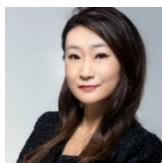


Little room for error

“I would rather have questions that can’t be answered than answers that can’t be questioned.” – Richard Feynman

Key takeaways

- A changing investment environment calls for unconventional approaches to portfolio construction to generate resilient income.
- Broadening global exposure, actively managing duration, and prioritising higher-quality credit are effective ways to mitigate volatility across both rates and equities.
- Security selection outweighs beta as a return driver when the distribution of possible scenarios is unusually wide.



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What happened in May

The stop-start dynamics of the Middle East conflict continued to drive bond market sentiment. The month featured persistent inflationary pressures, political instability in the UK, a long-awaited normalisation of Japanese yields, and a new Chair at the US Federal Reserve. Risk assets shrugged off geopolitics and galloped ahead, betting on the AI investment supercycle.

Our take and investment implications

The investment environment has shifted. We are now in an **inflationary** world with **rising yields**. This trend is further reinforced by developments in China. After 33 consecutive months of producer price index (PPI) deflation, April’s +2.8% print (up from -2.4% in October 2025) marks an inflection point that is **nothing short of a regime shift**. China has long acted as a global disinflationary anchor. That anchor may now be weakening, alongside an appreciating renminbi, adding to global inflationary pressures.

Rising yields are affecting countries and sectors unevenly. In the US, growth remains resilient, underpinned by strong corporate earnings, robust AI-driven capex, and an expanding fiscal deficit. As the earnings season concludes, companies in the S&P 500 index have delivered year-on-year earnings growth of more than 25% – the fastest pace in three years. Performance has been more broad-based than expected and sector-level return on invested capital (ROIC) remains sufficiently high to absorb higher funding costs.

The key question for the US is durability of such resilience. While AI-related investment continues at full speed with little sign of fatigue, non-AI capex remains subdued at just 1.5% of total spending. Broader investment seems constrained by structural factors – ie, labour supply – which dampen incentives to expand. This raises a vulnerability: **if AI capex were to slow, it could reveal a materially weaker underlying growth trajectory for the US economy.**

Beyond the US, **demand-side risks look underappreciated**, with data from Europe and Asia pointing to rising inflation and weak growth. While adjustments so far have been orderly, we note that the Iran conflict only affected the final month of the first quarter. Euro zone leading indicators point to more pronounced slowdowns in the second and third quarters of the year. And companies in Europe and most Asian countries do not have as high ROIC as US firms to absorb much higher interest rates.

Central bank policy divergence should remain the dominant theme. In the US, the new Federal Reserve (Fed) chair must navigate competing forces – rising inflation, AI-induced productivity gains and a K-shaped economy. Caution and policy inertia are likely the prudent approach. But if the energy shock feeds into core inflation and inflation expectations, the Fed’s ability to look through these pressures will be limited. In contrast, a rate hike by the European Central Bank (ECB) this month is fully priced in. The question is whether it represents a one-off recalibration to the energy shock or the start of broader tightening. We see it as the former for now, with the ECB remaining firmly data-dependent.

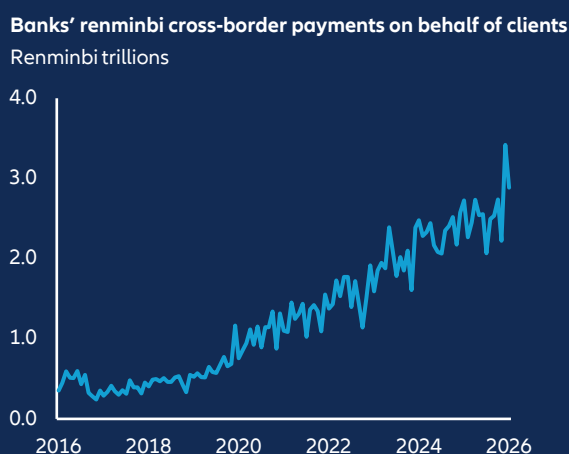
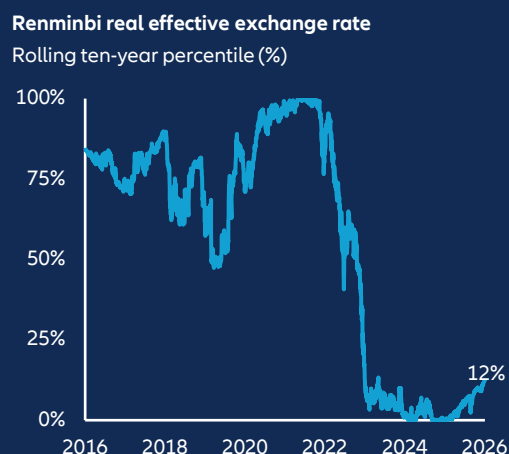
We continue to prefer a **shorter duration bias** across portfolios and stay invested in **high-quality** corporate credit and other spread assets for their higher coupon income (“carry”). Despite compressed credit spreads and ongoing noise around private debt, **we expect credit to outperform core rates in the months ahead**, thanks to the compounding power of carry and demand for income. Credit fundamentals remain solid, evidenced by strong earnings and healthy balance sheets. We are moderating our bearish stance on the US dollar, as relative growth dynamics and firmer commodity prices should provide near-term support, but maintain a structurally weaker outlook on the currency given rich valuations.

In an inflationary environment, we believe **having exposure to countries, currencies and securities that benefit from higher commodity prices** should provide a more effective hedge for growth-oriented portfolios than core rates. Overall, a genuinely global portfolio can exploit opportunities across economic and credit cycles, mitigating geographic and sector concentration risks while maximising diversification of income sources.

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A genuinely global portfolio can exploit opportunities across economic and credit cycles, mitigating geographic and sector concentration risks while maximising diversification of income sources

 CHART OF THE MONTH



Early signs of a reflationary trend in China could make the renminbi a strong diversifier

Source: Bloomberg, WIND, Allianz Global Investors. Data as at 8 June 2026. The information is provided for illustrative purposes only, it should not be considered a recommendation to purchase or sell any particular security or strategy or as investment advice. Past performance, or any prediction, projection or forecast, is not indicative of future performance.

The case for a stronger renminbi is not new. What may be changing is timing. Beijing is increasingly comfortable with currency strength as it aligns with domestic rebalancing, trade objectives and renminbi internationalisation. A more supportive policy stance could allow currency strength and internationalisation to reinforce one another, creating a virtuous cycle. With the currency valuations still depressed, Chinese government bonds – despite low yields – offer a practical way to express the renminbi re-rating theme. Beyond potential currency upside, they provide diversification and downside protection through a differentiated rates cycle and low correlation to global developed-market bonds. A structural long renminbi over the US dollar remains compelling.


FIXED INCOME FORWARD | WHAT TO WATCH

1 New Fed Chair

The new Chair of the US Federal Reserve, Kevin Warsh, takes over amid growing inflationary pressure and questions over institutional independence. His first Federal Open Market Committee (FOMC) meeting on 16-17 June should give clues on his approach. US President Donald Trump clearly expects Warsh to be open to pro-growth rate cuts, though strong inflation and labour market data may limit room to manoeuvre.

2 US Mega IPOs

The widely anticipated initial public offering (IPO) of rocketry business SpaceX on 12 June could be the largest public debut in history. The IPO arrives at a time of massive momentum across the AI and semiconductor sectors. The listing could either supercharge the broader risk-on technology rally or put pressure on liquidity in capital markets.

3 El Niño climate

There is an 80% likelihood of an El Niño climate event between June and August 2026, according to the World Meteorological Organization. Bringing high temperatures and extreme weather, such an event could further destabilise global commodity markets and fuel inflation. Agriculture is vulnerable, including rice, palm oil and coffee, because high energy and fertiliser costs due to the Iran conflict have disrupted crop-yield economics.


FIXED INCOME MARKET PERFORMANCE

Indicative market indices Data as at 31 May 2026	Total return year-to-date 2026 (%)	Total return May 2026 (%)	Yield- to-worst (%)	Effective duration (years)
Global convertible bonds	18.54	4.76	-2.8	1.6
Asian high yield	3.01	1.08	7.7	2.9
Global emerging-market sovereign bonds	2.58	1.00	6.9	6.3
US floating-rate notes	1.83	0.41	4.2	0.0
US high yield	1.62	0.48	7.0	3.0
Global government bonds AAA-AA	1.27	0.10	3.4	7.2
Euro high yield	1.24	1.05	5.4	3.0
Euro aggregate	0.88	1.06	3.2	6.3
Euro investment grade	0.87	0.89	3.5	4.6
Global aggregate	0.77	0.62	3.8	6.3
US investment grade	0.67	0.76	5.1	6.9
US Treasury bonds 1-3 years	0.55	0.11	4.0	1.7
Asian investment grade	0.49	0.38	5.1	4.7
US aggregate	0.38	0.31	4.7	6.0
Euro government bonds 1-3 years	0.32	0.47	2.6	2.0

Source: Bloomberg, ICE BofA and JP Morgan indices; Allianz Global Investors, data as at 31 May 2026. Index returns in USD-hedged except for Euro indices (in EUR). Asian and emerging-market indices represent USD denominated bonds. Yield-to-worst adjusts down the yield-to-maturity for corporate bonds which can be "called away" (redeemed optionally at predetermined times before their maturity date). Effective duration also takes into account the effect of these "call options". The information above is provided for illustrative purposes only, it should not be considered a recommendation to purchase or sell any particular security or strategy or as investment advice. Past performance, or any prediction, projection or forecast, is not indicative of future performance.

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Past performance does not predict future returns. If the currency in which the past performance is displayed differs from the currency of the country in which the investor resides, then the investor should be aware that due to the exchange rate fluctuations the performance shown may be higher or lower if converted into the investor's local currency.

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