July 2026

Franklin Templeton Investment Solutions

Allocation Views

AI froth, sticky inflation and the search for broader opportunity

Summary

We have improved our view on equities into July, despite signs of exuberance in some markets, as strong corporate fundamentals and healthy growth justify valuations.

Investor appetite for the artificial intelligence (AI) trade has concentrated equity index composition and caused some frothiness in technology stocks, but this appears to be contained, in our view. The broader equity market, notably in the United States, is supported by strong earnings and a resilient macro backdrop, while beneficiaries of AI capital expenditure (capex) continue to justify ambitious earnings growth expectations.

Material progress toward reopening the Strait of Hormuz has also significantly improved the outlook for equity markets in regions with a high sensitivity to energy prices.

Persistent inflation and hawkish policy rhetoric could challenge our view, though fiscal stimulus across many regions provides some offset.

Macro Themes

Steady growth

- Robust earnings expectations fuel an optimistic post-conflict outlook, supported by improving earnings breadth.
- The US economy has proven resilient, while labor-market data has stabilized.
- Leading economic indicators look healthy, but we are monitoring the impact of higher input costs.

Persistent inflation

- US inflation dynamics continue to be challenged by elevated core inflation, driven by services ex-housing.
- We expect limited second-order effects from the energy impulse, as conflict in Iran moves closer to a resolution.
- Core goods inflation is also above trend. Tariff pressures may have peaked but global supply chain tightness is currently providing an offset.

Policy bifurcation

- There is an increasing bifurcation between supportive fiscal policy and restrictive monetary policy as markets assess the energy price shock.
- The Middle East conflict has catalyzed a recalibration of policy expectations, with a tightening bias in most regions including the United States.
- Fiscal policy is supporting growth but contributing to expanding deficits. US tax refunds have been offsetting tariff headwinds, while energy support packages could also prove influential.

Portfolio Positioning Themes

Equity optimism

- Corporate fundamentals remain strong amid double-digit earnings growth expectations for the next 12 months.
- Conflict in the Middle East appears to be moving toward a resolution, and we would expect markets to look through any temporary setbacks.
- Positioning is showing signs of euphoria in some areas, but sentiment is neutral overall, remaining broadly supportive of risk assets.

Diversifying equity exposure

- We retain a preference for US large-cap equities, with a focus on the beneficiaries of AI capex. We also have diversified into value stocks amid concentration concerns.
- Reopening the Strait of Hormuz has improved our view of energy-sensitive markets in Japan and the euro area.
- We also favor emerging markets amid falling energy prices, healthy corporate fundamentals and exposure to AI capex beneficiaries.

Rebalancing duration

- We expect demand destruction to have a greater impact on monetary policy decisions than market pricing suggests, decreasing the chance that international central banks meet market hiking expectations.
- Resilient US growth and challenging inflation dynamics complicate Fed policy. We have moved further underweight US duration amid sustained upward pressure on yields.
- Excess returns for equities appear more attractive than credit, amid strong earnings and tight spreads.

We have improved our view of equities into July, despite signs of exuberance in some markets, as strong corporate fundamentals and healthy growth justify valuations.

Investor appetite for the artificial intelligence (AI) trade has concentrated equity index composition and caused some frothiness in technology stocks, but this appears to be contained, in our view. The US equity market is supported by strong earnings and a resilient macro backdrop, while beneficiaries of AI capital expenditure (capex) continue to justify ambitious earnings growth expectations.

Persistent inflation and hawkish policy rhetoric could challenge our view, though fiscal stimulus across many regions is providing some offset.

Goldilocks Has Left the Building, but the Porridge Is Still Hot...

The growth environment remains positive for risk assets, particularly in North America. The US economy is growing at a rate close to 3%, according to several regional federal bank forecasts[1], driven by personal consumption and business fixed investment.

June Purchasing Managers' Index (PMI) readings also point to solid activity across US manufacturing and services, although elevated prices and weak consumer confidence have been limiting growth.[2] Conditions are softer in Europe. The services sector contracted in June as input costs rose, even though eurozone cost inflation eased to its lowest level since the outbreak of war in the Middle East.

Falling energy prices are good news for inflation expectations, but core inflation remains persistently high in many regions. The US Federal Reserve's (Fed) preferred measure of core Personal Consumption Expenditure (PCE) inflation was well above target in May, coming in at 3.41% (year-on-year), accentuated by a recent uptick in services inflation. Similarly, euro-area annual inflation rose to 3.2% in May, up from 1.9% in March,[4] driven by services and energy, while food prices were also higher.

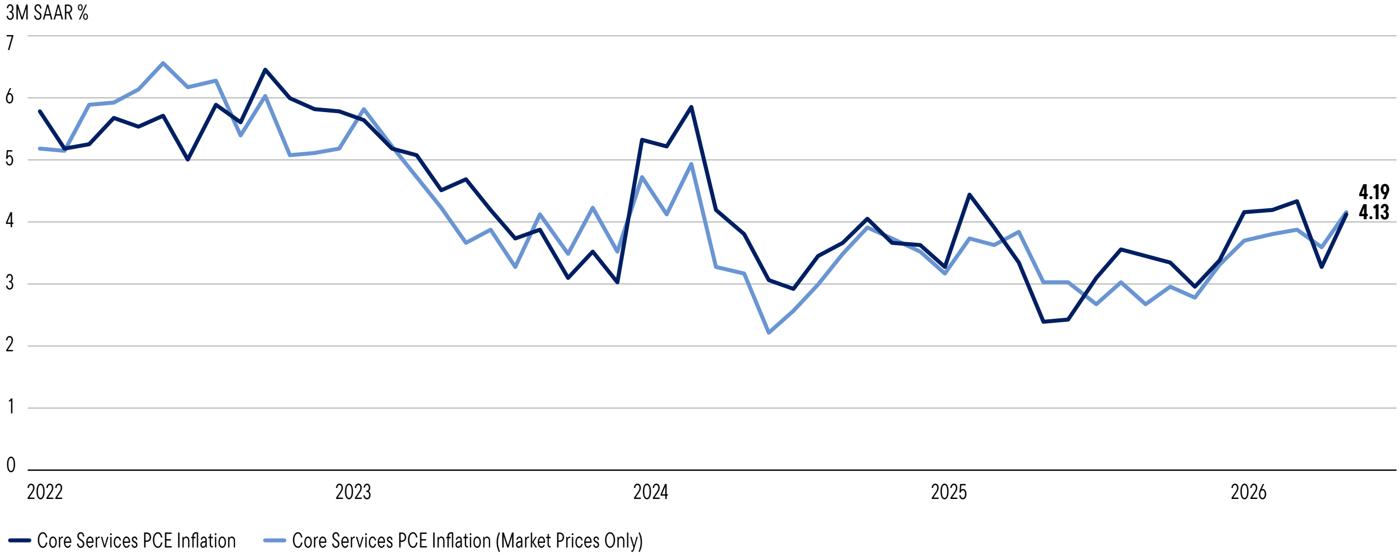
Persistent core inflation is the United States' chief concern because of its relative insulation from energy price volatility. This makes the Fed less likely than other central banks to respond to falling energy prices. Instead, supply-chain pressures, labor-market resilience and wage growth remain important drivers of US monetary policy.

These inflation dynamics have prompted a hawkish tilt to monetary policy in the United States and most other developed economies, even those with weaker macro backdrops such as the eurozone. This is creating a headwind to risk assets but is largely outweighed by strong corporate fundamentals, in our view.

1. Source: Federal Reserve Bank of Atlanta, GDP Now, July 1, 2026.
2. Source: S&P Global – June Flash PMIs.
3. Source: Bureau of Economic Analysis (BEA). As of June 2026.
4. Source: Eurostat. As of June 17, 2026.

US Services Inflation Has Recently Increased

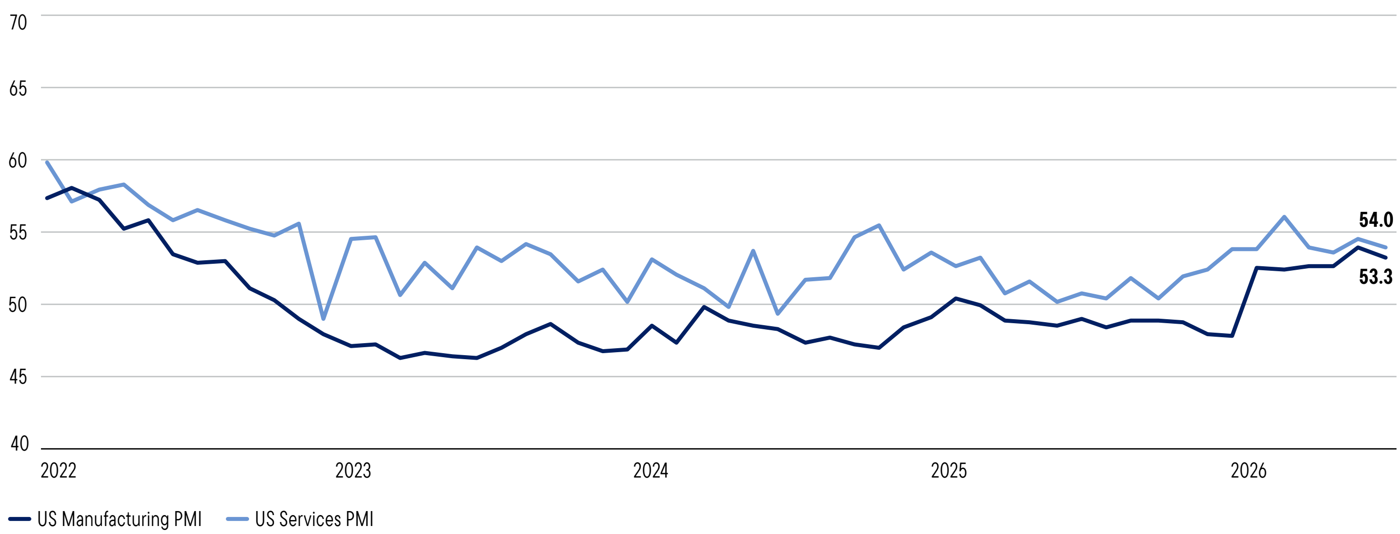
Exhibit 1: Core Services Personal Consumption Expenditures Inflation (3M SAAR %)



Source: Bureau Economic Analysis - Seasonally-adjusted Annual Rate (SAAR). May 2026.

US Growth Remains Resilient

Exhibit 2: US Manufacturing and Services Activity (ISM Business Survey; >50 Indicates Expansion)



Source: Institute of Supply Management. June 1, 2026.

Understanding the Earnings Bubble

Forward earnings expectations remain ambitious, particularly in the United States, where companies continue to justify lofty valuations with impressive earnings guidance.

Earnings for US large-cap stocks grew by 20% over the last year and consensus forecasts suggest they will grow by another 20% during the next 12 months.[5] Given that our optimism toward equities is founded on strong forward earnings growth, it is sensible to ask whether they are always an accurate predictor of total returns. Historical evidence implies earnings are a reasonable indicator of returns, except in the unlikely event of a monetary policy shock.[6]

However, using consensus earnings to time market downturns is more problematic, particularly with the extreme numbers we are observing across regions and styles. This includes 12-month forward earnings growth forecasts of 73.1% for the emerging markets (EMs) ex-China region and 28.6% for US growth stocks.

While we believe the beneficiaries of AI capex can meet earnings growth expectations, we are less confident that the "hyperscaler"[7] businesses spending that capital can achieve will provide a sufficient return on equity (ROI)—at least in the near term.

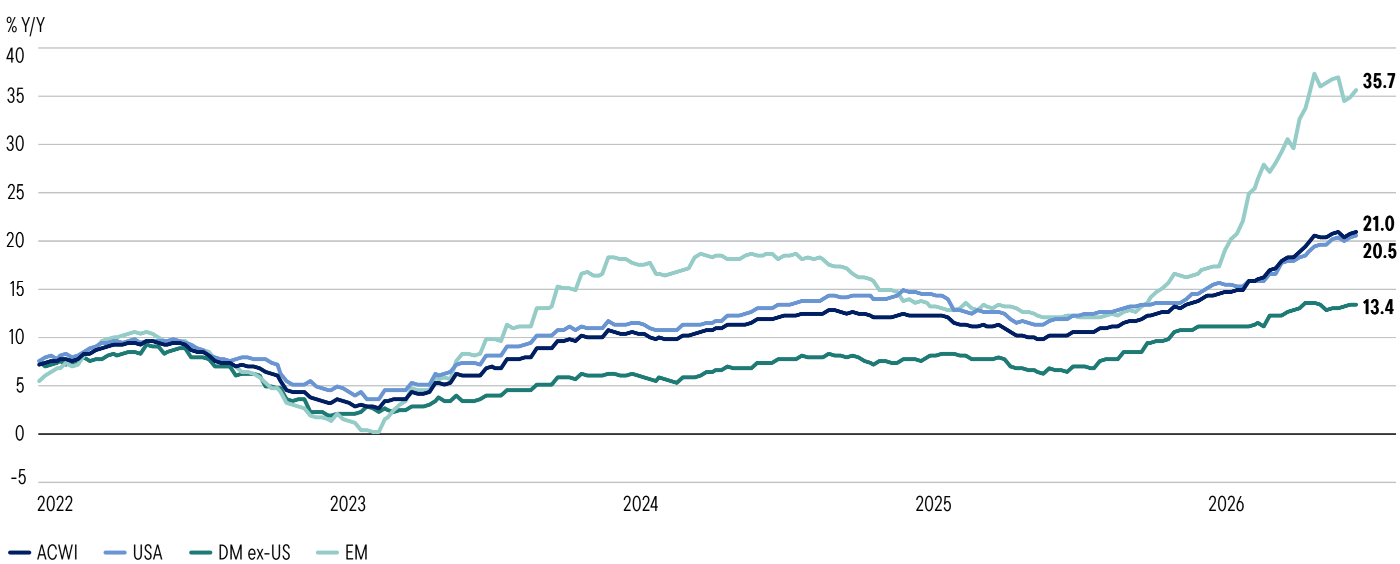
AI adoption continues apace, but there are signs of commoditization and an unwillingness from the customers of "hyperscalers" such as Meta Platforms and Microsoft to pay for expensive marginal AI gains.

Under these circumstances, using consensus forward earnings as a guide to time the turning point of the AI boom could leave portfolios exposed to material downside risk. We also note that the breadth of US earnings revisions has improved, just when earnings growth expectations (driven by a small number of mega-cap AI firms) have stopped accelerating.

We believe this is a compelling argument for diversifying equity risk by raising exposure to US value stocks and adding to markets with less AI concentration risk, such as Japan and the European Union.

Double-Digit Earnings Expectations

Exhibit 3: Next 12-Month Earnings Per Share (EPS) Growth Estimates (% Y/Y)



Source: Institutional Brokers' Estimate System (IBES). June 22, 2026.

5. Source: IBES – International Brokers' Estimate System. As of June 24, 2026. There is no assurance that any estimate, forecast or projection will be realized.
6. Ibid.
7. Hyperscalers are large cloud-computing companies that operate global data-center networks

Market Consequences from the Middle East Conflict

Material progress toward reopening the Strait of Hormuz has significantly improved the outlook for equity markets in regions with a high sensitivity to energy prices.

It is unlikely that traffic volumes will return to pre-war levels anytime soon, but the signing of a memorandum of understanding (MOU) by Iran and the United States has led Brent crude oil prices to fall sharply to US$72 per barrel by June 30, from US$112 per barrel in mid-May.[8]

Against this backdrop, our optimism toward risk assets in energy-sensitive regions has improved, meaning we add to the euro area and Japan and retain our positive view of EMs.

Although EU energy sources are well-diversified, the eurozone is sensitive to energy prices, with more than 60% of its natural gas imports exposed to spot prices. As a result, energy price volatility has impacted the dominant industrials sector via increased input costs, tighter margins and subdued activity. In May, annual energy price inflation reached 10.8%.[9]

Recent developments in the Middle East have improved the energy landscape significantly, with European natural gas prices falling by more than 15% between June 10 and June 30.[10] A healthier outlook, alongside an acceleration of the broadening-out trade away from technology growth stocks, convinces us to trim our underweight to the region's equities, despite relatively weak macro conditions.

We also have improved our view on the Japanese economy, which is extremely sensitive to energy prices and relies heavily on oil and natural gas supplies from the Middle East. Underlying corporate fundamentals were already strong in Japan due to fiscal stimulus and corporate reform, but energy uncertainty sharpened inflation risks, weakened the yen and depressed economic activity.

Forward earnings estimates have already started to improve following the MOU, as lower energy prices reduce input costs and lift margins. Earnings growth expectations for the next 12 months have risen to 13.2% as of June 23, up from 9% on June 2, 2026.[11]

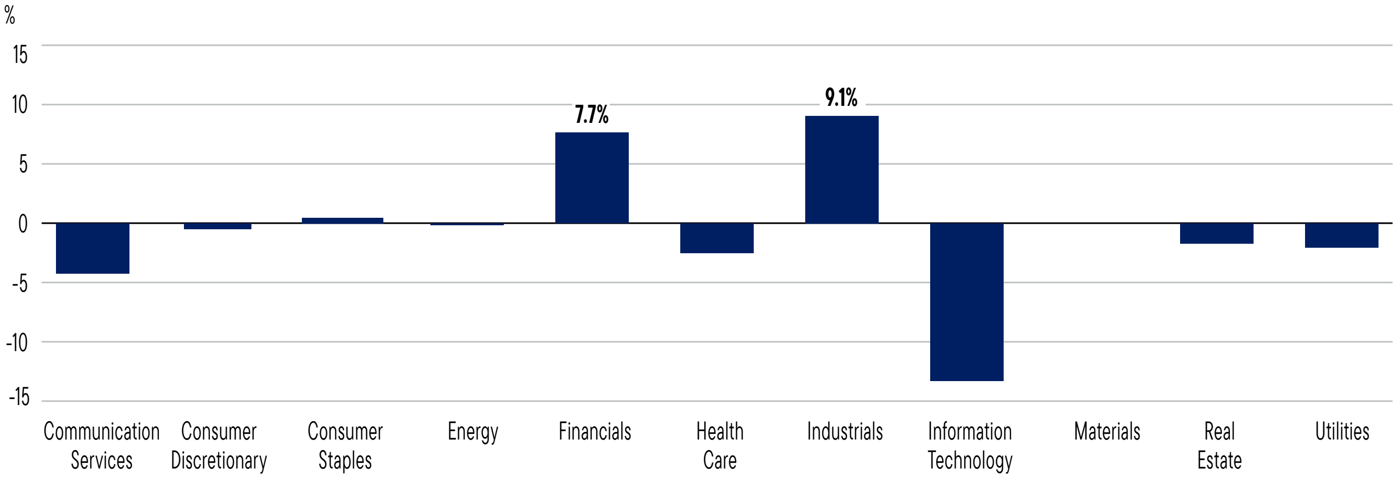
Elsewhere, we have neutralized Canadian equity exposure amid the outsized influence of financials, energy and materials stocks, which make up more than 70% of the TSX 60 Index.[12] Falling precious metals and energy prices influence our decisions, alongside a weak housing market.

We have also increased our underweight to Australian equities amid restrictive monetary policy, deteriorating domestic credit conditions and weak Chinese demand for commodity exports.

8. Source: Bloomberg. As of June 26, 2026.
9. Source: Eurostat – Euro Indicators. As of June 17, 2026.
10. Source: Bloomberg – Netherlands TTF Natural Gas Forward Month 1.
11. Source: IBES – International Brokers' Estimate System. As of June 24, 2026. There is no assurance that any estimate, forecast or projection will be realized.

Industrials and Financials Dominate the Euro Area Economy

Exhibit 4: MSCI EMU Index vs. MSCI ACWI Index Sector Composition



Source: MSCI. June 2026. The MSCI EMU Index (European Economic and Monetary Union) tracks mid- and large-cap equity performance across 10 developed Eurozone countries. The MSCI All Country World Index (ACWI) is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of developed and emerging markets. The MSCI ACWI consists of 45 country indices comprising 24 developed and 21 emerging market country indices. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges.

Finding Value in International Duration

The hawkish tilt to monetary policy adopted by most major central banks continues to influence our approach to duration positioning.

Markets expect the Fed to raise rates at least once in the next 12 months,[13] which is justified, in our view, given relatively robust growth, a resilient labor market and persistent core inflation.

Expectations for more restrictive policy, alongside upward pressure on yields from an expanding fiscal deficit, lead us to believe that US Treasury yields are below fair value. The recent rally in US Treasuries reinforces this view—10-year yields fell from 4.67% in mid-May to 4.37% by the end of June. As a result, we have increased our underweight to US duration.

Conversely, we see greater value in international duration, particularly in regions where inflation concerns have prompted the market to expect multiple interest-rate increases, regardless of weak macro conditions.

Market expectations for a change in policy rates from the European Central Bank (ECB) were recalibrated in June as the ECB raised interest rates by 25 basis points and Middle East tensions receded. However, markets still expect two more rate hikes during the next 12 months, amid ongoing inflation concerns.

Weak leading economic indicators suggest to us that the euro-area economy cannot absorb two more hikes, while falling energy prices should allow the ECB to hold or even cut rates to support growth.

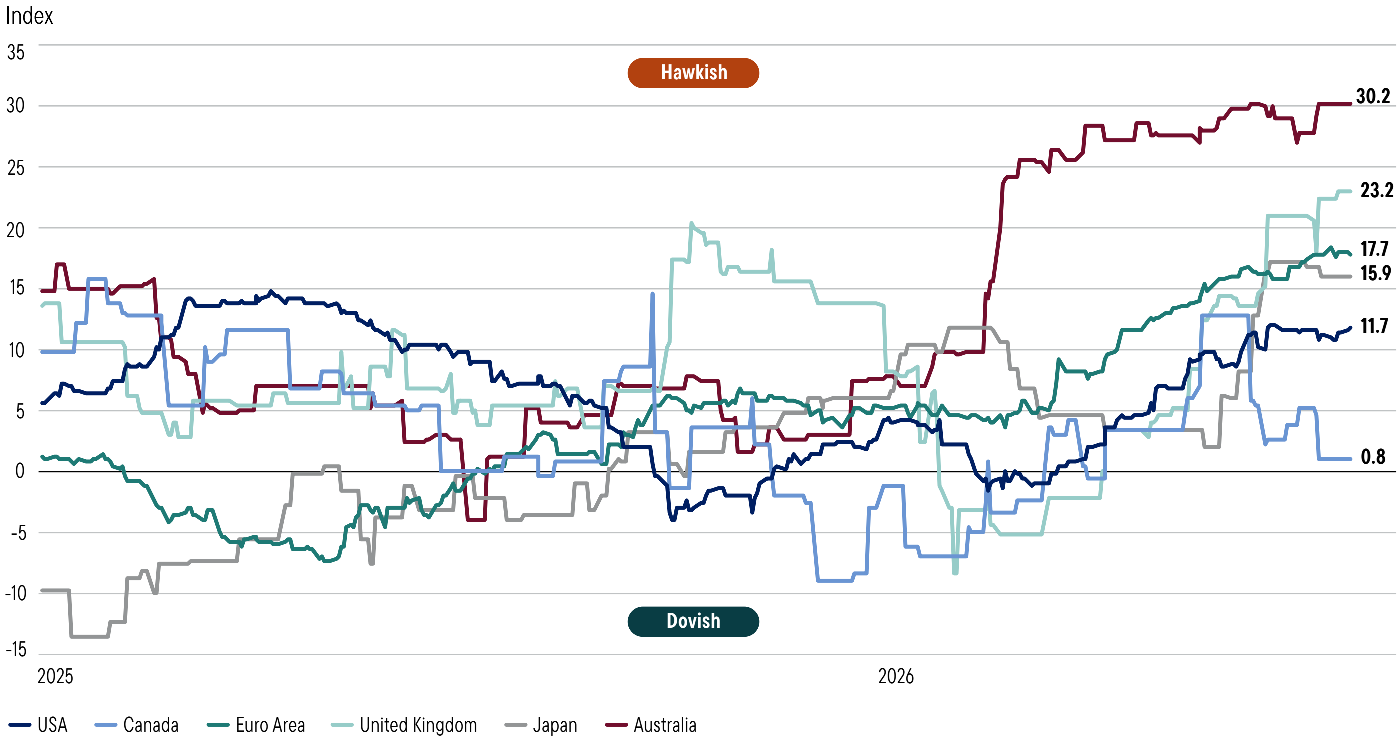
The exception to our duration thesis is Japan, despite market expectations for two rate hikes in the next 12 months. Persistent inflation, yen weakness, fiscal stimulus and monetary policy normalization all add significant upward pressure to government bond yields, indicating the market may be correct.

In addition, the value of Japanese government bonds as a downside hedge diminished when an already strong macro backdrop improved further, following the tentative reopening of the Strait of Hormuz.

12. The TSX 60 Index is a Canadian equity index made up of the 60 largest companies listed on the Toronto Stock Exchange. Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges.
13. Source: Bloomberg WIRP - Fed funds futures. As of June 30, 2026.

A Hawkish Tilt to Global Monetary Policy

Exhibit 5: Hawk/Dove Scores Assessed Using Guidance From Major Central Banks



Source: JP Morgan. July 2026.

Allocation Settings Views—July 2026

Pendulum settings reflect cross-asset-class views

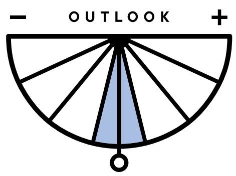
High level allocation tier

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

Equities

- Corporate fundamentals remain strong amid double-digit earnings growth expectations for the next 12 months.
- Continued progress toward the reopening of the Strait of Hormuz has improved our view of energy-sensitive markets.
- Positioning appears euphoric in some areas, curtailing our enthusiasm for growth stocks, but we remain positive on beneficiaries of AI capital expenditure.

Bonds



- The Middle East conflict has catalyzed a recalibration of policy expectations, with hikes now priced in for most regions including the United States.
- We expect demand destruction to play a greater role in inflation dynamics and monetary policy decisions than market pricing suggests.
- Resilient US growth and challenging inflation dynamics complicate Fed policy, in our view, supporting our underweight duration exposure relative to other markets.

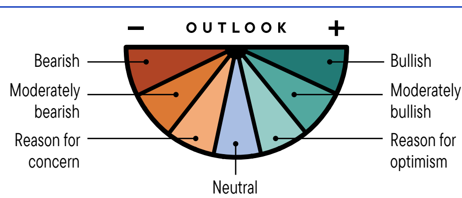
Alternatives

- Risks around energy price volatility are adequately priced into markets as tensions in Iran lessen and the Strait of Hormuz reopens.
- Beyond conflict in the Middle East, increased demand from AI offers long-term support to energy and industrial metals.
- Elsewhere, we see structural attractions in naturally diversifying alternatives such as private assets.

Cash

- Lower geopolitical left-tail risk and strong corporate fundamentals have influenced our increased overweight exposure to equities.
- That overweight to stocks is funded by an increased underweight to cash, in an environment where we are neutral on bonds.
- The requirement to lower portfolio interest-rate sensitivity has also moderated.

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

- Corporate fundamentals (both trailing and forward) are supportive, while momentum remains strong.
- S&P 500 corporate earnings are projected to grow by more than 20% year-on-year. The technology sector is on pace to grow earnings by much more than that.
- We are focused on the beneficiaries of AI capex which we believe have the best chance of meeting ambitious earnings growth expectations.

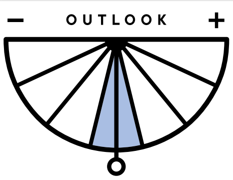
Value

United States

- AI capex spending on infrastructure build-out has spread beyond the technology sector into cooling systems, land, construction and power to satisfy insatiable demand for AI-augmented services.
- US macro growth remains resilient while employment data has stabilized, bolstering investor sentiment and supporting the broader market.
- We favor a diversified basket of large-cap core equities, as a counter to market concentration and rising input prices.

Small-Cap Stocks

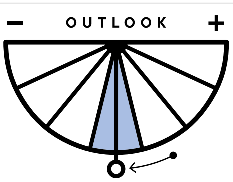
United States



- Ambitious earnings expectations for small-capitalization stocks are likely to be revised down, although the domestic US market is still broadly insulated from Middle East tensions.
- Fiscal stimulus has provided a floor for labor markets and consumption, despite waning consumer sentiment.
- However, higher interest rates disproportionately impact smaller businesses.

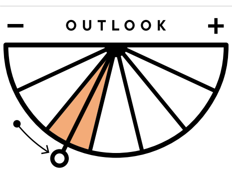
International

Canada



- Canadian earnings growth forecasts appear healthy relative to other international developed markets.
- However, falling gold and oil prices have limited Canada's ability to outperform given its heavy concentration in the materials and energy sectors.
- Manufacturing PMIs have improved, with output and new orders rising, but persistent inflation, weak employment growth and a tightening policy bias partly offset this progress.

Europe ex United Kingdom



- Economic growth indicators remain weak, impacted by rising input costs as well as structural weaknesses in Germany—including high energy costs, labor shortages and regulatory burdens.
- This is offset somewhat by the reopening of the Strait of Hormuz, which should push down energy prices and relieve pressure on the ECB as it pursues a mandate to reduce inflation.
- Against this background, we have improved our view of eurozone stocks but remain underweight amid weak domestic demand.

Allocation tier

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

United Kingdom

- UK consumers are saving more, while disposable income growth has fallen sharply into negative territory amid a weakening labor market.
- The United Kingdom is facing significant macro headwinds, including slowing economic growth and negative employment growth. Higher energy prices have exacerbated these factors by restricting policy support.
- UK earnings revisions have seen a boost from energy names, while revisions breadth has improved, but we prefer other international markets as a diversifier.

Japan

- Optimism toward Japanese equities has strengthened with the reopening of the Strait of Hormuz, given Japan's acute sensitivity to oil imports.
- Earnings estimates have rebounded due to improving confidence in the economy while trailing earnings remain very strong.
- Medium-term structural drivers, including corporate reform and targeted fiscal stimulus, remain in place and offer further support to equity markets.

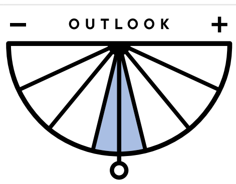
Australia

- Australian equities have underperformed during the last three months due to falling commodity prices and deteriorating macro conditions.
- Domestic demand is weakening, credit growth is showing signs of concern and housing prices are weakening, heading into a new policy regime that is negative for the future growth of the housing market.
- More restrictive monetary policy may be required to rein in above-trend inflation that could be fueled further by resilient wage growth, thus further dampening growth expectations.

Emerging ex China

- We retain optimism towards EM equities, against a background of strong corporate fundamentals and AI capex expenditure.
- Earnings expectations continue to rise rapidly across EMs ex-China, which is being driven by significant hyperscaler capex on hardware components made in Asia.
- The reopening of the Strait of Hormuz will reduce inflation pressures and input costs in energy-sensitive markets.

China



- China's economy remains K-shaped, with weak domestic demand offset by strong exports, reducing the urgency for stimulus.
- For equities, the outlook hinges on the domestic backdrop, with property weakness and persistent deflation continuing to weigh on sentiment.
- While new e-commerce regulations may help stabilize valuations at the margin, the broader backdrop of limited stimulus and uneven growth keeps us neutral.

Allocation tier

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

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

US Treasuries

- Markets are pricing in Fed rate hikes as inflation concerns grow and US growth and labor markets remain resilient.
- Long and intermediate-duration US Treasury yields have fallen during June and are now below fair value, in our view, making US duration less attractive.
- In addition, continued fiscal deficits and uncertainty around the new Fed regime may increase upward pressure on yields, supporting our increased underweight to US duration.

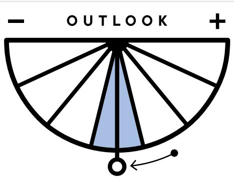
Eurozone Government Bonds

- In Europe, we expect demand destruction to play a greater role in monetary policy decisions than market pricing suggests, reducing the chances of interest-rate rises.
- Market expectations for policy rate rises have fallen recently, but at least one hike is still expected from the European Central Bank during the next 12 months, as of June end. We believe this is optimistic, given the relatively weak macro backdrop in the region.
- Inflation and energy risks have also receded following the reopening of the Strait of Hormuz, which should push yields lower over the medium term.

UK Government Bonds

- Ten-year Gilt yields are higher than fair value, in our view, while a less hawkish Bank of England increases their attractiveness.
- Slowing wage growth and weak labor market momentum are likely to further increase the attractiveness of UK Gilts.
- We expect demand destruction to play a greater role in monetary policy decisions than market pricing suggests, while recent political changes appear to have allayed fears of increased spending and expanding fiscal deficits.

Canada Government Bonds

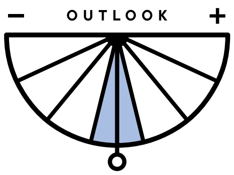
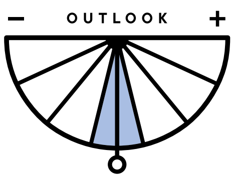
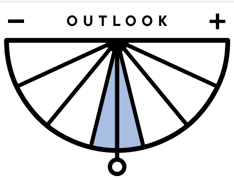


- The Bank of Canada (BoC) has prioritized inflation, regardless of whether it reduces demand and household spending, which could weaken economic activity.
- We think markets are pricing too many interest rate hikes from the BoC, given the economy's insulation from energy inflation and a weak housing market.
- However, sticky wage growth between 3%-4% supports resilient consumer spending and may inflame inflation. In this scenario, we believe the BoC has room to raise interest rates closer to equilibrium.

Japan Government Bonds

- A potential resolution to the Iran war has changed the risk/reward dynamic in Japanese assets, improving the outlook for Japanese equities.
- Despite falling energy prices, inflation expectations continue to rise, moving above Bank of Japan targets due to sticky wage-driven inflation, a weak Japanese yen and corporate pricing passthrough intentions.
- Continued monetary policy normalization and fiscal stimulus could see yields rise further, as would a reduction in demand for bonds linked to quantitative tightening.

Allocation tier

Asset class	Conviction	Our viewpoint
Australian Government Bonds		• Rising inflation concerns have led to a steep rise in yields. However, restrictive policy has added downside risks to growth, making duration attractive at current yields. • Growth is already expected to slow materially, with higher fuel prices, tighter financial conditions and softer household spending weighing on economic activity. • This leaves Australian government bonds looking more attractive on a relative basis, especially versus markets where fiscal and term-premium pressures are a larger headwind to duration.
Investment Grade		• The investment-grade sector has benefited from resilient corporate fundamentals and a supportive growth backdrop. • Tight spreads make the risk/reward profile less attractive. • In addition, increased bond issuance by hyper scalers to fund AI capex has increased the supply of investment-grade credit in the market, driving down prices.
High Yield and Loans		• Elevated Treasury base rates make current yields for high-yield bonds attractive, especially when default rates are contained. • However, upside from further spread compression is limited, offering a minimal cushion against slowing fundamentals. • In addition, excess returns on equities appear more attractive than credit amid strong earnings.
Emerging Market (EM) Debt		• We remain neutral on EM local-currency debt amid a strengthening US dollar and ongoing risks to macro stability in Asia. • EM local-currency debt still offers a compelling long-term opportunity, as fiscal and monetary policy stability, in tandem with corporate governance improvements, should help to boost inflows of foreign capital. • We see more current upside in equities, given strong earnings expectations in emerging markets.

Allocation Views

At **Franklin Templeton Investment Solutions (FTIS)**, we translate a wide variety of investor goals into portfolios powered by Franklin Templeton's best thinking around the globe. We serve a variety of institutional clients, ranging from sovereign wealth funds to public and private pension plans in addition to retail multi-asset clients around the world.

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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WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal.

Equity securities are subject to price fluctuation and possible loss of principal. **Large-capitalization companies** may fall out of favor with investors based on market and economic conditions. **Small- and mid-cap stocks** involve greater risks and volatility than large-cap stocks.

Fixed income securities involve interest rate, credit, inflation and reinvestment risks, and possible loss of principal. As interest rates rise, the value of fixed income securities falls. **Low-rated, high-yield bonds** are subject to greater price volatility, illiquidity and possibility of default.

The allocation of assets among different strategies, asset classes and investments may not prove beneficial or produce the desired results. To the extent a strategy invests in companies in **a specific country or region**, it may experience greater volatility than a strategy that is more broadly diversified geographically.

Commodity-related investments are subject to additional risks such as commodity index volatility, investor speculation, interest rates, weather, tax and regulatory developments.

International investments are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. These risks are magnified in **emerging markets.** The government's participation in the economy is still high and, therefore, **investments in China** will be subject to larger regulatory risk levels compared to many other countries.

Investing in privately held companies presents certain challenges and involves incremental risks as opposed to investments in public companies, such as dealing with the lack of available information about these companies as well as their general lack of liquidity.

Active management does not ensure gains or protect against market declines. **Diversification** does not guarantee a profit or protect against a loss.

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