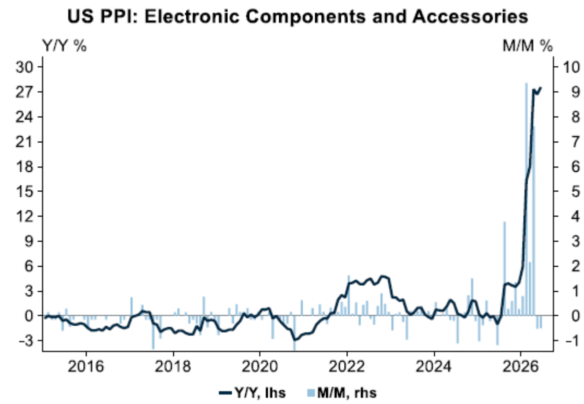
A Transitory Take on Soft Inflation

WEEKLY VIEW FROM THE DESK | July 20, 2026

LINK TO WEEKLY RETURNS TABLE

MACRO

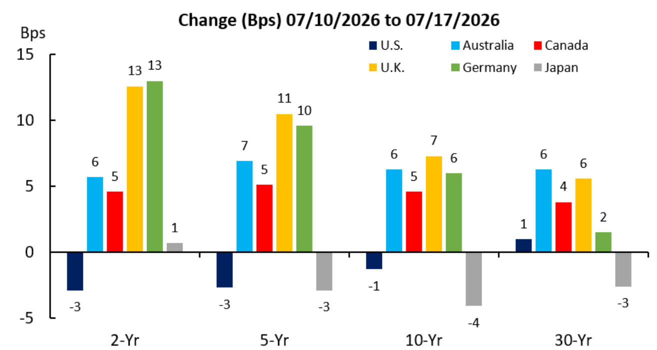
- Market participants continue to process the recent, softer-than-expected U.S. inflation readings. Negative month-over-month CPI and PPI readings for June indicate the potential for one of the softest core PCE readings—the Fed's favored inflation gauge—in at least a year. At this point, we see two paths for U.S. inflation from here. The first is one where inflation continues to fall markedly, prompting the Fed to hold rates or even cut them this year.
- However, we see few, if any, fundamental drivers clearing the path for lower inflation. For example, data series with little implications for future inflation—such as lodging, transportation, and communication services—pulled recent inflation readings lower. Furthermore, shipping through the Strait of Hormuz is again greatly disrupted as the conflict in the Middle East re-escalates.
- The second path is one where inflation remains elevated, leading the Fed to hike rates this year, which is where we believe conditions are heading. Indeed, the drivers of high inflation remain in place with above-trend GDP growth that will likely acclerate in the second half of 2026, a tightening labor market that will put upward pressure on wage growth, and supply side constraints in energy, tech, trade, and labor.
- Indeed, one only needs to observe the parabolic surge in the electronic components and accessories series of the PPI in the accompanying chart for sense of the constraints pertaining to the AI capex boom.
- Fed speakers have also maintained a hawkish tone, and a rate hike cannot be entirely ruled out for the July FOMC meeting. At the minimum, we think it could be a hawkish hold before the Fed implements three 25 bp hikes this year starting in September.



Source: PGIM

DEVELOPED MARKET RATES

- In the short term, we see the U.S. 10-year yield trading in a range of 4.35-4.70% (about 4.62% currently) and maintain a guardedly optimistic outlook given current levels in the context of the trading range. The short-term risks pertain to the Middle East conflict and potential upside surprises to growth and inflation.
- While AI-related developments and headlines may continue to jostle risk assets, we believe the bigger risk to credit spreads is on the rates side, particularly if the policy tightening indicated above were to take the shape of steady or jagged rate hikes.
- In MBS, mortgage fundamentals remain relatively stable, supply remains exceptionally light, and valuations appear more attractive after recent spread widening. While we remain tactically cautious, we are also close to turning more constructive if spreads widen further, particularly given the favorable supply-demand backdrop.



Source: PGIM

IG CORPORATES

- Last week brought $45B in new U.S. IG issuance, slightly higher than expected. Deals were 3.8x oversubscribed and came with a 3.3 bps concession. Mutual fund flows rose by $6.5B. Second-quarter bank earnings have been solid, with strong fee income and net interest income up as well. Overall, with 10% of companies having reported earnings, 88% have beaten expectations.
- There are growing signs of fatigue among the hyperscaler issuers, with declining order book sizes, wider spread concessions, and weak performance in the secondary market.
- In Europe, credit spreads remain resilient and rangebound with the EUR index just 2 bps wider last week. Primary market volume has finally dropped off, following larger-than-expected issuance in both June and the first half of July, and is expected to remain quiet going forward, with just €2.5-7.5B expected this week.

LEVERAGED FINANCE

- U.S. high yield spreads widened modestly, and yields decreased as total returns were mixed across sectors last week. Paper (+2.81%), financials (+0.37%), and energy (+0.23%) were the best performing sectors, while air transportation (-0.55%), telecom (-0.51%), and auto (-0.10%) were the worst. Unliked past risk-off episodes, any selling was orderly and focused on rate-sensitive, lower conviction credits. Last Tuesday's softer inflation data stabilized sentiment, although buying was focused on higher-quality paper and company-specific stories.

- High yield bond funds reports outflows totaling -$393M—the first outflow in seven weeks. Meanwhile, six new deals priced for $6.5B, increasing July's issuance to $8.8B. HY default activity increased in June, as Dish DBS filed for Chapter 11, affecting $9.75B in HY bonds and raised the default rate to 2.67%, which is a high since June 2024. We continue to expect default rates to remain where they are for the remainder of the year and decline modestly to around 2.5% next year.
- U.S. bank loans posted positive returns last week with Bs modestly outperforming. Sixteen new deals launched last week for $22B deals priced for $28B. B2/B rated Dwyer Omega did a $2.35B broadly syndicated loan to refinance a private credit issue, shaving pricing from +475 to +250 in the process.
- European high yield bond spreads were slightly tighter last week. About €5.B in HY issuance has priced so far this month-about €12B lower than last year. Loans remain very well supported, with CLO issuance remaining strong and default rates remaining muted.

EMERGING MARKETS

- EM hard currency sovereign spreads traded wider last week on a broader risk selloff. There was a bit of a theme with oil importers impacted the most, but the more concentrated positions were likewise wider along with geopolitically sensitive issuers. Technicals likely played a role, as there was chatter of a large U.S.-based investor selling credit, including EM debt.
- The current widening can continue as we appear to have reached a new phase of the Iran conflict, with even more uncertain outcomes. The market is still reaching for yield but paying attention to fundamentals. In the short term, there is likely to be continued market tension between geopolitical pressures, derisking/deleveraging and what seems to be resilient fundamentals otherwise. The market will also focus on the broader AI narrative and developments that could compromise global liquidity.
- It was a slightly softer tone last week, although benign inflation data and U.S. major bank earnings kept things orderly. EM corporate spreads were wider with C-rated issuers underperforming. The Latam oil and gas earnings season started with Vista Energy reporting very strong results, supported by high oil prices during the second quarter.
- Isbank of Turkey issued a 12NC7 tier-2 bond at 8.4%, which traded around reoffer (we passed). Vestel bonds continued to sell off (we are not involved). Braskem bonds were weaker in mid-50s with talks between bondholders and the company continuing.
- A 15% move in crude last week ended the prior two weeks' outperformance of EM rates over DM. While softer inflation data helped U.S. rates, it failed to move EM rates. Latam and CEEMEA underperformed Asia last week. The five-year swap yield in Hungary and Brazil was 33 bps higher. Oil-sensitive names such as India, South Africa, Czech, and Poland were also 20-25 bps higher. Mexico was the outperformer last week, helped by the softer inflation prints. The Bank of Korea hiked its policy rate by 25 bps to 2.75%, the first hike since May 2025. With the ceasefire over, volatility in the oil market is back; we should thus expect a volatile rest of the month.
- The EMFX index was flat last week. There were two opposing forces: the two soft U.S. inflation readings that pulled USD weaker and the rise in oil prices that pushed USD higher. Three currencies have driven returns this month: COP on continued post-election optimism; 2) KRW on technicals (Hynix ADR launch and Kospi drawdown); and 3) BRL on the back of higher oil. Otherwise, the theme this month has been oil-importing currencies underperforming.
- Even away from oil's rise, there was a subtle risk-off undertone amid underperformance in U.S. tech and Kospi. Last week, we reduced our long COP exposure given the strong rally, increased our short in PLN (versus EUR) on the back of a dovish NBP, took our KRW long to neutral, and reduced our IDR short. With Fed officials remaining hawkish, we think USD is still likely to be biased higher irrespective of oil moving higher or lower going forward. We retain our long high carry versus short low carry relative value and have a long USD bias.

SECURITIZED PRODUCTS

- CMBS conduit AAA spreads tightened 1-2 bps into the low to mid +70s in the secondary market last week. Subordinate tranches were little changed, with As in the +180 context and BBB-'s in the mid +400s. SASB spreads held steady after recent moves tighter. Top-tier AAA floaters are clearing in the +120-130 area. Fixed-rate seniors are trading in the +80s amid increased dispersion by property type and sponsor. CRE CLO spreads were framed tighter, with AAA new issue in the +135-140 area, while tier-two issuers were 5-25 bps wider. Two deals priced-one conduit and one agency.
- In RMBS, benchmark OBX Non-QM AAAs priced at T+118, 2 bps tighter on the week. Credit curves remain flat, with AAs/As/BBBs at T+135/145/170 and only 17/27/52 bps above AAAs. Second-lien CES tightened across the stack, with AAAs at T+115, 10 bps tighter on the week and now trading slightly inside Non-QM. CRT spreads remained stable, with spreads inching tighter across the stack.
- U.S. CLO spreads were generally unchanged. The credit curve remains flat, inside of long-term averages, as mezzanine tranches remain well supported in the primary market. However, secondary dispersion in lower mezzanine tranches is growing, driven by differences in portfolio quality and tail-risk exposure. U.S. issuance was $10B across 23 deals and European issuance was €1.8B across four deals.
- ABS spreads were generally unchanged. Capital stack compression has been evident over last few weeks with below IG contributing. U.S. and European sectors are at or near YTD tights. Australia remains an exception 10-20 bps off the tights depending on issuer, point in capital stack. Broker dealers net purchased $350M last week as flow has become more balanced. However, dealers net sold $2.8B YTD.

MUNICIPALS

- Munis struggled to gain momentum last week, selling off and underperforming Treasuries. Positive flows continue, with back-to-back weeks of $1.4 billion. YTD flows of $58 billion are the second highest on record, trailing only 2021.
- While August should bring a new helping of reinvestment, heavy calendar flow and expensive valuations will be met with the cross current of healthy fund flows and reinvestment.

THE RETURNS TABLE AS OF JULY 17, 2026

				Yield / OAS change (bps)					Total return (%)				
	Duration	YTM	OAS	WTD	MTD	QTD	YTD	Prior year	WTD	MTD	QTD	YTD	Prior year
Sovereign rates													
U.S. 2-Year	1.84	4.18	---	-3	0	0	71	27	0.13	0.13	0.13	0.63	2.97
U.S. 5-Year	4.42	4.28	---	-3	5	5	55	29	0.20	-0.14	-0.14	-0.32	2.57
U.S. 10-Year	7.83	4.55	---	-1	8	8	38	10	0.19	-0.64	-0.64	-0.62	3.67
U.S. 10-Year Breakeven	--	2.25	---	-1	1	1	0	-19	---	---	---	---	---
U.S. 10-Year TIPS	4.31	2.30	---	0	7	7	39	30	0.23	-0.26	-0.26	0.85	4.20
U.S. 20-Year	12.33	5.07	---	0	11	11	28	7	0.13	-1.39	-1.39	-0.95	3.70
U.S. 30-Year	15.18	5.07	---	1	12	12	23	6	0.00	-1.85	-1.85	-0.80	3.61
U.S. SOFR	---	---	---	4	-9	-9	-28	-75	0.07	0.17	0.17	2.02	4.00
UK 10-Year	7.31	4.95	---	8	19	19	47	30	-0.43	-1.03	-1.03	-0.29	2.97
Germany 10-Year	8.55	3.12	---	6	27	27	27	45	-0.43	-1.57	-1.57	-0.16	-0.41
Switzerland 10-Year	8.67	0.42	---	3	15	15	14	-2	-0.18	-1.21	-1.21	-0.56	0.62
Japan 10-Year	7.81	2.69	---	-4	2	2	63	113	0.34	0.05	0.05	-2.57	-5.47
Australia 10-Year	7.66	4.90	---	6	18	18	16	55	-0.36	-0.88	-0.88	1.56	0.62
Canada 10-Year	8.31	3.56	---	4	18	18	13	-1	-0.25	-1.06	-1.06	1.13	4.11
Major fixed income multi-sector indices		**YTW**											
Global Aggregate Unhedged	6.28	3.92	28	1	1	1	0	-3	0.03	-0.44	-0.44	-0.66	1.57
Global Aggregate Hedged	6.28	3.92	28	1	1	1	0	-3	-0.02	-0.57	-0.57	0.57	3.14
U.S. Aggregate	5.97	4.83	28	1	1	1	1	-3	0.13	-0.45	-0.45	0.16	4.31
Euro-Aggregate (Unhedged)	6.24	3.39	44	1	1	1	2	-7	-0.37	-1.26	-1.26	0.02	0.55
Japanese Aggregate	7.91	2.36	0	0	0	0	0	0	0.44	-0.13	-0.13	-2.91	-5.29
Major fixed income credit indices		**YTW**											
Mortgage-Backed (Agency)	5.57	5.09	27	1	2	2	5	-9	0.14	-0.42	-0.42	0.56	5.80
Global IG Corporate Bonds	5.95	4.84	79	1	2	2	0	-3	0.03	-0.56	-0.56	-0.39	3.26
U.S. IG Corporate Bonds	6.85	5.31	77	2	3	3	0	0	0.07	-0.70	-0.70	0.15	4.48
European IG Corporate	4.59	3.65	78	1	-2	-2	-1	-8	-0.32	-0.79	-0.79	0.53	1.37
U.S. High Yield Bonds	3.24	7.18	268	6	-1	-1	2	-13	0.03	0.15	0.15	2.11	6.04
European High Yield Bonds	3.10	5.84	276	0	-7	-7	-5	-37	-0.17	0.04	0.04	1.92	4.03
U.S. Leveraged Loans	0.3	9.13	489	-2	-11	-11	34	45	0.18	0.66	0.66	2.03	4.24
European Leveraged Loans	0.3	8.05	478	-2	-3	-3	4	24	0.16	0.27	0.27	2.03	3.30
EM Hard Currency Sovereigns	6.26	7.07	240	7	5	5	-13	-70	-0.20	-0.51	-0.51	2.77	11.45
EM Corporates	4.37	6.58	214	5	2	2	-23	-36	0.01	-0.06	-0.06	2.15	6.55
EM Currencies	---	5.79	---	0	0	0	0	0	-0.01	0.33	0.33	1.53	4.72
EM Local Rates	5.30	6.17	6	0	0	0	0	0	-0.36	-0.18	-0.18	1.51	5.01
CMBS	3.69	4.95	66	0	1	1	-9	-16	0.18	-0.05	-0.05	0.71	4.40
ABS	2.95	4.68	43	0	0	0	-9	-9	0.14	0.04	0.04	1.11	4.22
CLOs	3.96	5.23	128	0	0	0	-4	-8	0.09	0.21	0.21	2.61	5.07
Municipal Bonds	6.24	3.73	---	7	15	15	13	-32	-0.40	-0.80	-0.80	1.50	7.14

		Total return (%)				
	Level	WTD	MTD	QTD	YTD	Prior year
Equity / volatility indices						
S&P 500 Index	7,458	-1.5	-0.5	-0.5	9.6	19.8
DAX	24,831	-0.9	-0.7	-0.7	1.4	1.9
Stoxx 600	642	0.1	0.0	0.0	11.0	21.0
Nikkei 225	64,141	-6.4	-8.5	-8.5	28.5	63.5
Shanghai Composite	3,764	-5.6	-7.7	-7.7	-3.9	9.5
MSCI ACWI Index	1,109	-1.6	-1.0	-1.0	10.4	21.8
FTSE 100	10,600	1.0	1.0	1.0	8.7	21.9
MOVE Index	71	1.9	-1.5	-1.5	10.8	-17.2
VIX Index	19	24.9	14.1	14.1	25.6	13.6

		Change (%)				
	Spot	WTD	MTD	QTD	YTD	Prior year
FX / commodities						
EUR / USD	1.1	0.2	0.1	0.1	-2.6	-1.4
USD / JPY	162.4	0.4	-0.1	-0.1	3.6	9.3
GBP / USD	1.3	0.4	1.4	1.4	-0.2	0.3
EUR / CHF	0.9	0.0	0.0	0.0	-0.8	-1.1
USD / CHF	0.8	-0.2	-0.1	-0.1	1.9	0.3
USD (DXY)	100.8	-0.2	-0.4	-0.4	2.5	2.1
Oil	82.5	15.5	18.7	18.7	43.7	22.1
Gold	4017.4	-2.5	0.2	0.2	-7.0	20.3

Past performance is not a guarantee or a reliable indicator of future results. Sources: Bloomberg except EMD (J.P. Morgan), HY (ICE BofAML), Bank Loans (S&P), and CLOs (Palmer Square). European returns are unhedged in euros unless otherwise indicated. An investment cannot be made directly in an index.

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