From the US Market Desk

WAIT. Wut?

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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. Earnings season is in full swing, and we have many confirmations of a strong economy and a strong consumer. Namely, earnings reports from Coca-Cola, Starbucks, Visa, American Express, Ford, Capital One, the rails and truckers, and all of the big banks.
- We are watching the inflation picture closely. Oil prices have now pulled back about 10% to US$83.89. Our core Personal Consumption Expenditures forecast for the year is 3.0% - 3.5%; the most recent reading as of May was 3.4%.
- Kevin Warsh was interesting at this week's Federal Open Market Committee meeting. The press conference left me confused. On one hand, he believes that market pricing is a source of information for decisions. I agree with that completely. That said, the two-year note yield is currently at 4.22%, and 50 basis points (bps) over the high end of the Fed's current federal funds target range, defined as 3.50% – 3.75%. As I have been writing, two-year yields are a good historical predictor of Fed action. As of this writing, two-year yields point to higher policy rates—50 bps higher actually. But he seemed to downplay that and said something along the lines of the bond market doing the Fed's work for them. Ok. Someone should tell 30-year yields that, because the long end is from Missouri. Show me, Chairman Warsh. Show me.
- Meanwhile, the fed funds futures market is indicating a 64% chance of an interest-rate hike in September and a 40% chance of a hike in December. This data moves very fast, so this picture can and will change quickly depending on incoming data.
- Warsh also made multiple references to breakeven inflation rates. I have been watching this unfold as well and have been writing about the disconnect between the message from two-year yields (raise rates) versus breakevens (do nothing). Here is where we are today: One-year breakeven rates are 1.72%, up from a low of 1.06% on July 14. Two-year breakeven rates are now 2.14%, up from a low of 1.87% on July 17. Finally, five-year breakeven rates are 2.24%, up from the low of 2.17% on July 28. 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$99.90. Signs of intervention are present in the foreign exchange market today.

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$353.93, up about 20% Y/Y. For 2027, the consensus earnings estimate stands at US$402.86, representing a 14% 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 20.7x this year's earnings and 18.2x 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 18.2x forward multiple is crazy rich either—unless bond yields move significantly higher. We don't expect that, but that is a risk.
- This week we heard from a host of big-name companies. The vast majority pointed to strong consumer spending and/or industrial capex spend. Visa, Ford, Coca-Cola, Johnson Controls, Microsoft, Lam Research, Starbucks, Seagate, Teradyne—to name a few. The only significant disappointment was META; its capex guidance was raised at the low end of estimates and forward revenue guidance was a touch weak. You could argue the same for Qualcomm I suppose.
- 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.
- 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 recent 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. We favor buying on pullbacks.

Fixed Income

- We expect the 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 4.67%. We think adding duration risk is attractive over 4.75% or so. Core and core plus strategies should get closer looks, should rates remain elevated.
- The US yield curve has reversed course and has steepened modestly over the past week. The two-year/10-year spread is now 44 bps. Perhaps more indicative of where the market is headed, the fed funds/two-year spread is now 60 bps. Traditionally, the central bank's overnight lending rate has had a high correlation with the two-year US Treasury yield. This would imply that rates are headed higher, or that the two-year note might rally a bit. Of course both are possible.
- 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 47 bps over comparable Treasuries, only one bp wider over the past week. 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 289 bps over, 22 bps wider on the week. These are both relatively tight levels from a historical perspective, reflecting 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. The market is on pace for another year of record supply; however, tight spreads in taxable bonds have helped the markets absorb these high supply levels.
- Warsh's second policy meeting as Fed Chair this past week was definitely interesting. The Fed did not hike interest rates despite elevated inflation and low unemployment. But the Committee seems poised to possibly move in the fall or winter if the data allows, as three members dissented in favor of hiking by 25 bps. If 2% core inflation isn't a "soft target" as Warsh put it, some tightening might be in order; however, they'll need to keep an eye on how things evolve in light of geopolitical uncertainty/elevated energy prices, tariffs and the AI buildout.

Sentiment

- The percentage of bullish investors in the latest AAII survey (the week ending July 29) is 31%, a very low reading. The percentage of bearish investors in the AAII survey is now at 42%. 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 31, 2026. Important data provider notices and terms are 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 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.

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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