FRANKLIN TEMPLETON

Allocation Views

Earnings strength supports equity optimism

Franklin Templeton Investment Solutions | August 2026

Summary

We remain optimistic toward equities into August, as we look through renewed geopolitical tensions and inflation concerns to focus on strong corporate earnings.

In addition, recent equity market volatility has reset valuations for technology names and moderated sentiment and positioning indicators that were trending toward exuberance.

The overarching macro picture remains broadly neutral, despite the dampening effect further interest-rate rises could have. This isn't enough to fuel our optimistic view of equities alone, but, crucially, it does nothing to counter the persuasive "risk-on" argument offered by very strong corporate fundamentals.

We retain an artificial intelligence (AI) tilt within our portfolios with overweight exposure to US, Japan and emerging market (EM) equities. We are generally less optimistic toward markets with lower exposure to AI and technology, particularly those with sensitivity to energy and commodity prices.

We continue to see international duration as relatively attractive. Weaker macroeconomic outlooks outside the United States raise the likelihood that market expectations for interest-rate rises are too optimistic in those regions.

Macro Themes

Strong Growth

- Macro growth remains strong, supported by strong corporate earnings power.
- The US economy has proven especially resilient, while labor-market data has stabilized.
- Leading economic indicators look healthy, but we are monitoring the impact of higher input costs.

Complex Inflation

- Elevated core inflation continues to challenge US inflation dynamics, although recent data has been more positive.
- We expect limited second-order effects from the energy impulse, as supply-driven inflation will reduce real incomes and suppress consumer spending.
- Core goods inflation is also currently above trend. Tariff pressures may have waned, but we are monitoring global supply-chain tightness.

Tighter Monetary Policy

- Heightened tensions in the Middle East have catalyzed a recalibration of policy expectations, with a tightening bias in all major regions, including the United States.
- Fed Chair Warsh's new approach is creating additional uncertainty. We ultimately believe the Fed will need to tighten monetary policy.
- Fiscal policy is supporting growth but contributing to expanding deficits. Defense spending and energy support packages could also prove influential.

Portfolio Positioning Themes

Cross Asset: Risk-On

- Corporate fundamentals remain strong amid double-digit earnings growth expectations for the next 12 months.
- Macro growth remains constructive but is offset by a tougher inflation and policy backdrop.
- Sentiment and positioning have become less stretched, supporting equities, but remain volatile in narrow segments such as AI.

Equity Diversification

- Our equity exposure is tilted toward AI, reflected as overweight exposure to the US, EMs and Japan. Positioning has eased and creates a more constructive setup moving forward.
- Euro-area growth indicators have improved, but energy sensitivity limits our optimism for European equities.
- Australian equities remain our least-preferred region due to a mixture of weak domestic growth, unsupportive fiscal policies and tight monetary policy.

Neutral 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 elevated inflation complicate Fed policy. We improve our view of US Treasuries amid rising yields but maintain a relative preference for international duration.
- Excess returns for equities appear more attractive than credit, amid strong earnings and tight spreads.

Earnings Strength Supports Equity Optimism

We remain optimistic toward equities into August, as we look through renewed geopolitical tensions and inflation concerns to focus on strong corporate earnings.

In addition, recent equity market volatility has reset valuations for technology names and moderated sentiment and positioning indicators that were trending toward exuberance.

A Balanced Macro Outlook

The global macroeconomic environment appears relatively robust, led by the United States and Japan, while the outlook for the euro area has also improved, despite energy-related inflation concerns.

The Atlanta Fed Nowcast estimated annual US growth at 5.0% at July-end,[1] driven largely by consumer spending, suggesting a resilient economy that is not overly dependent on AI investment. This is backed by a stable labor market—US unemployment remained at 4.2% in June and nonfarm payroll employment rose by 57,000.[2]

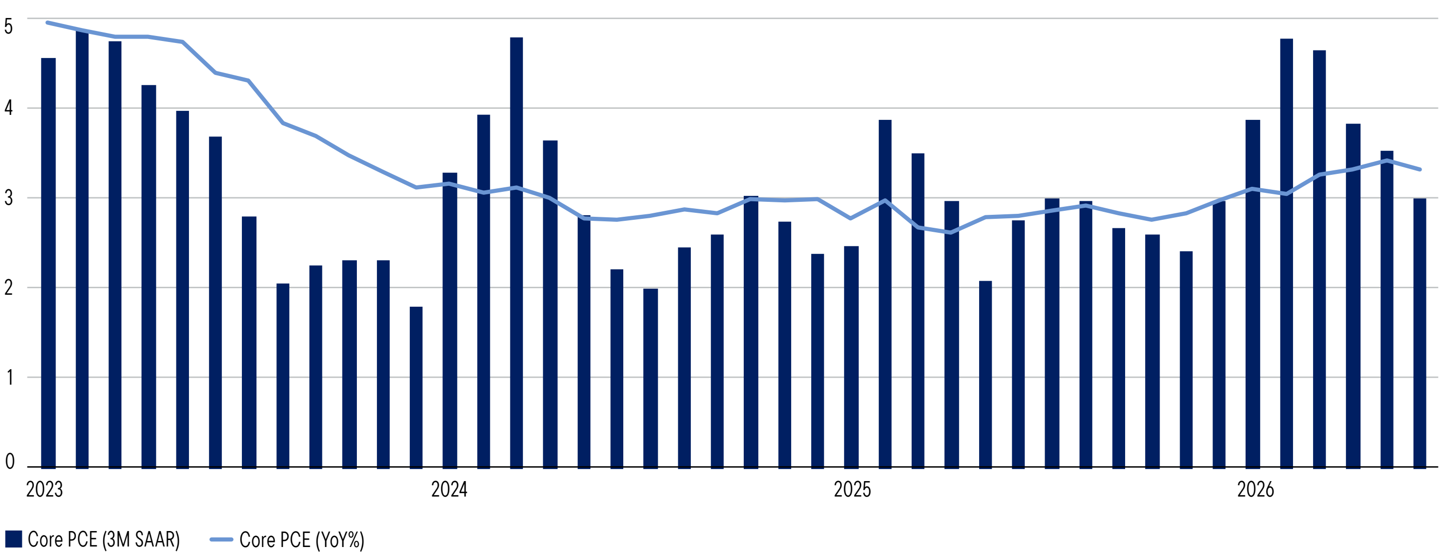
Inflation somewhat clouds this positive outlook, despite June's soft print, which saw headline Consumer Price Index (CPI) inflation fall to 3.5% (year-on-year) from 4.2% in May. The decline was primarily due to lower energy prices, which remain volatile and could likely rise again following a reescalation of Middle East tensions.

Annual core CPI inflation (less food and energy) remained elevated at 2.6% in June, while the Fed's preferred measure of core Personal Consumption Expenditures (PCE) inflation was higher still at 3.3% in June, well above the target of 2%.

In conclusion, the overarching macro picture looks broadly neutral to us, despite the dampening effect further interest-rate rises could have. This isn't enough to fuel our optimistic view of equities alone, but, crucially, it does nothing to counter the persuasive "risk-on" argument of very strong corporate fundamentals.

Persistent Core Inflation

Exhibit 1: US Core PCE Inflation (Year-on-Year) and Three-Month Seasonally-Adjusted Annual Rate (SAAR)



Source: Bureau of Economic Analysis (BEA). As of June 2026.

1. Source: Federal Reserve Bank of Atlanta – GDPNow. July 30, 2026. Annualized third-quarter growth rate of US real GDP.
2. Source: Bureau of Economic Analysis (BEA) – Employment Situation. July 2, 2026.

Double-Digit Earnings and an AI Tilt

As the second-quarter earnings season gets underway, we are seeing very few signs of weakness.

Market expectations for earnings growth over the next 12 months remain in double-digits, at more than 20% for global and US equities and 35% for EMs.[3] Revisions to earnings expectations have stopped accelerating, but remain positive, while earnings breadth has improved materially, notably in the United States. This suggests the heavy reliance on technology stocks to drive earnings higher has diminished slightly.

Our view on US equities shifted somewhat during July to a more style and size-neutral position. Despite this, we retain an AI tilt within our portfolios with overweight exposure to US, Japan and EM markets, where we see the most potential for growth.

The AI hardware and memory trade saw some volatility in July as investors took profits, but the underlying fundamentals of AI adoption haven't changed; meaning, these less-crowded positions make sense to us at lower valuations. This is particularly true in EMs, where stellar earnings are helping to contain price/earnings ratios.

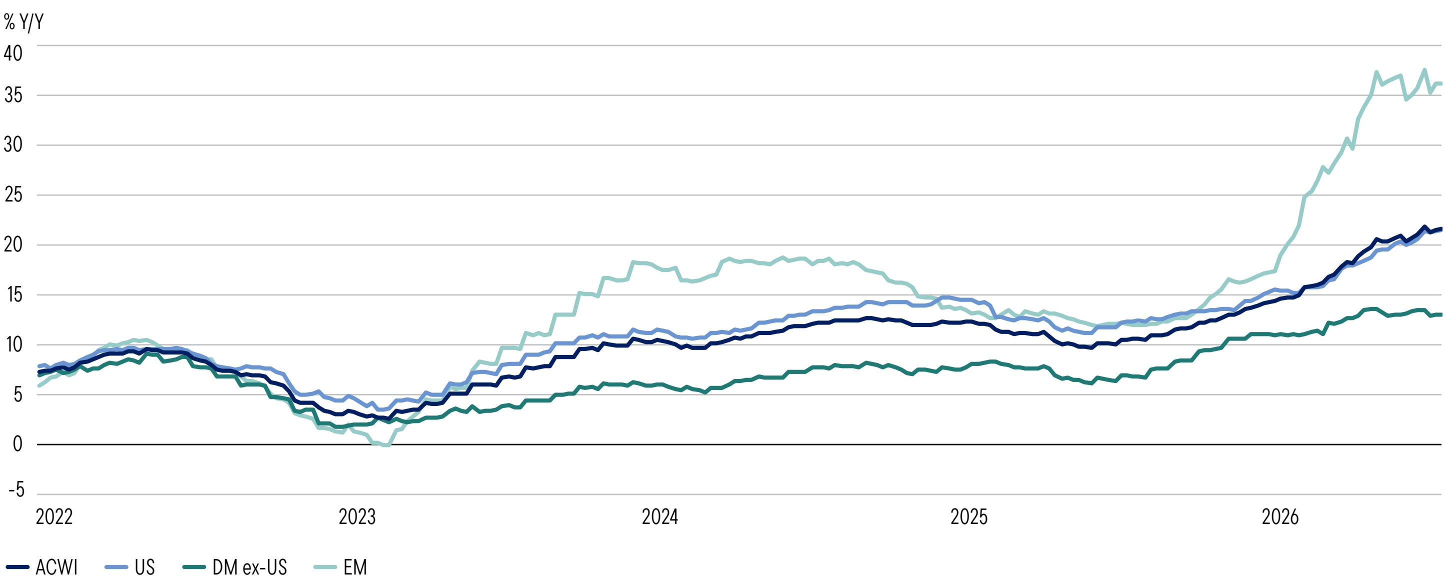
The wider question concerns the future pathway of AI adoption; namely, which businesses are likely to be the winners and losers from here. Asset allocators can only express these views imperfectly via style, size and geographical tilts, but this question still applies.

A trend for AI commoditization is a risk to our positive view of AI hardware, if it means that AI adopters in the broader economy no longer want or need to buy the latest AI models. This could result in lower capital expenditure (capex), which would be good for "hyperscaler" businesses but bad for semiconductor and hardware suppliers.

In addition, signs that AI adoption is beginning to drive material productivity gains would be a boost for the broader economy beyond growth stocks, leading to greater demand for AI infrastructure and ever broader adoption.

Strong Earnings Growth Expectations

Exhibit 2: Earnings-Per-Share (EPS) Growth Estimates for the Next 12 Months

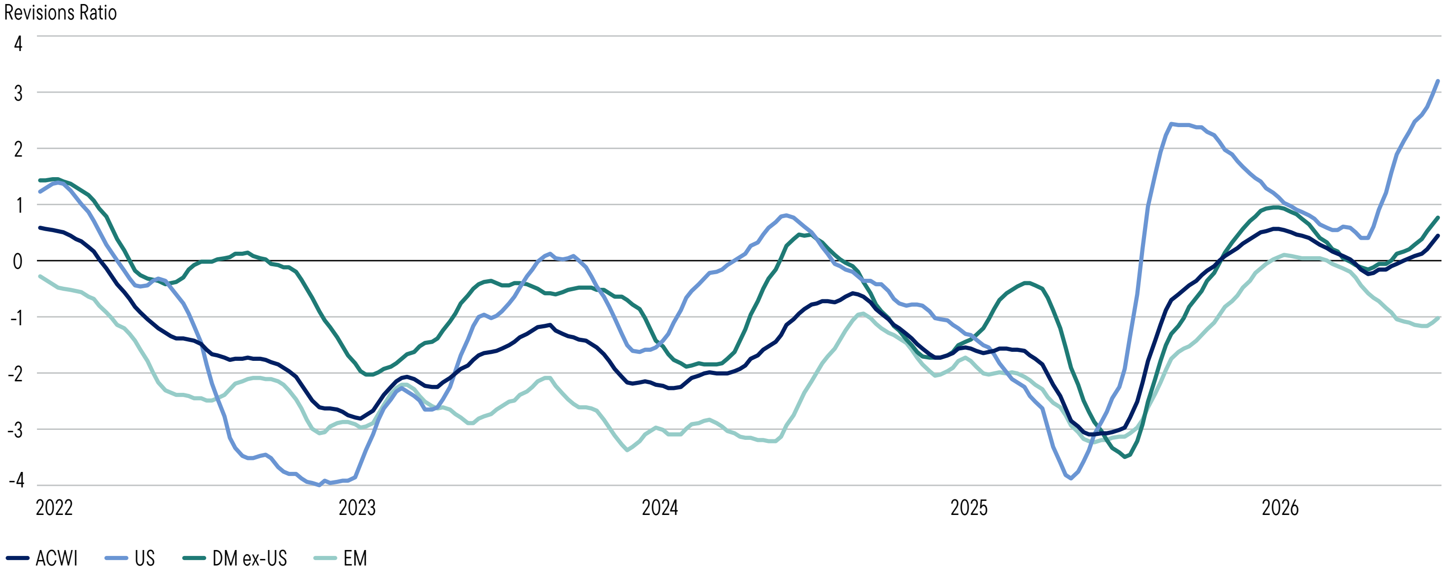


Source: Institutional Brokers' Estimate System (IBES). As of July 13, 2026.

3. Source: International Brokers' Estimate System (IBES) estimates. There is no assurance that any estimate, forecast or projection will be realized.

Improving Earnings Breadth

Exhibit 3: Revisions to Three-Month Earnings Breadth Expectations Across the Next 12 Months



Source: Institutional Brokers' Estimate System (IBES). As of July 13, 2026.
Revisions ratio - amount of upgrades minus downgrades as a percentage of overall index members.

Ripples from Iran

We are generally less optimistic toward markets with lower exposure to AI and technology, particularly those with a sensitivity to energy and commodity prices. Energy price volatility looms large in the minds of governments and central banks in regions with heavy dependence on commodity markets.

As a result, we remain underweight euro-area equities despite an improvement in some leading growth indicators, as energy concerns constrain growth and force a more hawkish approach from the European Central Bank (ECB). Purchasing Managers' Index (PMI) data for July[4] showed the private sector returning to growth amid waning cost pressures. However, higher oil prices and supply constraints could quickly derail this progress, in our view.

Elsewhere, the Australian economy has also been weakened by the Iranian conflict. The Reserve Bank of Australia (RBA) has hiked interest rates twice since the start of March, to offset inflation pressures embedded in wage growth.

Restrictive policy has fueled a deterioration in macro conditions, weakened domestic demand and depressed the housing market. A resultant weakening of the influential financials sector has combined with fragile Chinese demand for Australian commodities to degrade the economy further.

The financials and materials sectors make up 67% of the Australian index,[5] leading us to take a bearish view of Australian equities.

4. Source: S&P Global – Flash Eurozone PMI. July 24, 2026.
5. Source: MSCI Australia Index. Indexes are unmanaged and one cannot directly invest in them. **Past performance is not an indicator or a guarantee of future results.**

Selective Duration Positioning

US Treasury yields have risen sharply since the start of July amid renewed inflation pressures and heightened geopolitical conflict. As of July 31, 10-year yields had reached 4.74%[6] and moved higher than fair value, in our view.

As a result, US Treasuries have become more attractive, compelling us to trim our underweight allocation. However, we continue to see international duration as relatively more attractive, mainly because weaker macroeconomic outlooks outside the United States raise the likelihood that market expectations for interest-rate rises are too optimistic.

Robust US growth and jobs data weaken the case for interest-rate cuts from the Fed, while fiscal deficits and geopolitics could add further upward pressure to yields.

In contrast, we see more value in UK Gilts, where the domestic backdrop is increasingly supportive for duration, amid fragile economic growth, weak labor-market momentum and slowing wage growth. Inflation remains a risk in the United Kingdom, but we believe the Bank of England's base rate is already above neutral and may remain on hold.

This suggests material value, when set against market expectations for more than two interest-rate rises during the next 12 months,[7] particularly given the new Prime Minister, Andy Burnham, seems to understand the need for fiscal credibility.

A deteriorating growth outlook is also the basis for our improved view of Canadian government bonds, where the Bank of Canada has recently softened hawkish language in policy announcements amid weak leading economic indicators.

Elsewhere, we remain overweight euro-area government bonds, given slow growth and a weakening labor market, but trim our exposure as a hedge to energy sensitivity. Markets are pricing in more than two interest-rate rises during the next 12 months, and there is a possibility the ECB will view hikes as necessary to combat rising energy prices.

Despite this risk, we believe second-order effects from the energy impulse will be limited, as real income reductions suppress consumer spending.

Relative Value in Select International Bonds

Exhibit 4: 10-Year Bond Yield Equilibrium Assumptions vs. Current Yields

Equilibrium Assumptions	US	Canada	Euro Area	UK	Japan	Australia
Real 3M (r*)	1.25	0.75	0.25	0.85	0.25	1.25
Inflation	2.25	2.00	1.90	2.25	1.50	2.50
Nominal 3M Rate	3.50	2.75	2.15	3.10	1.75	3.75
Current 3M Rate	3.76	2.28	2.28	3.89	1.01	4.55
Difference	0.26	(0.47)	0.13	0.79	(0.74)	0.80
Term Premium	1.00	0.85	0.70	1.25	1.00	0.85
Cyclical Adjustment*	0.04	-0.07	0.02	0.12	-0.11	0.12
Cyclically Adjusted "Equilibrium" 10Y Rate	**4.54**	**3.53**	**2.87**	**4.47**	**2.64**	**4.72**
Current 10Y Rate	4.71	3.65	3.20	5.09	2.77	4.99
Difference (higher = more value)	**0.17**	**0.12**	**0.33**	**0.63**	**0.13**	**0.27**

** Cyclical adjustment reflects that current policy rates are not necessarily in equilibrium. We assume a two-year stepwise convergence to equilibrium.*

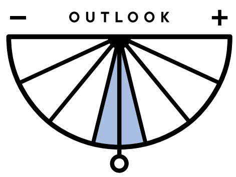
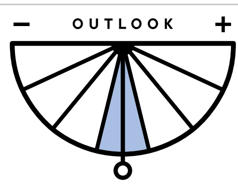
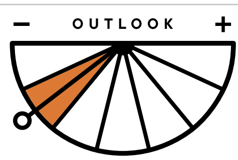
Source: Franklin Templeton Investment Solutions. As of July 29, 2026.

6. Source: Bloomberg.
7. Source: WIRP Bloomberg – base rate futures.

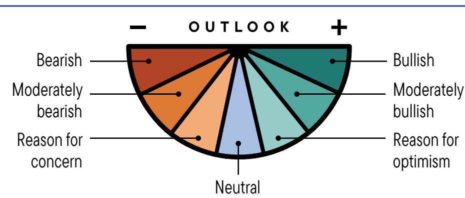
Allocation Settings Views—August 2026

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. • Strong earnings expectations and a supportive macro backdrop generally support valuations, as does less-exuberant sentiment and positioning. • Renewed tensions in the Middle East restrain our optimism amid rising inflation expectations, but growth remains constructive.
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 have increased as tensions in Iran resurface and traffic through the Strait of Hormuz remains limited. • 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		• Strong corporate fundamentals and improved technical indicators influence our 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.
- Earnings breadth has broadened amid a changing view of AI adoption and anxiety around ongoing capital expenditure. The continued strength on the AI hardware trade is in question amid a commoditization of AI platforms.

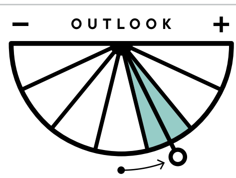
Value

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.
- However, we equalize style tilts in our US equity portfolio, favoring a diversified basket of large-cap core equities, as a counter to market concentration and rising input prices.

Small-Cap Stocks

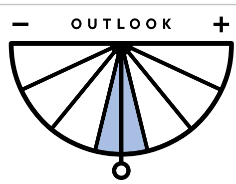
United States



- Ambitious earnings expectations for small-cap stocks are likely to be revised down, but the domestic US market is still broadly insulated from Middle East tensions.
- Fiscal stimulus has provided a floor for labor markets and consumption, helping to bolster US consumer spending.
- Higher interest rates disproportionately impact smaller businesses, but this should likely be offset by robust US growth. Consumer spending suggests growth is not solely dependent on AI investment.

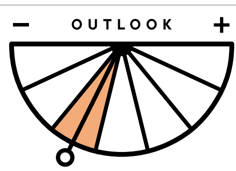
International

Canada



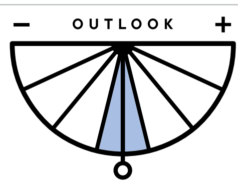
- Canadian earnings growth forecasts have begun to deteriorate, reflecting by a weaker macroeconomic outlook.
- Services PMIs weakened in June, amid high prices and ongoing geopolitical tensions.
- Any rise in gold and oil prices resulting from Middle East tensions may provide a boost to Canadian indexes, given their heavy concentration in the materials and energy sectors.

Europe ex United Kingdom



- Some economic growth indicators have improved but remain influenced by rising input costs as well as structural weaknesses in Germany—including high energy costs, labor shortages and regulatory burdens.
- Meaningful exposure to higher energy prices, lack of AI exposure, and tighter monetary policy on an absolute and relative basis has led to equity market underperformance.
- Against this background, we remain underweight, given overall levels of growth are weak.

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		• Medium-term structural drivers, including corporate reform and targeted fiscal stimulus, remain in place and offer further support to equity markets. • Optimism toward Japanese equities has dimmed slightly with renewed tensions in the Middle East, but growth regimes look relatively strong. Any progress toward fully reopening the Strait of Hormuz should disproportionately boost Japanese stocks, given the country's acute sensitivity to oil imports. • Earnings estimates have rebounded due to improving confidence in the economy while trailing earnings remain very strong.
Australia		• Australian equities have underperformed during the last three months due to 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. • Australian equity valuations have steadily risen, while earnings revisions and revisions breadth have deteriorated rapidly.
Emerging ex China		• We retain optimism toward EM equities against a background of strong corporate fundamentals and AI capital expenditure (capex). • AI commoditization could threaten AI hardware demand, but earnings expectations have continued to rise rapidly across EMs ex-China, fueled by steady margin expansion. • Forward price/earnings ratios have risen substantially but strong earnings are acting as a constraint.
China		• China's economy remains K-shaped, with weak domestic demand offset by strong exports, reducing the urgency for stimulus. • Forward and trailing earnings expectations look weak compared to broader EMs, reflecting the lack of economic growth drivers. • 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.
- However, US Treasury yields have now risen close to fair value, in our view, while a more prudent Fed may limit any near-term rise in term premia.
- The latest US consumer price index inflation print was soft, but core inflation is still above target. As a result, we have added to US duration but remain underweight.

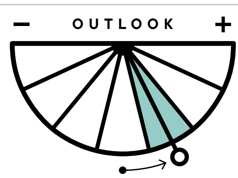
Eurozone Government Bonds

- The ECB held rates steady in July, but market expectations for policy rate rises have increased against the backdrop of Middle East tensions.
- Inflation concerns could push yields higher, curtailing our optimism for European duration. However, slow growth leaves us broadly positive.
- We still expect demand destruction to play a greater role in monetary policy decisions than market pricing suggests, but we have trimmed our overweight positioning for now.

UK Government Bonds

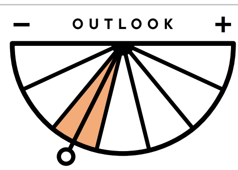
- The domestic UK backdrop is increasingly supportive for duration amid fragile economic growth, weak labor market momentum and slowing wage growth.
- Inflation remains a risk, but the evidence we see does not point to a Bank of England hiking cycle.
- In addition, the new Prime Minister Andy Burnham has strong incentives to maintain fiscal credibility, which should reduce political risk.

Canada Government Bonds



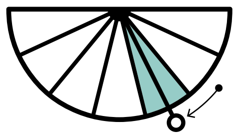
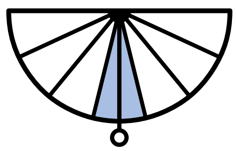
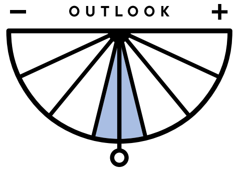
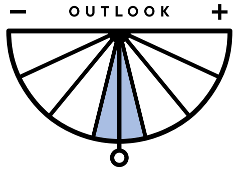
- The Bank of Canada (BoC) has prioritized inflation, regardless of whether it reduces demand and household spending, which could weaken economic activity.
- We think markets are pricing too many interest rate hikes from the BoC, given the economy's insulation from energy inflation and a weak macroeconomic outlook.
- The BoC has recently softened hawkish language in its policy announcements amid weakening economic indicators and labor market slack.

Japan Government Bonds



- Energy subsidies have restrained headline inflation, but underlying price pressures and inflation surprises mean the Bank of Japan (BoJ) may have to increase the pace of monetary policy normalization.
- However, inflation breakeven levels remain broadly neutral, suggesting markets are not pricing an uncontrolled inflation regime.
- We remain underweight Japanese government bonds, but size our position prudently, given attractive yields, BoJ purchases and domestic demand.

Allocation tier

Asset class	Conviction	Our viewpoint
Australian Government Bonds		• We think Australian government bonds still show some value, but less than before the recent rally in rates. • Monetary policy is now slightly restrictive and better placed to weigh downside growth risks as the tightening impulse feeds through. • Slowing growth means Australian government bonds remain 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. • Spreads remain tight, keeping the risk/reward profile relatively unattractive. • In addition, increased hyperscaler bond issuance 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 looks limited, offering a minimal cushion against slowing fundamentals. • In addition, excess returns on equities appear more attractive to us 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. • We believe 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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