Global Outlook

July 2026

A NEW MACRO REGIME

Geopolitics, fiscal pressures and trade fragmentation are increasingly shaping the macroeconomic outlook.

A more uncertain world means more frequent shifts in the balance of risks for markets and policymakers.

Understanding long-term structural trends will be critical to navigating the years ahead.

BEVAN GRAHAM

IMPLICATIONS FOR INVESTORS

Equity markets rebounded, with sentiment driven by microchip and AI optimism.

Profit outlook has improved, but pockets of speculation are a concern.

Elections, energy uncertainties, and interest rates pose potent second half year risks.

GREG FLEMING

SALT
Funds Management

A New Macro Regime

The second half of the year finds investors navigating an increasingly complex macroeconomic landscape. While recent attention has centred on developments in the Middle East, the bigger story is that many of the structural forces shaping today's investment environment have been building for several years.

We have long highlighted a number of structural themes that we believed would become increasingly important for investors including a more fragmented global trading system, heightened geopolitical tensions, ageing populations, rising fiscal pressures and the prospect of structurally higher inflation than experienced during much of the 2010s. Those themes are no longer longer-term possibilities. They are becoming more overt and increasingly influential in shaping economic outcomes and financial markets.

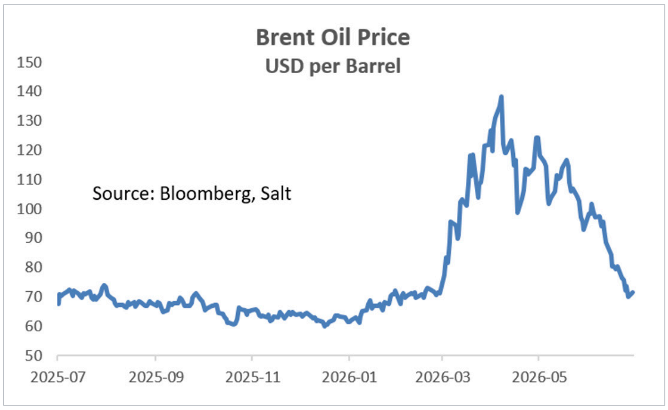
The result is a world in which policymakers face more difficult trade-offs than they have for some time. Central banks can no longer focus solely on supporting growth when inflation risks remain elevated. Governments are finding that higher debt levels and rising borrowing costs are reducing fiscal flexibility. Businesses are adapting to a world where resilience has become almost as important as efficiency, while investors must navigate a macroeconomic environment characterised by greater uncertainty and more frequent shifts in the balance of risks.

At first blush, financial markets have remained remarkably resilient. Equity markets have largely looked through recent geopolitical developments, while the retreat in oil prices has eased concerns about an immediate resurgence in global inflation. That resilience is encouraging, but it should not be mistaken for a return to the more benign macroeconomic environment of the past decade. The recent volatility has instead demonstrated how quickly the outlook can change as geopolitical events, supply disruptions and policy expectations interact.

The central message of this report is therefore not that the global economy is heading for crisis. Rather, it is that the macroeconomic regime continues to evolve. The relatively benign environment that characterised much of the decade following the Global Financial Crisis is giving way to one in which inflation is likely to prove more variable, policy choices more difficult and macroeconomic volatility more persistent. Understanding these structural shifts, rather than simply interpreting the latest economic data or market headline, will be critical to navigating the years ahead.

Iran and the geo-political outlook

Recent developments in the Middle East have provided an important reminder that geopolitical risks are no longer peripheral to the global economic outlook. The conflict between Israel, the US and Iran triggered a sharp rise in oil prices earlier in the year, raising concerns about a renewed inflation shock and a more difficult outlook for global growth. However, the subsequent fall in oil prices, helped by progress toward a more durable ceasefire and increased confidence that energy supplies can be maintained, has reduced the immediate inflationary threat.



That is clearly a welcome development. Lower oil prices ease pressure on household purchasing power, reduce input costs for businesses and lessen the risk that central banks will need to respond to another near-term inflation shock. It also helps explain why financial markets have been able to look through much of the recent geopolitical turmoil.

However, it would be premature to conclude that the macroeconomic risks have disappeared. If anything, recent events have highlighted how quickly the outlook can change. Oil prices moved sharply higher when supply risks intensified, then fell just as quickly as those risks appeared to fade. That volatility matters. It demonstrates that geopolitical developments can shift the balance of inflation and growth risks in a matter of days, even before the underlying economic data have changed.

The broader point is that geopolitical risk has become a more important macroeconomic variable. Energy infrastructure remains vulnerable, global inventories have been drawn down, and the Middle East remains central to global oil and gas supply. Even if the immediate conflict de-escalates, the region is unlikely to return quickly to a position of lasting stability. Markets may be right to price out the worst-case scenario, but they should not ignore the possibility of renewed disruption.

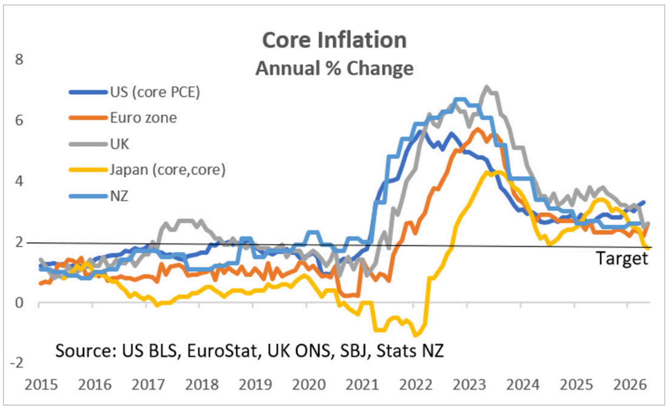
For investors and policymakers, the lesson is not that oil prices must remain high or that another inflation shock is inevitable. Rather, it is that the distribution of possible outcomes has widened. A more fragmented and geopolitically unstable world is one in which supply shocks can emerge quickly, risk premia can shift abruptly and confidence can be tested even when the underlying global economy remains resilient.

That is why the Iran conflict remains relevant to the outlook even as oil prices have fallen. It has reinforced one of the central themes we have highlighted for some time: geopolitical tensions are moving from the background to the foreground of the macroeconomic environment. They may not dominate every quarter, but they are increasingly capable of shaping the outlook for inflation, growth and financial markets.

Central banks in a more volatile macro environment

The recent fall in oil prices has eased one of the more immediate challenges facing central banks. At the height of the conflict in the Middle East, policymakers faced the prospect of another supply-side inflation shock arriving just as many economies were trying to complete the final stage of the disinflation process. That risk has diminished as energy prices have fallen back, giving central banks more room to focus on domestic inflation pressures and the evolving growth outlook.

But the episode still carries an important message. Central banks are operating in a more volatile macroeconomic environment than the one that prevailed before the pandemic. Inflation has eased from its peaks, but it has not disappeared as a policy challenge. Services inflation remains sticky in several economies, labour markets are cooling only gradually, and inflation expectations remain more vulnerable than they were during the low-inflation decade following the Global Financial Crisis.



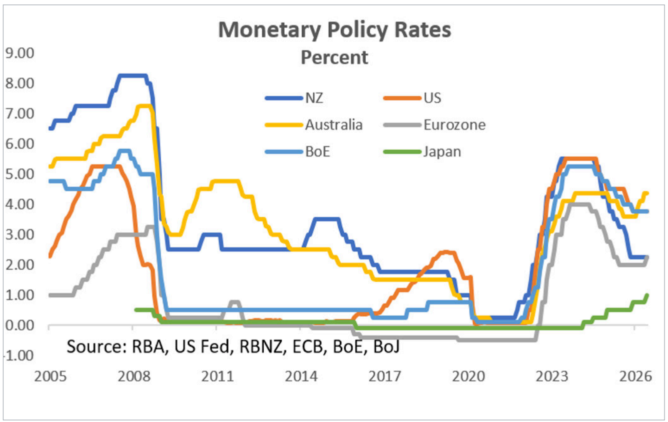
In that context, the recent oil price volatility matters even though the immediate inflation threat has faded. It shows how quickly central banks can be forced to reassess the balance of risks. A sustained rise in energy prices would have lifted headline inflation, squeezed real incomes and complicated decisions about whether to support growth or defend inflation credibility. The fact that this scenario has not materialised does not mean the risk was unimportant. It simply reinforces how much more uncertain the policy environment has become.

This makes the next phase of monetary policy more difficult. Markets remain keen to identify the point at which central banks can cut interest rates or return policy settings to neutral. But policymakers are likely to be more cautious. Having spent several years restoring inflation credibility, they will be reluctant to ease policy too quickly while inflation remains above target or while supply-side risks remain elevated.

The challenge will also vary across economies. Some central banks have more scope to look through temporary shocks because domestic demand is weak and spare capacity is emerging. Others face stickier inflation, more resilient activity or less confidence that inflation expectations are fully anchored. The Bank of Japan remains on a different path as it continues the process of policy normalisation, while the RBA and RBNZ must balance domestic capacity pressures against fragile household sectors and the uncertain global backdrop.

The broader point is that monetary policy is no longer operating in the benign environment of the 2010s. Central banks cannot assume that inflation shocks will quickly fade, nor can they respond to every growth concern with easier policy. The recent easing in oil prices is helpful, but it does not remove the need for caution. In a world of more frequent supply shocks, geopolitical uncertainty and structurally higher fiscal pressure, the range of possible outcomes is wider and the cost of policy mistakes is higher.

For central banks, that means judgement will matter more than ever. The task ahead is not simply to react to the latest data release, but to assess whether shocks are temporary or persistent, whether inflation expectations remain anchored and whether policy is appropriately calibrated for a more uncertain macroeconomic regime.



Warsh's Fed: Evolution, not revolution

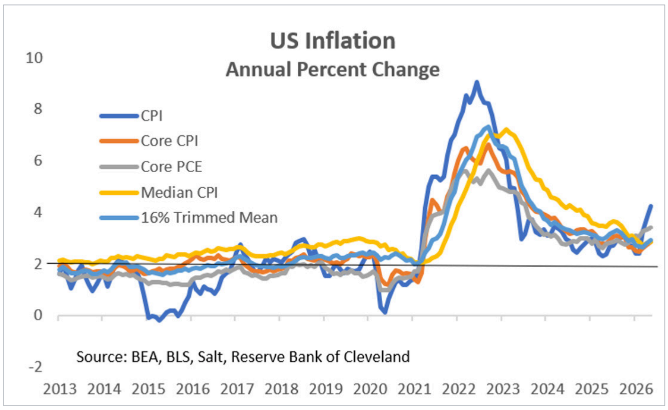
Kevin Warsh's arrival as Chair of the Federal Reserve is one of the most important institutional developments in global monetary policy. It matters not simply because of the next interest rate decision, but because it may signal a change in how the Fed thinks about its role, its framework and its communication with markets.

Warsh has long been associated with scepticism toward unconventional monetary policy such as Quantitative Easing (QE), concern about inflation credibility and a belief that the Fed should focus more narrowly on its core responsibilities. That makes his chairmanship potentially significant. But it would be a mistake to assume that a change in chair automatically produces a dramatic change in policy.

The Fed is a committee. Warsh cannot unilaterally deliver a more dovish or more hawkish central bank. Policy decisions still require consensus across the Federal Open Market Committee (the rate setting committee of the Federal Reserve), and the broader reaction function of the institution is shaped by staff analysis, the dual mandate, the inflation target and the credibility the Fed has built over decades. The chair matters greatly, but the Chair does not act alone.

That is why the more important issue may be institutional rather than immediate. Warsh's influence is likely to be felt through the Fed's framework, communication strategy and tolerance for inflation risk. A review of forward guidance, the dot plot and the way the Fed communicates uncertainty could have meaningful consequences for markets. If the Fed becomes less willing to provide detailed guidance, markets may need to price more uncertainty into the expected path of interest rates. That could lift volatility, particularly around inflation and labour market data.

There is also an interesting tension in Warsh's position. He was appointed with some expectation that he would be more sympathetic to lower rates and a stronger growth agenda. But the macro environment he inherits is not obviously conducive to aggressive easing. US growth has been resilient, inflation remains above target, and the Iran shock has created a renewed risk of higher energy prices. In that environment, the Fed's inflation credibility matters more, not less.

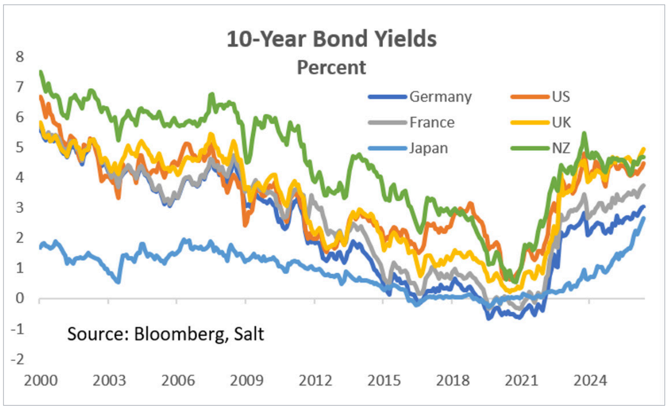


The other important dimension is productivity. Warsh has shown interest in the idea that artificial intelligence could lift productivity and allow stronger non-inflationary growth. That is possible, and it is a theme worth taking seriously. But central banks need to be careful about easing policy today on the assumption that productivity will improve tomorrow. The Greenspan-era analogy is tempting - a central bank prepared to look through strong growth because it believed the economy's supply potential had improved. The risk is that the productivity gains from AI may be real but slow, uneven and difficult to measure in real time.

The Warsh Fed is therefore best understood as evolution, not revolution. The reaction function may change at the margin. Communication may become less prescriptive. The inflation framework may be reviewed. But the basic constraint remains - if inflation is too high, the Fed cannot credibly behave as though it's not!

Bond markets and the return of term premium

One of the most important macro themes remains the behaviour of bond markets.

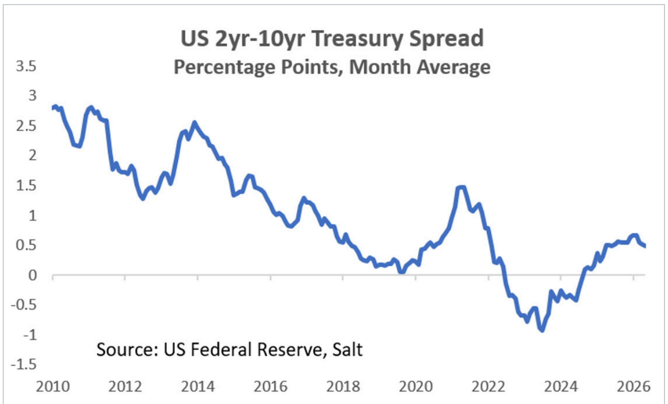


For much of the post-pandemic period, investors focused on the path of central bank policy rates. That still matters, but it is no longer the whole story. Increasingly, the long end of the yield curve is being driven by term premia, fiscal sustainability concerns and changing assumptions about the neutral rate.

This is a major shift from the pre-pandemic decade. During that period, low inflation, quantitative easing, strong global demand for safe assets and confidence in fiscal sustainability helped keep long-term bond yields low. Today, those supports are weaker as:

- inflation has been higher and more volatile,
- central banks are no longer large and predictable buyers of government bonds,
- fiscal deficits are larger,
- defence spending is rising,
- ageing populations are increasing pressure on public finances; and
- investors are demanding more compensation for holding long-duration government debt.

The steepening of yield curves across developed markets should not be ignored. It tells us that markets are not simply pricing the next central bank move. They are also reassessing the longer-term cost of capital. Even if policy rates eventually fall, long-term yields may not return to their pre-pandemic lows. That has implications for governments, households, corporates and asset valuations.



The US Treasury market is the most important example, but it is not the only one. Japan's gradual exit from ultra-loose monetary policy matters because Japanese investors have historically been major buyers of global bonds. Europe faces higher defence and energy-security spending. The UK continues to face questions about fiscal credibility. Smaller economies, including New Zealand, are not immune from these forces even if their starting positions are better.

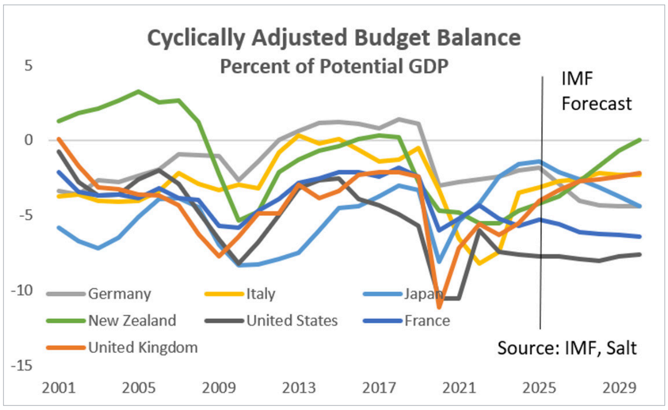
The key point is that fiscal credibility now matters more than it did when rates were close to zero. When interest costs were negligible, governments could run large deficits with limited immediate market pressure. That world has changed. Higher yields increase debt-servicing costs, which worsen deficits, which can in turn require still higher yields to attract buyers. Not every country is close to that dynamic, but more countries are moving in that direction.

This does not mean a sovereign debt crisis is inevitable. But it does mean investors should expect bond markets to remain more demanding. The long end of the curve is likely to behave less like a simple reflection of central bank expectations and more like a market judgement on inflation risk, fiscal policy and institutional credibility.

Fiscal dominance and sovereign debt

Fiscal policy is becoming one of the central macro stories of the next decade. The issue is not just that deficits are large. It is that the demands on government balance sheets are rising at the same time as the cost of servicing debt has increased.

Governments face pressure from multiple directions. Ageing populations are lifting pension and healthcare costs. Defence spending is rising as geopolitical tensions increase. Climate adaptation and energy security require investment. Industrial policy is back in fashion. Infrastructure needs are large. And voters, having lived through repeated shocks, are less tolerant of austerity and more inclined to expect governments to cushion the impact of crises.



That's a circle that's hard to square. If governments want to spend more, they need either stronger growth, higher taxes, lower spending elsewhere or more borrowing. Stronger productivity growth would be the best solution, but it cannot be assumed. Higher taxes are politically difficult. Spending restraint is also difficult, especially when large parts of expenditure are tied to perceived entitlements. That leaves borrowing, but bond markets are becoming less forgiving.

This is where the risk of fiscal dominance enters the discussion. Fiscal dominance does not necessarily mean central banks are directly financing governments. More subtly, it describes a world in which fiscal pressures increasingly shape the environment in which monetary policy operates. If governments are running large deficits and debt-servicing costs are rising, higher interest rates become more politically and economically painful. That can create pressure on central banks to tolerate higher inflation or ease policy earlier than they otherwise would.

The danger is that fiscal and monetary policy start working against each other. Central banks may be trying to restrain inflation while governments are adding demand or subsidising cost increases. Alternatively, governments may be forced into premature austerity just as economies slow. Neither outcome is ideal.

For smaller economies, the lesson is especially important. Fiscal credibility is a valuable asset. Countries with stronger public balance sheets retain more policy flexibility when shocks arrive. Countries that allow debt dynamics to deteriorate may find that markets impose discipline at precisely the moment flexibility is most needed.

New Zealand is not in the same fiscal position as the US, UK or parts of Europe. But it is not immune from the global repricing of sovereign risk. Higher global bond yields lift domestic borrowing costs, slower potential growth makes fiscal consolidation harder, and political pressure to spend more on infrastructure, health, defence and cost-of-living support is unlikely to disappear.

The broader point is that fiscal policy can no longer be treated as background noise. It is becoming a key driver of economic outcomes, bond yields and central bank constraints.

Productivity, AI and long-term growth

If fiscal sustainability is one of the defining macroeconomic challenges of the next decade, then productivity growth is the most compelling long-term solution. Stronger productivity allows economies to grow faster without generating inflation, lifts real wages, improves living standards and expands the tax base needed to support ageing populations. It is little surprise, therefore, that artificial intelligence has become one of the defining investment and economic themes of this decade.

The optimism surrounding AI is understandable. The technology has the potential to automate routine tasks, improve decision-making, accelerate scientific discovery and raise output across a wide range of industries. If those gains are realised on a broad scale, AI could lift potential growth and help economies navigate many of the structural challenges they face, from labour shortages to rising fiscal pressures.

However, the relationship between AI and inflation is likely to be more nuanced than many currently assume. The prevailing narrative is that AI will prove inherently disinflationary by boosting productivity and lowering business costs. That may ultimately prove true, but the transition is unlikely to be straightforward.

In the near term, AI could just as easily prove inflationary. Building an AI-enabled economy requires enormous investment in data centres, semiconductors, electricity generation, transmission networks and digital infrastructure. At the same time, demand for highly skilled labour is likely to remain strong as businesses compete for the expertise needed to develop and deploy these technologies. In other words, demand may increase well before the economy's productive capacity has expanded sufficiently to meet it.

History also suggests that major technological revolutions rarely deliver economy-wide productivity gains overnight. New technologies require complementary investment, organisational change and time for businesses to adapt. Productivity improvements typically emerge gradually as innovation diffuses across industries, rather than immediately following the initial wave of investment. The productivity gains from AI may ultimately prove substantial, but they are unlikely to be evenly distributed across firms, sectors or countries, nor are they likely to arrive as quickly as current market enthusiasm sometimes assumes.

This distinction is particularly important for central banks. If policymakers assume future productivity gains will rapidly offset current inflation pressures, they risk easing monetary policy prematurely. While AI undoubtedly has the potential to expand the economy's long-run supply capacity, monetary policy must respond to the economy that exists today, not the one that may emerge over the next decade.

For New Zealand, the productivity challenge is especially important. The economy continues to face relatively low potential growth, making it more susceptible to capacity constraints and limiting the rate at which living standards can improve sustainably. AI has the potential to become part of the solution, but it will not eliminate the need for broader structural reform. Investment in infrastructure, education, competition, regulation, business innovation and capital deepening will remain essential if New Zealand is to lift its long-term growth potential.

Structural themes move centre stage

The common theme running through this report is that many of the structural forces reshaping the global economy are no longer operating quietly in the background. Geopolitical tensions, trade fragmentation, demographic change, fiscal pressures and technological disruption have become increasingly important drivers of economic outcomes and financial markets.

None of these themes emerged overnight. Indeed, they have featured prominently in our long-term thinking for several years. What has changed is their visibility. Events such as the war in Iran, renewed concerns over fiscal sustainability and the emergence of artificial intelligence have brought these structural forces into much sharper focus. They are no longer simply long-term considerations for policymakers and investors. They are influencing the economic cycle here and now.

That shift is creating a more demanding macroeconomic environment. Central banks face more difficult trade-offs between inflation and growth. Governments must balance growing spending demands against increasingly constrained fiscal positions. Businesses are adapting to a world where resilience has become almost as important as efficiency. For investors, macroeconomic volatility is likely to remain higher than experienced through much of the decade following the Global Financial Crisis.

This does not imply that the outlook is uniformly negative. The global economy has repeatedly demonstrated its resilience, technological innovation continues to create new opportunities, and periods of structural change have often provided the foundation for the next phase of economic expansion. However, the environment is becoming more complex. Policymakers are likely to have less room for error, markets may become more sensitive to shifts in inflation and fiscal expectations, and geopolitical developments are increasingly influencing economic outcomes rather than simply creating temporary market noise.

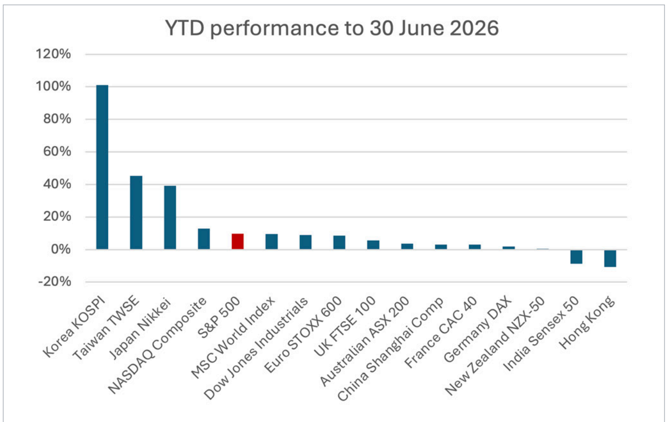
The challenge for investors is therefore unlikely to be a shortage of opportunities, but rather the need to navigate a world characterised by greater uncertainty, more frequent supply-side shocks and a broader range of macroeconomic outcomes. Periods of structural change have historically created both winners and losers. While the macroeconomic backdrop may become more demanding, it is also likely to create new opportunities for businesses, sectors and economies that are able to adapt successfully. Understanding the structural forces shaping that environment will become increasingly important.

Bevan Graham

Implications for Investors

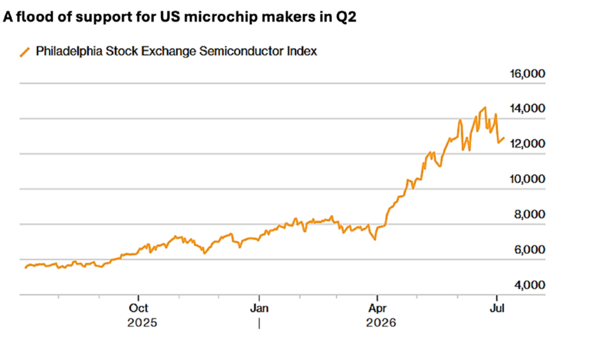
The "Semi Squad" rides to the Rescue

Despite a rocky June month characterised by resurgent worries about the sustainability of the AI trade and the persistence of inflation, the S&P 500 has gained 9.5% in 2026 Year-to-Date (YTD) after rebounding by 15% in Q2,and thereby posted its best quarter since Q2 2020. Continuing strength in Semiconductor company earnings and guidance helped to assuage investors' fears of any widespread profit shocks, amid a still-uncertain macro backdrop. The market took an increasingly confident stance that the Iran War, whilst driving up energy prices and complicating global trade and alliances, would ultimately prove marginal to US corporate profitability.



Source: LSEG, FactSet

The overall positive momentum in International Equities in the second quarter, however, continues to mask intensified swings in market sentiment. The enthusiasms and periods of re-assessment are alternating and leading to substantial volatility within individual markets. The current focus of this scrutiny in the semiconductor industry. Markets will need to assess whether recent pressure on hyperscaler shares changes the perceived path for AI capital expenditure. Indications that spending plans remain intact would help reassure investors that demand for AI infrastructure remains durable, but further evidence of caution could keep attention focused on very high valuations, massive financing needs, and extensive concentration risk.



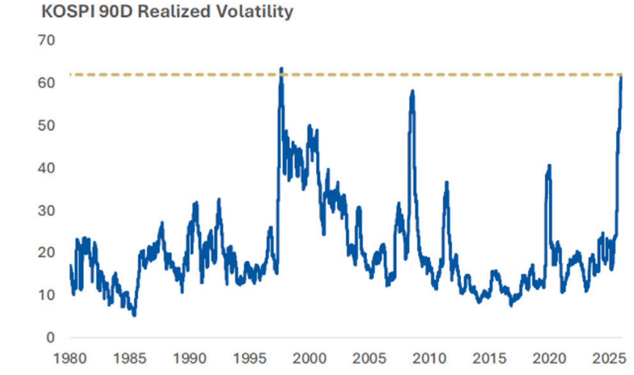
Source: Bloomberg

This is primarily evident at the level of industry sectors. However, at the individual country level, an extreme example is the South Korean KOSPI Index, home to Samsung and SK Hynix, which together make up just over half of the national equity index by weighting. The euphoric views in the second quarter on semiconductor demand and associated profit paths drove Korea to the largest individual gain over the period, the Kospi Index more than doubling in three months.

A comparable dynamic in Taiwan lifted their national equity index by 45% in the second quarter. However, the volatility level has surged, as shorter-term players rush in and out of trading vehicles to attempt to capture rapid upside and to cash out quickly.

As can be seen below, realised volatility on the Korean market surged, to a level last seen during the Asian economic crisis of 1997-98. However, this time around, the catalyst wasn't fear and flight, but fear of missing out (FOMO.) That degree of crowding does flag a risk to other comparable markets, in the event of any deterioration in the chip sector demand or profitability outlook. As in the frothier developed equity markets, this spike in volatility correlates with very high margin lending and leveraged positioning, which attests to fragility (even as Iran fears fade for the time being.) Energy importers with high microchip, electronics and even automotive reliance are clearly among the more vulnerable investment destinations, as the second half year begins. There is a degree of opacity in the order flows in some of the main markets which has been overlooked as many investors have clamoured to simply gain exposure to "All Things AI."

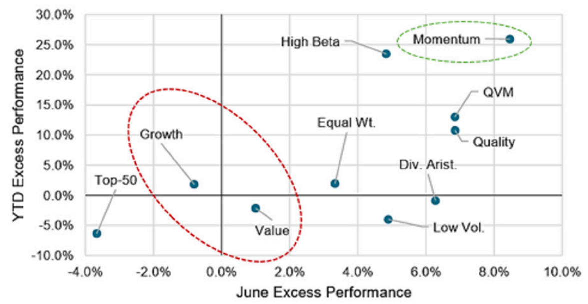
Korean Stock Exchange volatility at Asian crisis level on FOMO



Source: Morgan Stanley Research, Bloomberg

factors entered a strengthening phase, it is early days and significant economic or earnings change would be needed to push them ahead and reverse three years of underperformance by those defensive factors.

YTD and 1Mo. Excess Performance



Source: S&P Dow Jones Indices

A broadening away from the Mag-7...

Notwithstanding their recovery on the final trading day of the quarter, megacap equities underperformed, with the US S&P 500 Top 50 down 5% in June, as part of an ensuing rotation away from tech hyperscalers and toward chipmakers, and additionally into other defensive segments of the market. In June month, the small cap stocks continued to make up for lost ground, and the US Russell 2000 Index gained 3.6%, set against the one-month -1.1% decline in the S&P 500. A sustained, if incremental, rally in the US small caps universe over the last year has added up to a 35% one-year gain from the segment – 20% of which has occurred in 2026.

Except for Energy, Communications Services, and Utilities (which was unchanged,) all large-cap sectors ended the second quarter of 2026 with gains. Information Technology finished the quarter up 32%, despite a 3% pullback in June.

...but Momentum remains powerful

In terms of the equity market factors, the factors that ended the second quarter with relative gains were led by S&P 500 Momentum, which surged by a stellar 44% (15% above the Index return for the Quarter.). High-dividend and Low-volatility factor companies underperformed in the June quarter. The stocks rising at the fastest rate continued to be rewarded with massive inflows and consequently, with outperformance of the benchmark index. While many argue that this is self-fulfilling and is setting the US market up for a difficult period when Momentum no longer reigns, it must be acknowledged that for now, the periods of reversal have been short-lived and have been treated as opportunities to "buy-the-dip" and thus, to ride further upward momentum as the market rebounded. Thus, while in June month the Quality and Low Volatility defensively-oriented equity

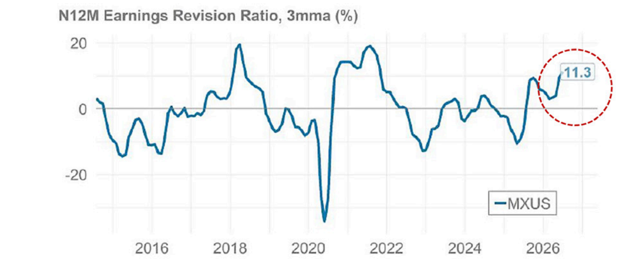
Persistently-soft NZD has boosted Global Shares' returns

The unhedged returns from global equities to NZ investors benefited during the quarter, as NZD slipped -1.2% against the US dollars over the three months and by -2.4% in 2026 YTD. This reflects a stronger US dollar which has unfolded this year, as markets priced out their earlier expectations of a meaningful policy easing path in the US this year. The NZ dollars' sogginess also prices in potential for only very incremental interest rate tightening in New Zealand, given the continuing fragility of the domestic economy – notably, in the North Island major cities. All the same, the domestic equity market is a rare outlier in the global developed markets universe, as its fundamentals are now indicating meaningful relative cheapness, and the NZ could well be a more compelling destination for defensively-inclined investor capital as asset allocators prepare for a different set of performance drivers into 2027.

US equity fundamentals outlook improved in Q2 2026

A positive reversal in the expected tendency of US companies' earnings revisions set in later last year, after the dilution of the so-called "Liberation Day" tariffs. Upward revisions to profit forecasts, as analysts diluted their prior trade war-based assumptions, carried market sentiment higher and the net balance of positive revisions only turned downwards again as 2025 ended. The relief in markets as companies adapted and profit hits proved "less bad" than anticipated arguably led to a positive overshooting and worrying US complacency. As the first quarter concluded, the balance of corporate earnings revisions, though still positive, has diminished, and that can presage an adjustment in overall equity market bullish sentiment. The market adjusted moderately downward and awaited a positive catalyst – which arrived, in the form of bullish outlook statements from an array of microchip sector multinationals, in US Europe, and Asia.

US corporate earnings outlook rebounds on chip makers



Source: MSCI, IBES as at 30 June 2026

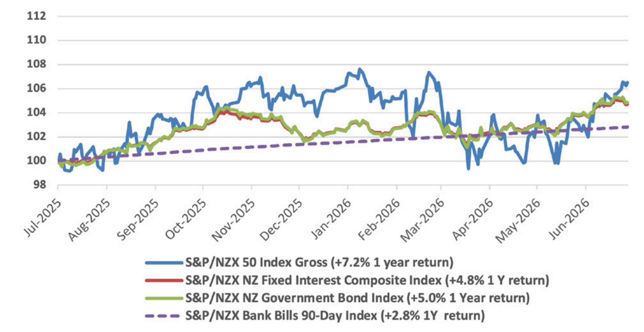
At the beginning of the second quarter, the rate at which earnings upgrades were exceeding downgrades for the US equity market looked to be sliding. However, and the quarter progressed, a juggernaut set of very positive statements from the world's major microprocessor producers gave the revisions ratio for prospective profits a meaningful second wind. While these are still forecasts and highly dependent on demand continuing apace and even accelerating, the lift in earnings forecasts for the next year undoubtedly assisted the US market's rapid and energic recovery from its first quarter weakness. There is now a high bar in place for the corporates concerned to realise those ambitious expectations for quarterly earnings, and investors will likely punish any enterprise unable to keep enthusiasm alive through maintaining a grow-grow-grow narrative.

It bears observing that the earnings momentum track for Japan, and the Emerging Markets have over the same period begun to move downward after moving sharply higher in early 2026. This partially reflects the impact of rising imported fossil fuel energy costs in those regions, which is not broadly the case as a major constraint on the Tech. sector in the US. Additionally, major US enterprises active in the AI-semiconductor capacity surge have both spent existing free cash-flow and been willing to issue debt securities to cover immediate, gargantuan investment costs. To a degree, the immediate profit impacts of steady or sustained inflation in energy prices is masked.

NZ equities log a respectable Second Quarter

New Zealand equities managed a 5.5% quarterly recovery and ended the second quarter little changed (+0.5%) on a YTD basis. An incipient recovery from late 2025 into in the first quarter of this year was effectively erased immediately after the oil price shock and its impact on global equity markets from February onward. However, by April, as news-flows clarified, a base had formed for domestic markets, and the NZ share market matched the return from the MSCI World equity index in May month. June month saw a 2% gain in the domestic market, ahead of the RBNZ's next move.

On our internal valuation metrics, NZ equities in June were priced on around a 6% discount to Australian equities, based on the bottom-up Discounted Cash-flow valuation methodology. All the same, investors in domestic shares need to be aware that fuel costs jumping and erratic consumer sentiment mean downward pressure on the earnings of some cyclical stocks, albeit mainly in the short-term.



Source: S&P Dow Jones Indices

Retaining a patient positive view of NZ equities

We retain a modest overweighting in NZ equities within our multi-sector diversified funds, and do not anticipate diluting that position in the remainder of this year. Whilst the New Zealand economy is still in the throes of the difficult domestic trading environment, we believe that the stimulatory period now completed by the Reserve Bank of New Zealand and the defensive nature of the industries that are heavily represented on the NZ exchange means that NZ equities should prove comparatively resilient. Into late-2026, we anticipate incremental domestic demand improvements, alongside some election year clarity, potentially allowing the local market to build upon its moderate one-year gains of 7% gross. At the time of writing, the NZX 50 Index reached an all-time high on an points basis, though there is definitely no euphoria present in the NZ market.

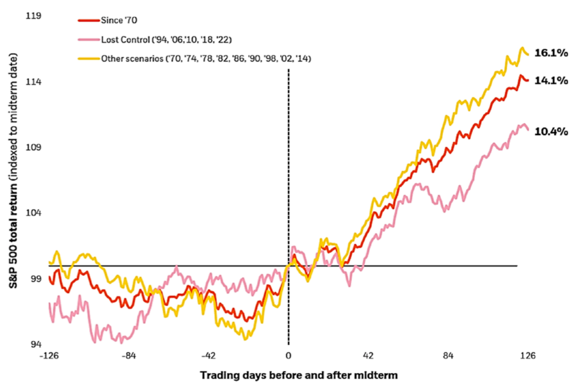
However, as the influence of US markets never leaves New Zealand unaffected, equity exposures should be carefully managed. NZ equity valuation multiples are rather more palatable than either Australian or US shares' - especially if one looks at the NZ market on a median stock basis. The NZ market is therefore at acceptable valuation levels and has scope to retain recent selective strength, assuming the negative global turn in risk appetite does not deepen into stagflation. There is still a preponderance of pessimism implied in many domestic equity prices, and longer-term NZ investors or international acquirers (after rigorous due diligence and comparative value analysis) will continue accumulating NZ equities in the remainder of this year and into 2027.

The NZX 50 Gross return over the last year is once again ahead of that of the returns from domestic bonds, and well ahead of the NZ cash return. That present situation – while understandable when the economy was still in borderline recession territory – now seems to undervalue the NZ equity market 's future returns potential. We would look to add exposure on geo-political weakness, but very selectively, given vulnerability of some domestic companies to any additional travel disruptions, fuel cost jumps, or export capacity challenges.

Possible US Equity impact of mid-Term elections

Historically, mid-term election years in the United States, where scope exists for a change in Congressional leadership, have been associated with more subdued market returns. But as the election nears, history has shown a tendency to rally. Since 1990, the average S&P 500 return in non mid-term years was 12% vs. only 3% in mid-term years. But that masks large dispersions at the sector level: Healthcare and Energy have historically held up better, whilst Industrials and Financials have tended to drag the market down in the full course of mid-term years (there have been 14 such instances, between 1970-2022.) However, since 1970, there have been only six comparable set-ups as the one that US voters face in 2026: where a single party controls the Presidency and both houses of Congress. The historical average returns pattern is shown below.

US S&P 500 in electoral mid-term years: (five months either side of election)



Source: Bloomberg, BlackRock

It the dominant party (i.e. the Republicans, in 2026) lose control on one or of both houses of Congress, the historical data indicates that average 6-month forward return after elections when the incumbent party loses control is materially lower (10%) than in other scenarios (16%).

Every year is unique, with its distinct fears and focus points. 2026 has arguably an even more intense array of critical issues facing the electoral and investing communities. The indifferent performance of US equities in the first quarter was more typical of the characteristic pattern shown in the chart, where this year's roughly -5% market decline fitted the pattern. However, the second quarter resurgence in US stocks goes dramatically against the typical mid-term trend.

That suggests either the AI-semiconductor narrative is so powerful that it has overwhelmed the typical policy-driven criteria for setting share market sentiment, or, that investors have jumped ahead and already priced in a positive resolution to pre-election uncertainty. These are likely elements of both explanations currently in play. The second possibility – investors getting ahead of expected good news – is an indication of another aspect of elevated current disappointment risks.

Although many of US government's waves of erratic, arbitrary, and certainty-sapping policies and geopolitical actions continue to hit the headlines, so far, market participants appear to be willing to take America's direction under Trump in their stride. This year has already seen piecemeal announcements from the Trump administration, proposing massive defence spending increases (fiscally fraught,) intervention in the listed market for rental homes (populist and ineffective,) and proposals to carve up the natural resource assets of Venezuela and even of Iran between US companies according to the President's personal judgment of their deserts.

Apologists for Trump's way of doing things dismiss these as transient and largely purely matters of his abrasive style, but with the Iran war now barely in abeyance, markets must face the fact that institutional disruption is a matter of considerable substance and real incomes are being eroded further, which ultimately hurts profits as well as sentiment, so the squeeze on consumers' wallets may not prove as temporary as Trump and his political allies have repeatedly predicted.

Greg Fleming

Conclusion: Our Investment and Asset Class outlook

- We still favour specific Equities over Bonds, and moved global fixed income funds to a longer duration profile at 4.9 years. Within Equities, we favour stable cash-flow compounders and within Bonds, prefer markets with good carry and scope to outperform in stickier inflation and cooling growth.
- Listed real assets of infrastructure and real estate have been strong performers and we retain confidence in these segments, as they are still not expensively valued.
- NZ's economy has been weak and patchy, but 2026 saw an improvement. However, investors are looking forward across the sentiment ravine to a recovery that is finally getting underway. Rate stability, strong terms of trade and greater corporate efficiency after a testing period should assist an incremental valuation improvement for NZ equities.
- Within the NZ market, large cap stocks screen as fairly- valued after de-rating but the median stock is slightly cheap. This is a similar theme to globally – mega caps are much more expensive than the median stock or equally-weighted index. Quality factors had a weak 2025-Q126, improved in Q2, and may be sought-after in any "stalled" markets.
- Trump risks remain significant. Deregulation is the key potential positive but may become much harder after mid-terms. Non-tariff barriers, immigration crackdown, war and energy brinkmanship are major supply-side shocks. The US fiscal deficit and Fed independence remain key risks, even with Warsh replacing Powell in the Chair. Trump may press harder for rate cuts in 2027. Especially if his Congressional support for policies is weakened.
- US Administration is clumsy managing all of these risks. Consumer Confidence is close to post-Covid lows, despite positive wealth effects and the news of the US-Iran ceasefire.
- All this at a time when US market valuations are in their 90th percentile of all-time levels – albeit highly concentrated in several bubbly sectors. Will the valuation reversion be orderly? Will investors wait for returns on investment to accrue, or get impatient?
- A great deal of investor enthusiasm is linked to the AI- Data centre – Space frontier story, and risks disappointment. Presently, prices for key US chipmakers, AI developers and satellite communications / data firms are very high, but in the decade ahead, profitability will require steadfast political support. Any change in US Government composition or spending priorities could easily upset the prevailing narrative and trigger sharp re-pricing.

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