For US institutional investors only

Q4 2026

US Investment Outlook

AI enters its political phase



Key takeaways

- As the AI buildout collides with US politics, US credit investors will need to weigh supply pressure, infrastructure constraints and issuer dispersion against the long-term growth potential of the asset class.
- We see attractive opportunities across securitized credit, particularly in esoteric ABS tied to digital infrastructure, where complexity and differentiated collateral can offer compelling relative value.
- Investment grade (IG) infrastructure credit remains a high-conviction area, supported by financing needs across digital infrastructure, power generation, transportation and energy-security projects.



AI enters its political phase

Artificial intelligence has spent the past several years primarily as a technology and investment story. It is now becoming a political one in the US and worldwide.

The November US midterms may matter less for the precise composition of Congress than for what they reveal about the AI concerns resonating with voters. Although AI still trails the economy, immigration and foreign affairs as a priority, public anxiety about its consequences is rising. For US credit investors, the key question is where that anxiety begins to constrain the investment cycle, alter the supply outlook and change the compensation required for AI-linked risk.

The emerging fault line is not simply between Democrats and Republicans. President Trump's administration has emphasized American AI leadership, competition with China, faster infrastructure development and relatively light federal regulation. Democrats generally favor stronger safeguards, but the political coalitions are more complicated: Populist Republicans are also questioning AI's costs and concentration, while governors and state legislators from both parties have resisted efforts by Washington to pre-empt state rules or limit their ability to regulate data-center construction.

That makes AI unusual: Both parties want the US to lead China, but neither can ignore the domestic costs of that race. Three political paths could emerge after the midterms, each with important implications for US credit.

First, China could win the political argument

If national security and technological competition dominate, policymakers may continue to prioritize rapid infrastructure development, permitting reform and access to energy. Bottlenecks in power, chips, powered buildings and skilled labor would likely extend the investment cycle rather than stop it. For US credit investors, this would support continued issuance from hyperscalers, utilities, data-center developers and the broader supply chain—potentially including large, well-telegraphed deals from mega-cap technology issuers as well as securitized and project-related financings tied to data-center capacity. The opportunity would remain substantial, but so would supply pressure and the need for issuer and structure selection.

Second, an infrastructure backlash could become the primary constraint

The first meaningful restrictions may fall not on frontier models but on the infrastructure surrounding AI: data centers, electricity, water and tax incentives. These costs are visible to households and can generate bipartisan pressure in ways that abstract model-safety arguments cannot. Local opposition is already raising project costs and timelines and could change

where data centers are built.

For US bondholders, this scenario could increase permitting, completion and refinancing risk. Attempts to secure capacity could pull capital expenditure and issuance forward, worsening market indigestion. Longer term, fewer projects could limit overbuilding risk and benefit completed assets. The result would probably be greater dispersion between operating projects and speculative developments, and among utilities able to allocate infrastructure costs without provoking a political response.

Third, labor could become the enduring political fault line

In the near term, the buildout is creating demand for specialized construction, engineering, electrical and technical workers. Those shortages can raise wages, construction costs and inflation before AI produces economy-wide disinflation. Over time, broader enterprise adoption could displace workers, particularly in entry-level and routine cognitive roles.

The absence of widespread layoffs this year does not settle that question. Enterprise deployment is harder than many expected: Companies must connect models to proprietary data, redesign workflows and build the governance, security and evaluation processes required for reliable use. Limited displacement today may therefore say more about implementation frictions than AI's eventual labor-market effects.

That uncertainty has market implications. A gradual transition could support productivity, profits and company fundamentals. A more abrupt displacement cycle could impair consumption and create weakness in consumer, banking and lower-quality sectors of the market, even if GDP remains supported by investment. It could also produce a complicated rates outcome: weaker employment and disinflation at the front end, but stronger productivity, fiscal responses and a higher neutral rate at the long end.

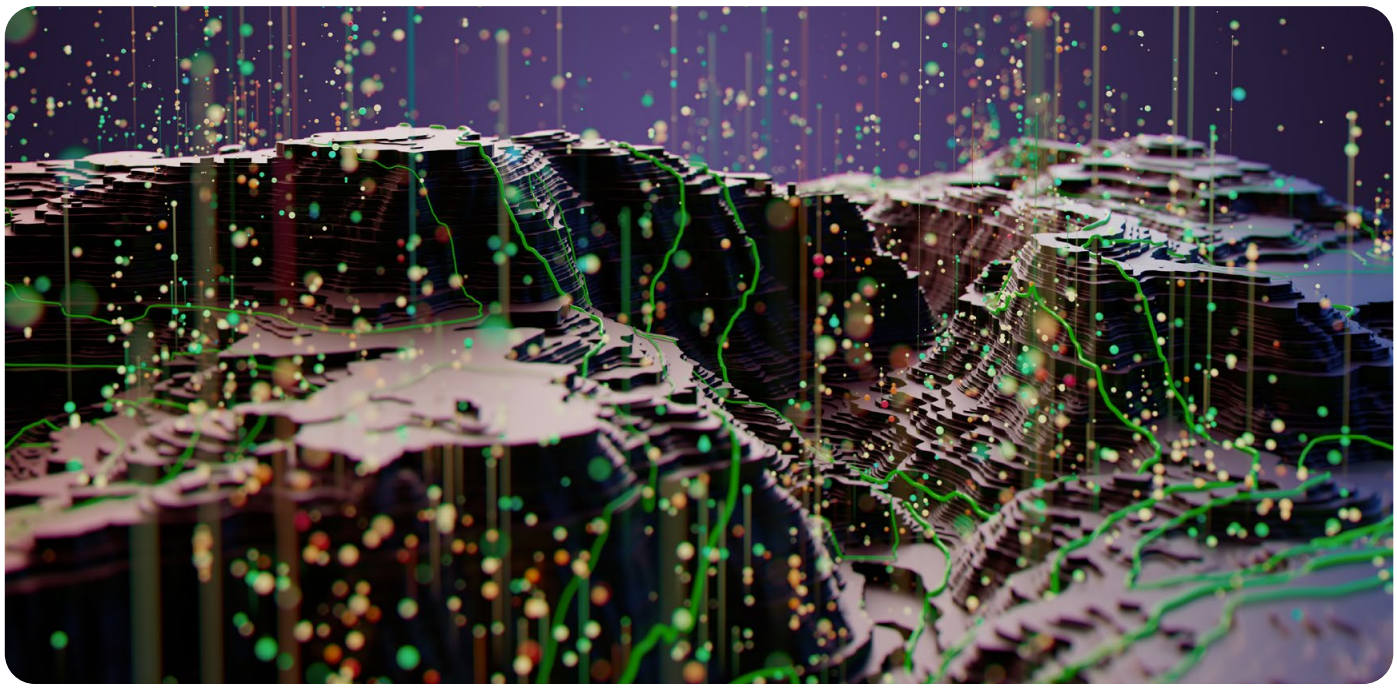
From politics to financing

Across all three paths, politics ultimately becomes a financing question. A year after the first mega AI debt deals, the buildout clearly depends on public bonds, securitized debt, private capital and hybrid structures. Goldman Sachs research tracks $578 billion of global AI-related debt issuance through mid-September this year.[1]

This year has also shown that with risk-free yields elevated and AI deals receiving a choppier reception, capital is not unlimited. Equity and IPO funding can strengthen the cushion beneath creditors, but safety, political and return-on-investment concerns could undermine valuations. The most consequential question is therefore whether the industry can finance the buildout, manage its physical footprint and demonstrate that its benefits are broadly shared.

For US credit investors, the implication is a more selective—not simply more bearish—view of AI-linked risk. Strong demand, elevated all-in yields and disciplined issuance windows can still support spreads, particularly for well-capitalized hyperscalers and data-center assets with clear contracted cash flows. But valuations leave less room for broad market tightening, and the next phase of the buildout is likely to bring more differentiation by issuer quality, funding structure and exposure to political or infrastructure constraints.

The better opportunities may come where technical pressure has created adequate compensation in higher-quality AI-linked issuers, balanced with defensive duration and select wider-trading credits that could benefit if conditions stabilize. Key risks include supply indigestion, weaker earnings quality, refinancing pressure and the possibility that politics constrains where, how and at what cost the buildout can be financed. Against this backdrop, we remain constructive but selective, viewing AI-related US credit as a relative-value, issuer-specific opportunity rather than a single-sector allocation.



Where we see opportunities

Active fixed income

Fixed income markets dominated headlines over the past quarter as risk-free rates continued to climb. The speed and magnitude of the repricing in US government bonds—and developed-market rates more broadly—have increased concern about risk-asset valuations.

While higher yields have created compelling income opportunities across pockets of the fixed income landscape and generally healthy corporate fundamentals continue to support demand, spreads are still near the tighter end of the historical spectrum across most asset classes, leaving less room for error.

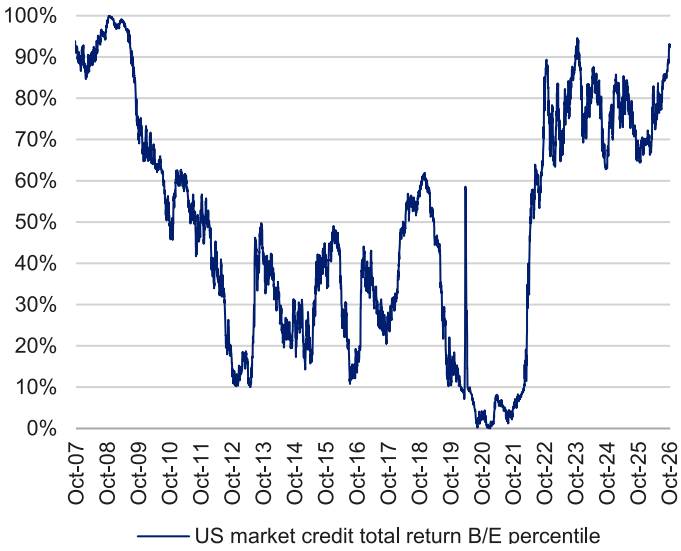
In this environment, we generally prefer carry over spread duration, given limited scope for further spread compression. Although we remain constructive on fixed income overall, our focus is increasingly on identifying issuers, structures and sectors where the available compensation adequately reflects the risks.

Investment grade (IG) public credit

All-in yields remain a supportive technical for the asset class and total return breakevens are near the most attractive levels in over 20 years (Figure 1). However, we are carefully weighing issuers' anticipated financing needs, business prospects and capital structure considerations against available spread compensation, rather than treating higher yields as the sole reason to add exposure. Within the asset class, we favor a balanced approach, combining selective return opportunities with defensive holdings.

- IG credit remains bifurcated with AI-related names and technology, media and telecommunications (TMT) significantly wider year-to-date, while ex-TMT sectors have proven resilient.
- While we believe there are tactical opportunities to be overweight select names within the AI-related complex with positive near-term catalysts, the market will likely demand more compensation to absorb the deluge of AI debt ahead of what is likely to be peak issuance in 2027. Unlike this year, our base case is the spread curve is likely to flatten in 2027 as issuance becomes more skewed to the front-end, with chip financing becoming a larger share of the AI debt theme and hyperscalers forced to offer larger new issue concessions.

Figure 1: Total return breakevens for IG public credit are near the most attractive levels in over 20 years



Source: L&G Asset Management – America, Bloomberg.
Data as of October 7, 2026.





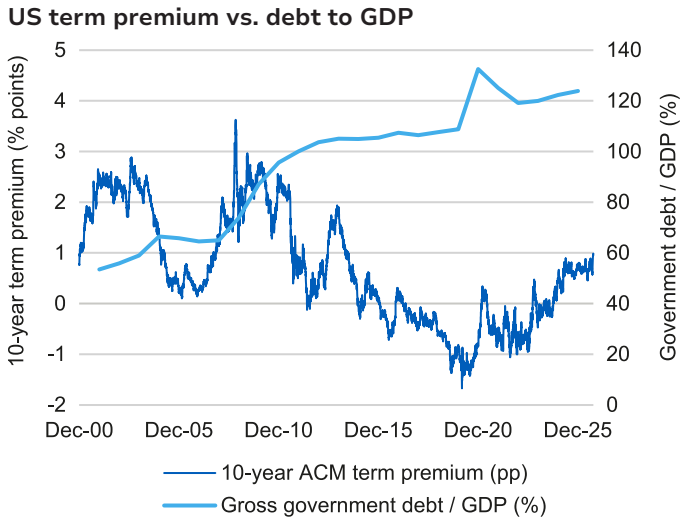
- We favor select utilities and capital-goods issuers supporting AI-related power infrastructure. Beyond AI, we see opportunities in select large banks with strong fundamentals and balance-sheet flexibility. We remain cautious on telecommunications, where competition, spectrum spending and AI-enabled customer switching could pressure revenues and increase borrowing needs.

Rates

The US 10-year yield finished the third quarter over 130 basis points (bps) higher than when the war with Iran began in February. While rising US indebtedness has featured prominently as a reason behind the surge in rates, measures of term premium are not yet signaling heightened alarm (Figure 2). Moreover, while inflation expectations have moved modestly higher since the Iran War began, real yields have accounted for over 90% of the increase in 10-year yields (Figure 3). While the hiking cycle in 2022 led to an inverted yield curve and rising expectations of recession, the recent repricing appears to be largely predicated on increasing competition for capital between persistent fiscal deficits and the unprecedented AI buildout, along with a constructive outlook for growth.

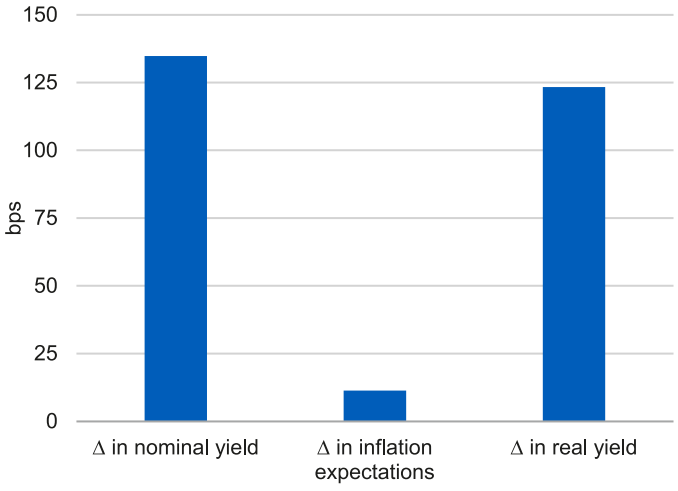
We believe a flexible approach to duration management is warranted at this point of the business cycle. We prefer the short and intermediate part of the yield curve as we believe risks are skewed for the Federal Reserve to deliver less

Figure 2: Measures of term premium not yet signaling heightened alarm



Source: L&G Asset Management – America, Bloomberg.
Data as of October 7, 2026.

Figure 3: Real yields are behind the increase in 10-year yields



Source: L&G Asset Management – America, Bloomberg.
Data as of October 7, 2026.

tightening over the next 12 months than the 80 bps of hikes the market is currently pricing in. Meanwhile, we view long bonds as a less reliable source of diversification in the face of rising inflation uncertainty, a negative technical backdrop and poor fiscal fundamentals across developed markets.

Securitized

We see opportunities across ABS, CLOs and select residential credit, with our strongest conviction in esoteric ABS. Although valuations have tightened, resilient fundamentals, firm demand and a steady new-issue calendar continue to reward active security selection.

- Within esoteric ABS, we favor sectors that compensate investors for complexity and differentiated collateral, particularly digital infrastructure and select whole-business securitizations. CLOs also benefit from institutional demand, despite tight valuations.
- In residential credit, we favor select non-agency RMBS, particularly non-QM transactions with attractive spreads and supportive housing fundamentals. We remain selective on collateral quality given limited stress history and more aggressive loan characteristics in parts of the market.

Emerging markets (EM)

We maintain a neutral near-term stance on emerging market debt, with a more constructive medium-term outlook. Resilient fundamentals, strong foreign exchange reserves and broad market access support credit quality, while default expectations remain low. Tight spreads warrant discipline, but do not, on their own, undermine the investment case given attractive all-in yields relative to peer asset classes. Supportive supply-and-demand dynamics reinforce the opportunity, though risks related to geopolitical uncertainty, Fed policy and inflation call for selectivity.

Liability driven investing

As pension plans improve funded status and move closer to their endgame objectives, we believe traditional buy and maintain (B&M) and enhanced buy and maintain strategies are well positioned for today's environment and the year ahead.

- Traditional B&M continues to offer many of the characteristics plans value most, including predictable cash flows, capital preservation and close alignment with long-dated liabilities. At the same time, the higher-rate environment and broader fixed income opportunity set create scope for investors to seek additional income, diversification and portfolio efficiency without abandoning the core principles of liability matching and disciplined underwriting.
- Enhanced B&M extends the traditional approach beyond investment grade corporate bonds to areas such as securitized credit, investment grade private debt, emerging market debt and selective high yield exposure. This broader universe may help plans capture incremental spread and diversification benefits while retaining the low-turnover, cash-flow-oriented discipline central to liability driven investing.



Private credit

Investment grade private credit

We favor infrastructure and select alternative-credit transactions, where complexity, structural protections and differentiated sourcing may provide attractive compensation. By comparison, corporate and real estate debt appear relatively tighter.

- Infrastructure remains our highest-conviction area, offering potential opportunities across digital infrastructure, power generation, LNG, transportation, hospitals and renewable energy. AI, data-center expansion, rising electricity demand and energy-security investment support financing needs, although we remain selective on commodity exposure and projects with limited operating histories.
- Within alternative credit, we favor select esoteric securitizations, credit tenant leases, fund-finance solutions and diversified payment-right transactions. We prioritize strong collateral, transparent asset-level underwriting and robust structural protections, while avoiding blind pools, weak eligibility criteria and structures with elevated loss severity.

Real assets

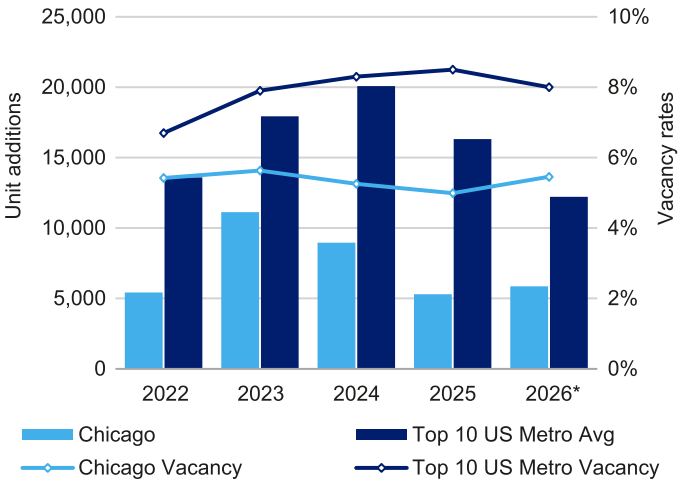
US real estate equity

Within US multifamily, we see opportunities in gateway markets—particularly San Francisco and Chicago. Both lagged earlier this decade as investment shifted toward secondary markets such as Sun Belt metros. Now, as those markets move toward supply-demand equilibrium, AI-driven job growth is reviving Bay Area demand, while Chicago's limited construction pipeline supports tight vacancy and rent growth.

After years of remote-work-driven population losses, the Bay Area's AI boom is strengthening multifamily demand. According to CBRE's 2026 Tech Talent report, the region has the nation's highest share of AI tech talent—a base of nearly 100,000 highly skilled, often younger workers. The resulting demand is placing pressure on the multifamily market: San Jose, San Francisco and the East Bay all rank among the top 20 metropolitan areas for projected annual rent growth in 2026 for 3-Star Multifamily properties, out of nearly 400 markets measured by CoStar nationwide.

Chicago's appeal is primarily supply driven. The metro added just over 7,600 units annually on average during the five years ending in 2026—the slowest pace among the 10 largest US metros—and fewer than 6,000 starts are projected for the 12 months ending in December, well below peer-market averages. This limited pipeline should keep vacancy near 5.5%, particularly for mid- and lower-tier housing. Chicago is also less exposed than many cities to extreme climate events, potentially giving its assets a lower climate-risk profile.

Figure 4: Chicago well under peer markets in unit additions, vacancy



Source: CoStar. Data as of October 7, 2026.
*Based on year-end forecast.



Figure 5: Three-month consensus macro scenario views and our probabilities

Base case: 55%

The AI buildout continues, with markets absorbing the heavier debt financing mix while still demanding discipline on each new dollar. Strong hyperscaler earnings keep circular vendor financing tolerable. The falling cost of intelligence grows demand faster than regulatory, political, and safety pressures can constrain supply or erode adoption. Inflation concern rises and falls with oil while core PCE eases past its peak and wage growth stays consistent with sub-2% inflation. In the Gulf, no deal materializes, but barrels keep reaching market and each attack-driven disruption proves short-lived, holding oil beneath its March highs. The Fed begins its hiking cycle at a measured pace, and the debate's horizon expands beyond just the next meeting to the terminal rate. Treasury keeps working to cap the long end, and markets keep testing each buyback announcement. White House pressure surfaces through market channels without altering the broader picture. The no-hire, no-fire equilibrium holds, and growth tracks toward the 1.8 to 2.5% range on fiscal policy and AI investment.

Bear case: 15%

De-escalation in the Gulf stalls, inventories draw down, and record crack spreads further push tight fuel supply through to prices at the pump. Price increases broaden across energy and commodities, wage pressure stirs, and markets price hikes well beyond the 75bp that would reverse last year's insurance cuts, implying a higher terminal rate. At that higher cost of capital, AI borrowing crowds out credit for the rest of the economy, and the Anthropic IPO casts doubt on whether frontier-lab profits justify it. Elevated energy prices squeeze real incomes, and weakness in semiconductor and hyperscaler stocks erodes the equity cushion behind top-quintile spending. Companies pivot from chasing growth to defending profits, putting job cuts on the table. Investor tolerance for soft labor prints thins just as slower hiring shows up in the data.

Bull case: 25%

Attacks on Gulf oil routes subside and production keeps reaching market, so the expected rise in headline inflation never fully materializes and inflation expectations fall. With the energy channel quiet, the Fed signals patience and markets unwind most of the hikes priced. Engineering productivity gains show up in faster software improvement and new demand, more companies build AI in-house, and hyperscaler margins hold. With AI challenging every moat, standing still means losing share, so companies prioritize revenue and market-share growth over margins. That expansion requires headcount, so hiring runs near the upper end of the breakeven rate and broadens across sectors, with wage growth reassuring on demand without stoking inflation concern. Easier financial conditions push growth toward the upper end of expectations, helped by a consumer economists routinely underestimate.

Recession: 5%

Iran escalates into the midterms and crude inventories run dry. Oil spikes, and the squeeze on real incomes hits spending hard. Firms facing weaker demand and higher input costs lean on AI to cut headcount, and the no-hire, no-fire equilibrium starts to give. The first negative payroll prints land, and the drawdown in AI-linked equities takes the top-quintile spending cushion with it. Surging headline inflation pins the Fed to its hiking path just as the labor market cracks. Markets look past the hikes and price a full cutting cycle over the next twelve months.

Source: L&G – Asset Management, America. Views as of October 7, 2026



Figure 6: Fixed income asset class relative views

	Underweight – –	–	Neutral ◇	+	Overweight ++
US Investment Grade	○	●	○	○	○
US MBS	○	●	○	○	○
US Treasuries	●	○	○	○	○
US High Yield	○	○	○	●	○
US Securitized Credit	○	○	○	○	●
EM Hard-Currency Short Duration	○	○	○	○	●

Source: L&G – Asset Management, America as of October 14, 2026. Rankings are based on a -2 (min. underweight) to +2 (max. overweight) scale.

Figure 7: Active views across securitized credit landscape

	Underweight – – –	– –	–	Neutral ◇	+	++	Overweight +++
ABS: Flow					●		
Valuations	○	○	○	●	○	○	○
Fundamentals	○	○	○	○	●	○	○
Technicals	○	○	○	○	○	●	○
ABS: Esoteric					●		
Valuations	○	○	○	○	●	○	○
Fundamentals	○	○	○	○	●	○	○
Technicals	○	○	○	○	●	○	○
CMBS				●			
Valuations	○	○	●	○	○	○	○
Fundamentals	○	○	○	●	○	○	○
Technicals	○	○	○	○	●	○	○
CLO					●		
Valuations	○	○	●	○	○	○	○
Fundamentals	○	○	○	●	○	○	○
Technicals	○	○	○	○	○	○	●
Agency MBS					●		
Valuations	○	○	○	○	●	○	○
Fundamentals	○	○	○	●	○	○	○
Technicals	○	○	○	○	●	○	○
Non-Agency RMBS					●		
Valuations	○	○	○	○	●	○	○
Fundamentals	○	○	○	○	●	○	○
Technicals	○	○	○	●	○	○	○

Source: L&G – Asset Management, America as of September 30, 2026. Rankings are based on a -3 (min. underweight) to +3 (max. overweight) scale.

Figure 8: Active views across private placements

		Underweight – –	–	Neutral ◇	+	Overweight ++
US Corporate	Supply dynamics	○	○	○	●	○
	Pricing	○	●	○	○	○
	Structural protections	○	○	● (+0.5)	○	○
US Infrastructure	Supply dynamics	○	○	○	○	●
	Pricing	○	○	○	●	○
	Structural protections	○	○	●	○	○
US Alternatives	Supply dynamics	○	○	○	●	○
	Pricing	○	○	●	○	○
	Structural protections	○	○	●	○	○
Real Estate Debt	Supply dynamics	○	○	●	○	○
	Pricing	○	●	○	○	○
	Structural protections	○	○	●	○	○

Source: L&G – Asset Management, America as of October 7, 2026. Rankings are based on a -2 (min. underweight) to +2 (max. overweight) scale.



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Notes

1. Source: Goldman Sachs. “Global Credit Trader: An Update on AI-Related Debt Issuance.” As of September 18, 2026.

Disclosures

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