H2 2026 Macroeconomic Outlook

AI Capital Expenditure, Inflation Stickiness, and a Hawkish Policy Turn

Monthly Macro Research · Sonny Xi · June 2026

Executive Summary

- **Surface vs. substance:** Global PMIs have returned to expansion, but the growth rests heavily on a single engine: AI infrastructure, rather than a broad-based recovery.
- **AI is the "new housing":** In the traditional HOPE framework, housing, which should lead, remains depressed; data-center capital expenditure has taken over its role as the new starting point that drives orders and profits.
- **Vulnerability 1 (cyclical sensitivity):** The technology sector has shifted from asset-light to asset-heavy and increasingly relies on debt financing, taking back on the cyclicality and rate sensitivity it had shed.
- **Vulnerability 2 (concentration):** Growth and equity markets in Japan, Korea, and Taiwan are highly concentrated in semiconductors (Korea's two chip giants alone make up over half of the KOSPI): "seemingly diversified, but in reality a bet on a single name."
- **Sticky inflation:** Core CPI remains above the 2% target, with PPI accelerating ahead of it; my own VAR model projects CPI staying above 4% through the year.
- **A hawkish Fed:** The dot-plot median has flipped from "cut" to "hike," and the market (CME FedWatch) has all but priced out a cut this year.
- **The dilemma and transmission:** Whether the Fed hikes, holds, or cuts, the rate lever will directly move the heavily financing-dependent AI build-out.
- **Allocation recommendation:** Reduce over-concentrated exposure to AI-hardware stocks and long-duration assets; modestly add short-duration assets and value stocks to manage concentration risk and improve portfolio resilience.

ALLOCATION VIEW

Trim Tech and Long-Duration Exposure; Add Short-Duration and Value

KEY FIGURES

CPI, May (y/y)	**4.2%**
Core CPI (y/y)	**2.9%**
Energy CPI (y/y)	**23.5%**
PPI final demand, May	**6.5%**
Fed funds target range	**3.50%–3.75%**
2026 dots above current	**9 of 18**
FedWatch: hike by Dec	**86.1%**
FedWatch: cut by Dec	**0%**
VAR model CPI forecast	**Above 4.0%**
Korea mfg PMI, May	**54.8**
Japan mfg PMI, May	**54.5**
Korea chip exports, May	**+167.7%**
TSMC weight in TAIEX	**~43%**
Hyperscaler capex, 2027	**~$1.1T**

FedWatch probabilities as of June 24.

ANALYST

Sonny Xi

Analytical Framework and Structure: Leading Indicators and the HOPE Transmission System

This series rests on one core methodology: to assess the future, lead with leading indicators rather than relying on the coincident and lagging indicators that reflect the present and the past.

Macro indicators fall into three groups: leading indicators (which point to future trends), coincident indicators (which describe the present), and lagging indicators (which confirm changes that have already occurred).

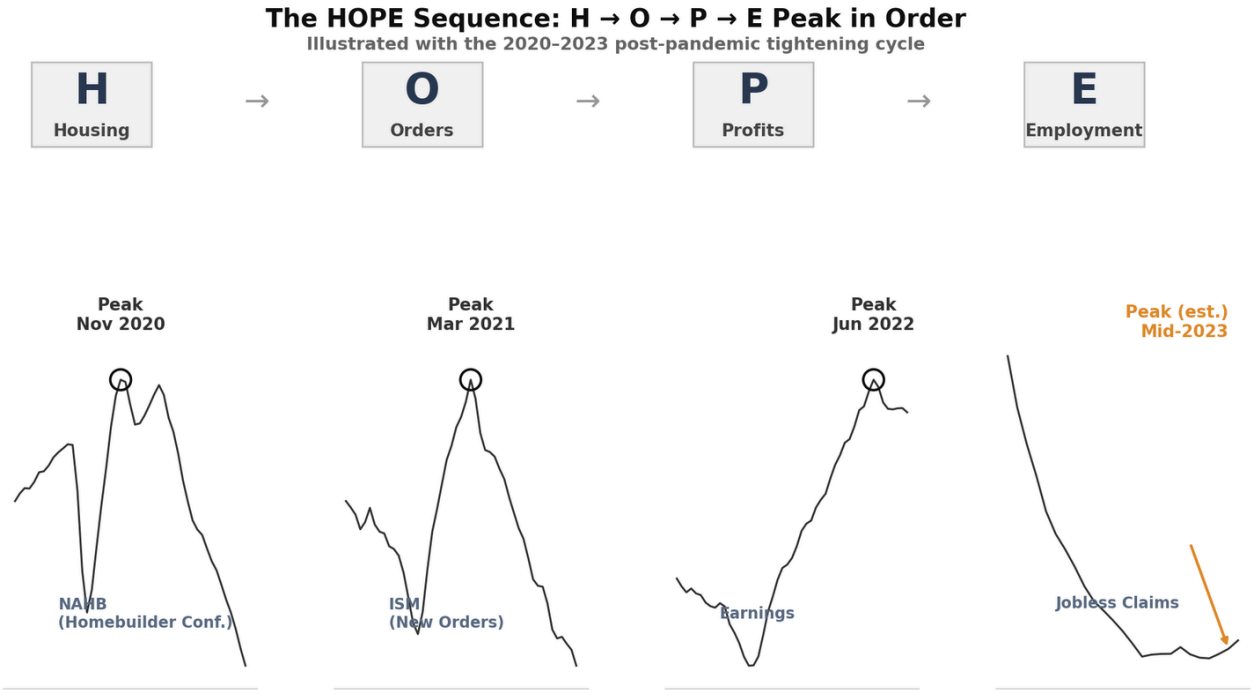
To anticipate the future, one should lead with leading indicators: common examples include the manufacturing PMI, housing starts and building permits, the equity market, new orders, M2 money supply, and the yield-curve spread; most of these flash signals before the economy turns. By contrast, nonfarm payrolls and the unemployment rate are more coincident or lagging: they move market sentiment and shape Fed policy, but "being watched by the market" and "being able to predict the future" are two different things.

This distinction matters all the more because labor is typically the last link in the economic cycle to turn. By the time employment data clearly weaken, the cycle has usually already reversed. Layer on the frequent and large revisions to payrolls in recent years (the 2025 annual benchmark was revised down by roughly 910,000 in one stroke), and their forward reliability deserves an even steeper discount. For this reason, a genuinely experienced macro analyst is not led around by a single month's jobs print, but anchors judgment on continuously tracked leading indicators.

And leading indicators do not exist in isolation: they transmit in sequence, which is precisely the backbone of this report's structure. The HOPE framework, proposed by Piper Sandler Chief Investment Strategist Michael Kantrowitz, is a representative system for describing this chain: Housing → Orders → Profits → Employment. The logic behind it is interest-rate sensitivity: housing is the most rate-sensitive and comes under pressure first when rates rise, then transmits in turn to orders, profits, and employment; the further toward the front of the chain, the stronger the lead, while employment is the "last domino to fall."

The HOPE Framework and Its Transmission Case

Exhibit 1. A historical example of HOPE transmission: H → O → P → E peak in sequence (2020–2023 post-pandemic tightening cycle)



Note: The four peak dates are from the original chart — Housing (Nov 2020) → Orders (Mar 2021) → Profits (Jun 2022) → Employment (mid-2023, est.) — illustrating the sequential transmission of the HOPE chain.

Note: Jobless claims are inverted (a trough in claims ≈ a peak in employment). Curve shapes are a stylized recreation of the Piper Sandler chart (Jan 2023), not the underlying data.

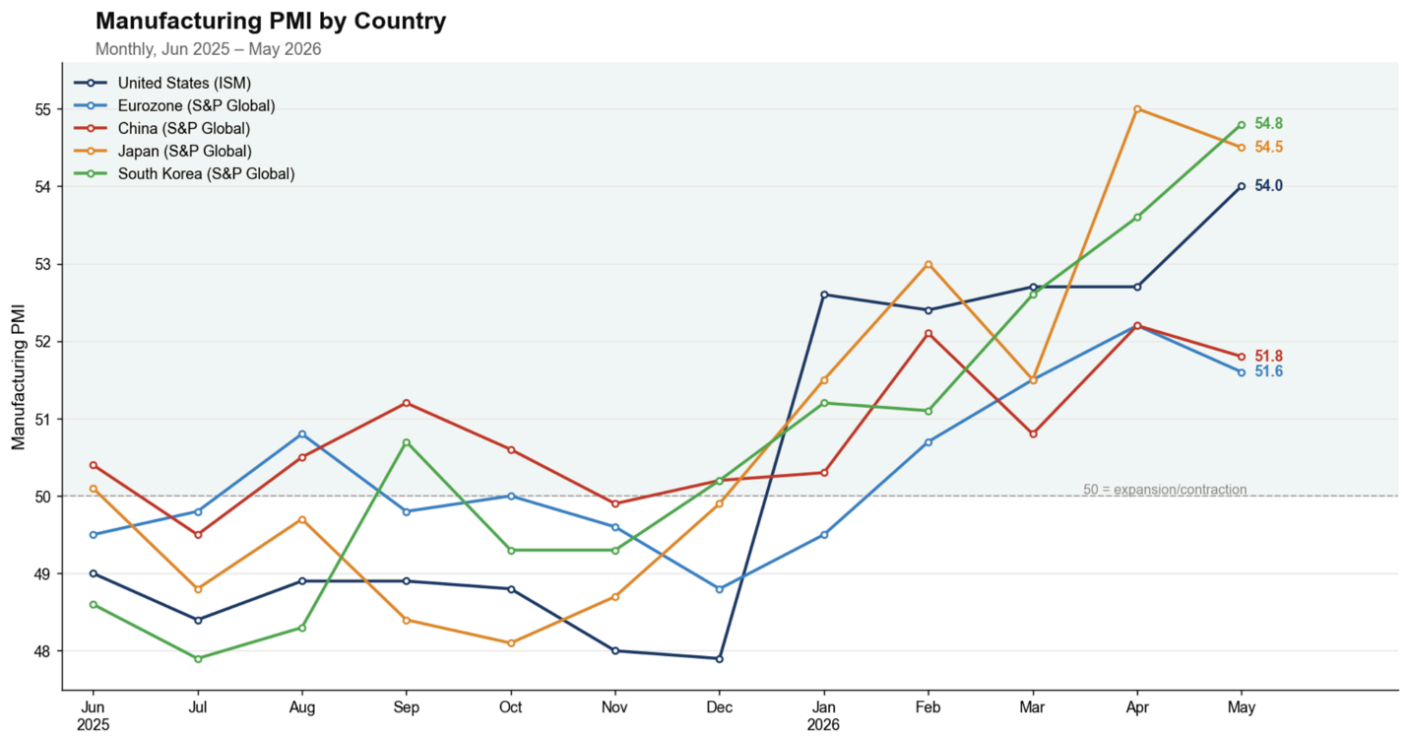
Source: Piper Sandler.

The overall structure of this report follows this HOPE transmission chain: starting from the construction engine as the "first link," it examines in turn how that transmits to orders, profits, and employment, and in the process reveals a key change: the starting point of this chain is no longer housing.

Leading Indicators of Macro Growth: ISM PMI and Manufacturing PMI

The ISM manufacturing PMI and the manufacturing PMI are generally the leading indicators that best capture overall macroeconomic growth; these two indices are themselves composites of many sub-indicators: new orders, supplier deliveries, new export orders, new import orders, and so on. The manufacturing PMI uses 50 as its dividing line: above 50 signals an expanding sector, while below 50 signals a contracting one.

Exhibit 2. Manufacturing PMI by country



Source: ISM (US), S&P Global (China, Eurozone, Japan, Korea).

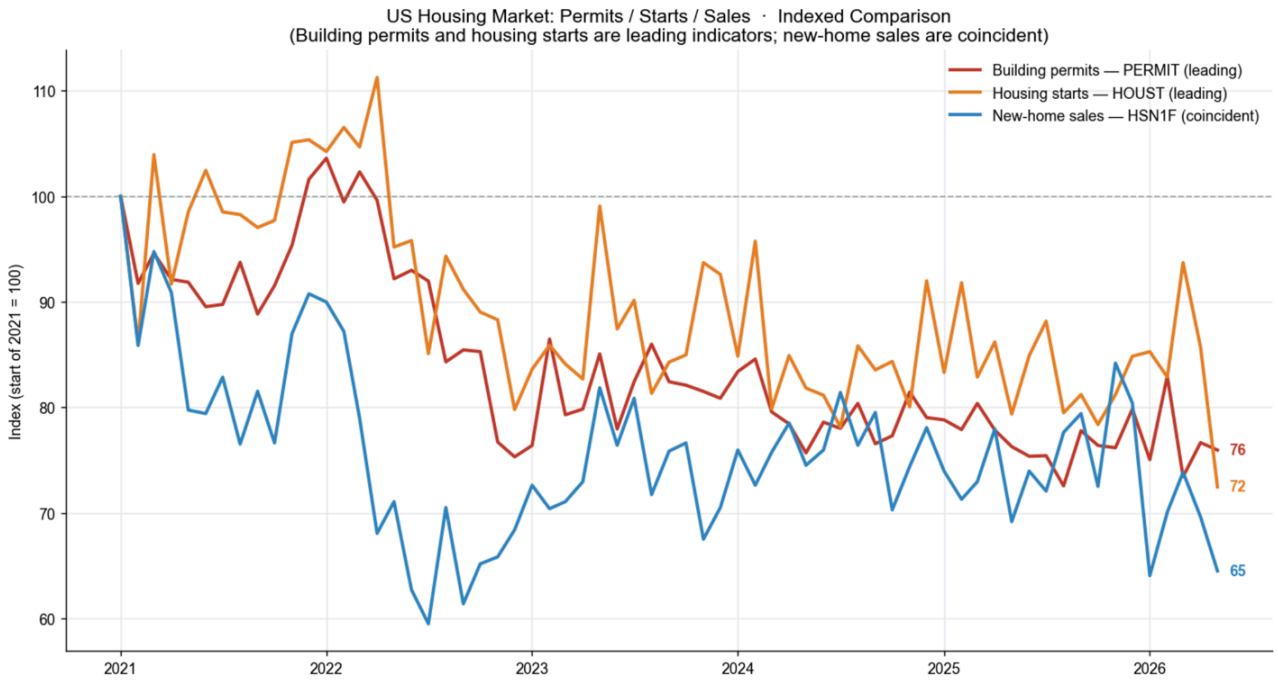
As the chart above shows, both the ISM manufacturing PMI and country-level manufacturing PMIs currently point to an expansionary macro trend across major economies. Manufacturing PMIs around the world bottomed in December 2025, rebounded above 50 from January 2026, and have since stayed above 50, driven largely by rapid order growth. Overall, manufacturing PMIs show economies in expansion.

As a leading indicator, the manufacturing PMI points to the direction of economic activity in the coming quarter, generally indicating that global demand remains strong; under the HOPE framework, rising orders should then drive corporate profits and, in turn, employment.

Does a manufacturing PMI above 50 really mean a full expansion? And how does it differ from the previous transmission system?

Although the US ISM manufacturing PMI and country-level PMIs are all in expansion territory above 50, in my view risks still lurk beneath. In the HOPE system, the first link that leads the entire chain is housing; yet since the pandemic, housing has been broadly depressed worldwide. In the US, for example, under the weight of high rates and inflation, housing has never recovered to its 2021 peak.

Exhibit 3. US housing permits, starts, and sales, 2021–2026



Source: FRED.

As the chart shows, US building permits, housing starts, and new-home sales are all below their overall 2021–2022 levels. Permits and starts are, by their nature, leading indicators (they occur before sales): when both stay persistently low, it usually means developers foresee potential future risks and falling margins and are therefore cutting capital expenditure and pulling back on new projects. It is worth emphasizing that the most forward-looking indicator, building permits, is still languishing at low levels and has not genuinely rebounded.

Under the traditional HOPE chain, depressed housing should transmit in turn to: fewer new orders → lower corporate profits → weaker employment. But here an intriguing contradiction appears: when the first link of the HOPE system (housing) is contracting or stagnant, why do global (and US) ISM PMIs instead show relatively strong expansion?

This leads to an interesting judgment: AI infrastructure (data centers) may have already taken over the "first transmission link" role originally played by housing in the HOPE system. The main logic behind the recent strength in the ISM PMI may be precisely that large-scale data-center capital expenditure is driving a chain of upstream orders and production activity, thereby supporting the manufacturing expansion reading.

AI-Infrastructure Data Centers as the New Starting Point (Housing)

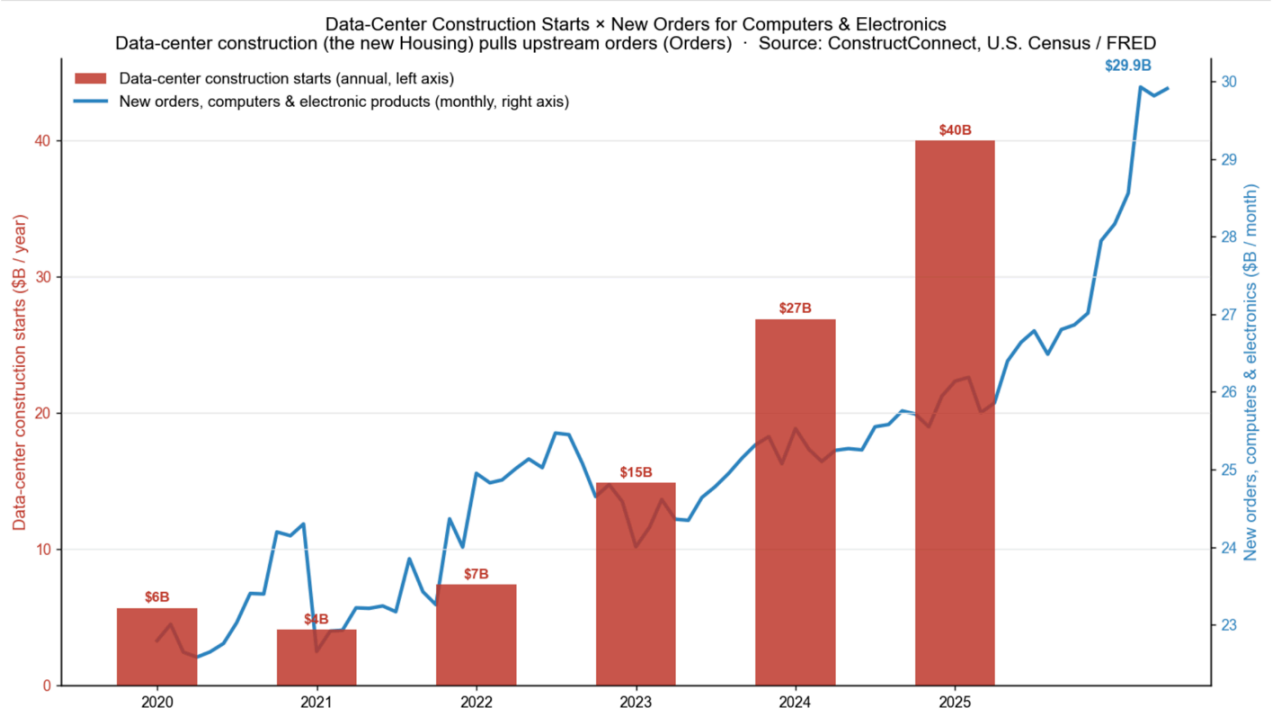
Unlike the housing market, AI-centric data-center infrastructure has become the new engine driving order growth. In past economic cycles, countries typically started from housing or related infrastructure projects (including industrial infrastructure) to complete the "orders → profits → employment" chain. This is of a piece with China's logic of using real estate and infrastructure investment to power the broader economy. But as housing remains under pressure in a high-rate environment and lacks growth, data centers are taking over from housing as the new engine driving construction and orders, in a different form.

AI infrastructure shares features with traditional real estate and infrastructure: it likewise requires large quantities of raw materials and construction inputs, such as steel and cement. But for AI infrastructure, the more decisive inputs are electronic components and power-supply equipment. The former (chips, servers, storage) constitutes computing power itself, while the latter (transformers, power distribution, cooling) is the hard constraint on a data center's operation. The vast construction demand transmits to related upstream orders, and then from orders to corporate profits and employment, replicating the construction-engine-driven transmission path of the HOPE system.

Looking at the current chain, AI-infrastructure orders are concentrated mainly in electronic components (Nvidia's GPUs, memory makers' DRAM and flash, and so on); the surge in orders has already transmitted to these suppliers' profits, as we have seen with record profits at companies like Nvidia, and has further passed through to hiring for related roles.

It should be noted, however, that the employment transmission of this chain is far less broad than that of housing: once built, data centers require limited operating labor, and the jobs they pull in are highly concentrated in high-skill links such as semiconductor design and power engineering, rather than the large pool of construction and upstream/downstream ordinary labor that housing absorbs. This also means that even if AI infrastructure supports orders and profits, its pull on the "E (employment)" link may be far thinner than in a traditional housing cycle.

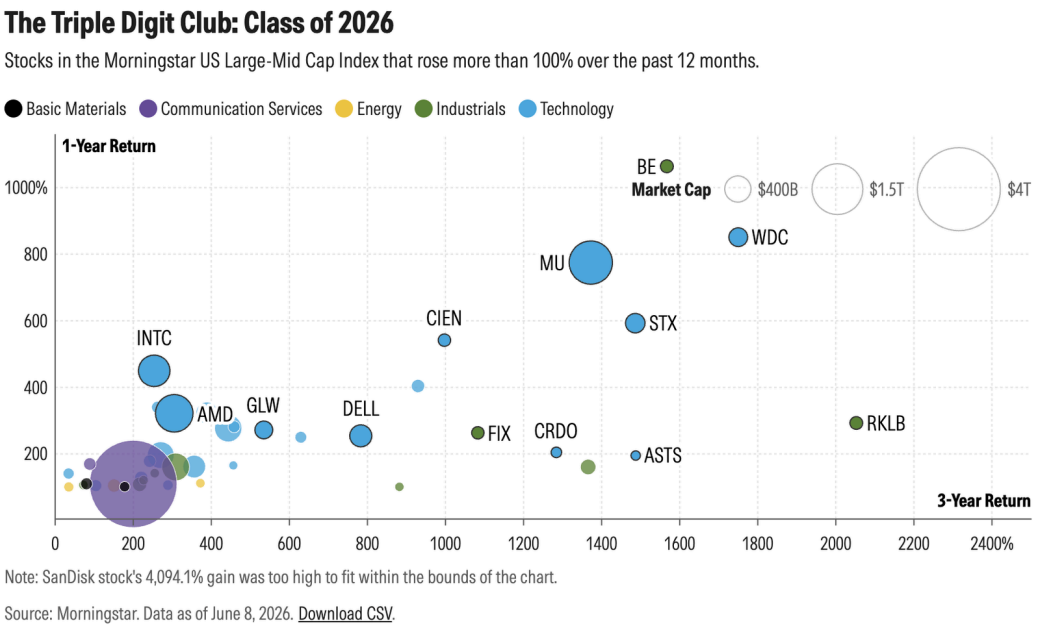
Exhibit 4. Data-center construction starts and new orders for computers and electronic products (2026 data-center construction not yet available)



Source: FRED, ConstructConnect.

As the chart shows, with the rise of AI technology, data-center construction spending has climbed together with orders for computer-related electronic products. AI infrastructure has substantially driven order volumes across the broader electronics sector. As is often said, the "shovel-sellers" across the compute supply chain are the biggest beneficiaries of the current AI-infrastructure wave.

Exhibit 5. The 2026 "triple-digit growth" stock club



Source: Morningstar.

As the chart above shows, the stocks that have risen sharply since 2025 are concentrated mainly in AI-infrastructure-related "shovel-seller" companies. Vast construction demand has pulled in large volumes of upstream orders, and semiconductor and other electronic-component makers have been the biggest gainers over this period: the surge in orders has transmitted directly to these companies' profits. Companies that supply key compute and storage for AI infrastructure, Intel (INTC), Western Digital (WDC), Seagate (STX), and AMD, have all posted triple-digit-plus gains over the past year; SanDisk in particular soared 4,094.1%, far beyond the chart's range.

At the same time, we can observe a group of related industrial and power-equipment companies benefiting as well. Beyond makers of generator sets and similar equipment such as Caterpillar (CAT), more notable are Vertiv (VRT: data-center power and cooling, up over 1,300% in three years), Comfort Systems (FIX: data-center HVAC), and nVent (NVT: electrical equipment), the direct beneficiaries of the "power bottleneck" link in data-center construction. Even Alphabet, with a market cap of $4.4 trillion, has joined the ranks of those that have doubled over the past 12 months.

To some extent, the equity market is itself a leading indicator. The rapid rise of these companies reflects investors' optimism about the durability of AI infrastructure. They believe AI infrastructure will continue to complete the economic transmission chain described above, and that these companies will keep winning more orders and steadily improving profits. But the question is: is this prosperity sustainable? Does this transmission chain itself harbor risks?

The risk behind a PMI above 50: is the economy now overly dependent on AI-infrastructure order growth?

We must acknowledge that the vitality and growth AI infrastructure brings to the economy are real, and that its demand is indeed strong. But at the same time, we should be wary: when an economy relies excessively on a single engine for growth, negative risks often lurk, because this is exactly the soil in which bubbles form.

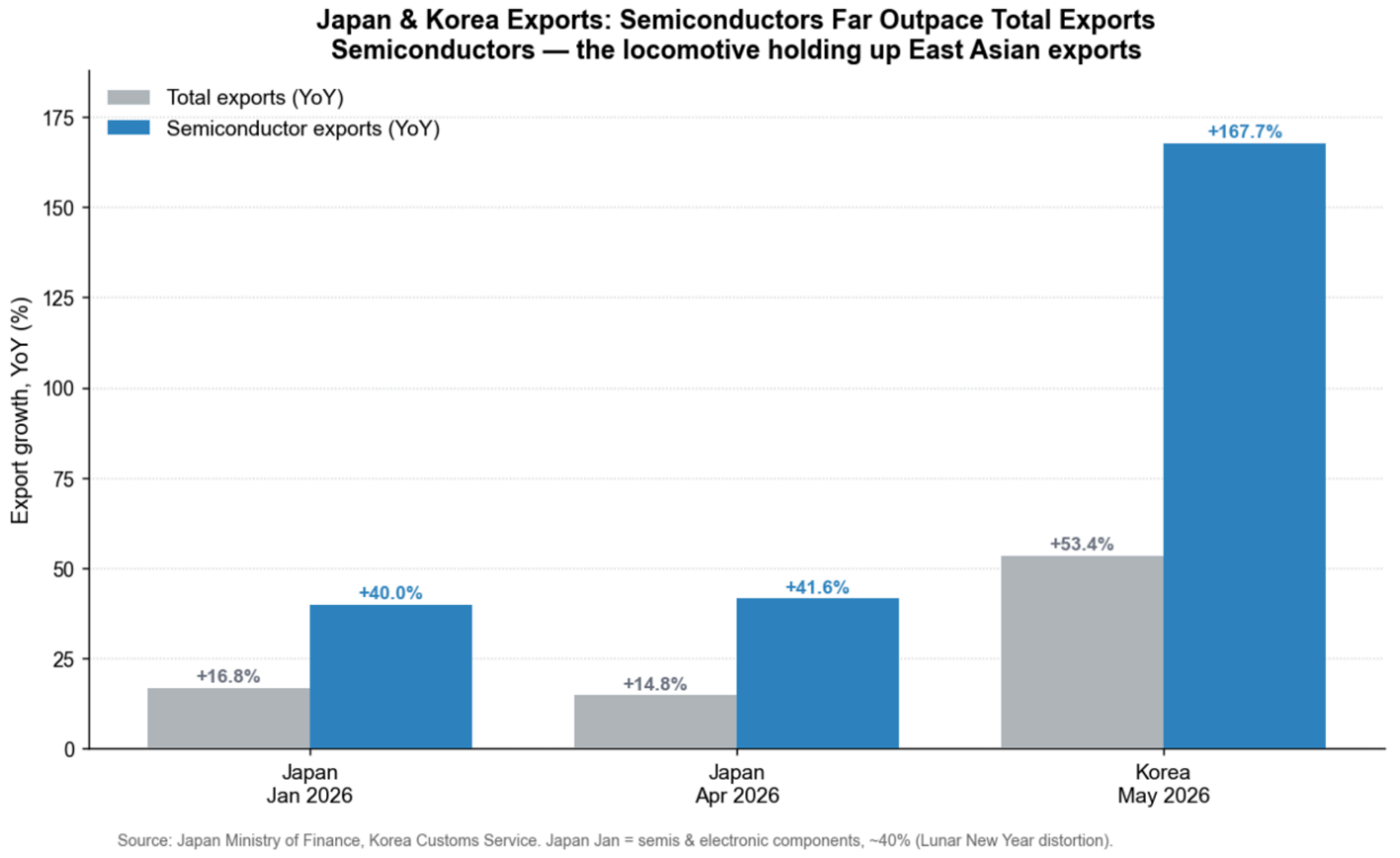
The typical path of a bubble is this: when overall economic growth is weak but one engine alone performs strongly, large amounts of capital rush into that area; once the inflowing liquidity exceeds what the engine can bear, or its eventual returns fail to deliver on the high expectations the market has assigned, the bubble bursts. The dot-com bubble around 2001 and the subprime crisis of 2008 both followed similar logic - the former was capital rushing into not-yet-profitable tech/telecom capital expenditure, the latter into over-financialized real estate.

To be clear, this is not enough to conclude that today's AI is a bubble, or that it must repeat the crises above. But what is certain is that today's AI investment exhibits several features similar to historical bubbles: a single engine, highly concentrated capital, and returns that remain to be verified. Whether it evolves along the same trajectory depends on the unanswered core question: whether AI's real returns can ultimately deliver on the expectations the market has priced in.

AI Infrastructure Pulls Semiconductors into Japan's and Korea's Economies

In recent S&P Global manufacturing PMI reports, Japan and Korea stand out among the world's major economies with strong readings. Korea's May manufacturing PMI hit 54.8 (a five-year high), and Japan's May reading reached 54.5, both showing strong expansion. Japan and Korea are classic export-oriented economies, which means their orders and demand depend heavily on external stimulus, and the PMI expansion is indeed reflected in their export growth (see chart).

Exhibit 6. Japan and Korea exports



Source: Japan Ministry of Finance, Korea Customs Service.

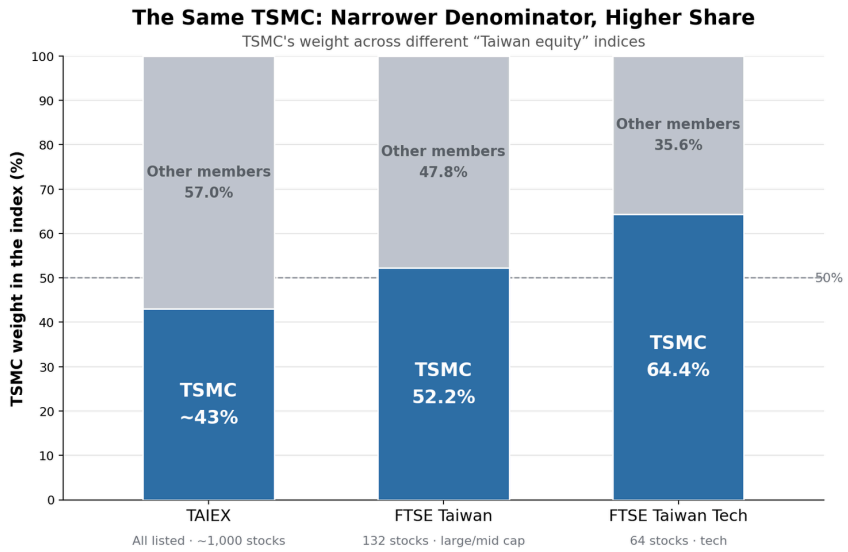
It should be noted, however, that this growth is highly concentrated in exports of semiconductors and related electronic components, driven by strong global demand for AI infrastructure. In Japan's case, April semiconductor exports rose 41.6% year-on-year, far above the 14.8% growth of its overall exports. Worth watching: Japan's other major export pillar, automobiles, is being hit on multiple fronts, under the shock of the Middle East war, exports to the Gulf have nearly stalled (exports to Iran and Qatar fell 99.9% and 62.4% respectively on a fiscal-year basis), and auto exports to the US have also fallen due to tariffs. But semiconductor strength has conveniently masked the weakness in the rest of exports.

This is even more extreme in Korea. Korea's May overall exports jumped 53.4% year-on-year, impressively reflected in its PMI; but semiconductors were almost the sole engine of that growth, surging 167.7% year-on-year, accounting for about 42% of exports and contributing roughly three-quarters of total export growth. In other words, strip out semiconductors, and Korea's traditional exports (especially autos, dragged by tariffs and geopolitics) are in fact weakening, merely masked by the chip surge.

More intriguing still: Japan and Korea should be among the economies most exposed to the Middle East energy crisis. Energy is a foundational input for industry, and surging prices and shortages should weigh heavily on their manufacturing; their current strength seems, on the surface, to "refute" this common sense. Yet this is not because they are immune to the energy shock, but because the semiconductor windfall from AI-infrastructure demand has temporarily overshadowed the pressure of energy costs. This means precisely that the growth of these two economies is now highly tied to demand in a single industry. Once that pillar wavers, the energy pressure and traditional-sector weakness it has masked will surface simultaneously. The sustainability of current growth is therefore a question that must carry a question mark.

Taiwan, another major link in the semiconductor supply chain, shows a similar trend. Semiconductor-supply-chain companies led by TSMC have become some of the largest stocks by market-cap weight in the Taiwan equity market, making up as much as 43% of the entire market.

Exhibit 7. TSMC's weight across different "Taiwan equity" indices



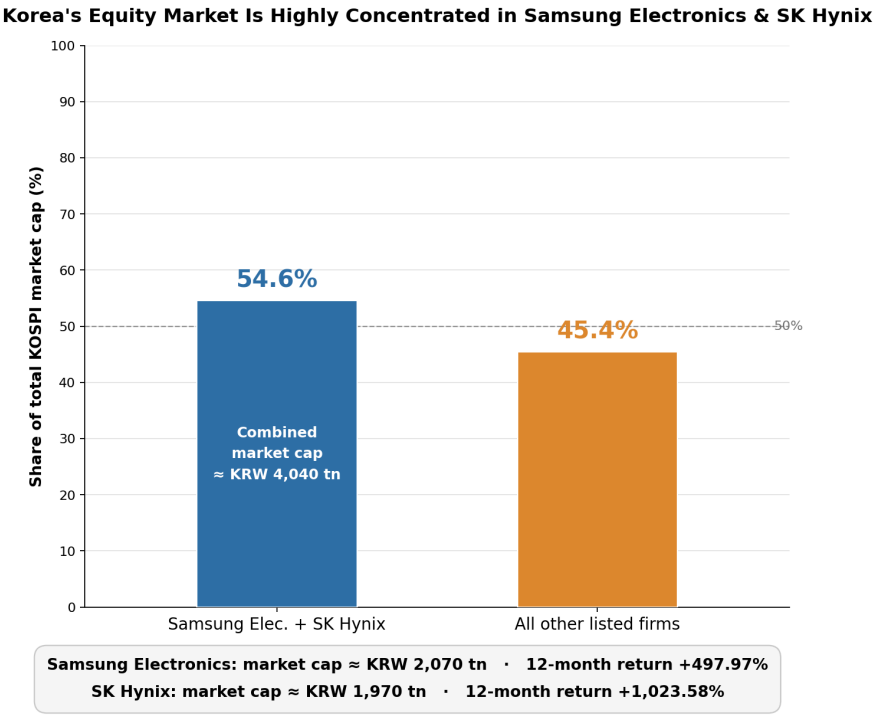
Note: TSMC's net market value is identical in both FTSE indices (TWDm 57,177,113); the difference in share comes purely from index scope (the denominator). TAIEX weight fluctuates daily with the share price (~42–44%). Source: FTSE Russell factsheets, TWSE, public market data.

Source: FTSE Russell, TWSE, public market data.

As the chart shows, TSMC's weight in the Taiwan equity market depends on which index is used as the yardstick. In the TAIEX (a free-float-weighted index covering all listed stocks with roughly a thousand constituents), TSMC's weight is about 43%; but when the scope narrows to the FTSE Taiwan index of 132 large- and mid-cap stocks, this rises to 52.2%; and if it narrows further to the FTSE Taiwan Technology index of just 64 tech stocks, it reaches 64.4%. It is worth emphasizing that TSMC's net market value is identical in the latter two indices (about TWD 57.2 trillion): the difference in weight does not stem from any change in TSMC's own size, but purely from the difference in index scope (the denominator). In other words, the narrower and more "investable" the index's constituents, the higher this single stock's weight.

Behind this phenomenon lies precisely the concentration risk consistent with the earlier discussion. When allocating to the Taiwan market, most global investors are not buying those thousands of small-cap stocks, but investable indices such as FTSE and MSCI and the ETFs linked to them, which means that more than half of their true exposure to the Taiwan market is in fact a bet on this one company. A seemingly diversified basket of large caps is in reality a highly concentrated bet on a single name. This is exactly the structure we observed in Korea (Samsung Electronics and SK Hynix together make up over half of the KOSPI), and even more extreme: in Taiwan, it is not two companies but only one that holds up the entire market. And the fate of that company hinges on the unverified core question of whether AI-infrastructure capital expenditure can be sustained. Once that engine wavers, the returns and risks of the so-called Taiwan equity market will swing along with this single stock.

Exhibit 8. Korea's equity market is highly concentrated in Samsung Electronics and SK Hynix



Note: As of 2026-06-19 close, common-stock market cap; KOSPI closed at 9,052 that day.
Source: KRX, Seoul Economic Daily, Korea Herald, stockanalysis.com

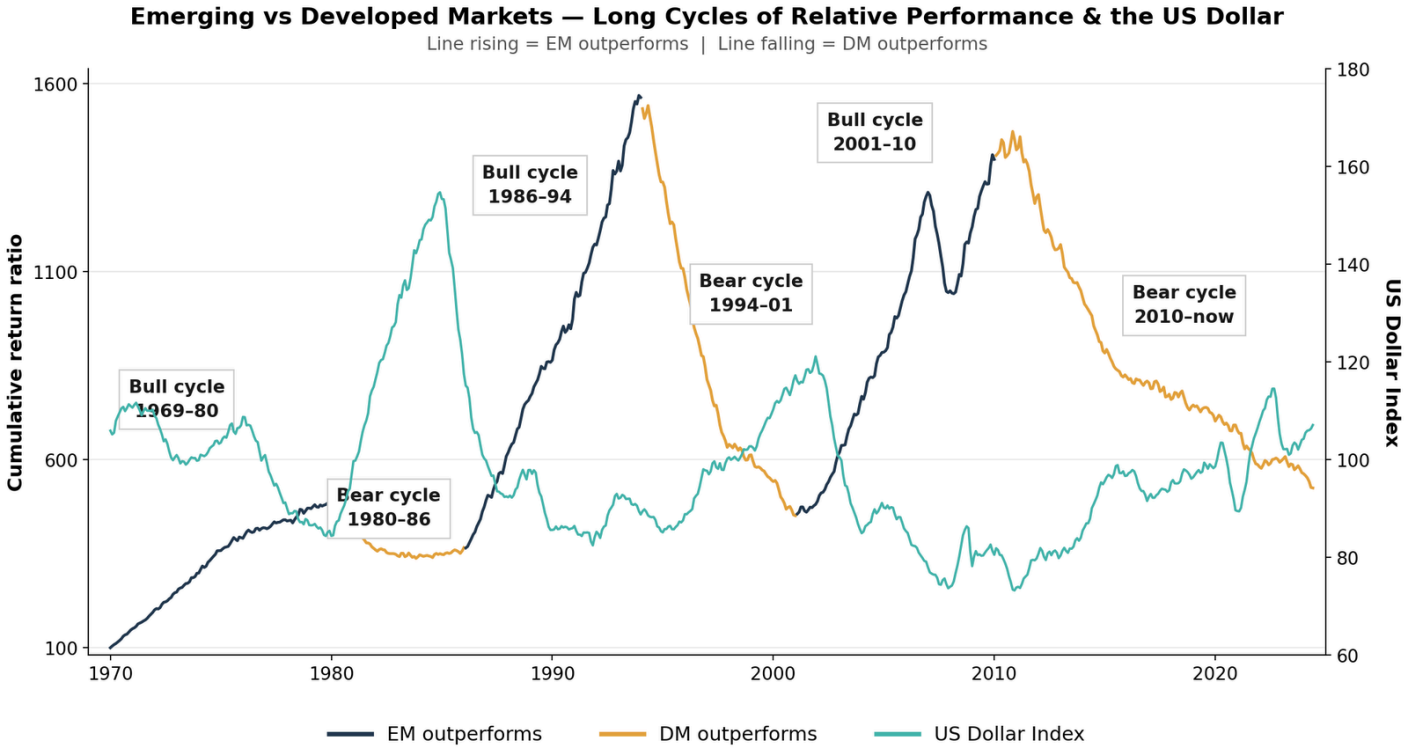
Source: KRX, Seoul Economic Daily, Korea Herald, stockanalysis.com.

A Shift in the AI-Infrastructure Model: From Counter-Cyclical to Cyclically Sensitive

The technology sector, unlike ordinary manufacturing, has a stronger tolerance for the economic cycle. Traditional manufacturing has classic cyclical sensitivity. In the cycle's upswing, when money and rates are looser and demand is expanding, manufacturing typically far outperforms services. But when the cycle turns to contraction, when money and rates tighten and demand approaches saturation, manufacturing's cyclical sensitivity is laid bare.

The reason technology has been relatively insensitive to the cycle lies mainly in its asset-light architecture. Unlike manufacturing, tech companies' growth does not rely on large-scale capital expenditure (building plants, purchasing production lines), but on accumulating and developing intangible assets; this asset-light model makes them naturally more immune to changes in the rate and credit environment. More importantly, tech companies have often "outsourced" cyclical sensitivity to the supply chain: with their pricing power and control over the supply chain, they can quickly ramp orders to upstream suppliers when demand expands and cut orders promptly when demand falls, thereby passing more of the macro shock onto suppliers and reducing its direct impact on their own cash flow.

Exhibit 9. Emerging vs. developed markets: long cycles of relative performance and the US dollar



Note: A stylized recreation of the original chart; line shapes are approximate. Refer to the original source for precise values.

Source: Wasatch Global Investors.

This model is especially clear in the chart above. The difference between emerging and developed markets fundamentally lies in their differing composition: developed markets, led by the US, are dominated by technology and related companies in both number and weight; emerging markets are dominated by manufacturing and commodity-related industries.

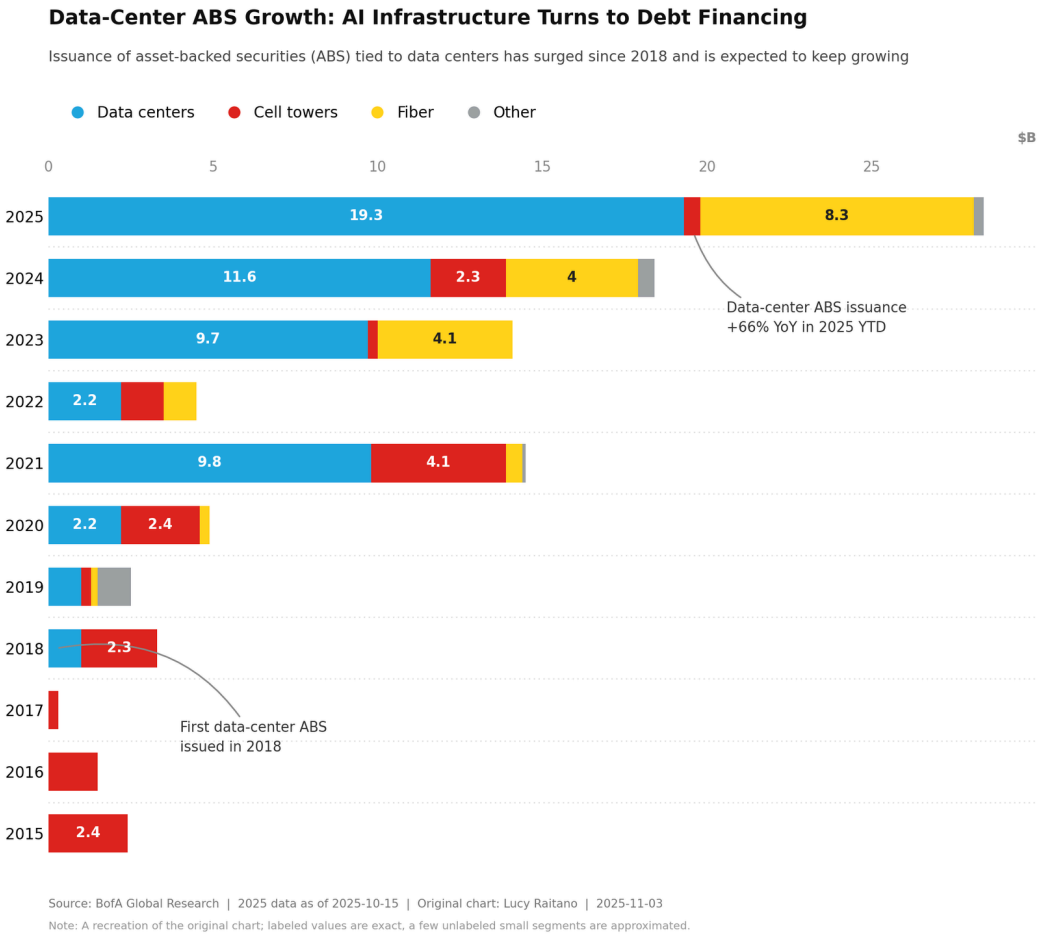
As the chart shows, in bull cycles emerging markets outperform developed markets, while in bear cycles the reverse holds, with developed markets outperforming. This stems largely from the difference in the two markets' composition. The reason US equities can keep rising is, crucially, their stronger resistance in bear cycles; emerging markets, though they can outperform in bull cycles, often suffer greater setbacks in bear cycles.

But this round of AI infrastructure is rewriting this logic. Tech companies are no longer merely placing orders to the supply chain in "asset-light" fashion. They are stepping onto the field themselves, becoming the principals of large-scale capital expenditure. Hyperscalers' hundred-billion-dollar-scale data-center outlays are, in essence, a form of asset-heavy expansion: they require land, power, plants, and vast quantities of chips and power equipment.

In other words, tech companies are adding back onto themselves the cyclical sensitivity they once outsourced. When the engine of growth switches from "intangible-asset development" to "physical infrastructure investment," their cash flow can no longer be decoupled from rates, financing costs, and the macro cycle. This is precisely the feature shared by traditional manufacturing and even the housing cycle. The once most counter-cyclical sector is, with its own hands, turning itself back into a cyclically sensitive, asset-heavy industry.

AI Infrastructure Is Increasingly Reliant on Debt Financing

Exhibit 10. Data-center ABS growth: AI infrastructure turns to debt financing



Source: BofA Global Research.

As the chart shows, the issuance scale of ABS (asset-backed securities) tied to data centers and fiber has expanded year by year, meaning that the volume of data-center-related debt financing is also swelling in tandem. This feature has been especially pronounced since 2022, right around the launch of ChatGPT.

Behind this lies a deeper signal: the technology sector is further increasing its own sensitivity to the economic cycle. When tech's capital expenditure shifts from the asset-light construction of the past to long-cycle, asset-heavy investment, and that investment increasingly relies on debt issuance for financing, its sensitivity to rates and monetary policy is significantly amplified.

At the company level, one of the clearest cases is Alphabet (Google) turning to the bond market to fund its vast AI-infrastructure outlays, becoming the second tech giant this year to issue debt heavily, after Oracle (which issued $25 billion a week earlier). Google's round was issued in three currencies: US dollars, sterling, and Swiss francs, with maturities ranging from 3 to 100 years; the US-dollar portion alone totaled $20 billion (above the initially expected $15 billion). Most striking is a 100-year "century bond" (sterling-denominated, around £1 billion in size). This is the first century bond issued by a tech company since Motorola in 1997, and it drew nearly 10x oversubscription. It is worth emphasizing that as recently as this March, Google reported total long-term debt of less than $11 billion: the shift from barely issuing debt to borrowing at this scale within a few months is itself a signal. (Sources: The Wall Street Journal, Bloomberg.)

Google raises a new round of equity to fund AI infrastructure

Exhibit 11. Google equity financing

THE WALL STREET JOURNAL

Google Seeks $80 Billion for AI Buildout; Berkshire Will Buy $10 Billion Stake

By Katherine Blunt

Updated June 1, 2026 7:37 pm ET

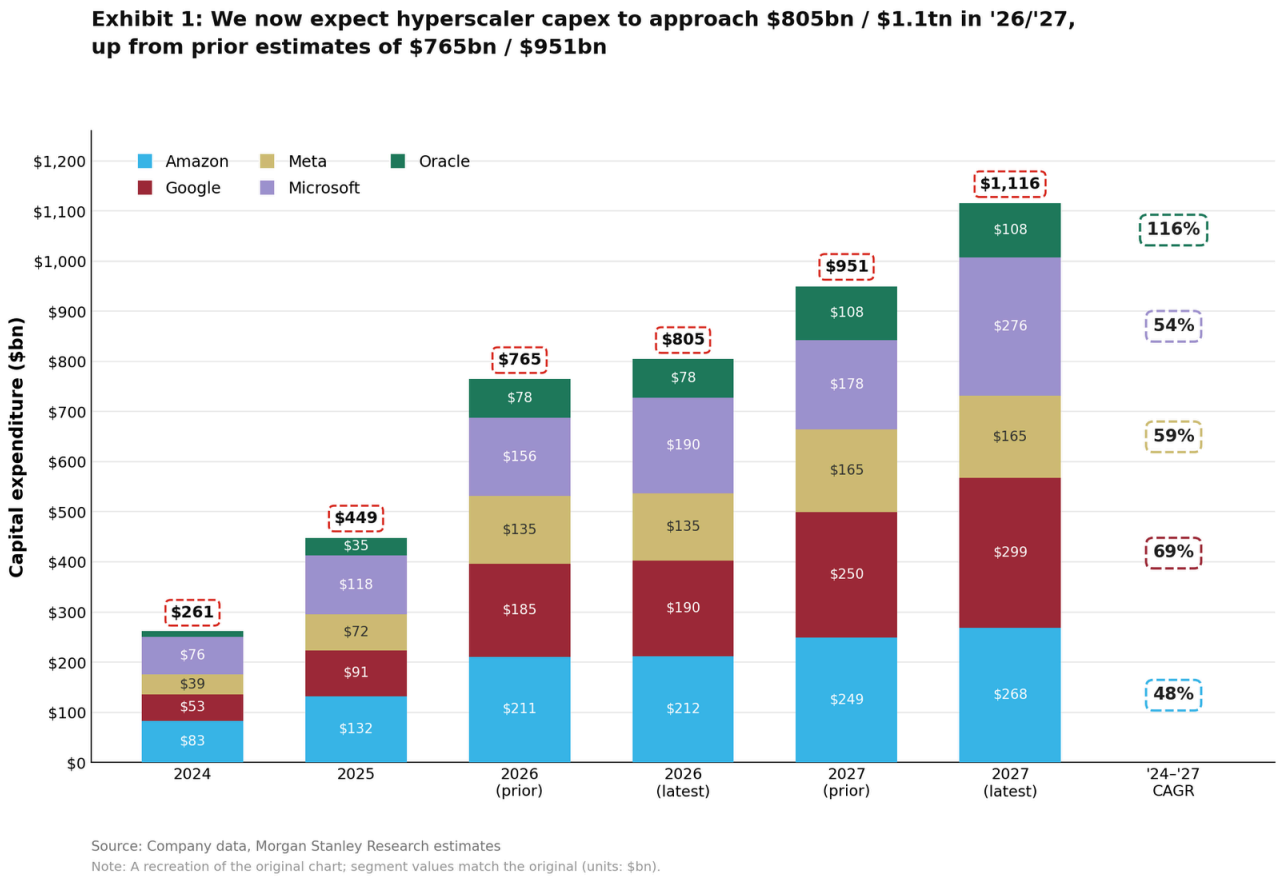
Source: The Wall Street Journal.

Google simultaneously announced an $80 billion equity issuance to fund AI investment, of which $10 billion was sold to Buffett's Berkshire Hathaway, with the remaining $70 billion raised through underwritten public offerings and similar means. What is telling here: even Google, the most cash-rich, highest-credit-rated of them all, cannot cover such aggressive outlays through debt alone, and must also dilute equity to raise funds. This is precisely how large the AI-infrastructure funding gap has become - already beyond what even tech giants' own cash flow can bear.

In other words, the funding source for AI data centers is gradually shifting from a model led by tech giants' own cash, which is relatively insulated from rates and the macro environment, to an outlay highly dependent on financing and extremely sensitive to rates and monetary policy. The implication of this shift is that the Fed's future hiking or cutting path, and the monetary-policy direction of major economies, will directly become an external tailwind or headwind shaping future capital expenditure. And as discussed above, this is the key link by which AI infrastructure "takes cyclical sensitivity back on": once the financing environment tightens, this debt-supported expansion will bear the brunt.

Morgan Stanley's forecast for the scale of hyperscaler capital expenditure

Exhibit 12. Morgan Stanley's hyperscaler capex forecast



Source: Company data, Morgan Stanley Research estimates
Note: A recreation of the original chart; segment values match the original (units: $bn).

Source: Morgan Stanley Research.

As the chart shows, future AI-infrastructure outlays will keep expanding: Morgan Stanley forecasts that the major hyperscalers' (Amazon, Google, Meta, Microsoft, Oracle) capital expenditure on AI infrastructure will keep climbing at high levels, reaching a combined order of roughly $1.1 trillion by 2027.

As discussed above, the current ISM manufacturing PMI is highly tied to this round of AI infrastructure. So as long as AI-infrastructure spending stays at high levels, it is a real stimulus to the current global economic system. But at the same time we should be wary: AI infrastructure's current high sensitivity to the macro environment (especially rates and financing conditions) injects new uncertainty and fragility into this "stimulus engine": the more the stimulus hinges on this one highly financing-dependent engine, the greater the drag on the whole system once its power source changes.

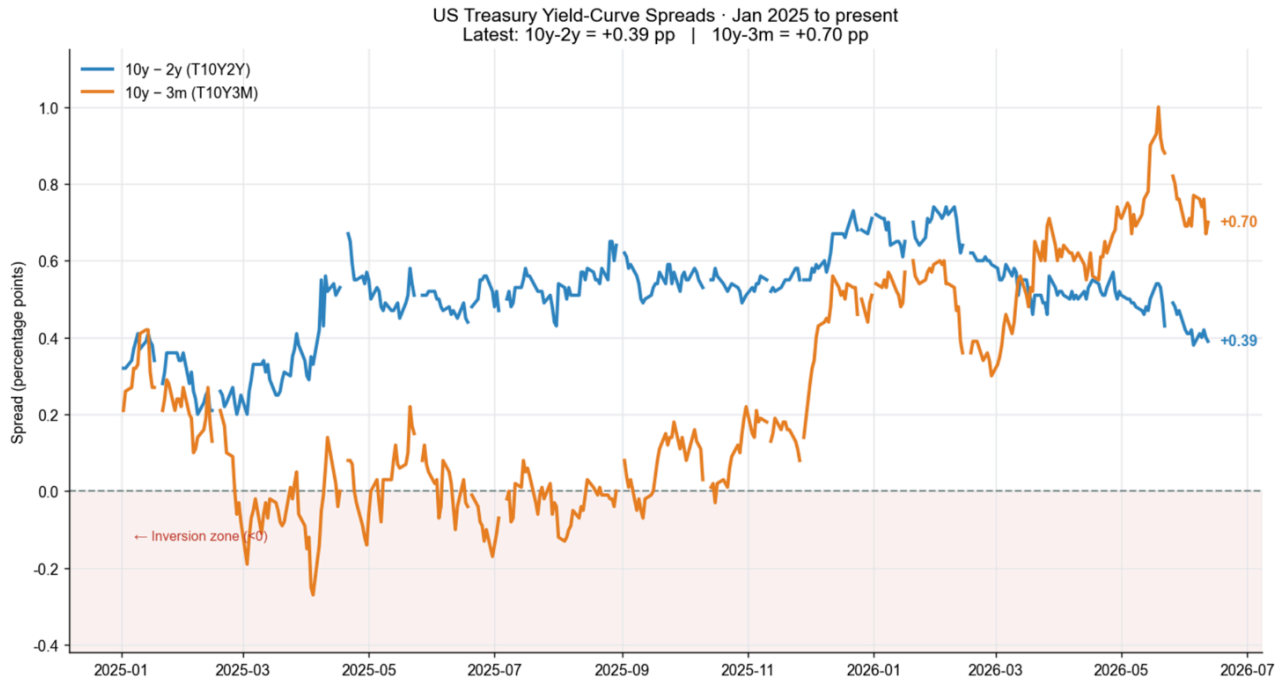
This concern has already begun to surface in the bond market's behavior. The persistent rise in long-end rates partly reflects bond investors' worries about future financing costs; and rising long-end rates in turn raise AI infrastructure's financing costs, pressuring this expansion that depends so heavily on debt issuance. In other words, the "headwind" the bond market is pricing may, in the future, transmit directly into a constraint on AI-infrastructure spending.

US Treasury Spreads (Long vs. Short): How Are Bondholders Pricing the Future?

The US Treasury spread reflects bond investors' relative expectations for long- and short-term risk and return. Unlike short-term rates, long-term Treasury yields are determined mainly by auction supply and demand; when long-term rates rise, it usually means investors see more risk in future bond investments and therefore demand higher yields as compensation.

Normally, long-term Treasury yields are higher than short-term ones, because the longer the maturity, the greater the risk borne (longer duration, higher rate risk). But there are also cases where short-term rates exceed long-term ones (the so-called yield-curve inversion). Inversion means the market expects future short-end rates (and economic momentum) to weaken, so the long end is instead lower, which is why the spread is widely used as one of the leading indicators for judging recession and expansion.

Exhibit 13. US Treasury spreads, 10y–2y and 10y–3m



Source: FRED.

The chart above shows US Treasury spreads from early 2025 to June 2026. The spread is widening in positive territory; since September 2025, the long–short spread has kept expanding. But is this a positive signal? By conventional logic, US Treasuries have experienced a prolonged inversion since the pandemic, and the shift to a positive spread should point to an economic recovery. Yet one thing to be wary of: this round of spread widening is mainly attributable to the persistent rise in long-term rates, not to a decline in the short end.

Exhibit 14. US long-end Treasury yields



Source: FRED.

The rise in long-end rates has lifted the spread, and this rise has been especially pronounced since the war in Iran began. After the Middle East war broke out, long-term rates kept climbing, possibly driven by two factors: first, rising market pricing of future economic risk, and second, intensifying worries about inflation pressure. At the same time, the Fed has not recently adjusted the policy rate, so the short end is anchored in place while the long end keeps rising, and the spread naturally widens.

But here an essential difference is worth emphasizing. In most past cases, spread widening was driven by Fed rate cuts, i.e., short-end rates falling while the long end held relatively steady, pulling out a positive spread (a "bull steepening"). The current phenomenon is reversing this: the spread's "engine" has switched from the short end to the long end.

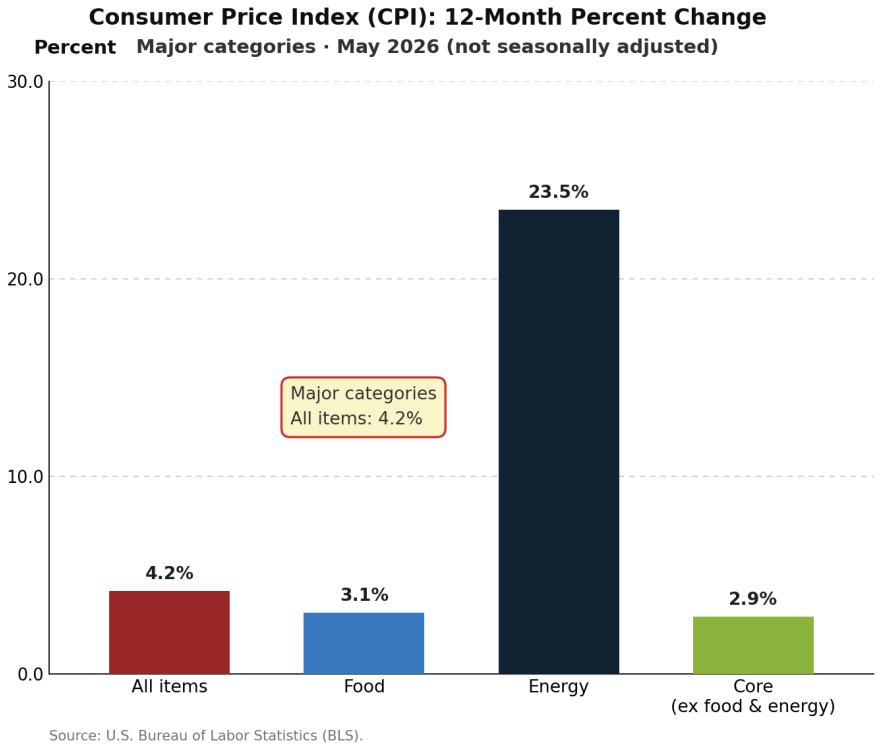
It is not the short end being pulled down by cuts, but the long end being pushed up by inflation and risk premia (a "bear steepening"). The two draw similar-looking spread curves, but with diametrically opposite meanings: the former is easing-driven and often foreshadows recovery; whereas the current rise in long-end rates instead exposes bond investors' warnings about future inflation and risk.

US Inflation Data: What Do the Model Forecast and Leading Indicators Signal?

The Fed has two policy objectives: first, to control inflation, anchoring the overall price level to a 2% year-on-year CPI benchmark; and second, to achieve maximum employment while maintaining vitality in the economy. So to assess the likely direction of future Fed decisions, we need to watch the leading indicators related to these two variables and their movements.

The May inflation data show CPI has risen to 4.2% year-on-year, climbing persistently since the war in Iran, up 0.5% from the prior month. The main source of inflation is energy (up 23.5% year-on-year); but notably, even excluding the more volatile food and energy, core CPI is still 2.9%, still above the Fed's 2.0% target. This means inflation pressure does not come solely from energy as a supply-side shock, but has broader stickiness.

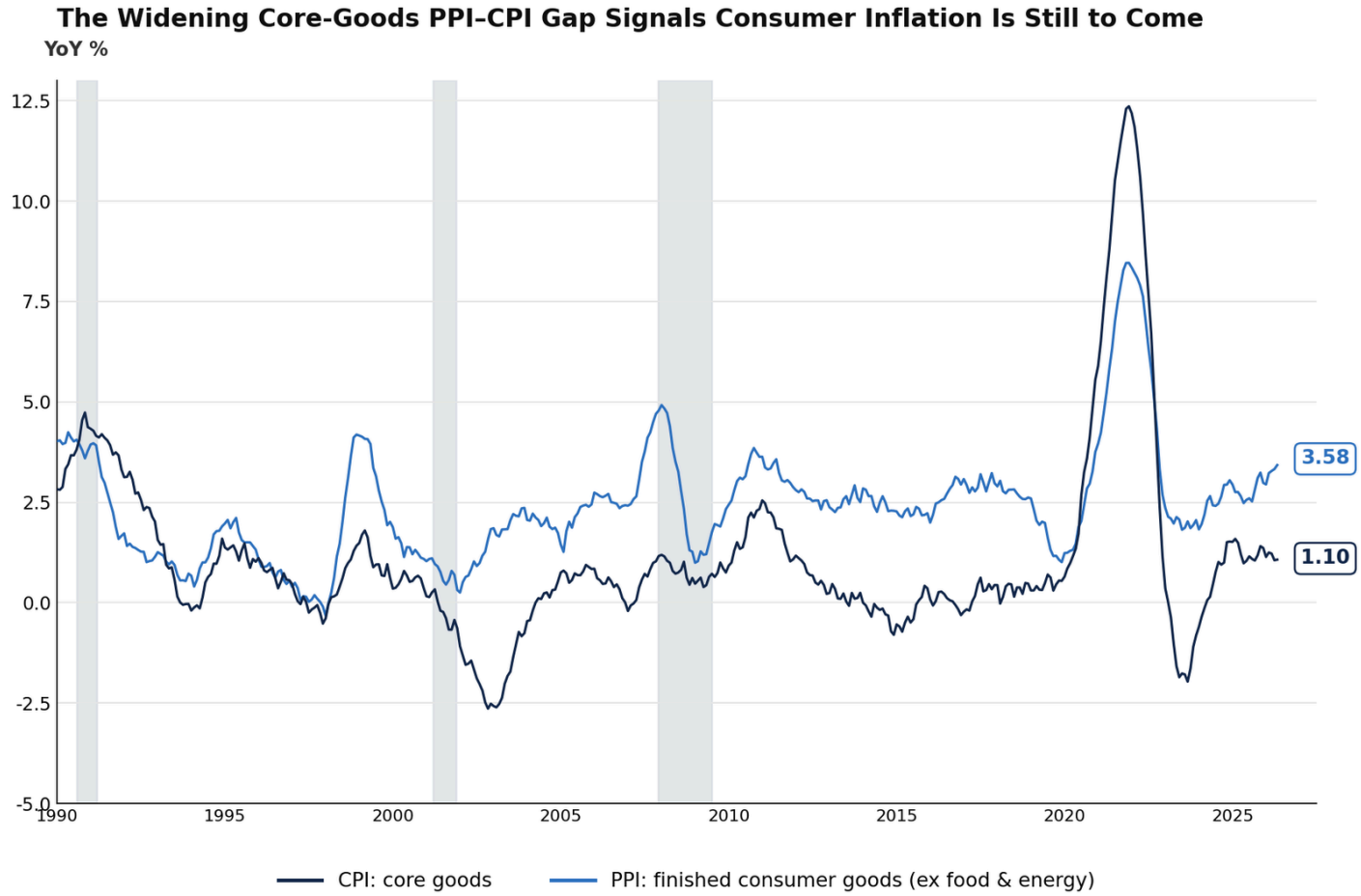
Exhibit 15. CPI 12-month percent change, May 2026



Source: US BLS.

This April, headline PPI (final demand) accelerated to 6.0% year-on-year, the highest since December 2022, and rose further to 6.5% in May. Production-end inflation pressure is accumulating rapidly and is already at a three-year high. Energy is the main cause, but price increases have spread broadly into services and trade. More noteworthy is the transmission: as the chart below shows, core-goods PPI (3.58%) is now clearly above core-goods CPI (1.10%), and the widening gap between the two means production-end cost pressure has not yet fully transmitted to the consumer end, leaving room for CPI to rise further.

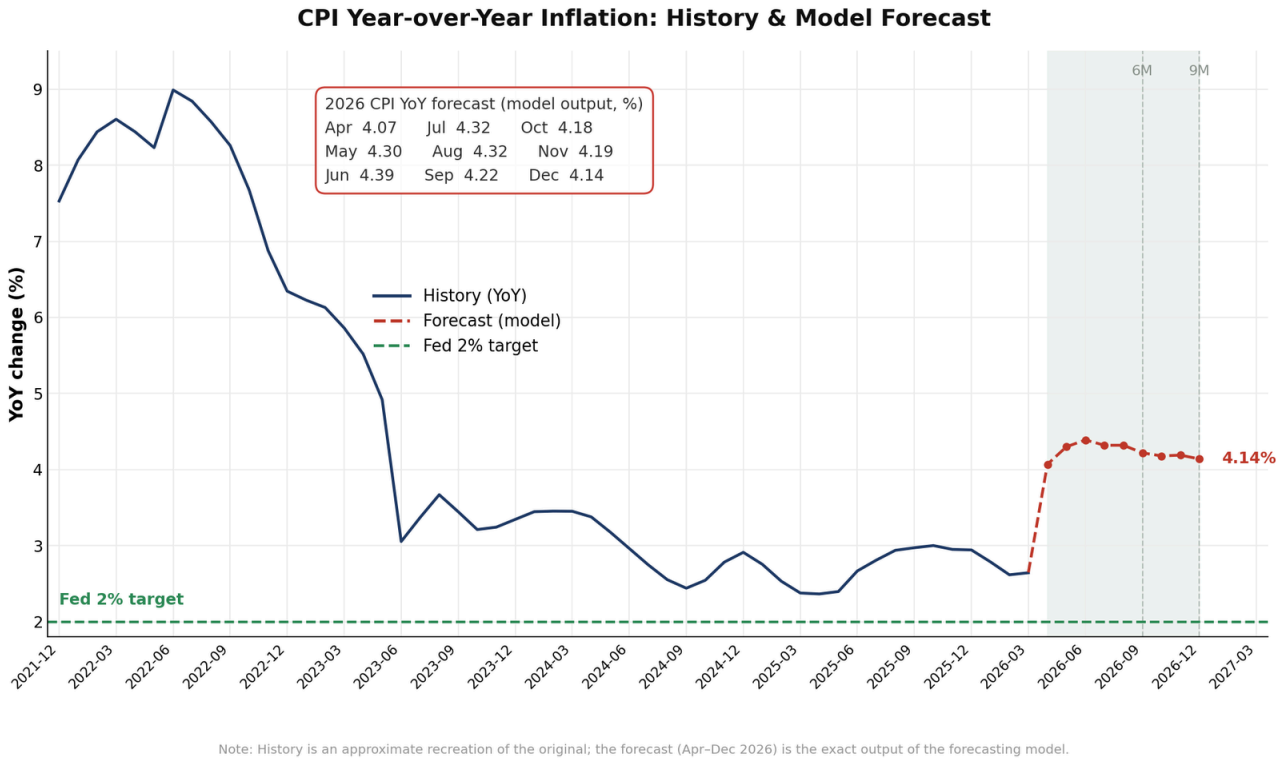
Exhibit 16. The widening core-goods PPI–CPI gap



Source: US BLS, RBC Economics.

The rapid rise in PPI shows that the cost pressure producers face is accumulating year by year, and this pressure usually transmits downstream to consumers. As the chart shows, PPI and CPI are highly correlated, and PPI typically leads CPI. Changes in PPI tend to appear before CPI. The current widening gap between PPI and CPI may mean that, in the future, companies will pass more inflation pressure onto consumers, pushing CPI higher.

Exhibit 17. CPI forecast



Note: History is an approximate recreation of the original; the forecast (Apr–Dec 2026) is the exact output of the forecasting model.

Source: FRED; VAR model built by the author, results for reference only.

Finally, according to my VAR model's forecast for CPI (shown above), which is based on historical data from 1997 to March 2026 and driven by six factors, the results show that CPI is very likely to stay in a high range above 4.0%. This further corroborates the possibility of inflation continuing to rise and then hovering at high levels. And the continued accumulation of inflation risk will be both a major obstacle to a Fed rate cut and a significant risk to companies' future profits.

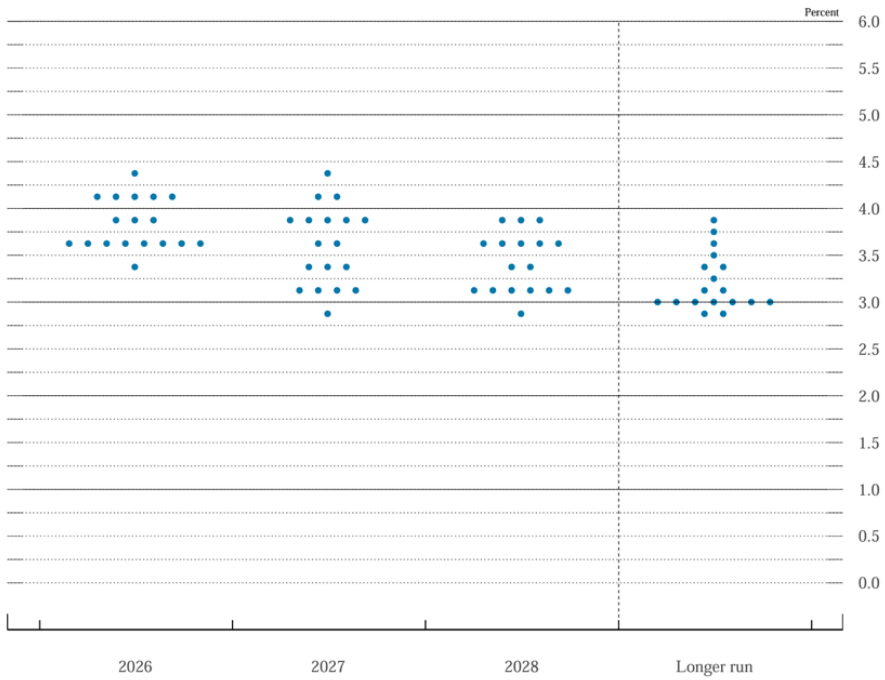
A Fed Rate Hike Has Become a Possible Event: How Would It Affect the Macroeconomy?

Combining all the information above, two main phenomena can be observed. First, on the growth side, the engine that has taken over part of housing's role, centered on AI infrastructure, is still driving growth, and demand is strong. Second, inflation risk is continuing to accumulate, and may stay high or even accelerate in the future. Together, these two phenomena point to one judgment: the Fed's future policy balance is tilting toward tightening, while the prior path to rate cuts has essentially closed.

This can also be seen in the Fed's latest dot plot (below). The current rate range is 3.50%–3.75% (midpoint 3.625%). In the 2026 projections, of 18 officials, 9 project rates above the current level (i.e., lean toward hiking), 8 project holding the current range unchanged, and only 1 projects a cut. In other words, officials favoring a hike now slightly outnumber those favoring a hold, while those expecting a cut have all but vanished. Compared with the March dot plot, whose median still pointed to a cut, this is a clear hawkish reversal. Although divisions remain within the committee, the balance has clearly tilted toward a hike, and cut expectations have been essentially priced out.

Exhibit 18. June 2026 Fed dot plot

Figure 2. FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate



Source: Federal Reserve.

But the Fed also faces a dilemma:

First, the inflation data show that risks are still rising. A hike can suppress inflation, but the cost is not to be ignored: today's AI infrastructure is highly bound up with the economic cycle, and it is itself a classic long-cycle, capital-heavy investment, highly sensitive to macro rates. A hike would form a significant headwind to AI-infrastructure expansion, and because AI infrastructure has taken over from housing as one of the core engines of this round of growth, hitting it could well push the whole economy from expansion into contraction.

Second, whether the Fed hikes or holds rates high, small and medium-sized enterprises and real estate will bear greater pressure. Compared with large enterprises, SMEs and real estate are far more sensitive to macro rates; in fact, since the post-pandemic hiking cycle, the pressure these two sectors bear has kept accumulating, and expansion has grown ever harder. Yet if the Fed chooses not to hike and instead turns to easing, inflation's risks and pressures will rise further.

How will the Fed decide, and how will it affect the economy? This needs to be analyzed across three different scenarios.

Scenario 1: The Fed chooses to hike

If the Fed chooses to hike, it could shock the current momentum of AI infrastructure. AI infrastructure is a classic long-cycle capital-expenditure project (long investment cycle, slow payback and cash recovery), naturally sensitive to rates; a hike would directly affect its actual investment and spending, and this effect would be further amplified now that AI infrastructure has begun to rely on debt financing.

So a hike would form a headwind to AI infrastructure from the financing-cost side, dampening its expansion and potentially weighing on the macroeconomy. A slowdown in AI-infrastructure investment would transmit upstream to orders. The business growth of companies supplying key electronic components for AI infrastructure would fall back accordingly.

For hardware-tech companies the market currently assigns high growth expectations, this would be a major blow: at that point, the market's valuations of them would have to be priced off newly downgraded future cash flows. A hiking decision would also spill over into commodity and crypto markets. After rates rise, capital may instead flow into risk-free, more attractive yield-bearing assets such as bonds, out of risk assets. In this scenario, however, inflation should be effectively suppressed and pull back; and if layered with a potential easing trend in the war in Iran, this could instead help the Fed reopen the path to cuts in the future (rather than now).

Scenario 2: The Fed chooses to hold rates

If the Fed chooses to keep rates unchanged, this is to some extent a compromise between "growth first" and "inflation control first." In this scenario, whether AI infrastructure can sustain its strength will depend on its future profit expectations. The reality may be that, as more participants such as private equity and private credit keep pouring in, AI infrastructure will keep strengthening; but this momentum will at the same time be constrained by inflation. As inflation rises, AI infrastructure's underlying costs may keep climbing: rising commodity prices may come not only from energy but also from metals such as copper and from rising electronic-component prices.

This will affect economies' future willingness and intensity in deploying capital to AI. This scenario could to some extent drive up AI-related commodities, but with cyclical components included, investors should remain cautious. Inflation in this scenario may keep rising, but as time passes and the market digests it, it may settle at a high but no-longer-rapidly-climbing level.

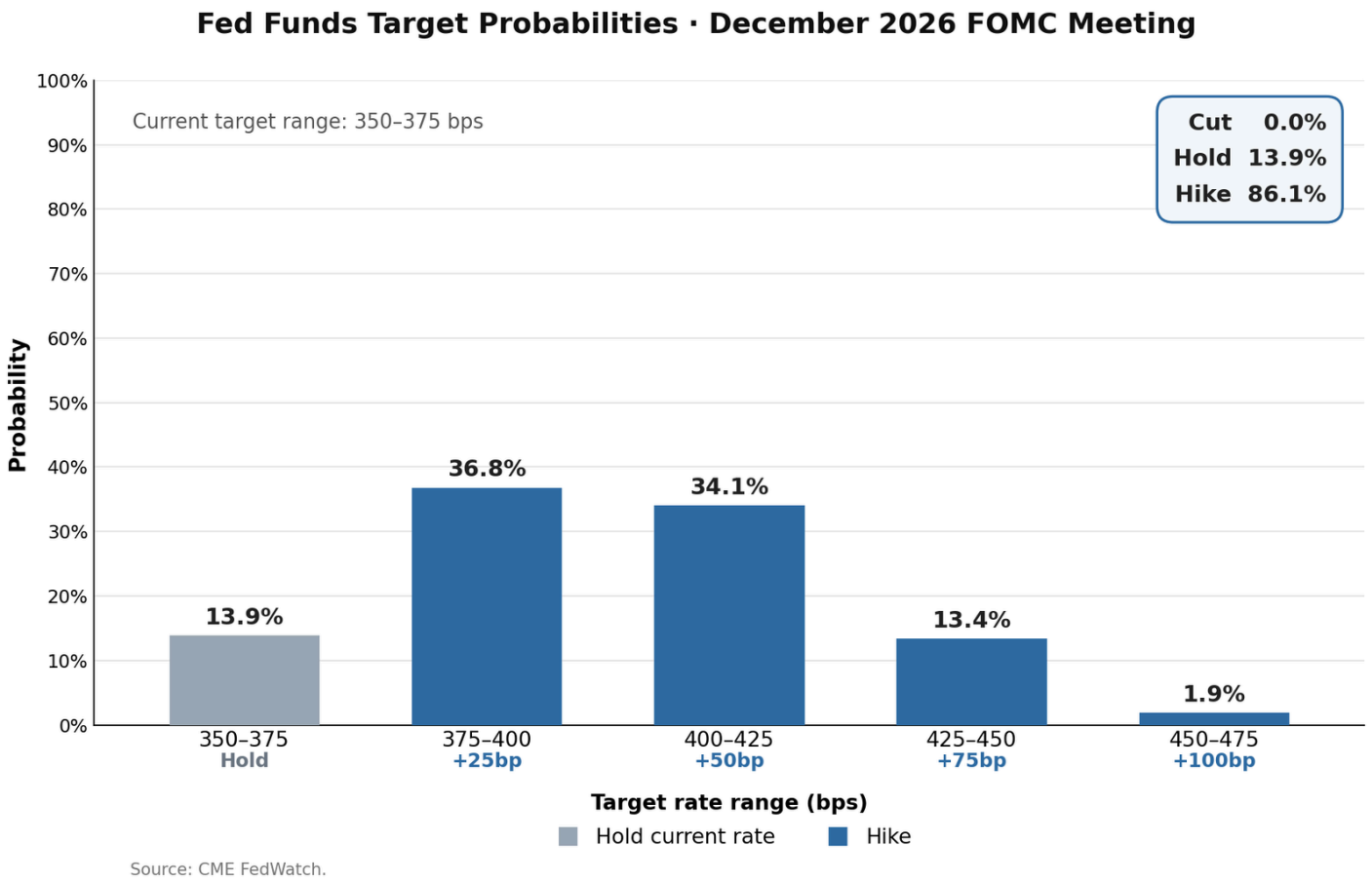
Scenario 3: The Fed chooses to cut

If the Fed chooses to cut, AI infrastructure could keep expanding at a pace beyond imagination: a cut injects more liquidity into it, especially benefiting this kind of long-cycle capital-expenditure project. A cut would also somewhat relieve the previously pressured SMEs and real estate. At the same time, commodities such as gold and the crypto market could see gains. More capital would flow to non-yielding or high-potential-return assets in pursuit of returns.

But this could also mean inflation getting completely out of control: inflation indicators such as CPI could surge toward 5.0%, eventually reaching levels that both consumers and businesses find hard to bear. In other words, a cut would stimulate equities and the economy in the short term, but the high inflation that follows would directly weigh on the economy over the medium to long term.

But based on current market expectations, the larger scenarios now lie in Scenarios 1 and 2. Because the Fed's path to cuts has now tightened, and on CME Group's FedWatch the market's current expectations have essentially eliminated cuts, concentrating mainly between hiking and holding.

Exhibit 19. Fed funds target probabilities, December 2026 FOMC meeting



Source: CME FedWatch.

CME FedWatch is an authoritative tool for observing the market's expectations of Fed policy. It is not a subjective forecast, but implied probabilities derived from the real-time prices of CME federal-funds futures, reflecting the collective expectations the whole market has traded out with real money. As of June 24, the tool shows the market pricing an 86.1% probability of a hike by December 2026 and a 0% probability of a cut, meaning the market has essentially priced out a cut this year.

Investment Recommendations: Trim Tech and Long-Duration Exposure; Add Short-Duration and Value

Combining the two analyses above, I recommend that investors modestly reduce their over-concentrated exposure to the technology sector, especially AI-infrastructure-related hardware-concept stocks. These "shovel-seller" hardware stocks (GPUs, memory chips, semiconductor equipment, etc.) have been the biggest winners of this round. Unlike the hyperscalers that fund AI investment, they have reaped large volumes of orders from the AI-infrastructure capital-expenditure wave, been assigned very high growth expectations by the market, and led the broad market in 2026.

However, these high expectations could be shocked in the hiking or higher-for-longer scenarios described above. Hardware tech is itself strongly cyclical (semiconductors are a classic cyclical industry), and this round of AI capital expenditure has further amplified that cyclicality; once a hike or high rates dampen the investment momentum of AI infrastructure, order growth could slow, and this upcycle could peak and roll over.

So reducing related exposure is, in essence, management of the portfolio's concentration risk, rather than a bet on market timing, and it is especially worth noting that the market has already shown signs of rotation from the hyperscalers toward "shovel-sellers" and even small caps, which itself signals the fragility of a concentrated bet.

From a more fundamental mechanism, a potential hiking cycle would pressure long-duration assets. The value of such assets depends heavily on cash-flow returns in the distant future, and is therefore highly sensitive to rates: when rates rise, on one hand the present value of distant future cash flows is discounted more heavily and valuations come under pressure; on the other hand, a higher risk-free rate also lifts the hurdle rate these assets require, weakening their relative appeal.

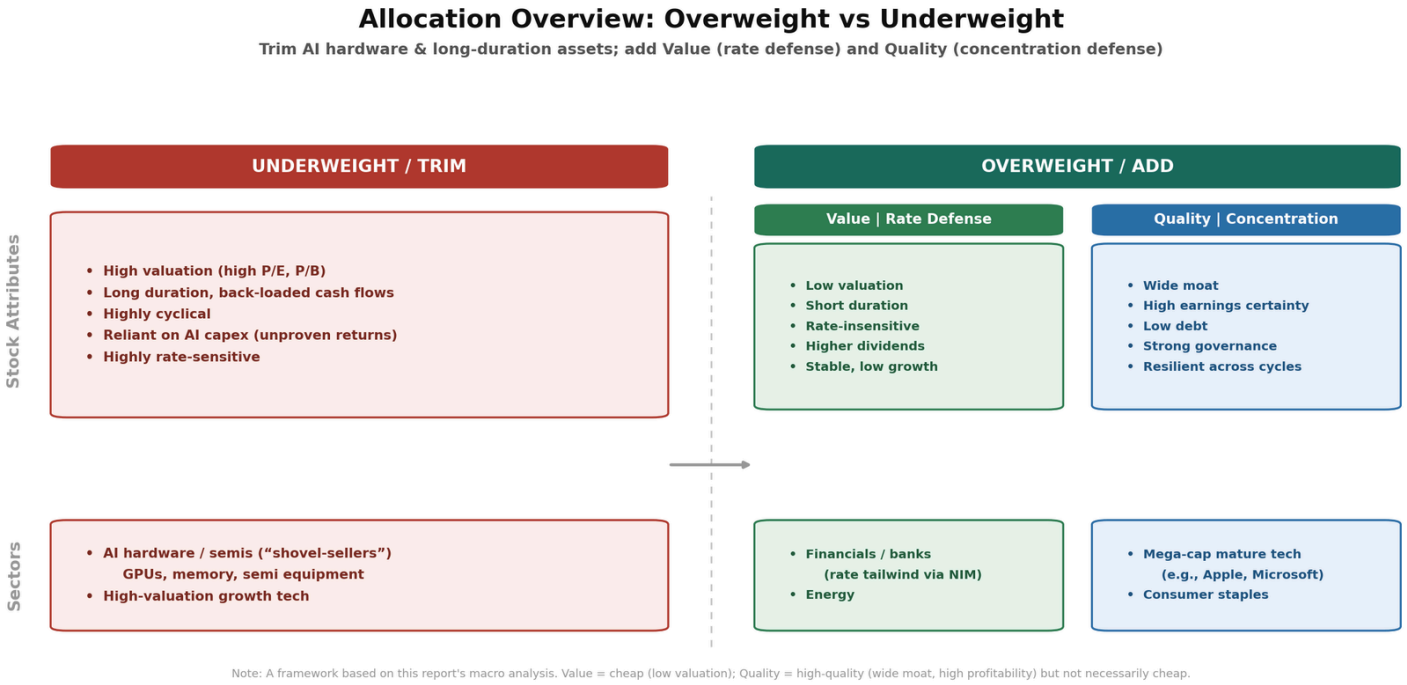
In other words, in a potential hiking cycle, long-duration assets are one of the asset classes most vulnerable to shocks. The underlying logic of adding short-duration assets and value stocks lies precisely in their lower sensitivity to rising rates. Unlike long-duration assets, short-duration assets have a shorter cash-flow recovery cycle, so rate changes have a limited impact on their valuations; moreover, capital is recovered quickly, so investors can more quickly reinvest principal at currently higher rates (the so-called "reinvestment advantage").

Value stocks, for their part, have the features of relatively stable cash flows and a smaller need for long-term capital investment going forward. Their fundamental difference from growth stocks first shows up in duration: value stocks usually have mature profit models, and their value comes more from stable cash flows in the present and near term (short duration, stable but limited growth); whereas growth stocks' value depends heavily on continued capital investment and the delivery of distant future growth (long duration). So in an environment where rates may rise and cut expectations are narrowing, value stocks' risk/reward relative to growth stocks is improving, and they may be the more resilient allocation direction.

At the same time, I also recommend adding quality companies with relatively steady valuations and higher quality attributes. Such quality stocks usually have a solid and wide moat, along with excellent financials, sustained profitability, and sound corporate governance, allowing them to cross different economic cycles. It is worth emphasizing that the logic for recommending quality stocks differs from that for value stocks above: adding value stocks is mainly because of their short duration and insensitivity to rates (defense via rates); whereas adding quality stocks is because, in an environment of a single AI engine and a highly concentrated market, their earnings certainty and risk resistance provide another layer of defense (defense via certainty). In other words, the former defends against rates, the latter against concentration risk.

Overview of Final Investment Recommendations

Exhibit 20. Overview of final investment recommendations



Note: A framework based on this report's macro analysis. Value = cheap (low valuation); Quality = high-quality (wide moat, high profitability) but not necessarily cheap.

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- Meta Platforms, Inc. (META): equity research report, October 2026
- CME Group Inc. (CME): equity research report, October 2026
- Amazon.com, Inc. (AMZN): equity research report, October 2026
- The Ensign Group (ENSG): sell recommendation
- H2 2026 Macro Outlook (this report)
- VAR macro forecasting model
- Constructing a Portfolio for a Five Percent Return Objective

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