



From the US Market Desk

Volatility creates opportunity



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Chris Galipeau

Senior Market Strategist
Franklin Templeton Institute

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Macro

- Our forecast for real gross domestic product (GDP) growth in 2026 is 2.5% (based on our [Global Investment Management Survey](#)), above the Federal Reserve (Fed) forecast of 2.3% and the Wall Street consensus of about 2%. The main drivers of our GDP forecast are the continued capital expenditure (capex) spend by big technology firms, a resilient consumer and higher tax refunds, as well as the possibility of future interest-rate cuts.
- We expect the Fed to cut short-term interest rates twice in 2026 and core personal consumption expenditures (PCE) to remain stable in the 2.5% to 3.0% range. The last tick for core PCE data came in at 3.0%, versus expectations of 2.9%. The U-3 unemployment rate is 4.3%, just off the recent high print in November of 4.5%, which was the highest level since October of 2021.
- Last week we found some good news in the Institute for Supply Management (ISM) data. The ISM Services Index came in at 56.1 vs. expectations of 53.5; this was the strongest reading since August of 2022. The ISM Services Prices Paid Index came in at 63 vs. expectations of 68.3, a little lower. This was contrary to the Producer Price Index (PPI) prices-paid data from a few weeks ago, which had come in hotter than expected. ISM Services New Orders came in at a strong 58.6 vs. expectations of 53.5, the strongest reading since September of 2024. Fastenal (FAST), which sells industrial and construction supplies, also released information last week (source: Fastenal February 2025 Information Web Release) that showed a significant uptick in its business in February. Stay tuned.
- Inflation expectations have moved up in the near term. One-year breakeven rates are now 4.22%, an alarming move to say the least, although there is a first-quarter seasonal component to this historically. No doubt some of this move, and maybe a lot of this move, is the result of higher oil and natural gas prices. Two-year breakeven rates are 2.99%. Five-year breakeven rates are 2.56%. These numbers represent bond market pricing of annualized inflation one, two and five years in the future.
- On the currency front, we are expecting the US dollar to be essentially flat for the year despite its recent volatility. The US Dollar Index (DXY) is trading at \$99 and is at the high side of its 11-month range, defined as \$96 to \$100. Many investors are concerned the US dollar will lose value, and some believe the dollar has recently weakened materially. The fact is, however, that the US dollar is at the same level today as it was in April 2025, and it is higher than in early July 2025, late September 2025 and mid-January 2026.

Equities

- We are constructive on US equities and have established a target range of 7,000 to 7,400 for the S&P 500, which we think will flow from 8% to 13% year-on-year (y/y) earnings-per-share (EPS) growth (based on our [Global Investment Management Survey](#)). We don't expect geopolitics to impact our outlook unless oil trades north of \$100 per barrel, and the price stays there for months. But we think it's reasonable to expect high levels of volatility to persist.

Equities (continued)

- Last week the CBOE Volatility Index (VIX) traded higher to 28. A VIX reading of 30 or higher is, for me, a line in the sand for taking action. Since 1990, when the VIX closed at 30 or higher on a weekly basis, forward returns for the S&P 500 have been positive with great consistency. In such periods, the three-month median forward returns have been 6.85% with an 80.28% hit rate; the six-month median forward returns are 15.15% with a hit rate of 80.28%; and the one-year median forward returns are 23.46% with a hit rate of 88.57%. I like those odds. If the VIX closes above 30 based on weekly data, it may be an attractive time to add to equity positions, especially with a dollar-cost averaging approach. As an active investor, I consider this signal to be a reason to get even more active.
- Similarly, if conditions worsen, and the VIX index closes over 50 on a weekly basis, I would see this as a signal to move fast rather than delay. Since 1990, median forward returns one-year after a VIX move to 50 were 24.06%, with a 100% hit rate.
- The tape has been rotating since January 2025. Over the last 14 months and through the close of March 4, 2026, the Russell 2000 Index is up 20.02%, the S&P 500 Index is up 18.50%, the S&P 500 Equal Weight Index is up 18.05%, and the Magnificent Seven (Mag 7) stocks (Alphabet, Amazon, Apple, Meta, Microsoft, Nvidia and Tesla) are up 18.04%. US small caps are the leader in the club house. The small-cap category also has the strongest two-year cumulative earnings growth rate in the United States. That is not a coincidence. We are bullish on US small-cap stocks, and we view periods when their prices are weaker as opportunities to initiate or add to positions.
- The global equity landscape has also been rotating since January of 2025. Over the last 14 months and through the close of March 4, 2026, Japan's market is up 41.26% in US-dollar terms, based on the NIKKEI 225 Index. The MSCI Emerging Markets Index is up 40.45% in US-dollar terms. We are bullish on Japan and emerging markets (EMs) and favor using this weakness to initiate or add to positions. Our research suggests that EMs have the strongest two-year cumulative earnings growth rates on the planet, believe it or not. You can read more about the global equity opportunity in our Institute paper, "[Broadening momentum: From US technology leadership to US small caps and emerging markets.](#)"
- In the near term, we are beholden to the situation in the Middle East. The biggest risk is the price of oil and natural gas. This risk is pronounced for Europe, Japan, China and India, to name a few. As mentioned earlier, if oil-per-barrel were to trade through \$100, it will be an inflation problem for the United States as well, depending on how long it stays elevated.
- Remember, a lot of challenges have hit this tape and, as of this writing, the S&P 500 is down only about 1% on the year, while small caps, mid caps and the S&P 500 Equal Weight Index are up between 6% and 7%. I think that is a meaningful observation and is likely a reflection of a strong earnings environment and a strong economy.
- Our bottom line is this: It's important to have a diversified equity playbook that includes large-, mid-, and small-cap exposure in the United States with a balance of growth and value. The same can be said for ex-US equity exposure: We think it's an attractive time to have exposure to emerging markets (EMs) and developed international markets. *Amid heightened volatility, it can be prudent to reduce investment concentration and spread out exposure.*
- For those who like podcasts, I'll be on the "Animal Spirits" podcast March 9. I had a blast recording it with Michael Batnick and Ben Carlson of Ritholz Wealth Management, and we talked about all of the themes above. Have a listen; I think you'll love it. I'll post the link when it's available.

Fixed income

- We expect US 10-year Treasury yields to trade in a range of 4.0% and 4.25% for the year. Last week, the yield rose to the midpoint of this range, about 4.14%. The two-year Treasury yield has been range-bound for the last few months as well, trading last week at 3.59%. The US yield curve has flattened recently, with the two-year to 10-year spread at 54 basis points (bps), down from 73 bps a few weeks ago. We expect bull steepening of the yield curve in 2026.
- We expect short-duration fixed income mandates and corporate credit to outperform cash this year. Considering our views on US 10-year yields, we do not expect duration to be a significant driver of total return this year. Rather, all-in yield capture seems to be the play.
- Despite fears of a looming credit crisis and the recent geopolitical events, corporate credit spreads are behaving. Investment-grade spreads (one-year to three-year option-adjusted spreads, or OAS) were 50 bps over Treasuries, up two clicks on the week. High-yield spreads, as proxied by the Bloomberg US Corporate High Yield Index OAS, were 281 bps over Treasuries, up three ticks on the week. Corporate fundamentals remain healthy. Significant spread compression from here seems unlikely, both in IG and HY space.

Fixed income (continued)

- We are bullish on municipal bonds this year; we find taxable equivalent yields to be attractive along with robust fundamentals. Importantly, the increased supply in the marketplace has run its course for now, and muni bonds have been performing well since last August. We think this positive trend can continue. To get a current update on the municipal sector, have a listen to Ben Barber, Director of Municipal Bonds at Franklin Templeton Fixed Income, and Rick Polsinello, my colleague at Franklin Templeton Institute, discussing "[The opportunity in municipal bonds](#)," in our recent "Talking Markets" podcast.

Sentiment

- The percentage of bullish investors in the latest AAI Investor Sentiment survey was 33%, matching the previous week. The percentage of bearish investors in the AAI survey was 36%, down three ticks from the previous week's reading.
- Neither of these readings are at extremes, but sentiment is growing more cautious. Remember, this is a contrary indicator.

We will continue to analyze the markets and will offer insights again next week.

*Source of data (except where noted) is Bloomberg as of March 6, 2026. There is no assurance that any forecast, projection or estimate will be realized. An investor cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges. **Past performance is not an indicator or a guarantee of future performance.** Important data provider notices and terms available at www.franklintempletondatasources.com.*

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Glossary of terms

The AAI (American Association of Individual Investors) Sentiment Survey: This survey offers insight into the opinions of individual investors by asking them their thoughts on where the market is heading in the next six months.

Breakeven rates: The difference between yields of Treasury bonds and TIPS for issues of the same tenor/maturity, calculated by subtracting TIPS yields from Treasuries; a measure of inflation.

Capital expenditure (capex): Funds that companies spend to acquire, upgrade or maintain physical assets, such as buildings, technology or equipment, with the purpose of maintaining or growing future operations.

Duration: A measure of how much a bond's price changes relative to changes in interest rates.

Hit rate: The percent of successful or positive outcomes over all observations.

Institute for Supply Management (ISM): An association of purchasing and supply management professionals, which conducts regular surveys of its membership to determine industry trends.

Option-adjusted spread (OAS): Measures the spread between a bond's interest rate and the risk-free rate, while adjusting for any embedded options like callables or mortgage-backed securities.

Personal Consumption Expenditures (PCE) and core PCE: Measures the price changes in goods and services purchased by US households; core PCE excludes food and energy prices. Both are measures of inflation.

Producer Price Index (PPI): An inflationary indicator published by the U.S. Bureau of Labor Statistics to evaluate wholesale price levels.

Taxable-equivalent yield: The yield of a municipal bond investment calculated to reflect the benefits of income tax exemption and to be comparable to the yield of a taxable bond.

U-3 unemployment rate: The official measure used by the US Bureau of Labor Statistics (BLS) to report the percentage of the labor force that is unemployed and actively seeking work.

Yield spreads/tights: Spreads are the difference between yields on differing debt instruments of varying maturities, credit ratings, issuers or risk levels. “Tight” in reference to spreads indicates small differences in yields.

Indexes

Indexes are unmanaged and one cannot directly invest in them. They do not include fees, expenses or sales charges. Past performance is not an indicator of future results.

Bloomberg US Corporate High Yield Index: Tracks the performance of the USD-denominated, high yield, fixed-rate corporate bond market.

MSCI Emerging Markets Index: A free float-adjusted, market capitalization-weighted index designed to measure the equity market performance of global emerging markets.

NIKKEI 225 Index: A price-weighted index composed of Japan’s top 225 blue-chip companies on the Tokyo Stock Exchange.

Russell 1000® Index: A market capitalization-weighted that measures the performance of the 1,000 largest companies in the Russell 3000® Index, which represents the majority of total US market capitalization.

Russell 2000® Index: A market capitalization-weighted index that measures the performance of the 2,000 smallest companies in the Russell 3000 Index.

S&P 500® Index (SPX): A market capitalization-weighted index of 500 stocks, a measure of broad US equity market performance.

S&P 500 Equal Weight Index (EWI): The equal-weight version of the S&P 500 Index. The index includes the same constituents as the capitalization weighted S&P 500, but each company is allocated a fixed weight, or 0.2% of the index total, at each quarterly rebalance.

US Dollar Index: A basket of six foreign currencies (euro, Japanese yen, UK pound sterling, Canadian dollar, Swedish krona, and Swiss franc) used to track the relative strength of the US dollar, with a higher index value representing US dollar strength.

The Chicago Board Options Exchange (CBOE) Volatility Index (VIX): A measure of market expectations of near-term volatility as conveyed by S&P 500 stock index option prices.

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal.

The **allocation of assets** among different strategies, asset classes and investments may not prove beneficial or produce desired results.

Diversification does not guarantee a profit or protect against a loss.

Equity securities are subject to price fluctuation and possible loss of principal.

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.

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 **investment style** may become out of favor, which may have a negative impact on performance.

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.

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