



June 12, 2026

Midyear Outlook for Equities & Fixed Income

COLLIN MARTIN: I'm Collin Martin

LIZ ANN SONDEERS: And I'm Liz Ann Sonders.

COLLIN: And this is *On Investing*, an original podcast from Charles Schwab. Every week we analyze what's happening in the markets and discuss how it might affect your investments.

LIZ ANN: Well, hi, Collin. We are going to focus on our respective midyear outlooks this week, but before we get into that, we did get some inflation readings this week that have to be addressed. The bottom line is prices are up. You had the overall Consumer Price Index, CPI, with a 4.2% increase for the 12 months ending in May. Big contributor to that very obviously being oil prices. But even core inflation, which strips away volatile food and energy prices, rose to 2.9% over the 12 months ending in May. I mean, there was ... core CPI was a little bit better than expected, but we also got the Producer Price Index out this morning, which was about in line to slightly hotter, depending on which metric.

But the good news with regard to the PPI is there were revisions, and for the most part, they were all revisions down, so net-net when you map what we got with Consumer Price Index and Producer Price Index to the PCE, the Personal Consumption Expenditures price index, which is the Fed's preferred measure, we're not seeing a massive spike in inflation, but it's also, in my view, not heading down to or near the Fed's target anytime soon. So speaking of the Fed, what are your thoughts on inflation and what the reaction function is likely to be?

COLLIN: Yeah, I think there's a few angles there. You touched on everything with the Consumer Price Index, CPI, and like you said, it's high, but it doesn't look like it's going to be coming down anytime soon, or maybe even up anytime soon. So when I look at the data, specifically that core reading you mentioned, that probably gave the Fed some solace in that 0.2% month-over-month change, a little bit better than expected, lower than expected.

I think when we look at these inflation readings, especially recently given the move up in oil and gas prices, surprises matter. And when we saw most of the CPI data coming in, meeting expectations with one important one a little bit lower, that's a good thing. So our view hasn't really changed. You know, we think the Fed will be patient for the time being and see how this evolves over the next few months.

Importantly, when we talk about inflation, we look at inflation expectations also. And there's no shortage of inflation expectation indicators out there. There's market based. There's survey based. One indicator we look at we get from the TIPS market, Treasury Inflation-Protected Securities, break-even rates. It's the difference between the yield on a traditional Treasury and the yield on a TIPS of a similar maturity. And one way to read it is it's an inflation expectation over that time frame.

And five-year TIPS break-even rates have declined a lot lately. And they're back where they were at the end of February. So before the conflict began. So I think that the Fed is probably pretty happy about that because inflation expectations can drive inflation if inflation expectations are high. People might pull forward their spending. And so I'd say that's generally good news, and in our view doesn't mean the Fed needs to act anytime soon.

But the idea of inflation spurring spending decisions, you know, I think the open-ended question is "Will this high inflation or high prices at the pump, for example, will that eat into spending?" And with this week's CPI release, we got the real average hourly earnings, you know, after the inflation adjustment. And on a year-over-year basis, they fell 0.7% in April as the second straight month of that year-over-year decline. So that's something that we're going to be focusing on, and I think the next few months will be important, especially as we're entering the summer season, vacation season, driving season. How does that flow into spending?

So given all that, what's your take, Liz Ann? You know, the CPI news and even the Producer Price Index news, what sort of effect is that having on the equity markets?

LIZ ANN: Well, I agree with you with regard to the Fed, and I think we've touched on it in prior episodes, but I think one factor that needs to be considered and monitored on a going-forward basis is the relationship between what's going on in the bond market and what's going on in the stock market. So we look at a variety of rolling-period correlations between the 10-year yield, which is, in the world of the bond market, the yield that has the most impact on the equity market, we look at the correlation between that and stock prices. And that recently has moved pretty deeply into negative territory. I think it's something that might be slightly more secular.

I know even before you became my co-host, Kathy and I had many an episode where we talked about the 25-or-so-year period called the Great Moderation, which was a period from the mid-to-late '90s up until the 2022 inflation spike. And it was an era marked by and driven by globalization, China joining the World Trade Organization, generally a benign inflation backdrop, very little inflation volatility. And in that, almost that entire period with the exception of 2008, and this is, by the way, something I do I did touch on in our equity and economic outlook, you had a positive relationship between bond yields and stock prices, because bond yields during that era were keying off the growth side of the equation, less on the inflation side of the equation. But if you look at the 30 years prior to the Great Moderation, which we've coined the "Temperamental Era," that was a period where it was the complete opposite. We had a negative correlation for about 30 years with just a few minor exceptions because bond yields were keying more off of inflation.

So higher inflation without necessarily better economic growth, not great for the equity market. We're back in negative correlation territory. It's bounced in and out of negative territory, but that's something that I'm keeping an eye on. That's a little bit more of a long-term way to think about the impact of inflation, what the bond market does, and how that feeds into the into the equity market.

As we mentioned, this is a focus on a summary from each of us on our respective midyear outlooks, so our outlooks for the second half of the year. And typically the case with our midyear outlooks, we like to take stock of the expectations we had at the beginning of the year when we all published our full-year outlooks. I will say also right up front that our outlooks are published on [schwab.com/learn](https://www.schwab.com/learn), and they are really in depth with lots of charts and graphs and much more detail relative to what we're going to get into here. So I'll turn it back to you. Give us some high-level teasers for the outlook that you guys published.

COLLIN: Yeah, well, I'll piggyback on your point first that that we have our much bigger articles that are posted. And like you said, lots of graphs, much more detail. So I'll give you some high points here about what we're seeing and expecting for the second half of the year. First, as it relates to the Federal Reserve, I kind of alluded to this before, but we expect the Fed to be on pause for the next several meetings. We expect them to hold rates steady through the end of the year, if we were to give that calendar-based guidance.

But we acknowledge that there's a lot of uncertainty right now. And if we look at the evolving expected path of Fed policy, we get data from the fed funds futures market. Right now, the implied probability of a hike has risen to 100% by December. Again, that's not our view. We derive that from the fed funds futures market. And we're just not there yet because we think the Federal Reserve and the various

policymakers will need to see how the next few months evolve and see what that inflationary trend looks like, not just obviously the rise in oil and gas prices, but what it's doing to core. And we mentioned before that the core CPI came in a little bit better than expected last month.

So the Fed on pause for the next several meetings, which means short-term investment, the yields they offer will probably hold steady. A lot, you know, money market fund yields, short-term CDs, Treasury bill yields, things like that, tend to be highly correlated to the fed funds rate.

If we look at slightly longer maturities, like the 10-year Treasury yield, Liz Ann, you mentioned that that's very important for the global economy and businesses. We expect it to hold in the 4% to 4.5% range that it's been in for the past few months. Admittedly, it's at the higher end of that right now. But all the factors that we saw as keeping long-term yields elevated as we came into the year are still very much present now. And that's high inflation. You know, if inflation's high, investors should demand higher yields to lock up their money for longer.

And especially with the inflation uncertainty you mentioned, that's something that can keep yields elevated. Budget concerns aren't going anywhere. We're going to continue to see more and more Treasury issuance over the years. And then the direction of global bond yields. The European Central Bank, the ECB, they hiked rates, and we're expecting a number of other developed-market central banks hike rates one or two more times as the year progresses. So that general rising trend in global bond yields could put somewhat of a floor under long-term Treasury yields or maybe even pull them up a little bit higher.

Now, with that view of the potential upside risks with 10-year Treasury yields and the Fed likely holding steady, we suggest investors favor a below-benchmark average duration, so short-to-intermediate term maturities. We don't think now is necessarily the time to be considering long-duration or long-maturity investments too aggressively because there is that upside risk in long-term yields. And the longer the maturity or duration, the more sensitive they are to interest rate changes.

Now with that outlook, it doesn't mean investors should focus only on very short-term investments because there's an opportunity cost there. And the yield curve is positively sloped. So as you move out gradually to slightly longer and slightly longer maturities, you are rewarded with slightly higher yields. So it doesn't mean you need to be in very, very short-term investments, short-to-intermediate term seems like a good happy medium to us.

And then in terms of opportunities in the taxable fixed-income space, we do think it's OK taking a little risk today. You know, in moderation and what's in line with your risk tolerance, of course. But we see investment-grade corporate bonds, high-yield corporate bonds, and preferred securities as more favorable today, you know, mainly because the economy's in a pretty good place. It's proven to be resilient. We're not really talking about recession risks right now, and in an environment where the labor market's been strengthening, corporate earnings and corporate profits have been strong and the economy's growing, we think it's OK to take a little risk with investment-grade or high-yield or even preferred securities.

I'll give three quick points on each area, Liz Ann, and then I'll kick it back to hear your thoughts. But with investment-grade corporates, we like the credit quality there. They have investment-grade credit ratings for a reason. Those are credit ratings of AAA down to BBB. And the average yield of the investment-grade corporate bond index that we track from Bloomberg is north of 5%. We think that's relatively attractive. With high-yield corporate bonds, we've seen a trend over the years of improving credit quality or improving credit ratings.

Where, yes, the bonds in the high-yield index, the high-yield universe, they are sub-investment grade or also called junk bonds. But we've seen the share of BB-rated issuers, which is that highest rung of the high-yield spectrum, that's been rising. And about 56% of the Bloomberg U.S. Corporate High-Yield Bond Index is comprised of BB-rated issuers.

And then finally with preferred securities, that this one's an interesting one because they are hybrid investments. They have characteristics of both stocks and bonds. And they tend to have very long maturities or no maturity dates at all, although they can usually be retired at the issuer's discretion after a certain period of time passes. And because of those long maturities or no maturity dates, they do tend to be sensitive to the direction of long-term Treasury yields.

And even though we don't suggest for most parts of the bond market that investors focus on long duration or long maturities, long maturity investments too aggressively, we're OK with preferreds mainly because when we look at correlations or relationships they have with different parts of the market, the credit-risk aspect tends to matter more than that interest-rate-risk aspect. And they have higher correlations with the S&P 500® and investment-grade and high-yield corporate bonds. So even though there is a risk of slightly higher yields, especially with long-term Treasuries, we're still comfortable taking a little risk with preferred securities today.

So with all that being said, how about you, Liz Ann? You said you have your article posted on Schwab.com. What are the Cliffs Notes version there?

LIZ ANN: Yeah, so thanks, Collin, and great summary. So we published ours a couple of weeks ago. I write these along with our colleague Kevin Gordon, and as we typically do, we start at the macro level looking at the economy and then dive down into the market. And you know, it is that time of the season where you assess the views at the beginning of the year, and maybe it's obvious, but one thing that we did not anticipate at the end of last year was that we were going to go into a war at the end of February. So that obviously changed the outlook as it relates to the economy, inflation in particular. That inflation, you were right to point out, has led to things like average hourly earnings, wage growth more broadly, to go into negative territory in real terms when you subtract that inflation out.

We start looking at overall GDP, which I agree there's not much that's flagging recession here. So GDP was strong in the first quarter, and there was, you know, a decent amount of breadth. Net exports was a bit of a drag. But we can track via something called a NowCast. Atlanta Fed does a "NowCast" called GDPNow. What that means is it's not a forecast. It's taking in data as it's being released and then assessing at that point what the likely GDP reading is. So we still have a couple of weeks left before the end of the quarter, and then we'll have some time to wait before we get the release. But again, a decent amount of breadth. But what really is happening inside the economy is the capital spending surge, which has a heavy bias on, using GDP lingo, nonresidential fixed investment, which is basically business capital spending. And within that, the main driver has been artificial intelligence, the AI kicker. So we talk a little bit about that.

We also dive into the labor market, which for the most part is healthy. You could nitpick a little bit and find reasons, not necessarily for near-term concern, but maybe things to watch. There's two surveys that the Bureau of Labor Statistics does every month, the establishment survey, from which payrolls are generated. And then there's also a household survey, which is just that, a survey of households. Establishment survey surveys businesses, and you've got the household survey, which surveys households. And that measure in a rolling six-month change has dipped into negative territory. And that has a tendency to lead the establishment survey that generates payroll. So that's just something that's on our radar.

You have had very strong data on job openings, and so that sets us up in a fairly healthy position looking into the second half of the year. I think further supports this notion that you touched on of the Fed being on hold for probably some period of time. I think the market has priced in a hike not coming until the end of the year. But

with every economic data point that comes in, those expectations around Fed policy are likely to adjust.

You talked about inflation expectations. And that made me think about one interesting chart that we put in our midyear outlook, which was the comparison between the, call it, standard misery index, and that's an index that was born out of the 1970s period of pretty high inflation, and it's simply the sum of CPI inflation and the unemployment rate. And that is relatively low right now compared to the huge increase that we saw in that metric in the 1970s.

But we also looked at what we're calling the "expected misery index." So for both of the components that you sum together, you can get expectations versions of that. So University of Michigan one-year forward inflation expectation, and we add the unemployment expectations. And those also come out of University of Michigan. That is through the roof. So that's another thing to monitor. And it ties in with one of the things that we've been writing about quite a bit, and we touch on in the outlook, which is the big ongoing difference between the soft economic data, the survey-based data, and the hard economic data, which is the actual data. And you see that in a lot of ways. University of Michigan consumer sentiment at an all-time low, not really reflecting what's going on in the economy, and certainly not reflecting what's going on in the stock market.

We dove into the stock market, starting with earnings, which really has been the most powerful fundamental support sitting under stocks, and why, notwithstanding some recent weakness in the market, the stock market has done extraordinarily well. You saw a huge bump up in first-quarter earnings growth. The result of that was analysts were in a position to raise second-quarter, third-quarter, fourth-quarter estimates, and full calendar year estimates. The only concern is ... what's interesting about earnings is at some point in the cycle, you get to a point where earnings are not too good to be true, but it gets to the point where the path of least resistance turns from moving higher to moving lower. And we put some interesting data in the outlook about earnings growth when it historically has been above 20%, which it is right now, you actually have somewhat weaker forward returns because the market is an anticipatory mechanism, looks at a high level of growth, and then starts to price in the eventual rolling over. I'm not sure we're imminently there, but it's just something to keep on the radar.

We also talked about breadth and that has been something that we also did not anticipate coming into this year, but that had a lot to do with the impact of the war. We had started to see in the first couple months of the year before the war a pretty meaningful broadening out. There's lots of ways to measure that, traditional breadth statistics like moving averages. But another way that we look at it is to look at the

percentage of stocks within an index like the S&P 500 that are outperforming the index itself. And by the end of February of this year, that had gotten to about 60 to 65% of stocks on a year-to-date basis within the S&P were outperforming the index itself. That recently dropped down into the mid-teens.

Good news is we're starting to see that improve again. Over the past month, it's about a third of the S&P is now outperforming the index itself. And I think we could again see some broadening out. The Russell 2000 is outperforming the S&P 500. We just have about even par between the S&P equal-weight index and the S&P cap-weighted index. I think this is a good backdrop for active managers. I think it's becoming again a little bit more of a stock-pickers market. Fundamentals are again starting to drive prices.

We do continue to think that there will be a lot of rotations, and not just rotations sector to sector, which that's been a story for the past couple of years, but rotations within a popular sector like technology, where you see these inside, below-the-surface rotations, a lot having to do with the short-term outlook from an AI perspective and who are the winners, who are the losers. I think this AI story is going to continue to be paramount in driving market performance, but we have seen a bit of a broadening out. One of the concerns was not just valuation, which has been an ongoing concern, but the circularity of financing in this AI sphere. So companies that are investing in each other as they build out AI.

And one concern that we mentioned, and we have a visual in the report, is that the hyperscalers capital spending as a share of total S&P capital spending is up to about 40% right now. That is extremely high relative to what we've seen over the past few years. At the same time, the hyperscalers' net income, as a share of S&P 500 net income, is only about 20%. So we've seen that spread widen out. That, I think, is part of the reason why there's some heightened sensitivity about how much longer this can go on at the pace that we are seeing.

We take a look at the end at maybe some slightly unique measures of investor sentiment. One that is a behavioral measure of investor sentiment, which is how much exposure do households have to equities. That reading is now at an all-time high. That's data that comes out of the Federal Reserve, as you know. We're looking at about 47% of household assets are invested in equities. And that's about triple where we were in the heart of the Global Financial Crisis. And that we need to be mindful of because this is where you connect the dots back into the economy. The wealth effect, for the most part, has been a significant tailwind for the economy.

At this heightened level, we just need to be mindful if there's something more significant that happens in the equity market, some sort of corrective phase that

goes beyond anything we've seen so far this year, that could translate into weaker consumption data because we start to lose the power of that wealth effect. So there was nothing that we were sort of flashing as red looking into the second half of the year. It was more notes of caution and what to be mindful of given the fact that the market has done as well as it has. Sentiment, in many ways, has gotten a bit frothy.

So we conclude by saying this is a backdrop where you want to heed the long-term disciplines around diversification across and within asset classes. And maybe the most important discipline in an environment like this around risk management is periodic rebalancing so that you're trimming back some of the areas within the equity market that have done well and maybe add into areas that have not done as well. And that supports the broadening-out expectation that we have as well.

COLLIN: Well let's look ahead to next week, Liz Ann. Anything that that you're paying particular attention to?

LIZ ANN: Well, the Fed meeting. I'm sure we both are. So we've got the first Fed meeting under the tutelage of new Fed Chair Kevin Warsh. So neither of us, I know, expect the Fed to do anything, but I think the statement, whether they remove the easing bias, what his first press conference looks like, what he talks to the press about as it relates to his vision as Fed chair.

And then, you know, there's a bunch of other data. We get industrial production—that's a key metric to gauge recession risk. And retail sales is probably the other and probably the most important metric that's coming out in terms of the economic data. How about you?

COLLIN: Well, like you said, the next week's Fed meeting, I think, will be very important, not for any decisions, but really the substance and how Kevin Warsh proceeds as the Fed chair. I think it's going to be really interesting. I've heard a lot of things, I've read a lot of things about how he might approach this. I've heard some people throwing out there that maybe he's not even going to put a dot out there with the dot plot because he's not a fan of that communication. I think there's a lot of unknowns, but I'm ... I look forward to the press conference and seeing what his approach is going forward. So I think that'll be really good.

We have retail sales. We mentioned this earlier, but will there be a time where we start to see a hit to spending from elevated gas prices? So I'll be paying attention to retail sales. And then finally, next week we get data from Treasury International Capital, or the TIC flows. That's from the U.S. Treasury. It gives us an idea of how, well, domestic or foreign investors are owning U.S. investments, but I look at it from the Treasury angle and what do flows look like? Are foreign central banks or foreign

private investors buying or selling Treasuries? And I think it's an important time right now, given the conflict in the Middle East, what does that mean for flows? Because that can flow into the level or trend in interest rates because it can become a supply-and-demand issue if we start to see flows, you know, slow down or turn negative. But so far, that hasn't been much of an issue.

Well that's it for this week. Thanks for listening. As a reminder, you can always keep up with us in real time on social media. I'm @CollinMartinCS on X and LinkedIn. That's Collin with two L's, and the CS is for Charles Schwab.

LIZ ANN: And I'm @LizAnnSonders on X and LinkedIn. Still lots of imposters, especially on X, so please make sure you're following the real me. And as we've already mentioned a couple of times here, you can find all of our written reports. They are typically chock full of charts and graphs at schwab.com/learn.

COLLIN: And if you've enjoyed the show, please consider leaving us a review on Apple Podcasts, a rating on Spotify, or feedback wherever you listen. And please tell a friend or more about the show, and we'll be back with a new episode next week.