

Corporate Bond Market Insight | July 2026

Resilient Growth Meets Rising Inflation

Key takeaways

- » The economy stayed resilient in the second quarter, despite geopolitical volatility, supported by earnings, consumer spending and AI-related investment.
- » Inflation pressures rose across producer and consumer prices, though lower energy prices may signal a near-term peak. Inflation is likely to remain elevated through year-end.
- » The Fed held rates steady under new chair Kevin Warsh while shifting to a more neutral, inflation-focused stance. He also offered less forward guidance in keeping with his beliefs.
- » Investment-grade corporates held up well despite record June issuance, with spreads near historic tights. Current yields may make laddered IG corporates an attractive volatility hedge.

Recap

The second quarter of 2026 saw stronger-than-expected economic growth, rising inflation, steady interest rates and robust corporate earnings. Kevin Warsh replaced Jerome Powell as chair of the Federal Reserve (Fed), which held the federal funds rate steady at his first meeting. The ebb and flow of geopolitical news created a great deal of volatility but did little to derail the strength in equity and credit markets or the economy. As the second quarter drew to a close, the tentative cessation of hostilities between Iran and the United States created a significant cutback in energy prices, suggesting relief from the growing inflation threat. Investment-grade (IG) credit performed well.

Inflationary pressures continue to grow, particularly at the producer or early-stage level. The Institute of Supply Management reports that 82.1% of the respondents paid higher materials prices, which is the fourth straight month above 70.0%. More importantly, given its much larger weight in the economy, inflationary pressures are also evident in the services sector. Over 70% of companies reported higher prices in each of the last three months. Early-stage inflation is also present in the Core Producer Price Index's 4.9% annual growth rate. Increases in producer prices are eventually reflected in Consumer Price Index (CPI), but with a lag. This suggests that even given the recent weakness in energy, that inflation pressure will remain elevated over the rest of the year.

Consumer prices also continue to move higher. The headline CPI rose 0.5% in May. This brings the annual growth rate to 4.2%, the highest in three years. Core CPI, which excludes food and energy, rose 0.2%, bringing the annual growth rate to 2.9%. The Fed's preferred inflation gauge, the Core Personal Consumption Price Index, is currently rising at a 3.4% annual rate, a full 1.4% above the Fed's 2.0% average inflation target.

Energy and tariffs have been significant contributors to the recent rise. For instance, over 60% of the monthly increase in May's headline CPI rate was energy related. The energy costs associated with the war are still working their way through the economy, but we think that either the May or June CPI will be inflation's high point for the year.

In Kevin Warsh's first meeting as Fed chair, the committee left the federal funds rate unchanged, but the bias moved from easing to neutral. Chair Warsh reinforced his reputation as an inflation hawk and confirmed his commitment to producing less forward guidance. In line with his stated belief that the Fed overcommunicates and encourages speculation when it issues too much forward guidance, he removed that section

from the post meeting statement, reducing it from 341 words to a brief 130 words. The statement ended with the definitive declaration that the "committee will deliver price stability." The subsequent yield curve flattening suggests that the markets believe him.

The summary of economic projections (SEP), represented by the dot plot, reflected a significant shift from the prior plot. Nine members now project increasing rates one or more times this year. This includes six who believe that there will be multiple hikes. Notably, chair Warsh declined to issue a projection. We expect the Fed will end the SEP and its accompanying dot plot soon.

Warsh also launched five task forces to assess multiple policies including communication, the balance sheet and the inflation framework. We expect significant changes to Fed messaging and operations over the coming quarters. Most importantly, we continue to view chair Warsh as a strong proponent of price stability.

IG corporates continue to perform well. Despite June's record \$184 billion in new issuance, IG credit spreads were little changed. It should be noted that June has typically seen lower issuance as the summer lull approaches, but the needs of hyperscalers are changing the historic issuance dynamic. At one point in June, IG credit spreads were within one basis points (bps) of the record low set just prior to the Great Financial Crisis even with this supply. Spreads widened modestly to end the quarter, mostly due to weakness in the hyperscalers, but remain within six bps of record tightness. Upgrades versus downgrades were strong in May with \$142 billion upgraded, a sharp increase from the \$77 billion in the prior month.

Against this backdrop, the 10-year Treasury yield increased three bps for the month and 15 bps for the quarter. 1–10 year IG credit spreads widened three bps for the month but compressed 16 bps for the quarter. As a result, the ICE BofA/Merrill Lynch 1–10 Year US Corporate Index returned 0.13% for the month, 1.03% for the quarter and 4.21% over the trailing one year. Changes in credit spreads across sectors were mixed. The best performing sectors were leisure and insurance, while media and telecommunications widened somewhat. For the quarter, all sectors tightened. Lower quality outperformed higher quality.

Capex spending on building of artificial intelligence infrastructure continued to support the expanding economy. With roughly two-thirds of the quarter's economic data reported, GDPNow projects solid second-quarter growth of 2.5%. Employment continues to surprise to the upside.

The three-month average growth rate of 188,000 non-farm jobs is solid, as is the three-month average growth rate of 166,000 monthly private payroll jobs. This is particularly notable in an environment where only modest job growth is needed to keep the unemployment rate stable. On a somewhat negative note, layoff announcements continued to trend higher and have reached the highest level since the COVID-19 layoffs in May 2020. The four-week average of initial jobless claims has also risen to 224,000, the highest since late 2025.

Consumer spending continues to support the economy. The Johnson Redbook Index, which measures year-over-year growth at the same retail location and covers 80% of all domestic retail sales, grew at a strong 10.5% rate. The retail sales control group, the part of retail sales that directly contributes to GDP, grew at a 0.7% rate in May.

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Looking forward

We continue to believe that laddered investment-grade corporates at current all-in yields offer a significant hedge against volatility. If inflation is indeed peaking, rates should begin to fall. But, we believe the high all-in-yield and the agnostic nature of ladder investment provides significant long-term cushion even if inflation continues to rise.

We think the Fed will be on hold through the balance of the year, but that less communication will see markets react more to events and releases as they occur.

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Parametric is headquartered at 800 Fifth Avenue, Suite 2800, Seattle, WA 98104. For more information regarding Parametric and its investment strategies, or to request a copy of Parametric's Form ADV or a list of composites, contact us at 206 694 5500 or visit www.parametricportfolio.com.

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