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From the US Market Desk

Earnings Strong. Bond Yields Remain a Risk.

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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 expenditure (capex) by big tech to build out artificial intelligence (AI) infrastructure, and the resilient consumer. The big banks just reported earnings, and they gave us a very clear and consistent message: The economy is strong and the consumer is spending. This has been their message for six consecutive quarters in a row.
- We are watching the inflation picture closely. Oil prices have rallied 40% over the last two weeks, and this may put some pressure on the Fed/Chair Warsh ahead of the Federal Open Market Committee meeting Wednesday, July 29. We expect no rate movement, but the press conference will certainly be interesting for the fixed income, equity and currency markets. Our core Personal Consumption Expenditures forecast for the year is 3.0% - 3.5%; the most recent reading as of May was 3.4%.
- This aggressive rally in oil prices is pushing up yields on two-year and 10-year Treasuries. Historically, two-year note yields have been a strong predictor of what the Fed will eventually do. If the two-year yield is above the effective fed funds rate, the bond market is telling us the Fed needs to raise rates. Right now, the two-year yield stands at 4.35%, the highest level since February of 2025 and 70 basis points (bps) over the effective fed funds rate. So that would call for two+ rate hikes. Fed fund futures now have close to two, 25 bps hikes priced in for December. However, breakeven rates tell a completely different story.
- Breakeven inflation rates have collapsed since March but ticked up slightly this past week. Breakeven rates are the difference between nominal bond yields and Treasury inflation protected securities. One-year breakeven rates are now 1.17% (down from 5.50%). Two-year breakeven rates have moved up a touch to 1.95% (down from 3.50%). Finally, five-year breakeven rates are 2.30%. The bond market seems less concerned about inflation and the five-year number being near the Fed's 2% inflation target. These numbers represent the bond markets' pricing of annualized inflation out one, two, and five years. I'm still not sure what to make of this conflict.
- 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 US$101.41, following US Treasury yields higher. This move is strongly against the consensus for a weaker dollar and slightly against our range-bound forecast, with US$100 at the top of that range.

Equities

- We are constructive on US equities and have established a year-end target range of 7400 - 7800 for the S&P 500 driven by 15+% year-over-year (Y/Y) earnings per share (EPS) growth. Second-quarter (Q2) earnings are off to a strong start, led by the big banks and a handful of cyclical names this past week. Consensus expectations for 2026 now sit at US$350.30, up about 17% Y/Y. For 2027, the consensus earnings estimate stands at US$401.89, representing a 16% Y/Y growth rate versus 2026. (See Franklin Templeton Institute's Global Investment Management Survey for more on earnings and our forecasts.)
- If we assume the consensus earnings estimates are reasonably correct, that puts the tape at 21.15x this year's earnings and 18.43x 2027 estimates. The long-term historical, forward multiple is about 17x. Portfolio managers are now focusing their efforts on corporate earnings power for calendar year 2027. I can't make a strong argument that the tape is "cheap" here, but I also can't make the argument that an 18.6 forward multiple is crazy rich either—unless bond yields move significantly higher. We don't expect that, but that is a risk.
- Three earnings reports had my attention this week. Guess what? They were not Google, Texas Instruments or Tesla! They were boring, economically sensitive names. I'm referring to United Rentals, Norfolk Southern and CSX Corp. United Rentals is an equipment rental business—think Sunbelt rental gear. Norfolk and CSX are obviously railroad operators. All three are very sensitive to the strength or weakness of the economy, and all three reported strong earnings and gave strong forward guidance.
- The management team of United Rentals spoke about strong and broad-based demand for large infrastructure projects, not all of that being artificial intelligence/data center buildout. Both CSX and Norfolk Southern pointed to strong intermodal demand and broad-based demand across categories, similar to what we heard from trucker JB Hunt last week. I triangulate earnings data to inform my views, and these reports substantiate and corroborate what we heard from the big banks last week: Namely, that the economy is strong and the consumer is resilient.
- Speaking of earnings, let's look at where the consensus stands for Q2. According to FactSet, expectations are for revenue growth of 12% Y/Y with all 11 S&P GIC sectors participating in positive growth. Earnings growth of 23% Y/Y is expected, with 10 of 11 S&P GIC sectors in the positive column. EBIT margins are 14% Y/Y. During Q2, earnings estimates have moved up. Typically, estimates would move down. Not this time. Earnings estimates have been revised higher by 3% vs -2% on average over the last five years, and -3% on average over the last 10 years. Energy, tech and materials lead the EPS charge.
- Let's talk about big tech. This week we heard from Google, Texas Instruments and Tesla. With respect to Google, earnings were strong, but investors were more focused on their capex guidance raise. That single data point took the stock down. Texas Instruments earnings were fine, with a big move into the print and a high bar. I really have never been able to figure out Tesla, beyond a bet on the out years for robotics and autonomous. (And investors are definitely betting on Elon.) Ditto those concepts for SpaceX. In the week ahead we will hear from Amazon, Microsoft, Qualcomm and Apple. I'll be listening closely to Amazon and Microsoft with respect to their capex plans and ability to demonstrate return on investment (ROI) on the spend. This will be a big test for the Mag 7 complex. A month ago, I wrote about the valuation in those names being more favorable. That's still true, but we also need the "fundamentals": earnings power + a sense of ROI on all the spend. I still think the risk/reward is good, but we need a catalyst.
- Over the past month I have written about my concern about the semiconductor space. I have no argument with the fundamentals; rather, my issue was the parabolic nature of those names. The froth is out at this point, but I would expect volatility to remain high in the space. I think the risk/reward has improved considerably after the selloff. Despite this violent rotation, the S&P 500 Index is within 200 bps of its all-time high. Rotation, not detonation.
- I want to call attention to an AI/tech "Talking Markets" podcast that I just recorded with Putnam equity Portfolio Managers Andy O'Brien and Bobby Gray. Andy and Bobby shared their views on where we are in the AI buildout, why they believe in the long-term implications and what the risks are. Find 30 minutes for this and I promise you that you will have a better understanding of the space.
- Bottom line: We think it's prudent to have a diversified equity playbook that includes US large-, mid- and small-cap exposure with a balance of growth and value. Large-cap growth is on sale here. The same can be said for ex-US equity exposure; emerging markets and Japanese stocks look attractive. We think it's prudent to reduce concentration and spread one's bets. Consider using any further consolidation to your advantage.

Fixed Income

- We expect 10-year US Treasury bond to yield in the range of 4.25% - 4.75% for the year. As of this writing, the last trade was 4.70%. We think adding duration risk is attractive over 4.75%. We are on the doorstep of action here!
- The US yield curve has flattened. The 2-year/10-year spread is now 34 bps, twisting a touch flatter 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 looks attractive.
- Credit spreads remain well behaved in the face of higher yields. Investment-grade spreads, as proxied by the Bloomberg US Corporate 1-3 year Option-Adjusted Spread (OAS), are now 46 bps over comparable Treasuries. Investment-grade spreads are a few basis points from five-year tights. High-yield spreads, as proxied by the Bloomberg US Corporate HY OAS, are now 267 bps over. Both are essentially flat week on week. The tightness reflects a strong fundamental backdrop, with corporate profitability being the main driver.
- We are bullish on municipal bonds 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 on municipal bonds, "Municipal bonds are back."

Sentiment

- The percentage of bullish investors in the AAII survey is down to 29%, a huge move down from last week's 45% reading. This is the lowest reading of bulls since May of 2025, on the heels of the tariff tantrum. The percentage of bearish investors in the AAII survey is now at 42%, up from 33% in the prior week. The collapse in the bull camp is noticeable. The wall of worry is still in place.
- Bull markets peak on euphoria. I don't think we are there yet.

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 July 23, 2026. Important data provider notices and terms are available at www.franklintempletondatasources.com.

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Glossary of Terms

The AAII (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.

Earnings per share (EPS): The portion of a company's profit allocated to each outstanding share of common stock. An index EPS is an aggregation of the EPS of its component companies.

EBIT: Earnings before interest and taxes.

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

Global Industry Classification Standard (GICS®): Developed in 1999 by S&P Dow Jones Indices and MSCI, GICS was designed in response to the global financial community's need for accurate, complete and standard industry definitions.

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.

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.

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.

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

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Small- and mid-cap stocks involve greater risks and volatility than large-cap stocks.

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