

WARSH AT THE CONTROLS: OTHER FORCES ALSO DRIVING RATES

President Trump has finally got his preferred Fed Chair – at a moment when markets are increasingly uncertain about the likelihood of any interest rate cuts this year, let alone the deep cuts that the President has been calling for since he took office. Good news as well as bad news explains the shift in expectations. A push and pull between AI hopes and geopolitical fears is defining market moves.

This week, hopes for an Iran deal have been raised again, with reports of possible agreement on a further 60-day ceasefire, combined with reopening the Strait of Hormuz. That would reassure investors. But important details remain uncertain, including on next steps with the US blockade and the disposition of nuclear material. Other mooted proposals, such as a possible \$300 billion investment fund to support post-war building and reconstruction, may not be realistic. And, as ever, President Trump – who reportedly has yet to consider the potential deal – may change it all.

As for interest rates, equity markets tell the good news story. In the US, the S&P is up again, for the ninth week running. The rally has spread beyond the tech hyperscalers that build AI models to companies producing and selling the inputs, from chips to energy. Investors are also driving rallies in innovative space and drone-related companies, and eagerly anticipating record-breaking IPOs such as SpaceX and Anthropic. The recent winning streak has left the S&P at new record levels, up 1.5% on the week and 10.2% since before the Iran war.

This is not just a US story. Equity markets elsewhere are strong. European equities have

lagged their US peers year-to-date, reflecting lower AI exposure and greater exposure to the Iran War-induced terms-of-trade shock. But they are still up. Select markets elsewhere have performed exceptionally well. No market embodies the AI-mania more than Korea, with the MSCI Korea index up north of 110% so far this year, already eclipsing 2025's 100% return.

A global investment boom driven largely by hopes for AI is fueling investor high spirits. It will also put structural upward pressure on real interest rates.

So much for the good news behind shifting rate expectations. For much of May, bond traders focused on the bad news: inflation and government deficits. In May, markets moved to price in more inflation and rate hikes, rather than cuts, as the Strait of Hormuz stayed effectively closed and oil prices remained high. Looming government deficits and debt were an additional reason to sell. Yields shot up. A relief rally in the last days of May was not enough to reverse the earlier increases in 2-year and 10-year Treasury rates. And, new Fed Chair notwithstanding, markets now see a fifty-fifty chance of a policy rate rise by the end of this year.

Against this backdrop, RockCreek sees three key themes for investors to watch:

1. AI and technology: broadening and deepening – but watch valuations.

It is increasingly clear that the technological breakthroughs in AI signaled in late 2022 with the release of OpenAI's ChatGPT are likely to drive

long-term structural changes in the global economy. These changes will impact companies and markets in the US and elsewhere as innovations surprise and disrupt and markets anticipate and react. To stay ahead, investors need to think critically about how companies can become or remain profitable by developing and using AI. Just as important, and a focus this month, is which crucial inputs are in short supply and can command premium prices.

2. Oil and energy: Iran conflict driving supply and price; AI feeding demand

The Iran war launched in late February by the US and Israel is holding up oil and gas prices beyond their 2025 levels at a time of exceptional demand for energy to power the “compute” needed for AI models. Renewable energy holds promise. At the same time, countries with oil and gas supplies, such as Canada, are helping to fill the supply gap. Dire predictions of oil prices rising as high as \$200 a barrel have not materialized. Instead, prices have shot up above \$100 a barrel and then plunged below, with the latest news about the Strait of Hormuz. Over time, prices even at the recent “lows” of \$90 to \$95, will feed into broader inflation, dampening consumer demand.

3. IPOs: mega companies moving from private to public

Elon Musk’s SpaceX has grabbed most of the attention as the world’s biggest ever IPO by orders of magnitude is readied for market at a valuation target of an astonishing \$1.75 trillion, or more. Enthusiasm is spilling over to other space companies. SpaceX is not the only mega IPO exciting investors. In the AI enterprise sector, Anthropic is emerging as the cleaner near-term story, with rapid revenue growth and strategic backing from Amazon and Google. OpenAI is potentially larger, but structurally more complex, given its governance and capital requirements. The impact on public markets of these new entrants will grow over time.

CONSUMERS GLOOMY, BUT STILL SPENDING

The “vibecession” in the US continues to deepen – some are now terming it a “permacession”. Despite continued strong overall economic growth and employment, Americans are unhappy about the economy. Indeed, consumer sentiment in May dropped once again, to an all-time low.

Behind the overall numbers of steady, low unemployment at 4.3% and above expectations payroll growth of 115,000 reported this month, there are divergences across income levels and industry. And while rising stock prices encourage many of the better off to spend more, most of the 60% of Americans who own some stock have only a small amount. And among lower income households, equity exposure – at just under 30% of households – contrasts with the nearly universal exposure of those with incomes above \$100,000.

Perhaps most importantly, the confluence of the AI boom and the Iran war, on top of tariff-driven inflation, has a mostly negative impact on many households. Inflation has persisted significantly above the Fed’s 2% target. Average earnings are barely keeping pace. And higher rates from investment and deficit pressures are making key purchases – notably housing – more expensive.

So far, consumers have not stopped spending. This week’s personal consumer data showed that demand has remained resilient. That underlying strength has been another factor supporting profits and markets. Economists differ on how sustainable it will be in the face of stubbornly high inflation.

CENTRAL BANKS SHIFT

Worries about inflation are making central banks cautious. Some have clearly signaled an end to easing. Others, notably the European Central Bank (ECB), see the next rate move as a hike, perhaps as early as June. Again, the story goes beyond the US. The Iran war and its impact on prices, not just for oil and gas but beyond, goes worldwide. In the US,

the monthly change in the inflation measure traditionally preferred by the Fed – the core PCE (personal consumption expenditure) – was better than expected in April. But the year-on-year headline change remained elevated, at 3.8%.

Oil prices have not shot up as much as some feared at the outset of the Iran war. One reason, as [Robin Brooks](#) points out, is that more muted price increases are enough to affect both demand and supply. Fewer Americans are driving and flying for vacations this summer, while Korea and other Asian countries are substituting Canadian, US and other oil and gas producers for some of the flows they were getting from the Persian Gulf. The economic impact is likely to be slower and more diffuse than first predicted. But higher oil prices will feed through to prices more generally, whether to food from fertilizer or consumer products from higher transport costs. With fuel supply chains under pressure, jet fuel inventories have tightened significantly, causing global jet fuel prices to roughly double since the start of the Iran war. The resulting volatility and uncertainty are reinforcing the strategic importance of sustainable aviation fuels, as carriers look to reduce long-term exposure to geopolitical disruptions.

PICKS AND SHOVELS, RAW MATERIALS, DEFENSE AND EVERYTHING SPACE

Investors are realizing that the sellers of the “picks and shovels” needed to create AI products – from energy to construction to semiconductor chips – will share in the AI boom, for as long as it lasts and is profitable. The impact is spreading beyond the US, including to emerging markets with needed inputs, like Brazil and Korea.

Other innovative sectors are also rallying, particularly related to defense and space. Markets have seen a substantial re-rating across the “space economy,” driving sharp rallies across launch, satellite, and aerospace names. Publicly traded companies including Rocket Lab, AST SpaceMobile,

Intuitive Machines, Planet Labs, and Redwire have all rallied meaningfully in recent weeks, while ETFs tied to aerospace and space infrastructure have also seen strong inflows. A similar dynamic is playing out across drone and autonomous defense systems. Growing geopolitical instability, rising defense spending, and investor enthusiasm around companies such as Anduril are accelerating interest in software-defined warfare, autonomous systems, sensors, and low-cost drone platforms.

EQUITIES

Headline index gains mask a highly fragmented equity market. S&P 500 stock correlations have collapsed, with the rolling 3-month pairwise correlation dropping to just 13%—lower than 98% of the time since 2022. This extreme dispersion is most acute in tech, where capital continues to chase a migrating hardware bottleneck: first it was GPUs for training, then High Bandwidth Memory (HBM), and now CPUs for inference as agentic AI takes off. Conversely, traditional software has lagged heavily. This discount reflects a deep institutional debate over true fundamentals; while generative AI will undoubtedly cannibalize certain legacy software models, other platforms will successfully weaponize it to expand their moats, creating a highly mispriced and bifurcated sector. Elsewhere, investor enthusiasm for the anticipated IPO of Quantinuum has reignited speculation across the broader quantum ecosystem, driving renewed rallies in companies such as IonQ, Rigetti Computing, and D-Wave Quantum.

Classic late-cycle warning signs are flashing, though. The S&P 500 dividend yield has compressed to 1.05%, approaching its lowest levels since the 1999 dot-com peak, while the equity risk premium has turned negative. With a negative premium, long-duration risk is amplified; the math dictates that nearly 80% of the index's current present value relies on expected cash flows projected more than three years into the future. This vulnerability is paired with highly leveraged

positioning; FINRA's latest figures show April 2026 margin debt hit an all-time record of \$1.304 trillion, up a stunning 53% year-over-year. While nominal debt records are expected in a rising market, this rate of acceleration signals intense retail and institutional leverage. Looking ahead, if the highly anticipated pipeline of massive tech IPOs eventually comes to market, there are concerns that this will test remaining market liquidity. As discussed below, some others are more sanguine.

The conundrum for allocators is that while late-cycle macro metrics warrant caution, the secular transformation driven by artificial intelligence is real, structural, and likely to persist for years. We also see potential in other innovative sectors – notably space and quantum computing – in their early stages. And we remain firm believers in the long-term potential of AI, especially given that forward earnings multiples for pure-play hardware providers remain remarkably reasonable. However, the path forward will not be a straight line. The sustainability of exponential earnings growth remains a critical question mark, and the market's heavy concentration exposes portfolios to localized volatility if the infrastructure spend temporarily cools. Institutional discipline requires acknowledging these near-term risks without missing the broader generational upside. To navigate this environment, portfolios should maintain an anchored exposure to core AI infrastructure winners while actively building positions in overlooked, high-quality growth companies operating in entirely AI-agnostic categories. This balanced approach ensures portfolios remain fully engaged in the technology sector's structural upside, while capturing highly attractive, uncorrelated alpha across the broader market.

IPO MARKETS

The IPO market is clearly reopening, though not in a broad-based or evenly distributed fashion. Instead,

public investors are showing overwhelming demand for “scarcity assets” – companies positioned at the center of the AI buildout across compute, energy, data, infrastructure, and strategic platforms. The result is not simply a return of growth investing, but a more targeted reopening centered on businesses viewed as foundational to the next generation of AI infrastructure.

Cerebras Systems is perhaps the clearest example. The AI inference-chip company priced above its revised IPO range at \$185 per share, raised roughly \$5.5 billion, and traded sharply higher following its debut, despite significant customer concentration, with OpenAI reportedly accounting for the vast majority of revenue. Cerebras is also emerging at an important moment in the AI cycle, as the market increasingly shifts from model training toward inference – the process of actually running AI models in production. While training has historically consumed the majority of AI infrastructure spending, inference workloads are expected to scale much more broadly as enterprise and consumer adoption increases. Investors increasingly appear focused on architectures optimized for speed, efficiency, and low-latency inference at scale, positioning companies such as Cerebras as potential beneficiaries of the next phase of AI deployment.

More broadly, the IPO cycle is no longer confined to software. Investors are increasingly funding the physical infrastructure required to support AI deployment at scale, including semiconductors, power generation, connectivity, and data infrastructure. Fervo Energy, which focuses on geothermal energy for data centers, raised approximately \$1.9 billion in an upsized IPO amid growing investor focus on the energy intensity of AI workloads. X-energy similarly raised roughly \$1 billion in an upsized offering supported by demand for next-generation nuclear power solutions. In many respects, AI has transformed electricity itself into a growth market.

The most important IPO in the offing remains SpaceX. Market expectations have increasingly converged around a valuation approaching \$2 trillion, with the company reportedly targeting an offering size in the \$75–80 billion range. That would make it the largest IPO in history. Following its combination with xAI, the platform now combines launch infrastructure, satellite communications, AI models, and potentially application-layer distribution, following reported plans to acquire Anysphere (Cursor). Equally important is the question of float. At a multi-trillion-dollar valuation, a relatively small public float could create significant scarcity dynamics and substantial passive demand from index and ETF buyers. State Street has estimated that at a \$2 trillion valuation, SpaceX could represent roughly 3% of the Russell 1000 on a full market-cap basis, though actual index inclusion would happen over time, and depend heavily on float and structure.

The IPO also raises broader questions around passive investing itself. The cumulative impact of these listings will likely extend well beyond the technology sector itself. Over time, these companies could materially reshape public equity indices, passive capital flows, and institutional portfolio construction, particularly as an increasing share of market performance becomes concentrated in a relatively small number of AI-linked platforms.

S&P Dow Jones has already launched consultations exploring accelerated index inclusion rules and relaxed float requirements for “MegaCap” IPOs, reflecting growing tension between indexes as neutral reflections of market capitalization versus curated baskets of “investable” companies. Importantly, fears that SpaceX could overwhelm the IPO market may be overstated. Even assuming SpaceX raises the full \$80 billion – alongside similarly large offerings from Anthropic and OpenAI – aggregate issuance would still remain below the relative scale of the 2021 IPO market as a percentage of total US equity market capitalization.

The more important question may not be whether markets can absorb the supply, but rather how aggressively investors are willing to concentrate capital into a relatively small number of AI-linked platforms.

FIXED INCOME

The most striking thing in fixed income so far this month has been the march upwards of US yields (despite a small retracement this past week) as risk assets continue to soar. The US moves are particularly noteworthy when decomposed across curve, nominal and real measures, and geographies. Most often, when real yields rise and breakeven inflation falls, broad assets are negatively impacted. The fact that this has not happened in May suggests the market may be expecting stronger growth.

To begin with, expectations for a Fed hike by the end of 2026 increased in May, at one point surpassing the peak probability witnessed during the volatility shock in March amid stress around the war in Iran. It has since settled around a 50% probability with the rest of the curve moving higher as well, suggesting markets are still concerned about an uptick in inflation.

At the same time, breakeven inflation across the curve has fallen in the US, and most prominently at the two-year point. Mechanically, this means real interest rates have risen more than nominal rates. This is significant for two reasons. First, investors are indicating that their inflation expectations have fallen despite the ongoing conflict. It is possible that this reflects a belief that one hike will be enough to quell current inflationary pressures, but higher asset prices would simultaneously reflect a belief that forward rate policy will not be overly restrictive. Second, investors are requiring a higher real rate of return to hold US sovereign debt. The positive interpretation of this second point is the market is anticipating a higher rate of growth, the negative possibility is concerns over burgeoning

fiscal deficits. Of course it could also be a blending of the two. Either way, it would seem that fixed income markets are pricing a more dynamic path forward for growth and inflation than was the case just a few weeks ago.

When looking across geographies, the moves in US rates are even more stark. In both Europe and the UK, nominal and breakeven rates both fell, suggesting that markets in those regions are becoming more optimistic about a resolution to the conflict in Iran and/or that a monetary policy response will be sufficient to quell the energy passthrough. Indeed, those markets are still pricing multiple hikes this year.