



From the US Market Desk

Rotation Nation. Large-Cap Growth on Sale.



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Macro

- Our real gross domestic product (GDP) forecast for 2026 is 2.5% (based on our [Global Investment Management Survey](#)) versus the Federal Reserve's (Fed's) forecast of 2.2% and the Wall Street consensus of around 2%. The main drivers of our GDP forecast are the continued capital expenditures by big tech to build out artificial intelligence (AI) infrastructure, and the resilient consumer. The third first-quarter GDP revision came in today at 2.1%, up from the second revision of 1.6%. This is a good example of why collecting readings faster would help us all get accurate government data. As I said last week, my takeaway from Fed Chair Warsh's press conference was that we should expect changes in the way the government collects data and assesses the timeliness of that data. This is an issue that we have been talking about for decades; namely, using backward-looking, hard-to-collect data is not ideal when it comes to setting policy. My favorite part of the press conference was this quote from Warsh, "Financial markets are the most important source of information." I agree with that wholeheartedly.
- We have a conflict to discuss. Historically, two-year note yields are a strong predictor of what the Fed will eventually do. If two-year yields are above the effective fed funds rate, that is the bond market telling us the Fed needs to raise rates. Right now, the two-year yield is 4.12% (down from 4.23%), 50 basis points (bps) over the effective fed funds rate. That would imply two rate hikes. Fed fund futures now have one 25-bp hike priced in for December. However, breakeven rates tell a completely different story.
- Breakeven inflation rates have completely collapsed. One-year breakeven rates are now 1.57% (down from 5.50%), the lowest level since October 2024. Two-year breakeven rates are also back to October 2024 levels, closing at 2.02% (down from 3.50%). Finally, five-year breakeven rates are 2.23%, also back to where they were in October of 2024. The bond market seems less concerned about inflation and the five-year number is basically at the Fed's 2% target. These numbers represent the bond markets' pricing of annualized inflation out one, two and five years. I'm not sure what to make of this conflict right now, so I'll keep monitoring the situation and report back as it evolves.
- On the currency front, we are expecting the US dollar to be essentially flat for the year despite the recent volatility. The US Dollar Index is trading at \$101.43, breaking out from a one-year base. This move is strong versus the consensus of a weaker dollar and slightly against our range-bound forecast with \$100 at the top of that range.

Equities

- We are constructive on US equities and have established a target range of 7400 - 7800 for the S&P 500 Index, driven by 15+% year-over-year (Y/Y) earnings-per-share (EPS) growth. First-quarter earnings exceeded consensus expectations, which has served to drive the S&P 500's 2026 earnings estimate to \$341 today, up from \$310 at the start of the year. Would you believe that the tape is cheaper today than it was on January 1, despite being up 7% year-to-date (YTD)? It is. Coming into the year, the tape was 22.5x 2026 estimates. Today the tape trades at 21.5x earnings. (See Franklin Templeton Institute's [Global Investment Management Survey](#) for more on earnings and our forecasts.)
- When it comes to equities, according to my analysis, the single most important variable is forward earnings growth. Corporate profitability. The only thing that puts earnings under severe pressure are recessions. A new Fed chair might get challenged by markets in the near term, but a lot would have to go wrong to cause earnings degradation. As of this writing, I see zero chance of recession.
- We reiterate our "broadening" call on equities and emphasize our bullish call on US small- and mid-cap stocks, and we continue to favor emerging market equities and equities in Japan. Earnings estimates have steadily ticked up all year and I'll repeat: *earnings drive stock prices—not geopolitics*.
- The Equal Weight S&P 500 Index, representing the "average stock," is up 11.53% as of this writing (June 25 close). The cap-weighted S&P 500 is up 8.09%. The "average stock" is beating the index by 344 basis points. The average stock acts better than the index. This looks bullish to me.
- Leadership is found in the small-cap space. with Russell 2000 Value Index up 22.53%, the Russell 2000 Index up 21.96%, and the Russell 2000 Growth Index up 21.42%. The Russell 2000 Index has outperformed the S&P 500 by 13.87% YTD. We have been pushing our small-cap thesis since January of 2025. Strength in forward earnings growth has driven this view. This is still true today, and we think it will continue through 2027. As we see it, it makes sense to have exposure to small-caps—and we'd be looking to buy on pullbacks.
- Mid-cap stocks are also strong YTD. The S&P 400 Midcap Growth Index is up 19.99%, the S&P 400 Index is up 16.35%, and S&P Midcap Value Index is up 12.61%. The S&P 400 Midcap Index is outperforming the S&P 500 by 8.26% YTD. So, exposure to mid-caps also makes sense. And again, we'd be looking to buy on pullbacks.
- The Russell 1000 Large-Cap Value Index is up 17.10% vs the Russell 1000 Large-Cap Growth Index, up just 0.7% YTD. The Russell Large-Cap Value Index has outperformed the S&P 500 Index by 9%. So, we also think exposure to large value makes sense. And we'd be looking to buy pullbacks here, too.
- Bringing up the rear YTD is the vaunted Magnificent Seven basket, which is down 6.80% YTD and is 14.89% behind the S&P 500 Index on the year.
- Within the Mag Seven basket, Microsoft (MSFT) is the biggest drag, down 26.72% YTD. Google is the biggest winner, up 9.95%. The Mag Seven median YTD performance is -1.65% and the mean is -6.95%.
- This massive underperformance in Mag Seven has probably gone too far in my estimation. These stocks, collectively, are now as oversold as they have been in five years. Looking at technical indicators, the relative strength index on the basket is 28.7. As such, these stocks are technically oversold and may be worth a look. Fundamentally, the Mag Seven basket is trading at 22x 2027 EPS estimates. EPS growth, all in, is +20% Y/Y in 2027 vs 2026. The price-to-earnings-to growth (PEG) ratio is about 1. It looks like a good time to buy, in my view.
- Bottom line: We think it's prudent 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. Large growth is on sale right now. The same can be said for ex-US equity exposure: emerging markets and Japan are attractive. Our takeaway is to reduce concentration and spread one's bets. Consider using any further consolidation to an advantage.

Fixed Income

- We expect the 10-year US Treasury bond to yield in the range of 4.25% - 4.75% for the year. Last trade 4.38%. We think duration risk is attractive toward 4.75%.
- The US yield curve flattened quickly on the heels of Fed Chair Warsh's comments. The 2-year/10-year spread moved all the way down to 27 bps. This is a function of two-year yields moving higher (10-year yields have been well-behaved).
- Credit spreads have made big moves (tightening) in the last two months. Investment-grade (IG) spreads, as proxied by the Bloomberg US Corporate 1-3 year Option-Adjusted Spread (OAS), are now only 43 bps over comparable Treasuries. IG spreads are a few basis points from five-year tight. High-yield spreads, as proxied by the Bloomberg US Corporate HY OAS, are now 277 bps over, moving up slightly on the week.
- We expect short-duration fixed income mandates and corporate credit to outperform cash again 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, although recent spread widening might create an opportunity for additional total return. Clipping coupons is attractive.
- We are bullish munis and find taxable equivalent yields to be attractive along with robust fundamentals. Importantly, municipal bonds can offer potential diversification benefits relative to most taxable fixed income mandates. Consider using some cash to add muni exposure in taxable accounts. Have a read of our latest piece, "[Municipal bonds are back.](#)"

Sentiment

- The percentage of bullish investors in the latest AAll survey is 45%, hey now! That is up from 37% last week. The percentage of bearish investors in the AAll survey is 36%, down from 39% last week. No signal here as I see it, but complacency sets in when the percentage of bulls trades north of 50%. Something to watch. Bull markets peak on euphoria. I don't think we are there yet, but I am on watch.

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

Source of data (except where noted) is Bloomberg and Franklin Templeton Institute, as of June 18, 2026. Important data provider notices and terms available at www.franklintempletondatasources.com.

The Franklin Templeton Institute Global Investment Management Survey is a biannual outlook survey designed to give a view across our investment teams. The Franklin Templeton Institute identifies the median across the survey answers and develops the outlook. The survey received responses from around 200 portfolio managers, directors of research and chief investment officers, representing participation across equity, private equity, fixed income, private debt, real estate, digital assets, hedge funds and secondary private markets. Each of our investment teams is independent and has its own views.

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.

Federal funds (FF) rate: The interest rate that depository institutions such as banks charge other institutions for holding overnight reserves.

Hit rate: The percentage of positive positions or returns over a specific period.

Magnificent Seven: Refers to shares of Apple, Microsoft, Amazon, Alphabet, Meta Platforms, Nvidia, and Tesla.

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.

Price/Earnings-to-Growth (PEG) Ratio: Financial metric to determine a stock's true value by dividing its standard P/E ratio by its expected earnings growth rate.

Relative Strength Index (RSI): A momentum indicator that measures the speed and magnitude of recent security price changes, used in technical market analysis.

Tape: A reference to broad market performance, based on the ticker tape that transmitted stock prices during the 19th and 20th centuries.

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.

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.

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 1000® Growth Index: A market capitalization-weighted index that measures the performance of Russell 1000® Index companies with relatively higher price-to-book ratios and higher forecasted growth rates.

Russell 1000® Value Index: A market capitalization-weighted index that measures the performance of Russell 1000® Index companies with relatively lower price-to-book ratios and lower forecasted growth rates.

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

Russell 2000® Growth Index: A market capitalization-weighted index that measures the performance of the 2,000 smallest companies in the Russell 3000 Index with relatively higher price-to-book ratios and higher forecasted growth rates.

Russell 2000® Value Index: A market capitalization-weighted index that measures the performance of the 2,000 smallest companies in the Russell 3000 Index with relatively lower price-to-book ratios and lower forecasted growth rates.

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.

S&P MidCap 400® Index: A market capitalization-weighted index of 400 stocks of mid-size companies, distinct from the large-cap S&P 500.

The S&P MidCap® 400 Growth Index: An unmanaged, float-adjusted market capitalization-weighted index comprised of stocks from the S&P MidCap 400 that are classified as growth stocks based on three factors: sales growth, the ratio of earnings change to price, and momentum.

The S&P MidCap® 400 Value Index: An unmanaged, float-adjusted market capitalization-weighted index comprised of stocks from the S&P MidCap 400 that are classified as value stocks based on three factors: the ratios of book value, earnings and sales to price.

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.

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.

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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.

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

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