

Quarterly Investment Update Q2 2026

Overall Market Review and Economics

The second quarter of 2026 was unusually eventful, even by the standards of the post-pandemic market cycle. Investors had to process a shifting geopolitical backdrop, another round of powerful equity market gains, a still-resilient economy, and growing evidence that the artificial intelligence investment cycle is beginning to create real productivity gains. Despite several moments that could have unsettled markets, risk assets and most fixed income investments remained well supported through quarter-end. In light of another quarter of large returns, we have updated our capital markets assumptions (CMAs) and present them below.

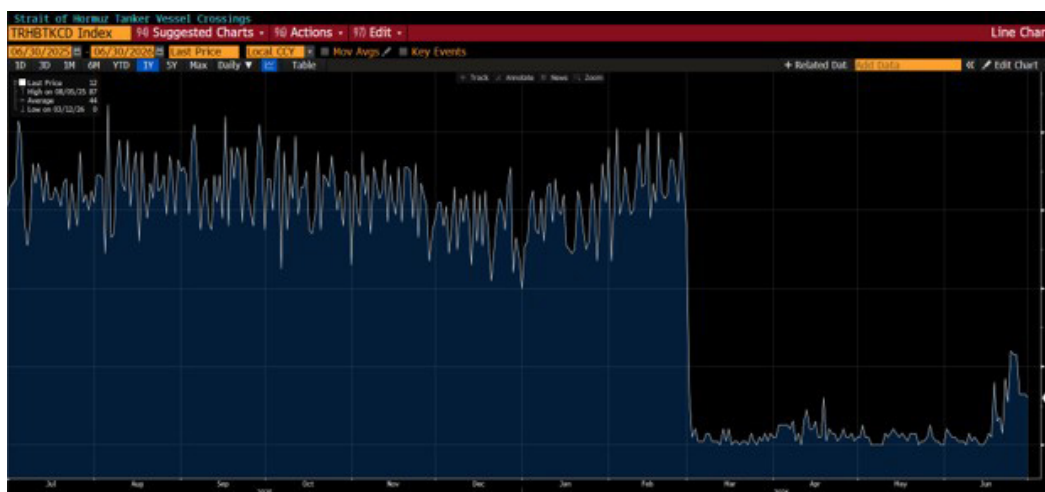


As with previous capital market assumption reviews, we show our expectations for stock markets including and excluding mean-reversion in valuations. In most cases, the two methodologies produce similar results, except for U.S. large capitalization equities, whose valuations currently sit at a significant premium to long-term averages. Many of our expectations remain similar to what was published in our previous quarterly update, which is to be expected. The only market segment we would call out would be emerging markets. The MSCI Emerging Markets index increased more than 24% in the second quarter alone. And while earnings growth has been solid, much of that return came about through valuation expansion. This has compressed our 10-year emerging market expectations by 1.1% per year relative to last quarter, a meaningful amount that reflects the incredible returns investors have realized in recent periods.

We have made some changes to our expected returns methodology within equities and have added new asset class Capital Market Assumptions (CMAs) into the mix as well. Within equities, we have incorporated our expectations for buyback effects into our CMAs. This change modestly increased our expected returns for U.S. Large Cap stocks but had little effect on other market segments. Despite this, we still find the exercise worthwhile as it sharpens our view of forward returns. We have also added expected returns for leveraged loans, high yield municipal bonds, private equity, private debt, and private real estate to our quarterly CMA update. Our CMA process for private markets is new and differs somewhat from our public market process, and a technical paper explaining the details of that methodology are available upon request. In all, aside from U.S. mid and small equities and private equity, we largely expect fixed income investments to deliver pre-tax returns in line with equities in the coming decade.

Iran War and Energy Prices: Risks Still Prevalent but Quickly Receding

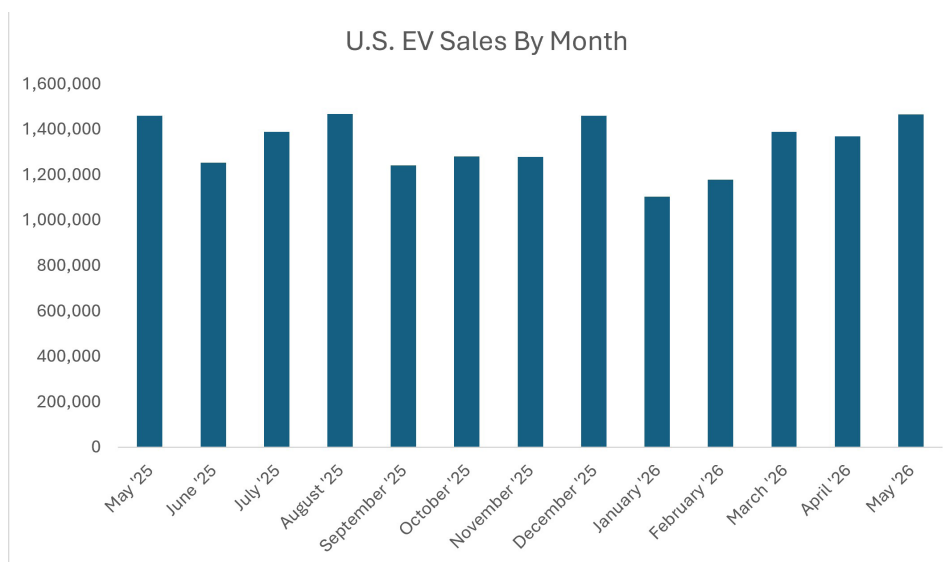
The most important development of this past quarter was arguably what did not happen. A broader conflict in the Middle East, and particularly a sustained disruption in the Strait of Hormuz, represented one of the clearest risks to both markets and the global economy. As the U.S. and Iran reached a memorandum of understanding and the outlines of a larger peace treaty, traffic through the Strait began to normalize, and energy markets quickly moved from worrying about dangerously low inventories to debating the possibility of excess supply (see below).



Source: Bloomberg, data as of 6/30/2026

That shift does not eliminate the risk. Continued skirmishes mean the region remains important to monitor, and most agree it will take time for traffic through the strait to fully normalize. But for now, both sides appear to recognize the value of keeping a larger kinetic war off the table and allowing energy markets to function more normally.

One factor that mitigates oil shock risk in our view is that they tend to change consumer behavior quickly. One of the more interesting developments in recent data has been renewed strength in electric vehicle (EV) demand, not only in the United States but also in Europe and parts of Asia. Despite the recent sunset of federal tax incentives to purchase EVs, their sales are near all-time highs again in response to volatile gasoline prices. While it is too early to know whether this represents a durable change in consumer preferences, it is a reminder that the U.S. economy is incredibly flexible and is typically resilient even in the face of severe macroeconomic shocks.



Source: Argonne National Laboratory, data through May 2026

Markets: Strong Returns, Wider Dispersion

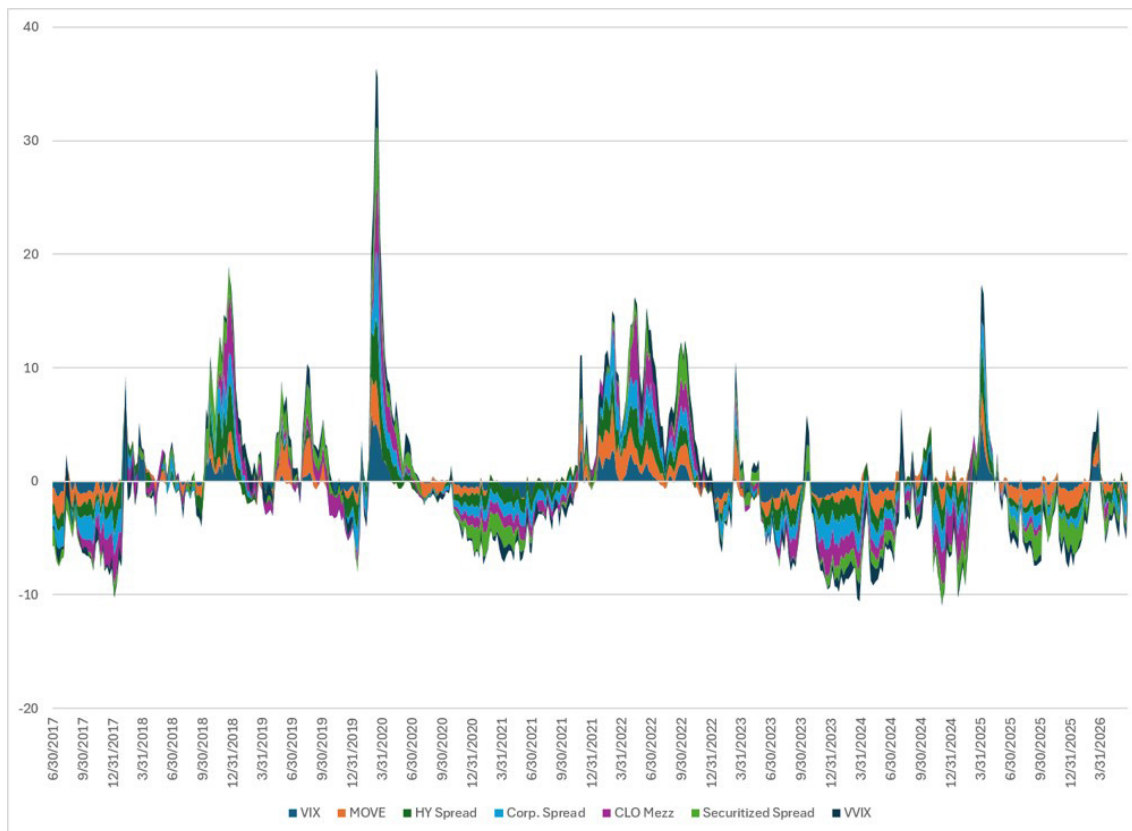
Outside of geopolitics, the quarter also featured some of the largest headlines and market movements we can recall seeing in recent years. The SpaceX IPO was notable not only because of its size and public attention, but it also helped make 2026 one of the largest years on record for new share issuance (a subject we will return to later). At the individual stock level, market moves were equally striking. Snowflake, a company with a market capitalization approaching \$90 billion today and is followed by more than 40 professional analysts, rose more than 35% in a single day after reporting earnings on May 28. While Snowflake stood out, it was not an isolated event. There were many similar examples across large, heavily followed companies that produced unusually sharp gains or losses around earnings announcements.

This market environment has been characterized by high single-stock volatility and relatively low correlations, creating large dispersion in outcomes among companies and their share prices. That combination has historically been a more favorable backdrop for active management and certain alternative investment strategies, because there is more room for company-specific research, security selection, and relative-value positioning to effect broader portfolio outcomes. Whether this environment persists remains to be seen, but the contrast with markets of prior years where broad themes largely drove most equity prices in the same direction is stark.

Despite risks posed by narrowing market breadth (i.e. positive returns clustering around companies adjacent to the AI theme), we are encouraged by the fact that much of the market's strength continues to be supported by earnings growth rather than valuation expansion. Forward valuations are not cheap, but they have been held in check by continued upward revisions to profit expectations. Capital spending among hyperscalers remains the central driver of earnings growth. That spending is flowing through to revenues and earnings for many companies directly tied to the buildout. While initial labor productivity data is encouraging, we would take broader signals around continued earnings growth outside of the mega-cap technology space as a bullish sign that the overall economy is benefitting from this capital expenditure.

The Economy: Improving Data Balanced Against a More Hawkish Fed

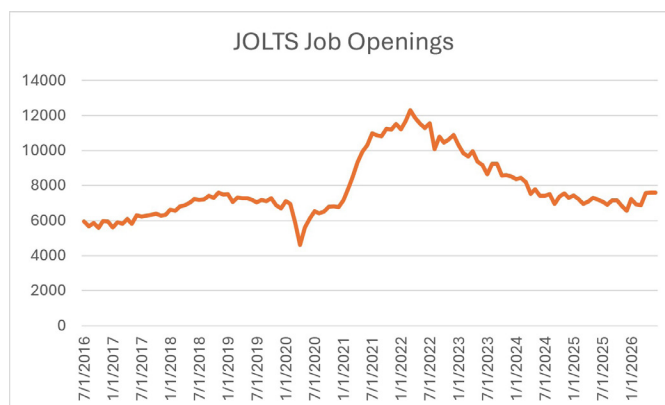
The economic backdrop also improved during the quarter. Our composite risk measure remains low relative to history, though not yet at the sort of extreme levels that would normally signal complacency.



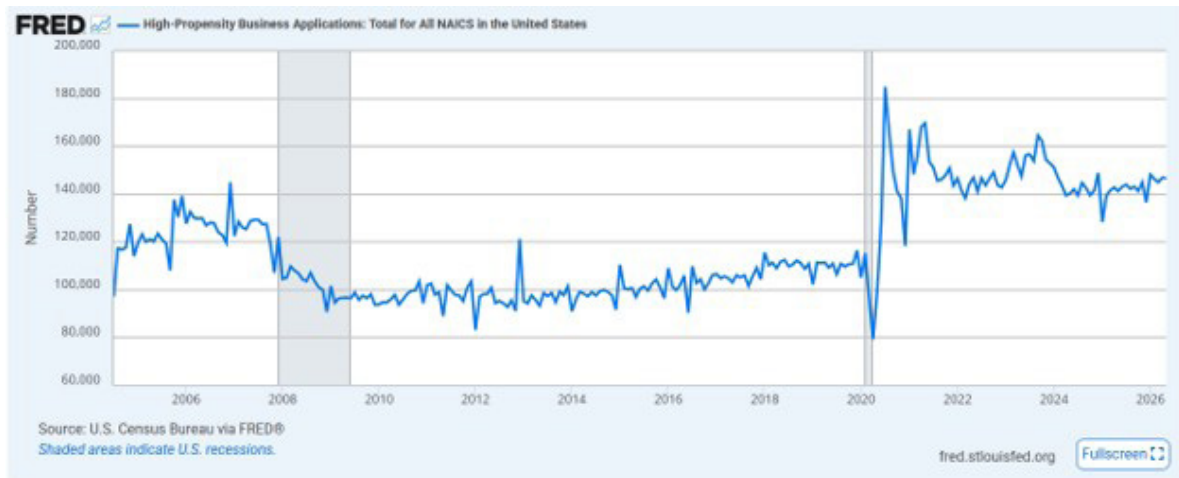
Source: Bloomberg and Cambridge Investment Research, data as of 6/26/2026

In our view, the near-term risk of an economic downturn remains low. A key reason supporting that view is that fiscal deficit spending continues to support both corporate earnings and nominal GDP growth (we wrote about this relationship in detail in our last quarterly update). While the long-term sustainability of large deficits is a separate question, the near-term effect is straightforward: government spending remains a meaningful source of demand for the economy.

We are also beginning to see signs that labor markets are tightening again, which is not surprising given the economic backdrop. Job openings remain elevated, and new business applications have been increasing toward post-pandemic highs. That combination is generally encouraging for growth. It suggests that businesses still see enough opportunity to hire, invest, and form new companies.



Source: Bloomberg, data as of 6/30/2026



Source: St. Louis Fed, data as of 5/31/2026

While this is typically very positive news for the economy and stock markets, the challenge this time around is that stronger labor and growth data can also complicate the Federal Reserve's job. We continue to believe the Fed is more likely to remain on hold than resume rate hikes, particularly given new Fed Chair Kevin Warsh's stated focus on the potential for productivity gains driven by this massive AI-related investment. Still, the risk is that a series of strong data points pushes the Fed toward a more hawkish tone, or even toward additional tightening. In our view, that remains one of the more important risks for markets. Futures markets are pricing in a more than 70% chance that the Fed delivers at least one rate hike, and a more than 40% chance of two hikes or more.



Source: Chicago Mercantile Exchange, data as of 6/30/2026

Short-term interest rates remain central to the uneven recovery we have described in prior updates. Higher rates continue to benefit savers and some asset owners, but they pressure borrowers, rate-sensitive consumers, and parts of the economy that rely on financing. This has contributed to the “K-shaped” pattern in which some households and companies are doing quite well while others remain under strain. High U.S. rates are also creating pressure outside the United States. Japan is one example, where persistent yen weakness has been partly tied to the interest rate differential between Japan and the United States. These cross-market pressures are manageable today, but could create market instability in the future given the size of Japan’s economy, capital markets, and treasury holdings.

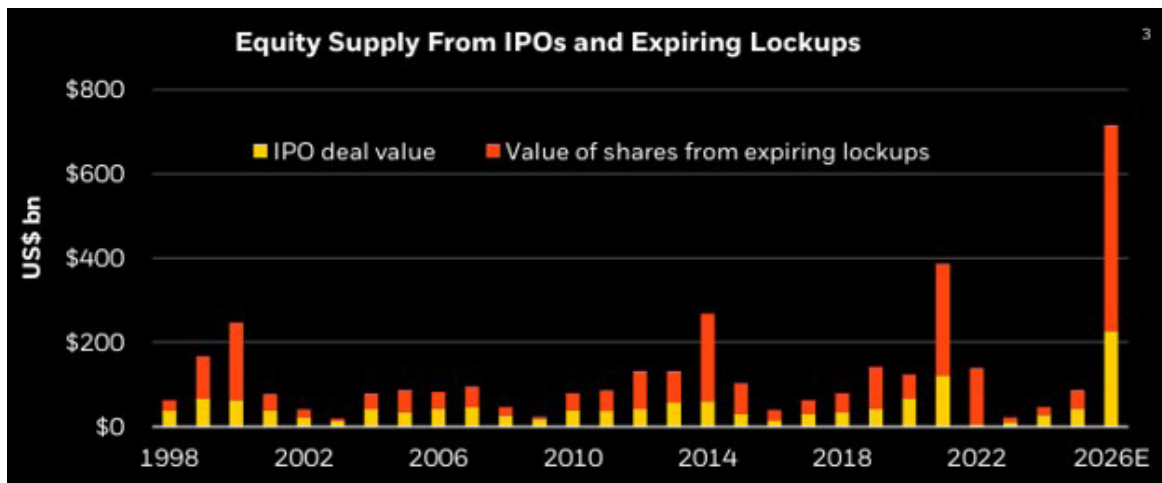
Thoughts on Equity Supply and Demand: Leverage and Share Sales

When formulating our views on specific markets, we pay close attention to the fundamentals of the particular asset class, its valuation, and any technical buying or selling pressure we can identify ahead of time. In light of that, we are paying close attention to the ways leverage is building in the financial system and the technical impacts it can have on markets. This round of leverage build-up does not look like 2008. The leverage is not primarily concentrated in bank balance sheets or opaque mortgage structures. Instead, it is showing up in areas such as retail options trading (specifically in zero-day-to-expiration (0DTE) or 0DTE options), leveraged ETFs, and increasingly in single-stock and sector-focused leveraged products.

Leveraged ETF assets are at all-time high levels, with Citadel Securities estimating the market to be \$218B in size, nearly five times what it was in June 2020. The fastest growth has been in products related to individual stocks and sectors, especially semiconductors (which now comprise close to 30% of the market overall). We believe this activity has contributed to at least some portion of the parabolic price increases in technology and semiconductor shares we have seen this quarter. Our concern is not simply that prices have gone up, but that leverage can amplify both upside and downside movements. This is especially the case when investors are crowded into similar trades, and there is strong evidence that is the case today. The June 23 decline in the PHLX Semiconductor Index, which fell nearly 8% in a single day, offered a reminder of how quickly these trades can unravel. While that move down was quickly reversed and did not cause any broad spillover effects, a larger and more lasting unwind could have a more meaningful impact.

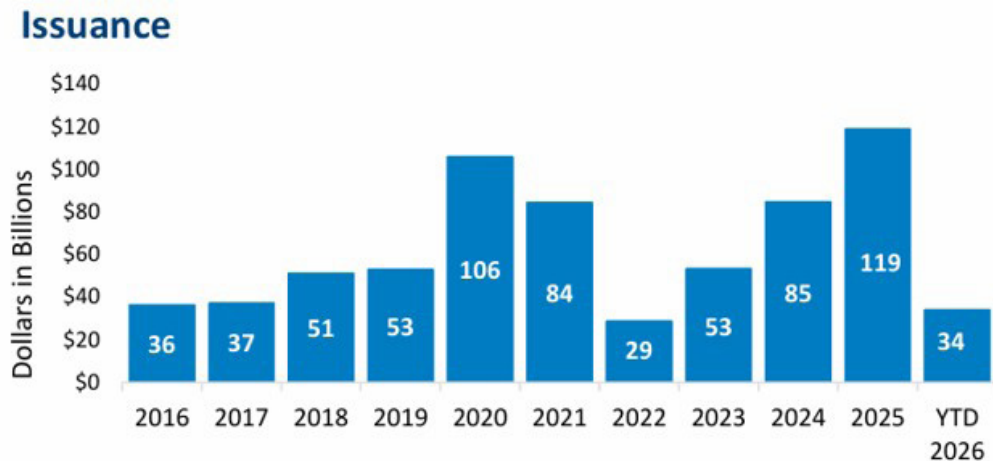
We are also watching similar dynamics outside the United States. Retail leverage and speculative trading activity have been even more pronounced in parts of Asia, especially South Korea and Taiwan. Price movements have been even more extreme in those two countries, with South Korea and Taiwan’s respective indexes delivering returns of nearly 100% and 67% in the first half of the year. None of this means that a correction is imminent, but it does mean the path of returns can reverse quickly and in a disorderly way if investors are forced to reduce risk quickly.

A second market-structure issue is the changing balance between equity demand and equity supply. For much of the past decade, demand for equities has far exceeded supply. Share repurchases, limited IPO activity, and strong flows into passive strategies helped create a persistent tailwind for equities. This consistently pushed market valuations higher, especially in the U.S., and boosted total shareholder returns in the process. That backdrop may be changing. The SpaceX IPO is the most visible example, but it is not the only one. Large IPOs, secondary offerings, and convertible bond issuance are all increasing the amount of equity or equity-like supply that markets must absorb. A chart of IPO activity is presented below.



Source: BlackRock, data as of June 2026

Google's recently announced new share issuance, worth tens of billions of dollars and representing its first meaningful equity capital raise since its IPO, is particularly notable. If a company with Google's cash generation and balance sheet strength chooses to raise equity capital, it likely says something about the size of investment needs across the largest technology platforms. It also supports the view that other hyperscalers may follow soon, further adding to equity supply concerns. Convertible bond issuance, which set a record in 2025 and appears likely to remain heavy in 2026, adds another layer to the supply if markets continue to rise. These securities have features that are similar to both fixed income and equity securities, but can convert into new shares outstanding when share prices rise above pre-specified prices.



Source: Calamos, data as of April 30, 2026

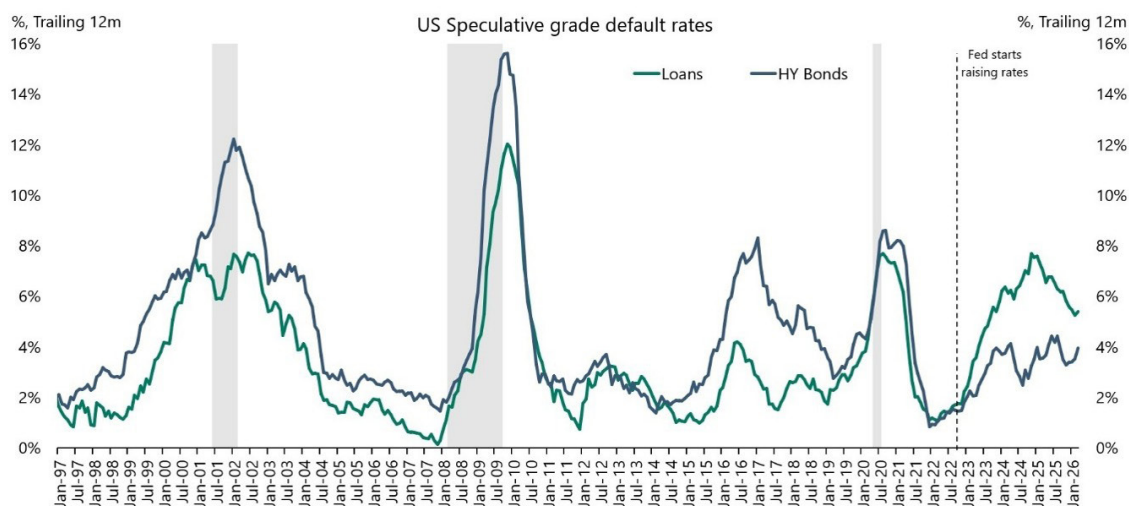
While announced buybacks remain large in the U.S., it is important for investors to consider the tailwinds of the past are not likely to be there to support equity valuations in the coming quarters.

Portfolio Positioning: Favor Credit Over Equities

Given this backdrop, we believe investors should remain invested but selective. We are currently recommending a neutral weight to equities. We are certainly not bearish on markets. Earnings growth remains strong, the economy is resilient, and the AI investment cycle continues to provide a powerful tailwind. However, valuations are no longer a source of obvious support, leverage has increased in certain corners of the market, and the coming wave of equity supply may reduce one of the structural tailwinds that has supported stocks in recent years. This neutral view also begins to align our current tactical market views with our long-term capital market assumptions presented at the start of this report.

By contrast, we currently prefer taking risk in credit markets rather than equities. Credit investments are not without their share of risk, but their starting all-in yields and expected returns remain attractive relative to much of the equity market. Continued nominal GDP growth should help keep default rates contained, and we are seeing credit events decline or remain subdued, particularly in the leveraged loan market (see below). Leveraged loans also tend to have a higher correlation to inflation than many traditional fixed income assets, which can be useful if inflation remains more persistent than expected.

Credit metrics are improving



Source: Apollo, data as of 5/12/2026

The short end of the yield curve also continues to look compelling. If the Fed remains on hold, investors can earn attractive income amounts without taking significant duration risk. And if we are wrong and the economy slows more than expected, credit investments are likely to hold up better than equities in that environment. In a market where many risk assets have already performed well, we think that a combination of solid income with continued exposure to solid GDP growth will serve investors well.

Closing Thoughts

The second quarter reinforced several themes that we have been analyzing for some time. The economy remains more durable than many expected. Corporate earnings are being supported by fiscal spending, technology investment, and improving productivity. Equity markets continue to reward companies tied to the AI capital spending cycle, but the range of outcomes across individual stocks has widened materially. At the same time, leverage and speculative activity are growing in areas that could make market drawdowns sharper when they occur.

Our base case remains constructive, but not complacent. We do not see near-term recession risk as elevated, and we believe the earnings backdrop can continue to support markets. However, the combination of high short-term rates, crowded equity leadership, rising use of leverage, and increasing equity supply argues for a more balanced approach. In practical terms, that means maintaining equity exposure that is neutral to a portfolio's stated benchmark, emphasizing quality and selectivity; and leaning more heavily into areas of credit where income, fundamentals, and inflation sensitivity remain favorable. Our table of asset class views and brief explanations is presented below.

As always, we will continue to monitor the data, policy backdrop, and market technicals closely.

Equities	Current Weighting	Outlook
U.S. Large Cap	Neutral	Excellent fundamental and earnings growth. High concentration of largest names and high starting valuations keep us neutral on this asset. IPO activity and share sales also concern us. We are not recommending any active positioning among sectors or styles today.
U.S. Mid and Small Cap	Neutral	Modest valuations and falling interest should provide a tailwind to investors here. We currently recommend a neutral weight but might look to change to overweight if we start to see evidence of earnings growth inflecting higher.
EAFE	Neutral	Diversifying into international equities still make sense in our view, given the potential for modest U.S. equity returns from these levels. Worrisome trends in sovereign debt yields and potential negative growth shocks keep us neutral relative to benchmark.
EM	Neutral	Extraordinary returns in certain countries, high retail investor participation, and rapid earnings growth have defined returns in emerging markets this year. While not extreme, valuations are high relative to long-term averages and there is some evidence of froth. We maintain our neutral view given solid diversification properties of this asset class.

Duration	Current Weighting	Outlook
Treasuries	Underweight	While rates are solidly positive across the yield curve, huge potential net new treasury supply and continued refinancing needs keep us modestly short duration relative to benchmark expressed primarily through a treasury underweight. We are evaluating this underweight in light of falling volatility and correlations with equities.
IG Corporates	Underweight	Narrow spreads combined with significant upcoming issuance keep us underweight this segment, despite our economic outlook. If spreads normalize we will look to upgrade our outlook.
Agency Mortgages	Overweight	Solid spreads relative to both treasuries and high quality corporate bonds still make this our preferred way to obtain duration exposure. Normalizing treasury volatility is a positive for mortgages.
Munis	Neutral	After-tax yields of high quality municipal bonds are solid today. Term premiums, or the pickup in yield earned from increasing duration, remains solid among municipal bonds. We also think there is opportunity to boost income levels in higher yielding municipal bonds as well.

Credit	Current Weighting	Outlook
High Yield	Neutral	Fundamental changes to the index with respect to quality composition and duration, along with our economic outlook means we expect defaults to remain subdued. Spreads have rebounded this quarter so we are actively evaluating this outlook.
Leveraged Loans	Neutral	While underwriting standards were admittedly poor in recent years, we are upgrading Leveraged Loans from underweight to neutral. This is informed by our view that the default cycle in this sector is easing, and there is value in the short end of the treasury yield curve.
Structured Credit	Overweight	Structured credit remains our favored way to gain credit exposure, as this segment offers solid yields with modest credit and duration risk. Our favorite segments within this asset class include Non-Agency RMBS and CMBS, as the collateral values for both are likely to rise in 2026.

Alternatives	Current Weighting	Outlook
Private Equity	Overweight	Reinvigorated capital markets should promote portfolio realizations and returns. Our economic outlook, combined with lower borrowing costs leads us to believe these asset classes should provide total return that outperforms public markets. Manager selection is key here.
Private Debt	Neutral	We have seen some concerning defaults in this arena, along with some concern around underwriting standards. However, we still think this asset class will deliver solid liquid returns even as there has been softness in broader bond markets. We expect the private debt market to continue to grow. Like private equity, manager selection is key.



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