

Equities overweight edges higher

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Each month, the State Street Investment Management Investment Solutions Group (ISG) meets to debate and ultimately determine a Tactical Asset Allocation (TAA) to guide near-term investment decisions for client portfolios. Here we report on the team’s most recent discussion.

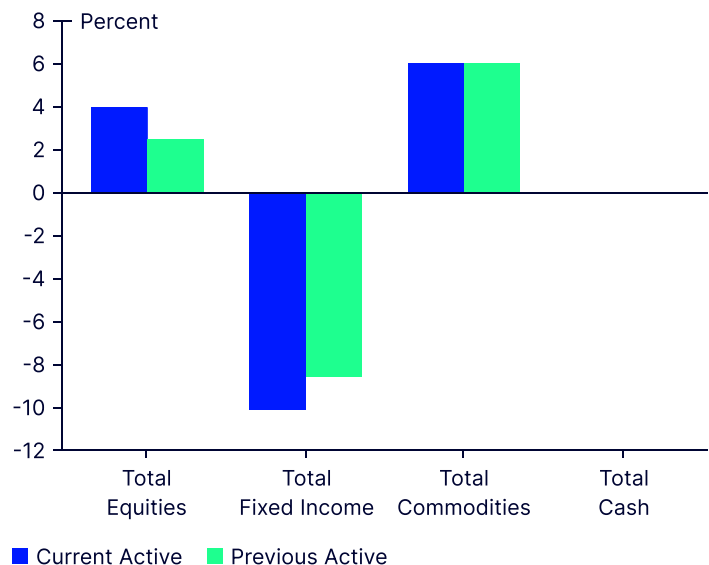
Macro backdrop

Despite persistent geopolitical uncertainty and ongoing headlines surrounding US–Iran tensions, the US economy has continued to demonstrate resilience—something it has managed through a wide range scenarios over the years. While pockets of weakness remain, including elevated delinquencies, softer small business optimism, and weak consumer sentiment, the broader economy still appears to be on solid footing. Our overall economic view remains constructive; however, what has changed is our expectation for monetary policy, as it is becoming increasingly likely that the Federal Reserve will remain on hold through 2026. The Fed’s dual mandate remains centered on supporting maximum employment while guiding inflation back toward its 2% objective.

While labor data remains mixed, aggregate conditions now appear more stable. Measures such as the labor diffusion index, ISM employment surveys, and the Conference Board’s labor differential still point to sluggish hiring conditions, but unemployment

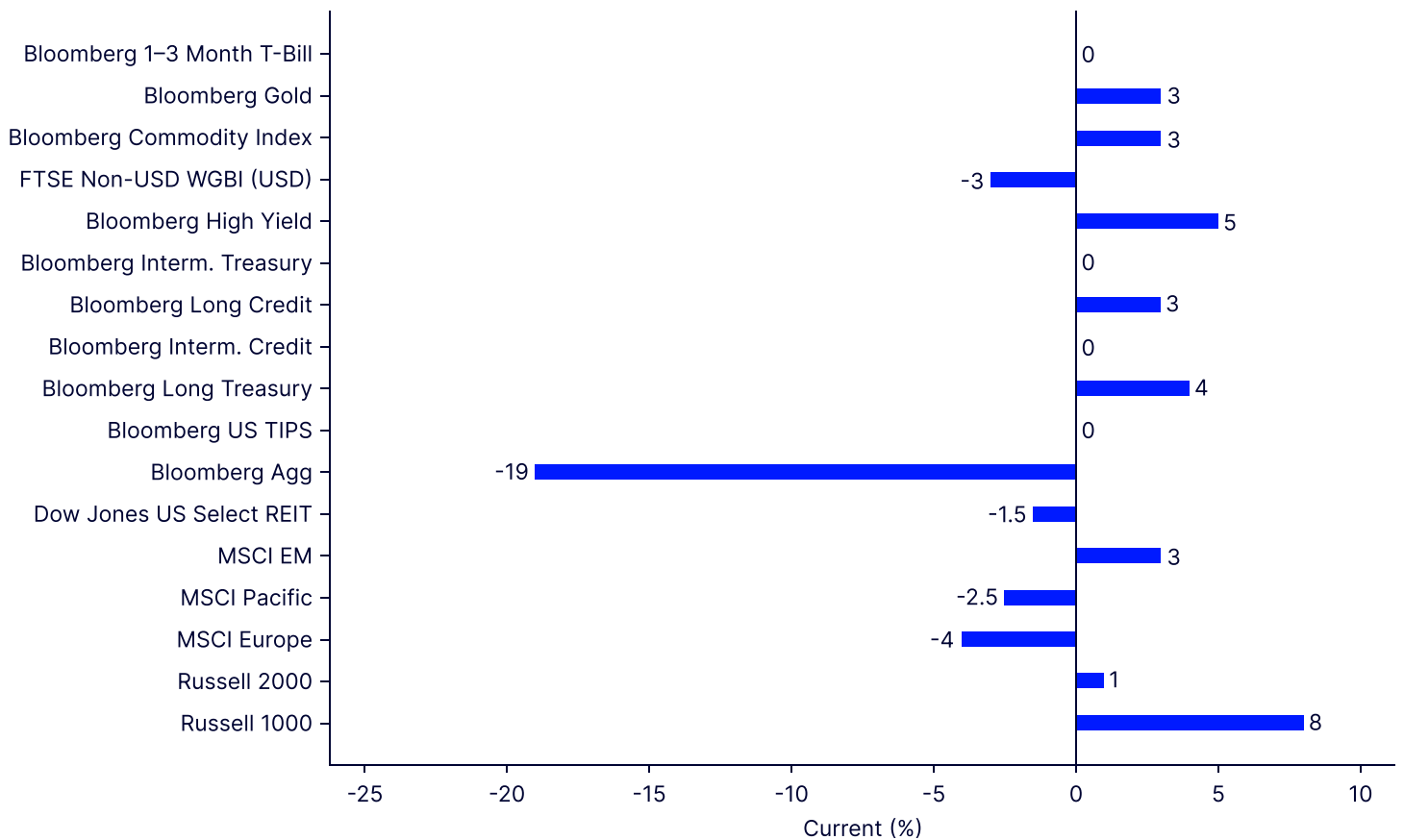
claims remain constructive, JOLTS job openings have improved, and recent payroll data suggest labor demand has stabilized. In addition, broader capex expansion beyond hyperscalers, supported in part by full depreciation incentives under the One Big Beautiful Bill Act and healthy corporate revenues, should support employment.

Figure 1: Model portfolio tactical positions for the US



Note: The benchmark allocation is equities—57%, fixed income—40%, commodities—3%, and cash—0%. The tactical positioning chart shows the active positioning of these asset classes relative to their respective benchmarks (represented as 0%), comparing the current and previous month. Source: State Street Investment Management, as of June 5, 2026. The model portfolio positions presented above are representative of ISG’s market views and our positioning for our tactical portfolios as of the date given. The results shown were achieved by means of a mathematical formula and are not indicative of actual future results which could differ substantially. This information should not be considered a recommendation to invest in a particular sector or to buy or sell any security shown. It is not known whether the sectors or securities shown will be profitable in the future.

Figure 2: Benchmark asset classes and their weightage



Source: State Street Investment Management, as of June 5, 2026. Investment grade bonds consist of investment grade credit, Treasuries and aggregate bonds.

Overall, the recent stabilization in labor markets is likely to relieve pressure on the Fed, allowing greater focus on the uncertain near-term inflation backdrop. While core goods inflation has continued to gradually ease, core services inflation and the Fed’s preferred super core measure, which excludes housing, have both remained elevated, signaling persistent underlying price pressures. Real-time rent measures still point to further moderation in shelter inflation, but other indicators have been less encouraging, including a sharp increase in small businesses planning to raise prices, firmer import and producer prices, and elevated prices paid components within the ISM surveys.

Wage growth will remain an important area to monitor, although trends to date have continued to move gradually lower. Overall, the combination of sticky inflation and elevated uncertainty surrounding near-term price pressures is likely to keep the Fed cautious and on hold as it looks to avoid reigniting inflation through premature rate cuts.

Directional trades and risk positioning

Our quantitative framework signals a constructive backdrop for risk assets. Consistent with last month, our assessment of risk appetite continued to improve, and our equity forecast strengthened further. While our expectations for credit spreads softened modestly, the overall outlook stays positive. With the balance of signals tilting more favorably toward equities, we modestly increased our overweight while trimming our allocation to aggregate bonds.

Despite ongoing Middle East uncertainty and persistent inflation pressures, markets appear focused on the prospect of an eventual US–Iran agreement, while AI optimism and US labor market stabilization have further supported sentiment. Our Market Regime Indicator (MRI) has continued to grind lower, now reflecting solid risk appetite at levels last seen toward the end of 2025. No major shift has occurred across individual factors, but the prevailing trend stays supportive, the equity trend

factor is firmly risk-on, and both our risk support factor and implied volatility measures have edged into slightly positive territory.

Equity implied volatility has receded but stays somewhat elevated, while currency implied volatility has dropped back to euphoric levels. Elsewhere, sentiment spreads have also returned to neutral after briefly spiking into risk-off territory around the onset of the Iran conflict. Overall, the MRI points to a favorable environment for risk assets.

For equities, improvement across multiple factors brought a more optimistic outlook this month. The recovery in investor sentiment following the onset of the Iran conflict has pushed equity prices higher, and our model captures this through strengthening short-term price momentum. The other side of that rally, however, is that valuations have become less attractive given strong returns over the past quarter.

Meanwhile, analysts have grown increasingly bullish, and expectations for both sales and earnings have continued to rise, reaching some of the highest levels our quantitative model has recorded over the past decade. Finally, our quality metrics are still stable, reflecting a healthy corporate backdrop and continuing to contribute positively to our forecast.

Within fixed income, our outlook for duration assets has improved, with our model now expecting a modest decline in the level of yields. While equity momentum and risk appetite remain solid, fading commodity momentum, a signal of easing inflationary pressures, combined with longer-term trend signals suggest rates are likely to drift lower. For credit, our model continues to point toward tighter spreads, though less convincingly than last month.

The moderation reflects two key inputs: a slowdown in the pace of improvement in equity implied volatility and a move higher in yields, both of which temper the outlook for further spread compression. That said, strong equity momentum and healthy risk appetite remain supportive, keeping our overall bias toward tighter spreads. For non-US government bonds, rising yields in Canada and expectations for a stronger US dollar weigh on the return outlook.

From a positioning standpoint, we modestly increased equity exposure to a 4.0% overweight, funded by a reduction in US aggregate bonds, resulting in a slight decrease in overall fixed income exposure.

Relative value trades and positioning

Within equities, our regional forecasts continue to diverge, with the US outlook improving relative to non-US markets. The US is still attractive across nearly all dimensions of our model, with strengthening price momentum and improving sentiment driving the upgrade.

Our REITs outlook, while still negative, has improved. Price momentum, though still weak on a relative basis, has begun to recover, and sentiment indicators are less pessimistic than earlier in the year. Supportive yield curve dynamics and easing credit risk conditions have also contributed to the improved outlook.

The most notable downgrade was Pacific equities, which fell to the bottom of our rankings alongside Europe, weighing on our broader non-US developed market view. Momentum for the region has faded from positive to neutral, sentiment has become less supportive, and valuations have deteriorated. Against this backdrop, we reduced Pacific equity exposure, extending our underweight, and redeployed the proceeds into REITs, narrowing our underweight.

Within fixed income, we repositioned the portfolio to reflect a more constructive outlook for US bonds. We reduced non-US government bond exposure, moving back to underweight, and extended our overweight to long US government bonds. We continue to favor longer-duration positioning and maintain meaningful exposure to spread sectors.

Within equity sectors, communication services remains our top-ranked sector, with an outlook that has strengthened relative to the broader market. The sector scores well across nearly every dimension of our model, with robust price momentum, strong sentiment, and solid quality characteristics all supporting the view. Energy continues to offer an attractive outlook, supported by deeply discounted valuations and favorable sentiment.

While price momentum has moderated slightly, amid volatile oil markets, and macroeconomic signals have been less supportive, we still expect the sector to deliver solid returns. Industrials stands out for its consistency—while not a leader in any single area, it ranks well across the board, with solid momentum, sturdy sentiment, and improving analyst expectations for both sales and earnings. Consumer staples, in contrast, slipped in our rankings as fading price momentum and deteriorating sentiment weighed on the outlook, though our overall forecast for the sector remains positive.

To see sample Tactical Asset Allocations (TAA) and learn more about how TAA is used in portfolio construction, please contact your State Street relationship manager.

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Illiquid risk/Asset investments may have difficulty in liquidating an investment position without taking a significant discount from current market value, which can be a significant problem with certain lightly traded securities.

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