Franklin Templeton Institute

From US concentration to global opportunity

Staying invested while preparing for volatility

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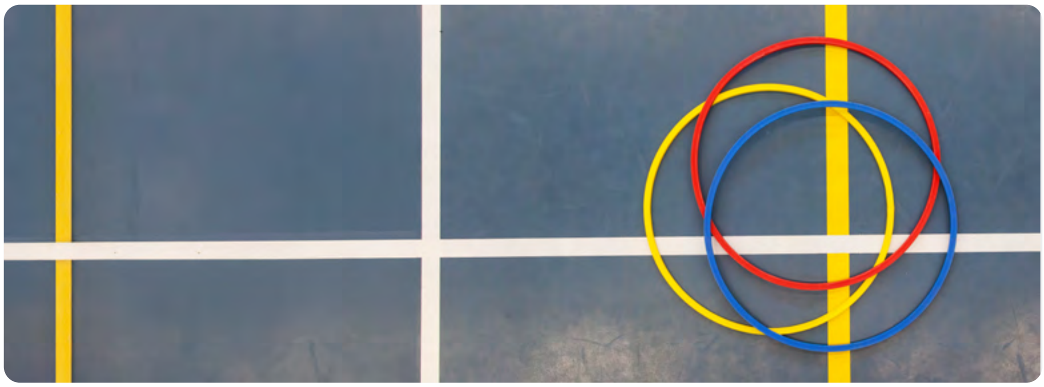


In our recent publications, "From US technology leadership to US small caps and emerging markets," (January 2026) and "Get ready for a broader US market," (January 2025) we highlighted a setup that is rare but powerful: strong economic growth, broad earnings participation and unusually high market concentration.

Historically, this combination creates fertile ground for market broadening—away from a narrow group of leaders and toward international equities, small-capitalization stocks and less-favored sectors within the United States.

This process was quietly underway through most of 2025 and became more dynamic in recent months. We believe this global rotational bull market can persist over the coming years. However, markets rarely move in straight lines. Even in healthy bull markets, higher volatility and periodic pullbacks are normal—and often create the best opportunities to add risk at more attractive prices.

One framework, two plausible market paths

From a strategic perspective, we view the current environment through the lens of two plausible market paths: Map A and Map B. These are not competing forecasts. They are two components of the same investment framework.

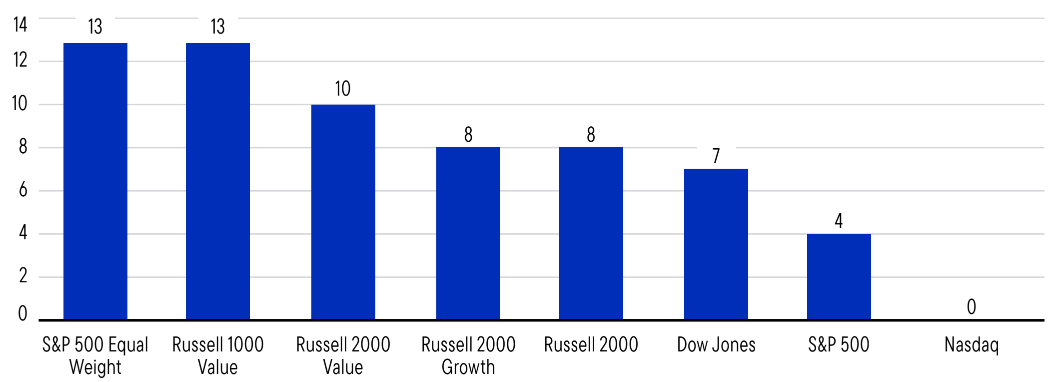
Map A: Broadening within a supportive macro backdrop

Map A reflects the environment markets are currently pricing. It assumes:

- Continued support from monetary and fiscal policy
- Strong productivity gains, including gains from technological adoption
- Resilient gross domestic product (GDP) growth with inflation contained
- High expectations for earnings growth
- Geopolitical risks that are largely priced in, deferred or ignored

Under this scenario, market leadership has continued to broaden, volatility has remained contained, and a constructive macro and liquidity backdrop has supported risk assets. This framework helps explain why markets have remained resilient despite recurring policy uncertainty and ongoing geopolitical risks. Notably, several major US indexes have reached new all-time highs this year, with the S&P 500 Equal Weight Index and value stocks leading the advance.

Exhibit 1: US Equity Indexes Show Broader Leadership with Record Highs



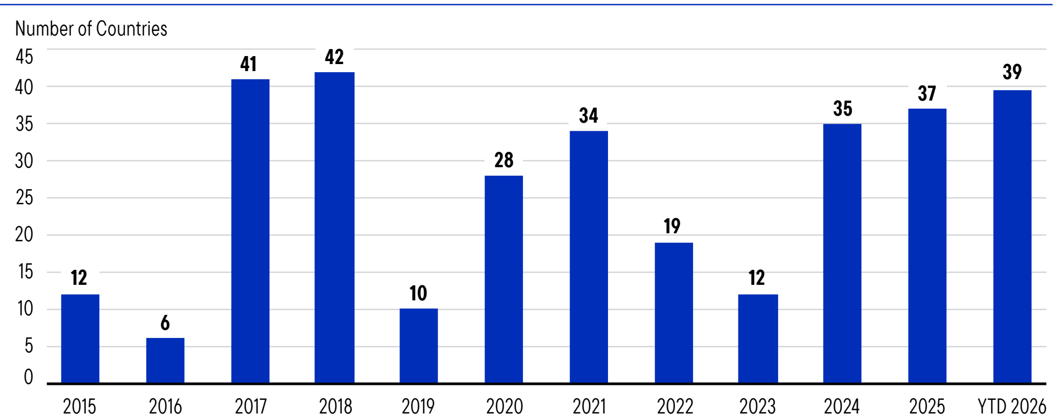
Sources: Macrobond, Bloomberg. Analysis by Franklin Templeton Institute. Data as of February 17, 2026. **Past performance is not an indicator or guarantee of future results.**

Looking globally, 39 countries have reached new one-year highs with many emerging market countries and Japan breaking to new multi-year highs.

Exhibit 2: Dozens of Global Markets Have Reached Recent Highs

MSCI ACWI: Stock Indexes Hitting One-Year Highs

2015 through February 10, 2026



Sources: FactSet, MSCI. Analysis by Franklin Templeton Institute and Franklin Templeton Global Research Library. Data as of February 10, 2026. **Past performance is not an indicator or guarantee of future results.**

This is the hallmark of a *rotational global bull market*, not a narrow or fragile advance.

Map B: A volatility regime shift triggered by surprise

Map B reflects a different—but historically common—path. It assumes that an unexpected shock could force markets to reassess one or more assumptions embedded in Map A. Such shocks can include:

- A policy mistake
- A geopolitical escalation
- A sharper-than-expected earnings or margin reset

When these events occur, volatility typically rises *abruptly,* not gradually. Correlations increase, diversification becomes less effective in the short term, and markets reprice risk faster than fundamentals alone would justify.

Episodes such as the December 2018 Federal Reserve interest-rate tightening scare, the COVID-19 pandemic shock and sharp, event-driven selloffs in recent years illustrate this dynamic, which is characterized by sudden drawdowns driven by uncertainty rather than economic collapse. Then, recoveries followed once stability returned.

The key challenge for investors is rarely predicting the shock itself. It is being positioned to withstand the initial repricing *without events forcing the need to act* at precisely the wrong time.

Recent volatility: rotation, not breakdown

Recent events have reminded investors that rotations are rarely smooth. Volatility has picked up across several asset classes, catching many investors off guard, particularly in precious and industrial metals, as well as software stocks and cryptocurrencies.

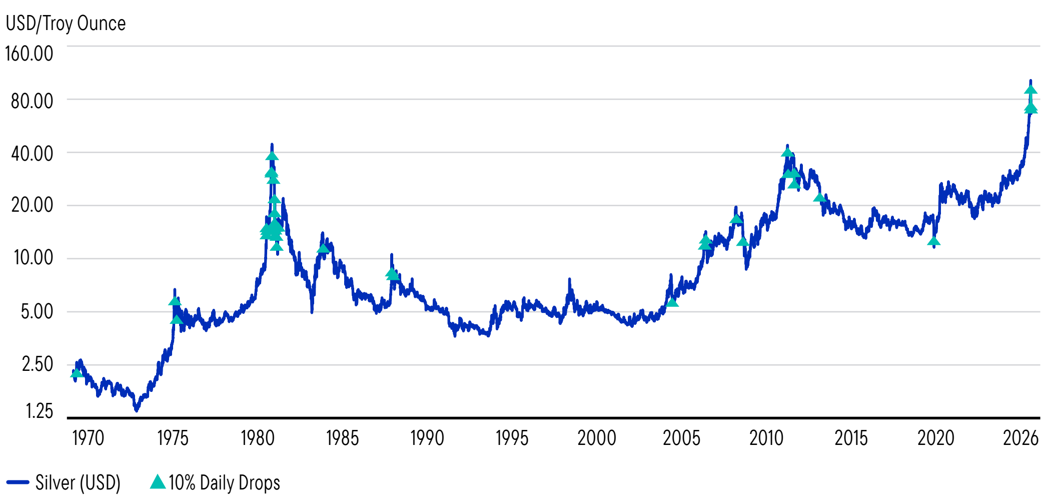
Metals

After parabolic moves, sharp pullbacks should not be surprising. As Exhibit 3 shows, 10% declines in silver have occurred repeatedly during strong bull markets, often marking local peaks rather than trend reversals.

Exhibit 3: It's Not Unusual for Silver Prices to Drop 10% after Peaking Rapidly

Volatility Spikes in Silver Prices

As of February 6, 2026



Sources: LBMA, S&P Global, Bloomberg and Macrobond. Analysis by Franklin Templeton Institute. Data as of February 6, 2026.
Past performance is not an indicator or guarantee of future results.

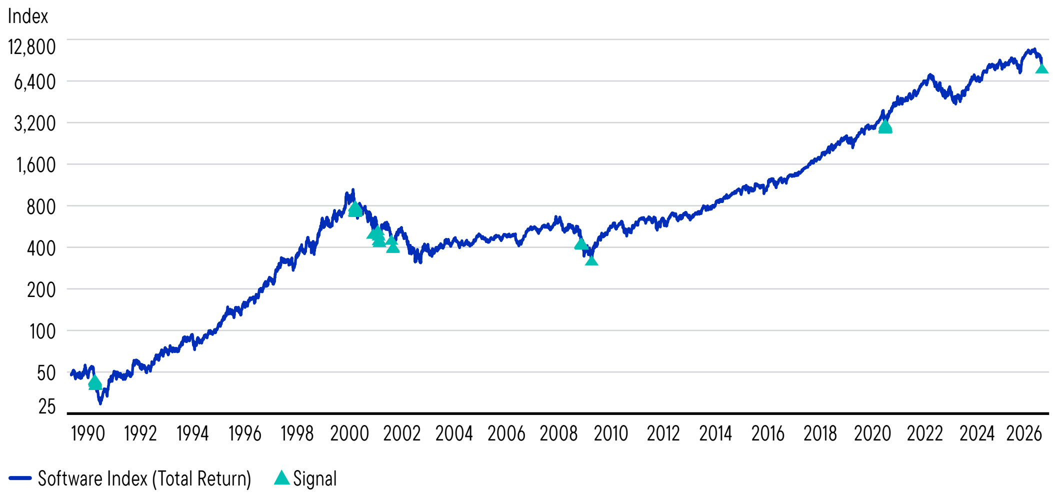
Software stocks

This year, software stocks experienced a 20% *drawdown in just 20 days*—a magnitude of decline previously seen near the COVID-19 pandemic lows or during sharp bear-market rallies in prior recessions. These moves are uncomfortable, but not unprecedented during periods of rapid leadership rotation.

Exhibit 4: Software Stocks Corrected Sharply at the Start of 2026

Sharp Correction in Software Stocks

As of February 17, 2026



Sources: S&P Global, Bloomberg, Macrobond. S&P Software & Services Select Industry Index. Analysis by Franklin Templeton Institute. Data as of February 17, 2026. The signals (teal plot points) represent price declines of at least 20% within 20 days.
Past performance is not an indicator or guarantee of future results.

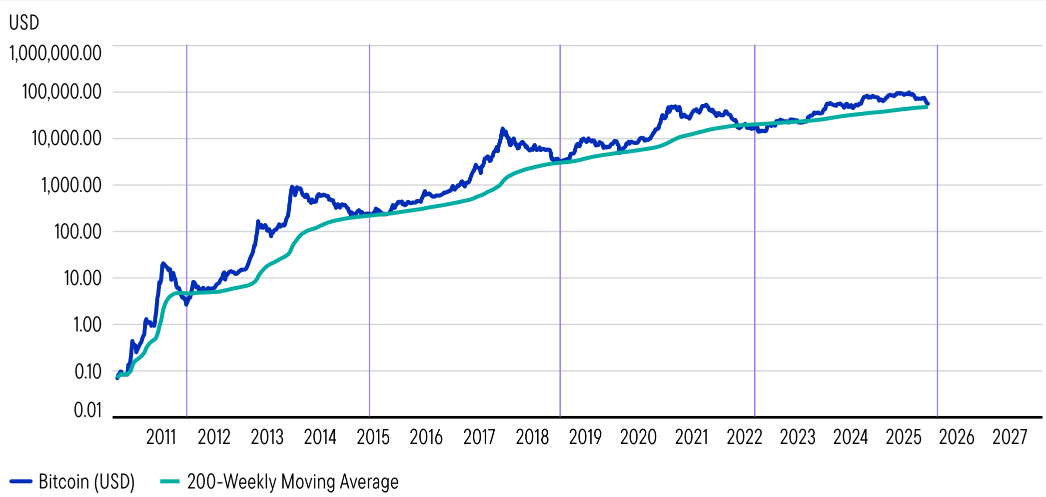
Bitcoin

Bitcoin's price action is perhaps the least surprising. It continues to follow its halving cycle, with major tops and bottoms occurring roughly every four years, often gravitating toward the **200-week moving average** during periods of stress. Crypto remains a high-volatility asset class, and sharp drawdowns have been part of its long-term pattern. Historical patterns may not persist in the future.

Exhibit 5: Bitcoin's Recent Decline Is Part of a Long-Term Pattern

Bitcoin Four-Year Cycle

As of February 17, 2026



Sources: Macrobond, Bloomberg, Macrobond Financial AB. Analysis by Franklin Templeton Institute. Data as of February 17, 2026.
Past performance is not an indicator or guarantee of future results.

What volatility is signaling beneath the surface

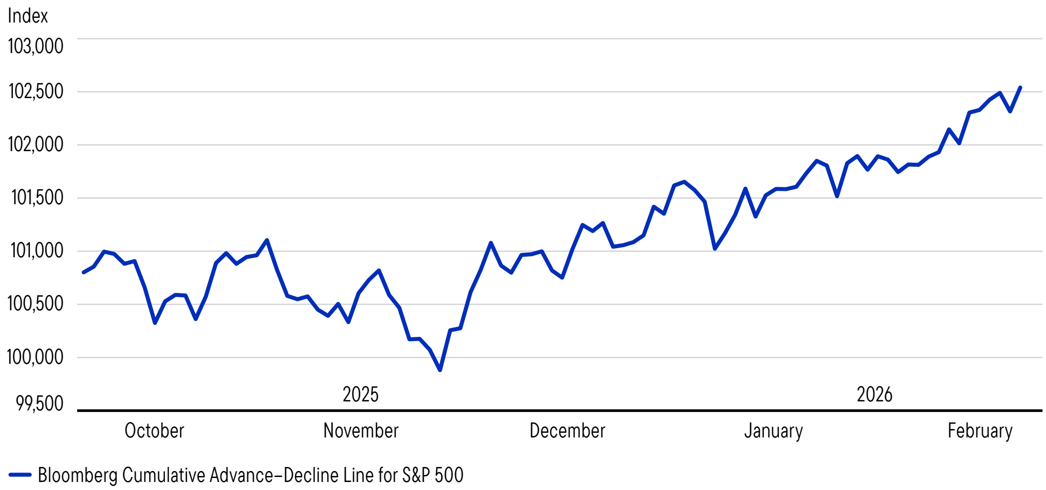
Despite recent turbulence, the broader market continues to show signs of resilience. In early February 2026, the correlation between the S&P 500 Index (market-capitalization-weighted) and the S&P 500 Equal Weight Index fell to nearly zero.[1] While both indexes contain the same constituents, they differ in weighting methodology—yet their recent divergence suggests that market leadership is shifting. This decoupling points to capital rotating away from mega-cap stocks and into smaller-weighted constituents, reinforcing the theme of broadening participation beneath the surface.

Additional evidence of healthy rotation is shown in the exhibit below. The S&P 500 advance–decline line—which tracks the cumulative number of advancing stocks minus declining stocks—has reached a new all-time high. This indicates that an expanding share of the market is driving gains, which we view as a constructive signal for overall market breadth.

Exhibit 6: Signal from S&P 500 Index Advance–Decline Line Has Strengthened

New All-Time Highs in Advance–Decline Index Signal Strength

As of February 17, 2026



Sources: Macrobond, Bloomberg. Analysis by Franklin Templeton Institute. Data as of February 17, 2026. The (TRADCADS) index value is cumulative, representing the sum of the previous value and the net advance–decline value of the S&P 500, which is calculated using SPXADV (S&P 500 Advance) Index – SPXDCL (S&P 500 Decline) Index. **Past performance is not an indicator or guarantee of future results.**

However, important internal signals suggest that volatility is likely to remain elevated:

- First, the **Nasdaq 100 has not made a new all-time high in more than 77 days**,[2] even as other major equity indexes have continued to push to new records. This divergence points to waning momentum in tech space that has been leading the market since the October 2022 bottom.
- Second, **market breadth within the Nasdaq Index has deteriorated**. The Nasdaq Advance–Decline Index has turned lower, reflecting rising bifurcation across technology stocks. Over the past three months, performance within the Nasdaq 100 has been evenly split, with roughly half of constituents advancing and half declining.
- Third, recent weeks have seen **pronounced rotation into defensive sectors such as consumer staples and utilities,** both of which have significantly outperformed technology stocks and the broader market. Historically, sustained rotation into defensive areas tends to coincide with rising uncertainty and stress beneath the surface, rather than periods of market calm.

1. Sources: FT Institute, Macrobond, S&P Global.
2. As of February 17, 2026.

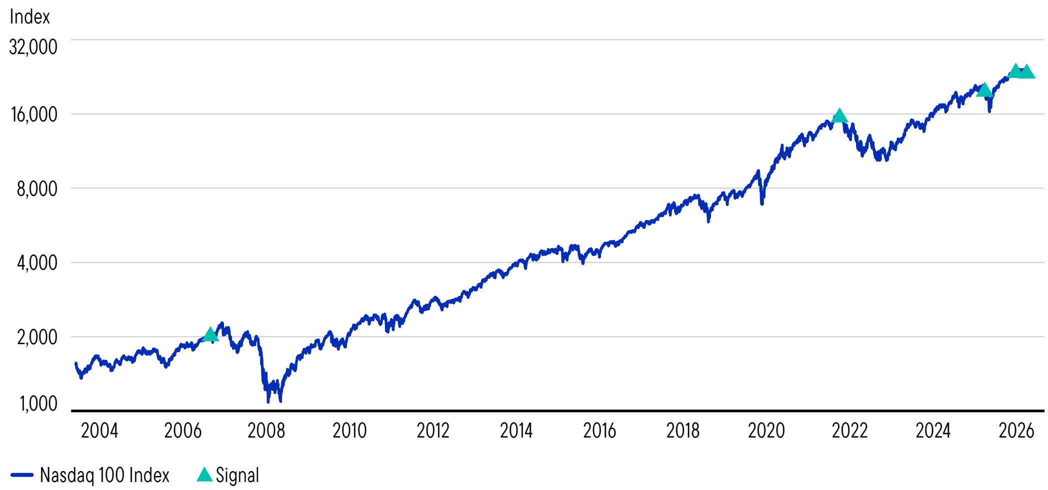
Weakness in the technology sector has created room for relative strength in the rest of the S&P 500 Index, small-cap equities and the Dow Jones Industrial Average—which recently surpassed the 50,000 milestone. However, such rapid leadership rotation is rarely a low-volatility process.

Notably, within the Nasdaq 100, the share of stocks reaching new 52-week highs and new 52-week lows is above 9% in both cases, an unusually rare configuration that signals rising intra-index volatility and rapid leadership rotation.

Exhibit 7: Within Nasdaq 100, More Stocks Are Reaching New Highs or New Lows

Growing Dispersion across Nasdaq Constituents

As of February 17, 2026



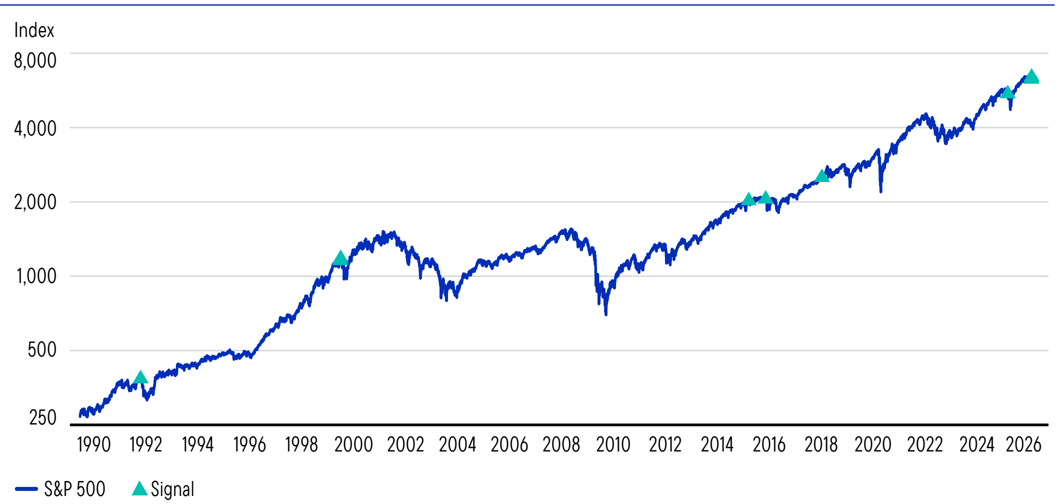
Sources: Nasdaq, S&P Global, Bloomberg, Macrobond. Analysis by Franklin Templeton Institute. Data as of February 17, 2026. The signals (teal plot points) represent when the percent of Nasdaq 100 stocks at one-year lows is above (>) 9%, and the percent of Nasdaq 100 stocks at one-year highs is above (>) 9% and the S&P 500 Index (SPX) has made a new all-time high over the prior 10 days. **Past performance is not an indicator or guarantee of future results.**

Similarly, rotation into defensive sectors has historically coincided with periods of elevated market volatility—not necessarily during bear markets, but environments in which pullbacks have become more frequent. The current market is experiencing an unusually sharp rotation, resulting in a rare degree of bifurcation beneath the surface: More than 10% of S&P 500 constituents have made new 52-week highs at the same time that more than 4% have made new 52-week lows.

Exhibit 8: Within S&P 500, More Stocks Have Reached New Highs or New Lows

Rising Market Bifurcation Beneath the S&P 500

As of February 17, 2026



Sources: Nasdaq, S&P Global, Bloomberg, Macrobond. Analysis by Franklin Templeton Institute. The signals (teal plot points) represent when the percent of Nasdaq 100 stocks at one-year lows is above (>) 4% and the percent of SPX stocks at one-year highs is above (>) 10%. Data as of February 17, 2026. **Past performance is not an indicator or guarantee of future results.**

What does it all mean for the S&P 500?

We expect modest gains for major US equity indexes in 2026 but with significant dispersion beneath the surface. We see this environment as well-suited for:

- Active management
- Exposure to less-favored stocks and sectors
- Thoughtful international diversification

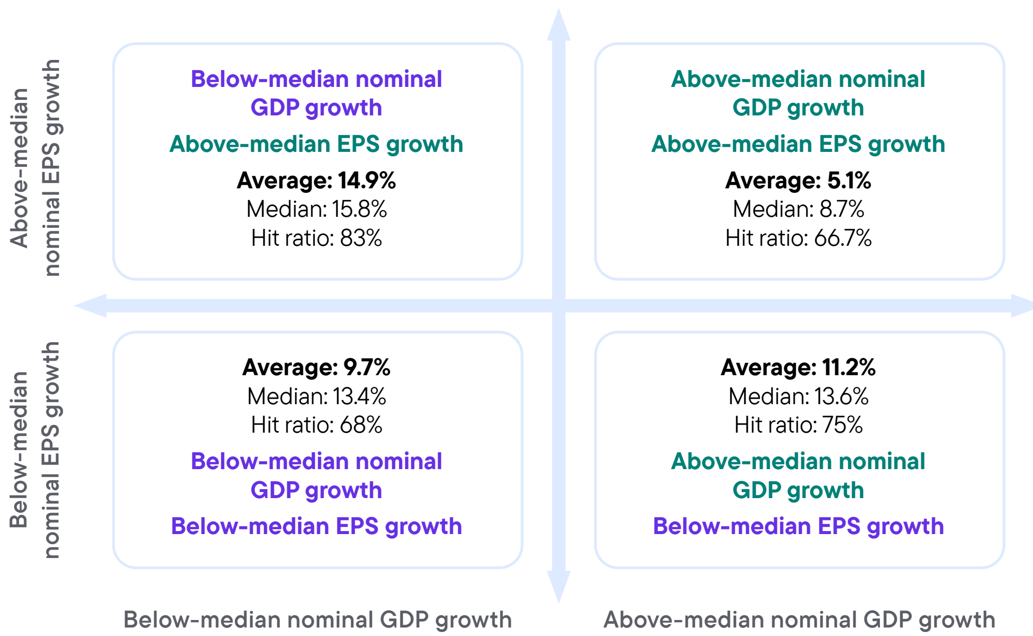
The US economy remains in a “goldilocks” phase, which means a combination of strong GDP growth, stable inflation, supportive policy conditions and solid earnings growth. These fundamentals support risk assets—but valuation and cycle dynamics matter.

Our analysis shows that in years when economic and earnings growth are strongest, S&P 500 returns tend to be modest, averaging around 5%.

Exhibit 9: Index Performance in Different EPS and GDP Growth Regimes

Average S&P 500 Annual Price Returns During Different EPS and GDP Growth Regimes

As of February 17, 2026



Sources: FactSet, S&P Dow Indices, Robert J. Shilller (Yale University), US Bureau of Economic Analysis. Analysis by Franklin Templeton Institute and Global Research Library. Average, median and hit ratios based on monthly S&P 500 return data for rolling, calendar-year periods from December 31, 1954 through December 31, 2024. The hit ratio is the success rate of a series of attempts to do or achieve something as measured against a potential outcome or result. **Past performance is not an indicator or guarantee of future results.**

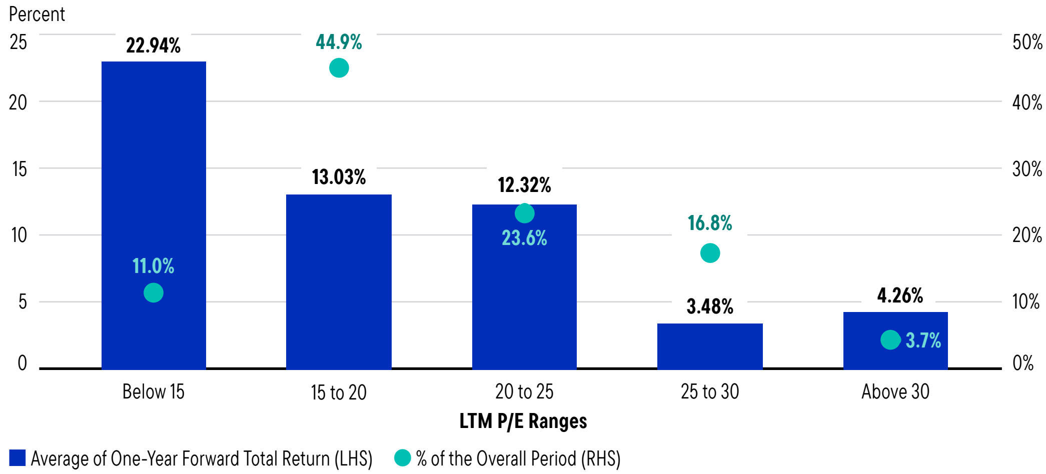
Similarly, history suggests that elevated valuations tend to cap forward returns. When the market’s trailing P/E has fallen within the 25–30 range—a regime that has occurred about 17% of the time—subsequent one-year returns have averaged roughly 3.5%. With the current P/E near 28,[3] the market is now operating within this historically lower-return valuation band.

3. Source: FactSet. As of February 11, 2026.

Exhibit 10: Current Equity Valuations May Limit Forward Returns

S&P 500: Relationship Between P/E and One-Year Forward Returns

May 31, 1990–December 31, 2025



Sources: FactSet, MSCI, S&P Dow Indices. Analysis by Franklin Templeton Institute and Global Research Library. Data for the period May 31, 1990–December 31, 2025. LTM means last 12 months. Indexes are unmanaged and one cannot invest directly in an index. **Past performance is not an indicator or guarantee of future results.**

Valuations do not cause corrections, but they *reduce the margin for error*. In this environment, even modest disappointments can drive outsized price moves, history suggests.

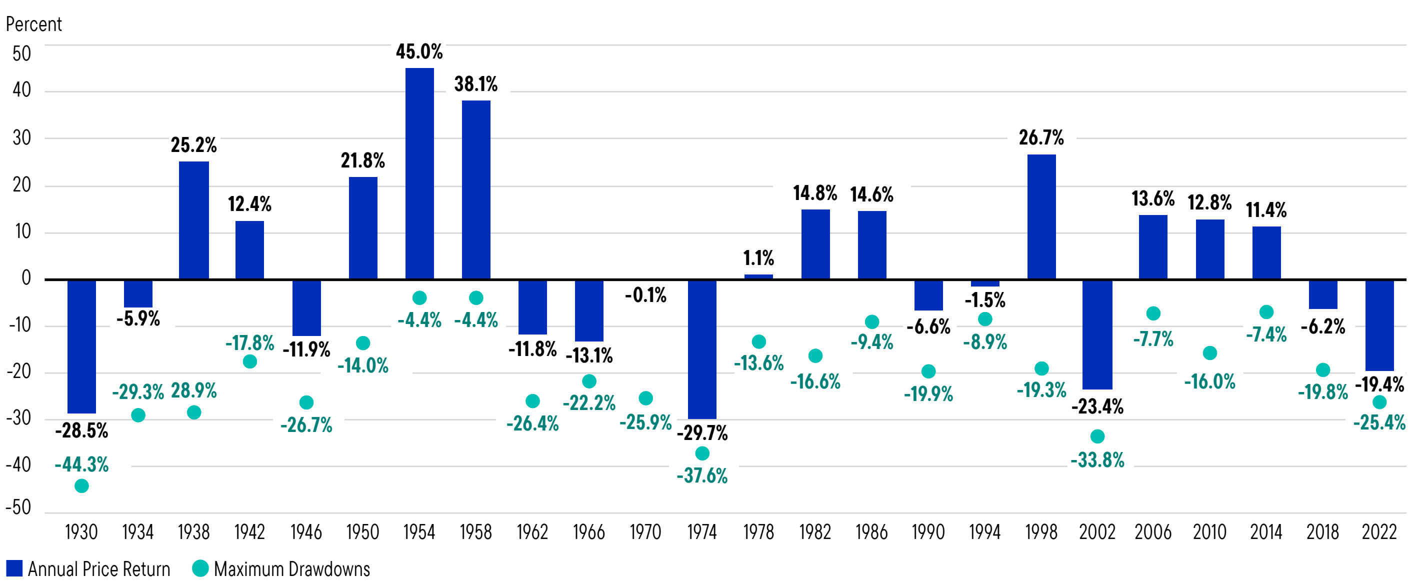
Midterm election years: volatile, but opportunity-rich

Market cycles also matter. Historically, only seven of 13 post-war bull markets have extended into a fourth year and returns in year four have often been mixed.[4]

The **midterm year** of the US presidential four-year election cycle has also been among the most volatile periods for equities. **Drawdowns of approximately 20%** have occurred, on average, once every four years—and frequently these happen during midterm election years.

Exhibit 11: S&P 500 Performance in Midterm Years Has Been Mixed

S&P 500 Annual Price Returns vs. Maximum Drawdowns in Midterm Election Years since 1930



Sources: FactSet, S&P Dow Indices. Analysis by Franklin Templeton Institute and Franklin Templeton Global Research Library. **Past performance is not an indicator or guarantee of future results.**

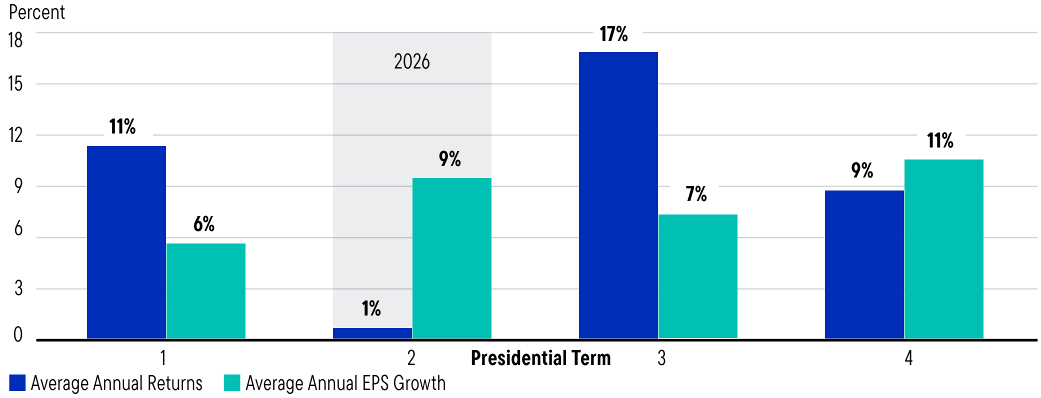
4. Source: Franklin Templeton Institute Research.

What's important, midterm election years tend to be more volatile, even when earnings growth remains solid.

Exhibit 12: US Equity Performance Has Significantly Lagged Earnings in Midterm Years

Average of Annual EPS Growth and Annual Returns

1970–2025



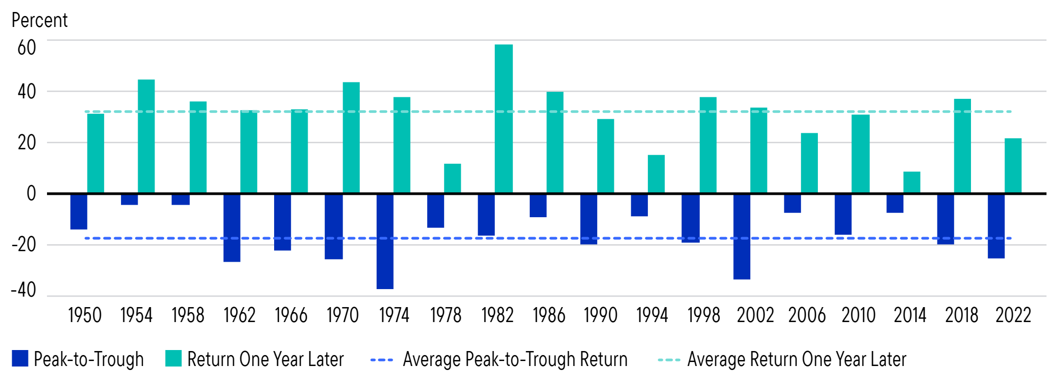
Sources: FactSet, S&P Dow Indices. Analysis by Franklin Templeton Institute and Franklin Templeton Global Research Library. Data for the years 1970–2025. The average EPS return is calculated using company earnings per share reported over the prior 12 months. **Past performance is not an indicator or guarantee of future results.**

Yet history also delivers an important counterpoint—buying equities during midterm election years—particularly near periods of peak uncertainty—has generated average one-year forward returns of approximately 32% following midterm market bottoms.

Exhibit 13: Midterm Years Have Offered Attractive Buying Opportunities

S&P 500: Peak-to-Trough During a Midterm Year and Next One-Year Returns

1950–2022



Sources: FactSet, S&P Dow Indices. Analysis by Franklin Templeton Institute and Global Research Library. Peak-to-trough data represents the market's decline from a peak level to a subsequent trough within each midterm election year. Return one year later represents the market return over the one-year period beginning at each trough. **Past performance is not an indicator or guarantee of future results.**

Managing risk is not market timing

Map A and Map B do not require two portfolios. They require discipline.

We believe a robust long-term framework rests on three principles:

1. Remain invested in a well-diversified portfolio of high-quality assets
2. Manage risk when you can, not when you must—when markets compel taking action
3. Add risk when the odds are favorable, not when complacency is high

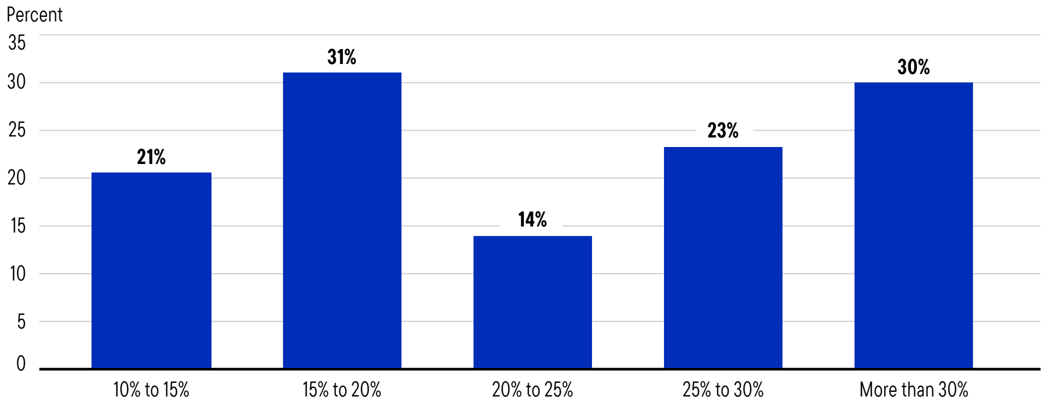
Market corrections are not anomalies. They are recurring features of equity investing. While long-term equity returns have averaged roughly 12.5% per year, investors who stayed disciplined through volatility were the ones who earned those types of returns.

History shows that buying during 15%–20% drawdowns has resulted in approximately 30% higher returns one year later, on average. This is not market timing—it is probability-aware portfolio management.

Exhibit 14: Market Drawdowns Have Often Given Way to One-Year Rallies

S&P 500 Maximum Drawdown Ranges and One-Year Forward Returns

As of February 6, 2026



Sources: S&P Global, Bloomberg, Macrobond. Analysis by Franklin Templeton Institute and Global Research Library. The period analyzed for S&P 500 drawdowns is from January 31, 1928 to December 31, 2025. There were 60 years in which drawdowns were greater than 10%. Data as of February 6, 2026. **Past performance is not an indicator or guarantee of future results.**

Bottom line

We remain constructive on US and global equities over the long term. We believe the global rotational bull market remains intact, supported by solid fundamentals and broadening participation.

At the same time, elevated valuations, crowded sentiment and midterm cycle dynamics point to a higher likelihood of volatility. Rather than undermining the investment case, this environment reinforces the importance of preparation and disciplined portfolio management.

The objective is not to forecast the timing of the next drawdown, but to ensure portfolios retain the flexibility to respond constructively—by rebalancing, selectively adding exposure and improving long-term outcomes when market conditions become less favorable.

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Glossary of terms

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

Earnings per share (EPS): A company's earnings divided by its outstanding shares of stock.

Equal-weight S&P 500 Index: The stocks of the S&P 500 weighted equally rather than by market capitalization, as in the case of the S&P 500 Index.

GDPNow: A running estimate of real GDP growth based on available economic data for the current measured quarter; not an official forecast of the Atlanta Federal Reserve Bank.

Hit rate: The success rate of a series of attempts to do or achieve something as measured against a potential outcome or result.

Price-earnings multiple: A ratio calculated by dividing a company's share price by its earnings per share, a measure of valuation.

Index definitions

Past performance is not an indicator or a guarantee of future performance. Indexes are unmanaged and one cannot invest directly in an index. They do not include fees, expenses or sales charges. Important data provider notices and terms available at www.franklintempletondatasources.com.

Dow Jones Industrial Average (DJIA): An unmanaged index composed of 30 blue-chip stocks, each with annual sales exceeding US$7 billion. The DJIA is price-weighted, reflects large-cap companies representative of US industry and historically has moved in tandem with other major market indexes such as the S&P 500.

MSCI All-Country World Index (ACWI): Captures large- and mid-cap representation across 23 developed markets and 24 emerging markets countries. With 2,517 constituents, the index covers approximately 85% of the global investable equity opportunity set.

The LBMA Gold and Silver Price benchmarks are the global benchmark prices for unallocated gold and silver delivered in London and are administered by ICE Benchmark Administration Limited. The LBMA Silver price auction is independently operated and administered by ICE Benchmark Administration Limited (IBA). The price is set daily in US dollars per troy ounce at 12:00 noon London time.

Nasdaq 100 Index: A modified capitalization-weighted index comprised of 100 of the largest non-financial companies listed on the National Market tier of the Nasdaq stock market.

Nasdaq Composite Index: A market capitalization-weighted index of more than 2,500 stocks listed on the Nasdaq stock exchange.

Russell 1000® Index: A market capitalization-weighted index 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 those Russell 2000 Index companies 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 Russell 2000 Index companies 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 widely-used S&P 500, which includes the same constituents as the capitalization-weighted S&P 500, but with each company 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.

S&P 500 Software (Industry) Index: Tracking the performance of companies in the software industry, this index includes a selection of companies in the S&P 500 that are significant players in the software sector, providing a measure of the overall market performance of software-related stocks.

S&P Software & Services Select Industry Index (SPSISS) tracks the performance of companies in the software and services sector, representing various sub-industries such as application software, IT consulting and internet services.

WHAT ARE THE RISKS?

All investments involve risks, including possible loss of principal.

Blockchain and cryptocurrency investments are subject to various risks, including inability to develop digital asset applications or to capitalize on those applications, theft, loss or destruction of cryptographic keys, the possibility that digital asset technologies may never be fully implemented, cybersecurity risk, conflicting intellectual property claims, and inconsistent and changing regulations. Speculative trading in bitcoins and other forms of cryptocurrencies, many of which have exhibited extreme price volatility, carries significant risk; an investor can lose the entire amount of their investment. Blockchain technology is a new and relatively untested technology and may never be implemented to a scale that provides identifiable benefits. If a cryptocurrency is deemed a security, it may be deemed to violate federal securities laws. There may be a limited or no secondary market for cryptocurrencies.

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

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.

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.

Large-capitalization stocks 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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