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The limits of carry

Head of Multi-Asset Macro Investing Michael Contopoulos explains why, with credit spreads at historic tights and rates moving higher, investors should focus on resilient yield, as there is limited room for price appreciation.

Key takeaways:

- Liquidity, not credit quality, is likely to be the primary risk in corporate markets, particularly as stress emerges in private credit and investors are forced to sell what they can, not what they want.
- Spikes in rate and equity volatility should further erode carry, creating asymmetric downside risk.
- In our view, the current environment argues for patience, flexibility, and an emphasis on resilient yield over stretched credit.

The economy is stronger than the narrative

The U.S. economy is stronger than widely perceived. Despite tariffs, geopolitical conflict, and what appears to be late-cycle dynamics, profit growth remains positive and liquidity continues to be supportive. Inflation is moving higher, not lower, while labor market data remains exceptionally strong. In fact, we haven't seen jobless claims this low since the "Guns & Butter" era of the 1960s, despite today's much larger labor force.

Yet recent market narratives have focused on something far narrower: a handful of mega-cap artificial intelligence (AI) beneficiaries and expectations for Federal Reserve (Fed) easing. In our view, this disconnect is not being driven by fundamentals.

What the market is saying	What the data shows
<ul style="list-style-type: none"> • Labor market is cracking 	<ul style="list-style-type: none"> • Jobless claims near 1960s lows
<ul style="list-style-type: none"> • Fed needs to cut rates 	<ul style="list-style-type: none"> • Treasuries pricing inflation, not growth shock
<ul style="list-style-type: none"> • AI will boost productivity and inflation will fade 	<ul style="list-style-type: none"> • Inflation bottomed in April 2025* • National Bureau of Economic Research: 80%-90% of firms see no AI lift on labor productivity**
<ul style="list-style-type: none"> • War is good for technology and credit 	<ul style="list-style-type: none"> • War is inflationary and a cause for volatility, which is usually bad for credit and technology

*Source: Core PCE, Bloomberg Finance L.P. **as of May 1, 2026.

Corporate credit: Not getting paid for risk

If underlying economic and profit conditions remain resilient, why have investment-grade corporate bonds (IG corporates) delivered such weak returns? Since Q4 2025, IG corporates have returned -0.2% and are down 1% this year. Munis, collateralized loan obligations (CLOs), mortgage-backed securities and medium-term Treasuries, all areas RBA has leaned into over the last 8 months, have all outperformed IG corporates and have positive returns since end September 2025¹. The answer is straightforward: With spreads at historic tight and rates moving higher, there is limited room for price appreciation.

As the old fixed income saying goes, “The path to hell is paved with carry.” When corporate spreads are this tight, picking up pennies in front of a steamroller isn’t prudent.

The setup	The historical record
<ul style="list-style-type: none">IG spreads below 80 basis points (bps) (near historic lows)	<ul style="list-style-type: none">97% of the time, IG corporates underperform the Bloomberg US Aggregate Bond Index the following year*
<ul style="list-style-type: none">HY spreads below 270 bps (near historic lows)	<ul style="list-style-type: none">87% of the time, HY underperforms the Bloomberg US Agg the following year*
<ul style="list-style-type: none">Interest rates moving higher	<ul style="list-style-type: none">Price appreciation becomes limited
<ul style="list-style-type: none">Carry dominates returns	<ul style="list-style-type: none">Structural bids for credit tend to appear near market peaks

*Data through October 2024. Source: Bloomberg Finance. IG represented by Bloomberg US Corporate Bond Index, HY represented by Bloomberg US Corporate High Yield Bond Index.

Positioning: Boring is beautiful

In this environment, we believe the focus should be on reliable yield. War is inherently inflationary, the economy remains resilient, and Treasury yields are more likely to move higher than lower. Liquidity, not credit quality, is likely to be the primary risk in corporate markets, particularly as stress emerges in private credit and investors are forced to sell what they can, not what they want.

Spikes in rate and equity volatility should further erode carry, creating asymmetric downside risk. In our view, that argues for patience, flexibility, and an emphasis on reliable yield over stretched credit risk.

- Underweight investment-grade and high-yield corporates
- Overweight floating-rate and short-duration assets
- Remain patient and flexible as opportunities emerge
- Favor dividends, international equities, value, gold, and high-quality short-duration fixed income

¹ Source: Bloomberg Finance. Returns for 30 September 2025 through 19 May 2026. Indices used to represent asset classes: IG Corporates = Bloomberg US Corporate Bond Index, Munis = ICE BofA National Long-Term Core Plus Municipal Securities Index, CLOs = US CLOIE AAA Index, mortgage-back securities = Bloomberg US MBS Index, medium-term Treasuries = ICE US Treasury 7-10 Year Bond Index.

Definitions

Basis point (bp) equals 1/100 of a percentage point. 1 bp = 0.01%, 100 bps = 1%.

Bloomberg US Aggregate Bond Index is a broad-based measure of the investment grade, US dollar-denominated, fixed-rate taxable bond market.

Bloomberg US Corporate Bond Index measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate bond market.

Bloomberg US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Bonds from issuers with an emerging markets country of risk, based on Bloomberg EM country definition, are excluded.

Bloomberg U.S. Mortgage Backed Securities (MBS) Index measures the performance of U.S. fixed-rate agency mortgage backed pass-through securities

Carry is the excess income earned from holding a higher yielding security relative to another.

Credit Spread is the difference in yield between securities with similar maturity but different credit quality. Widening spreads generally indicate deteriorating creditworthiness of corporate borrowers, and narrowing indicate improving.

Fundamentals: information that contributes to the valuation of a security, such as a company's earnings or the evaluation of its management team, as well as wider economic factors.

ICE BofA National Long-Term Core Plus Municipal Securities Index is a benchmark designed to track the overall performance of U.S. dollar-denominated, investment-grade, tax-exempt debt publicly issued by U.S. states, territories, and political subdivisions.

ICE U.S. Treasury 7-10 Year Bond Index measures the performance of publicly issued U.S. Treasury securities with a remaining maturity greater than seven years and up to ten years. It is a market-capitalization-weighted benchmark used to track the intermediate segment of the U.S. government debt market

Late cycle: economic growth slows as the economy reaches its full potential, wages start to rise, and inflation begins to pick up, leading to lower demand, falling corporate earnings.

US CLOIE AAA Index (formally the J.P. Morgan AAA-Rated CLO ETF Index) is a benchmark that measures the performance of U.S. dollar-denominated, AAA-rated Collateralized Loan Obligation (CLO) debt securities.

Volatility measures risk using the dispersion of returns for a given investment.

Risks

Fixed income securities are subject to interest rate, inflation, credit and default risk. The bond market is volatile. As interest rates rise, bond prices usually fall, and vice versa. The return of principal is not guaranteed, and prices may decline if an issuer fails to make timely payments or its credit strength weakens.

Collateralized Loan Obligations (CLOs) are debt securities issued in different tranches, with varying degrees of risk, and backed by an underlying portfolio consisting primarily of below investment grade corporate loans. The return of principal is not guaranteed, and prices may decline if payments are not made timely or credit strength weakens. CLOs are subject to liquidity risk, interest rate risk, credit risk, call risk and the risk of default of the underlying assets.

Mortgage-backed securities (MBS) may be more sensitive to interest rate changes. They are subject to extension risk, where borrowers extend the duration of their mortgages as interest rates rise, and prepayment risk, where borrowers pay off their mortgages earlier as interest rates fall. These risks may reduce returns.

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