



MARKET COMMENTARY

08 July 2026

MARKETS REMAIN RESILIENT WITH MIXED UNDERCURRENTS

Most financial markets ended the first half of 2026 with positive returns, while the second quarter marked a clear shift in the macro and market backdrop. The interim US-Iran deal was the defining event of Q2, pulling oil prices sharply lower, easing earlier stagflation fears and creating a more supportive environment for assets. Major equity market performance was mixed in June, spurred by solid earnings, continued enthusiasm for AI related businesses, and the easing of Middle East tensions. UK equities underperformed

with domestic politics and still elevated inflation dampening risk appetite, whereas Japanese equities delivered an impressive rise of almost 6%, helped by ongoing corporate governance reforms and improving profitability. Leadership remained concentrated in technology and semiconductor names, with energy held back by the reversal in crude, and more defensive sectors such as financials, healthcare and parts of consumer staples only just starting to pick up having recorded softer returns.

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S&P 500 eyes its high

The performance of the benchmark US index this year



Source: LSEG | Burton Frierson

Following its historic surge in Q1, Brent crude went on to record its sharpest quarterly decline since the pandemic, reducing the inflationary impulse from energy and allowing stagflation concerns to fade. That change helped the S&P 500 to deliver a gain of around 15% over the quarter, its strongest performance since the post-pandemic rebound of 2020, and supported exceptional returns from semiconductor and AI-exposed stocks, with the key chip index more than doubling year to date.

CORPORATE CREDIT DEFAULT EXPECTATIONS ARE STILL BENIGN

Through June, government bond yields stayed relatively elevated across major developed economies, reflecting lingering concerns about inflation persistence and fiscal deficits. However, easing stagflation worries helped stabilise rates and improved confidence that the policy stance is shifting from aggressive tightening towards cautious, data-dependent easing. Higher-quality sovereign bonds began to regain appeal as portfolio diversifiers, particularly for investors looking to hedge against equity weakness after such a strong, tech-led quarter. Corporate credit default expectations are still benign, and corporate balance sheets are broadly solid.

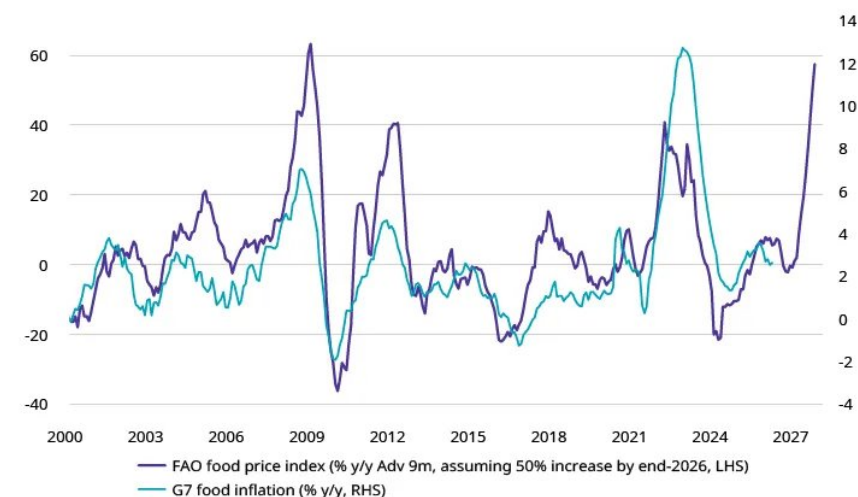
Gold continued to weaken as risk appetite stabilised, but real yields remained relatively elevated, while industrial metals are benefiting from ongoing investment in AI-related infrastructure, electrification and digital networks. Demand for data centres, renewable energy and grid upgrades provide a structural support even as some investors are questioning whether recent price strength is starting to run ahead of fundamentals.

Entering the second half of 2026, global economic growth may have moderated but continues to run ahead of earlier expectations in several developed economies. Labour markets are reasonably firm, consumer spending is steady and ongoing business investment gives cause for optimism. Inflation is trending lower, helped by the pull-back in energy, but central banks are signalling caution. The emphasis is on gradual, data-driven flexibility rather than rapid or synchronised cutting cycles.

Overall, Q2 has reinforced both the market opportunities and the risks. Structural themes such as AI-driven productivity, digital and green capital expenditure, and broadly healthy corporate profitability, continue to justify the long-term case for equities. But gains have become increasingly concentrated, and geopolitical tensions remain a persistent feature rather than a resolved risk. There is still reason for exposure to growth and risk assets, but it is most compelling when paired with diversification across regions and asset classes, and disciplined assessment and sizing within the technology sector.

POTENTIAL EL NIÑO FOOD SHOCK

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Source: LSEG Datastream. 617892

As June closed, attention started to edge away from stabilising energy markets towards a new potential source of inflation: global food prices. A strengthening El Niño is raising the risk of a broad-based, weather-driven supply shock rather than just another routine seasonal pattern. This El Niño matters because of its expected intensity, timing and global reach. Forecasts point to a strong event building into the second half of 2026 across multiple key growing regions at the same time. That means droughts, heatwaves and erratic rainfall could hit Asia, Africa, Australia and the Americas together, disrupting a wide range of crops rather than isolated harvests.

Grains, livestock and palm oil sit at the centre of the concern. Wheat, maize, rice and soybeans underpin most global calories, so weaker monsoons in India and Southeast Asia, plus drier conditions in Australia, Southern Africa and South America, could push staple prices higher. Livestock producers then face a double squeeze as heat lowers animal productivity, while higher grain prices lift feed costs, pressuring meat and dairy prices. Indonesia and Malaysia dominate global palm oil supply and typically see drier weather during El Niño. Any meaningful hit to output can quickly spill over into other vegetable oils, amplifying food inflation across processed foods and consumer products. The combination of a potentially strong, globally synchronised El Niño and still-elevated headline inflation means even moderate price spikes could be uncomfortable for central banks and consumers alike.

AI APPLICATION AND MONETISATION

**THE EMPHASIS IS
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For the past three years, the AI story has largely been about infrastructure. Hyperscalers have committed hundreds of billions of dollars to data centres, semiconductors and power capacity, and investors have rewarded the companies that supply the picks and shovels of the AI build-out. That narrative still holds, but market attention is beginning to widen. Increasingly, the key question is not just how much is being spent on AI capacity, but what that capacity is actually being used for, and whether it can be turned into revenue.

Enterprise spending on AI applications has grown sharply and buyers are behaving differently from the last major technology cycle. A clear majority of new enterprise AI use cases are now bought in rather than built internally and AI-native tools are converting trial users into paying customers at close to double the rate of traditional software. Businesses are moving past experimentation and are prepared to pay for tools that deliver measurable returns, rather than treating AI as an innovation project sitting outside core operations.

Three sectors illustrate where this application layer is developing fastest. In banking, AI has moved from isolated pilots to embedded infrastructure across fraud detection, credit decisioning, customer engagement and increasingly agentic workflows that execute multi-step tasks with limited human intervention. Generative AI alone is expected to add materially to global banking revenues, and institutions are now being judged less on whether they have adopted AI and more on whether they have operationalised it at scale.

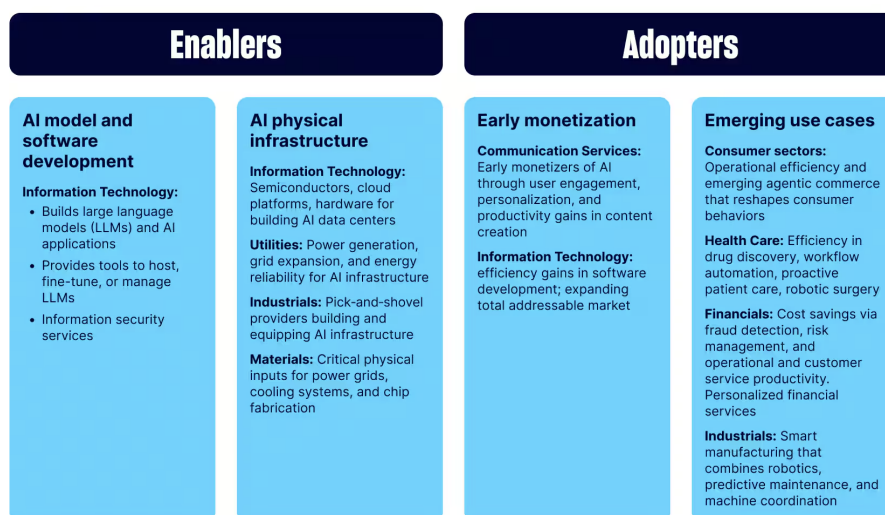
In healthcare, the growth trajectory is even more striking. Diagnostic imaging, clinical documentation and administrative automation are among the most mature use cases, with well over 1,000 AI-enabled medical devices now authorised by regulators. The emphasis is shifting from technical novelty towards proven clinical and operational benefit.

**PORTFOLIOS
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Utilities occupy a more complex position, as both drivers of AI-related demand and adopters of the technology. The same data-centre boom fuelling infrastructure investment is placing new strain on power grids. Infrastructure exposure has been the more straightforward AI trade of the past two years. The next phase may reward a different set of qualities as focus turns to recurring revenue, high margins,

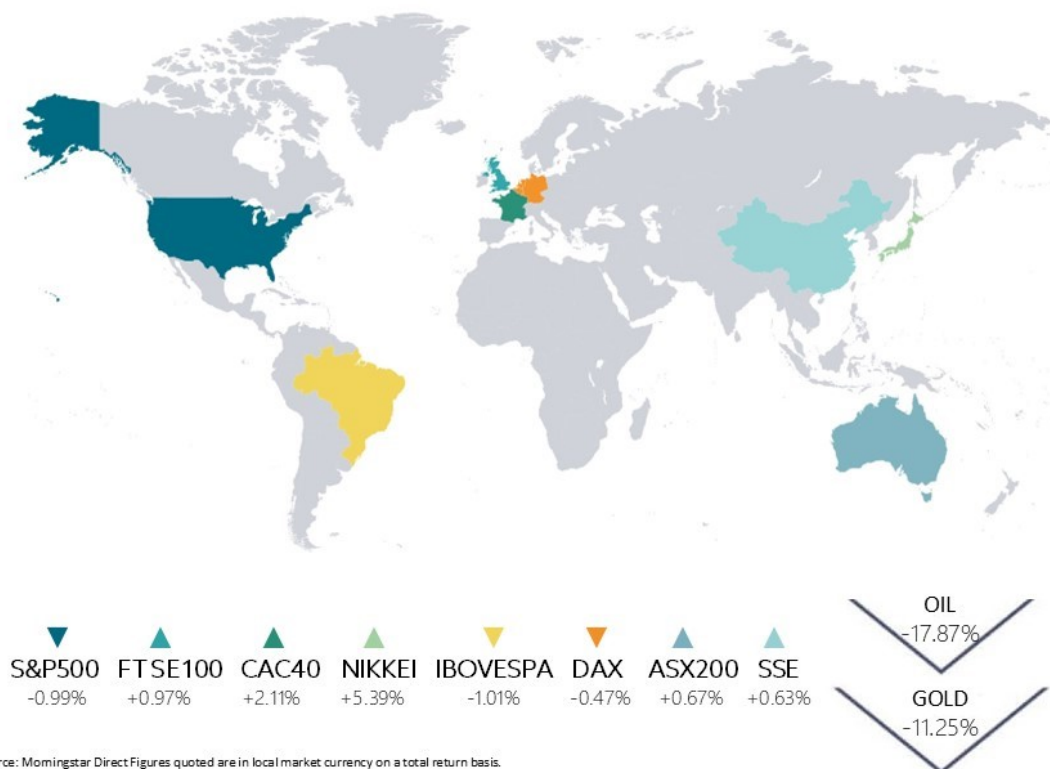
and demonstrable productivity gains at the point of use. Not every application-layer company will succeed, and questions about ultimate return on investment remain far from settled. But the direction of travel is clear enough that portfolios built solely around AI's foundations may now need to widen their view to include what is being built on top of them.

Figure 1: AI value chain



Source: State Street Investment Management ETF Research, June 2026. For illustrative purposes only.

GLOBAL MARKET RETURNS - JUNE 2026





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