

Corporate Bond Market Insight | March 2026

How are the Fed and Investors Adjusting to AI?

Key takeaways

- » In the wake of the Supreme Court ruling on IEEPA tariffs, the president announced a new, likely temporary, 15% global tariff. Estimates say that the government may need to refund nearly \$300 billion in collected tariff revenue to corporations if lengthy challenges in court are successful.
- » The Fed is contending with artificial intelligence (AI) caused disruptions to employment, inflation and the economy, and it's unclear if it will be successful easing into the new paradigm shift.
- » Core PCE rose unexpectedly at month end, solidifying concerns that progress toward the Fed's inflation goal has stalled.
- » Credit spreads widened in February, and concerns around private credit specifically intensified with the equity prices of several large private credit funds declining.

Recap

The Supreme Court ruled in February that tariffs created under the International Emergency Economic Powers Act (IEEPA) were illegal, worries around private credit intensified and the U.S. struck Iran with a barrage of air strikes. New fears of disruptions to the software industry created significant equity volatility. However, large-capitalization indexes like the S&P 500® are still in the same ranges that have defined trading over the last six months. The economic backdrop was mixed, and inflation ran modestly hotter than expected. Ten-year Treasury yields fell while credit spreads widened.

Tariffs are the centerpiece of the president's economic policy, and we expect that he will pursue all means to replace the now illegal IEEPA tariffs. Following the Supreme Court's ruling, the president announced a new 15% global tariff under section 122 of the Trade Act of 1974. Exemptions exist for critical minerals, pharmaceuticals and other critical needs, but these tariffs are temporary and will expire in 150 days unless Congress votes to extend them. In the meantime, the administration is working to enact new tariffs under sections 301 and 232. Section 301 relates to unfair trade practices and 232 to national security. Estimates are that the government will have to refund nearly \$300 billion in collected tariff revenue to corporations, although the mechanism to do so is unclear and the court cases are certain to last for years.

The Fed didn't meet in February, but the January minutes were more hawkish than expected. It's notable that several voting members have shifted from advocating for cuts toward a more cautious wait-and-see posture. In his farewell remarks, retiring Atlanta Fed president Raphael Bostic advocated for pausing while policy rates are still in mildly restrictive territory. He went on to say that progress on inflation has "stalled out." We think this is the majority view of the voting members.

This is a complicated time for the Fed while it contends with the disruptions AI is having on employment, inflation and the economy. The Fed's traditional tools are designed to offset cyclical economic swings, but it's growing clear that the economy is facing significant structural change. How effective they will be in easing the transition to a new paradigm remains to be seen. Chair Jerome Powell will preside over both March and April meetings, and unless there is clear economic deterioration, we expect the Fed to remain on hold until his term is over.

Investors are beginning to factor the disruptions of agentic AI's rapidly expanding abilities into their portfolios. In late February, concerns around the viability of the software as a service (SaaS) model, and potential spillovers into other technology-related sectors, intensified, and both credit and equity sectors cheapened. This is a significant change from the last few years when credit and equity sectors rallied in a highly correlated manner. Concerns around disruption are now creating a clear distinction between sectors. In an environment where name and sector dispersion is increasing, credit analysis is incrementally more important to investors.

Credit spreads widened in February, but underlying fundamentals are still solid. Strong balance sheets and earnings coupled with low default rates and an economy that continues to perform well are all contributing to general stability.

Concerns around private credit intensified during the month. Equity prices of several large private credit funds declined, in some cases following announced dividend reductions. Investor focus has centered on the sector's exposure to technology, particularly software, and the potential impact that AI-driven disruption could have on underlying loan performance. In general, business development companies (BDCs) are especially vulnerable to volatility given the relatively lower liquidity and weaker credit quality of their investments, combined with a shareholder base that includes a significant proportion of retail investors. While we remain vigilant, our assessment is that these developments reflect largely idiosyncratic issues rather than a meaningful increase in systemic risk.

February issuance was again high. Year-to-date issuance is already approaching \$400 billion, and firms are upping 2026 issuance estimates to the \$1.8 to \$2 trillion range. However, the supply is being well received. For instance, Google issued a \$1.4 billion 100-year Sterling bond that was nearly ten times oversubscribed. Other large hyperscaler issues have been oversubscribed three to four times. Demand for corporates is still strong.

Against this backdrop, the 10-year Treasury yield fell 30 basis points (bps) for the month, and 1-10 year investment-grade (IG) credit spreads widened 11 bps for the month. As a result, the ICE BofA/Merrill Lynch 1–10 Year US Corporate Index returned 0.95% for the month and 7.09% over the trailing one year. For the month, all sectors widened. The best performing sectors were energy and telecommunications, while the worst performing sectors were services, financial services and insurance. Higher quality outperformed lower quality.

The month's economic results were mixed. Nonfarm payrolls rose by 130,000 and the unemployment rate fell from 4.4% to 4.3%. The private sector added a solid 173,000 new jobs even while government employment shrank. Average hourly earnings and average hours worked both rose. There was also a large downward revision to last year's payrolls. The revision reduced the 2025 average monthly non-farm payroll gain from 49,000 to 15,000. However, despite the mediocre job gain, it's notable that the high prime working age employment suggests that the U.S. is running near full employment.

The first estimate of Q4-25 GDP was also weaker than expected. The disruptions from the government shutdown mostly created the weaknesses. Private sector GDP grew at a solid 2.8% annual rate. The Fed's preferred inflation gauge, core PCE, rose an unexpectedly strong 0.4% when the month ended. This increased the year-over-year rate to 3.00%, the highest since April 2025. Producer prices also rose significantly with core prices up 0.8% month over month and 3.6% year over year.

Looking forward

Monetary and fiscal stimulus continue to function like economic tailwinds. Combined with the continued growth in AI infrastructure spending, near-term prospects for a recession are low. The likelihood of disruption from agentic AI is growing and is beginning to show up in the sectors most affected such as software and IT services. Some first-quarter impact from winter storm Fern is also likely; however, much of the lost GDP is delayed rather than destroyed and should serve to boost second quarter's GDP. We're closely watching a rally in crude due to a significant increase in geopolitical risk. Increasing energy costs can be a drag on GDP, but the duration and consequence of the disruption isn't yet clear. The dispersion in returns suggests that credit analysis will become ever more important. The mechanics of ladder investing will again prove important while uncertainty hedges.

ABOUT

Parametric Portfolio Associates LLC (“Parametric”), headquartered in Seattle, is registered as an investment advisor with the US Securities and Exchange Commission under the Investment Advisers Act of 1940. Parametric is a leading global asset management firm, providing investment strategies and customized exposure management directly to institutional investors and indirectly to individual investors through financial intermediaries. Parametric offers a variety of rules-based investment strategies, including alpha-seeking equity, fixed income, alternative and options strategies. Parametric also offers implementation services, including customized equity, traditional overlay and centralized portfolio management. Parametric is part of Morgan Stanley Investment Management, the asset management division of Morgan Stanley, and offers these capabilities through offices located in Seattle, Boston, Minneapolis, New York and Westport, Connecticut.

DISCLOSURES

This material may not be reproduced, in whole or in part, without the written consent of Parametric. Parametric and its affiliates are not responsible for its use by other parties.

This information is intended solely to report on investment strategies and opportunities identified by Parametric. Opinions and estimates offered constitute our judgment and are subject to change without notice, as are statements of financial market trends, which are based on current market conditions. We believe the information provided here is reliable but do not warrant its accuracy or completeness. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Past performance is not indicative of future results. The views and strategies described may not be suitable for all investors. Investing entails risks, and there can be no assurance that Parametric will achieve profits or avoid incurring losses. Parametric and Morgan Stanley do not provide legal, tax or accounting advice or services. Clients should consult with their own tax or legal advisor prior to entering into any transaction or strategy described herein.

Charts, graphs and other visual presentations and text information were derived from internal, proprietary or service vendor technology sources or may have been extracted from other firm databases. As a result, the tabulation of certain reports may not precisely match other published data. Data may have originated from various sources, including, but not limited to, Bloomberg, MSCI/Barra, FactSet or other systems and programs. Parametric makes no representation or endorsement concerning the accuracy or propriety of information received from any third party.

The views expressed in this report are those of the authors and are current only through the date stated at the top of this page. These views are subject to change at any time based on market or other conditions, and Parametric disclaims any responsibility to update such views. These views may not be relied on as investment advice and, because investment decisions are based on many factors, may not be relied on as an indication of trading intent on behalf of any Parametric strategy. This commentary may contain statements that are not historical facts, referred to as “forward-looking statements.” The strategy’s actual future results may differ significantly from those stated in any forward-looking statement, depending on factors such as changes in securities or financial markets or general economic conditions.

References to specific securities and their issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, a recommendation to purchase or sell such securities. There is no guarantee as to its accuracy or completeness. Past performance is no guarantee of future results. All investments are subject to the risk of loss. Prospective investors should consult with a tax or legal advisor before making any investment decision.

The index data referenced herein is the property of ICE Data Indices, LLC (“ICE”), its affiliates and its third-party suppliers. ICE, its affiliates and its third-party suppliers accept no liability in connection with its use.

An imbalance in supply and demand in the income market may result in valuation uncertainties and greater volatility, less liquidity, widening credit spreads and a lack of price transparency in the market. As interest rates rise, the value of certain income investments is likely to decline. Investments in income securities may be affected by changes in the creditworthiness of the issuer and are subject to the risk of nonpayment of principal and interest. The value of income securities also may decline because of real or perceived concerns about the issuer’s ability to make principal and interest payments. While certain US government–sponsored agencies may be chartered or sponsored by acts of Congress, their securities are neither issued nor guaranteed by the US Treasury. Mortgage- and asset-backed securities are subject to credit, interest rate, prepayment and extension risk. Derivative instruments can be used to take both long and short positions, be highly volatile, result in economic leverage (which can magnify losses) and involve risks in addition to the risks of the underlying instrument on which the derivative is based, such as counterparty, correlation and liquidity risk. Diversification does not guarantee profit or eliminate the risk of loss.

All contents ©2026 Parametric Portfolio Associates LLC. All rights reserved. Parametric Portfolio Associates®, Parametric with the triangle logo, Custom Core®, Custom to the Core®, and Make passive investing personal® are trademarks registered in the U.S. Patent and Trademark Office.

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.

NOT FDIC INSURED. NO BANK GUARANTEE. MAY LOSE VALUE. NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY. NOT A DEPOSIT.