



A Note from the AB Fixed Income Trading Desk

Thoughts from Our Senior Portfolio Managers

New Highs, Old Risks

“You can’t predict. You can prepare.”—Howard Marks

As the world turns toward the World Cup, markets are sorting through their own field of winners and losers across stocks and bonds. New highs do not erase old risks; they change how much room markets have to absorb them. Two months after the Iran ceasefire was announced, investors are still waiting for the next “deal” that always seems close, but not quite complete. Gas prices have stayed above \$4 per gallon, central banks have turned more cautious and growth risks have not gone away. Yet corporate earnings have been strong, the labor market remains intact and equities ended May at record highs. That tension is the story: markets are acting more confidently, but the margin for error has narrowed. In this note, we unpack the May rally, what it means for fixed-income investors, and how the balance between growth, inflation and policy continues to shape the opportunity set.

Recent Market Events and Data Releases (May 2026)

Equity Rally: Corporate earnings helped support the improvement in market sentiment and reinforced the equity market recovery. First-quarter results were stronger than expected, with a large share of S&P 500 companies beating earnings estimates and overall earnings growth running at its strongest pace since 2021. Large-cap technology, communication services, financials and industrials were among the key contributors, supported in part by continued AI-related momentum. The S&P 500 ended May at all-time highs, helped by strong earnings, leadership from large-cap technology stocks and improved geopolitical sentiment after the Iran conflict de-escalated. The index is now more than 1,100 points, or roughly 18%, above its first-quarter lows (*Display 1*) and also up nearly 10% year-to-date, leaving valuations more elevated as markets price in a more constructive earnings backdrop.

Credit: Credit markets strengthened alongside equities. Investment-grade spreads moved near historically tight levels at roughly 72 basis points, while high-yield spreads ended May at 257 basis points (*Display 2*). Stronger earnings and higher stock prices helped improve the market’s view of corporate balance sheets, while demand for corporate bonds remained solid. New issuance was generally well received, and broad public-credit fundamentals remained stable. At the same time, leveraged-loan defaults and private credit exposures continued to receive market attention.

Rates: Treasury yields remained elevated even after partially retracing their late-May move higher. The 10-year Treasury yield was around 4.50% to end the month of May (*Display 3*), while short-term inflation expectations moved back toward longer-term averages and closer to the Fed’s target range (*Display 4*). The main change was in expectations for Federal Reserve policy. Markets moved away from the clearer rate-cut path that had been priced in at the start of the year and assigned a higher probability to the possibility of a rate hike over the next 12 months (*Display 5*). Real yields also remained firm, and the yield curve stayed positively sloped, reflecting a market still adjusting to the possibility that policy rates may stay higher for longer.

Macro: Economic data were mixed but still consistent with a growing economy. Inflation picked up again in April, with both CPI and personal consumption expenditures inflation running above levels consistent with the Fed’s target, and core CPI rising to 2.8% year over year. First-quarter GDP was revised lower but remained positive. Spending data were also mixed: retail sales continued to show consumer spending growth in nominal terms, though inflation reduced the strength of real spending. Manufacturing data improved in May, with the ISM Manufacturing Index rising to a four-year high as new orders and production increased. However, the details were not uniformly positive. Survey commentary continued to point to price pressures tied to energy, geopolitical uncertainty and data-center demand, while also noting softer consumer demand and broader business uncertainty. The S&P Global manufacturing PMI was revised down slightly in its final May reading, and April construction spending increased modestly, though prior months were revised lower.

Jobs: The labor market looked more resilient in May, posting a third consecutive solid month of hiring. Nonfarm payrolls increased by 172,000, while March and April were revised higher by a combined 93,000 jobs. The unemployment rate held steady at 4.3%, labor-force participation was unchanged at 61.8%, and wage growth remained steady, with average hourly earnings up 0.3% for the month and 3.4% over the year. Job gains were led by leisure and hospitality, local government and health care, while financial activities declined. The rebound in hiring has helped ease concerns that emerged from the labor-market deterioration in late 2025. It also carries clear policy implications: with the labor side of the Fed’s mandate looking less urgent, the bar for rate cuts has moved higher while inflation risks remain front and center.

Portfolio Manager Perspectives

Growth Risks: We think the growth backdrop is stronger than the headlines suggest, but less forgiving than asset prices imply. Consumer spending remains resilient, labor conditions have cooled without cracking and AI-related capital spending continues to provide meaningful support to business investment. A durable de-escalation in Iran and normalization of energy flows through the Strait of Hormuz would also be growth-positive and disinflationary at the margin. Fiscal spending driven by the military conflict should remain a mechanical support to nominal growth as well.

The caveat is energy. If oil flows remain constrained or prices move materially higher, the impulse shifts quickly from supportive to stagflationary. Higher energy costs would pressure real incomes, weigh on consumer demand and complicate the disinflation story. Our base case remains that growth can hold up, but the market's tolerance for disappointment has clearly narrowed.

Central Banks: We expect central banks to remain more cautious than markets wanted at the start of the year. In the US, the Fed is no longer facing a labor market that demands immediate support, while inflation risks have become harder to dismiss. The Fed can look through a temporary spike in headline inflation, but it will be much less willing to look through a persistent energy shock if it begins to feed into core inflation, wage expectations or longer-term inflation psychology.

Kevin Warsh's nomination also matters for tone. We would expect the Fed to remain disciplined in its messaging until his first press conference, with a bias toward preserving inflation-fighting credibility. Outside the US, policy divergence should remain important. Europe and the UK are more exposed to energy-price pass-through, while the Bank of Japan remains on a more hawkish path. The broad point is simple: the global easing cycle investors hoped for at the start of the year has become less synchronized and more conditional.

Application for Rates: Rates are now being pulled between stronger growth and still-contained long-term inflation expectations. May payrolls weakened the case for near-term cuts by showing that labor-market risks have faded, while AI-related capex and resilient demand suggest the economy may be less restricted by current policy than previously assumed. At the same time, breakeven inflation expectations have moved back toward more normal ranges, leaving elevated nominal yields largely a function of firm real yields, stronger growth expectations and uncertainty around the Fed's reaction function.

We now think the Fed is most likely to stay on hold, with a high bar for both cuts and hikes. Cuts are harder to justify with the labor market improving, but hikes are not obvious either: recent inflation pressure appears tied more to energy, tariffs and supply-side dynamics than broad overheating, and additional tightening could weigh on already softer rate-sensitive sectors like housing without meaningfully slowing the AI investment cycle. That keeps rate volatility elevated and reinforces our preference for the belly of the curve, where carry remains attractive, volatility should be more measured and downside protection is most valuable if growth risks reassert themselves.

Application for Credit: We remain constructive on credit, but we think the easy part of the spread rally is behind us. All-in yields remain attractive, fundamentals are still solid, corporate earnings have held up well and moderate inflation can support nominal revenue growth. Defaults should remain manageable if growth stays positive, and even in a weaker macro scenario, we would expect the first impact to show up through valuations before it becomes a broader credit-cycle problem.

That said, tight spreads leave less room for error. We would not add credit beta indiscriminately. We believe the better approach is to use credit deliberately: emphasize income, quality, diversification and structures that can withstand a wider range of outcomes. For investors, we continue to think credit can be funded from both sides of the traditional 60/40 portfolio. From cash, it can improve income potential. From equities, high yield and short-duration high yield can reduce reliance on equity upside while still keeping clients invested in a constructive growth environment.

Investment Implications

We continue to prefer a balanced fixed-income posture with a global tilt. Markets have rallied on the back of AI enthusiasm or potential euphoria. Tech sensitive markets have driven the semiconductor sector in the S&P up 33% year to date. However, tighter credit spreads, elevated Treasury yields and a more cautious central-bank backdrop argue for portfolios that are diversified by region, rate cycle and credit exposure. For advisors, this is a good time to review whether client portfolios are overly concentrated in US duration, US corporate credit or cash-like exposures.

- **Global Bond—USD Hedged:** A USD-hedged global bond strategy can be a practical complement to core bond allocations. Central banks are no longer moving in lockstep, creating opportunities across global yield curves as policy paths diverge by region. A hedged global approach allows investors to maintain high-quality, intermediate-duration exposure while giving portfolio managers the flexibility to shift between US and non-US markets as conditions change. For clients who still need ballast against equity volatility but want more flexibility than a traditional US-only core bond allocation, global bond can broaden the opportunity set without abandoning quality.

- **Global High Yield:** Credit fundamentals remain supported by healthy earnings and demand for income, but with US high-yield spreads already tight, we believe the next step should be broader rather than simply bigger. A global high-yield allocation can expand the opportunity set beyond US corporate credit by adding exposure to European high yield, emerging-market corporates and select securitized credit. We believe that broader mix can provide additional sources of income, regional diversification and exposure to different economic and credit cycles. For advisors, the key message is that clients who already own high yield may not need more US high yield; they may need a more diversified version of the exposure.
- **Short-Duration High Yield:** For clients who believe the economy can hold together but are not ready to take a full step into broad high yield, short-duration high yield remains a useful middle ground. These strategies typically focus on higher-quality high-yield issuers, carry less spread duration than the broad high-yield market and sit in a part of the curve that still offers attractive income. Yields above 6% can help improve portfolio income, while the shorter-duration profile can help reduce sensitivity to rate volatility and limit drawdown risk if market sentiment weakens. This is not risk-free, but it can be a more measured way to add credit exposure for clients who want more income without taking on the full volatility of the broader high-yield market.

Bottom line: The rally has improved confidence, but it has also reduced the margin for error. That makes diversification more important, not less. We believe global bonds, global high yield and short-duration high yield each offer a different way to help clients stay invested, increase income and manage risk in a market where both rates and spreads leave less room for error.

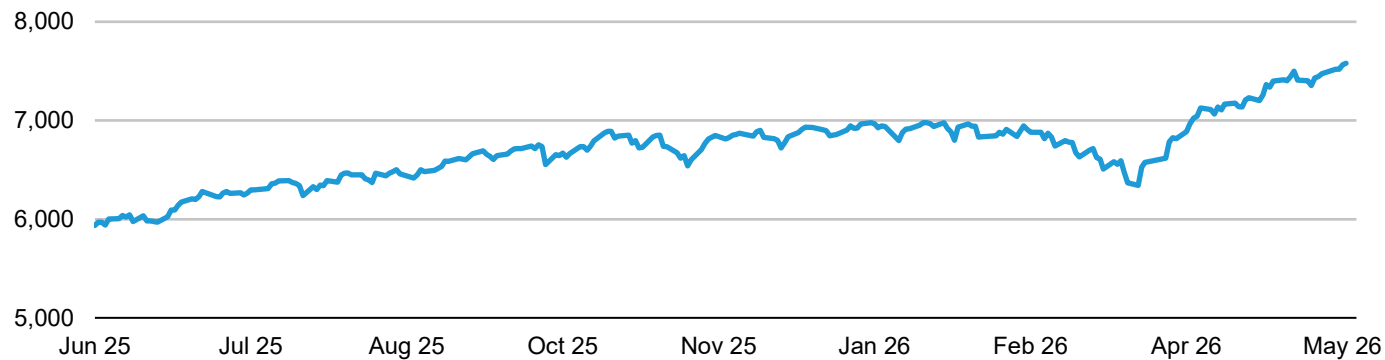
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Display 1: Equity Markets Rallied to New Highs in May

S&P 500—Last Price (USD)

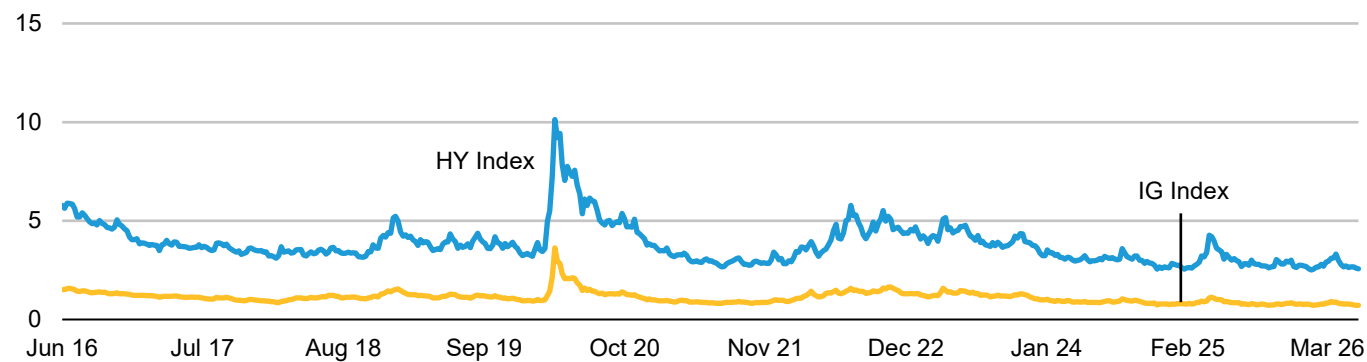


As of May 31, 2026

Source: Bloomberg

Display 2: Credit Spreads Have Tightened Back to a Sliver Within All-Time Tights

Bloomberg Corporate Bond Indices (Option-Adjusted Spread)



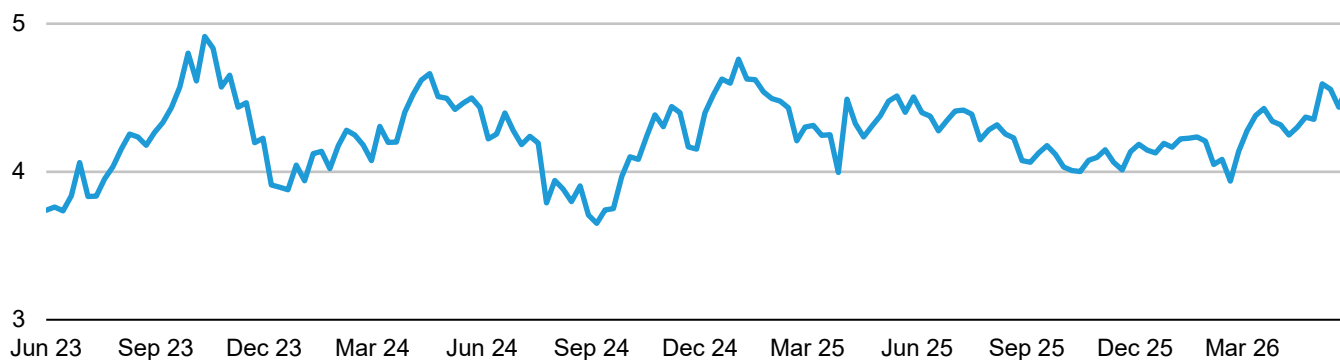
HY: high-yield; IG: investment-grade

As of May 31, 2026

Source: Bloomberg

Display 3: Treasury Yields Remain Near Local Highs Despite Month-End Retracement

10-Year Treasury Bond (Yield to Maturity)



As of May 31, 2026

Source: Bloomberg

Display 4: Inflation Expectations Have Fallen Back to Recent Averages

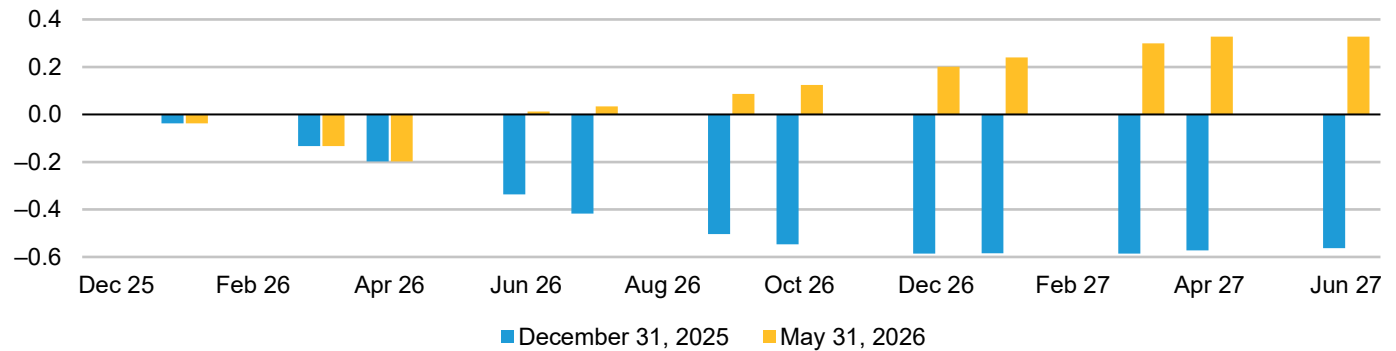
One-Year Break-Even Inflation Expectation (Percent)



As of May 31, 2026
Source: Bloomberg

Display 5: The Market Is Now Pricing In a Substantial Probability of a Fed Hike Within the Next Year

Number of Hikes/Cuts (25 bps Increments)



bps: basis points
As of May 31, 2026
Source: Bloomberg

Investment Risks to Consider

The value of an investment can go down as well as up, and investors may not get back the full amount they invested. Capital is at risk. Past performance does not guarantee future results.

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