

Equities lead, bonds catch up

Insights
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Robert W Spencer, CFA
Senior Portfolio Strategist

Keith M Snell, CFA
Portfolio Analyst

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

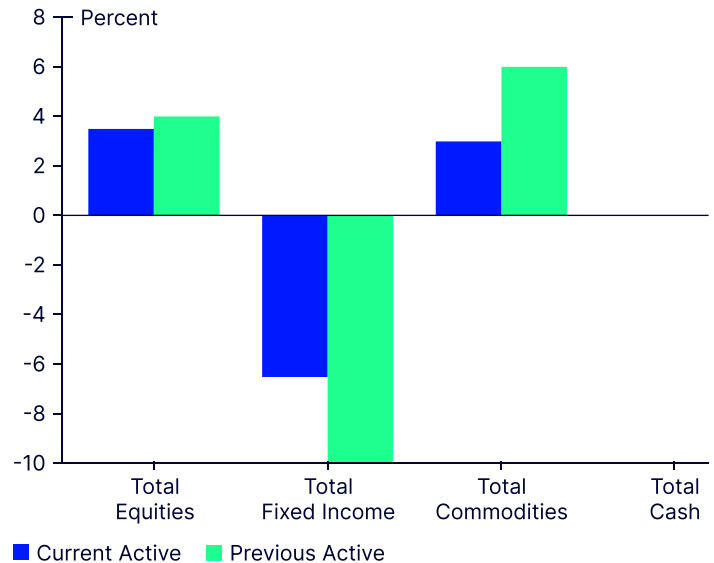
While tensions in the Middle East have re-emerged, we do not currently view them as signaling a return to the heightened conflict seen earlier this year. The recent exchanges appear more consistent with the periodic flare-ups that have occurred since the April ceasefire and, in our view, neither side has a strong incentive to re-enter a sustained military conflict given the significant political and economic costs involved.

Our base case remains that negotiations will continue amid intermittent tensions, though the region remains an important source of geopolitical risk, with potential implications for energy markets, inflation, and global growth.

The US economy continues to show resilience despite higher interest rates and persistent inflation pressures. Looking ahead, we expect growth to remain supported by expanding business activity, healthy corporate fundamentals, and continued investment in areas such as AI and infrastructure.

While the labor market has moderated, conditions are not dire, with jobless claims still relatively low and little evidence of a significant increase in layoffs.

Figure 1: Model portfolio tactical positions for the US

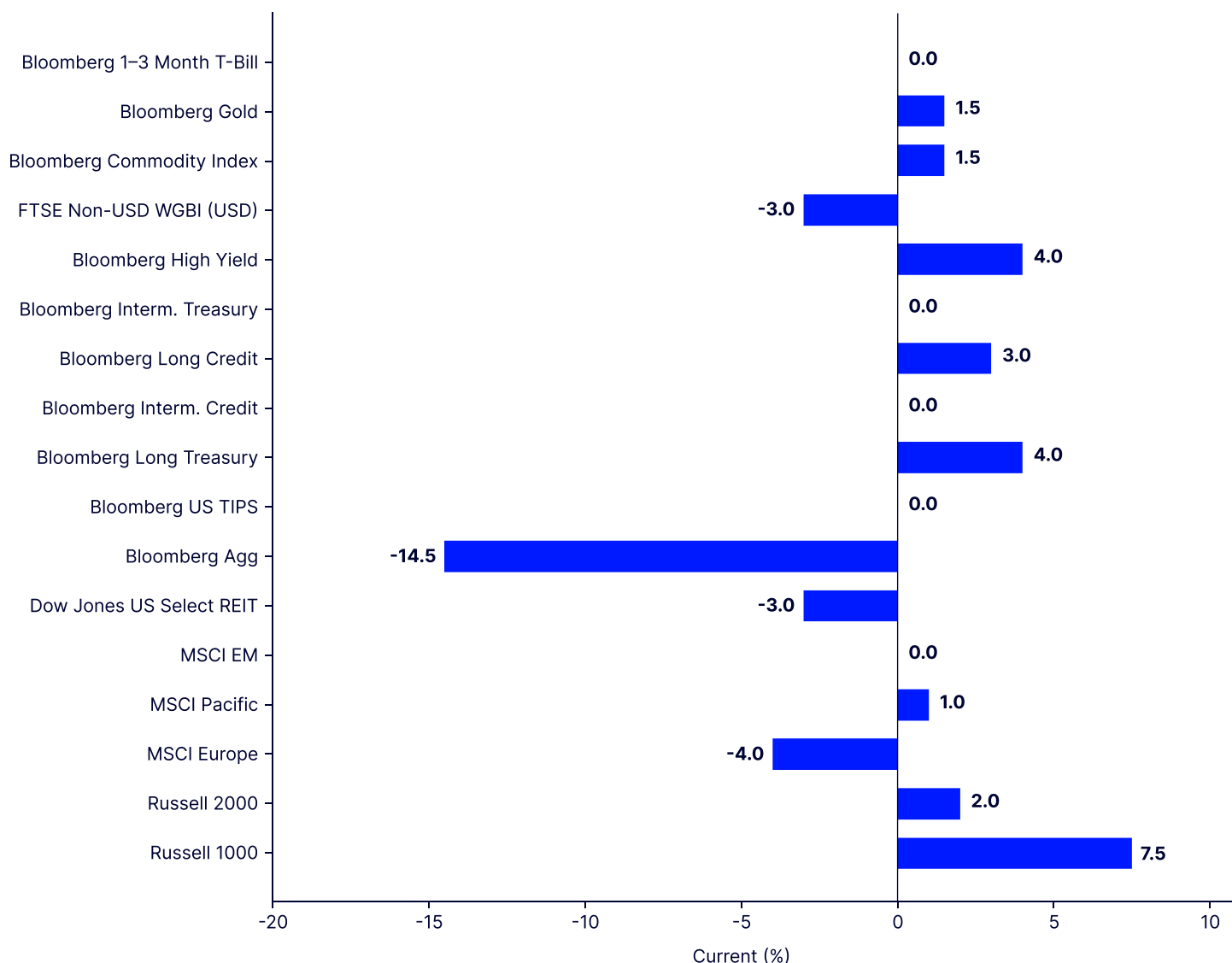


Note: The benchmark allocation is equities—57%, fixed income—40%, commodities—3%, and cash—0%. The tactical positioning chart shows the active positioning of these asset classes relative to their respective benchmarks (represented as 0%), comparing the current and previous month. Source: State Street Investment Management, as of July 8, 2026. The model portfolio positions presented above are representative of ISGs 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.

This, combined with lower energy prices, should help sustain economic growth through the remainder of the year.

That said, risks remain. Consumers continue to be the backbone of the economy, but savings cushions have largely been depleted, confidence remains mixed, real wage growth is negative, and households appear increasingly price sensitive. Household wealth remains elevated, but disposable income has leveled off while savings rates have fallen.

Figure 2: Benchmark asset classes and their weightage



Source: State Street Investment Management, as of July 8, 2026. Investment grade bonds consist of investment grade credit, Treasuries and aggregate bonds.

In addition, fiscal support from the One Big Beautiful Bill Act has faded, leaving consumers with less cushion to absorb shocks and making growth increasingly dependent on private-sector demand. As a result, we expect the economy to remain on a positive trajectory, though downside risks tied to consumer spending warrant close monitoring.

Inflation should continue to cool at the headline level as lower energy prices filter through the economy, but

underlying inflation pressures remain persistent. Elevated services inflation, rising small-business pricing plans, higher import prices, and firm PMI price measures suggest that progress toward the Fed's target may be slow.

As a result, while the case for additional tightening has weakened, resilient growth and sticky core inflation are likely to keep the Fed cautious, with any policy easing dependent on further improvement in inflation.

Directional trades and risk positioning

Our quantitative framework remains supportive of equities, with risk appetite and return forecasts continuing to signal an upside and justify an overweight position. While the fixed-income outlook improved meaningfully, with the model now anticipating a larger decline in interest rates, our conviction in spread sectors has moderated, though it remains positive. Expectations for gold and broad commodities also softened. Given a more balanced opportunity set across asset classes, we modestly reduced equity, gold, and commodity exposures and reallocated capital to fixed income.

Our proprietary Market Regime Indicator (MRI) remains supportive of risk assets, reflecting a generally favorable investment backdrop. Risk sentiment stabilized during the month as tensions in the Middle East eased and oil prices declined, while resilient economic data continued to reinforce confidence in the growth outlook.

Within the model, measures of sentiment spreads and overall risk support have stabilized in modestly positive territory, and equity market trends remain particularly strong, reflecting continued investor optimism. At the same time, some components of the model continue to warrant caution, most notably our assessment of credit market sentiment and equity implied volatility.

However, tight credit spreads and subdued currency market volatility suggest investors remain willing to take risks. Taken together, the MRI continues to indicate a favorable environment for risk assets, although select areas of the model warrant ongoing monitoring.

Our equity outlook improved modestly this month, supported by stronger price momentum across both our short- and long-term indicators and a less challenging macroeconomic backdrop. Quality measures remain robust, and while analysts continue to raise sales and earnings expectations, the pace of those upgrades has begun to moderate.

Offsetting these positives, valuation measures suggest equities remain expensive, while our longer-term risk premium estimates indicate that investors are not being compensated as attractively for taking equity risk relative to the opportunities currently available in high-quality bonds.

Within fixed income, our forecast became more constructive as several signals began to favor lower yields. While long-term momentum across equities and commodities remains positive, recent price trends have softened, suggesting easing inflation pressures and a more supportive backdrop for bonds. In addition, our valuation signal continues to indicate that yields remain elevated relative to long-term norms, supporting further mean reversion.

Across the Treasury curve, the model anticipates additional flattening as resilient economic activity and persistent inflation keep upward pressure on shorter-term rates relative to longer maturities.

Within credit markets, attractive carry continues to support returns, and our model expects yields to decline, though credit spreads are expected to widen modestly amid higher interest rates and slowing equity market momentum. Overall, we anticipate positive returns across the fixed-income landscape.

Within real assets, our forecasts for gold and broad commodities became less constructive. Gold was pressured by softer technical and fundamental signals, particularly as a stronger US dollar and higher real rates reduced its appeal.

While our commodity outlook also moderated, all underlying indicators remained supportive, though each softened month over month, leaving the overall backdrop constructive but with a somewhat lower level of conviction.

Relative value trades and positioning

Within equities, the US remains our preferred market, supported broadly across most factors in our model. We also became more constructive on US small caps, where improved valuations and a still-supportive economic backdrop enhanced their relative attractiveness versus large-cap stocks. Conversely, our view on REITs weakened due to lagging long-term momentum and less favorable sentiment.

Outside the US, we saw notable shifts in our regional outlooks. Our forecast for emerging markets deteriorated as attractive momentum and sentiment indicators were increasingly offset by weaker macroeconomic conditions, less favorable valuations, and weak quality characteristics. Conversely, our outlook for Pacific equities improved, supported by stronger recent market performance, improving analyst sentiment, and a more constructive macroeconomic environment.

These changes resulted in several portfolio adjustments during the month. We reduced our overweight position in emerging markets back to neutral and increased our underweight position in REITs. Capital was reallocated to Pacific equities, where we re-established a modest overweight position, and to US small caps, where we further increased our existing overweight.

Given our expectation for wider credit spreads but lower overall yields, we reduced our allocation to high-yield

bonds and increased our exposure to aggregate bonds. While the portfolio continues to favor longer-duration and spread sectors, this adjustment better aligns positioning with our updated return forecasts and improves the balance of opportunities across fixed income.

Within equity sectors, communication services and industrials remain our preferred exposures. While our outlook for communication services moderated somewhat as sentiment softened, the sector continues to benefit from strong price momentum, attractive quality fundamentals, and favorable relative valuations. Industrials are supported by robust earnings and sales expectations, as well as some of the strongest market momentum among sectors.

Our view on energy remains positive but has become less compelling this month. As oil prices retreated from their earlier highs, price momentum became less supportive and sentiment weakened, resulting in a lower relative ranking within our framework. In response, we reallocated a portion of our exposure to technology and health care. Despite unappealing valuations, technology ranks well across other factors, with price momentum and sentiment helping to support a positive outlook. Health care, meanwhile, benefits from improved momentum and relatively attractive valuations, resulting in a more favorable overall outlook.

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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There are risks associated with investing in Real Assets and the Real Assets sector, including real estate, precious metals and natural resources. Investments can be significantly affected by events relating to these industries.

Bonds generally present less short-term risk and volatility than stocks but contain interest rate risk (as interest rates rise, bond prices usually fall); issuer default risk; issuer credit risk; liquidity risk; and inflation risk. These effects are usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

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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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