

Corporate Bond Market Insight | June 2026

# Rising Prices, Resilient Credit and A Reduced Fed Footprint

## Key takeaways

- » Inflation rose in May, with headline CPI at 3.8% and Core PCE at 3.3%, as increasing energy costs filter through the broader economy.
- » Kevin Warsh's arrival as Fed chair signals a likely shift toward tighter inflation discipline, reduced forward guidance and a smaller Fed footprint in markets.
- » Investment-grade corporate bonds remained well supported while strong earnings, solid balance sheets and attractive yields helped absorb heavy new issuance.
- » Although growth and labor data remained firm, consumer spending is weakening while inflation outpaces wages and households rely more on savings and credit cards.

## Recap

The ebb and flow of geopolitical news dominated again in May. The cease fire with Iran held and energy prices, while still high, stabilized. Rising inflation and a strengthening business environment led the Federal Reserve (Fed) to hold rates steady. Kevin Warsh was sworn in as the new Fed chair, corporate earnings were strong and business investment grew at the fastest pace in nearly three years. Large capitalization equities rallied sharply, setting new all-time highs, corporate credit spreads improved and interest rates rose modestly.

Inflation is becoming a significant problem. The 3.8% year-over-year (YOY) headline CPI is the highest reported in three years. The Fed's preferred inflation gauge, core PCE, rose 0.2% in April. This brings the YOY measure to 3.3%, a full 1.3% above the Fed target and the highest since November of 2023. It's worth noting that core PCE excludes both food and energy. More concerning, inflation at the producer level is rising while demand for raw materials to build data centers pushes commodities and services prices higher. This is a trend that predates the Iran war. While companies will absorb some of the early-stage inflation, it's likely that these costs will mostly be pushed through to consumers over coming months.

On May 22, Kevin Warsh was sworn in as the 17th chair of the Fed. His 14-year term as chair will end in May 2030 and his term as a member of the board will end in January 2040. A wide array of complex economic, inflation and political questions will immediately challenge his tenure.

Chair Warsh has strong credentials. He previously sat on the board from 2006 through 2011. His tenure ended when he resigned in protest over the implementation of the second round of quantitative easing (QE2). At the time, he believed that the long-term inflationary risks of more stimulus outweighed the temporary benefits. To his credit, he was the only sitting governor to publicly voice doubts over the need for more stimulus.

He has also expressed skepticism about current communication policy, particularly regarding forward guidance on the path of monetary policy. He believes that excessive guidance traps the Fed in a defined narrative that discourages change and limits flexibility. He also believes that guidance encourages speculation rather than restraint on the part of investors. A good example of a communication vehicle that may be eliminated or curtailed is the quarterly Summary of Economic Projections. The summary projects the Fed's economic consensus around GDP, the unemployment rate and inflation. It then projects the data into a future federal

funds rate (the dot plot). Investors forget that the Fed is always data and event dependent, and the Fed believes that the information contained in the dot plot is a policy promise rather than a best guess.

Warsh's general view is that innovation-created productivity gains such as artificial intelligence (AI) and financial deregulation will lower the neutral rate for federal funds. But he must first deal with the current rise in inflation before he turns his attention toward an economy undergoing revolutionary change.

During his confirmation, he expressed a dovish bias, but more recent comments suggest that he thinks rates should be held steady until the current rise in inflation is curtailed. Comments from several of the current voting members suggest that the balance of the committee has become more focused on the inflation portion of the dual mandate. We expect that the Warsh Fed will significantly constrain forward guidance, be far less interventionist, more diligent on inflation and will seek a smaller Fed footprint on markets. We think it's likely that he will work to shrink the Fed's balance sheet, but that the rapid growth in fiscal deficits may make the task difficult.

Despite the rise in rates and robust issuance, investment-grade (IG) credit spreads have improved to near their post financial crisis tightness. Strong corporate earnings, solid balance sheets, high all-in yields and signs of economic growth are all contributing to the strong demand. Credit spreads tightened despite nearly \$185 billion in new issuance. Hyperscalers again dominated the new supply. New IG issuance is still on track to reach the vicinity of \$2 trillion by the end of the year and to this point, the new supply has been readily absorbed.

Against this backdrop, the 10-year Treasury yield rose six basis points (bps) for the month and 1- to 10-year IG credit spreads narrowed eight bps for the month. As a result, the ICE BofA/Merrill Lynch 1-10 Year US Corporate Index returned 0.37% for the month, and 5.45% over the trailing one year. All sectors tightened for the month. The best performing sectors were automotive and leisure while basic industry lagged somewhat. Lower quality outperformed higher quality.

The economy continued to perform well. April non-farm payrolls rose 115,000, well above consensus estimates, while March payrolls were revised slightly higher to 185,000. The two months are the first back-to-back monthly increases in almost a year. The three-month average gain of 48,000 is well above the level needed to keep the unemployment rate from rising. The Institute for Supply Management (ISM) Manufacturing Purchasing Managers Index (PMI) remained

above 50 for the fourth consecutive month and the forward-looking new orders component remained strong. The services PMI also remained above 50. Both manufacturing and services managers reported widespread price increases. The Atlanta Fed's GDPNow estimate suggests that, with roughly one-third of the second quarter's data in place, growth will be near 4.0%.

Retail sales remained strong with the control group, the portion of retail sales that flows through to GDP, rising a solid 0.5%. This leaves growth at a 4.9% year-over-year nominal rate. On a less promising note, inflation in excess of wage growth is eroding consumer purchasing power. Savings drawdowns and credit card spending is increasingly supporting current spending, particularly among the lower economic cohorts who haven't enjoyed the wealth effects that rallying equities and higher rates have created.

## Looking forward

The second half of the year is likely to be more volatile than the first half. The new Fed chair is inheriting a strong economy, but inflation risk is rising and geopolitical risks are far from resolved. Data center growth should continue to power the economy, but with consumers beginning to draw on savings and credit cards to support spending, the consumer outlook is fading somewhat. No matter, IG corporate balance sheets are still in solid shape, earnings are strong and all-in yields continue to support investment in IG corporate bonds.

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