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Capital at Risk.



Q4 2025

Active Fixed Income Outlook:

Timing the cycle



Timing the cycle: why it remains important

Investors now face two very powerful competing forces: exponential AI-related capex and a slowing US economy



Colin Reddie
Head of Active Strategies
/ Co-Head of Global Fixed Income

AI – All that glitters?

The world's tech giants are boosting their AI-related capital expenditure (capex) with no signs of slowing down. According to the Wall Street Journal, Meta*, Microsoft*, Amazon* and Alphabet* are set to spend \$400 billion this year in capex, with a large chunk of this used to build AI infrastructure such as data centres.

In its second quarter financial report, Meta made its commitment to AI spend clear: “We currently expect another year of similarly significant capital expenditures dollar growth in 2026 as we continue aggressively pursuing opportunities to bring additional capacity online to meet the needs of our artificial intelligence efforts and business operations”.

This is hugely significant both from a macroeconomic and market valuation perspective. Initial indications suggest that this opportunity will be truly meaningful in terms of broadness and depth in its ability to both disrupt and create new industries. On that basis, while we believe that we are still early in investors' estimations of the potential impact, the possibility remains that at some stage in the future, as the market becomes more aware of the scope of disruption, we may enter bubble territory. Now is the time to take stock and carefully consider where we are in the cycle and crucially, what may come next.

The probability of an investment outcome changes as our position in an economic or business cycle changes. Therefore, we can look to increase our odds by attempting to ascertain what stage of the cycle we currently stand in. Good cycle timing remains one of the hardest and most satisfying aspects of being an investor. Done well, it will likely account for a lot of the success an investment team and its process enjoy.

Recession red flags

A pressing question for investors watching the latest global trade developments is: could US tariffs spur a recession? When it comes to making a call on recession, we believe the key is corporate redundancies. However, there are no strong indicators that could give us much advance warning on companies' firing decisions – with monthly business surveys providing an average of 1-2 months' notice. The latest payroll report dismissed hopes of a hiring rebound after August's soft print. The US economy is now adding fewer than 30,000 jobs per month on a three-month average, with June figures revised to a loss of 13,000. Additionally, in September the Bureau of Labor Statistics (BLS) issued a preliminary revision of -911,000 jobs for the 12 months ending in March 2025, reducing average monthly growth from 146,000 to 70,000. This appears tied to the BLS birth-death model overstating new business formation, especially among small and medium-sized firms. If this trend persists, June may not be the only month with negative payrolls this year. Therefore, further deterioration in those hiring intentions from here could lead us to upgrade our views on recession from a risk to our base case.

Inflation has been the buzzword for investors for some time – and while always a key consideration – is currently subordinated to the cycle call. In a recession, no one is likely to worry about inflation because it is expected to fall (with a lag).

***For illustrative purposes only. Reference to a particular security is on a historic basis and does not mean that the security is currently held or will be held within an L&G portfolio. The above information does not constitute a recommendation to buy or sell any security. Assumptions, opinions, and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass.**



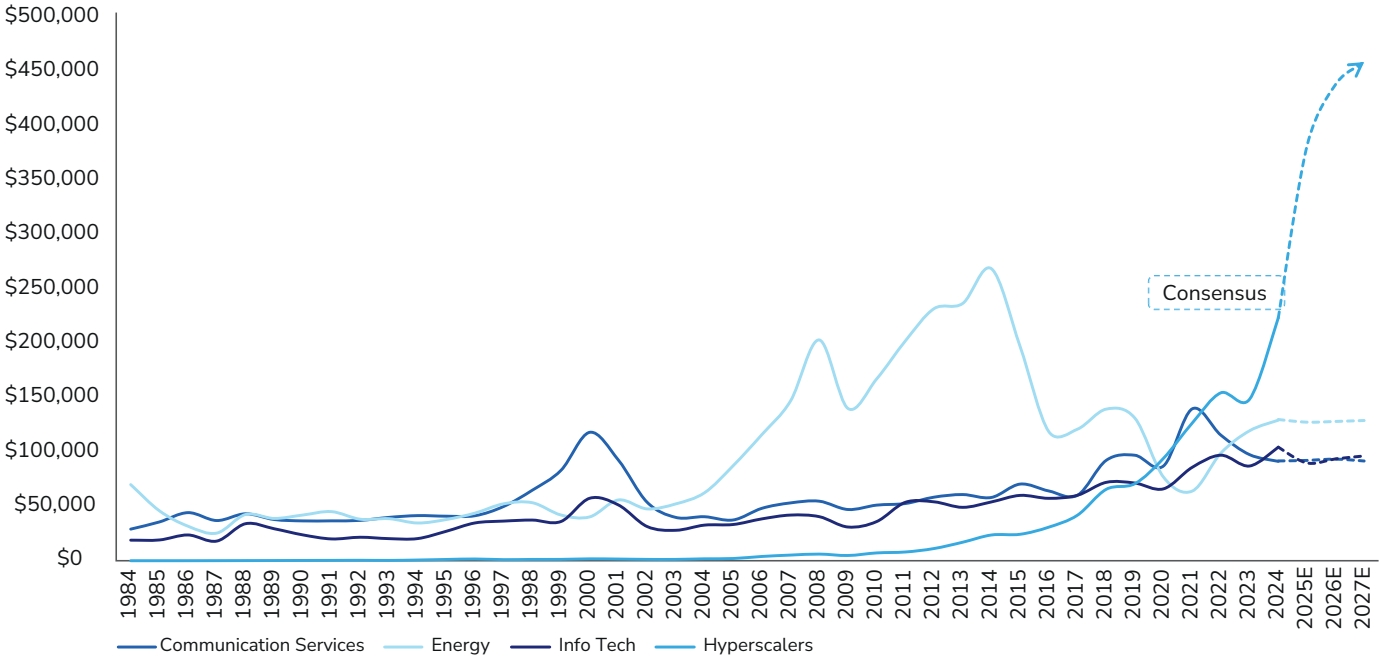
The tricky inflation call is determining if the cycle delivers a soft landing or muddle-through scenario. We have a few crosscurrents: housing costs are going down, while goods prices are going up. The latter is not just a result of trade tariff developments, but also thanks to 10% depreciation in the US dollar in the first half of the year. While an obvious benefit for emerging markets, we are detecting a rowing debate on the US dollar. There is a circularity to this, but if US asset performance deteriorates, the outflow from US markets – or increases dollar hedging – it could trigger a self-reinforcing cycle that would become an issue for financial markets more broadly.

Despite the slowing US labour market, both the Employment Cost Index and Average Hourly Earnings have been sticky in recent months at a near 4% annual rate. If the labour market stays the same, with the decline in labour demand broadly matched by a fall in labour supply, then wage growth may not slow or

may not slow down at a fast enough pace to justify multiple interest rate cuts by the US Federal Reserve. The central bank’s decision in September to cut rates by 25 basis point (bps), despite being presented as a consensus decision, reveals plenty of disagreement about the outlook. It was also clear that in addition to their dual-mandate, employment and price stability, they are fighting on a new front – preserving their independence.

Given everything that has happened this year: tariffs at post-1945 highs, a Fed under political pressure, sticky inflation at above target, the relative market resilience (barring the US dollar) may be a surprise to many. Post-Liberation Day markets are a different world to pre-Liberation Day. In any recessionary scenario, even a shallow one given the lack of meaningful imbalances, equities would not be unscathed. However, in a muddle-through scenario, we believe that AI will determine how much further upside for risk assets there is for the rest of the year.

Capex spend (\$mm)



Source: Morgan Stanley, as at September 2025. Assumptions, opinions, and estimates are provided for illustrative purposes only. There is no guarantee that any forecasts made will come to pass.

Credit Scorecard

▲ Upgraded ▼ Downgraded — Unchanged

Strategy	Score	June			September		
US Credit	-3	-2	-1	N	+1	+2	+3
EU credit	-3	-2	-1	N	+1	+2	+3
UK Credit	-3	-2	-1	N	+1	+2	+3
Global credit	-3	-2	-1	N	+1	+2	+3

Source: L&G as at 19 September 2025. – can be subject to change at any point.

These scores reflect the view of the US Credit, EUR Credit, UK Credit and Global Credit teams in relation to the expected credit returns in their market in the next 1-3 months. Those may differ from the views from the unconstrained team who score each market on a relative basis.

Key risk

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Unconstrained strategies: what's on the horizon?

Why it's important to be flexible in unpredictable times



Mat Rees
Head of Global
Unconstrained Fixed
Income



Enda Mulry
Portfolio Manager –
Global Bond Strategies



Amelie Chowna
Senior Fixed Income
Investment Specialist



The past – what just happened?

In September, the US Federal Reserve (Fed) cut interest rates for the first time this year by 25 basis points (bps). The updated dot plot is largely in line with market expectations, suggesting two more such cuts this year, followed by a further 75 - 100bps of cuts in 2026.

The move followed a weak US jobs report in August and a dovish Jackson Hole speech by Fed chair Powell, which led to a large drop in short-dated US Treasury bond yields, with the 2-year bond yield falling 33 basis points (bps) over the month.

Longer-dated Treasury yields fell in early September, lagging the move at the short end.

This extra risk premium reflected actions by President Trump, such as firing the Bureau of Labour Statistics Commissioner and calling for the resignation of a Fed member, which have raised concerns about Fed independence. Nevertheless, the September Fed meeting did show some resistance to the challenges from the administration, with near-unanimous support for the consensus 25bps cut, even from two Fed governors who were appointed by President Trump in his first administration.

Meanwhile, the Bank of England chose to cut interest rates by 25bps in August, but the rhetoric was relatively hawkish, while the European Central Bank kept rates unchanged at its September meeting.

French political noise impacted European credit markets, with the euro investment grade index spread widening initially, before tightening back towards the end of the month. High yield indices outperformed, with spreads a little tighter on the month.

The present – uncertainty reigns

We believe uncertainty is the new certainty due to geopolitical issues including the potential impact of US tariffs on the global economy. Therefore adopting a flexible approach by exploring opportunities across fixed income markets globally could help investors navigate idiosyncratic market risks. In our view, not being tied to a benchmark, sector, region or narrow duration target could help investors prepare for surprises.

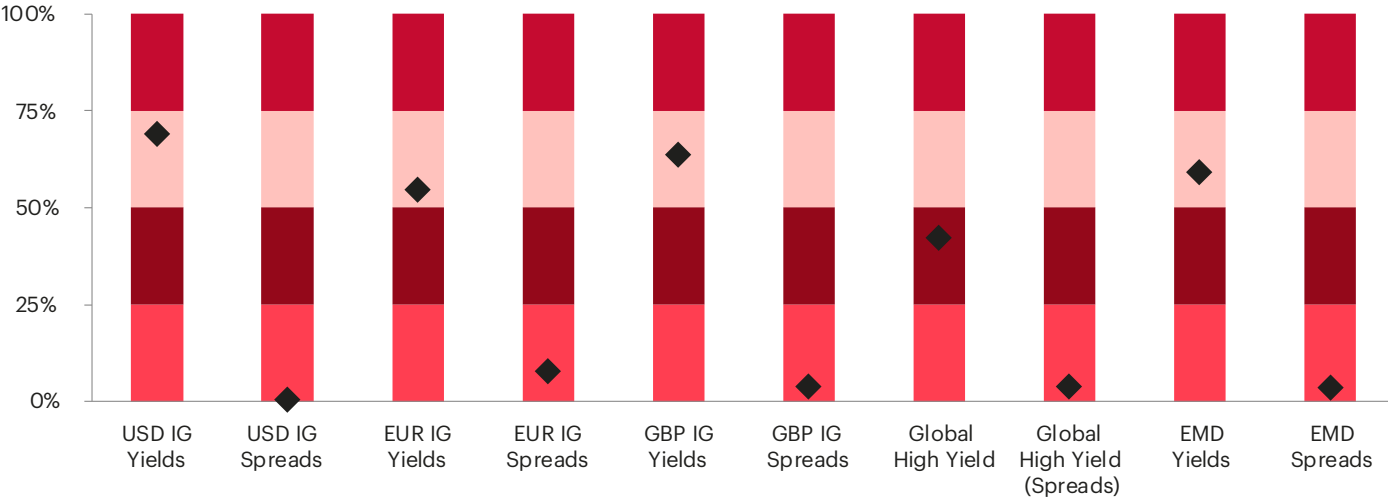
Predicting gross domestic product or inflation moves on a consistent and accurate basis is near impossible, so we focus our efforts on probing consensus economic views and where adopting contrarian positions can be beneficial.

With government bonds, we think longer maturity yield curves are very steep, particularly in Japan and the UK. There is also a strong consensus that these curves will steepen even more, while we believe that governments are not incentivised to issue the most expensive debt. Therefore, we are more inclined to use yield curve flattening strategies at the long end.

In our view, current credit buyers are driven more by yields than spreads. It's feasible that spreads can remain tight while yields remain attractive. Therefore, we have maintained exposure to credit, building slightly larger liquidity buffers and levels of hedges using credit default swap indices.

Like many investors, we are driven to pursue both yield and carry to generate returns and smooth out some market volatility. With this in mind, we are currently exploring opportunities in bank subordinated debt, US corporate hybrids and selected areas of hard currency emerging market and high yield debt and shorter duration Investment grade.

Yield and Spread Percentile Analysis



Bloomberg, L&G as at 11 September 2025

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Outlook – what could go right or wrong?

Looking ahead, fixed income (and equity) markets have been supported by the prospect of Fed rate cuts and the large amount of capex spending by US tech companies. But there remains the risk that inflation is nudged higher due to tariffs or growth (either in the tech sector or more widely) disappointments, which could put credit valuations under pressure. The recent weakening in labour market data cemented market views that the Fed will cut interest rates over the next 18 months, leading to an increase in inflows into credit. Additionally, the start of Fed rate cut programme could lead to some outflows from the huge \$7.5 trillion held in US money market funds, some of which could potentially be directed towards fixed income. Therefore, we maintain a

constructive short-term view on credit, which continues to be buoyed by strong demand and limited longer dated supply.

We believe US economic activity is likely to have a bigger impact on volatility than in other regions such as Europe, due to the tension between weakening labour market data and inflation remaining stubbornly above the Fed's target.

There are also valid concerns from foreign investors about the implications of the end of US exceptionalism, although there are very few deep, liquid alternative markets.

The credit market's robust supply and demand dynamics could be challenged should a large proportion of the US tech capex spend be funded via debt markets, which could result in a widening in spreads. US spread valuations continue to be slightly tighter than in Europe on a historical basis, which combined with the factors described above means we believe it's important to maintain a balanced portfolio, without excessive concentrations in US credit.

Credit Scorecard

Strategy	Score September						
Global IG USD	-3	-2	-1	N	+1	+2	+3
Global IG EUR	-3	-2	-1	N	+1	+2	+3
Global IG GBP	-3	-2	-1	N	+1	+2	+3
US Securitized	-3	-2	-1	N	+1	+2	+3
Subordinated Debt	-3	-2	-1	N	+1	+2	+3
Global High Yield	-3	-2	-1	N	+1	+2	+3
Emerging Market Debt	-3	-2	-1	N	+1	+2	+3
Cash	-3	-2	-1	N	+1	+2	+3
Duration	-3	-2	-1	N	+1	+2	+3

Source: L&G as at 30 September 2025 – can be subject to change at any point.

Their scores may differ from the scores shown in the subsequent sections of the outlook, which express views on individual markets on a stand-alone basis.

Key risk

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European credit: political shocks, rate cuts, and a flight to quality

How we’re walking the tightrope by
balancing caution and opportunity



Marc Rovers
Head of European Credit



Magdi Yasin
Fixed Income Investment Specialist

The past – what just happened?

European credit markets have experienced volatility in recent months, shaped by a mix of political, monetary, and geopolitical developments. At the same time yields have proven to be remarkably stable moving between 3 and 3.2% as moves in government bond yields were partly offset by opposite moves in credit spreads.

In August, political uncertainty in France – centred around Prime Minister François Bayrou’s likely loss of a confidence vote – triggered a sharp rise in French sovereign risk, with spreads between French and German 10-year bonds widening up to 15 basis points and French yields approaching Italian levels. This instability weighed on French corporate issuers, leading to some underperformance, though to a much lesser extent than that of French sovereign, and a widening of euro investment grade credit spreads. European markets also continue to be influenced by Germany’s historic reform

of its constitutional debt brake, enabling substantial new infrastructure and defence spending and triggering a sharp repricing in rates.

The European Central Bank (ECB) has lowered interest rates twice in March and June by a quarter basis point each time, before signalling a prolonged pause in policy changes in July, prompting a drop in Euro government bond yields. In contrast, the Bank of England cut rates by one quarter basis points in response to persistent inflation, but its hawkish tone pushed gilt yields higher and supported sterling.

Throughout the third quarter of 2025, European credit delivered robust total returns, driven by strong investor demand and a tightening of spreads to multi-year lows amid a favourable backdrop.

The present – value amid volatility

We are prioritising higher-rated issuers over BBBs and keeping portfolio beta near neutral (~1.0) and duration flat (in line with its benchmark) to avoid adding undue risk at what are historically tight valuations. Key macro drivers have reinforced a more cautious approach: euro credit spreads hit the 10th percentile of historical levels by mid-August, even as the ECB signalled policy pauses. With yields relatively stable, credit markets have been supported by strong technicals, but we expect volatility to pick up as heavy new issuance returns in September. In this context, we maintain a more cautious bias, favouring high-quality credit, more defensive sectors, and a well-diversified approach that avoids over-extension on risk.

We are significantly underweight French credit as French corporate spreads were too small. As political uncertainty has risen, this led to French corporates somewhat underperforming but not enough to warrant a change in this position we believe especially when looking at French banks. Conversely, we see pockets of value in defensive sectors: notably, we hold an overweight in UK utilities, especially water companies, which we believe offer attractive spreads after regulatory pressure drove them cheaper than the market.

We're also currently leaning more towards financials (banks) and select infrastructure and utility names where fundamentals are robust and new issues provided entry points. European banks are benefiting from higher rates and solid balance sheets, and their debt still offers reasonable spread pickup; we remain underweight economically sensitive industrials as we are concerned about growth and a potentially delayed impact of the US tariffs.



Outlook

European investment grade (IG) credit markets enter the fourth quarter with a cautious outlook amid lingering macroeconomic and political uncertainties. The ECB is expected to hold rates steady

after earlier modest cuts, but fiscal shifts (like Germany's expanded public investment) and political risks (such as recent turmoil in France's government) could still add volatility. The tariffs imposed by the US administration also add another layer of uncertainty, potentially impacting US inflation and corporate margins, with global trade flows still very much unclear.

Credit spreads hover near multi-year tight levels after a summer rally, leaving valuations rich and little room for error. Even as bond issuance picks up from the summer lull, strong demand and steady inflows should support the market. New deals have been largely absorbed without major concessions, yet elevated hedging activity and neutral broker positioning reflects investors' wariness heading towards the end of the year.

What could go wrong?

- Valuations are stretched, with euro IG spreads near historical tights, leaving little room for error.
- Following the French Prime Minister's resignation on 6 October, continued political instability in France could cause further widening of spreads and drag down French corporate performance.
- The impact of US tariffs become clearer in the macro data leading to concerns about US inflation and global growth.
- Recession risks in the eurozone could rise with the US tariffs and Chinese competition, weakening corporate fundamentals and increasing downgrade pressure.
- Rising geopolitical tensions and a further expansion of the war in Ukraine into countries bordering the conflict area.
- Investor sentiment remains fragile, and any reversal in fund flows could amplify spread widening with no ECB backstop through the corporate sector purchase programme.
- Cross-currency volatility and rising FX hedging costs may reduce global demand for euro credit.



Credit Scorecard

▲ Upgraded ▼ Downgraded — Unchanged

Strategy

Score

June

September

Euro credit

-3

-2

-1

N

+1

+2

+3

Source: L&G as at 19 September 2025 – can be subject to change at any point.

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Emerging market debt: momentum backed by fundamentals

Macroeconomic dynamics continue to support emerging nations, with US policy uncertainties also boosting EMD



Raza Agha
Head of Emerging
Market Sovereign
Strategy



Viraj Nadgir
Senior Fixed Income
Specialist



The present – high carry, solid fundamentals

EM fundamentals remain strong, with positive credit ratings momentum continuing as upgrades outpace downgrades. Notably, there were no EM sovereign defaults in 2024 and year to date in 2025 so far, while the number of corporate defaults have declined versus previous years.

This speaks to macroeconomic dynamics continuing to support emerging nations. The International Monetary Fund projects EM growth at around 4% for 2025, outpacing the ~1.5% anticipated for the advanced economies, such as the US, UK, Japan and Germany. Inflation in EM continues to trend downwards and many EM central banks now have room to cut rates or have already begun cutting (e.g. in Latin America).

On the external front, commodity prices have been relatively firm, supported by demand and constrained supply, which has benefitted EM commodity exporters. For oil-importing EMs (mostly in Asia), the good news is that oil prices have not spiked and in fact remained within a moderate range, easing pressures on trade balances. These trade surpluses have underpinned continued surpluses on the current account this year, which will aid the continued building of foreign exchange reserves, already at record levels.

Meanwhile, despite the record level of issuance in primary markets, EM spreads are tight, leaving limited room for further compression. Investment-grade spreads are near their tightest levels since 2007. In contrast, we believe high-yield EM spreads still offer relative value compared to historical levels and to US and Euro high yield. This said, even after this year's spread rally, in our view yields remain attractive—7.1% for sovereigns and 6.3% for corporates—providing a cushion against any potential spread widening.

The past – what just happened?

Emerging market debt (EMD) has performed impressively in 2025 so far, delivering robust returns despite global volatility. As of 12 September, emerging market (EM) hard currency sovereigns have returned 10.6% year-to-date, while corporates have gained 7.2% . These gains have largely been driven by movements in US Treasuries, with additional support from modest spread tightening – especially in the high-yield segment. EM local markets have outperformed, posting a 15.4% return, buoyed by a weaker US dollar.

Credit Scorecard

▲ Upgraded ▼ Downgraded — Unchanged

Strategy

Score

June

September

Emerging market debt

-3

-2

-1

N

+1

+2

+3



Source: L&G as at 19 September 2025 – can be subject to change at any point.

Key risk

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Outlook

On 17 September, the US Federal Reserve (Fed) cut interest rates for the first time this year, by 25 basis points. This interest rate-cutting cycle is expected to be a tailwind for EM assets. Since 2007, EMD has delivered positive returns in every Fed cutting cycle except during the 2008 financial crisis. Another factor working in favour of the asset class is technicals. Investor positioning is still cautious relative to the improving fundamentals, meaning many investors under-invested in EMD. This is starting to change: over the past few months, fund flows into EM bond funds have increased as allocations have increased, including from crossover accounts. Clearly, policy and institutional uncertainties in the US have led some global investors to diversify into EM assets, boosting inflows, attracted by the relatively high all-in yields.

What could go wrong?

The focus for investors remains the outlook for US macro and markets. The current market narrative assumes no significant resurgence of inflation amid Fed rate cuts this year. Hence, a key risk is resurgent inflation on the back of trade tariffs which stifles market expectations around US monetary policy. Investors are also closely watching US growth dynamics with the base case assuming no recession in the near term. Thus, data releases that point to a weaker-than-expected economy would unnerve markets.



Global high yield: quiet strength beyond the headlines

Global high yield remains resilient; benefiting from strong corporate fundamentals and liquidity, with robust technicals



John Ryan
Head of Global High Yield



Sophia Hunt
Senior Fixed Income
Investment Specialist

The past – What just happened?

Markets have continued to digest the implications of US President Trump’s tariff policy, with volatility driven more by political headlines than economic fundamentals. Investors have largely adopted a ‘wait and see’ approach, interpreting aggressive proposals as negotiating tactics rather than imminent policy shifts.

High-yield spreads tightened by approximately 20 basis points (bps) since the end of June, with yields peaking at 6.32%* before retracing to around 6.05%*. This tightening reflects improved risk sentiment and a robust technical backdrop, with strong inflows and limited new issuance supporting valuations.

European and emerging market high yield segments led the rally, buoyed by strong technicals (light supply, sustained inflows) and broad spread compression. US high yield also rose but was more modest as higher Treasury yields partly offset its gains. From a credit ratings perspective, single-B credits performed roughly in line with double-B credits across the globe.

*Unhedged yield for the ICE BAML BB-B Global non-financial index (HWXC)

The present –positioned for income with a regional tilt away from US

We maintain our macro credit score at +1, reflecting our view that credit risk remains attractively priced. We believe the high yield market acts as a strong income asset class, with investors generally compensated for default risk (particular in the BB and B rated cohorts). Comparisons to historic spreads should bear in mind that the current high yield index is higher quality (BBs dominating with 60% of the index versus less than 8% of CCCs), lower duration (3 years versus the historical average of 4 years) and the reference government bonds are more volatile and lower quality now than historically. This is illustrated in the Sharpe Ratios table below which compares various US asset classes – with corporate credit, particularly the BB cohort producing persistently higher Sharpe ratios versus government bonds (and investment grade credit). Yields at 6.1%* are close to the historic median, and duration remains low at 3.2 years.

	US Current 5 year	US Current 10 year	US BBB	USBB	USB	USCCC	S&P 500
5 years	-0.13	-0.41	0.11	0.59	0.72	0.99	0.92
10 years	0.17	0.00	0.42	0.72	0.63	0.62	0.94
15 years	0.32	0.17	0.56	0.89	0.77	0.61	1.05
20 years	0.68	0.37	0.69	0.98	0.79	0.10	0.77
25 years	0.91	0.54	0.81	1.08	0.83	0.72	0.57

Source: Bloomberg, BAML as at 31 August 2025

Key risk

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The high-yield market is benefiting from strong corporate fundamentals and liquidity, with technicals remaining robust due to limited net new supply and strong demand.

Regionally, we remain overweight Europe and emerging markets (EM) and underweight the US. In our view, European credit benefits from consistent policymaking and fiscal support, while EM offers similar macro risks to the US but with higher spreads and yields. US policy-related downside risks are not fully priced in, reinforcing our cautious stance.

Sector-wise, we continue to favour media and technology, real estate, and aerospace/defence. We remain underweight automotive and utilities, which face structural challenges and capital intensity.

*Unhedged yield for the ICE BAML BB-B Global non-financial index (HWXC)



Outlook – Coupon-like returns with limited tail risk

The global high yield market continues to exhibit resilience despite various global challenges. Market consensus has shifted away from a technical recession in

the US in 2025 and global growth is low but steady – a very supportive backdrop for credit. The US Federal Reserve’s move to cut rates by quarter point in September and signal there may be more to come is a strong potential tailwind. Within this context, our outlook for global high yield remains positive, with a focus on carry and selective risk-taking.

We believe spreads can tighten further into year end, within a relatively narrow band of outcomes. The market is likely to deliver coupon-like returns, currently around 6.2%, with the index already up 6.8% YTD* at the time of writing.¹

What could go wrong?

- Policy disruption and constraints: While escalating policy shocks or geopolitics could tighten financial conditions, a mild US recession alone is unlikely to cause a spike in defaults unless credit transmission deteriorates more broadly.
- Inflation rebound: The main risk to yield demand and the carry trade. We believe high yield’s low duration offers resilience in stagflationary environments compared to other fixed income asset classes, although absolute returns would be lower.

*USD hedged total returns for the ICE BAML BB-B Global non-financial index (HWXC)

Credit Scorecard

▲ Upgraded ▼ Downgraded — Unchanged

Strategy

Score

June

September

Global high yield

-3

-2

-1

N

+1

+2

+3

Source: L&G as at 19 September 2025 – can be subject to change at any point.

Key risk

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1. As at 10 September 2025

Research and active engagement: spotlight on Sukuk

How the transformation of the sukuk market could affect issuers, investors and the broader Islamic finance ecosystem



Court Gilbert
Senior Credit Analyst



Yew Thong Choong
Credit Analyst



Jason Tan
Credit Analyst



The past – what just happened?

In November 2023, AAOIFI released a draft of Shariah Standard No. 62 for public consultation. This marked a pivotal moment for the global sukuk market, which had reached an estimated value of US\$1 trillion by the end of 2024, with annual issuance nearing US\$200 billion.

‘Sukuk’ are Shariah-compliant financial instruments that confer partial ownership in an underlying asset or project and seek to generate returns based on profits rather than interest. That’s because Shariah law prohibits the payment or receipt of interest, as well as investment in sectors such as gambling, alcohol, weaponry and some meat-based products.

The sukuk market, a cornerstone of Shariah-compliant finance, is on the cusp of a significant transformation. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) has proposed Shariah Standard No. 62, which aims to enhance the authenticity and investor protection of sukuk instruments.

As this draft standard undergoes industry consultation and revision, its potential implications for issuers, investors and the broader Islamic finance ecosystem are becoming increasingly apparent. This article explores the recent developments, current market positioning, future outlook and associated risks surrounding Standard 62.

The draft standard proposes a fundamental shift in sukuk structuring, particularly the requirement for a legal transfer of asset ownership from issuer to investor. This move aims to replace symbolic or beneficial ownership with enforceable, asset-backed arrangements, thereby aligning sukuk more closely with Shariah principles of transparency and risk-sharing. As of April 2025, the standard remains in draft form, with revisions underway based on industry feedback.

The present – potential market impact

The proposed changes have sparked considerable debate within the market. If implemented, the requirement for enforceable asset ownership could increase transaction costs due to legal formalities, asset registration and tax tracking. These costs may be passed on to investors, potentially reducing the appeal of sukuk instruments. Issuers, particularly sovereigns and corporates, may be hesitant to relinquish control over strategic assets, which could dampen issuance appetite. The shift in risk profile – from issuer creditworthiness to asset performance – could make sukuk investments more equity-like, which may not align with the mandates of certain investors.

From a market positioning perspective, sukuk typically trade at a premium to conventional bonds due to strong local investor support. However, international managers often favour conventional bonds for their higher yields and similar credit risk profiles. These managers may engage with sukuk opportunistically, especially during primary issuance or when spreads widen. Given the lower carry of sukuk, many maintain an underweight position, awaiting clarity on the final form of Standard 62.



Outlook

Despite potential short-term disruptions, we believe the long-term outlook for Islamic finance remains positive. Key sukuk-issuing countries such as Malaysia, Saudi Arabia and Indonesia currently follow their own national

Shariah frameworks and do not mandate AAOIFI standards. These jurisdictions, which accounted for 68% of 2024's total sukuk issuance,² may adopt Standard 62 selectively, depending on the benefits of attracting AAOIFI-compliant investors. As these economies continue to grow, they are expected to remain central to the sukuk market, albeit with possible adjustments in issuance pace and structure.

The transition period of one to three years proposed by AAOIFI could lead to a temporary surge in sukuk supply, as issuers seek to front-load funding under the current framework. Institutional investors committed to AAOIFI-compliant instruments may absorb this supply, especially if future issuance becomes more constrained.

What could go wrong?

Several risks accompany the implementation of Standard 62. Increased transaction costs and structural complexity may deter issuers and investors alike. Rating agencies may need to reassess both new and grandfathered sukuk, introducing potential rating uncertainty. In extreme cases, issuers facing financial distress could challenge their obligations on grounds of Shariah non-compliance, potentially leading to restructuring scenarios. The equity-like risk profile may also alienate investors who are not equipped to manage asset performance risk.

Ultimately, we believe the success of Standard 62 will depend on the flexibility of its implementation and the willingness of market participants to adapt to a more rigorous Shariah framework.

2. S&P, L&G as at January 2025

Unless otherwise stated all views expressed are by L&G as at October 2025.

Contact us:

For further information about the Asset Management business of L&G, please visit am.landg.com or contact your usual L&G representative.



Key risk

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