

Introduction

Bond markets delivered broadly positive returns in May despite a persistently challenging macroeconomic and geopolitical backdrop. While risk assets advanced meaningfully as investor sentiment improved following a period of heightened caution, sovereign bond markets remained primarily driven by the evolving inflation outlook and its implications for monetary policy and economic growth.

Geopolitical tensions in the Middle East continued to shape market dynamics during the month. Disruptions to shipping through the Strait of Hormuz - a critical global energy transit route - contributed to a sharp rise in oil prices. At the same time, the absence of a definitive diplomatic resolution to the conflict prolonged uncertainty and heightened concerns over energy supplies. This, in turn, prompted investors to reassess monetary policy expectations, pushing bond yields higher amid renewed inflation concerns.

Against this backdrop, U.S. Treasury yields moved higher over the month as investors increasingly priced in a prolonged "higher-for-longer" policy stance from the Federal Reserve. In contrast, European sovereign bond yields generally declined as cautious optimism surrounding a potential U.S.-Iran agreement helped alleviate inflation concerns and supported demand for government bonds.

Investors also scrutinised the latest inflation data from Europe's largest economies for clues regarding the European Central Bank's policy trajectory. Germany's inflation rate moderated in May despite elevated energy prices. Meanwhile, inflation in France, Spain, and Italy accelerated, remaining above the ECB's 2% target and underscoring the uneven nature of price pressures across the region.

Corporate credit markets also remained resilient, generating positive returns during the month. Supported by stable corporate fundamentals and continued investor demand for yield, credit spreads tightened. Global high-yield credit returned 0.52%, reflecting sustained investor appetite for credit risk.

Market Environment and Performance

While data released earlier in the year pointed to continued economic resilience, the forward-looking outlook is becoming increasingly uncertain amid sustained tensions in the Middle East. The resulting rise in energy prices poses a potential headwind to growth, with higher costs likely to weigh on consumer spending.

Growth momentum in the U.S. sustained in Q1 2026, with GDP annualized growth expanding at an annualized 1.6%, up from 0.5% in Q4 but below 2% in the advance estimate, primarily reflecting downward revisions to investment and consumer spending. Meanwhile, net trade contributed negatively, as exports rose by 13.1% while imports jumped 21.1%. Government spending rose as activity resumed following the end of the government shutdown.

Headline U.S. inflation accelerated to 3.8% in April 2026, the highest level since May 2023, primarily driven by higher energy prices. Despite softer growth, labour market conditions remained resilient. Unemployment held steady at 4.3% while nonfarm payrolls increased by 115K in April, above forecasts.

On the policy front, minutes from the Federal Open Market Committee (FOMC) meeting in April 2026 revealed that a majority of policymakers viewed further policy tightening as potentially necessary should inflation remain persistently above the Federal Reserve's 2% target. To address the possibility of rate hikes, many participants preferred removing language from the post-meeting statement that suggested an easing bias.

In the Eurozone, economic activity weakened amid spillover effects from Middle East tensions. Q1 2026 growth slowed to its weakest pace since Q2 2024, while the S&P Global Eurozone Composite PMI fell into contraction territory. Forward-looking indicators also pointed to a weakening outlook, with the S&P Global Eurozone Composite PMI declining to 47.5 in May from 48.8, marking the sharpest contraction in private-sector activity since October 2023. The decline was driven by services, which fell at their fastest rate in over five years, while manufacturing remained relatively resilient despite slowing. Input costs rose at the fastest pace in three years, prompting firms to raise prices, eroding purchasing power. As a result, employment fell for a fifth consecutive month and business sentiment weakened further.

Consumer price inflation rose to 3.2% in May, up from 3.0% in April and matching market expectations, according to a preliminary estimate. This marked the highest reading since September 2023 and the third consecutive month in which inflation has exceeded the ECB's 2% target, as energy costs soared 10.9%.

Fund Performance

The CC High Income Bond Fund posted a gain of 0.50% in May. The portfolio manager maintained an active strategy, continuing to gradually enhance the fund's income profile by selectively capturing emerging opportunities while maintaining a close focus on duration.

During the month, a new position in Molins, a global leader in construction materials, was initiated using cash proceeds. In addition, the fund switched into new bond issues from existing issuers that had come to market at more attractive yields, thereby enhancing overall portfolio income. These included CCO Holdings, Ineos, Tenet Healthcare, Millicom, and Occidental Petroleum.

Market and Investment Outlook

While the conflict raises serious humanitarian concerns for civilians in the affected areas, it has also prompted a sharp rise in oil prices, pushing bond yields overall higher. The broader economic implications (particularly from an inflationary standpoint) will largely depend on how prolonged and extensive the conflict becomes, though it has so far remained persistent. Disruptions around the Strait of Hormuz, while not absolute, have been sufficient to materially affect oil flows, sustaining upward pressure on energy prices and complicating the inflation outlook, with potential implications for the path of monetary policy.

In this environment, a cautious yet proactive investment approach is warranted. While heightened uncertainty may limit the pace of new bond issuance, it could also create pockets of opportunity. At the time of writing, we maintain our view that fixed income returns are likely to be increasingly driven by income rather than capital appreciation, underscoring the importance of securing attractive coupons from issuers with strong credit fundamentals.

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