Asset Allocation Insights

USD EDITION

QUARTERLY REPORT | **JUNE 2026**

AI capex fuels economic growth and drives equities to new highs, but high fuel prices risk demand destruction. Energy security has become economic security.

Equity markets are at all-time highs, but AI is the only story in town
Since the equity market rebound in April, fewer than 15 names contributed more than 50% of the total return of the FTSE All-World Index, all of which are related to the AI theme. That jumps to 75% if we include the wider Technology industry. Leadership is very narrow.

Forward-looking growth measures are declining, with inflation expectations elevated
AI capex is driving growth, while broad cross-sectional measures of growth have been turning down since February. Hot inflation prints show that high inflation has been driven by more than just energy. Over the last 3M, the energy trade has been the main driver of FX moves.

But value matters and valuations are looking more reasonable
Relative to history, government bond yields look quite attractive, but risky corporate bonds are rich with spreads near 10-year lows. Whilst equities are still rich, they are no longer at extreme valuations. FTSE Dev APAC ex Japan is in the bottom decile for valuations over the last 10Y.

Taiwan overtakes China as the largest market in the FTSE Emerging Index
FTSE Taiwan has returned >60% YTD, driven by strong performance from TSMC and MediaTek. Relative performance has increased Taiwan's weight in the FTSE Emerging Index from c. 19% 12M ago to c. 33%; TSMC alone has a weight of ~17% in the Emerging index.

Energy security is a requirement for economic security
Closure of the Strait of Hormuz has highlighted the risk not just to energy prices, but to energy security. The first-order effect is substitution within fossil fuels, but long term it catalyses the green energy transition; FTSE Environmental Opportunities Index is up 21.6% YTD.

Correlations sharply higher; allocators need to think harder about diversification
Equity-bond correlations have been strongly positive (+0.44) on a rolling 52W basis, reducing the diversification benefit from bonds. Within fixed income the correlation between nominal and inflation-linked bonds is +0.88, mitigating some of the inflation hedging benefits of linkers.

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Chart 1: Fewer than 15 stocks, all linked to AI & semiconductors have generated >50% of the return of the FTSE All-World Index since March.

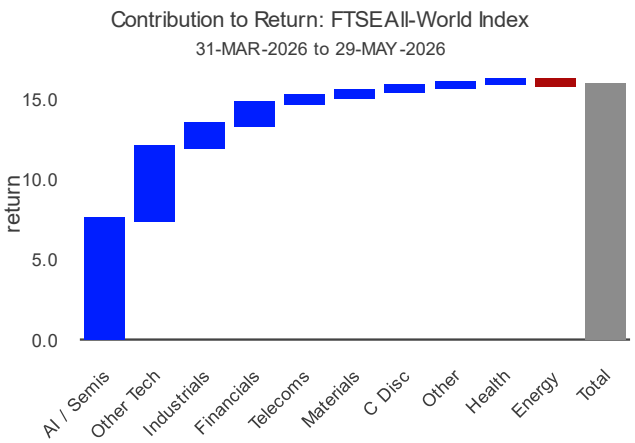
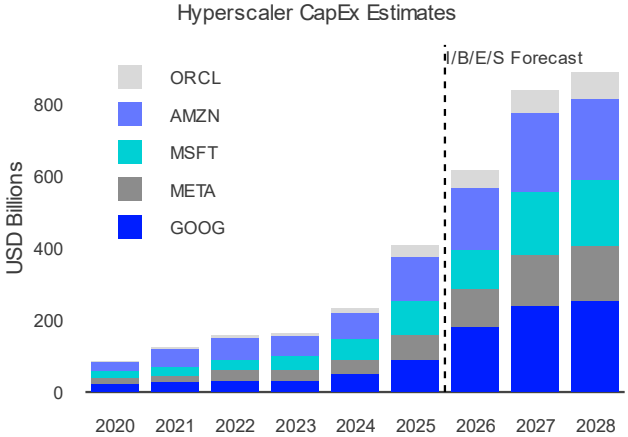


Chart 2: IBES estimates show 5 names in the US are expected to spend >$600 billion in AI related capex in 2026 – a 50% increase on 2025.



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Financial Markets Overview

Macro: Estimates for Real GDP growth in the US came in at a respectable 1.6% in Q1, revised down from 2.0%. However, the underlying data shows the lion's share came from 'Investment' which is largely attributable to AI capex, with the consumer relatively subdued. Spending on AI capex by hyperscalers is expected to grow >50% YoY in 2026 to over $600bn and continue growing to >$900bn in 2028 which may fuel further economic growth.

Outside of the AI theme, macro data has been softening since the start of the Middle East conflict. Reuters Poll 2026 Real GDP have declined, consumer confidence is extremely weak, and there are indications that higher inflation expectations are becoming more entrenched; that matters because entrenched expectations shift central bank reaction functions and make them more hawkish.

Equities: Since the rebound (from 31 March) in equities after the initial Middle East energy shock, <15 names have contributed >50% of the total return of the FTSE All-World; all linked to the AI theme. Key beneficiaries are those we have labelled as the 'picks and shovels' of AI, those involved in hardware. Allocators need to be more granular than 'just' Technology. Within FTSE All-World Technology there is a c.50ppt YTD performance spread between Hardware & Software, and the top performing industry is Telecommunications because Samsung is classified as a telco but is also a leading supplier of High Bandwidth Memory (HBM). AI capex is projected to grow on IBES estimates although we highlight that in the Q1 earnings season investor reaction to increased capex spending has become more discerning, with markets wanting to see a clearer link between investment and revenue.

Fixed Income (Rates & Credit): G7 7-10yr sovereign yields have risen to levels higher than those seen a year ago, driven by higher inflation expectations and near-cyclical-high real yields. 7-10yr Treasury yields were near 4.4% by end-May, with 10Y term premium generally higher in 2026 vs 2025 average. US and Europe 20s/2s curves bear flattened over 3M due to rising expectations of central banks' hawkish stance, while JGB curve bear steepened to the steepest level in a decade.

Credit spreads have re-tightened to historically low levels, aligned with the risk-on sentiment in equities. Empirical results based on index data since 2000s confirm starting valuations have been correlated with forward returns in Fixed Income, with credit currently rich and rates cheap relative to their own histories. Across equity and fixed income, healthy corporate balance sheets and strong earnings growth related to AI optimism mean equities & credit have both rallied, while poor fiscal situations, geopolitical instability and high term-premia are keeping sovereign yields elevated.

Emerging Markets: EM equities (2.5%) underperformed DMs (8.1%) over 3M, mainly due to EMs' larger exposure to the energy shock since March. Taiwan's key role in the AI supply chain helped boost the real economy, as well as its equity market (12M returns of 124%). EM capital flows in April point to a stronger recovery in fixed income than in equities during the initial recovery phase.

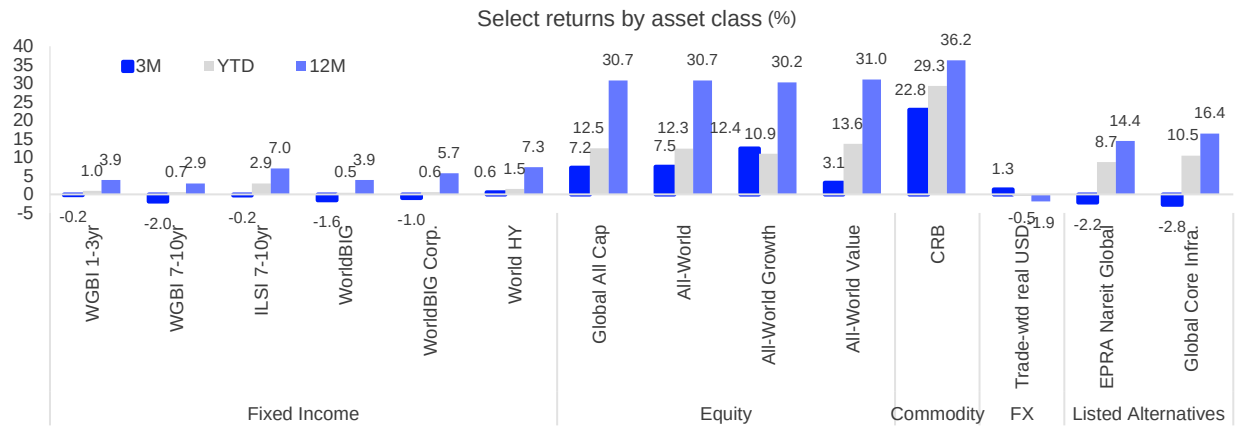
Commodities: The Brent Crude futures curve has flattened since the peak in the spot price, around 31 March, but longer expiries remain anchored around $80 per barrel. The interpretation is that energy markets are anticipating a faster normalisation of oil supply, but that the risk premium is being priced higher for longer, which would lead to higher average energy prices. Meanwhile 'energy transition' commodities like copper and lithium have rallied YTD on firm demand for alternative energy sources.

Currency: Exposure to the energy trade has been the primary driver of FX moves over 3M. Relative to the USD, the Norwegian Krone (NOK) and the Brazilian Real (BRL) appreciated, whilst currencies like the Korean Won (KRW) and the Indian Rupee (INR) where the economies are large net importers of energy depreciated.

Through May, the Bank of Japan (BoJ) spent a record ¥11.7 trillion (approx. $73bn) defending the Yen, potentially to create support around the psychologically important ¥160 per dollar level. Allocators to Japanese assets should factor in their expectations for dollar-yen and hence whether to hedge their Japanese exposures.

Correlation & Cross-asset: From 2022-2025 cross-asset correlations had broadly been declining, but they have gapped higher in 2026. Rolling 52W correlation between equity and bonds is circa. +0.4 vs. a 10Y trend of -0.2 implying less protection from bonds in a balanced portfolio. Broadly, intra-equity correlations are near 10Y averages with the notable exception of EM where the DM-EM correlation has spiked up and EMs are co-moving more closely with DM peers. Within Fixed Income nominal-linker bond correlation is circa. +0.9 meaning broad index-linked exposures aren't necessarily going to act as a hedge against stagflation.

Chart 1: Commodities led returns over 3M, YTD, and 12M, largely driven by the oil price rally. All-World equities (7.5%) outperformed fixed income over 3M, helped by the recovery in risk-on sentiment in April and May. Within equities, Growth (12.4%) caught up quickly with Value (3.1%) over 3M, narrowing their YTD gap. Inflation-linked (ILSI 7-10YR 2.9%) continued to outperform nominal sovereign and corporate bonds YTD. Listed Alternatives lost 2.2-2.8% over 3M, lagging equities YTD. The US dollar strengthened 1.3% over 3M, particularly versus many EMs which are vulnerable to the energy supply shock.



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Macroeconomic Backdrop

Repercussions of the Middle East conflict showing in macro data. Reuters Poll expectations for real GDP for 2026 have broadly been downgraded since February.

The Brent Crude futures curve flattened in May, implying greater confidence in a resolution around the Strait of Hormuz and normalisation of oil supply in the near term. It is important to note longer-dated contracts (>12M) are still pricing in higher-for-longer risk premia implying a protracted period of high energy prices even if a resolution is achieved.

Macro surprises have been mixed: US, UK & Japanese macro data has been surprising positively, whilst European data has undershot already downgraded expectations. US real GDP grew by 1.6% in Q1 (BEA) but primarily fuelled by Investment, and largely attributable to AI capex. Meanwhile US consumer sentiment is weakest it has ever been, with data back to 1959, and CPI printed at 4.2% YoY for May. Notably, US inflation isn't 'just' energy prices, with Core CPI running at 2.8% and several sub-components >3%. This matters because if inflation becomes more widespread, and high inflation expectations become entrenched, then it increases the probability of a hawkish Fed bias..

Chart 1: Since Feb '26 Reuters Poll real GDP estimates for 2026 have declined between -0.2% and -0.6% for the US, UK, Europe, Japan and India; Korea has been flat and China has increased 0.1%.

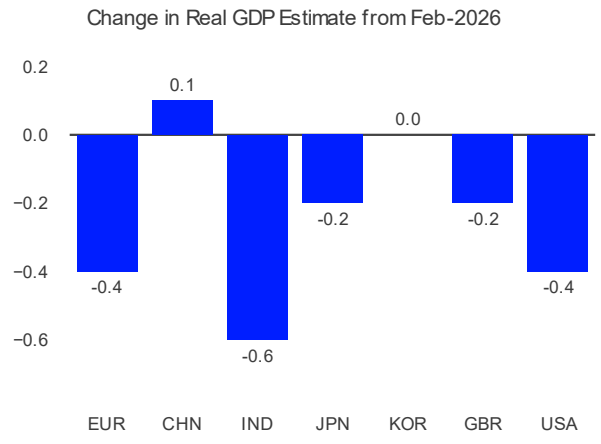


Chart 2: US, UK & Japanese data surprising to the upside, whilst European data undershot expectations. Expectations in the UK had been downgraded and data showed some resilience. Source: Citi

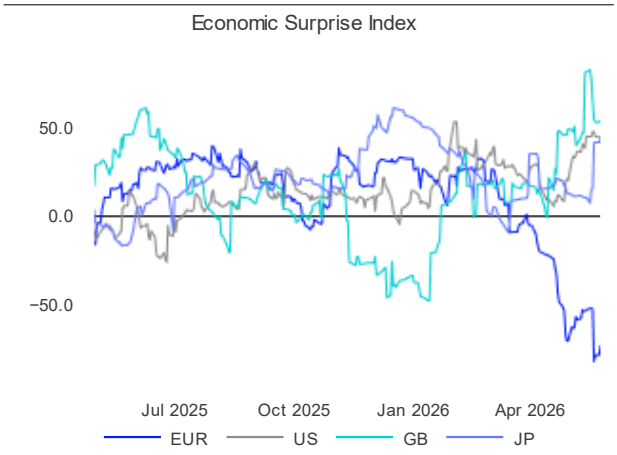


Chart 3: The front of the Brent curve has flattened, but the longer end (>12M) is higher than at end-March implying a higher risk premium, accounting for the risk of further supply shocks, rebuilding costs etc.

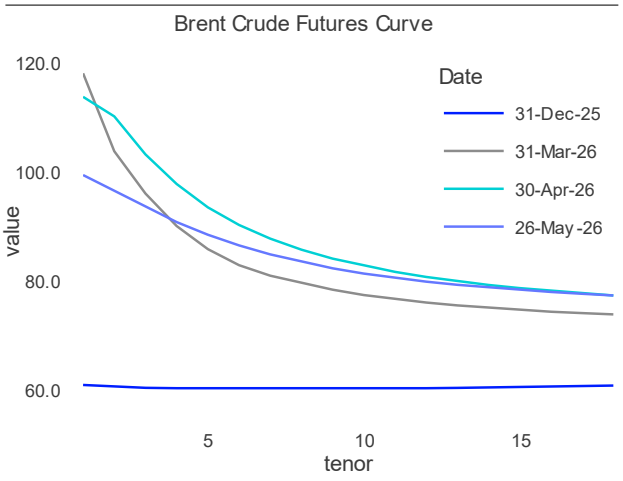


Chart 4: US real GDP grew by 1.6% in Q1 (revised down from 2.0%), although there was an outsized contribution from Investment and the consumer remained subdued. Source: Bureau of Economic Analysis

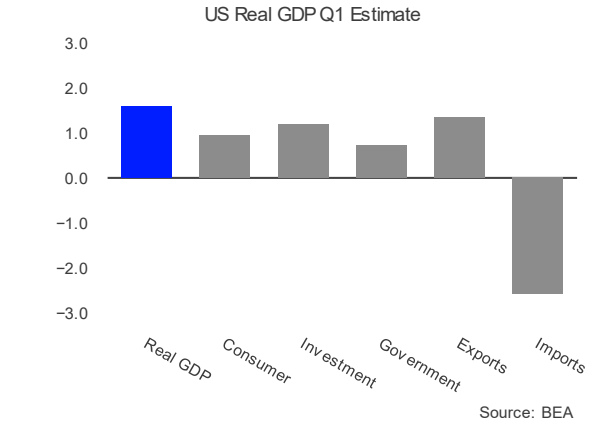
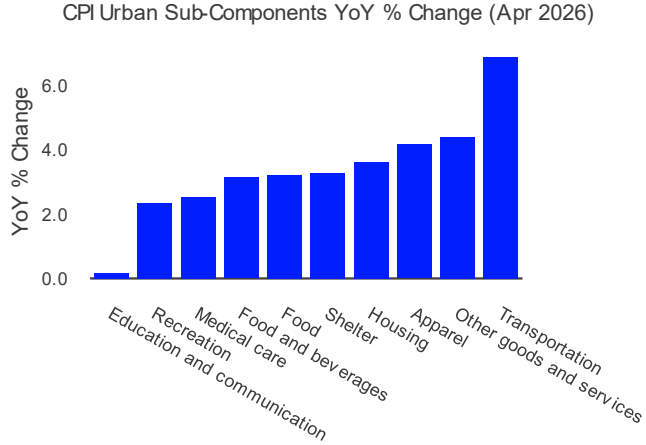


Chart 5: Whilst energy was a large contributor to headline US CPI rising, several sub-components are tracking >3% including Shelter, Transport, Food and Apparel; this risks ingraining high inflation expectations.



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Macroeconomic Backdrop (Continued)

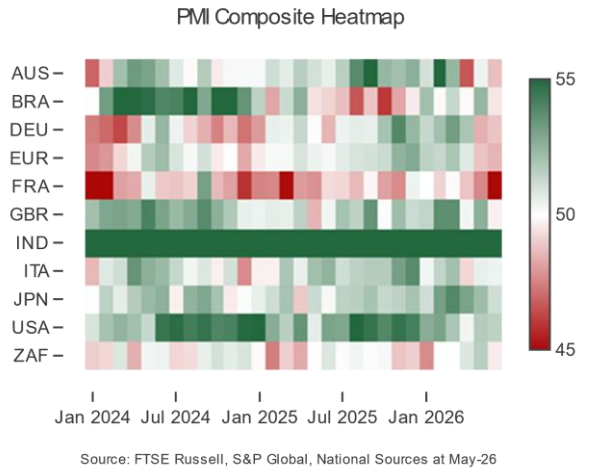
Consumer confidence is also weak on the other side of the Atlantic. European inflation expectations (2Y inflation swaps), have risen from 1.7% to 2.9% YTD. Concurrently, the Euro PMI composite has fallen <50, the level separating expansion from contraction. Weakening PMIs isn't just a European story with composite PMIs having broadly weakened globally, implying a softer growth outlook.

Export growth in South Korea & Taiwan has grown exponentially as the markets are the 'picks and shovels' of AI. Demand for AI hardware is expected to continue, with IBES estimates suggesting capex spend for the top 5 hyperscalers is expected to grow by 50% in 2026 to >$600bn; current estimates for 2028 are >$900bn.

Whilst Asian exports have been growing rapidly at a global level there is an interesting spread opening between the value and the volume of trade. IMF data on maritime trade shows the value of trade has increased by c. 2% YoY, whilst the volume of trade has declined c. 4%.

AI is powering growth, but stagflation risks are elevated as the breadth of growth has declined and inflation spreads outside of energy risk becoming more entrenched.

Chart 1: YTD PMI composites have broadly turned lower in developed markets, with Europe dipping <50, the level which separates expansion from contraction; several emerging markets have seen improvement.



Source: FTSE Russell, S&P Global, National Sources at May-26

Chart 2: Consumer sentiment in the US is the weakest it has ever been in the U-Mich survey going back to 1959. In Europe, sentiment is back to 2022 levels but isn't yet at the trough of the inflation crisis from 2022/23.

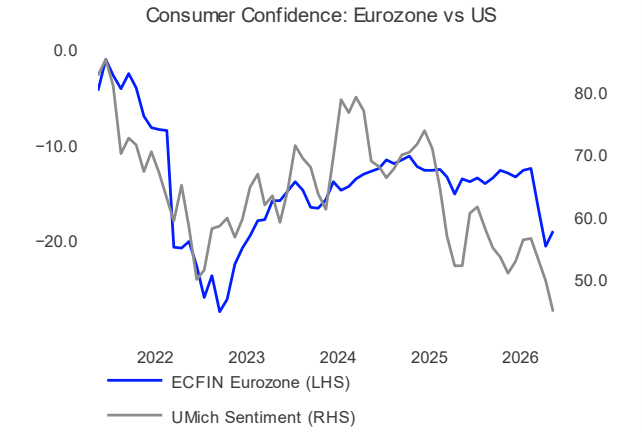


Chart 3: Korea has a dominant share in High Bandwidth Memory (HBM) which is a key bottleneck in AI workflows. Demand has driven semiconductor export growth to circa 170% YoY in May.

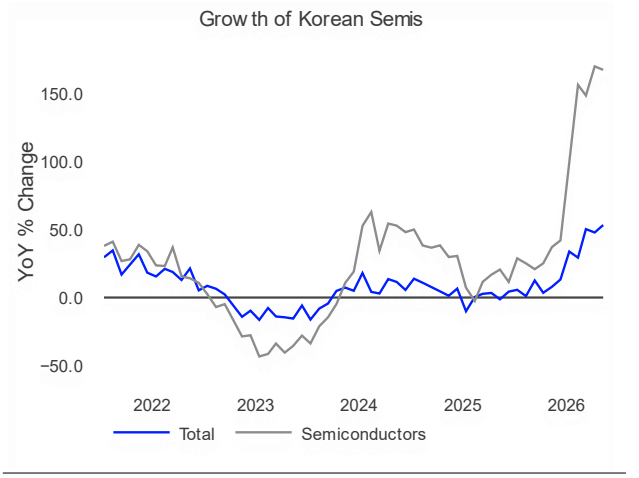


Chart 4: Maritime global trade values have grown as the price of goods has increased, but the volumes of goods traded have seen a notable decline year-over-year. Source: IMF Port Watch

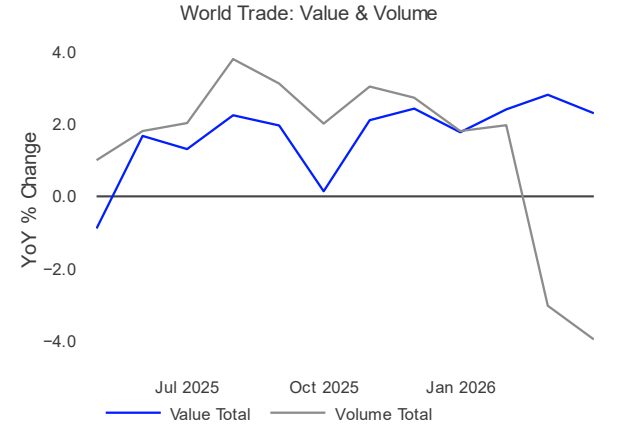
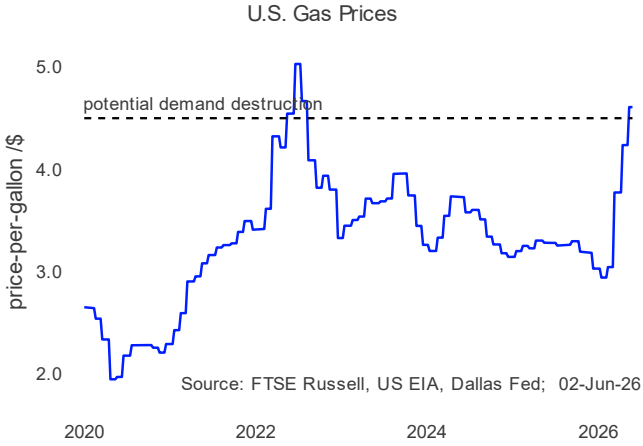


Chart 5: Gas prices in the US have crossed $4.50 per gallon, a level that work by the Dallas Fed had highlighted may signal demand destruction. This is an important signal in the run up to the US mid-terms in Nov.



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Sovereign Yield Curves

Inflation expectations were a key driver of higher sovereign yields over 3M, led by the UK.

The energy shock in the Middle East has brought sovereign yields to new cycle highs, with 7-10yr Treasury yields rising to 4.36%, the highest since Jan 2025. Treasury 10Y term premium has been higher in 2026 vs 2025 average. UK 7-10yr yields eased modestly from April peak, but stayed near 4.7%, a level last seen back in 2008. The prospect of looser fiscal policy supported the elevated yields in the UK. Chinese 7-10yr yields fell back to 1.6%, less correlated with peers (Chart 1).

Inflation expectations have been a key driver of rising yields since the Middle East conflict started. Market-implied US 1-3yr inflation expectation has fallen from the April peak of 3.2% to 2.7%, but levels remain higher than pre-shock. In response to higher inflation expectation, futures markets have repriced materially higher over 3M, with the expected policy rate by end-2026 rising by about 70bps, while expectations from 2028 onward have increased by roughly 100bps (Charts 2, 3 &5).

US and Europe 20s/2s yield curves *bear flattened* over 3M, as shorter yields rose more on prospects of potential rate hikes. But investors are still better compensated for holding duration, with curve slopes above their 10yr means. In contrast, the JGB curve *bear steepened* to the steepest level in a decade.

Chart 1: G7 government bond yields rebounded from Feb lows and now stand at percentile levels above those seen a year ago. UK and US 7-10yr yields are well above their long-term averages since 2000. JGB 7-10yr yields climbed further to 2.5%, the highest since 2000.

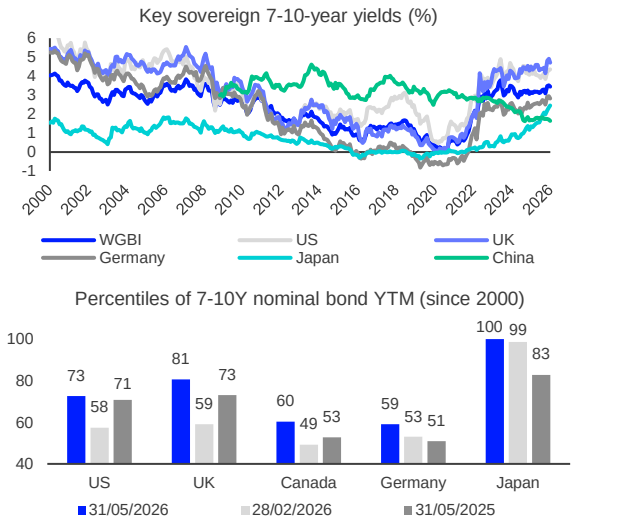
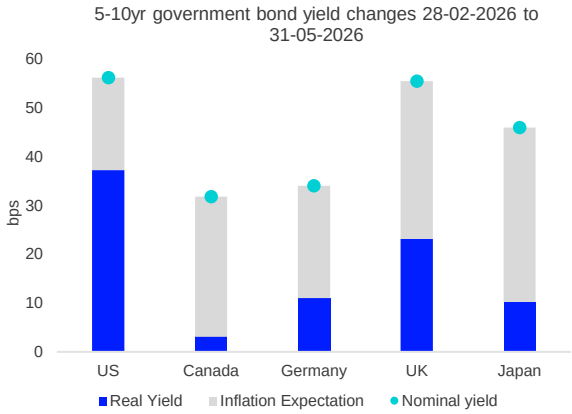


Chart 2: 5-10yr nominal yield increases since end-Feb were largely driven by higher oil-related inflation expectations, with the UK particularly exposed due to its dependence on imported energy.

Chart 3: Market-implied US 1-3yr inflation rate has eased from April peak of 3.2%, to 2.7%. Compared to pre-March levels, breakeven inflation rates are still modestly higher across all maturities, particularly in 7-10yr.



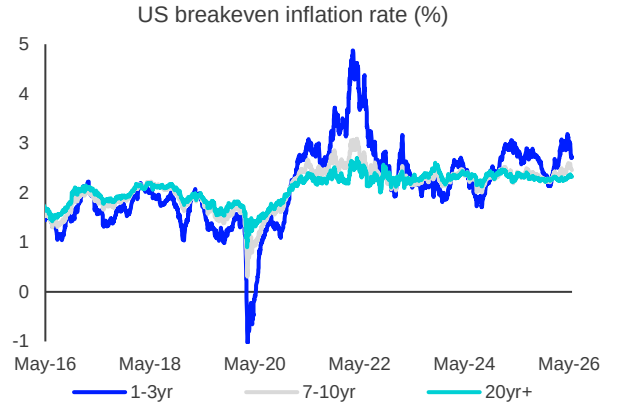
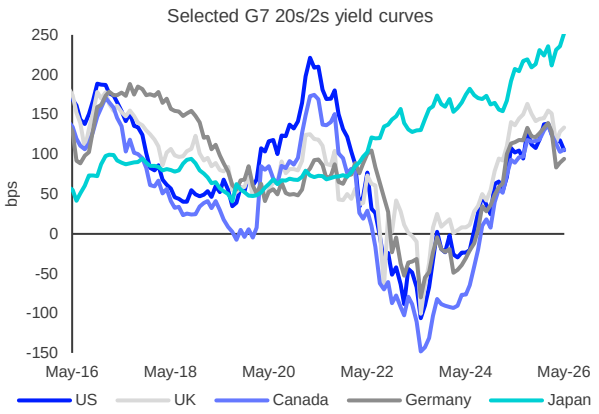
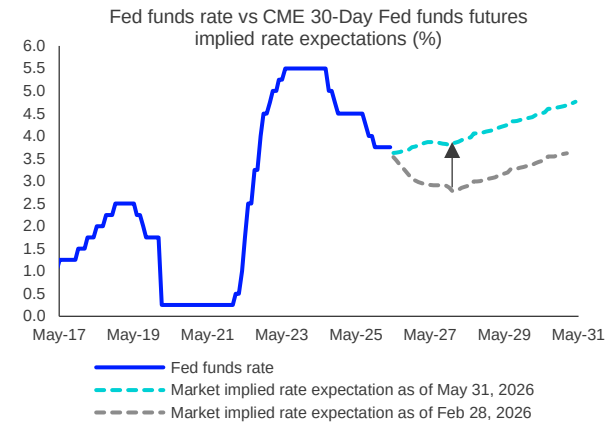


Chart 4: US and UK 20s/2s curves *bear flattened* to levels last seen a year ago, as shorter yields rose more sharply vs longs. German curve flattened to a larger extent. JGB curve further *bear steepened*.

Chart 5: Market expectation of the US policy rate has moved up over 3M, due to higher inflation expectations. The expected policy rate by end-2026 was up by 70bps, while those for 2028 and beyond were up by 1%.





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Credit

Credit spreads have re-tightened to historical lows, mirroring the recovery in equities. But valuations are stretched, which limits the scope for further spread compression.

Emerging HY and US HY led 3M returns in credit markets, with returns of up to 1.8%. Euro bond returns were offset by EUR depreciation vs USD (-1.2% over 3M). High yield generally outperformed IG YTD, across the US, Euro and EM. The rise in IG CMDI (Corporate Market Distressed Index) relative to HY likely reflects greater sensitivity of IG to rates volatility recently, while HY benefited from the risk-on rebound (Charts 1 & 5).

Credit spreads widened only modestly following the energy shock, in contrast to the sharp widening during the Covid shock. US IG and HY remain the richest across regions, indicated by spread percentiles near the lowest over 10Y (Charts 2 & 3). Both improved credit quality (Chart 4) and shorter durations in corporate bond markets may help explain tighter spreads in recent years.

With spreads already very tight, and risk-free yields still elevated, corporate bond returns have been driven more by carry and rates than by spread compression.

Chart 1: Over 12M, corporate bonds broadly outperformed sovereign returns of up to 4%. HY outperformed IG across major regions, most notably in Emerging credit (EM HY 8.8% vs EM IG 6%).

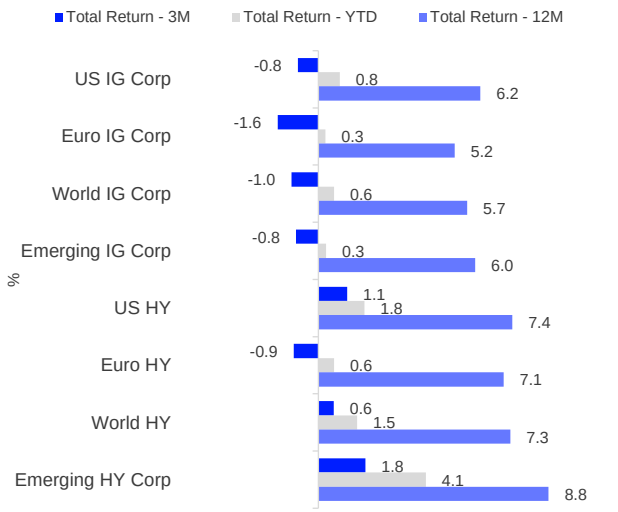


Chart 2: IG credit spreads tightened in April and May, to 10-year lows, after a modest tick up in March. IG spreads proved more resilient to the energy shock, widening far less than during Covid, including in EM IG.

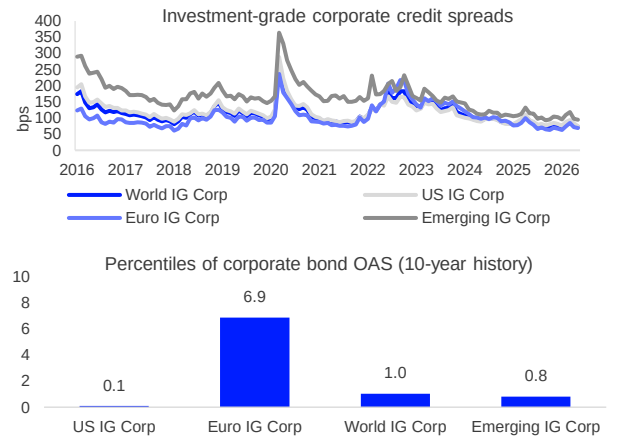
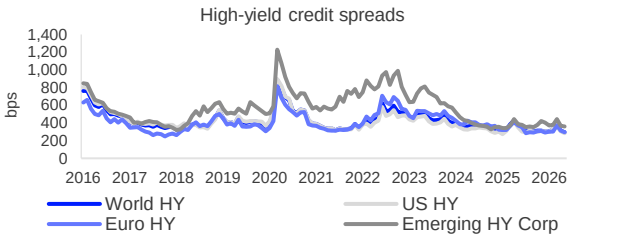


Chart 3: HY spreads tightened to YTD lows in May 2026, across the globe, staying near the lowest levels over 10Y. US HY spreads (285 bps) are now tighter than Euro HY (294 bps) and Emerging HY (360 bps).



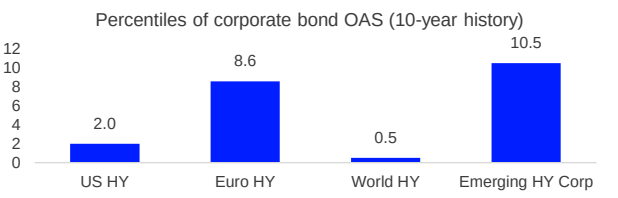


Chart 4: Credit quality of the high yield universe has improved in both US and Euro, alongside spread compressing. Euro HY credit quality remains better than US peers (Euro BB 68% vs US BB 56%).

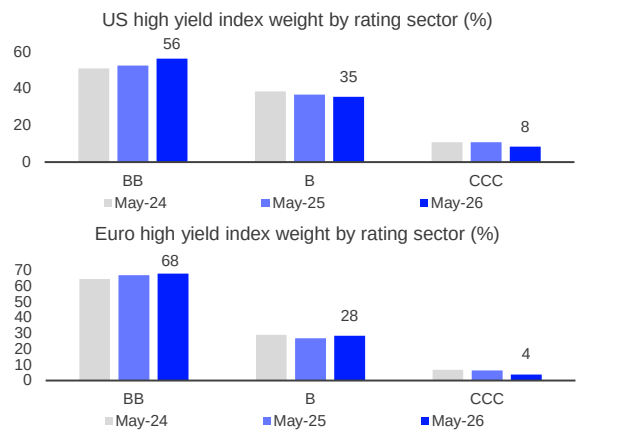
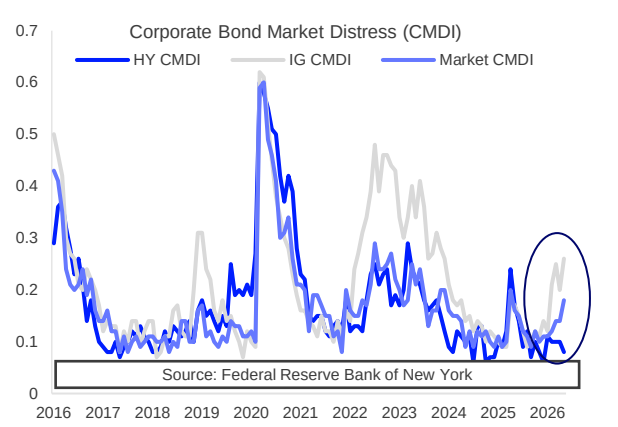


Chart 5: US market CMDI* increased to 0.18 in May, from 0.11 at end-2025, largely driven by the IG sector (from 0.14 to 0.26). HY distress index ticked up early this year, while falling back to 0.08 the latest.



Source: FTSE Russell/LSEG. All data as of May 31, 2026 unless otherwise stated. *Corporate Bond Market Distress Index. Past performance is no guarantee of future results. This report should not be considered "research" for the purposes of MIFID II. Please see the end for important legal disclosures. Results in this report are for research / illustrative purposes and do not represent the official performance of the indices.

Spotlight: Does valuation really matter in Fixed Income?

Across government and credit markets, higher starting yields and wider spreads have historically been reliable predictors of stronger forward returns.

Empirical results, based on data from FTSE Russell indexes, show peak correlation of subsequent returns with initial valuations occurs where time to maturity is closest to the investment horizon, for both US Treasuries and US HY (Chart 1); 2Y for the 1-3Y Treasury index, 3Y for US HY (given a mean modified duration of 4.6).

For longer-duration Treasuries, 7-10Y and 20Y+, mean reversion in yields causes the duration effect to average out over time, leaving starting yields, carry and roll-down as dominant drivers of returns, with generally positive yield curves. This is seen in Chart 2. Despite wide variation in duration price effects across yield ranges from 2000-2016, forward returns closely track starting yields. Similar to Treasuries, US HY forward returns have largely tracked starting valuations, measured by OAS* (see Chart 4).

Furthermore, average forward returns in Treasury yield quintiles reveal strong valuation effects, with higher starting yields associated with stronger forward returns, and vice versa. The same pattern is evident across major G7 bond markets, including the lowest yielding JGBs (Chart 3).

Chart 1:Empirical results support the economic intuition that yields and spreads have stronger predictive power for future returns when bond duration matches the investment horizon. 20Y forward returns may be subject to higher auto-correlation due to greater overlap in observations.

	US 1-3Y index yield	US 7-10Y index yield	US 20Y+ index yield	US high yield OAS
1Y Fwd returns	0.84	0.53	0.40	0.64
2Y Fwd returns	**0.95**	0.67	0.55	0.80
3Y Fwd returns	0.94	0.74	0.65	**0.82**
5Y Fwd returns	0.79	0.79	0.74	0.79
7Y Fwd returns	0.78	0.83	0.73	0.46
10Y Fwd returns	0.78	**0.92**	0.83	0.58
20Y Fwd returns	0.94	0.90	**0.89**	0.87

Chart 2: US Treasuries and UK gilts show that forward returns have generally tracked starting yields. The evidence is that initial valuations tend to be highly correlated with future returns for government bonds.

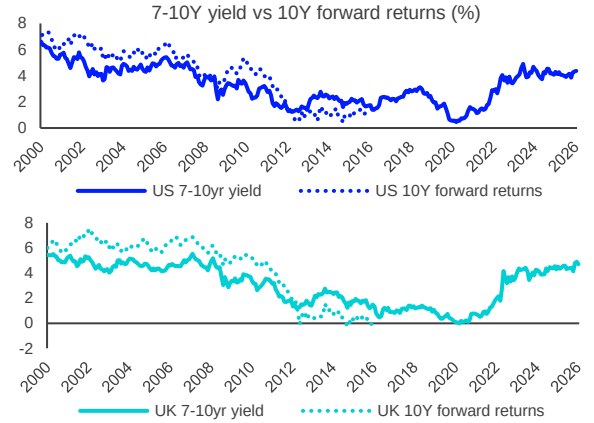


Chart 3: Periods with higher starting yields (Quintile 5) are correlated with higher average forward returns, when investment horizons broadly match index maturity tenors. This is true across major G7 govt bond markets.

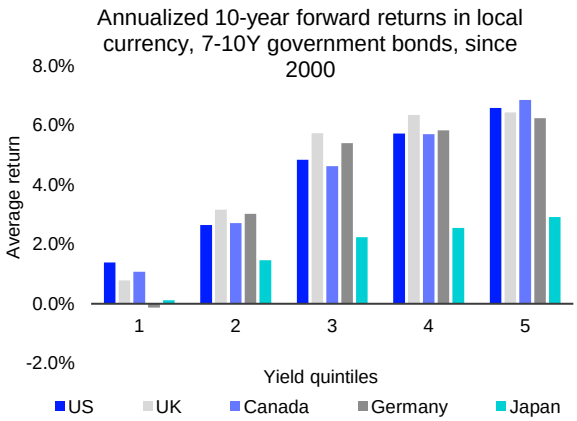


Chart 4: Lower valuations (lower bond prices and wider credit spreads) have historically led to higher future returns for US HY. This relationship is notable during periods of contractions and crises like the GFC.

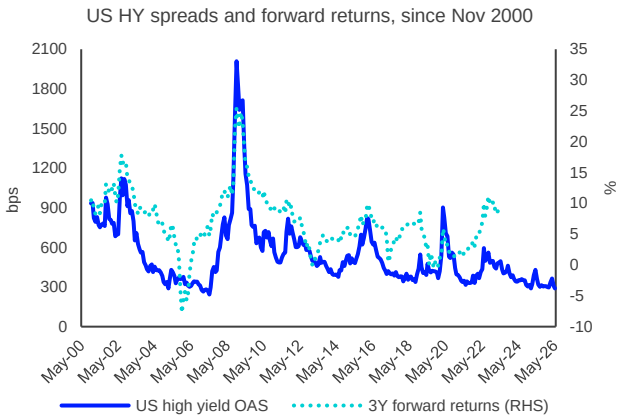
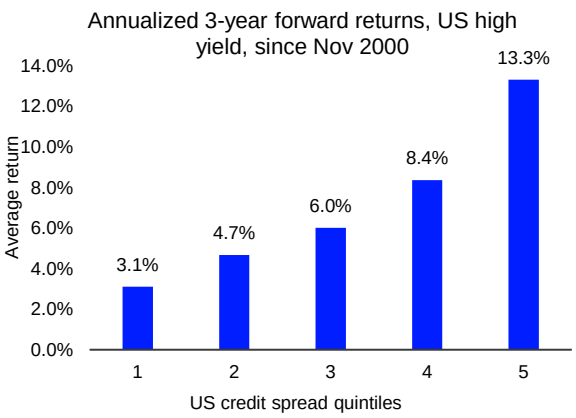


Chart 5: Similar to govt bonds, US HY forward returns are highly correlated with starting valuations. Wider credit spreads (Q5 contains the highest OAS) show strong positive correlation with future returns.



Source: FTSE Russell/LSEG. All data as of May 31, 2026 unless otherwise stated. *US Multi Asset | High Yield & Equities | FTSE Russell. Past performance is no guarantee of future results. This report should not be considered "research" for the purposes of MIFID II. Please see the end for important legal disclosures. Results in this report are for research / illustrative purposes and do not represent the official performance of the indices.

Equities

YTD the FTSE All-World index returned 12.3%. The top-performing region was Dev APAC ex Japan, posting a 50.0% return, with Korea posting >113% return.

Since the rebound in April, AI has, almost single-handedly, driven equity markets higher. By industry, Telecoms have returned 42.4% YTD to end May but c. 60% of that is attributable to just Samsung; 75% including Cisco Systems. Questions have been raised about whether AI is in a bubble. Compared to the dot-com bubble, FTSE USA Technology has a forward PE of ~21x compared to a peak of >48x in March 2000 and capex from the top 5 US hyperscalers is expected to be >$900bn in 2028, doubling the 2025 spend.

AI capex underscores the hardware vs. software disconnect, where FTSE All-World Hardware has outperformed Software by ~50ppts YTD. Playing 'picks and shovels' at an index level favours Korea and Taiwan which are heavily concentrated in semiconductor manufacturing.

Q1 earnings season saw investors become more discerning about capex, with big names being sold off after beats where the markets couldn't link capex to future revenue.

Chart 1: YTD & over 12M FTSE Developed APAC ex Japan and Japan have been top performers, with FTSE China consistently lagging.

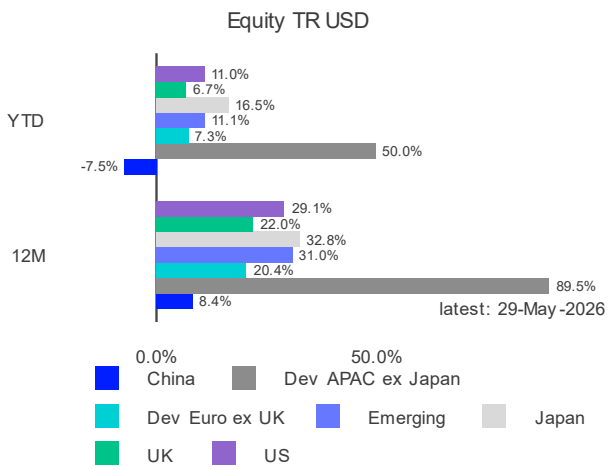


Chart 2: The funnel shows a Sharpe Ratio between 1-2x & highlights how exceptional risk-adjusted returns of Tech & Telecoms have been.

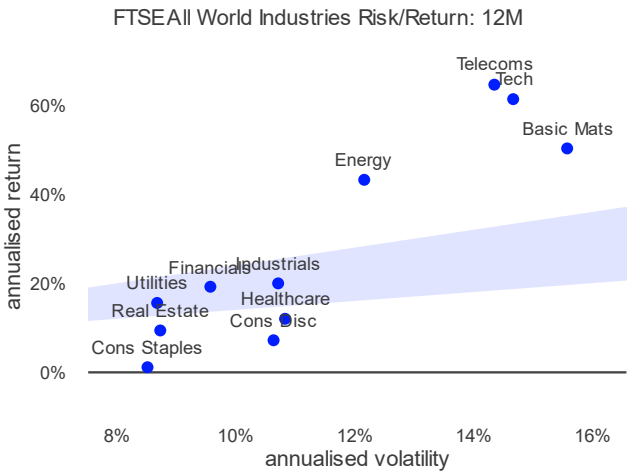


Chart 3: Telecoms have been the top performing industry YTD and 12M although this can primarily be attributed to Samsung & Cisco Systems.

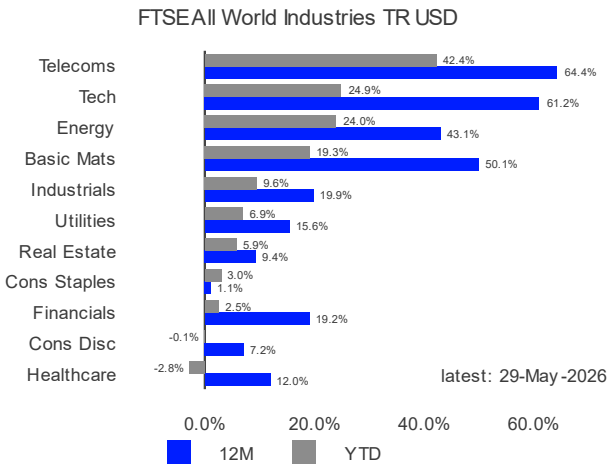


Chart 4: Hardware is dominating Software due to demand for AI and the risk of companies using AI to disintermediate software companies.

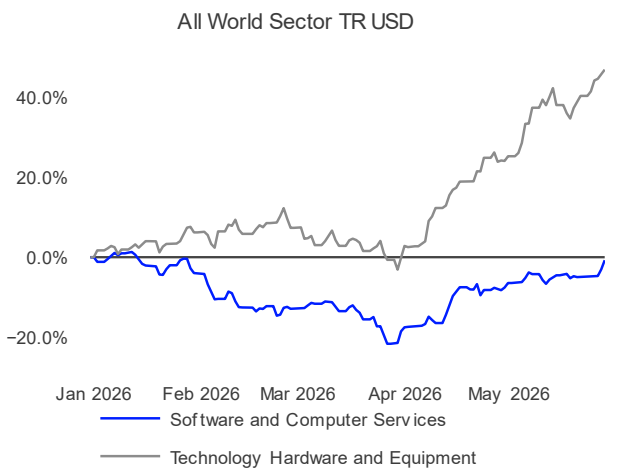
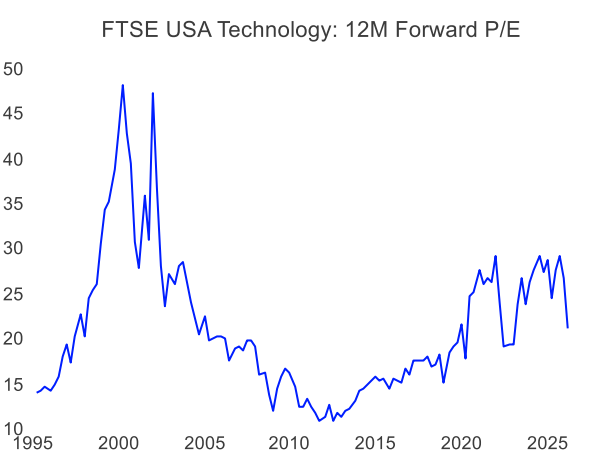


Chart 5: If AI is a bubble, it's not showing in forward P/E. FTSE USA Technology is trading on a 21x vs. 48.3x at the peak of the dot.com era.



Source: LSEG Datastream

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Equities (continued)

Decomposing 12M returns, earnings growth has been the primary driver, with moderate multiple expansion. Dev APAC ex Japan and Japan are the exceptions.

Despite being the top-performing market over 12M, Dev APAC ex Japan has seen forward earnings expectations exceed returns & hence multiple contraction; Japan's return was primarily multiple expansion as markets anticipate structural reform and fiscal policy changes.

In Dev APAC ex Japan 12M forward EPS estimates continue to be upgraded and have grown >30% in 3M. The scale masks that Developed equities have seen a notable increase of c. 7% over the same period.

Forward PE multiples have derated YTD making equities relatively less rich. Dev APAC ex Japan at 10.8x is in the cheapest decile over the last 10Y. Critically the US & EM have fallen to the 71st & 82nd percentiles from extremely rich levels above the 90th percentile coming into 2026.

The BoJ has been defending the depreciating Yen in May. Allocators need to consider their FX view and whether to hedge equity exposure, especially if the important ¥160 level breaks.

Chart 1: Decomposing 12M returns shows equity returns over the last 12M were driven primarily from improving earnings expectations.

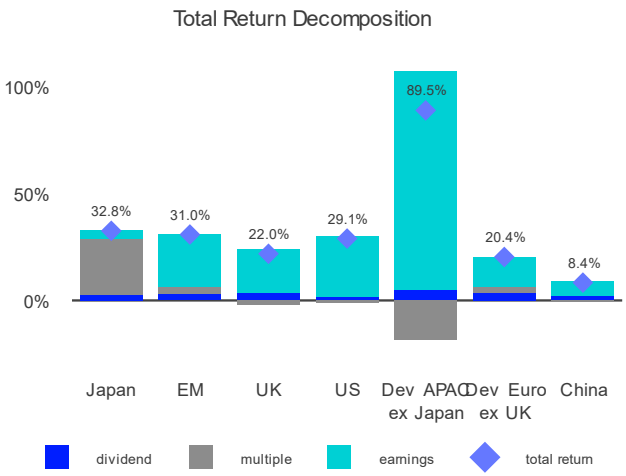


Chart 2: Forward PE multiples have derated YTD from extremely rich levels. The FTSE All-World is now <+1 standard deviation rich over 10Y.

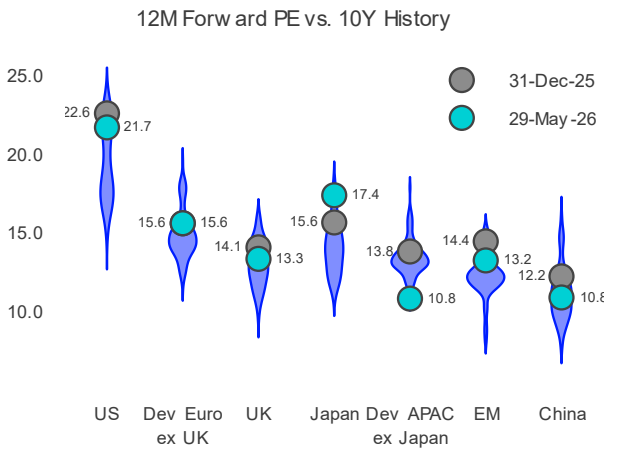


Chart 3: Developed APAC ex Japan has had a >30% increase in EPS estimates over 3M with Developed Markets rising >7% over the period.

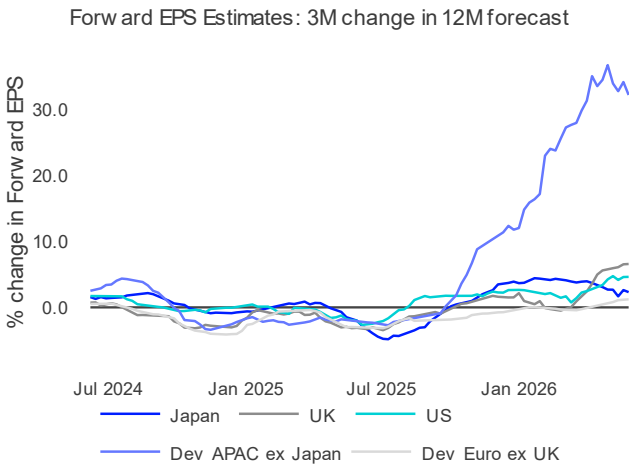


Chart 4: Depreciation of the Yen has been slowed by the BoJ defending the currency. Hedged indices may benefit if weakening continues.

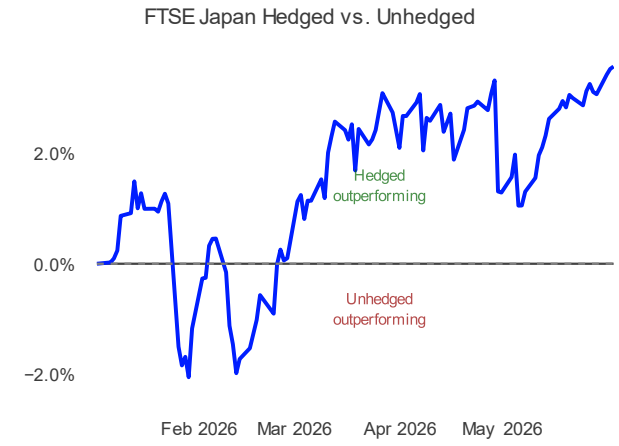
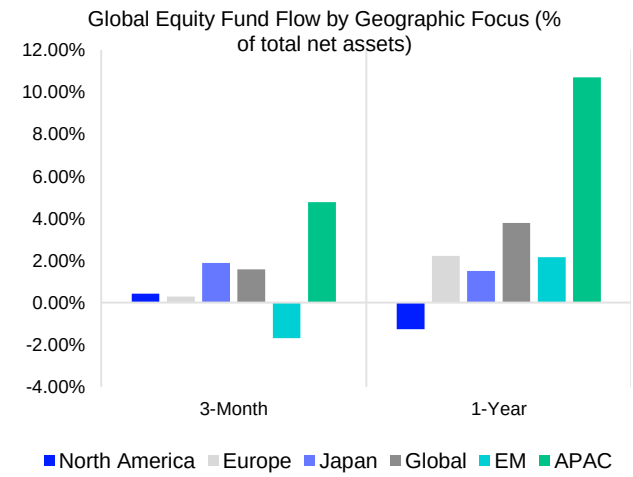


Chart 5: Geographic fund flows show strong subscriptions to APAC, Global & Japanese equity funds over 3M & 12M. Source: LSEG Lipper



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Spotlight: After the Energy Shock

The immediate response to an energy shock is typically fossil-fuel heavy: drawdowns of oil inventory or substitution for dirtier, but readily available, sources like coal. But long-term responses are often structural.

In the wake of the Middle East conflict this is what has happened. The International Energy Agency (IEA) is coordinating the release of 400 million barrels of reserves, the largest in history, and coal prices have risen 22% YTD.

Closure of the Strait of Hormuz raises issues not 'just' about the price of oil, but of energy security. We consider South Africa as a case study, where successive failures from Eskom, the state utility, led to the country facing rolling black-outs from 2018 onward, peaking in 2023 with >300 days of outages. Faced with no energy security the private market invested in renewables, and the registered renewable energy generation capacity grew to c. 20GW at the end of 2025. NTCSA data from April 2026 indicates c. 13% of total generative capacity is now from rooftop solar. Critically, despite outages functionally ending in 2024 the rate of solar registrations has been increasing, reflecting a combination of momentum and the decreasing cost of solar.

The transition is already happening elsewhere. In 2025, all of the growth in global electricity demand was supplied with renewable energy and clean energy investment ran at about twice the level of fossil fuel investment. In the short term, European electric vehicle (EV) registrations are up 51% YoY to March 2026 on E-Mobility data. In the UK, Octopus Energy has seen a 50% spike in installations of solar panels and a 30% increase in installations of heat pumps.

In terms of beneficiaries, China dominates in clean energy manufacturing with a c. 70-80% market share across solar, wind and battery technologies (IEA, 2026). For investors, the FTSE Environmental Opportunities All Share index (of companies producing green economy products and services) is 9.1% ahead of the FTSE Global All Cap YTD. Other potential beneficiaries are the commodities and miners of energy transition commodities such as copper, lithium and rare-earth minerals. The cost of capital is a risk to the green energy transition as initial capex is a hurdle to adoption.

This spotlight is a high-level summary of our paper: "After the Energy Shock" by Indrani De, Lee Clements and David McNay. Published on May 26, 2026.

Chart 1: Newcastle coal price ($/mt)
Demand for coal has increased, particularly in Asia, as short-term replacement for Middle Eastern gas.

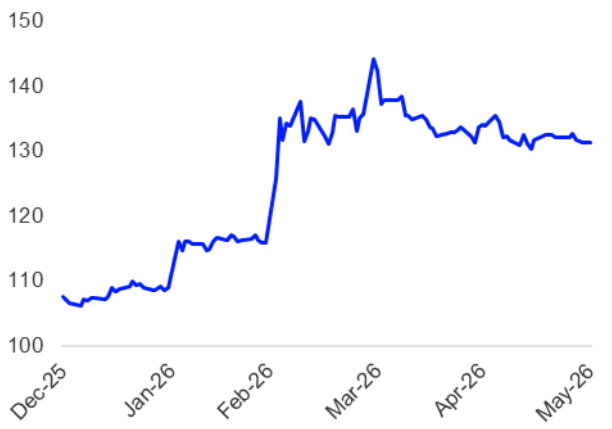

Chart 2: South Africa went from effectively zero registered renewables in 2020 to circa. 20GW of capacity with solar accounting for >2/3rds.
Source: National Energy Regulator South Africa (NERSA)

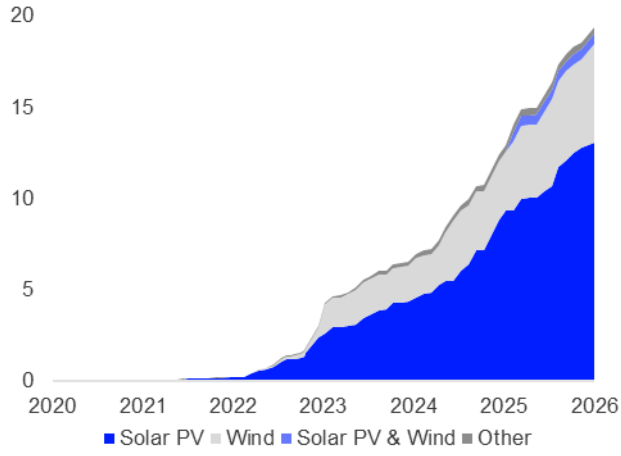

Chart 3: 2025 Global electricity supply & demand growth (TWh).
All growth in electricity demand was supplied by alternative energy, predominantly solar, whilst fossil's contribution fell. (Ember 2026)

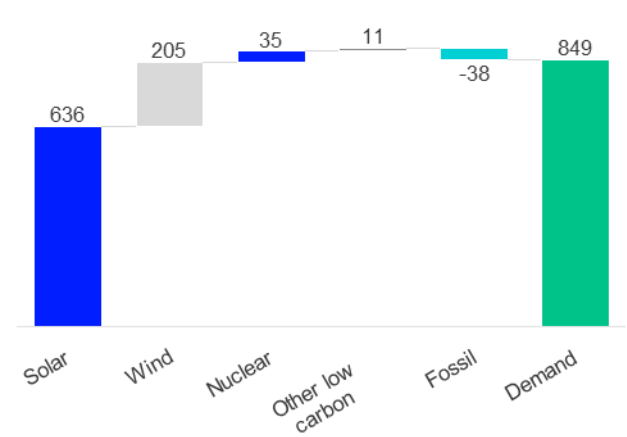

Chart 4: 12m rolling relative performance of FTSE Environmental opportunities All Share vTSE Global All Cap (TR, USD)
Strongest historical performance outside of 2020/21 period.

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Emerging Markets

While EM equities lagged DMs over 3M, EM bonds outperformed DM counterparts. Capital flows point to a stronger recovery in fixed income than in equities, while equity returns were notably diverged across EMs.

EM equities generally lagged DMs over 3M, with Taiwan a notable exception (+27.7%). Nevertheless, EMs rebounded strongly in April alongside DMs, showing resilience despite significant exposure to the energy shock. Taiwan's sustained rally has lifted its weight in the FTSE EM Index above China's, supported by its central role in the AI supply chain, which has boosted both market capitalization and the real economy. Taiwan's Q1 GDP grew 13.7% YoY, whilst the IMF upgraded its 2026 growth forecast from 2.1% to 5.2%.

In contrast to equities, EM government bonds continued to outperform DM peers. Capital flow data suggests the initial recovery phase has been concentrated in fixed income rather than risk-on equities, pointing to greater investor confidence in EM macro and sovereign credit fundamentals than in risk assets. This is also evident in EM Asia 7-10yr sovereign spreads vs the US, which have generally narrowed over the past decade. The Philippines is the main exception, with spreads widening since March amid greater vulnerability to the energy supply shock. In Latin America, spreads for Brazil and Mexico remain broadly in line with their 2016 levels (Chart 5).

Chart 1: EM equities underperformed DMs over 3M, with returns of EM 2.5% vs DM 8.1%. Taiwan equities continued to rally, driven by strong AI demand, while India & China lagged on lower weights in hardware.

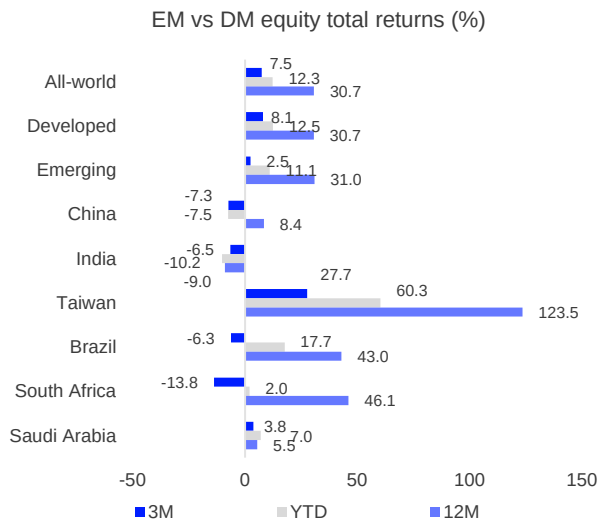


Chart 2: Following 12M rallies, Taiwan has become the largest market within the FTSE EM index, with a weight of 32.8%, overtaking China (27.4%). India's index weight declined to 15.4% from 21.7% 1yr ago.

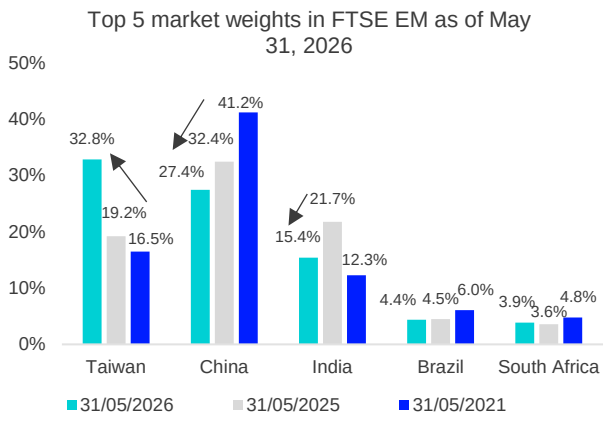


Chart 3: EM* capital flows rebounded sharply in April, reversing most of the outflows in March during the risk-off episode. Debt inflows of $51.9 billion led the rebound, with modest inflows of $6.4 billion to EM equities.

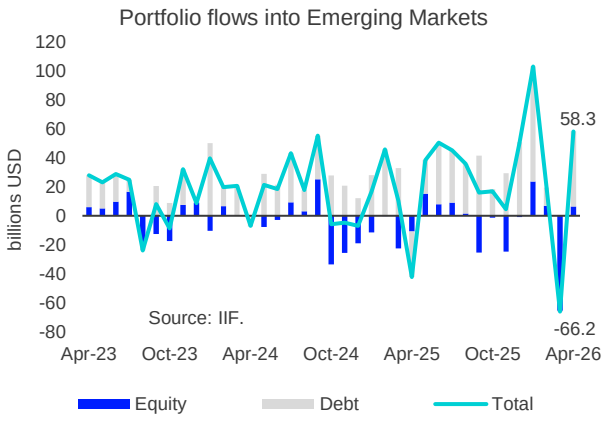


Chart 4: In contrast to equities underperformance, due to the risk-off selloff, EM govt bonds continued to outperform DMs over 3M. China and Brazil gained up to 2.6%, helped by currency appreciation.

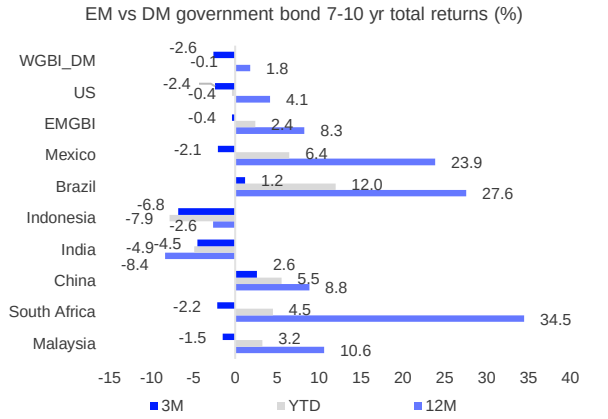
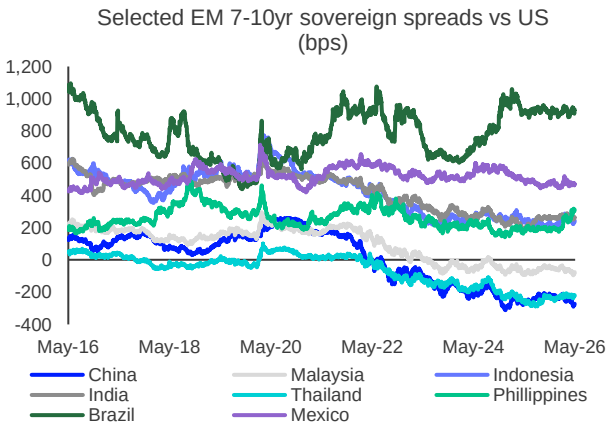


Chart 5: EM Asia sovereign spreads vs the US have narrowed over 10Y, led by China and Malaysia. In contrast, spreads in Brazil and Mexico remain near levels seen in 2016.



Source: FTSE Russell/LSEG. All data as of May 31, 2026 unless otherwise stated. Past performance is no guarantee of future results. *EM defined by IIF incorporates South Korea, which is a DM market by FTSE country classification as of May 2026. This report should not be considered "research" for the purposes of MIFID II. Please see the end for important legal disclosures. Results in this report are for research / illustrative purposes and do not represent the official performance of the indices.

Commodities

Spot prices for Brent have fallen from YTD highs, but longer-expiries remain anchored. Gold prices have been shaped by two opposing forces: elevated real yields and resilient demand from investors and central banks.

3M commodities' performance leaders shifted from silver and gold to oil (returning 26.9%, despite retreating from its March cycle highs). Risk reversals, a measure of skew, show Brent 3M risk reversals have cheapened but are still heavily skewed call side, suggesting energy markets are still paying a premium to hedge against higher oil prices. YTD, commodities have posted broad-based gains, led by oil (51%) & aluminium (22%). Elevated geopolitical risk has kept commodity volatility high relative to the 3Y trend, but strong returns over 12M (36%) means the CRB Index has had strong risk-adjusted returns relative to bonds and equities.

Gold demand remained resilient in Q1, with total demand up 2% y/y, supported by solid investment demand and continued central bank buying. Gold-backed ETFs saw further net inflows in Q1, albeit at a slower pace than in 1Q25. Gold prices have been range-bound, as central bank reserve demand and investment demand have helped offset the headwind from elevated real interest rates (Charts 4 & 5).

Chart 1: Oil continued to lead Commodity gains, with 3M returns of 26.9% , despite easing from March peak. Silver and gold prices retreated, losing up to c.16% over 3M. Commodities broadly gained over 12M, led by Silver.

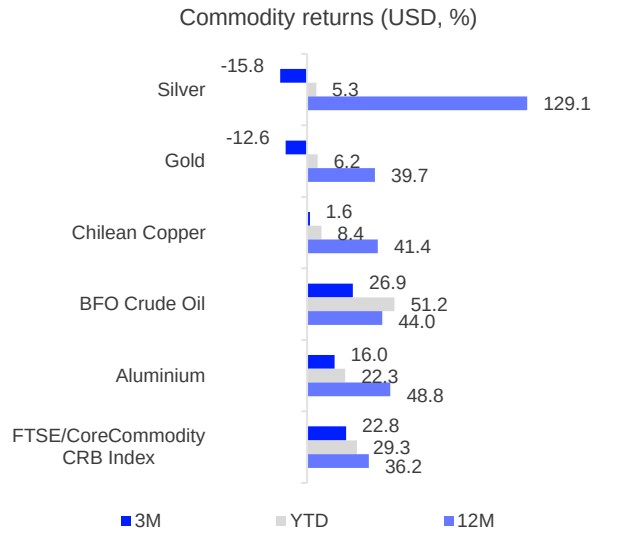


Chart 2: Beyond its strong absolute performance, the CRB index has also rallied remarkably vs bonds YTD. Despite the sharp rebound in equities, commodities have largely maintained their relative performance.

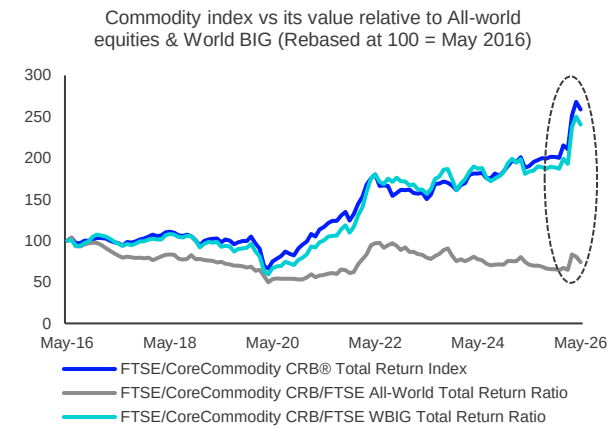


Chart 3: Brent Crude risk-reversals are still to the call side, implying traders are paying to hedge upside moves in oil, but the measure moved markedly lower in May implying the cost of protection has cheapened.

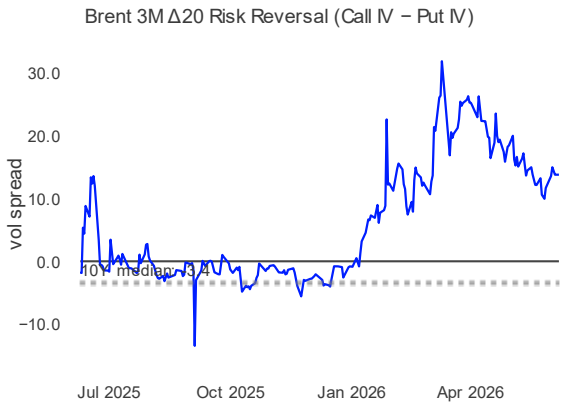


Chart 4: Gold demand remained resilient through 26Q1, supported by investment demand & central bank purchases. Gold-backed ETFs' demand stayed positive in Q1, but grew at the slowest pace since 2025.

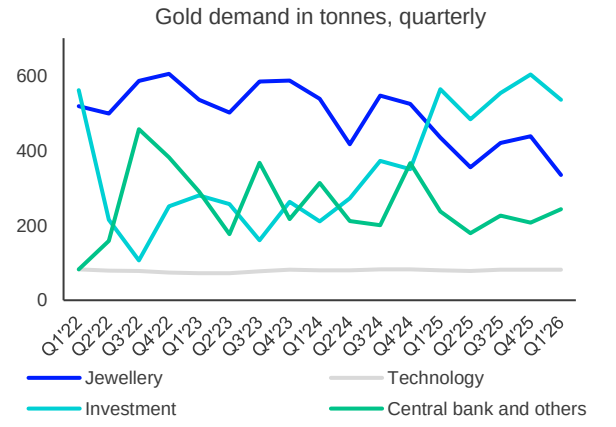
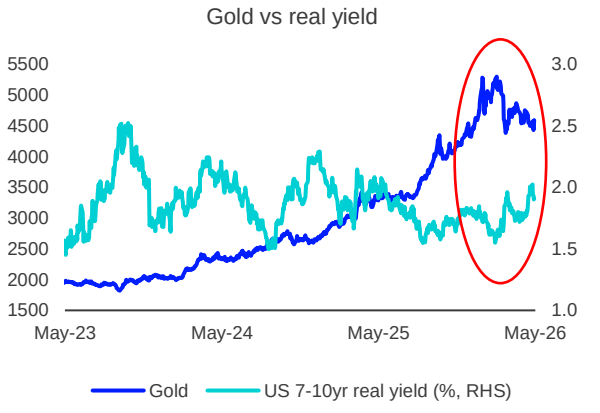


Chart 5: Gold price has been negatively correlated with real interest rates recently, consistent with gold's role as a non-yielding asset. Reserve diversification demand has supported central banks' buying.



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Listed Alternatives

Over 12M, Listed Real Estate and Infrastructure have underperformed equity & broad commodities, but outperformed fixed income on a risk-adjusted basis.

For both, relative underperformance can be attributed more to outperformance of equities due to AI / Tech, achieving a Sharpe ratio of 1.2x and 1.6x for real estate and infrastructure, respectively.

Infrastructure performed well during the March sell-off where we had described it as performing like a "new defensive" due to significant exposure to regulated utilities, which have both inelastic demand and the ability to pass through higher energy prices. Listed Infrastructure is also exposed to AI power generation providing indirect exposure to the theme, although infrastructure-bond correlations are above trend which highlights the market's concern about rate sensitivity.

Within REITs, Data Centres have caught a bid as part of the wider AI theme. Data Centres have been a volatile sub-sector within real estate due to tension between broad AI demand, constraints around energy supply and hyperscalers building out their own capacity vs. rented capacity.

Chart 1: Global Infrastructure & EPRA Nareit Global underperformed equity over 12M but the difference was largely the effect of Technology.

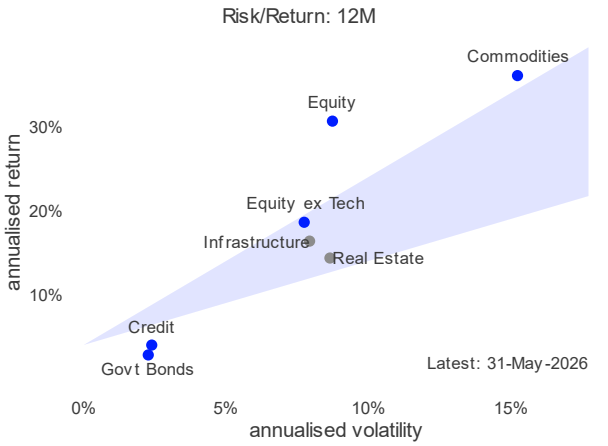


Chart 2: Listed Infrastructure posted negative returns over 3M as equities rebounded; it outperformed in March as a new defensive asset.

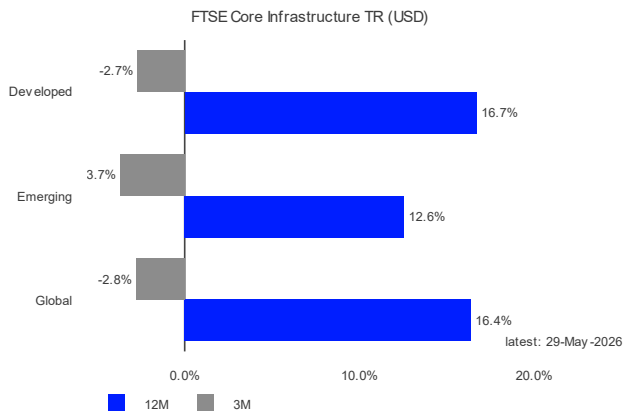


Chart 3: Data Centre & Lodging REITS have been positive over 3M. Lodging is cyclical & benefiting from expected excess demand in 2026.

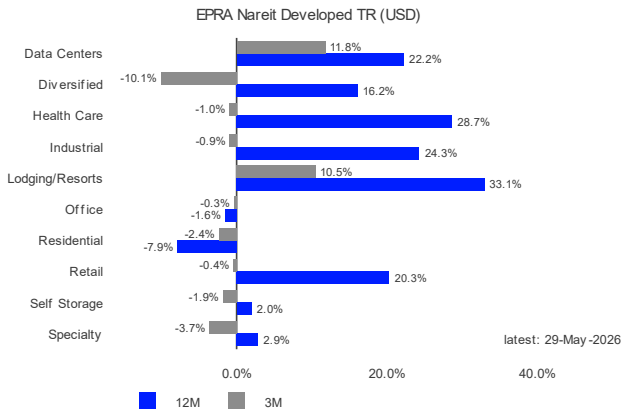


Chart 4: Rolling correlations between infrastructure and equity are the lowest they have been since inception, implying diversification benefits.

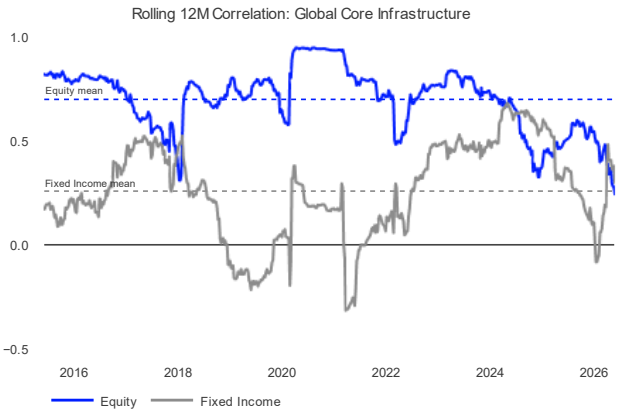
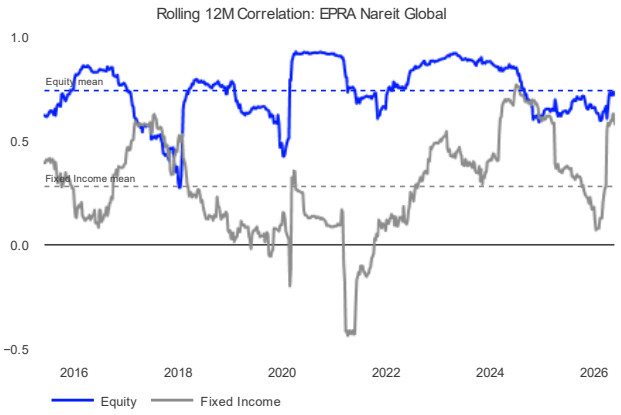


Chart 5: Rate sensitivity of both Real Estate & Infrastructure (Chart 4) is showing up in correlations to bonds which have increased above trend.



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Currencies

Energy trade exposure emerged as a key driver of FX performance. AUD/JPY carry trades in the retail FX market highlight rising vulnerability to an unwind.

Over 3M, FX moves were largely driven by countries' energy trade exposure. The Norwegian Krone appreciated, supported by its status as a major energy exporter, and a restrictive policy stance. The Brazilian Real was underpinned by high interest rates (despite 50bps rate cuts) & supportive commodity prices. In contrast, most EM currencies weakened, reflecting greater reliance on energy imports and sensitivity to risk-off sentiment.

The BoJ has been intervening to support the yen, smoothing depreciation & defending the c. 160 level in USD/JPY, close to where USD/JPY traded 2Y ago. Rising energy prices have increased Japan's import costs and worsened its terms of trade, putting renewed downward pressure on the yen.

Despite its modest size, Japanese retail FX is closely watched as a transparent gauge of sentiment and positioning in yen-funded carry trades. Higher AUD/JPY trading volumes in 2026 alongside a build-up in net long AUD exposure indicate stronger demand for the AUD/JPY carry trade. However, concentrated positioning increases vulnerability to a sharp unwind if market sentiment deteriorates.

Chart 1: Over 3M, US dollar benefitted from the US net energy exporter status, while EM currencies were hit harder by the energy shock than DMs, due to EMs' larger dependence on energy import.

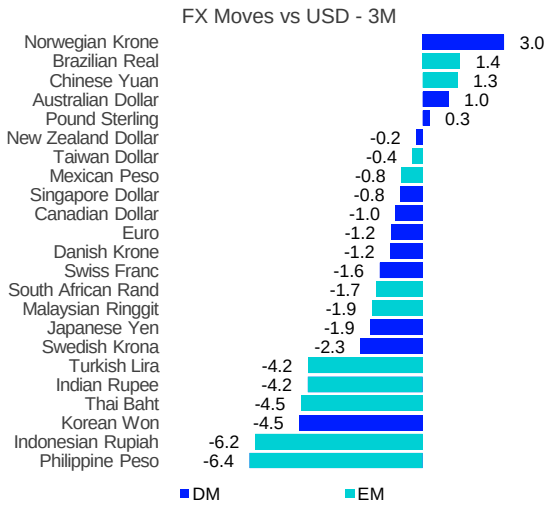


Chart 2: The Yen weakened in May, with USD/JPY depreciating to ~160. The BoJ FX intervention did not lift yen materially, as Japan's energy-import dependence outweighed favorable rate differentials.

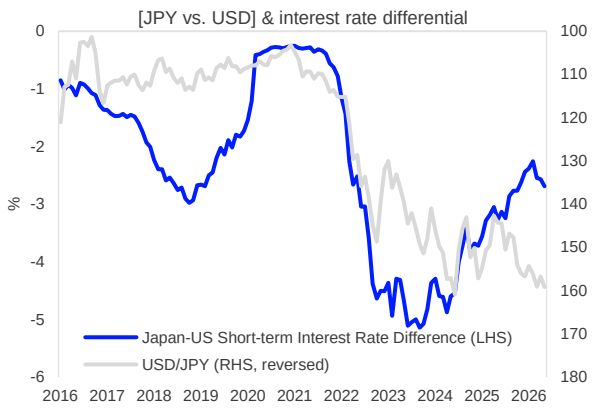


Chart 3: The AUD rallied to its highest vs USD since May 2022, driven by rapidly widening rate differentials. Elevated inflation, exacerbated by the energy shock, reinforced expectations of a hawkish RBA stance.

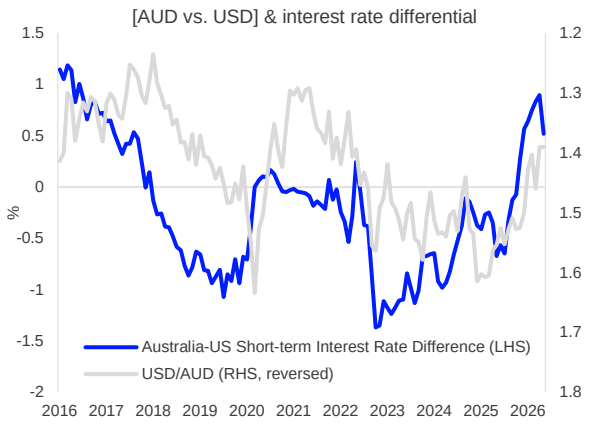


Chart 4: AUD/JPY, often viewed as a barometer of risk appetite, has closely track Aus-Japan rate differentials over the past 10Y. The spread widening in the recent year has renewed support for carry trades.

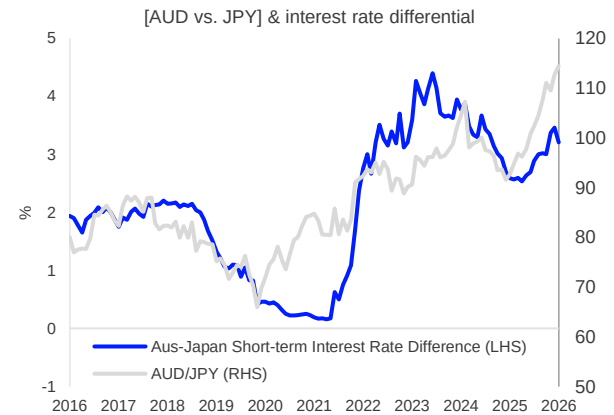
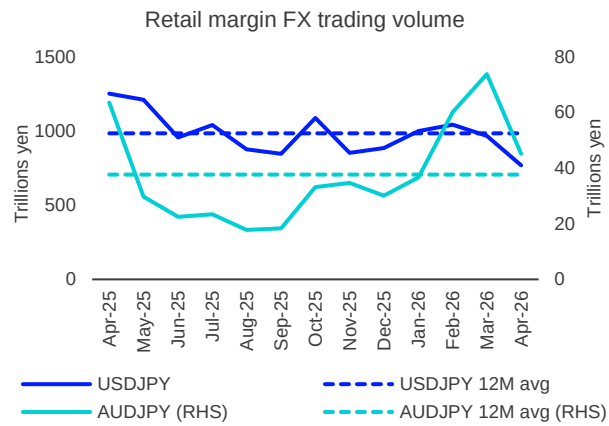


Chart 5*: Retail FX activity suggests a shift in investor focus from USD/JPY to AUD/JPY recently. USD/JPY trading volume fell below 12M avg by April, while AUD/JPY has remained above the 12M avg YTD.



Source: FTSE Russell/LSEG. All data as of May 31, 2026 unless otherwise stated. *Sourced from The Financial Futures Association of Japan. Past performance is no guarantee of future results. This report should not be considered "research" for the purposes of MIFID II. Please see the end for important legal disclosures. Results in this report are for research / illustrative purposes and do not represent the official performance of the indices.

Digital assets

Bitcoin has fallen roughly 27% YTD while the FTSE All-World advanced 12%, suggesting the drawdown is not simply a function of broad risk aversion.

The decline in Bitcoin appears more closely linked to the interest rate backdrop. Bitcoin's rolling correlation with inflation-linked yields turned negative during its February and May sell-offs, consistent with rising yields weighing on Bitcoin even as equities subsequently recovered. The yield repricing that followed the US inflation print on 12 May coincided with the late-May leg lower, as higher yields raised the opportunity cost of holding a non-yielding, long-duration asset.

Flows likely amplified the move. Digital asset ETFs swung from positive inflows to approximately -$82 million of total net outflows year to date. With spot ETFs an important marginal source of institutional demand, redemptions can reinforce price weakness. Bitcoin's equity correlation remains positive but loose, and its tail sensitivity is acute: since 2020, annualised returns have been strongly positive in low-to-moderate volatility regimes but deeply negative once equity volatility reaches its highest percentiles.

Chart 1: YTD Bitcoin has fallen sharply while equities and US Tech advanced; gold remained neutral, highlighting Bitcoin's divergence from broad markets despite positive correlation.

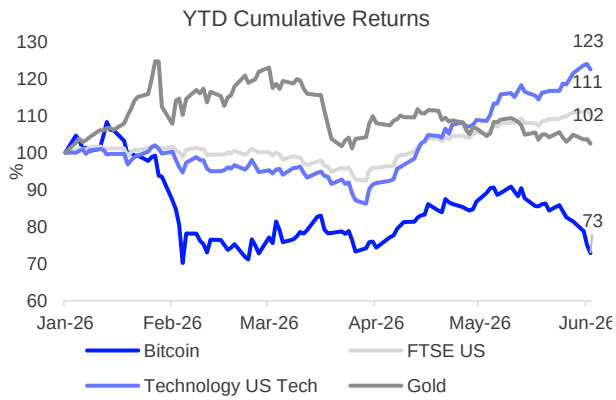


Chart 2: Bitcoin's correlation with inflation-linked bonds turned sharply negative during the February and May sell-offs. Its correlation to equities remains positive but weak, hence a divergence in performance.

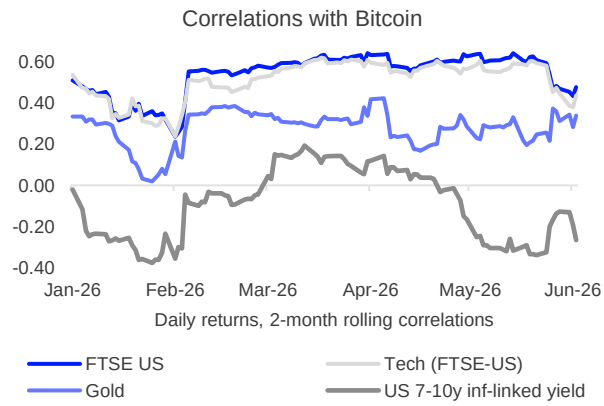


Chart 3: Bitcoin against 10Y Treasury yields. The yield repricing following the 12 May inflation read coincided with the late-month sell-off in digital assets.

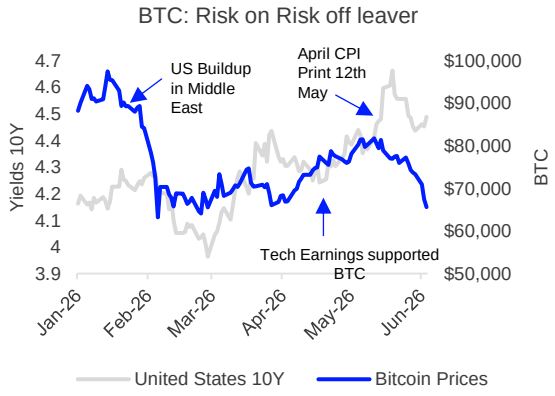


Chart 4: Cumulative digital assets fund flows have turned to net outflows as Bitcoin has fallen, pointing to weaker demand across the digital assets space.

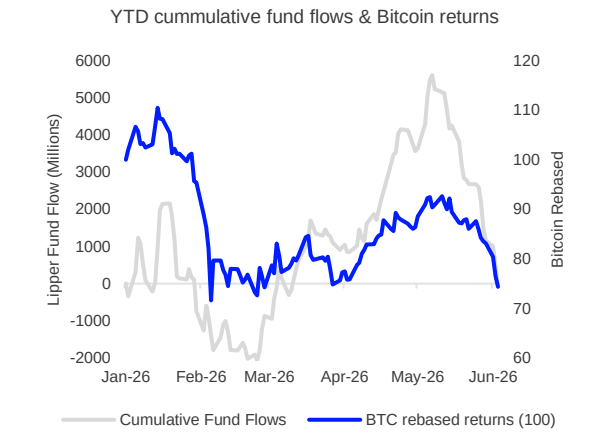
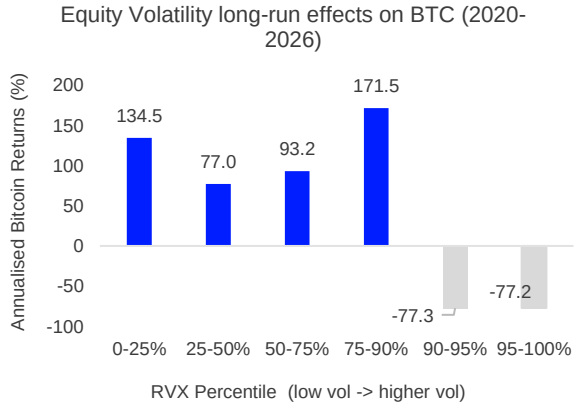


Chart 5: Since 2020, Bitcoin has delivered strong annualised returns in low-to-moderate equity-volatility regimes, but deeply negative returns once equity volatility reaches its highest percentiles.



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Cross-Asset: Equities and Fixed Income

Cross-asset signals are mixed. In broad terms, relative valuations favour sovereign bonds, but momentum and risk indicators would tend to favour equity.

On a yield-to-maturity (YTM) basis, conventional & inflation linked govt bonds are close to the cheapest they have been over 10Y, whereas IG and HY credits are close to their richest. All-in yields on credit look reasonable, but that is driven by the duration component rather than the spread.

Discounting forward earnings yield by the 10Y treasury yield, bonds broadly appear better value than equity – however the signal only looks extreme for US equities.

Historical tights on credit spreads limits potential gains from spread compression, meaning future returns are likely from harvesting the yield. On a forward earnings yield basis equities have derated YTD and whilst still rich they are no longer at extreme levels. Combining these factors tends to favour equities over HY if the risk rally continues.

Implied risk measures point to the market positioned with a pro-risk tilt; Russell 2000 options are skewed to being cheap, relative to the 10Y median, to protect against downside moves in the index and the RVX has normalized to around its post-Covid trend. In aggregate, longer-term value measures favour bonds over equity, whilst short-term tactical signals are more risk on.

Chart 1:Using yield measures relative to each asset class's own 10Y history we see that conventional & inflation-linked government bonds look cheap whilst Investment Grade and High Yield bonds look very rich.

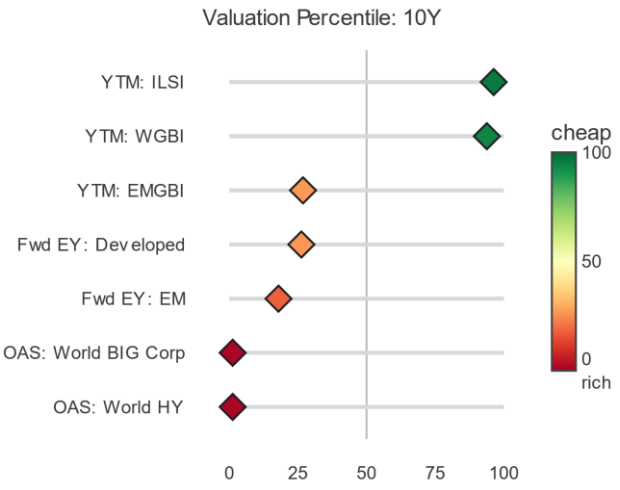


Chart 2: Relative to equity, bonds look good value across most major regions. On this measure US equities look particularly rich vs. bonds, whereas Dev APAC ex Japan stands out with equity looking better value.

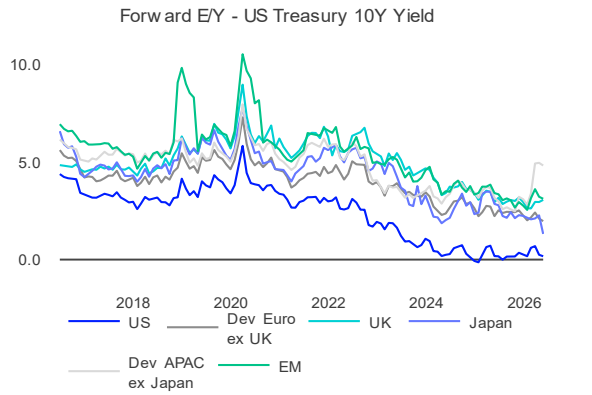


Chart 3: Relative stock-bond valuations have also diverged from macro indicators since 2022. The disconnect may reflect optimism around long-term AI-driven growth that is not captured by near-term PMI data.

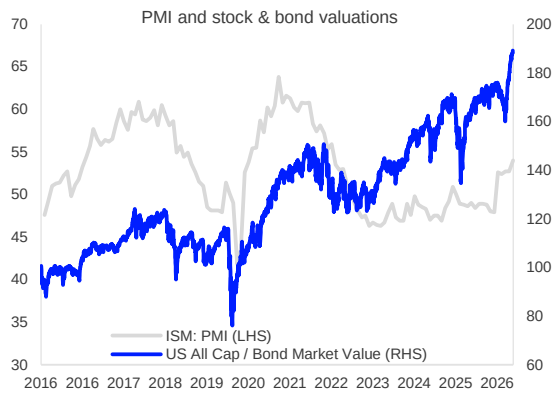


Chart 4: Implied volatility, measured by the RVX has moderated. At the start of the Middle East conflict, it was trending towards 2022 levels but has since moderated to more normal levels for the post-Covid period.

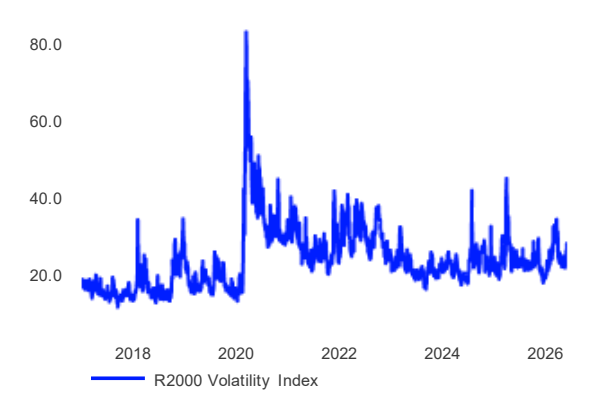
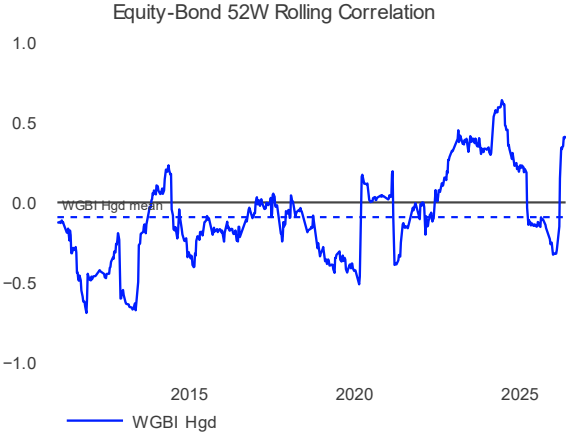


Chart 5: The rolling 52W correlation between equity and bonds rebounded sharply to +0.44 from the Jan low of -0.33. This snaps the trend of declining correlation which had persisted since 2024.



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Cross Asset: Return and Risk (continued)

Dev APAC ex Japan equities significantly outperformed by risk-adjusted returns, while fixed income and oil lagged.

1Y risk-adjusted returns were strongest in equities with Dev APAC ex Japan (boosted by Korea's returning 89.5%, with volatility of 22%) the top performer, followed by the US & EM. US & World HY delivered risk-adjusted returns comparable to leading equities, outperforming other fixed income. Oil, copper, gold, and broader commodities were among top performers by absolute 12M returns, but lagged US and EM equities in risk-adjusted return terms. Inflation-linked government bonds outperformed conventional bonds, in both absolute and risk-adjusted returns, while US Treasuries outperformed global peers.

Across asset classes, the earnings and income yields landscape has shifted markedly over the past decade. Fixed income yields rose sharply following the global monetary tightening cycle that began in 2022 and have since stayed at levels comparable to those of other major asset classes. Infrastructure earnings yields (EY) have generally remained elevated, reflecting a combination of resilient earnings growth and still-compressed valuation multiples (due to higher discount rates). In contrast, equity EY have trended lower over the same period, largely reflecting multiple expansion and higher equity valuations. Real Estate has transitioned from one of the most attractively valued asset before Covid to the lowest EY asset.

Chart 1: Developed APAC ex Japan equities continued to lead 1-year risk-adjusted returns, with a ratio of 4.1, followed by US equities (2.5). Russell 2000 modestly outperformed US high yield and Russell 1000. EM equities (2.2) remained among the top performers, outperforming other non-US equities (led by Japan 2.1). Within fixed income, US high yield (2.6) and World HY (2.1) remain the leaders, followed by US inflation-linked (1.7) and US IG Corp (1.6). Oil (0.9) still lagged due to remarkably higher volatility, despite significant 1-year outright returns of 44%.

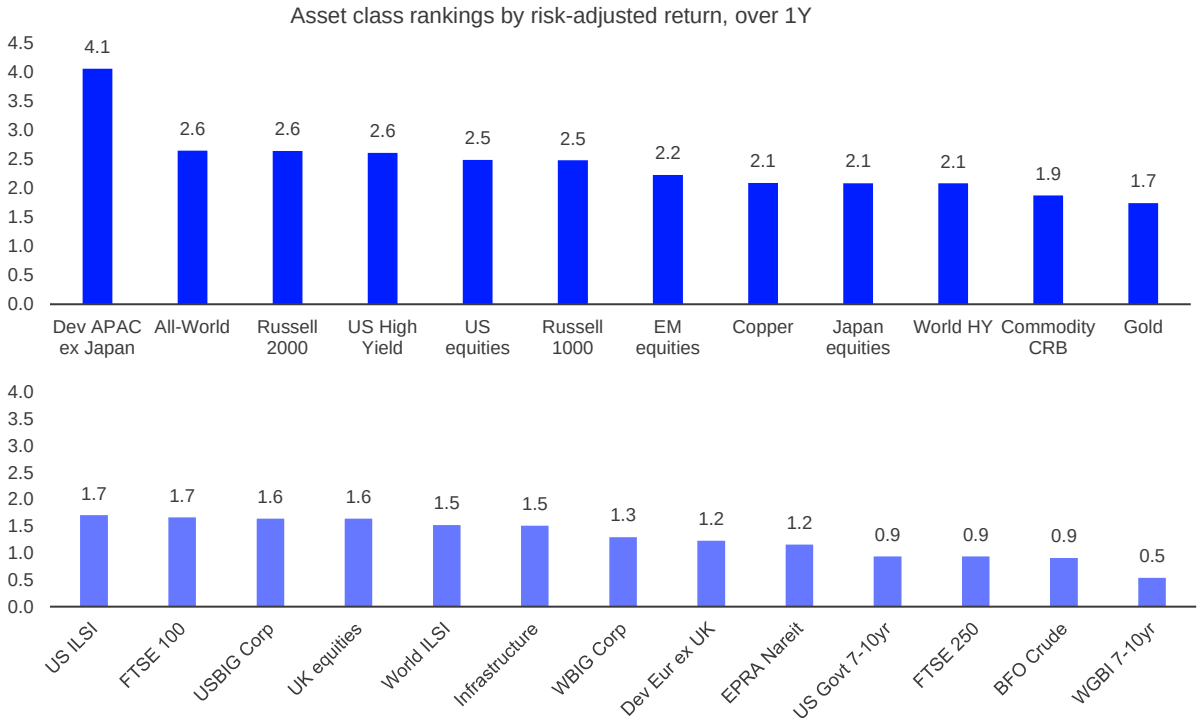
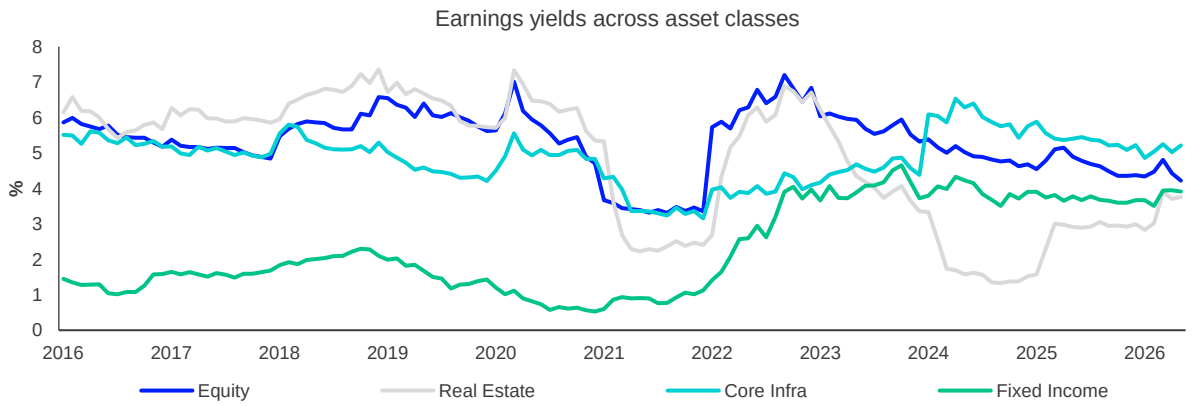


Chart 2: The rise in interest rates since 2022 has restored the yield appeal of fixed income, while equity earnings yields have compressed alongside higher price-to-earnings multiples. Real Estate has moved to the lowest earnings-yielding asset, compared to among the highest before Covid.



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Cross Asset: Correlations

After a period of declining correlation from 2022 to 2025, cross-asset correlations have gapped higher YTD implying fewer diversification benefits between asset classes. 52W pairwise correlation between the FTSE All-World and the WGBI Hedged USD, a key barometer, has moved to +0.41 from -0.30 as equities and bonds have moved together.

The bottom-left of chart 1 shows 10Y correlations, whilst the top-right of the matrix shows current 52W correlations. 52W regional intra-equity correlations have moved broadly in line with long-term trends. The notable exception is Emerging Market equity correlations which are elevated; EM-DM correlation is currently around +0.8 vs. a trend of +0.6.

Within Fixed Income there has been a notable shift in the correlation between index-linked and nominal bonds, which has risen materially to +0.88 from a long-term trend of +0.65. Higher nominal-linker correlation implies allocators need to be selective when using inflation-linked bonds to hedge inflation.

Chart 1 shows a very clear break from trend for commodity correlation; turning dark red. Those numbers should be approached with caution because the effect is heavily driven by oil prices since the start of the conflict in Iran. Oil-equity correlations are -0.47 vs. a 0.04 trend, whilst equity-gold and equity-copper have moved slightly above 10Y averages.

In Chart 2 we show an alternative measure looking at FTSE All-World industry and seeing what percentage of variance can be explained by a single factor. Currently, c. 52% is explained by the first principal component, relative to the 10Y average of 68%. The implication is that, relative to history, there is a greater opportunity set for alpha generation through selection for those able to take granular positions, and benefits to diversification from those who can't.

Chart 1: Correlation matrix showing both the 10-year and the 52-week correlations. The portion of the matrix below the diagonal is 10-year correlations with the top half of the matrix showing 12-month correlations; weekly total return data. Colour gradient shows strong positive correlation (+1) as dark green, strong negative correlation (-1) as red with zero correlation as white. Short-term trend in 2026 has been toward higher cross-asset correlations.

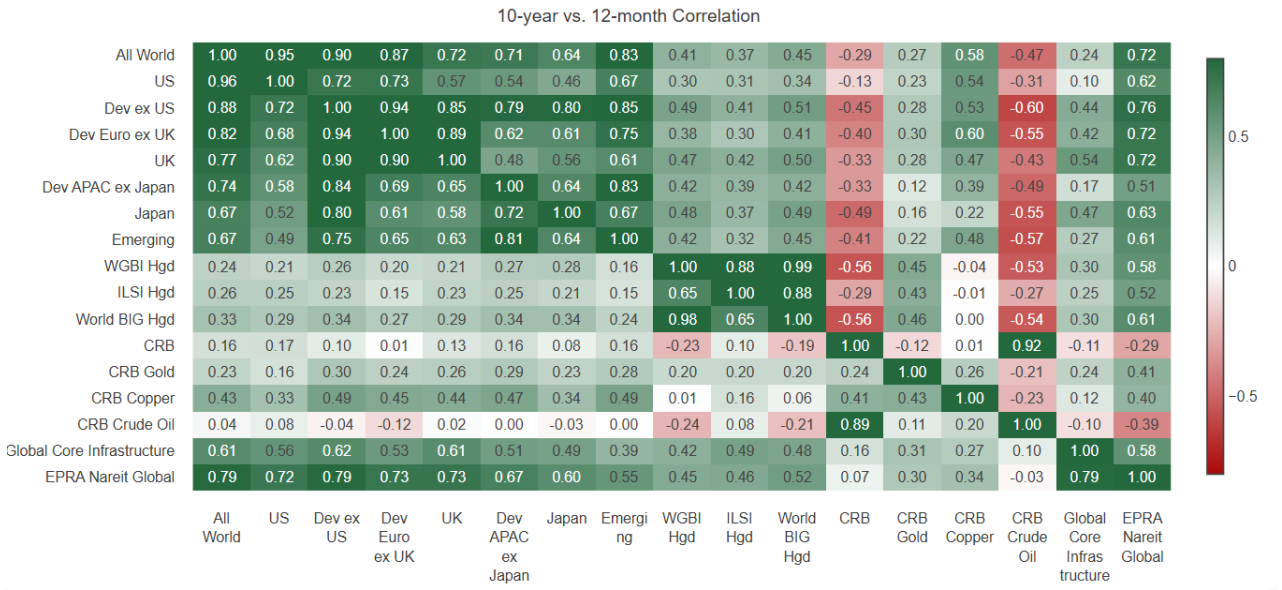
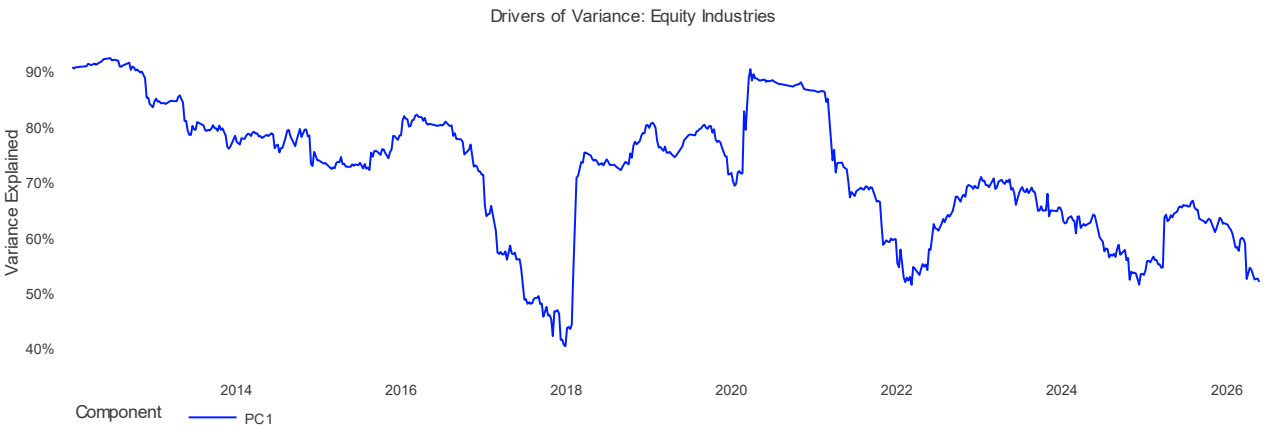


Chart 2: We monitor the percentage of total variance of FTSE All World Industry returns explained by the single largest factor – also known as the principal eigenvector. A higher number implies a single factor is dominating markets, reducing benefits of diversification. This measure has recently declined to 52%, a level which has been hit on two other occasions since 2018. It implies a greater opportunity set for industry allocation and hence stock selection.



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Appendix 1: List of indices used in report

Name	Mnemonic/Code	Name	Mnemonic/Code
Russell 1000 Index	R1000	World Government Bond Index 1-3yr	WGBI_1-3
Russell 2000 Index	R2000	World Government Bond Index 7-10yr	WGBI_7-10
FTSE Global All Cap Index	GEISLMS	US Treasury 7-10yr	US_TSY7-10
FTSE All-World Growth Index	AWORLDSG	UK 7-10yr	GB_TSY7-10
FTSE All-World Value Index	AWORLDSV	Germany 7-10yr	DE_TSY7-10
Russell 1000 Growth Index	R1000G	Japan 7-10yr	JP_TSY7-10
Russell 1000 Value Index	R1000V	China 7-10yr	CN_TSY_7-10
FTSE USA Index	WIUSA	US Treasury 1-3yr	US_TSY1-3
FTSE UK Index	WIGBR	US Treasury 20+yr	US_TSY20+
FTSE Developed Europe Index	AWDEURS	UK 1-3yr	GB_TSY1-3
FTSE Developed Europe ex UK Index	AWDEXUKS	UK 20+yr	GB_TSY20+
FTSE Japan Index	WIJPN	Canada 1-3yr	CA_TSY1-3
FTSE Developed Asia Pacific ex Japan Index	AWDPACXJ	Canada 20+yr	CA_TSY20+
FTSE China Index	WICHN	Germany 1-3yr	DE_TSY1-3
FTSE Emerging Index	AWALLE	Germany 20+yr	DE_TSY20+
FTSE All-World Index	AWORLDS	Japan 1-3yr	JP_TSY1-3
FTSE Global Core Infrastructure Index	FGCII	Japan 20+yr	JP_TSY20+
FTSE EPRA Nareit Global Index	ENHG	World Inflation-Linked Securities Index 7-10yr	ILSI_7-10
FTSE Europe ex UK Index	AWEXUKS	US Treasury 5-10yr	US_TSY5-10
FTSE Asia Pacific ex Japan Index	AWPACXJA	US Inflation-Linked Securities Index 5-10yr	ILSI_US_5-10
FTSE USA All Cap Index	LMSUSA	Canada 5-10yr	CA_TSY5-10
FTSE Developed Index	AWD	Canadian Inflation-Linked Securities Index 5-10yr	ILSI_CA_5-10
FTSE All-World ex US Index	AWXUSAS	Germany 5-10yr	DE_TSY5-10
FTSE Global Large Cap Index	GEISLC	German Inflation-Linked Securities Index 5-10yr	ILSI_DE_5-10
FTSE Global Small Cap Index	GEISSC	UK 5-10yr	GB_TSY5-10
FTSE Developed Large Cap Index	LCD	UK Inflation-Linked Securities Index 7-10yr	ILSI_GB_7-10
FTSE Developed Small Cap Index	SCD	Japan 5-10yr	JP_TSY5-10
FTSE Developed Growth Index	DGWLD	Japanese Inflation-Linked Securities Index 5-10yr	ILSI_JP_5-10
FTSE Developed Value Index	DVWLD	US Inflation-Linked Securities Index 1-3yr	ILSI_US_1-3
FTSE/CoreCommodity CRB® Index	RJEFCRT	US Inflation-Linked Securities Index 7-10yr	ILSI_US_7-10
Russell 2000 Implied Volatility Index	RVX	US Inflation-Linked Securities Index 20yr+	ILSI_US_20+
FTSE India Index	WIIND	FTSE World Broad Investment-Grade Bond Index (WorldBIG®)	WBIG
FTSE Indonesia Index	WIIDN	World Broad Investment-Grade Bond Index Corporate	WBIG_CORP
FTSE Malaysia Index	WIMAL	US Broad Investment-Grade Bond Index Corporate	BIG_CORP
FTSE Philippines Index	WIPHL	Euro Broad Investment-Grade Bond Index Corporate	EBIG_CORP
FTSE Taiwan Index	WITWN	Emerging Markets US Dollar Broad Bond Index Corporate – Investment-Grade	EMBBI_CORP_IG
FTSE Thailand Index	WITHA	US High-Yield Market Index	HY_MKT_US
FTSE Czech Republic Index	WICZH	Pan-European High-Yield Bond Index - EUR	EUROPE_HYM_EUR
FTSE Saudi Arabia Index	WISAU	Emerging Markets US Dollar Broad Bond Index Corporate – High-Yield	EMBBI_CORP_HY
FTSE South Africa Index	WIZAF	FTSE World High-Yield Bond Index	WHYM
FTSE Brazil Index	WIBRA	WGBI Developed Markets 7-10yr	WGBI_DM_7-10
FTSE Colombia Index	WICOL	EMGBI 7-10yr	EMGBI_7-10
FTSE Mexico Index	WIMEX	Brazilian GBI 7-10yr	BR_TSY_7-10
FTSE All World Basic Materials	F1AWBM$	Mexican GBI 7-10yr	MX_TSY_7-10
FTSE All World Consumer Discretionary	F1AWCS$	Indian GBI 7-10yr	IN_TSY_7-10
FTSE All World Consumer Staples	F1AWCG$	Indonesian GBI 7-10yr	ID_TSY_7-10
FTSE All World Energy	F1AWO1$	South African GBI 7-10yr	ZA_TSY_7-10
FTSE All World Financials	F1AWFN$	Malaysian GBI 7-10yr	MY_TSY_7-10
FTSE All World Healthcare	F1AWH1$	Thai GBI 7-10yr	TH_TSY_7-10
FTSE All World Industrials	F1AWID$	Philippines GBI 7-10yr	PH_TSY_7-10
FTSE All World Technology	F1AWG1$	Australia 1-3yr	AU_TSY1-3
FTSE All World Telecommunications	F1AWT1$		
FTSE All World Utilities	F1AWU1$		
FTSE All World Precious Metals & Mining	F3AWMM$		
FTSE All World Industrial Materials	F3AWPF$		
FTSE All World Chemicals	F3AWC3$		
FTSE All World Industrial Metals	F3AWIU$		

Appendix 2: Methodology Reference Guide

Report calculations

- Unless noted otherwise, all performance calculations are in US dollar.
- All credit spreads are with reference to the US 7-10 year Treasury bond index.
- Option-adjusted spread percentiles are calculated by comparing current index-level spreads to a fixed, historic 10-year window of month-end index-level OAS.
- Risk premium in equity is calculated as the earnings yield (E/P) of the All-World Developed index minus the yield of US Treasury 7-10 years. Risk premiums in high yield are their credit spreads relative to yield of US Treasury 7-10 years.
- Correlation matrix among asset classes is calculated using weekly returns over the time frame of analysis mentioned in the chart heading.
- Dendrogram for cluster analysis similarly uses weekly total returns in USD over the time frame of analysis.
- All data is as of May 31, 2026, unless otherwise stated.

Appendix 3: Geopolitical flash points

Geopolitical flashpoint

For analysis looking at historical market reactions around geopolitical events we use the following table of events

Start Date	Event
22-Sep-80	Iran-Iraq War
02-Apr-82	Falklands War
01-Jan-84	Tanker War
01-Jan-86	Saudi Oil Price Collapse
02-Aug-90	Iraq Invasion of Kuwait
17-Jan-91	Operation Desert Storm
21-Jul-95	Third Taiwan Strait Crisis
16-Dec-98	Operation Desert Fox
24-Mar-99	Kosovo War NATO Air Campaign
03-May-99	Kargil War
11-Sep-01	September 11 Attacks
07-Oct-01	United States Intervention in Afghanistan
02-Dec-02	Venezuela Oil Strike
20-Mar-03	Iraq War 2003 Invasion
11-Mar-04	Madrid Train Bombings
07-Jul-05	London Bombings
12-Jul-06	Israel Hezbollah War
07-Aug-08	Russia Georgia War
11-Feb-11	Arab Spring Egypt
15-Feb-11	Libya Civil War
18-Mar-11	Syrian Civil War
27-Feb-14	Crimea Seizure
10-Jun-14	ISIS Captures Mosul
26-Mar-15	Yemen War
12-Jul-16	South China Sea Tribunal Ruling
07-Apr-17	United States Strike on Syrian Airbase
14-Apr-18	United States United Kingdom France Syria Strikes
08-May-18	United States Withdrawal from Iran Nuclear Deal
26-Feb-19	India Pakistan Crisis Balakot Airstrike
12-May-19	Strait of Hormuz Tanker Sabotage
20-Jun-19	Iran Shoots Down United States Drone
14-Sep-19	Abqaiq Khurais Attack
03-Jan-20	Killing of Qasem Soleimani
24-Feb-22	Russia Ukraine War Full Scale
07-Oct-23	Israel Hamas Escalation
13-Apr-24	Iran Israel Direct Missile Exchange

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