between seniority tiers, or across similar sectors and regions.

It may also involve identifying technical drivers such as index rebalancing, new-issue concessions, or forced selling in less-liquid segments that temporarily push spreads away from fair value.

Importantly, this approach can be implemented while keeping top-down exposures (duration, curve, currency, and broad sector allocations) close to benchmark, which

may help investors seek excess returns without materially changing the portfolio's overall risk profile.

In our view, the potential advantage is not only higher excess returns but also greater control over where risk is taken because the return drivers are anchored in bottom-up credit research and analysis.

### Investment implications

Security selection may offer an attractive source of alpha diversification in global, multi-sector strategies.

Given the dislocations in global markets, fundamental differentiation is likely to be a key market driver in the period ahead. In particular, there are going to be winners and losers as a result of the AI-driven technological disruption. Concretely, we see AI's impact filtering through fixed income in sector-specific ways.

On the 'winner' side, parts of technology and communications may benefit from sustained capex cycles, and segments of utilities and infrastructure-linked issuers could see stronger demand tied to data-centre power, grid investment, and related supply chains. Select securitised and project-finance exposures may also gain from assets with durable cash flows where AI-driven demand is more visible.

On the 'loser' side, issuers exposed to automation risk, faster product obsolescence, or weaker pricing power could face margin pressure and higher refinancing risk, which may show up first in spread widening and curve steepening.

For global multi-sector investors, this reinforces the case for bottom-up fundamental research to distinguish between beneficiaries and those where credit metrics may deteriorate despite an unchanged macro backdrop.

Against this setting and looking forward, we believe that security selection is well positioned to be a key con-

tributor to excess returns, and, by extension, to fixed income total returns.

In addition, we are of the opinion that security selection may offer style diversification in global, multi-sector strategies, because active managers that identify security selection as their primary source of alpha appear to be in the minority. More importantly, security selection may help generate higher excess returns, especially in relation to other sources of alpha. **FS**

#### Notes

1. A Z-score measures how many standard deviations a data point is above or below the mean of a distribution.

#### Disclosures

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#### The quote

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