Global Fixed Income Strategy

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In this issue

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Executive summary

- **AI-led growth:** US growth is increasingly driven by AI and tech capex, but overall growth remains moderate (around 2–2.5%) with sticky inflation and a Fed on hold.
- **Narrow economic strength:** Outside of AI, the economy is softer—consumption has cooled, real income growth is weak, and housing remains a drag.
- **AI capex supercycle:** Big Tech investment is surging (spending by the Big 4 is expected to reach USD725 billion in 2026), with persistent capacity constraints implying continued strong spending into 2027.
- **Limited macro spillover:** Despite its scale, AI investment alone is not large enough to lift the USD31 trillion US economy to 3–4% growth without broader economic strength.

It's becoming clear that US growth is increasingly being led by AI and other technology-related investment. This month, we try to put a number on it—and, just as important, check how the rest of the economy is doing.

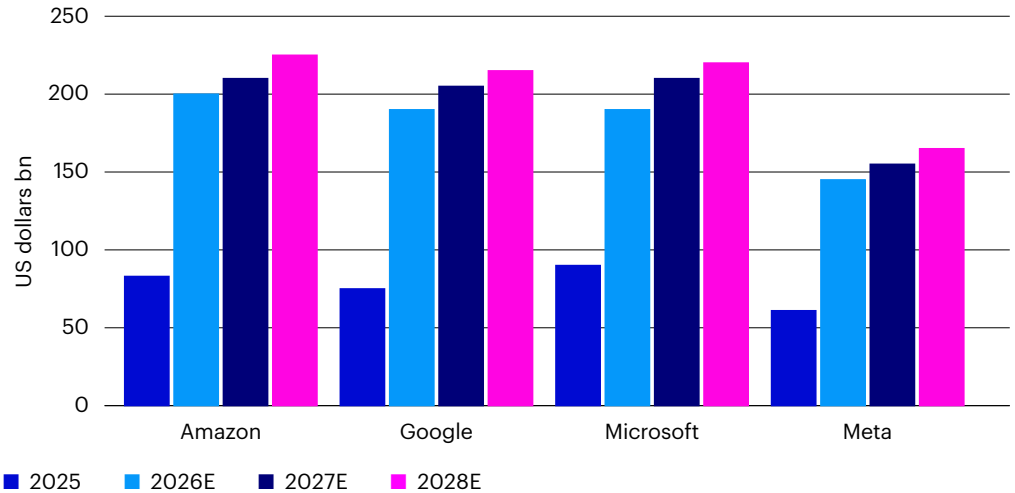
Our baseline view remains: resilient US growth around potential (around 2%), sticky inflation around 3%, and a Federal Reserve (Fed) on hold. The key point is that the US economy is not experiencing broad-based growth; AI investment is powerful, but much of the rest of the economy has been softer. Consumption has moderated, real income growth is weak and housing remains a drag. That is why we expect growth in the 2–2.5% range this year rather than a strong pace of 3.5–4.0%.

The AI capex "supercycle" is accelerating

A supercycle is unlike a typical economic, sector or asset class cycle—it's much longer and broad-based, and affects multiple markets, such as equities, commodities and interest rates. Drivers tend to be structural, such as demographic, technological or geopolitical, and create persistent imbalances—demand can outpace supply (or vice-versa) for years.

We believe we are in an AI infrastructure spending supercycle, and expect it to be a major boost to investment growth in the coming years. In 2026, we expect capital expenditure (capex) by the "Big 4" tech companies (Amazon, Meta, Microsoft and Google) to reach USD725 billion, an 80% increase compared to 2025.[1] This means capital expenditure will likely be 45% to 57% of revenue, which is historically unprecedented.[2]

Figure 1: Capital expenditures among "Big 4"



Source: Company earnings, Q1 2026. E=estimate.For illustrative purposes only. It does not represent a recommendation to buy/hold/sell the security(ies). It must not be seen as investment advice.

1. Source: Company earnings, Q1 2026, Epoch AI, Credit Sights, Futurum Group. Data as of March 31, 2026.
2. Source: Company earnings, Q1 2026. Data as of March 31, 2026.

Even with this massive level of capex, companies indicate they are still capacity-constrained when it comes to "compute", the processing power needed to run software and process data. According to Microsoft Chief Financial Officer, Amy Hood, Microsoft expects to be capacity-constrained through at least 2026, despite setting 2026 capex at USD190 billion.[3] Google Chief Executive Officer, Sundar Pichai, confirmed that Alphabet is compute-constrained in the near term, despite raising capex guidance again in the first quarter.[4] This imbalance suggests continued momentum in AI-related capex going forward.

Figure 2: Four layers of simultaneous constraint

GPU/Chip Production Tightest 2026 constraint	**36–52 week lead times for data-center GPUs** Forward orders consumed most of the NVIDIA allocations through YE26
Memory (HBM & DRAM) Price shock rippling economy-wide	**DRAM prices up 600% in 2025. NAND up 300%** AI data centers crowd out consumer memory supply
Power & Grid 3–8 year interconnection wait times	**US faces a 50 GW supply gap for data centers through 2030** Dominion Energy Virginia fielded 40.2 GW of new requests in 2025 alone
Physical Construction ⅓ of 2026 capacity breaking ground	**17 GW of US data center capacity expected in 2026, ~50% experiencing delays** Cost: USD183/sqft (2020) → USD488sqft (2026) Skilled labor gap: 75–140K workers

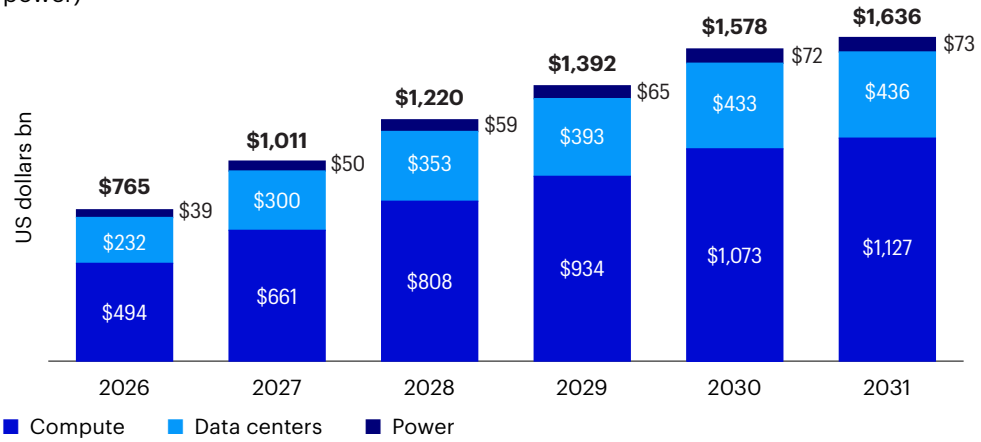
Source: CNAS (May 2026); Clarifai; Morgan Stanley AI Power & Water Report (March 2026); Spheron Blog; S&P Global. Data as of May 31, 2026.

AI is booming—but US growth is not broad-based

These latest estimates of AI-related investment spending are striking. And due to the capacity constraints that remain, investment is expected to be even stronger next year. Given these huge numbers, AI spend is becoming a major contributor to US growth.

Figure 3: Aggregate AI capex estimates (USD billion)

(Est. USD7.6 trillion of capital from 2026 to 2031 across compute, data centers and power)



Source: Goldman Sachs Global Institute. Goldman Sachs Global Investment Research Nvidia projections (as of March 3, 2026). Note: Forecasts and expectations are based on material assumptions subject to change. Assumes Nvidia accounts for 75% of total compute spend in each period. Assumes 5% yoy compute growth past the projection period (2031). Uses VR200 (Rubin) chip as baseline spec (USD80.5K per GPU [incl. node costs] and 3000 W per package) across all years. Assumes 1.2 PUE, USD15 mn per MW for data centers, and USD2500 per kW for new power. Assumes 15% of required data center space is brownfield (i.e., excluded from calculation) in 2026, growing to 30% in 2031. Totals may not sum due to rounding. $ is US dollars.

3. Source: Financial Times, "Tech results as it happened: Google, Meta and Microsoft boost AI spending forecasts", April 30, 2026.
4. Source: Financial Times, "Tech results as it happened: Google, Meta and Microsoft boost AI spending forecasts", April 30, 2026.

In addition to the boost from AI capex, US corporate fundamentals are also strong. Earnings growth among Standard & Poor's 500 Index companies has been impressive, helping to support some of the financing needed for this capex. Importantly, this is not just a "Magnificent Seven" story.[5] While the mega-cap tech companies are obviously central to the AI investment boom, median-company earnings growth also appears solid.

Productivity growth has provided another boost in recent years. Nonfarm productivity slowed after the global financial crisis, remained weak through much of the 2010s, and then appeared to pick up toward the end of the decade. The pandemic period is noisy and difficult to interpret, and we typically need three to five years to identify a true shift in productivity trends. But it does look as though there has been a change for the better. We can debate how much of this is due to AI, but the broader point is that companies are profitable, investment is strong and productivity performance has improved.

So why are we still projecting growth in the 2% to 2.5% range?

One reason we do not pencil in an economic boom at this point is that AI is not large enough to transform the entire growth outlook on its own. Nonresidential fixed investment contributed about 1.3 percentage points to first-quarter GDP growth, which is strong and on the high side historically, but not unprecedented.[6] This is the key point: Even though AI investment is large and economically meaningful, the US economy is much larger. In an economy now exceeding USD31 trillion, AI capex can provide an important boost, but it is not enough by itself to generate 3% or 4% real GDP growth if the rest of the economy is not also strong.[7] This is not a pessimistic message—we still foresee decent growth prospects ahead—but it is a reminder, in our view, to size the AI impulse appropriately.

5. The Magnificent Seven are the small group of mega-cap US companies that dominate equity markets: Apple, Microsoft, Alphabet (Google), Amazon, Meta (Facebook), Nvidia, Tesla
6. Source: US Bureau of Economic Analysis. Data as of April 30, 2026.
7. Source: US Bureau of Economic Analysis. Data as of April 30, 2026.

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Global credit strategy

From Hormuz to healthcare—Pharma's overlooked supply chain risk

Executive summary

- **Pharma supply chains are highly exposed to energy shock:** 99% of active pharmaceutical ingredients rely on petrochemical inputs, with critical dependencies on Gulf energy flows—particularly via the Strait of Hormuz.
- **Structural fragility limits substitution:** Tight regulatory requirements and concentrated suppliers mean disruptions cannot be quickly offset, potentially turning logistics shocks into production stoppages.
- **Rising systemic risk and non-linear outcomes:** Prolonged disruption can trigger shortages, producer cash-flow stress and credit deterioration, with potential spillovers into public health and broader supply chains.

Last month we explained how the second-order shocks of the Gulf conflict have disrupted supply chains beyond energy, pressuring goods prices from fertilizers to plastic packaging. We argued that the most underappreciated supply chain vulnerability is pharmaceuticals.

This month, we dig deeper into this critical product. Approximately 99% of active pharmaceutical ingredients (APIs) and their precursors are derived from petrochemical feedstocks.[8] India, which provides half of the generic drug prescriptions in the US and is a leading global supplier, depends on the Strait of Hormuz for around 40% of its crude oil imports, which go into its pharmaceutical manufacturing process.[9] Chemical inputs used the process are also frequently consolidated in Dubai and the United Arab Emirates before onward shipment.

Unique vulnerabilities in pharmaceutical supply chains

A sustained closure of Hormuz poses a unique threat to pharmaceuticals because it impacts the industry's most vulnerable points: upstream chemical inputs (i.e., chemical building blocks for APIs), tightly qualified supplier networks, and time-sensitive logistics that move intermediates (partially processed compounds) and finished medicines. Unlike other sectors, pharma substitutions are restricted by Good Manufacturing Practice requirements (strict regulatory standards that ensure that drugs are consistently produced and controlled for quality, safety, and efficacy), regulatory filings, stability (drug shelf life) data, and quality agreements (contracts that specify who is responsible for ensuring drug quality and regulatory compliance across the supply chain).

These constraints transform what would be a procurement issue in other industries into a risk of production stoppage for drugs. This fragility is intensified by the concentration of key starting materials (KSMs) (base chemicals that make APIs) and intermediates, as well as the complex multi-border routing required to connect chemical operations to API reactors and, ultimately, to formulation plants and distributors.

The Strait of Hormuz: a major chokepoint

Hormuz is one of the world's most critical maritime chokepoints, with very limited alternatives if traffic is disrupted. Such disruptions quickly affect the availability and cost of petrochemical derivatives and the industrial energy used in chemical processing. Even when production continues, near-closure scenarios force rerouting, adding significant transit time and uncertainty that undermines the tight production scheduling and inventory planning in pharmaceuticals. For example, rerouting around the Cape of Good Hope adds approximately 10–14 days to key Asia–Europe shipping lanes, along with sharp increases in war-risk insurance and emergency surcharges. These delays are especially costly in pharmaceuticals, where longer transit times increase inventory requirements, raise the risk of missing production batch windows,

8. Source: Industrial Info Resources (IIR). Data as of July 19, 2022.
9. Source: Reuters via CNBC TV18. Data as of April 17, 2026.

and push more shipments into expensive expedited modes—costs that generic suppliers often cannot absorb without impacting their margins.

Upstream supply risks: key starting materials and intermediates

The most acute vulnerabilities emerge in the upstream layers—KSMs, solvents, reagents, and intermediates—because these inputs often have only one or two approved suppliers globally, and switching sources is a lengthy process. The greatest exposure is in raw materials and early production steps, which are more challenging to reconfigure than final-stage API or finished dosage manufacturing. When a chokepoint shock constrains chemical availability or increases delivered costs (the purchase price plus all costs required to transport, insure, and deliver the product), the industry cannot easily find alternatives within weeks; it must qualify new sources, validate processes, and update regulatory documentation. This transforms a logistics disruption into a multi-quarter risk of shortages and backorders.

Pharmaceutical logistics: sensitive and complex

Pharmaceutical distribution is not merely shipping boxes. Moving APIs and intermediates is often time-sensitive to match batch schedules and quality control release windows. Finished products, including temperature-sensitive biologics and vaccines, require validated routes and careful handling. Longer voyages and congested transshipment points raise the probability of temperature excursions (storing or transporting a product above or below its specified temperature limits) and product write-offs, shifting more risk onto quality systems through deviations from approved processes, investigations, and potential recall decisions. Logistics costs expand sharply under these conditions, with higher freight rates, insurance premiums, and surcharges—which are damaging for low-margin generic manufacturers and distributors.

Economic and supply chain impacts

Generic manufacturers often operate under contracts, tenders, and reimbursement structures in which pricing resets with a delay. Therefore, sudden increases in input and freight costs immediately impact EBITDA, tying up cash in higher inventory and longer transit cycles.[10] As liquidity tightens, weaker credits may reduce production of the least profitable products, worsening shortages of older essential medicines. The European Union's ongoing work on critical medicines supply chain vulnerabilities has highlighted that production concentration, dependence on non-regional API supply, and economic viability challenges are central drivers of shortage risk—all aggravated by a chokepoint disruption.[11]

Non-linear outcomes and systemic risks

Another critical factor is the potential for non-linear outcomes once safety stocks are depleted. Early in a disruption, supply chains may cope by paying premium freight, drawing down inventory and prioritizing high-value products. However, prolonged disruption can trigger future failures, including missed batches due to missing intermediates, delayed quality control testing, and constrained downstream replenishment, leading to regional shortages. In such scenarios, the impact becomes both a public health and a credit issue. We are monitoring companies closely for any indicated delays in their supply chains, which is the first indication of potential issues. Once delays start, it likely means additional demands on a company's cash flow via the need to hold more inventory and potentially compensate supply chain partners for any production delays. These situations may also lead to a reduction in revenues as well as increased expenses, and, for more highly leveraged companies, covenants in banking agreements may be breached, requiring amendments and potentially higher borrowing costs.

10. EBITDA is earnings before interest, taxes, depreciation and amortization.
11. Source: "Assessment of the supply chain vulnerabilities for the first tranche of the Union list of critical medicines". June 2024.

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Interest rate outlook

US: Neutral

We maintain a neutral position on US interest rates. The bond market is now pricing in Federal Reserve (Fed) rate hikes over the next year. We do not believe the Fed will hike and, as a result, this pricing is attractive, in our view. However, geopolitical uncertainty is still high and either an escalation or drawn out conflict could cause the market to price a more aggressive Fed next year. As a result of the balance of risks, we remain neutral.

Europe: Neutral

The rapid rise in energy costs has upended the outlook for eurozone growth and inflation and raised the prospect that the European Central Bank (ECB) will be forced to hike policy rates to prevent inflationary effects from spreading. At the most recent ECB meeting, President Lagarde seemed comfortable with the notion of a June rate hike unless there was a significant change to the outlook. Since then, energy price developments have been somewhat more benign than feared, but a hike in the coming months is still highly likely. Market pricing on the short end has adjusted from the most extreme levels, and now seems fair, in our view, especially in the context of relative pricing versus other central banks. The outlook for longer-term European sovereign yields remains uncertain. Higher energy prices will likely require fiscal support measures from eurozone governments and calls for greater defense and energy transition-related spending have intensified—all of which would likely increase long-end bond risk premia.

China: Overweight

We have turned more positive on Chinese onshore government bonds, despite a recovery in inflation. Abundant liquidity conditions, still relatively lukewarm domestic demand and strong export growth are expected to contribute to demand for central government bonds, especially as the ultra-long end still presents a notable premium over the front-end. The price level pick-up is likely perceived as driven by shorter-term factors, such as the oil price spike and geopolitical events, and we expect the central bank to continue its supportive policy in the year ahead.

Japan: Neutral

Yields in the over 10-year segment of the Japanese government bond market (JGB) have risen sharply over the last month. The catalyst for the repricing was the announcement by the Takaichi administration that the government would initiate a supplementary budget to offset the impact of higher energy prices. The market was caught off guard by this announcement and feared a further flood of JGB supply into a market already fearing that a weaker yen, higher energy prices and a dovish Bank of Japan (BoJ) would stoke upside inflation risks. Since the initial announcement, the government has indicated that the budget would not exceed three trillion yen and will not increase JGB issuance. This has calmed fears and should limit the upside for long-end yields from current valuations. However, short-end valuations are not particularly attractive, in our view, with further BoJ hiking likely this year, potentially starting as soon as the June 16 meeting.

UK: Neutral

UK gilt yields spiked higher in May to a peak of 5.17%, as concerns about rising global inflation and potentially easier fiscal policy under a new prime minister deterred investors.[12] However, a combination of weaker domestic employment and inflation data, combined with the commitment of prospective leadership contender Andy Burnham to maintain the current fiscal rules, resulted in a sharp retracement of yields back to 4.87% at month end.[13] Looking forward, the risk premium for Bank of England (BoE) hikes looks less excessive relative to Fed pricing, however, there is scope for the market to price further rates convergence between the UK and eurozone, with the BoE more reluctant to hike than the ECB. The longer end of the curve is likely to remain volatile, as

12. Source: Bloomberg L.P. Data as of May 26, 2026.
13. Source: Bloomberg L.P. Data as of May 26, 2026.

the market reacts to headlines around the future policy platforms of the various Labour leadership contenders. However, if favorite Andy Burnham becomes prime minister, his room for maneuver will likely be relatively limited if he keeps his commitment to the current fiscal rules

Australia: Overweight

Recent domestic Australian data suggest tightening financial conditions following three successive Reserve Bank of Australia (RBA) rate hikes that are starting to weigh on housing activity and business/consumer sentiment. Recent RBA rhetoric suggests that policymakers might want to wait to see the impact of past tightening before deciding to push rates higher. This raises the bar for further near-term rate hikes and makes it likely that the terminal rate will be relatively close to current levels. If inflation moderates from the second quarter, as expected, current yields still offer some value, in our view, albeit after the Australian market's recent outperformance of US Treasuries, the market will likely be more sensitive to global developments than in the recent past.

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Currency outlook

USD: Overweight

With the market no longer pricing interest rate cuts, the US dollar looks increasingly attractive, in our view. Persistent uncertainty surrounding the Iran conflict also increases the attractiveness of US dollar longs. With the US economy less exposed to energy market disruptions and the direct consequences of supply chain distortions, we favor an overweight US dollar stance.

EUR: Underweight

The eurozone is particularly exposed to energy market disruptions if the current uncertainty persists, with inflation likely to be higher and growth likely to be challenged. The ECB is attentive to inflation risks and the chance of rate hikes is now high. We think the euro could remain under pressure versus the US dollar while markets remain at such a high level of uncertainty but we maintain a positive view of the euro on a cross basis versus smaller currencies like the British pound.

RMB: Overweight

We are overweight the renminbi over the medium term. Central Bank Governor Pan said at the China Development Forum that China has no need or intention to use currency depreciation to gain a trade advantage. China will likely facilitate more international investment in Chinese capital markets and further improve arrangements for renminbi cross-border use. In our view, this could indicate that China may use the window of US dollar strength to keep the USD/RMB pair relatively stable, while potentially showing strength against other major currencies. This is in addition to the substantial Chinese trade surplus recorded year-to-date.

JPY: Neutral

The yen has retraced almost all its gains versus the US dollar and euro since the Ministry of Finance intervened in late April. The relatively dovish BoJ relative to a more hawkish shift by the Fed and ECB, combined with higher energy prices and resilient risk assets, has kept the yen on the back foot. While further depreciation should be capped by the threat of intervention, it is unlikely the yen will rally substantially until US and European data weaken to the extent that rate hikes are likely to be foregone or even reversed. Japanese investors remain reluctant to buy domestic assets or hedge currency risk, despite better relative valuations. The potential for Fed and ECB hikes in the near future will likely further deter any major changes in allocations.

GBP: Underweight

The British pound has remained surprisingly resilient, despite weaker domestic data and a volatile political environment. It is possible that positioning has supported the pound. However, looking forward, a less attractive relative yield story should weigh on the pound, with politics and energy posing additional downside tail risks.

AUD: Overweight

The terms of trade and carry remain supportive of the Australian dollar, particularly against energy-importing, low-carry currencies in Europe and Asia. However, some signs of weakening in Australian data might cap gains going forward from wider interest rate differentials. Further appreciation will probably require the terms of trade to do more of the heavy lifting than carry alone. A shift to Fed hikes could hit the Australian dollar, as interest rate differentials narrow and global risk appetite declines.

Panelist

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The bottom line

Customization, tax efficiency and control—why fixed income SMAs are growing

We speak with Tim Benzel and Sean Fuller from Invesco's Fixed Income Separately Managed Account (SMA) platform, which manages around USD33 billion in assets across 22 thousand individual portfolios.[14]

Q: Why are separately managed accounts (SMAs) growing so quickly?

Tim: The SMA industry is currently experiencing a structural shift, with assets projected to exceed USD5.1 trillion by the end of 2026.[15] While historically reserved for the ultra-wealthy, the industry is now seeing a massive "democratization", driven by falling account minimums and a demand for more personalized outcomes. Drivers are technology enhancements, a trend toward personalization, demand for capital and tax efficiency, and a desire for transparency and control. Against this backdrop, financial advisors have shifted their value proposition from basic portfolio management to holistic advice and active tax management, offering clients a more customizable experience.

Q: How does Invesco's Fixed Income SMA platform cater to these trends?

Tim: Our platform is built around providing clients with optionality as to how their portfolio should be managed. We offer a variety of different investment strategies to meet a variety of different investment objectives. Options for portfolio construction include selection across different sectors, maturity profiles, credit qualities, and environmental, social and governance (ESG) incorporations. Tax-efficiency has long been at the heart of our investment process. The tax-efficient nature of municipal bonds, along with the ability to efficiently conduct tax-loss harvesting with our portfolios, is an ongoing trading focus.

Q: How have you leveraged technology across your business?

Sean: Technology is incorporated into all aspects of our portfolio management and trading processes. From assisting in the identification and capturing of market opportunities to ensuring that portfolios within a given strategy are positioned consistently with one another, we have built a proprietary tech stack that spans multiple functions and workstreams. The benefit of customization is meaningful to clients but can be challenging to implement at scale. Technology has allowed us to systematize that customization, so that we can deliver a high-quality investment experience to each client that chooses us.

Q: How does the current environment influence the management of your strategies?

Tim: Elevated yields and interest rate volatility are generally good for the SMA wrapper. Attractive yield levels relative to recent history mean clients are realizing elevated income in their portfolios as cash flows are reinvested into bonds with high rates. Interest rate volatility opens up tax-loss harvesting opportunities, where tax-assets can be generated for clients to use across their investment portfolios. We are exercising some degree of caution with the level of credit risk within our strategies, but we have plenty of high quality, liquid bonds that can be sold quickly if market opportunities arise.

14. Source: Invesco. Data as of April 30, 2026.
15. Source: Informa (projection). Data as of March 2025.

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Investment risks

The value of investments and any income will fluctuate (this may partly be the result of exchange rate fluctuations) and investors may not get back the full amount invested.

Fixed-income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

Non-investment grade bonds, also called high yield bonds or junk bonds, pay higher yields but also carry more risk and a lower credit rating than an investment grade bond.

The risks of investing in securities of foreign issuers, including emerging market issuers, can include fluctuations in foreign currencies, political and economic instability, and foreign taxation issues.

The performance of an investment concentrated in issuers of a certain region or country is expected to be closely tied to conditions within that region and to be more volatile than more geographically diversified investments.

Important information

All information is sourced from Invesco, unless otherwise stated.

All data as of May 29, 2026, unless otherwise stated. All data is USD, unless otherwise stated.

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