

Market Perspectives

Quarterly Highlights

- Conflict in the Middle East:** The Iran conflict sent Brent crude oil prices surging toward \$120 per barrel, pushed headline inflation to 4.2% year-over-year, and forced markets to reprice the Federal Reserve's interest rate path. A fragile ceasefire eased oil back toward \$70 per barrel, but aftershocks from the heightened uncertainty continue to linger.
- Hawkish Fed Pivot:** Fed Chair Kevin Warsh presided over his first Federal Open Market Committee meeting, holding rates steady at 3.50% to 3.75% while delivering a hawkish dot plot that shifted the median 2026 year-end rate projection up to 3.8% from 3.4% in March. The shift erased prior market expectations for rate cuts in 2026, with the futures markets signaling a meaningful risk of further tightening if inflation remains elevated.
- Economic Resilience:** Beneath the market volatility, the U.S. economy continued to demonstrate resilience, although signs of labor market cooling emerged late in the quarter. Following stronger hiring earlier in the spring, nonfarm payroll growth slowed sharply to just 57,000 jobs in June, well below the expected 113,000. At the same time, the unemployment rate edged down to 4.2%, though the decline was aided by a lower labor force participation rate. Despite softer labor data, corporate earnings estimates for the S&P 500 show expectations for 24% year-over-year growth in the second quarter, with contributions increasingly becoming broader-based.
- Credit Spreads:** Investment-grade credit spreads tightened to 0.9% and high-yield spreads compressed to 2.8%, both sitting near historically low levels, even as headline inflation ran above 4% and the Fed pivoted toward a more hawkish outlook. The disconnect between historically tight spreads and an uncertain macro environment suggests that credit markets are continuing to price in a narrative of economic resilience. While fundamentals remain supportive of this, greater credit dispersion is to be expected, given that valuations provide less cushion against unexpected shocks.

In This Issue

- Quarterly Highlights
- Performance Recap
- Market Themes
- Fund Positioning

FIGURE 1. Asset Class Returns & U.S. Macro

As of June 30, 2026

U.S. Equity	Q2 2026	Q1 2026	1Y
S&P 500	15.2	-4.3	22.3
Dow Jones	13.4	-3.2	20.6
Nasdaq Composite	21.6	-7.0	29.5
Russell 3000	15.4	-4.0	22.8

International Equity	Q2 2026	Q1 2026	1Y
MSCI EAFE	10.8	-1.2	20.2
MSCI EM	24.1	-0.2	43.5
MSCI Europe	10.9	-2.8	18.6
MSCI ACWI	14.9	-3.2	23.7
MSCI ACWI ex U.S.	14.5	-0.7	27.7

U.S. Fixed Income	Q2 2026	Q1 2026	1Y
U.S. Aggregate	0.7	0.0	3.8
U.S. Intermediate Aggregate	0.5	0.1	3.8
U.S. Treasury	0.3	0.0	2.7
U.S. Corporate	1.4	-0.5	4.3
U.S. Corporate High Yield	2.5	-0.5	5.9

U.S. Macro	Q2 2026	Q1 2026	Q4 2025
Real GDP (QoQ)	1.2	2.1	0.5
Inflation (YoY)	4.2	3.3	2.7
Unemployment	4.2	4.3	4.4
10-Year Treasury Yield	4.5	4.3	4.2

Russell U.S. Equity Indices (Q2 2026)			
	Value	Blend	Growth
Large Cap	13.9%	15.1%	16.7%
Mid Cap	13.4%	13.8%	14.5%
Small Cap	17.2%	21.5%	25.7%

Bloomberg U.S. Fixed Income Indices (Q2 2026)			
	Short	Mid	Long
Investment Grade	0.4%	0.7%	1.5%
BBB	1.0%	1.2%	2.7%
High Yield	1.9%	2.5%	6.0%

Source: Morningstar Direct, Bloomberg. US Equity indices show the total return for each respective index. International Equity indices show the net return in U.S. dollars for each respective MSCI index. U.S. Fixed Income indices show the total return for each respective Bloomberg index. The latest quarterly real GDP is an estimate provided by the Federal Reserve Bank of Atlanta. Inflation is represented by All-items CPI. Russell U.S. Equity Indices show the total returns for each respective style of the Russell 1000, Russell Mid-Cap, and Russell 2000 indices. Bloomberg U.S. Fixed Income Indices show the total returns for each respective duration bucket of the Bloomberg Aggregate, Bloomberg U.S. Credit BBB, and Bloomberg Corporate High Yield indices.

(Continued)



Performance Recap

S&P 500 Sector Divergence: The S&P 500 delivered a strong quarter, with Technology reclaiming sector leadership, gaining nearly 32% over the period.* Energy was the notable laggard during the quarter, declining 13% as oil prices retreated from their Iran-war highs. However, despite the second-quarter pullback, Energy remained one of the market's strongest-performing sectors on a year-to-date basis, up nearly 20% through the end of June.

Strength in International Equities: Over the quarter, the MSCI ACWI ex-U.S. index gained 14%, while emerging markets added to their recent gains with another 24% surge. South Korea was the standout country within emerging markets, gaining over 87% during the quarter based on AI-driven semiconductor demand. At the margins, however, a strengthening dollar in June moderated unhedged returns for U.S. investors in non-US markets.

Flattening Yield Curve: The 10 year U.S. Treasury yield ended the quarter 0.2% higher at 4.5%. In contrast, shorter dated yields moved 0.4% higher, with the two year yield ending the period at 4.2%, as markets repriced the Fed's higher-for-longer policy path. The move at the short end of the curve resulted in a flatter yield curve with the spread between the 10-year and two-year treasuries sitting in a modest 0.3% range.



* Source: S&P 500 Information Technology Sector Total Return Index; Bloomberg.

Market Themes



Theme 1: Higher for Longer

Real Rates Rise: The Fed's higher for longer posture took on renewed urgency as energy driven inflation led to a hawkish revision in the June dot plot. The median policy rate projection for 2026 moved higher, alongside an upward revision to inflation expectations, signaling a more restrictive policy path. Notably, nine of eighteen FOMC participants now project at least one rate hike in 2026, marking a clear shift away from the prior easing bias, at least for the time being.

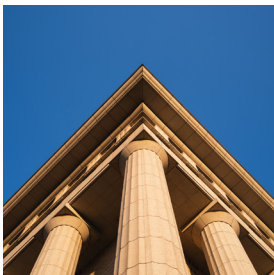
Bond Yields Repriced: These shifting policy expectations drove a sharp repricing across the yield curve, with yields moving higher throughout the quarter. Term premiums grew as investors reassessed the likelihood of sustained restrictive policy and uncertainties surrounding inflation, putting longer-duration assets under pressure. Worth noting, however, is the persistent move lower in two-year breakeven inflation expectations, indicating that market participants may be expecting yields to be driven by rising real rates, more so than increasing inflation expectations.



Theme 2: Energy Disruption

Supply Shocks: The escalation in geopolitical tensions and resulting energy supply disruptions reintroduced risks to inflation while simultaneously clouding the growth outlook. Higher oil prices raised concerns that energy-driven price pressures could slow the disinflation process and complicate the central banks' efforts to return inflation to target without undermining economic growth.

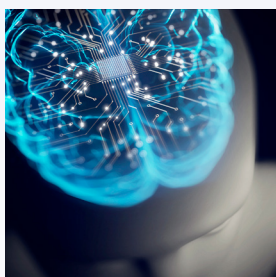
Safe Havens: Gold entered the quarter on strong footing as investors turned to traditional safe-haven assets in response to geopolitical tensions and lingering inflation concerns. However, a hawkish Fed pivot, rising real yields, and a strengthening dollar eroded that premium. Gold finished the quarter down roughly 14%. The decline served as a reminder that, while gold can provide valuable portfolio diversification during periods of stress, its appeal can diminish when rising yields increase the opportunity cost of holding non-income-producing assets.



Theme 3: Central Bank Divergence

Evolving Interest Rate Paths: The Fed remained on hold but began pricing in the risk of renewed rate hikes, while the European Central Bank raised rates by 25 bps in response to heightened inflation. The Bank of England held steady at 3.75% following rate cuts last year, while the Chinese central bank continued to ease policy to support growth. These divergent monetary paths drove currency movements and cross-border capital flows.

Dollar Rebounds: The repricing of U.S. monetary policy expectations and wider interest-rate differentials versus many global peers supported a recovery in the U.S. dollar during the quarter. The stronger dollar reversed part of the currency tailwind that had previously benefited unhedged international equity returns for U.S.-based investors, highlighting how exchange-rate movements can materially influence relative performance between domestic and foreign markets.



Theme 4: AI Capex

Rising Tide Lifts All Boats: Artificial intelligence continued to dominate corporate capital allocation in the second quarter. The largest hyperscalers — Microsoft, Google, Amazon, Meta, and Oracle — are on track to deploy, by some estimates, \$750 billion in AI-related capital expenditures in 2026. The magnitude of this investment is estimated to add nearly 2.5% to U.S. GDP,* rapidly approaching the magnitude of government defense spending. This surge in investment is also providing a broad-based earnings tailwind to the market, supporting growth across the supply chain, from semiconductors and hardware to infrastructure and utilities.

All Eyes on ROI: As capex intensity continues to rise, the largest hyperscalers are facing near-term free cash flow compression and turning to both debt and equity issuance to fund ongoing investment. Investor focus has shifted to ROI, specifically the duration of the spending cycle and the timing and magnitude of returns.



Theme 5: Broadening Leadership

Earnings Participation: The S&P 500 remains heavily concentrated, with a small group of mega-cap technology companies accounting for a disproportionate share of the index. Yet the earnings story is beginning to broaden out. Estimates for earnings growth in the second quarter show double-digit growth in five of the eleven S&P sectors, including Industrials, Materials, Utilities, and, of course, Technology. However, the sustainability of this broader earnings growth remains a point of focus, particularly given its interdependence on continued AI driven capex.

Market Breadth: Year-to-date outperformance of the equal-weighted S&P 500 relative to the market-cap weighted index signals a broadening market, with participation extending well beyond the mega-cap leadership. The semi-annual Russell rebalancing reinforces this broadening market trend by migrating expanding small- and mid-cap companies upward into larger-cap tiers, distributing capital across a wider base. However, it simultaneously increases mega-cap concentration within the largest tiers as passive funds are forced to buy the index's fastest-growing, dominant winners.

* Source: Goldman Sachs Global Investment Research; MissionSquare Investments.



Fund Positioning

Equities Over Fixed Income

- Strong earnings momentum (S&P 500 +28.6% year-over-year in Q1 2026), improving labor markets (three-month Nonfarm Payrolls average at 188,000), and consumption tailwinds have driven a sharp rebound in risk assets despite elevated energy prices.
- An expected moderation in energy prices, alongside continued earnings strength and macro resilience, reinforces our tactical preference for equities over bonds.

Growth Over Value

- While strong first-half activity supported value outperformance, weakening underlying fundamentals, including declining savings rates, subdued consumer confidence, and rising factory job cuts, point to increasing fragility in demand sustainability.
- Recent manufacturing strength appears partly inventory-led amid supply uncertainty, alongside rising input cost pressures, reinforcing concerns over the durability of the cyclical value recovery.
- A demand-driven AI CapEx cycle, supported by strong cloud growth, enterprise backlogs, and pricing power across the stack, continues to underpin resilient, high-quality earnings growth, reinforcing our tactical overweight to growth equities.

Mid-Cap Over Small-Cap

- The Fed's recent shift toward market-driven rate discovery and reduced forward guidance is likely to tighten financial conditions and elevate dispersion, favoring companies with stronger balance sheets and more resilient funding profiles.
- In this environment of reduced liquidity support and greater macro uncertainty, mid-cap companies are better positioned than small-cap entities to navigate funding pressures and earnings volatility, reinforcing our preference for mid-cap equities.

U.S. Over Non-U.S. Equities

- Economic activity in the Eurozone remains subdued (Q1 2026 GDP: -0.2% year-over-year), with the Purchasing Managers' Index indicating contracting output in France and Germany, while tighter ECB policy amid energy-driven inflation adds to growth constraints.
- Domestic demand remains weak in China, while external vulnerabilities persist across emerging markets. These vulnerabilities are particularly evident in India's currency weakness and sensitivity to oil prices, U.S. dollar strength, and global capital flows.
- Against a backdrop of relatively stronger U.S. growth, policy divergence, and potential for continued dollar strength, we maintain an overweight to U.S. equities and a modest underweight to international and emerging market equities.

Longer Duration Over Shorter Duration

- The current U.S. yield curve offers attractive income opportunities across maturities, supporting a balanced approach between duration positioning and diversification benefits.
- While markets are currently pricing in one additional rate hike by year-end, we expect the Fed to remain on hold and instead rely on balance sheet policy to tighten financial conditions.

Contributing Authors:

Shari Hensrud, PhD, CFA®
Senior Vice President, Chief Investment Officer

Oliver Meng, CFA®, CAIA®, FRM®
Head of Stable Value

Andy Kim, CFA®, CAIA®
Vice President, Head of Equity

Michael Sands, CFA®
Associate Fund Manager, Asset Allocation

Ashish Prasad, CFA®
Fund Manager, Asset Allocation

Disclosures: The information contained herein is for informational purposes only and is not intended as a solicitation, nor does it constitute investment, tax, or legal advice. Reference to any fund or asset class is not a recommendation to buy, sell, or hold that fund or asset class. Neither MissionSquare nor its subsidiaries are responsible for any investment action taken as a result of the information presented or interpretation of such information. Investors should carefully consider their own investment goals, risk tolerance, and liquidity needs before making an investment decision. Investing involves risk, including possible loss of the amount invested.

Please note that this content was created as of the date indicated, reflects the author's opinions, and is subject to change, without notice, due to market conditions or other factors.

We are MissionSquare — let's talk.

MissionSquare 777 N. Capitol Street, NE, Washington, DC 20002-4240 missionsquare.com

672079-0726-W3501