INVESTMENT OUTLOOK

JULY 2026

Two starkly contrasting trends marked the second quarter: a historic, stagflationary energy price shock and a sustained AI-related investment boom that continued to drive stock markets. Global equities rose by around 14 percent despite persistently high geopolitical uncertainty, rising inflation, slowing growth, and a hawkish monetary policy turn in major economies.

At its peak, the closure of the Strait of Hormuz removed roughly 20 million barrels per day, approximately one-fifth of global supply. The subsequent price shock triggered a sharp rise in inflation, compressing real household incomes from Frankfurt to Tokyo and pushing the Eurozone to the brink of a technical recession. And yet, by the end of June, major equity indices stood close to all-time highs. Understanding this apparent disconnect requires separating what markets are pricing from what economies are living.

The macro reality of Q2 was unambiguously difficult for much of the world. The Eurozone slightly contracted in the first quarter and business surveys pointed to stagnation or mild contraction through the second, with the ECB choosing to raise rates in June despite the bloc‘s weak growth backdrop. In the United States, consumption slowed as higher energy costs eroded real incomes and household savings buffers thinned. Japan faced a deterioration in its terms of trade, with the Bank of Japan intervening in currency markets and raising its policy rate to the highest level since 1995 to contain inflation and curb the yen‘s depreciation. Emerging markets absorbed the shock better than feared, but complete energy market normalisation will be measured in quarters and years rather than months. The full opening of the Strait of Hormuz is essential, but Gulf production has to recover and destroyed infrastructure needs to be rebuilt.

Against this backdrop, the equities rally demands an explanation, and two factors stand out. Corporate earnings were exceptional: the first-quarter 2026 season was the strongest since 2021, with *S&P 500* companies delivering close to 29 percent earnings growth year-on-year. And analysts continued to raise second-quarter estimates as the quarter drew to a close. That said, growth in earnings forecasts is near previous cyclical peaks and appears to rely on the thesis that AI investment has come to function as a macro override — a source of growth that is largely decoupled from the broader economy. One of the quarter‘s defining events was the SpaceX IPO on June 12, the largest in history, raising 75 billion US dollars at a valuation of 1.8 trillion dollars – all based on imaginative business plans that border on science fiction and questionable corporate governance. We don‘t know whether these lofty expectations will be met, but when expectations are great, so too is the potential for disappointment.

Meanwhile, the monetary backdrop is shifting in ways that markets may not have fully absorbed. The removal of forward guidance and the notably more austere communication from new Fed Chair Kevin Warsh may represent a structural turn. The era of recursive monetary accommodation, with the Fed trying to accommodate markets while markets endeavoured to anticipate the Fed’s policy path, may have ended, to be replaced by a less predictable policy regime and an interest rate path that carries structurally higher uncertainty. Gold‘s sharp reversal from its January highs, driven by rising real yields and the unwinding of the debasement trade, is perhaps the clearest signal that this transition is underway.

In this environment, we believe investment discipline again matters more than directional conviction. Our approach through the second quarter has been to rebalance systematically rather than react to the day’s headlines. We took equity gains in May to keep risk exposure in line with strategic targets, and we rebuilt our gold allocation at more attractive levels following profit-taking early in the year. Diversification across risk factors, geographies, asset classes and strategies is not a compromise in this environment; rather, it’s the point. Valuations are a reliable guide to medium-term returns, but they are a poor guide to timing. Rallies can persist longer than the fundamentals justify, and cutting exposure prematurely can be as costly as chasing them. With extreme equity market concentration, a fragile agreement underpinning oil market stability, and a potential new Fed regime on the horizon, the second half of 2026 calls for portfolios that are built to absorb surprises.

1.1 NORTH AMERICA

- The US economy posted a muted recovery in Q1 2026, expanding by an annualised 2.1 percent over the quarter, driven by a post-shutdown rebound in government expenditures (+4.4 percent) and firmer private investment (+7.9 percent). Consumption growth slowed markedly, from 1.9 to 0.5 percent QoQ annualised, while surging imports curbed headline growth.

- Timely indicators pointed to broadly stable US growth in Q2 with uneven underlying demand. The government spending boost likely faded, and households faced pressure from declining real incomes amid higher commodity prices linked to the Iran conflict, elevated uncertainty, and depleted savings buffers.

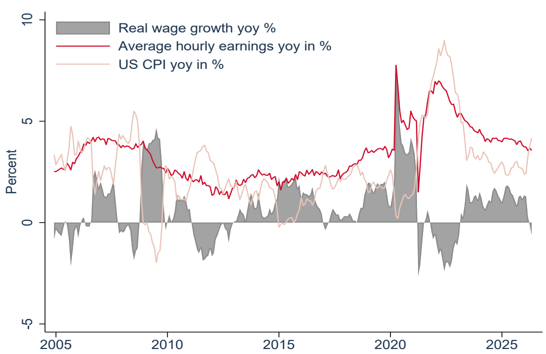
- Labour market resilience provided a partial offset, with job growth exceeding expectations in Q2. Unemployment may edge modestly lower, as the bar to keep it stable is low. That said, the median duration of unemployment among displaced workers edged higher, pointing to growing skill mismatches driven in part by AI adoption and ongoing digitalisation.

- Consumer sentiment reflects this tension. The *University of Michigan Consumer Sentiment Index* temporarily fell to a historic low in May — its weakest reading since the late 1970s — reflecting deteriorating household finances. The *Conference Board Consumer Confidence Index*, which focuses on labour market conditions, stayed closer to its historical average. An eventual equity market correction remains a material downside risk to consumption, as it would unwind the wealth effect that has supported spending.

- With consumption growth likely to remain modest and the fiscal impulse turning increasingly negative over the course of this year — per *Hutchins Center* projections — US GDP growth should continue to rely primarily on AI-related investment.

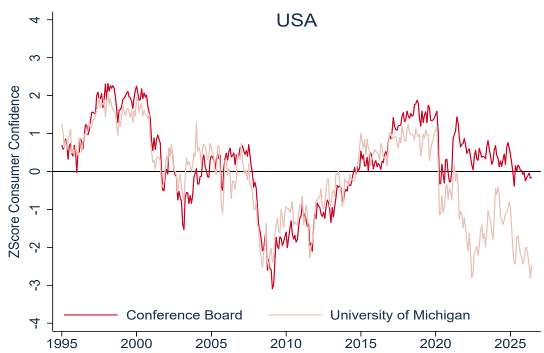
- The Federal Reserve held rates steady through Q2, but the tone has turned hawkish since new Chair Kevin Warsh took office in June. The rate-cutting cycle has effectively ended and may reverse. Warsh has already overhauled the Fed's communications, shortening its statements and dropping forward guidance while launching five task forces covering communication, balance sheet policy, real-time data use, AI's impact on productivity and the labour market, and the inflation framework. Taken all together, these moves imply structurally higher uncertainty around the policy rate path, in our view, which should translate into elevated and more volatile Treasury risk premiums at the front end.

Shrinking real earnings



Source: LSEG, MFO

Conflicting influences and mixed feelings



Source: LSEG, MFO

1.2 EUROPE

- The commodity price shock from the Iran conflict and the deeply negative GDP numbers for Ireland (-12 percent QoQ) left a mark on the Eurozone in Q1 2026. GDP contracted by 0.2 percent over the quarter, driven by falling net exports and lower investment. Consumption growth slowed to 0.2 percent QoQ, while government expenditures provided a modest offset, expanding by 0.5 percent.

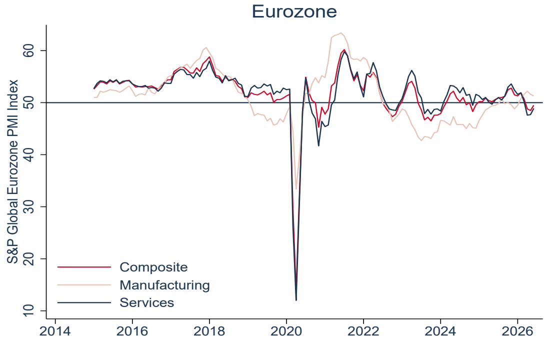
- Economic momentum continued to deteriorate through Q2, raising the likelihood of a technical recession, that is, two consecutive quarters with negative GDP growth. The *Eurozone Composite PMI* fell into contractionary territory in April and remained there throughout the quarter, consistent with GDP stagnation or a slight contraction.

- The slowdown was led by services, where demand is more sensitive to the real income squeeze from higher commodity prices. Manufacturing PMIs bucked the trend, rising as firms built precautionary inventories ahead of anticipated supply disruptions and price increases. PMI sub-indices confirmed the stagflationary character of the shock, with input prices rising sharply while output prices fell slightly across both sectors in April and May. Flash PMI readings for June suggested a slight easing of price pressures, albeit from elevated levels.

- Rising prices eroded consumer purchasing power, with Eurozone CPI accelerating from 1.9 percent in February to 3.2 percent in May. Consumer confidence fell visibly from March and continued to decline into Q2. Even if the Strait of Hormuz is reopened, the commodity price shock will take some time to fully dissipate, casting a shadow over the consumer outlook for the remainder of 2026. The labour market has so far remained a stabilising factor, with unemployment steady at 6.3 percent, near its historical low. However, the employment PMI sub-index signals growing caution as firms reported cutting jobs on a net basis in June for the sixth consecutive month.

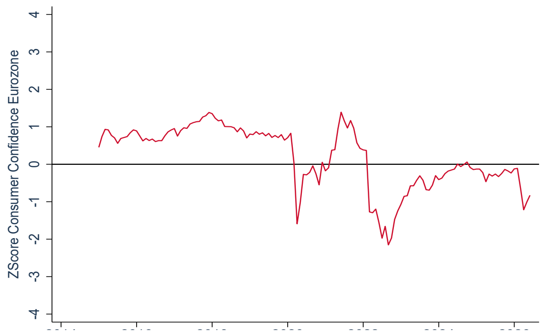
- The ECB finds itself navigating a classic stagflationary dilemma. Despite trimming its 2026 growth forecast for the Eurozone from 1.2 before the shock to 0.8 percent in June, the Governing Council prioritised the inflation risk and raised the main refinancing rate by 25 basis points to 2.4 percent in June — a decision that reinforces the headwinds buffeting an already fragile recovery.

Business activity and...



Source: LSEG, MFO

...consumer sentiment amid a stagflationary shock



Source: LSEG, MFO

1.3 ASIA AND EMERGING ECONOMIES

- EM business conditions cooled following the stagflationary commodity shock in late-February. Input cost inflation rose sharply — compounded in several markets by US dollar strength and local currency weakness — while services activity and manufacturing output both slowed in April before partially recovering in May but not fully regaining pre-shock levels. Crucially, however, the price shock did not approach the extremes of the pandemic or the 2022 commodity crisis.

- Growth projections were revised down accordingly. The World Bank's June forecast put growth for emerging market and developing economies at 3.6 percent in 2026 — a 0.4 percentage point downward revision from January – and 1.5 percent for advanced economies, down by 0.1 percentage points.

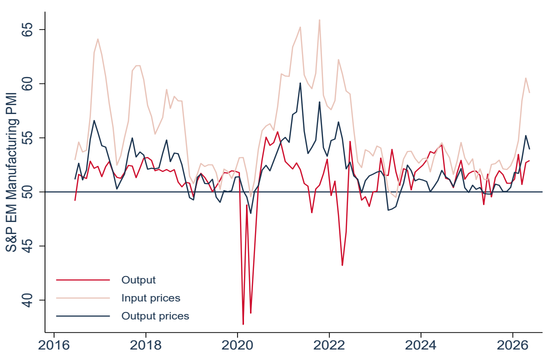
- That resilience is notable given the shock's magnitude: the Hormuz closure initially removed roughly 20 million barrels per day, approximately one-fifth of global supply. Oil market equilibrium was restored through increased Atlantic Basin exports, partial rerouting via Saudi and UAE bypass pipelines, strategic reserve releases, and demand destruction, the latter driven primarily by government conservation measures and a sharp reduction in Chinese refinery imports.

- Full recovery, however, will be a multi-year process. Resumption of Hormuz transits is necessary but must be followed by restoration of production in the Gulf states — expected by the IEA in early 2027 — inventory rebuilding, and reconstruction of destroyed infrastructure, most consequentially the Ras Laffan LNG complex in Qatar, the world's largest gas liquefaction facility, which has been offline since early March, with repairs estimated to need three to five years.

- Despite the adverse backdrop, China's Q1 GDP surprised to the upside, supported by infrastructure spending and resilient exports. Business activity continued to improve into Q2, pointing to a modest demand recovery. Beneath the headline, however, China's consumption remains subdued, deflation pressure persists, and the property sector overhang is unresolved, while demographic pressures weigh on trend growth.

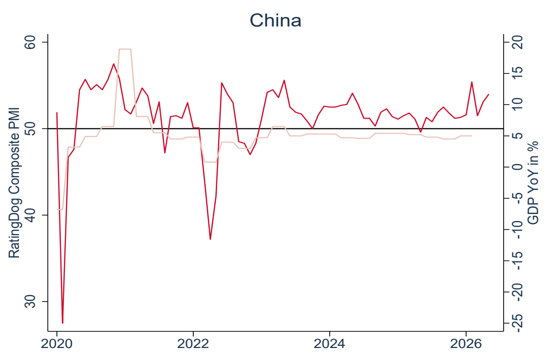
- Korea stood out as a regional outlier, driven by the AI-fuelled semiconductor boom that outweighed the drag from the energy shock. GDP expanded by 1.7 percent in Q1 — the strongest rate since 2020 — and semiconductor exports surged 169 percent year-over-year in May to a record high. The recovery has been K-shaped, however, with non-tech manufacturing, steel, and construction remaining under pressure.

Prices up, margins squeezed



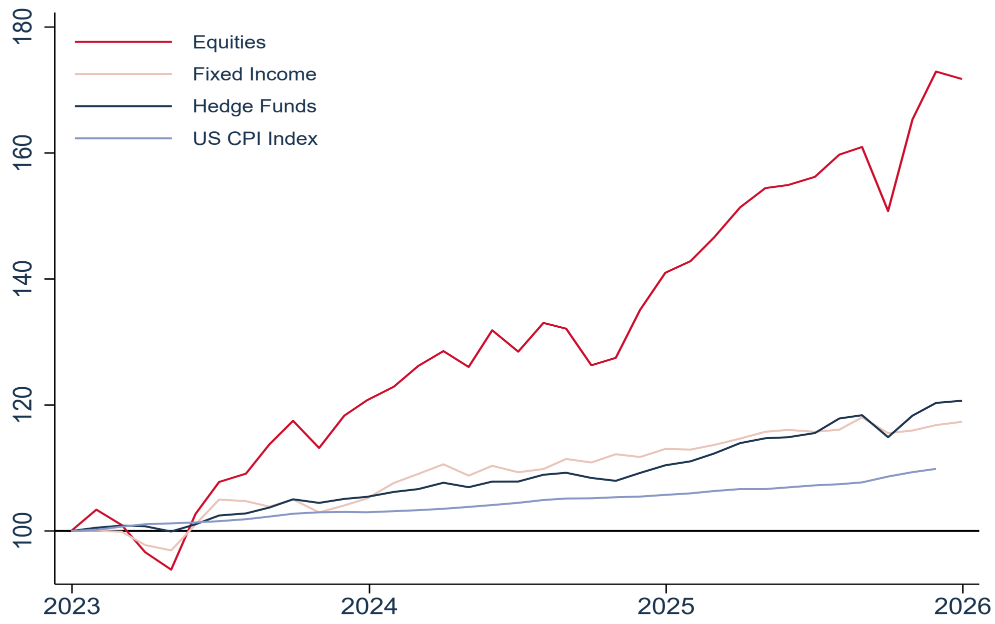
Source: LSEG, MFO

Cyclical stabilisation in China



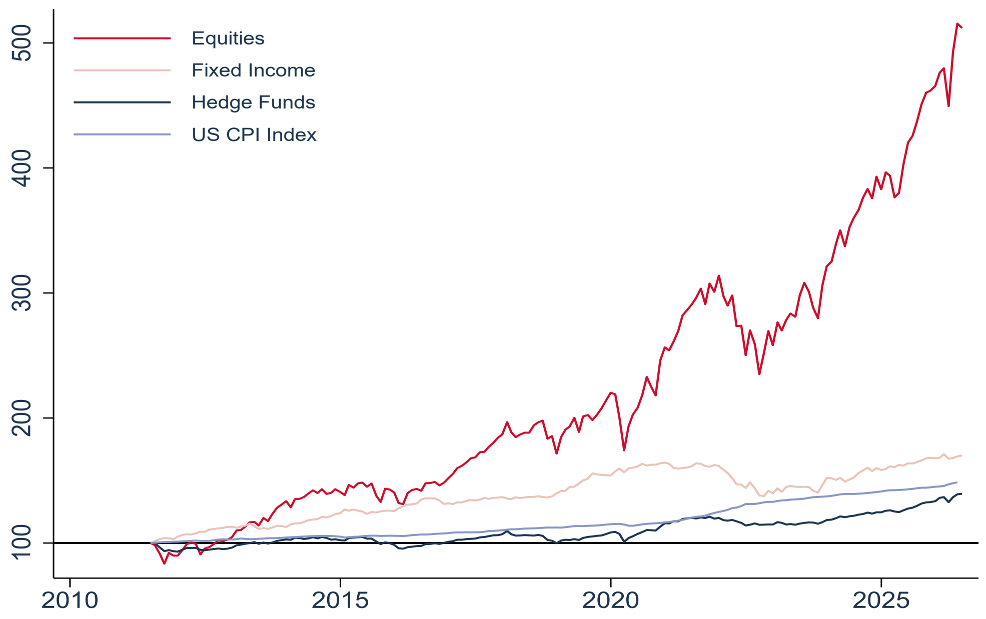
Source: LSEG, MFO

Medium-term market developments



Source: LSEG, MFO

Long-term market developments



Source: LSEG, MFO

2.1 EQUITIES

- The second quarter of 2026 was defined by a market recovery against a backdrop of continued uncertainty. The Middle East conflict and the Strait of Hormuz disruption kept geopolitical risks elevated throughout the quarter, and oil prices, though retreating from the extreme peaks of early April, remained well above pre-conflict levels, weighing on consumers and growth expectations across many economies. And yet equities staged a powerful reversal thanks to sustained enthusiasm around artificial intelligence, a robust corporate earnings season, and improving hopes for a diplomatic resolution in Iran, which drove major indices to new all-time highs, even as consumer confidence in the US and Europe was well below long-term averages.

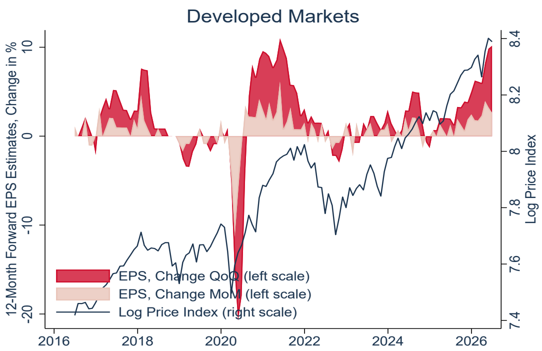
- Corporate earnings were the backbone of the rally. According to *FactSet*, the Q1 2026 season was the strongest since 2021, with 85 percent of *S&P 500* companies beating expectations and the index delivering year-on-year earnings growth of close to 29 percent. For Q2, analysts have continued to raise their estimates, with expected growth now at around 22 percent, above both the five- and ten-year averages, while more companies than usual issued positive guidance, further underpinning confidence in the outlook.

- During the second quarter of 2026, global equity markets delivered strong, broad-based gains. Japan led the way, with the *Nikkei 225* rising 37.3 percent in JPY, while *MSCI Asia ex Japan* gained 27.8 percent in USD. US equities also performed strongly, with the *Nasdaq 100* up 27.7 percent and the *S&P 500* advancing 15.2 percent, both in USD. European equities followed, with the *MSCI Europe Index* gaining 12.2 percent in EUR and Switzerland‘s *SPI* up 12.2 percent in CHF.

- The quarter‘s dominant theme was AI‘s continued evolution, with the narrative shifting from infrastructure buildout towards monetisation across software, enterprise and digital services — well supported by corporate earnings delivery. The defining market event was the SpaceX IPO on June 12 — the largest in history, raising USD 75 billion on a USD 1.8 trillion valuation. Changes to index rules created significant forced buying from passive funds, with further waves of mechanical buying still ahead, raising questions about valuation, liquidity and index mechanics.

- We continue to hold a neutral view on global equities, with a relative preference for non-US markets where valuations are more attractive and earnings forecasts are stronger — a view validated by the quarter‘s relative performance. Geopolitical developments, monetary policy and AI earnings durability are key variables to watch in H2.

Forecast earnings growth near peaks



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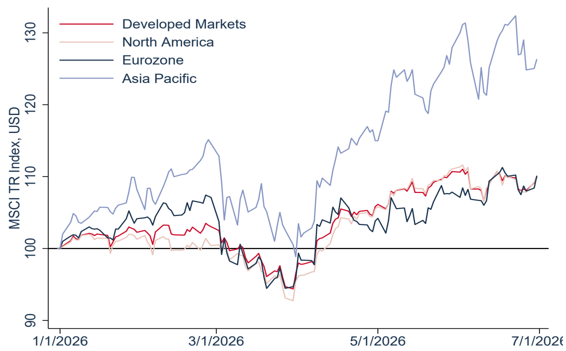
Asia with strong momentum



Source: LSEG, MFO

2.2 FIXED INCOME

- Global bond markets endured another difficult quarter, shaped by the US-Iran conflict, hawkish central bank pivots and volatile energy prices. A succession of ceasefire announcements followed by renewed hostilities drove sharp swings in the interest rate curve in both directions, while credit markets held up well due to solid underlying corporate fundamentals, resulting in a modest 1.3 percent positive total return for global investment grade bonds, as measured by the *Bloomberg Global Aggregate Index (USD hedged)*.

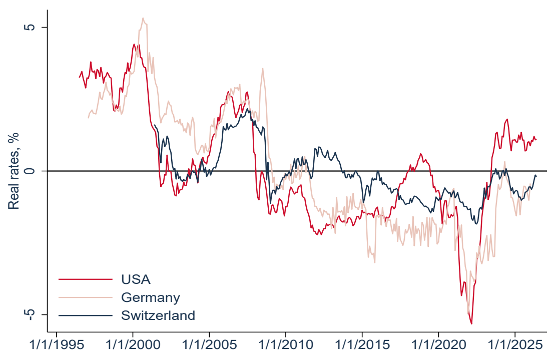
- Brent crude surged sharply before falling after the early April ceasefire, briefly lowering real yields and US inflation breakevens – the inflation rate at which investors see no advantage in either nominal or inflation-linked bonds – as well as nominal yields. As tensions resurfaced and the Strait remained closed, oil prices and rates rebounded, leaving breakevens above pre-conflict levels. In May, renewed ceasefire progress triggered a further decline in Brent, leading to a clear compression in breakevens. However, persistent core inflation kept long-end real yields elevated as markets fully priced out Fed rate cuts for 2026 and the 30-year Treasury yield moved above 5 percent. June saw the quarter's most consequential central bank actions. The ECB raised its key interest rates by 25 basis points – its first increase since 2023 – responding to accelerating Eurozone inflation. The move raised stagflation concerns given the bloc's current weak growth backdrop.

- In the US, incoming Fed Chair Kevin Warsh held his first FOMC meeting and kept rates steady at 3.50–3.75 percent, but he removed the easing bias in his policy statement, which was a notably shorter, more austere communication. The market now prices one Fed rate hike as soon as September with potentially another one by year-end.

- Credit markets broadly held up, supported by resilient corporate fundamentals and improving risk sentiment as ceasefire optimism grew. Investment-grade and high-yield spreads both tightened modestly from Q1, from 0.9 percent to 0.8 percent for US investment grade and 3.3 percent to 2.8 percent for US high yield, according to *ICE BofA Option-Adjusted Spreads*.

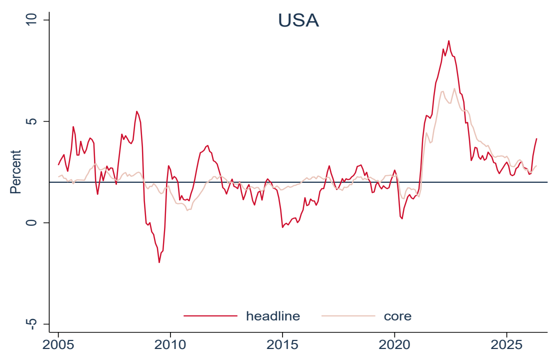
- Overall, Q2 was defined by whipsawing headlines, with the Iran conflict driving outsized moves across energy, rates and credit. Progress toward a ceasefire and falling oil prices offer a constructive signal for the second half, but hawkish shifts at both the Fed and ECB argue for continued caution. We maintain a neutral duration stance and disciplined credit selection.

Rising real rates...



Source: LSEG, MFO

...and stubborn US CPI inflation



Source: LSEG, MFO

HEDGE FUNDS, PRIVATE MARKETS AND COMMODITIES

- All strategies generated positive returns during Q2. Equity long/short was the strongest performer, benefiting from a constructive market backdrop. Early in the quarter, sentiment was supported by the announcement of a ceasefire between the US and Iran, while ongoing AI-driven strength in the technology sector and optimism around a robust IPO pipeline further underpinned markets. Global macro strategies also returned to positive territory following losses in March. Managers navigated multiple reversals in interest rates and commodities relatively well, although overall risk appetite remained somewhat subdued.

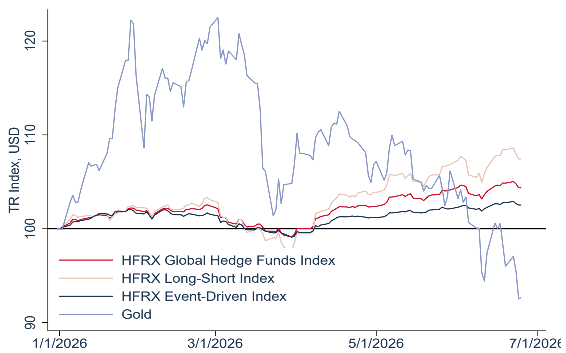
- Gold shifted from pronounced volatility in the first quarter to a sustained downward trend in the second. This decline was primarily driven by rising interest rates, a stronger US dollar, and a reduction in speculative demand. In addition, the first Fed meeting with Kevin Warsh as the chair was interpreted as hawkish by the market and led to a decline in the US dollar debasement trade. As a result, gold's year-to-date performance turned negative, with the yellow metal officially entering a bear market after falling by more than 20 percent from its January peak.

CURRENCIES

- After depreciating in April and May, the trade-weighted US dollar reversed course and appreciated in the second half of the quarter, ending the quarter up 0.6 percent, driven by expectations of a tighter monetary stance and rising USD rates. On a trade-weighted basis, the dollar appears only slightly overvalued on average, with variations across individual currency pairs.

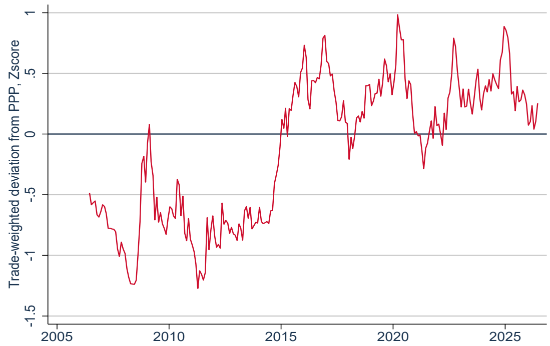
- The Swiss franc traced a volatile sideways pattern throughout the quarter after the SNB signalled an increased willingness to intervene in currency markets following the franc's marked appreciation earlier in the year. The franc currently trades near fair value against both the euro and the US dollar, and we expect the structural appreciation trend to continue given persistently lower inflation in Switzerland relative to its main trading partners.

Gold quickly unwinds recent gains



Source: LSEG, MFO

US dollar near fair value



Source: LSEG, MFO

3. INVESTMENT VIEWS

- Equities: We maintain a neutral allocation, reflecting robust market trends and positive earnings surprises, against a backdrop of extreme market concentration, potentially overblown AI-related optimism, heightened uncertainty from geopolitics, lingering tariffs, the stagflationary commodity price shock, and an increasingly hawkish monetary policy outlook. In May, we realised gains to keep equity risk exposure in line with our target. Within the allocation, we retain a slight overweight in non-US markets, given their more attractive valuations, expected structural portfolio shifts related to USD de-risking, and solid momentum in EM and Asian markets.

- Fixed Income: Our stance remains neutral at the asset-class level and highly selective within the allocation. Yield volatility from the energy price shock was absorbed relatively well, as solid yield levels provided partial compensation for price swings, at least in US dollar. Fresh headwinds have nonetheless emerged: major central banks have turned more hawkish in response to renewed inflation pressure, and the deteriorating fiscal outlook of key sovereign issuers remains a structural concern. Whether incoming Fed Chair Kevin Warsh establishes a new policy regime capable of imposing discipline on Treasury markets is a key question for the asset class, in our view.

- Gold: Rising real yields, increasingly negative momentum, and liquidity-driven selling continued to weigh on gold in Q2, more than erasing its early-year gains. Following profit-taking in mid-February, after gold's initial rally, we used the subsequent correction to rebalance back to the middle of our target range at more attractive entry levels in late June.

- Hedge Funds: We maintain a neutral allocation within our diversified hedge fund portfolio, which comprises equity long/short, uncorrelated, convex and unconstrained fixed income strategies. We remain confident that their flexibility and diversifying properties contribute meaningfully to multi-asset portfolio stability.

Overview

	Equities				Fixed income		Alternatives			Liquidity
	North-America	Europe	Asia-Pacific	Emerging Markets	Duration	Credit	Hedge Funds	Commodities	Precious Metals	
Macro	→	→	→	→	→	↘	→	→	↘	→
Market	↗	→	↗	↗	↘	→	↗	→	↘	→
Valuation	↘	↘	↘	↘	→	→			↓	→
Sentiment	→	→	↗	↗	→	↘	→	→	→	→
Aggregate	→	→	↗	↗	→	↘	→	→	↘	→

Source: MFO

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