February 2026

Franklin Templeton Investment Solutions

Allocation Views

Confidence, not complacency

Not FDIC Insured | No Bank Guarantee | May Lose Value

Summary

Equity valuations are top of mind among investors as we move into February, amid stretched sentiment and positioning and challenging corporate earnings expectations.

While we recognize these concerns as valid, we believe strong macro and corporate fundamentals should continue to support markets. Deeper analysis of growth, inflation and earnings gives us confidence that current optimism draws from solid foundations rather than irrational exuberance.

We believe rich valuations are justified by above-trend growth, which has combined with ongoing disinflation to create a “goldilocks” environment for equities. We also expect fiscal and monetary policy to be broadly supportive, dependent on the impact of political crosswinds. Beyond macro considerations, we view a healthy corporate earnings environment as bullish for risk assets.

Stretched sentiment and positioning is a contrarian indicator that supports a more bearish approach to risk, but in our view, strong fundamentals outweigh this.

Against this background, we remain modestly overweight equities within our policy portfolio, balanced by an underweight to fixed income. We also allocate to commodities and alternatives for diversification and hedging purposes.

Macro themes

A resilient growth story

- Leading economic indicators have strengthened, fueled by artificial intelligence (AI) capex (capital expenditure) and high-end consumers.
- Corporate sentiment appears strong, as evidenced by positive earnings revisions and guidance for calendar year 2026.
- The US economy has proven robust. Labor market data has softened from a strong position but is stabilizing and currently shows no signs of collapsing.

Moderating inflation trends

- Inflation remains above central-bank targets in most developed economies, although the trends are broadly disinflationary.
- Tariffs have been absorbed by both consumer prices and business margins. Core goods inflation could persist, but pressures have likely peaked.
- Services inflation has eased due to lower housing costs and wages, helping counteract higher goods inflation.

Policy leans supportive

- Economic crosswinds may prevent the Federal Reserve (Fed) from cutting rates again in the near term, but we expect moderate easing over the next year.
- Several major central banks remain in easing cycles, but the global policy environment has become more complex and is increasingly bifurcated.
- Fiscal policy in major economies is an increasingly influential driver of asset prices. We believe US tax refunds will likely offset tariff headwinds, while stimulus measures in Japan and Germany could also prove supportive.

Portfolio positioning themes

Responsibly bullish

- Positive earnings revisions and guidance support equity market momentum, outweighing valuation concerns, in our view.
- Leading and current indicators of economic strength remain broadly positive and support risk assets.
- Sentiment and positioning have become more stretched. We believe this is a slight headwind for risk assets and feeds into the ongoing valuations debate.

Opportunity in emerging markets (EMs)

- Earnings expectations are rising rapidly across EM ex China, influencing our more constructive view on the region. Macro conditions are also supportive.
- We retain our optimistic view of US large-capitalization stocks, relative to small caps and regional equities. Robust earnings and a supportive macro backdrop guide our thinking.
- We remain broadly pessimistic toward international developed market equities.

Underweight government bonds

- Strong growth is challenging longer-term market expectations for Fed easing, in our view. Elsewhere, central bank rhetoric has become more hawkish recently.
- Fiscal deficits are widening in major economies, as governments increase spending or cut taxes to stimulate growth. Consequent yield effects make us selective on duration.
- Tight spreads diminish the risk-adjusted returns available from credit. Earnings growth leads us to favor equities.

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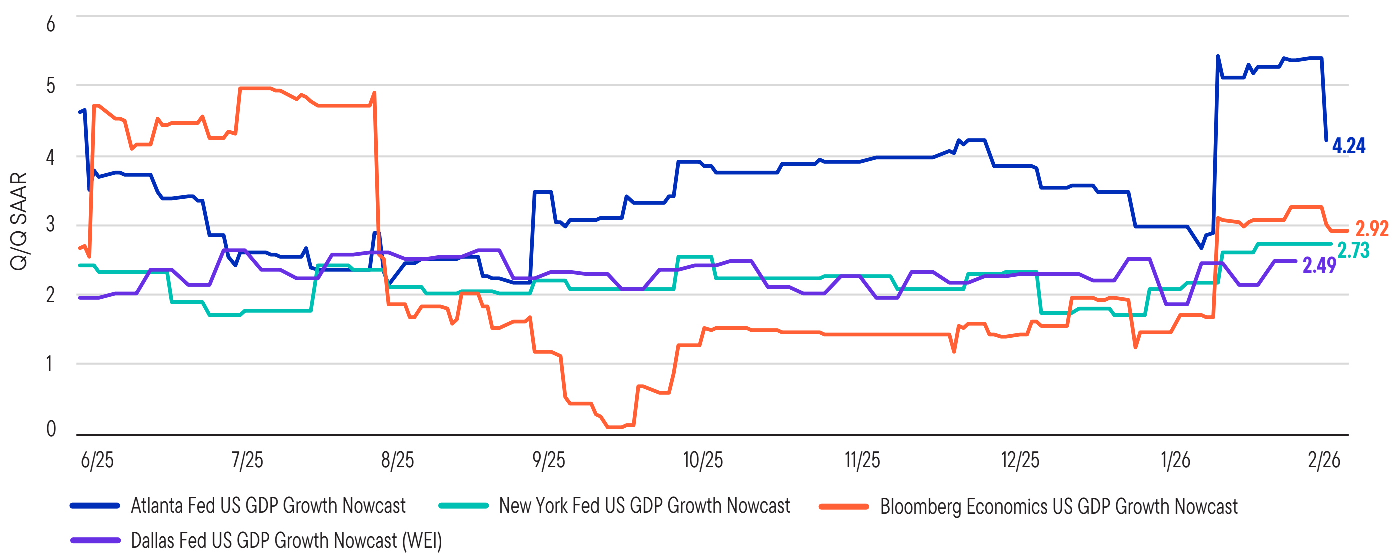
Goldilocks gains

Indicators of global growth have improved this month, notably for the United States and Canada, and now align more closely with Nowcast data from regional Fed banks. The Atlanta Fed GDPNow model estimates that the US economy is growing at an annual rate of 4.20%,[1] with personal consumption the largest contributor to that forecast.

Concerns remain about the drivers of growth in an increasingly "K-shaped" US economy, but, regardless of source, strong consumption has fueled above-trend numbers. This has combined with ongoing disinflation to create a "goldilocks" environment for equities, in our view, justifying rich valuations.

Robust US Growth

Exhibit 1: US GDP Growth Nowcasts from Regional Federal Reserve Banks (Q/Q SAAR)



Sources: Atlanta Fed, Dallas Fed, New York Fed, Macrobond – Seasonally-Adjusted Annual Rate of GDP Growth (SAAR). As of January 29, 2026.

Moderating services and housing inflation underpins disinflation and is offsetting sticky goods inflation. US Consumer Price Index (CPI) inflation stood at 2.7% in December, as food prices rose by 0.7% to reach 3.1% year-on-year. However, core inflation (less energy and food) was lower at 2.6%.[2] Elsewhere, the effect of tariffs on prices appears transitory and may already have peaked.

Rhetoric from the Fed has broadly turned more hawkish now that a recent softening of employment data has stabilized. However, we do not expect rates to rise, but rather to remain steady or fall slightly, dependent on the impact of political crosswinds, offering further support to risk assets.

Growth and inflation dynamics outside the United States are also broadly favorable, notably in EMs where powerful global themes such as AI, de-dollarization[3] and trade dynamics have bolstered growth. A focus on domestic markets and greater monetary policy autonomy has been instrumental in controlling inflation.

1. Source: Atlanta Fed GDPNow model. Federal Reserve Bank of Atlanta. February 2, 2026.
2. Source: US Bureau of Labor Statistics. January 13, 2026.
3. De-dollarization means reducing the use of US dollars as a global reserve currency.

Escalating earnings

Beyond macro considerations, we can point to strong corporate fundamentals to bolster our case for a bullish view on risk assets. Global trailing earnings per share (EPS) and revisions to forward EPS growth estimates for the next 12 months look healthy.

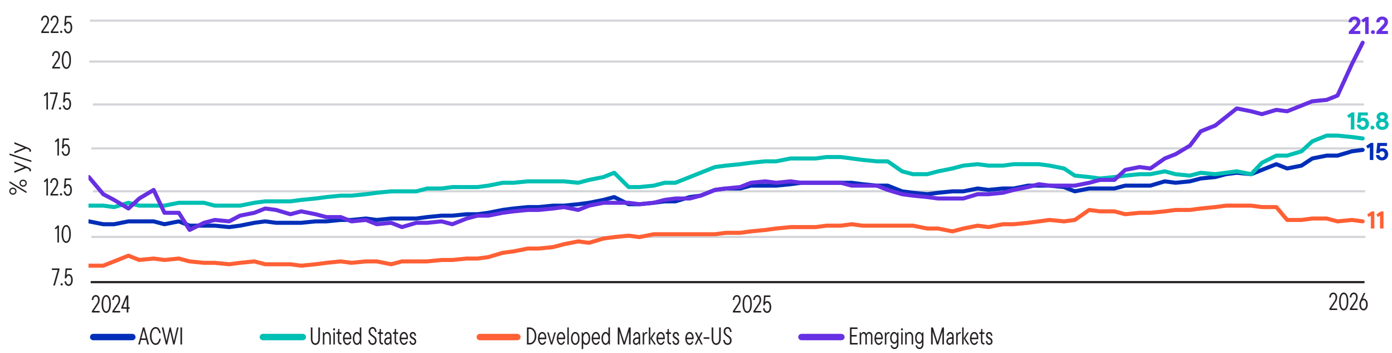
In the United States, market consensus suggests earnings will likely grow 15.5% in the next year, while our fair value EPS model predicts a more modest, but still impressive, 10.5%.[4] These expectations may be difficult to meet, but they are predicated on an economic outlook with few storm clouds on the horizon.

Elsewhere, earnings revisions for EM equities continue to accelerate and outstrip the rest of the world by a significant margin, as corporate governance reforms combine with productivity improvements to supercharge forecasts.

Revisions breadth does appear to be peaking in developed markets, meaning fewer companies are seeing upward revisions to earnings expectations. However, this is a development that requires monitoring for signs of deterioration rather than a situation that should set alarm bells ringing.

Healthy Earnings Growth

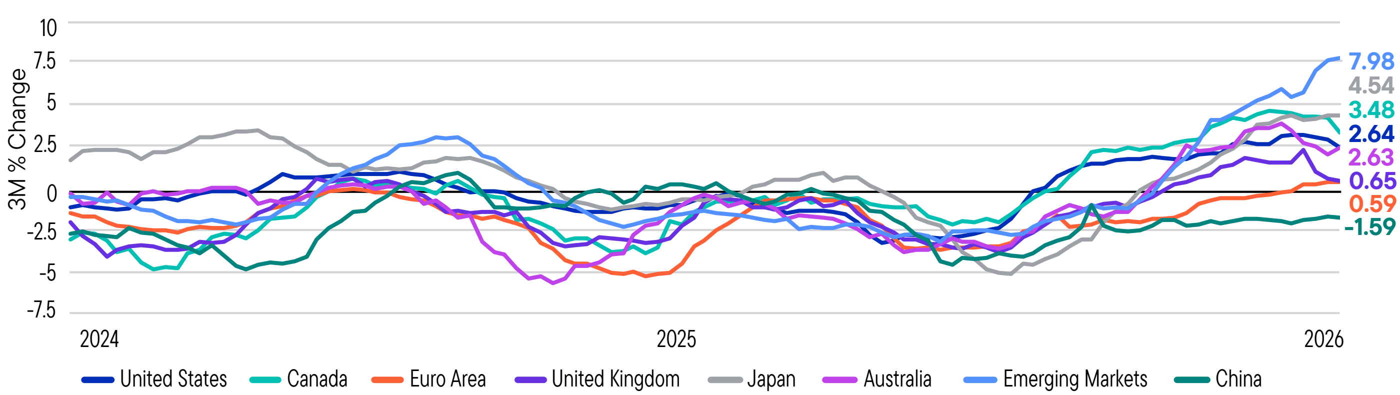
Exhibit 2: IBES Consensus Estimates of Global Corporate Earnings Growth for 2026



Source: Macrobond – Institutional Brokers' Estimate System (I/B/E/S). As of January 19, 2026. There is no assurance that any estimate, forecast or projection will be realized.

EM Earnings Revisions Outstripping Other Regions

Exhibit 3: Three-month % Change in IBES Consensus Earnings Revisions for the Next 12 Months



Source: Macrobond – Institutional Brokers' Estimate System (I/B/E/S). As of January 26, 2026.

4. Source: Institutional Brokers' Estimate System (I/B/E/S). As of January 20, 2026.

A note of caution

While we are confident in our bullish conviction, it is tempered slightly by several indicators and events that imply overconfidence or have the potential to fuel uncertainty.

Investor sentiment and positioning have become more optimistic during the past month and may now be considered stretched. Several indicators are in the top quartile versus history, suggesting a level of exuberance often seen prior to a market drawdown.

Retail investors are less hesitant, while measures of positioning for hedge funds, asset managers and volatility control managers are also showing increased optimism.

Additionally, unorthodox US government policy poses a risk to investor sentiment, as highlighted by the recent reemergence of trade tensions linked to territorial control of Greenland.

The potential for a trade war between Europe and the United States weakened the US dollar and triggered a selloff in equities, serving as a reminder of valuation sensitivities.

Consistently elevated policy uncertainty raises the possibility of incremental reallocation away from US assets, including equities, which would impact allocation decisions.

Taking all these arguments into account, we remain modestly overweight equities within our policy portfolio. This is balanced by an underweight to fixed income as we continue to see upward pressure on longer-term yields from fiscal uncertainty, prompting a selective approach to duration. We also hold small overweight allocations to commodities and alternatives for diversification and hedging purposes.

European headwinds

Some commentators believe European equities are set to continue last year's strong performance into 2026, backed by fiscal stimulus and monetary policy support. However, we see multiple headwinds for European markets that leave us more pessimistic on the region.

Leading indicators of economic activity are positive for the eurozone, as fiscal stimulus measures have boosted defense and infrastructure investment. However, broader purchasing managers' index (PMI) data show weakness, notably in manufacturing. This is likely due to weak external demand for European exports, influenced by competition from China in important sectors such as automotives. It is important to note here that European PMI data are historically highly correlated to equity performance.

Turning to fiscal stimulus; we know that Germany has a greater capacity to increase government spending than other eurozone nations thanks to its historical debt brake. German public investment is driving growth, but it is highly targeted at the defense sector, while tighter bank lending standards and subdued corporate loan demand have curtailed private investment.

These headwinds factor into weakening forward EPS revisions[5] for the eurozone.

5. Source: Institutional Brokers' Estimate System (I/B/E/S). As of January 20, 2026.

Staying selective on duration

We remain broadly pessimistic toward the bonds of governments with uncertain fiscal dynamics, or those with solid economic fundamentals.

Our underweight to US Treasuries is predicated on a combination of strong fundamentals and an unpredictable fiscal policy environment. Tax cuts, in combination with uncertainty around the legality of tariff income, could act to widen fiscal deficits, putting upward pressure on long-term bond yields.

Persistent policy uncertainty also undermines safe-haven demand for US Treasuries and fuels de-dollarization trends. This, in turn, makes the US Treasury more reliant on yield-sensitive buyers, particularly if issuance increases to fund government spending.

Our assessment of eurozone bonds has also moderated, given the macro and policy mix looks less supportive for duration than other regions. We see scope for long-term German Bund yields to rise amid resilient growth and increased fiscal stimulus. This could slow disinflation in the region, leading the European Central Bank (ECB) to curtail monetary policy easing, particularly given labor market resilience.

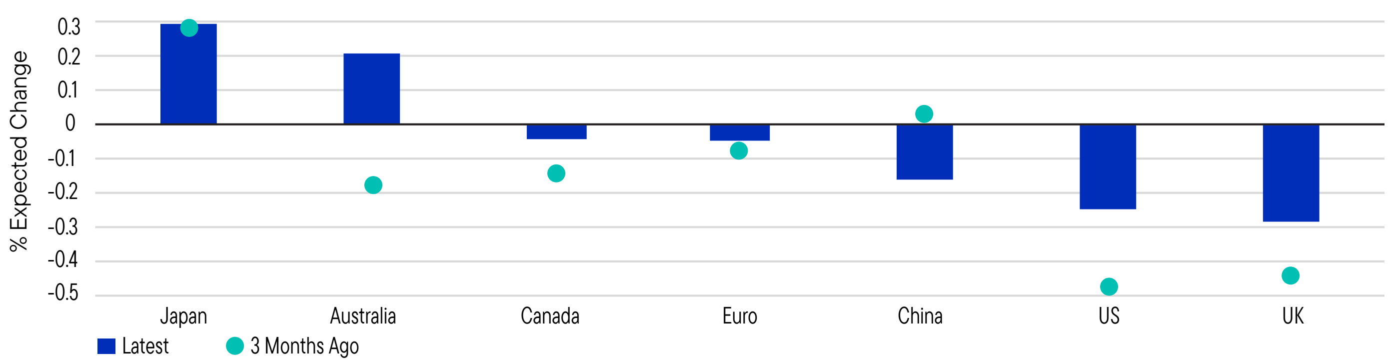
Higher sovereign issuance due to increased government spending is also likely to apply upward pressure to yields, unless international investors increase flows to eurozone bonds as a safe-haven alternative to US Treasuries.

Additionally, long-term Japanese government bond (JGB) yields rose sharply in January following the announcement of snap elections. The prospect of increased fiscal stimulus in combination with tax cuts has forced markets to question the sustainability of Japanese government debt levels, pushing 30-year JGB yields above 3.50%.[6] Volatility is likely to persist until post-election fiscal clarity improves, thus supporting our decision for neutral positioning.

As a result, our selective bond positioning remains focused on the United Kingdom and Canada, where weaker macro backdrops increase the possibility of further interest-rate cuts.

Dialing Down the Doves

Exhibit 4: Market Expectations for Policy Rate Changes Over the Next Six Month Period



Sources: Macrobond, Bloomberg. As of February 2, 2026.

EM debt opportunities

EM local-currency debt has become an attractive proposition for international capital seeking attractive returns, particularly as ongoing corporate governance reforms and enhanced fiscal stability have improved risk-adjusted returns.

Easier global financial conditions, in the wake of Fed easing, should also support EM debt, as should the fiscal strain and policy uncertainty manifesting itself in developed markets.

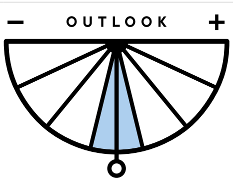
Tight spreads have limited the carry available from EM local-currency debt, but the greenback remains structurally expensive and should continue to depreciate, boosting returns for US dollar-denominated portfolios.

6. Source: Bloomberg, as of February 2, 2026.

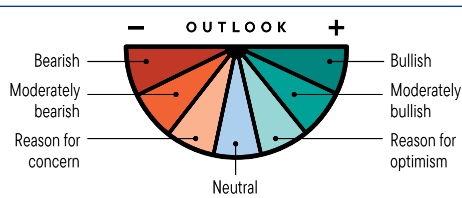
Allocation settings views—February 2026

Pendulum settings reflect cross-asset-class views

High level allocation tier

Asset class	Conviction	Our viewpoint
Equities		• Strong corporate fundamentals, as evidenced by positive forward earnings revisions and guidance, have supported equity market momentum. This outweighs valuation concerns, in our view. • Leading economic indicators have strengthened, fueled by AI capex and high-end consumers. • Stretched sentiment and positioning offer a slight headwind for risk assets.
Bonds		• Resilient growth and a stable unemployment rate may prevent the Fed from cutting interest rates again in the near term. This maintains upward pressure on longer-term yields, in our view, curtailing our preference for US duration. • Inflation remains above central-bank targets in most developed economies. Services inflation has moderated, but goods inflation could remain sticky through the end of this year, despite evidence that pressures have peaked. • Elevated fiscal spending linked to tax extensions and rebates in the US, and higher defense spending in Europe, should maintain upward pressure on yields in those areas.
Alternatives		• Our view on commodities has moderated slightly, despite strong demand for precious metals, as oil demand softens and global inventories rise. • However, a resilient global growth backdrop and increased demand from AI offer long-term support to energy and industrial metals. Supply constraints linked to geopolitical risks are also a factor. • Elsewhere, we see structural attractions in naturally diversifying alternatives such as private assets.
Cash		• We believe elevated short-term yields offer attractive risk-free returns. • However, the requirement to lower our portfolios' interest-rate sensitivity has moderated as yields have risen month-on-month. • Additionally, a neutral cash allocation reflects our more positive view of equities and commodities.

Understanding the pendulum graphic



Arrows represent any change since the last month end.

Allocation tier

Asset class | **Conviction** | **Our viewpoint**

Equity regions: Pendulum settings relative to equity asset class broadly

Growth

United States

- We have seen US economic growth hold up well despite some softening of labor market data, while relatively strong profitability and healthy cash flows have been supporting large-cap AI names.
- A resilient high-end consumer, accommodative fiscal policy and AI capex should keep US growth afloat in the first half of 2026.
- Inflation continues to fall in the United States, as services prices move lower and tariff-driven goods inflation appears overstated. Loose US financial conditions and Fed cuts should support US equities.

Value

United States

- US equities have historically proven defensive during periods of macro uncertainty. In addition, positioning and sentiment indicators suggest that discretionary buyers still under-own US value stocks.
- Trailing earnings-per-share growth for US value stocks is starting to accelerate, indicating healthy earnings breadth.
- Corporate guidance is among the rosiest we have ever seen, with fourth-quarter guidance breadth among the strongest since 2011.

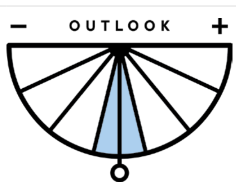
Small-Cap Stocks

United States

- Earnings revisions are starting to moderate relative to large caps, while ambitious forward earnings-growth expectations appear optimistic.
- Trailing earnings-per-share (EPS) have fallen dramatically. At +7%, it is roughly half of its large-cap peers and showing negative momentum.
- Small caps have been on strong run relative to large caps, but we are unconvinced about the sustainability of this outperformance given the lack of quality within small caps.

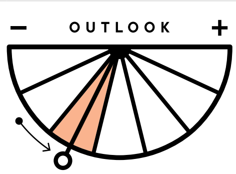
International

Canada



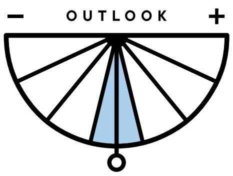
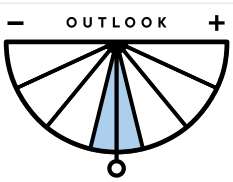
- Canada's over-reliance on commodities is a weakness, in our view, given softening global demand for oil and rising inventories.
- PMI data in both services and manufacturing has weakened as business activity contracted in December.
- The Bank of Canada (BoC) has chosen to prioritize sticky inflation and is likely to keep interest rates on hold rather than stimulate the economy.

Europe ex United Kingdom



- We have trimmed our underweight to eurozone equities slightly as trailing EPS growth has jumped from 3.7% in October to 12.4% at the start of 2026, largely driven by banks and defense stocks.
- However, manufacturing activity continues to weaken, due to structural weaknesses in Germany—including high energy costs, labor shortages and regulatory burdens.
- A subdued macro backdrop and weak domestic demand could begin to weigh on eurozone equities. We are seeing this reflected in forward earnings growth revisions for the next 12 months, which remain negative and are the worst among our eight regions.

Allocation tier

Asset class	Conviction	Our viewpoint
United Kingdom		• The United Kingdom is our most defensive equity region. We are not in a defensive environment for risk assets, particularly among global equities. • The United Kingdom is facing significant macro headwinds, including slowing growth and labor market weakness. Fiscal tightening in the November budget is likely to exacerbate these factors. • Earnings revisions are weak and remain far behind leading regions, including EMs, United States and Canada.
Japan		• The new Japanese government coalition is pushing ahead with fiscal policy stimulus despite elevated inflation. Corporate reform should also provide support to equities. • The Japanese yen has weakened recently, but if policy support succeeds in strengthening the currency, it will negatively impact exporters. • Earnings estimates are rising rapidly, but continued yen weakness is a concern for unhedged US-dollar investors, keeping us neutral.
Australia		• Australia's position as a tariff insulator is now less meaningful following the completion of several major US trade deals. Weak demand in China also likely puts a ceiling on Australia's industrial production momentum in the months ahead • Hotter-than-expected inflation has eliminated hopes for further interest-rate cuts from the Reserve Bank of Australia (RBA). Manufacturing PMIs have continued to fall into contractionary territory, and industrial production growth was negative throughout 2025. • Corporate earnings revisions have begun to decline, while trailing earnings have also been weak. Equity market breadth has fallen amid persistently weak productivity.
Emerging ex China		• Earnings expectations are rising rapidly across EM ex-China, largely due to influential Asian economies. • Surges in both equity market momentum and breadth have accompanied positive earnings revisions, particularly in South Korea and Taiwan. • Thematic areas such as AI and tariffs point toward a positive macro backdrop for EM ex China. Korea and Taiwan have much to gain from continued large-scale AI capex.
China		• Retail investors armed with significant household savings continue to support Chinese equity markets, although strong flows have been fueling volatility. • Recent equity market weakness does not materially diminish the attractiveness of China's leading tech companies amid positive AI developments, in our view. • Macro and corporate fundamentals in China remain weak and fiscal and monetary stimulus measures have had little impact. Domestic demand continues to stagnate due to a deteriorating property sector, a weak labor market and low consumer confidence.

Allocation tier

Asset class | **Conviction** | **Our viewpoint**

Fixed income sectors: Pendulum settings relative to fixed income asset class broadly

US Treasuries

- A supportive economy could hinder Fed easing, in our view.
- Fiscal deficits may increase if tariff receipts are curtailed or judged illegal.
- Additionally, reduced foreign ownership of US Treasuries, as part of a de-dollarization trend, increases dependence on price-sensitive purchasers.

Eurozone Government Bonds

- Disinflation has slowed in the eurozone, while leading indicators of growth remain broadly supportive, making it difficult for the ECB to ease further.
- Labor markets remain tight and financial conditions are easy, further influencing the ECB to remain on an extended hold.
- German fiscal expansion could result in increased sovereign issuance, adding further upward pressure to eurozone yields.

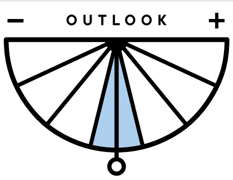
UK Government Bonds

- Slowing wage growth, weak labor market momentum and looming fiscal tightening are likely to increase the attractiveness of UK Gilts.
- The UK government has raised taxes to narrow its fiscal deficit. As back-loaded taxes feed through, it is likely to slow economic growth, lower inflation and compound labor-market weakness.
- With policy still above neutral, the Bank of England (BoE) should have room to ease further as growth slows and disinflation continues.

Canada Government Bonds

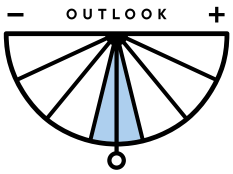
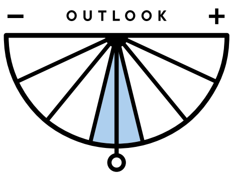
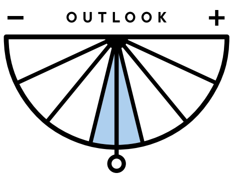
- The Canadian economy remains relatively weak, amid waning energy demand and a dependence on cyclical sectors.
- Labor market data looks robust but is skewed by part-time workers, in our analysis.
- Markets have priced-in rate increases from the BoC, but we think this is optimistic and would expect yields to fall from here.

Japan Government Bonds



- We believe recent interest-rate increases have moved JGB yields closer to equilibrium.
- Upcoming elections have increased the likelihood of additional stimulative fiscal policy, leading long-term yields to rise further.
- More attractive yields improve returns relative to other government bonds, encouraging inflows from repatriated domestic money.

Allocation tier

Asset class	Conviction	Our viewpoint
Australian Government Bonds		• The RBA left interest rates unchanged at its December meeting amid firming inflation, although recent language from RBA officials has skewed increasingly hawkish. • The RBA remains data-dependent and has deemed a tight labor market, sticky inflation and a stable macro environment as reasons to pause further stimulus. • However, weakening economic activity and slowing employment growth may change that calculus.
Investment Grade		• The investment-grade sector has benefited from resilient corporate fundamentals and improved guidance, but a modest deterioration in macro forecasts is a concern. • Credit spreads remain narrow, making the risk/return profile less attractive to us despite loose financial conditions. • Against this background, we hold a neutral position on higher-quality credit, preferring the potential defensive features of government bonds.
High Yield and Loans		• Stretched valuations limit the cushion from carry. • We expect higher issuance in the asset class, which should keep spreads tight, as should a supportive macro backdrop. • We believe the balance of risk and rewards favors neutrality.
Emerging Market (EM) Debt		• EM local-currency debt offers a compelling opportunity as Fed easing and expectations for a weaker US dollar could create powerful tailwinds for assets denominated in EM currencies. • The fiscal weakness in developed market economies strengthens the case for EM exposure, in our view, potentially improving risk-adjusted returns. • We believe growing fiscal and monetary policy stability, in tandem with corporate governance improvements, should help to boost inflows of foreign capital.

Allocation Views

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The hallmark of our approach is a central forum—the Investment Strategy and Research Committee (ISRC)—which generates a top-down view across asset classes and regions. Furthermore, it connects and synthesizes the bottom-up sector and regional insights of the global investment teams at Franklin Templeton. The ISRC also calibrates firmwide views with original analysis from our dedicated teams, which include both fundamental and quantitative research professionals.

FTIS actively engages with clients in an ongoing, collaborative partnership, to understand each client's particular needs and then to draw from our extensive global resources and capabilities to meet those goals. These portfolios are built, managed and monitored in the framework established by the ISRC, and undergo rigorous tests under multiple scenarios and market regimes.

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