



Monthly Commentary | September 2026

Economic Outlook and Key Themes

U.S. Economic Outlook

Steady U.S. Growth Outlook, Inflation Elevated But Is Expected to Moderate

- ◆ We see real gross domestic product growth of around 2 percent in 2026 and 2027, underpinned by robust business investment as the AI buildout continues. Fiscal support to consumers will fade in coming months, which could moderate spending, but upper-income consumers continue to be supported by strong wealth gains. A steady labor market should put a floor under consumption. Job gains have stabilized and show improving breadth. Low labor supply growth has helped the unemployment rate tick down, and we expect it will remain around current levels over the next year.
- ◆ Growth in AI investment should continue to accelerate in the near term, keeping domestic demand growth steady, even as consumption moderates. Hyperscalers continue to signal strong investment growth, while broadening profitability should also support capital expenditures (capex). That said, the U.S. expansion is increasingly reliant on a narrow set of drivers in the form of tech investment and wealth-driven consumer spending. Any disruption to the AI investment thesis would present a downside risk to growth, both by reducing investment activity and by reversing equity gains.
- ◆ Core Personal Consumption Expenditures (PCE) inflation remains elevated, but we expect a slow disinflation ahead. Year-over-year readings are likely to stay above 3 percent through year end, but sequential run rates should show more progress. Tariff effects have receded, and while AI capex spillovers are pushing up consumer prices, we think the impulse has peaked. Passthrough of war-related costs from energy and supply chain disruptions remains an upside risk, but medium-term fundamentals continue to support a disinflationary path over time, given cooling wage and housing inflation along with solid productivity growth.

We Expect Two Rate Hikes in 2026 That May Be Reversed in 2027 if Inflation Falls

- ◆ Federal Reserve (Fed) Chair Warsh's Jackson Hole speech helped clarify his monetary policy framework. He affirmed the 2 percent PCE target and interest rates as the primary policy tool, reducing uncertainty. Warsh also affirmed his focus on inflation and suggested that unless it was moving toward target "clearly and at sufficient speed," the Federal Open Market Committee would have "work to do."
- ◆ With recent insufficient progress on inflation, we expect two rate hikes this year with a peak policy rate in the 4–4.25 percent range. This would be a shallower rate hiking cycle than most prior ones as policy rates are already closer to neutral. As the disinflationary trend becomes more evident in late 2027, the Fed could begin to reverse these hikes. This differs from market pricing, which reflects expectations for further rate hikes next year.
- ◆ We expect Fed balance sheet policy will maintain an ample reserves regime while seeking to reduce demand for reserves gradually.

Investment Implications

- ◆ We view current yields as attractive, particularly in the front and intermediate Treasury tenors, given our policy outlook.
- ◆ Corporate fundamentals remain strong, and we see healthy investor demand for fixed income. Earnings growth has been robust, keeping rating migration balanced. While AI disruption could lift defaults modestly in leveraged loans and private credit, we see pressures as broadly contained.
- ◆ Supply technicals have widened spreads in some sectors. AI-related capex is fueling record gross investment-grade issuance and strong supply, creating attractive entry points for selective investment in issues backed by high quality credits. Recent geopolitical developments have added to spread volatility, providing strong opportunities for sector and security selection.
- ◆ Our positioning continues to center on diversification and income generation. We have been using our excess liquidity to take advantage of market opportunities but are keeping dry powder with the expectation that volatility will persist. We continue to favor Agency and non-Agency residential mortgage-backed securities where spreads remain relatively attractive vs. investment-grade corporates.

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Key Themes

Treasury Yields Approach Top of Our Range

- ◆ Yields have risen globally this year amid supply driven inflation shocks and resilient growth. Surging oil prices led to increased pricing of policy tightening across markets. At the same time, the global economy proved relatively resilient to the associated economic shock. In the United States, heavy long-duration corporate issuance tied to AI investment has pressured the long end, contributing to the pressures.
- ◆ More recently, U.S. fiscal concerns have come into sharper focus, pushing term premiums up. With the United States running record peacetime deficits outside a recession, lower-than-expected tariff revenue and prospective defense spending have intensified concerns about an unsustainable debt trajectory. Although Treasury announced an out-of-calendar buyback expansion in August, yields have continued to rise. Lasting relief requires fiscal consolidation, which U.S. Treasury Secretary Bessent has emphasized.
- ◆ Treasury yields are already reflecting upside scenarios. Markets are pricing an elevated path for policy rates and term premiums. While resilient growth, high issuance, and fiscal concerns may keep long yields near the top of our range, we see asymmetric risks at current levels. The 10-year yield may reach a ceiling around 5 percent as it starts to weigh on growth.

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