MARKETING MATERIAL

CIO View

CIO View Quarterly | Quarterly Market Outlook – Q2 2026

May 25, 2026

Positives in negative times

Micro beats macro. The Iran war and inflation are being overshadowed in the markets by the AI boom, where profits are no longer artificial but real. Markets are bifurcated in many ways.

Vincenzo Vedda
Chief Investment Officer

> "We call it bifurcation: the market is heading down two tracks. The AI train, to take a metaphor from old technology, is steaming ahead, with more and more sectors getting on board. But growth faces a bottleneck in the Strait of Hormuz, from which inflation is beginning to emanate. In the short to medium term, much still depends on the Iran crisis. But in twelve months' time, in our view, that crisis should be in the past, allowing economies and markets to move forward."

Surprises, negative developments, and positive outlooks. This is how one might summarize what has happened between our strategy meetings of February 26 and May 19. The attack on Iran by the U.S. and Israel has substantially influenced our 12-month forecasts in two negative ways. We have had to revise the growth rates of most economic regions slightly downward and inflation rates slightly upward. As a result, central banks have lost considerable room for maneuvering (i.e., for interest rate cuts). Among the surprises is the fact that the Strait of Hormuz has remained largely closed for much longer than originally feared, and a viable peace agreement is still not in sight. Equally surprising, however, is just how resilient the global economy has nevertheless remained, as evidenced by strong corporate earnings in the first quarter – not only in the technology sector.

As a result of this, our latest capital market forecasts differ surprisingly little from those in February. Our positive outlook is based, on the one hand, on the resilience of economic actors, who demonstrated previously during Covid and the Ukraine war how quickly they can adapt to changing conditions. Another positive is the still surprisingly strong momentum of the AI boom. Two examples: first, within twelve months, analysts' estimates for the capital expenditure (capex) volume of the five major hyperscalers in 2026 have almost doubled to nearly USD 800 billion; second, one-third of the U.S.'s economic growth this year is likely to be driven by AI investments. The momentum appears unbroken, especially as AI-related investments are spreading to more and more sectors.

Of course, there is no shortage of risks. Purely from a market-technical perspective, a failed IPO by one of the U.S. tech giants (particularly SpaceX, Anthropic, or OpenAI) could dampen the euphoria, as could any indication that AI investments are creating capacity that significantly exceeds sustainable demand. A blockade of the Strait of Hormuz extending into autumn would also jeopardize our forecasts, as would escalating concerns in the government bond market given still unchecked budget deficits, particularly in the U.S., where the government's debt levels are already high.

Outlook for June 2027: declining inflation, growing corporate earnings, rising asset prices

Inflation and growth concerns, such as those triggered by the Iran war, do not initially sound like a stable foundation for rising asset prices. The oil-price shock directly impacts prices and keeps inflation risks high. At the same time, it is beginning to weigh on growth, as higher energy costs constrain both consumption and investment. However, our price targets for June 2027 are based on market expectations for the twelve months that follow. We believe that by then the inflationary pressures stemming from the Iran war should have subsided significantly and inflation rates should already be declining. By then, the economic headwinds from disrupted supply chains should also have smoothed out. For the time being, however, uncertainty surrounding the Iran war is likely to cause further volatility in the markets.

Central banks' room for maneuver likely to increase as commodity prices fall; total returns on bonds attractive

Based on an oil price forecast of USD 82 per barrel of Brent in a year's time, manageable second-round inflationary effects and moderate economic growth, we see a favorable environment for bonds. In the U.S., contrary to market expectations, we see rate cuts rather than hikes from the U.S. Federal Reserve (Fed) as likely. Accordingly, we expect falling bond yields, particularly at the short end. We also expect lower yields for German government bonds, especially at the short end. Corporate bonds are supported by continued strong demand and in our view attractive total returns, even though tight spreads to government bonds leave little room for disappointment from a valuation perspective. In currencies, we see a well-supported dollar as long as the geopolitical situation remains unsettled. Assuming an easing in tensions, we would expect the dollar to weaken against most currencies.

In equities, not only the tech sector is benefiting from the AI boom

The most important driver of equity markets remains AI-related technology. Strong earnings growth in the tech sector, rising investments by hyperscalers, supply bottlenecks and increasing success for AI providers in monetizing their products are sustaining the momentum. We expect different sector weightings in indexes to continue to be reflected in regional equity performance. Asia and the U.S. benefit disproportionately from the AI boom while regions with a more diversified structure lag behind. European equities are also more affected by two nearby wars.

We have upgraded emerging markets (which include semiconductor heavyweights in South Korea and Taiwan) to Positive. Japan remains Positive just as the U.S. remains Neutral due to cyclically high earnings combined with high valuations. At the sector level, we have upgraded Utilities as an additional AI beneficiary and downgraded the Healthcare sector, where earnings growth has fallen short of expectations.

Another disruptive year calls for diversification

Micro beats macro is a concise description of current market conditions. As two wars continue and global trade structures keep being disrupted, the consensus nevertheless expects earnings growth for the MSCI AC World Index of around 25%. That would be unprecedented outside recovery phases following a recession. We therefore see earnings growth, rather than expanding multiples -- we are reducing our target price earnings multiples -- as the likely main driver of equity markets. Equities are also continuing to benefit from a mildly inflationary environment. Bonds, for their part, currently offer high total returns and could serve as a relative hedge should economic growth weaken more than expected. Gold and alternative investments, for example in energy-related infrastructure, could, in our view, help to make a portfolio more resilient against different scenarios. Our belief in remaining diversified across regions, sectors and asset classes has not weakened.

[1] All data according to Bloomberg Finance, L.P. as of 5/20/26 if not stated otherwise

Glossary

Brent crude is a grade of crude oil dominant in the European market.

Capital expenditure (Capex) are funds used by a company to acquire or upgrade physical assets such as property, industrial buildings or equipment.

Emerging markets (EM) are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

A hedge is an investment to reduce the risk of adverse price movements in an asset.

Hyperscalers are large cloud service providers, which can provide services such as computing and storage at enterprise scale.

Inflation is the rate at which the general level of prices for goods and services is rising and, subsequently, purchasing power is falling.

The MSCI AC World Index captures large- and mid-cap companies across 23 developed- and 24 emerging-market countries.

A recession is, technically, when an economy contracts for two successive quarters but is often used in a looser way to indicate declining output.

The spread is the difference between the quoted rates of return on two different investments, usually of different credit quality.

The U.S. Federal Reserve, often referred to as "the Fed," is the central bank of the United States.

Volatility is the degree of variation of a trading-price series over time. It can be used as a measure of an asset's risk.

Yield is the income return on an investment referring to the interest or dividends received from a security and is usually expressed annually as a percentage based on the investment's cost, its current market value or its face value.

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as of 5/20/26; 102647_9 (05/2026)