Morningstar® Markets Observer

Q3 2026 Data as of June 30, 2026

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Market Overview

Stocks Bounce Back in the Second Quarter

Equity markets staged a sharp rebound in the second quarter, led by the Morningstar Emerging Markets Index's 22.4% gain and a 15.5% return for US Large Cap. Large-growth stocks outperformed their value counterparts by 26 percentage points, driven by renewed enthusiasm for mega-cap technology and artificial intelligence names. Bonds lagged as yields rose across the curve, with the 5-year Treasury yield climbing to 4.2% from 3.8% a year earlier. Broad commodities fell 8.1% as oil prices plummeted following the first quarter's spike.

Market Dashboard

		Return (%)						Fundamental Measures			
Equities	**Dividend Yield**	**YTD**	**3 Mo**	**1 Yr**	**3 Yrs**	**5 Yrs**	**10 Yrs**	**P/E**	**P/B**	**P/S**	**P/C**
Morningstar US Large Cap	0.9	8.5	15.5	21.9	21.9	13.8	16.2	28.3	6.5	5.1	22.3
Morningstar US Small Cap	1.3	14.0	14.0	27.0	15.6	6.9	10.7	20.1	2.6	1.7	11.9
Morningstar Developed-Markets ex-US	2.6	8.7	9.5	20.9	16.8	8.8	9.7	18.5	2.2	1.8	11.3
Morningstar Emerging Markets	1.8	21.9	22.4	39.1	21.5	7.3	10.1	17.5	2.3	2.0	13.1

Fixed Income	**Yield to Maturity**						
Morningstar US Core Bond	4.7	0.8	0.7	3.8	4.1	0.0	1.5
Morningstar US Corporate Bond	5.2	1.0	1.4	4.3	5.2	0.3	2.5
Morningstar US High-Yield Bond	7.3	1.9	2.4	5.8	8.9	4.2	5.8
Morningstar US Municipal Bond	3.9	2.2	2.4	7.0	3.8	1.0	2.2
Morningstar Emerging-Markets Bond	6.0	1.7	3.0	7.5	7.5	1.2	3.2

Interest Rates (%)	**Current**	**1 Yr Ago**
2 Yr Treasury	4.1	3.7
5 Yr Treasury	4.2	3.8
10 Yr Treasury	4.4	4.2
20 Yr Treasury	4.9	4.8
Prime Rate	6.8	7.5

Broad Commodities							
Bloomberg Commodity		14.4	–8.1	25.5	11.7	9.4	5.8

Commodities (USD)		
Brent Crude Oil	73	68
Gold	4,026	3,287

3-Month Return (%)

	Value	Blend	Growth
Large	5.0	16.5	31.1
Mid	5.5	14.6	29.9
Small	10.8	11.8	20.1

- >8.0
- 4.0 to 7.9
- 0.0 to 3.9
- –3.9 to –0.1
- –7.9 to –4.0
- <–8.0

1-Year Return (%)

	Value	Blend	Growth
Large	18.9	18.9	20.2
Mid	23.4	22.1	23.0
Small	27.2	23.8	30.4

- >20.0
- 10.0 to 19.9
- 0.0 to 9.9
- –9.9 to –0.1
- –19.9 to –10.0
- <–20.0

5-Year Return (%)

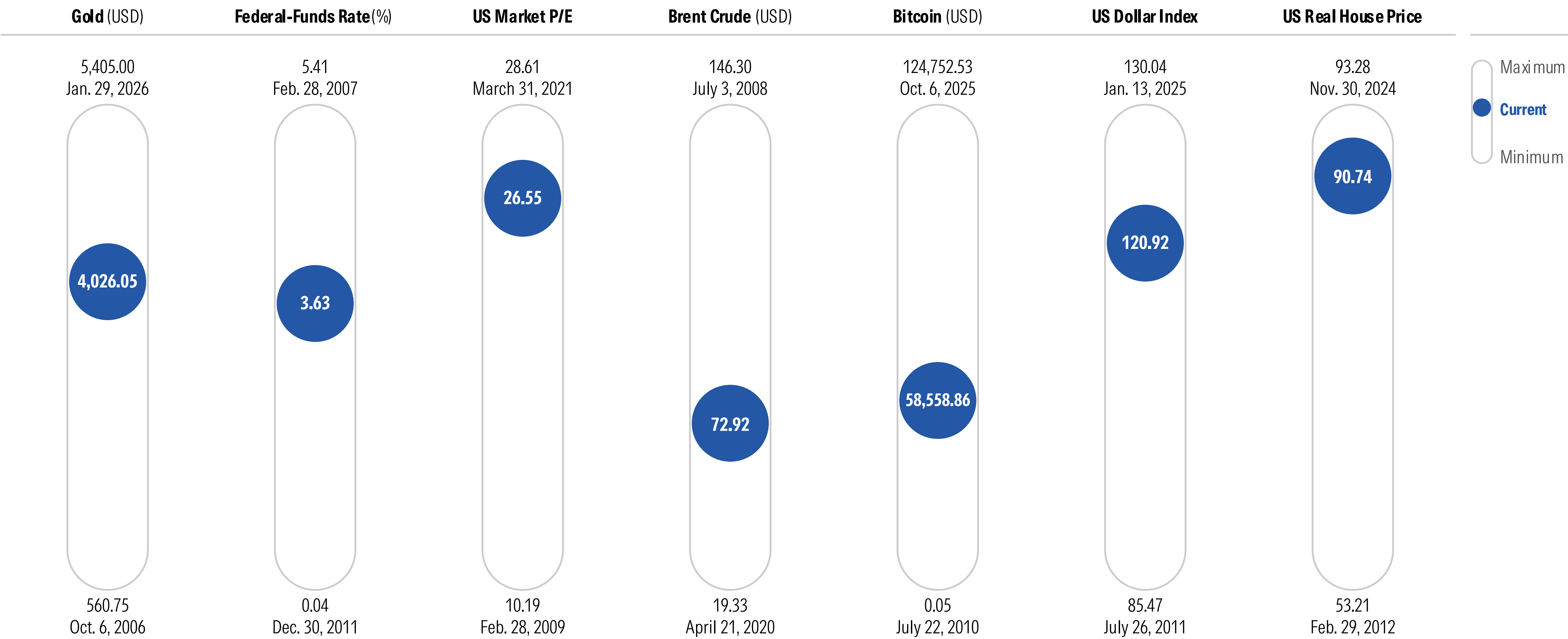
	Value	Blend	Growth
Large	11.7	12.5	10.2
Mid	10.6	8.7	7.4
Small	9.0	7.5	4.1

- >20.0
- 10.0 to 19.9
- 0.0 to 9.9
- –9.9 to –0.1
- –19.9 to –10.0
- <–20.0

Gold and Oil Retreat From Highs

Crude oil prices dropped 38% in 2026's second quarter as supply disruptions from the Iran war eased. Bitcoin continued to decline from its October 2025 record high, falling 3.8% in the second quarter. US house prices remained near record levels as supply continued to trail homebuyer demand. Interest rates held steady at 3.63% following Kevin Warsh's first Federal Open Market Committee meeting as the new Federal Reserve Chair.

Market Thermometer



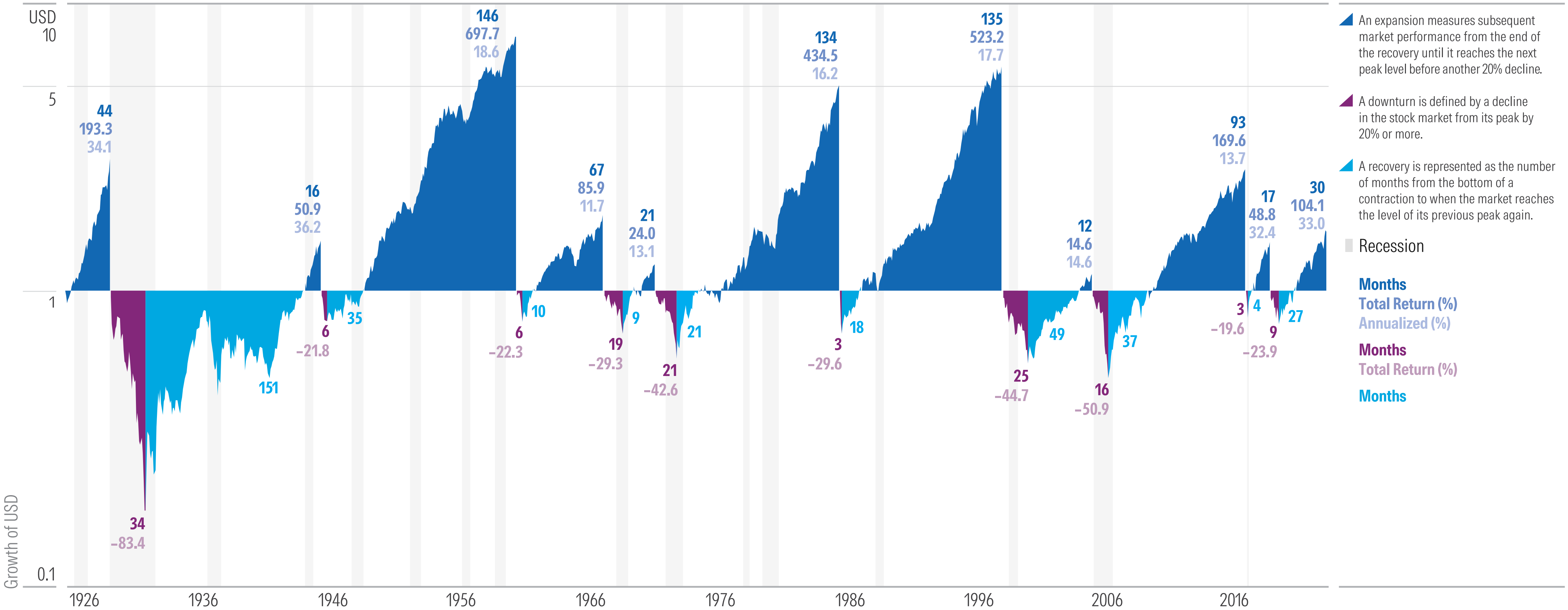
QMO16

Source: Morningstar Direct, Federal Reserve Bank of St. Louis, National Association of Realtors, Macrobond. Minimums and Maximums for the period July 1, 2006, to June 30, 2026.

US Market Soars Despite Ongoing War

US equities rose in the second quarter of 2026, bringing the current expansion to 30 months. The US stock market staved off a downturn with strong second-quarter returns reversing the first quarter's decline. Falling oil prices and refreshed AI sentiment helped power US stocks ahead. The US market gained 33% annualized and 104.1% total since 2022's downturn.

US Market Downturns, Recoveries, and Expansions



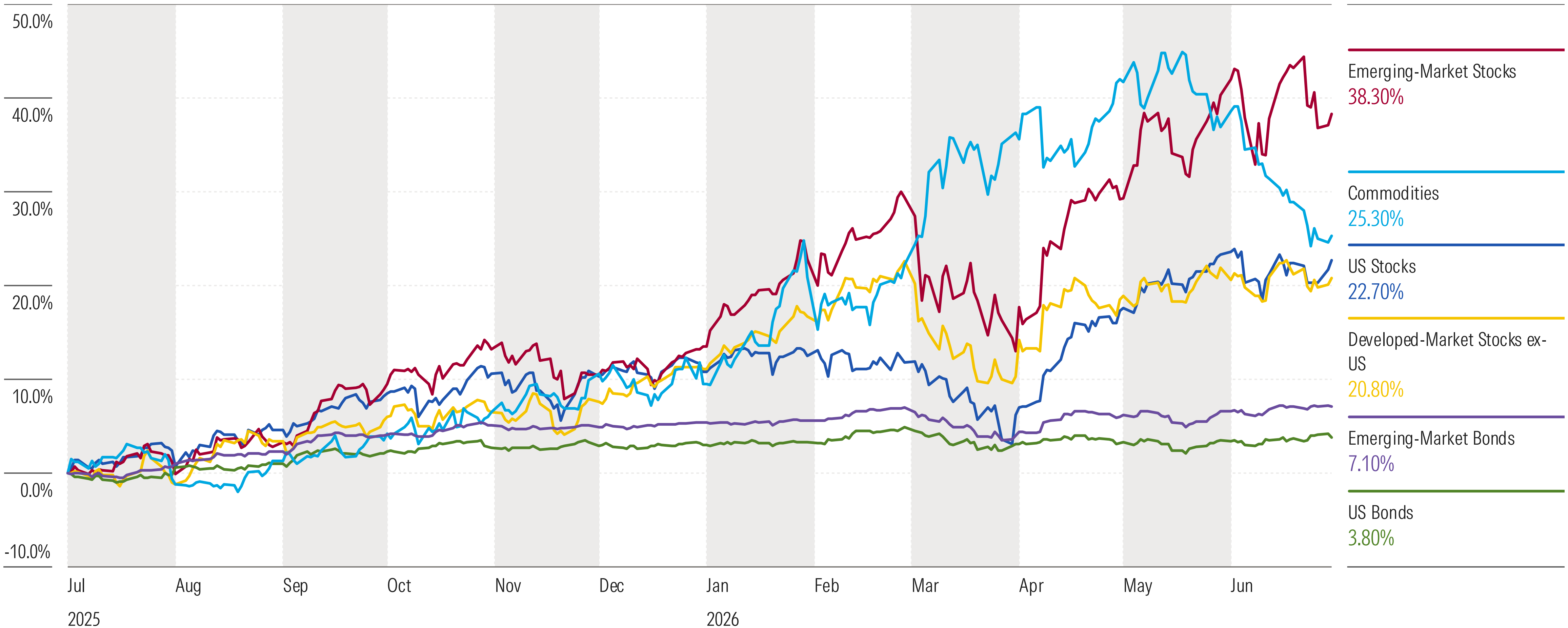
QM06

Source: Stocks—Ibbotson Associates SBBI US Large Stock Index. Recession data from the National Bureau of Economic Research. Data as of June 30, 2026.

Emerging-Market Stocks Test New Highs as Commodities Fall

Emerging-market stocks gained 38.3% for the year ended June 2026, as a surge in AI-memory hardware companies such as Samsung and SK Hynix lifted returns for the entire region. US stocks caught up to their developed-market counterparts following the latter's strong start to 2026. Commodities reversed course in May, as oil's price spike proved short-lived. Ongoing tensions in the Middle East, however, threaten any prolonged decline. Emerging-market bonds grew slightly in the second quarter of 2026, while investment-grade US bonds fell over the same period.

Trailing 12-Month Performance of Major Asset Classes



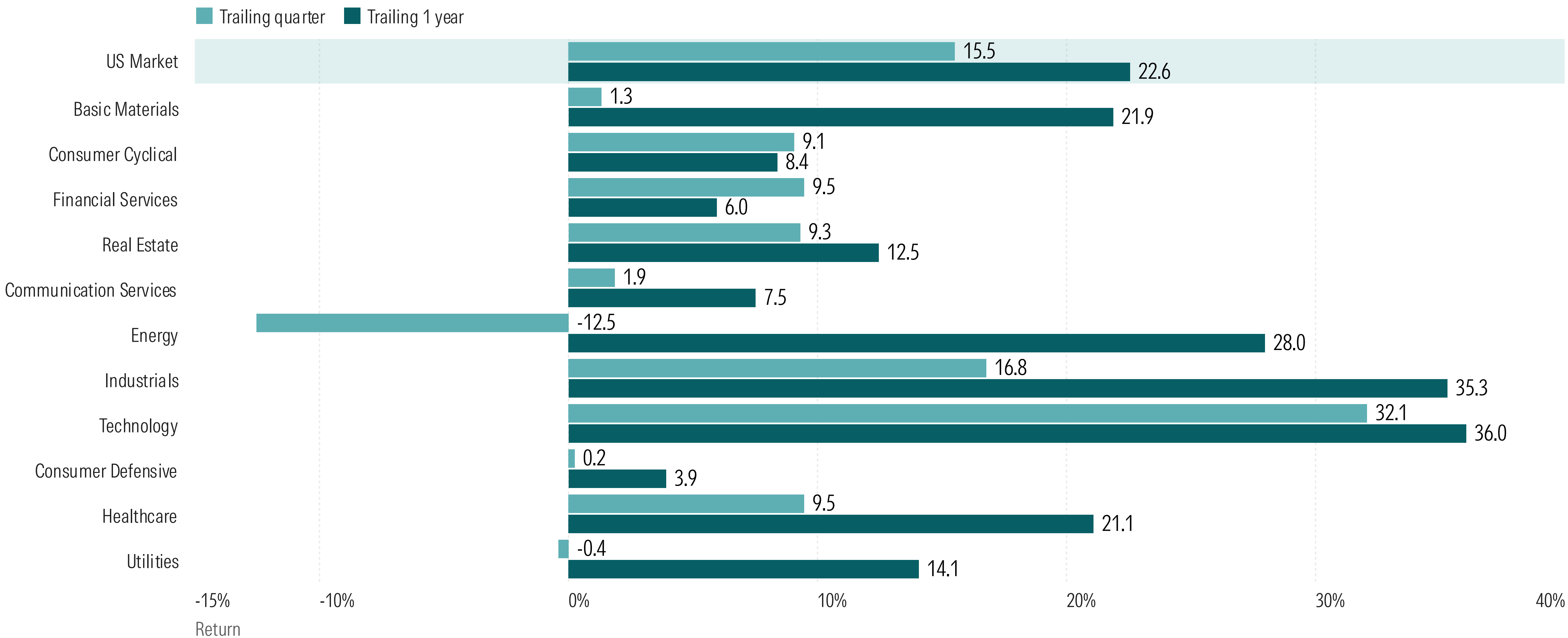
QM01

Source: US stocks—Morningstar US Market Index. Developed-market stocks ex-US—Morningstar Developed Markets ex-US Index. Emerging-market stocks—Morningstar Emerging Markets Index. US bonds—Morningstar Core Bond Index. Emerging-market stocks—Morningstar Emerging Markets Composite Bond. Commodities—Bloomberg Commodity Index. Data as of June 30, 2026.

Most US Sectors Strongly Positive

A rotation from defensive to growth sectors occurred in the second quarter as the broader US market reversed early-year losses. The US market gained 15.5% for the quarter, contributing to a trailing one-year gain of 22.6%. Technology led the rotation, gaining 32.1% over the quarter and 36.0% over the last year. Energy remains strongly positive over the last year despite falling 12.5% in the second quarter. A rapid rise in oil prices in March 2026 followed by a swift decline in the second quarter of 2026 is behind these moves.

US Equity Sector Performance

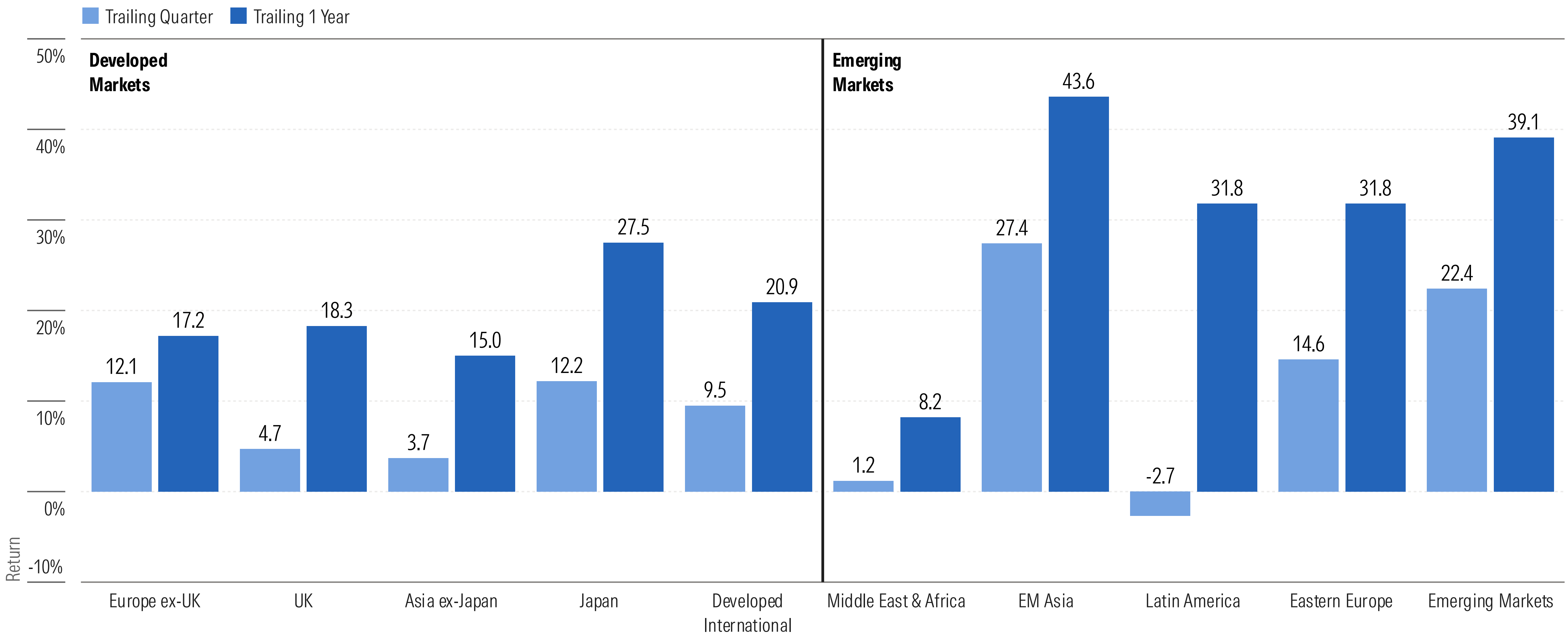


Source: Morningstar Sector Indexes. Data as of June 30, 2026.

Most Foreign Stock Markets Strongly Positive

International stock markets rallied in the second quarter of 2026, rebounding from mixed results in the first quarter. Foreign developed markets rose 9.5%, and emerging markets enjoyed a 22.4% gain last quarter. Asian emerging markets stood apart thanks to sky-high returns for select technology stocks in Taiwan and South Korea. Conversely, Latin America was the only region with negative returns during the quarter, though it was still strongly positive over the last year.

International Stock Market Performance

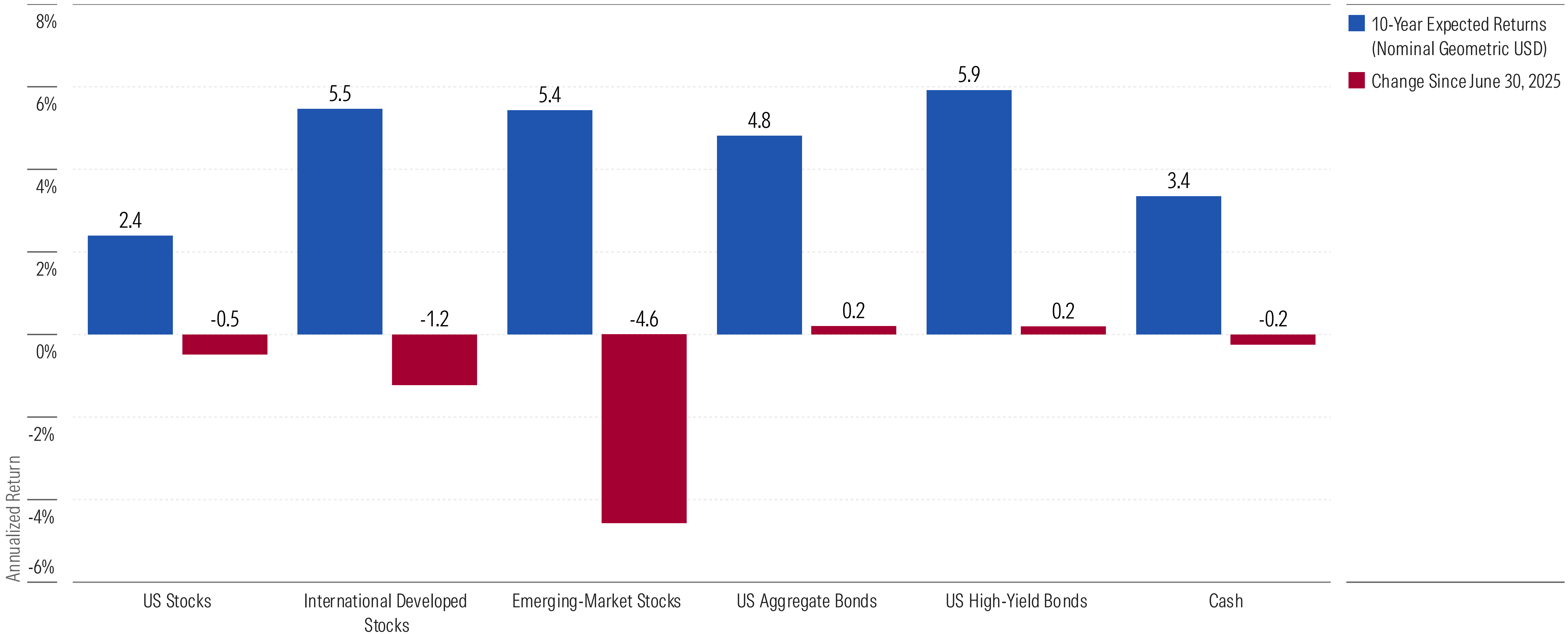


Source: Morningstar Indexes. All returns are calculated in US dollars. Data as of June 30, 2026.

Valuation-Implied Returns: Expect a Moderation in Foreign Stocks

Valuation-implied returns serve as a useful measure for cross-asset-class comparisons. Although emerging-market stocks continue to look attractive, their blockbuster recent results have put a dent in future expectations, shifting this group's 10-year expected annualized return down by 4.6 percentage points since June 2025. US high-yield bonds hold the highest expected returns over the next decade, with valuation-implied returns for the asset class growing by 0.2 percentage points amid moderately widening spreads.

10-Year Valuation-Implied Returns

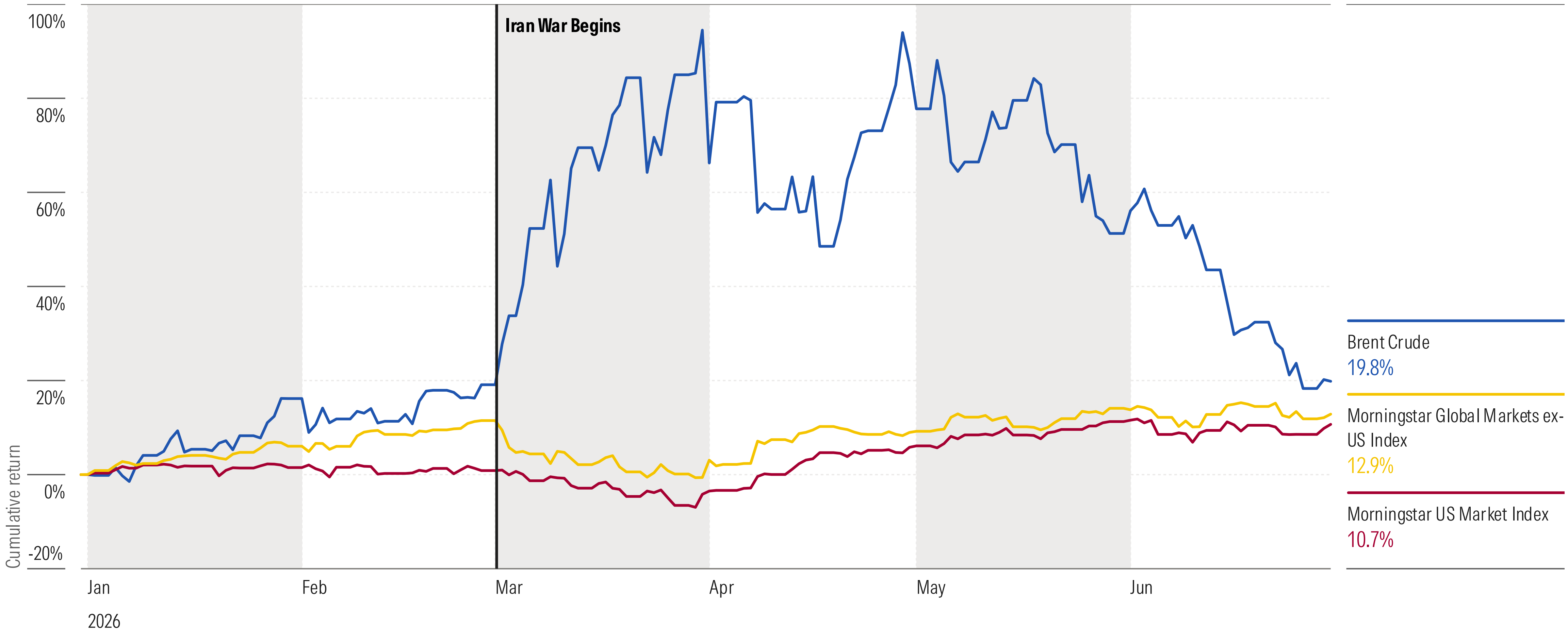


QMO8

Oil's Wild Ride Continues

Oil prices experienced significant volatility since the Iran war began on Feb. 28. Brent crude nearly doubled in price in the first quarter, while US and ex-US equity markets fell 4.2% and 0.6%, respectively, reversing early-year gains. Oil prices reversed course in the second quarter. Despite a brief surge in late April, they have steadily declined since. Overall, Brent crude ended 2026's first half up 19.8%. Meanwhile, US and foreign stocks have more than recovered from their March lows.

Oil Prices vs. US and Global Markets Over the Trailing 12 Months



QMO20

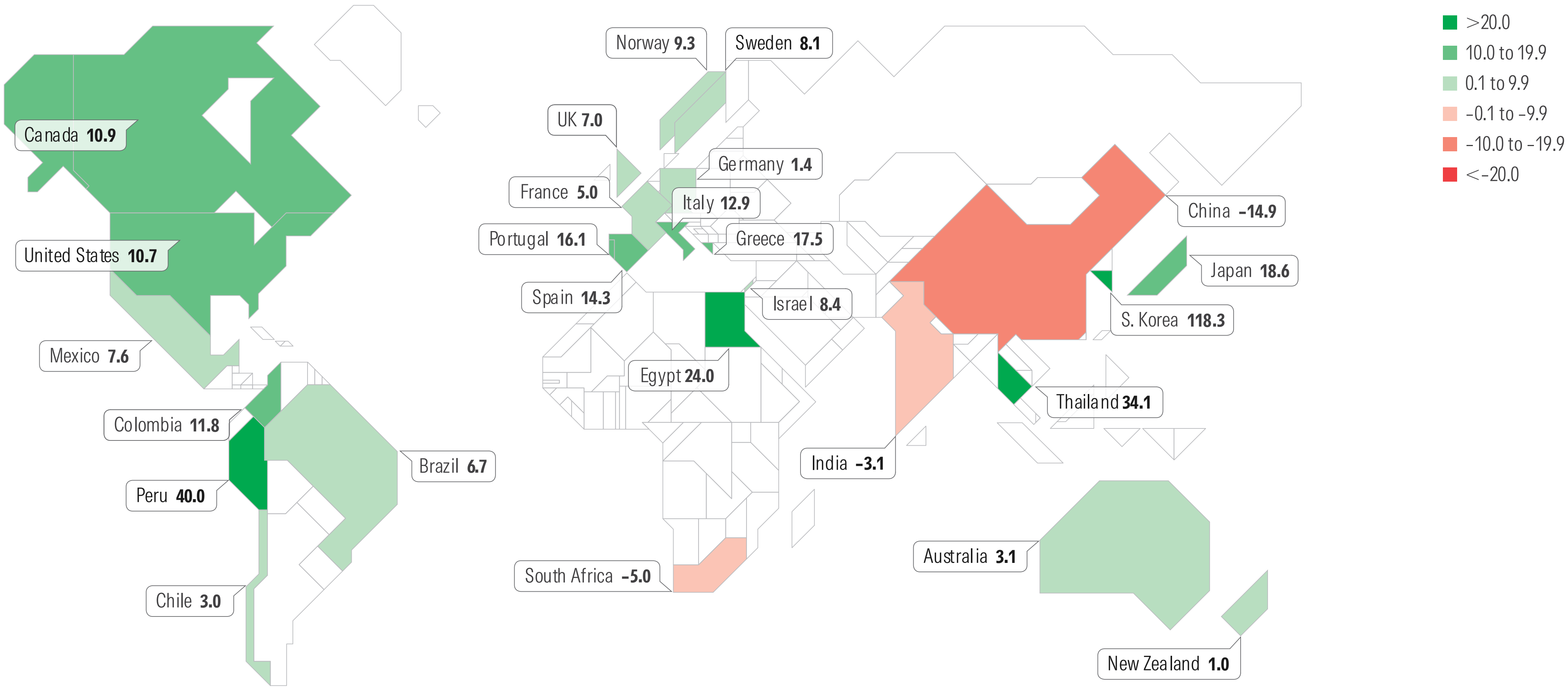
Source: Morningstar Direct. Data as of June 30, 2026.

Equities

Global Market Barometer

Global equity markets delivered mostly strong results during the first six months of 2026 despite getting off to a shaky start. South Korea led other major markets by a wide margin, benefiting from an astonishing rally in semiconductor and memory-chip companies. Peru, Thailand, and Egypt also stood out following strong economic growth. On the other hand, China, India, and South Africa declined in the first half of the year. China, in particular, is expecting slower economic growth than it previously enjoyed.

Year-to-Date Returns of Morningstar Country Indexes in Base Currency



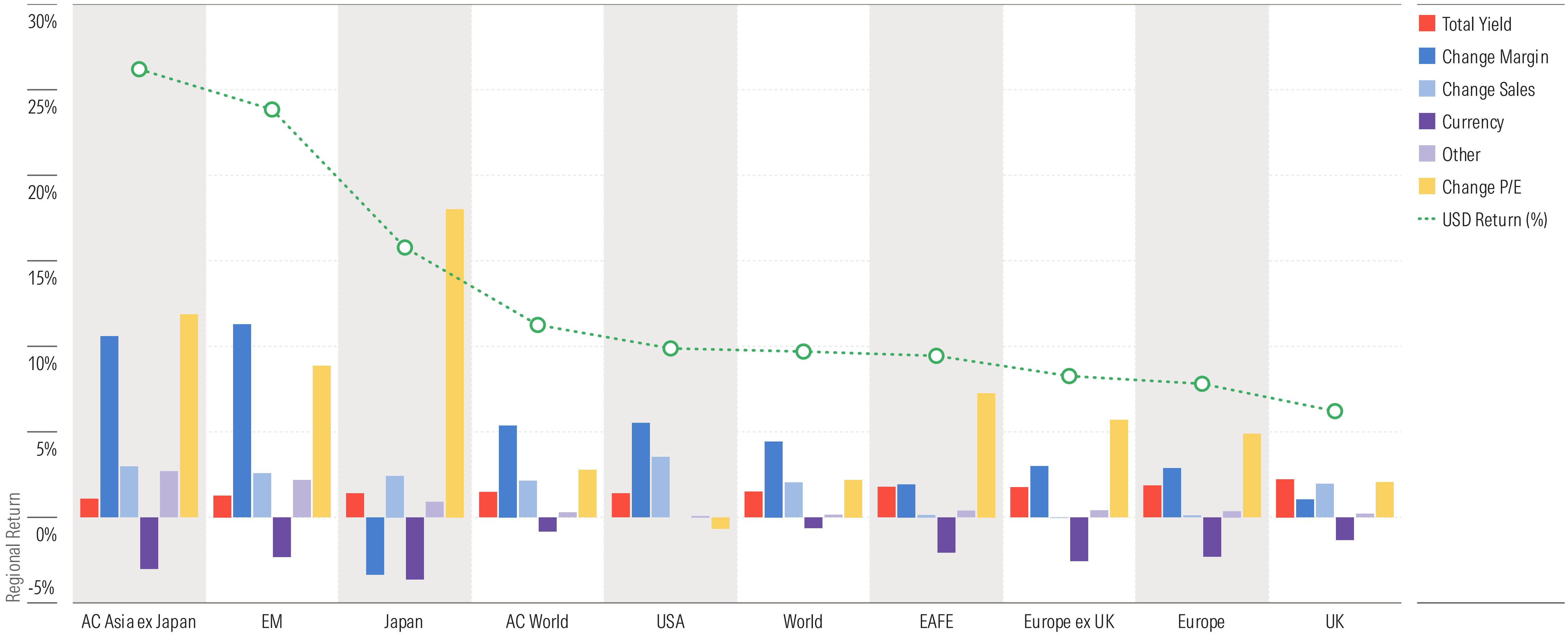
QE47

Source: Morningstar Country and Region Indexes. Data as June 30, 2026.

Global Stock Market Performance Decomposition

Asia ex-Japan and emerging markets broadly led the way in 2026's first half, driven by improving margins and price/earnings multiple expansion despite currency headwinds. Japan's return also relied on a strong P/E rerating, which more than offset drags from currency and margin compression. The US, Europe, and the UK posted more modest gains. The US benefited from margin expansion and sales growth, while Europe and the UK leaned on P/E gains to offset currency pressure.

2026 Year-to-Date Return Decomposition by Country



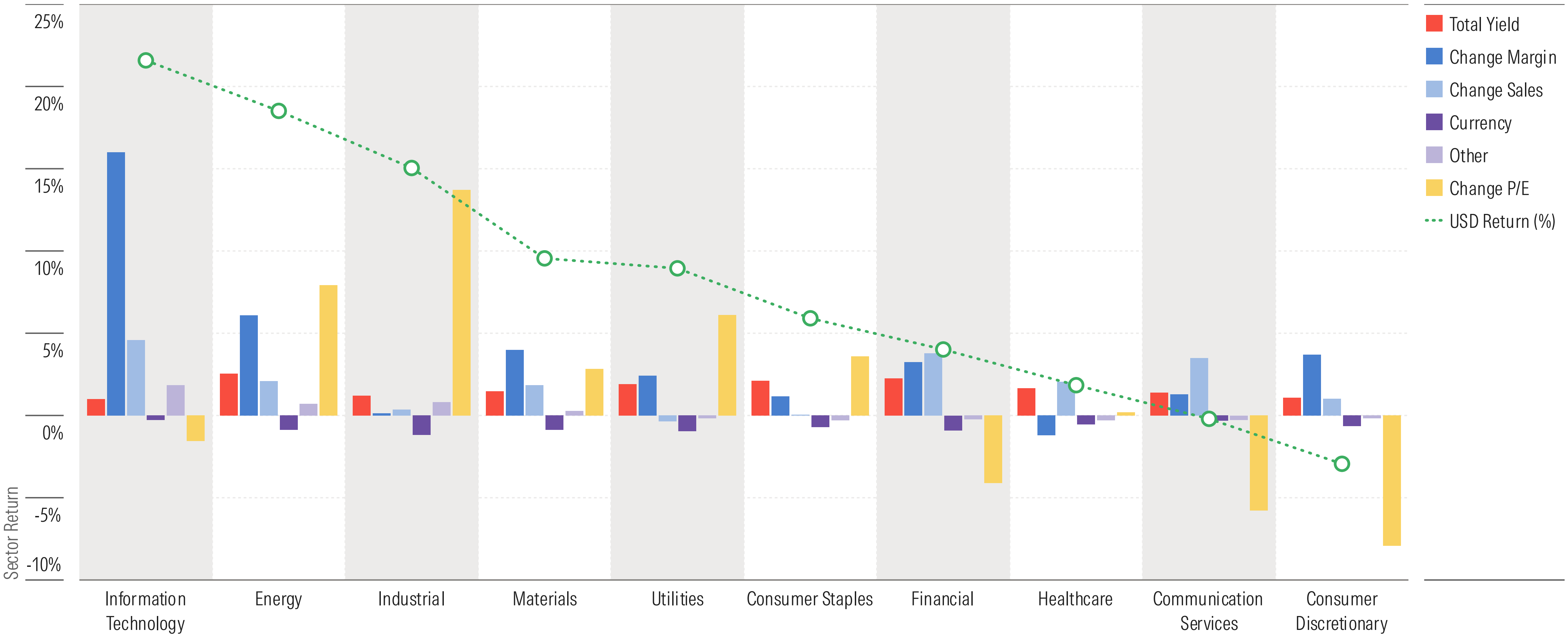
QE58A

Source: Morningstar Direct. Data as of June 30, 2026. For illustrative purposes only.

Sector Performance Decomposition

Information technology led global developed-market sector returns so far in 2026, fueled almost entirely by margin expansion. Energy and industrials stocks followed, with energy's gains attributable to both margin expansion and P/E gains. Industrials, meanwhile, leaned mostly on P/E rerating, as investors bid up their prices at a faster pace than their earnings grew. Communication services and consumer discretionary lagged, with investors taking a dimmer view of their current earnings, pulling the latter into negative territory for the year to date.

2026 Year-to-Date Return Decomposition by Developed-Market Sector



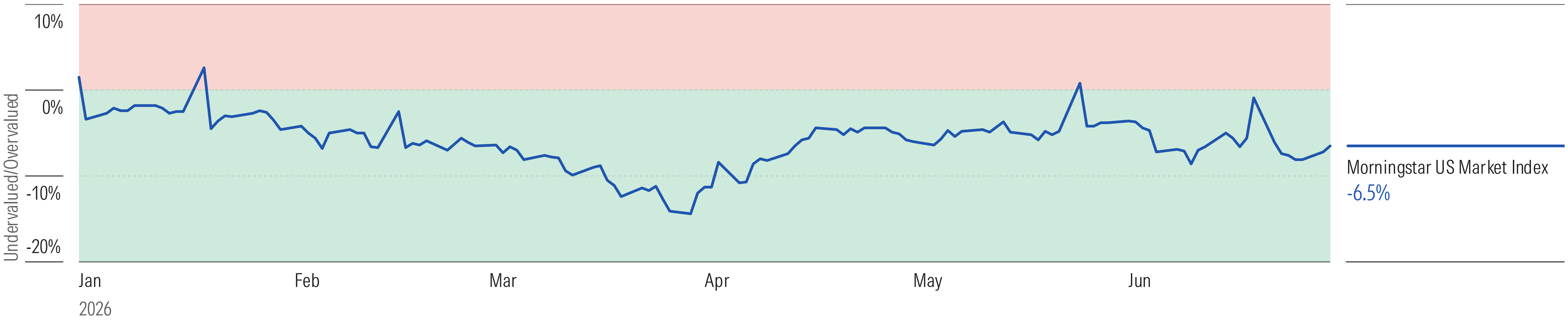
QE58B

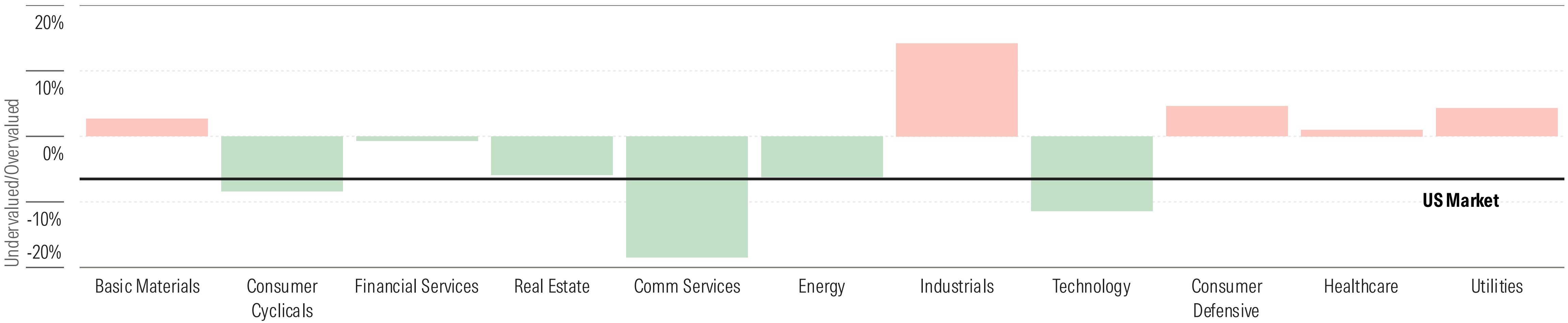
Source: Morningstar Direct. Data as of June 30, 2026. For illustrative purposes only.

Morningstar Price/Fair Value

The median stock in the Morningstar US Market Index remained undervalued for most of the second quarter of 2026. Communication services was the most undervalued sector at the end of June, followed by technology and consumer cyclicals. In contrast, industrials stocks appear the most overvalued, possibly resulting from strong performance and the continued data center buildout. Basic materials, consumer defensive, healthcare, and utilities stocks also traded above their fair value at the end of the second quarter.

Morningstar US Market Price/Fair Value, Year-to-Date

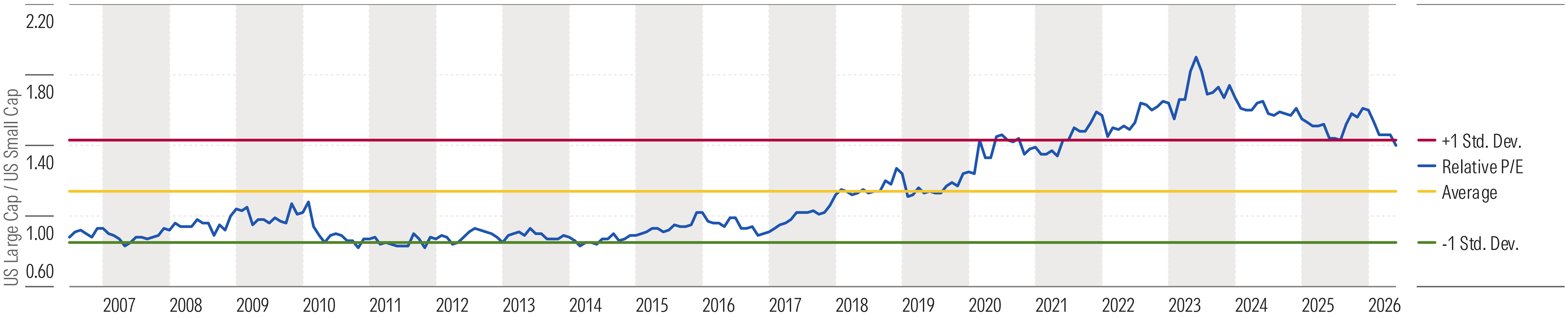


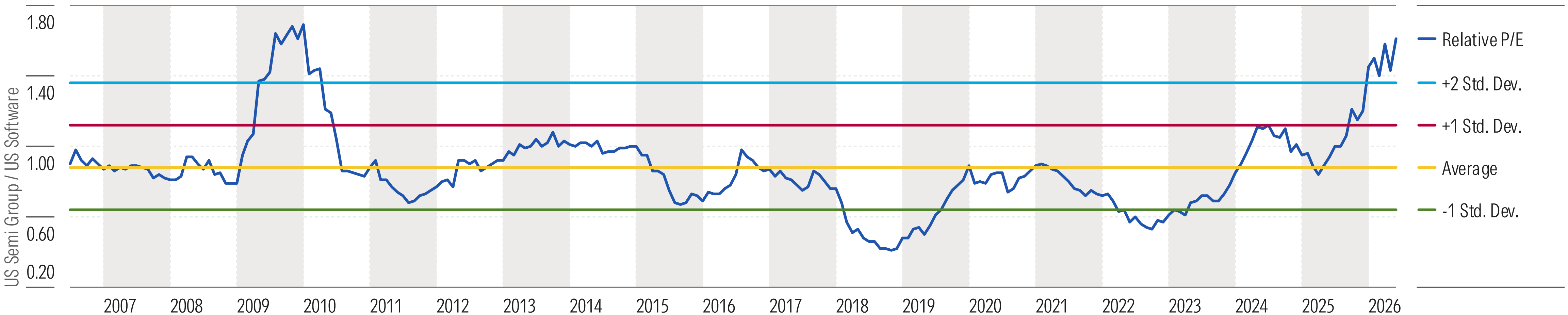


What's Cheap? Size and Industry Valuations Diverge

US large-cap equities' long-standing premium over US small caps has normalized a bit in 2026 so far, but it still has a long way to go to close the gap completely. Within technology, however, two industries have been moving in opposite directions. Prices and valuations of semiconductor companies keep climbing on resilient chip demand, bringing their price/earnings ratios far above historical norms. Meanwhile, software valuations have been weighed down by AI-displacement fears. Many software stocks are trading well below their recent highs.

Trailing Relative P/E





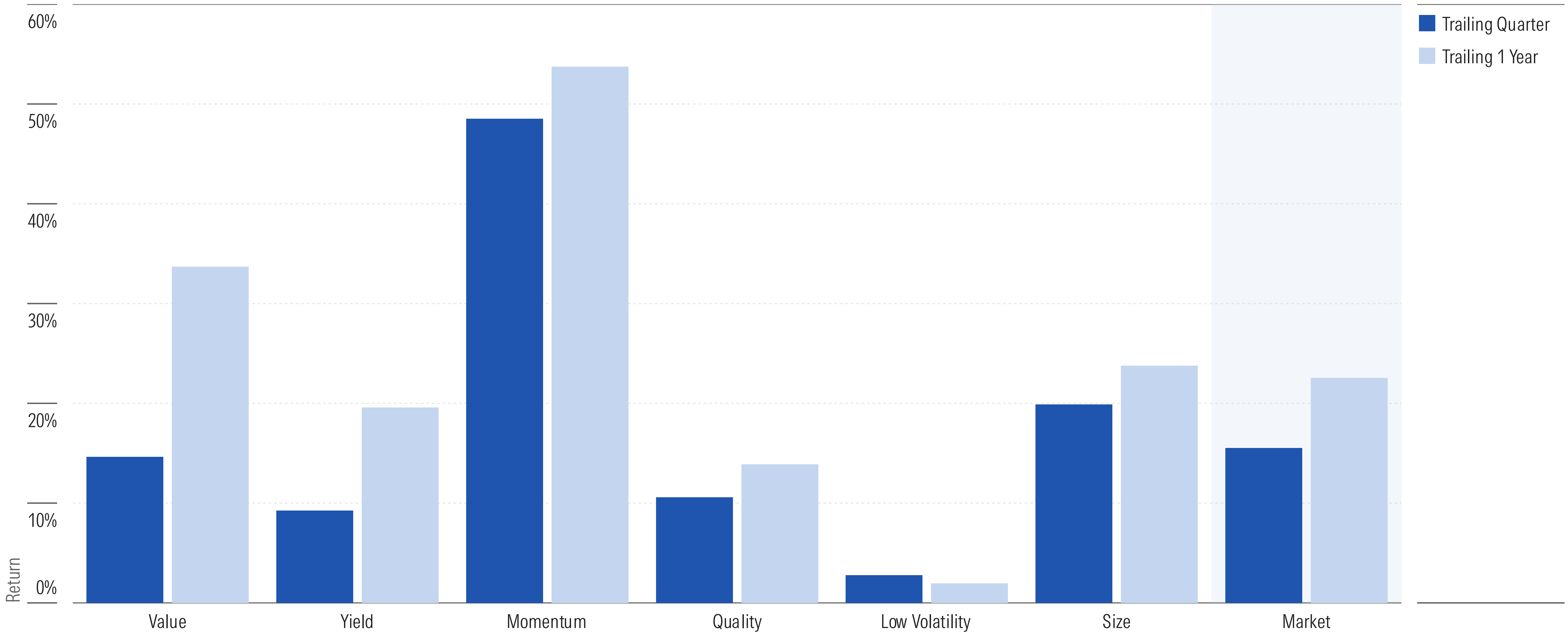
QE63

Source: Morningstar Direct. Indexes: Morningstar US Large, Morningstar US Small, Morningstar Global xUS TME, Morningstar US TME. Data as of June 30, 2026. For illustrative purposes only.

Momentum Came Roaring Back

Momentum led the way by a wide margin over both the trailing quarter and trailing year, driven largely by extended rallies in AI and semiconductor stocks. Value and size also outperformed the market on a trailing-year basis, as market leadership also broadened. Low volatility, meanwhile, lagged significantly across both periods, as investors favored riskier positions over more defensive exposures.

Performance of Factor-Based Portfolios



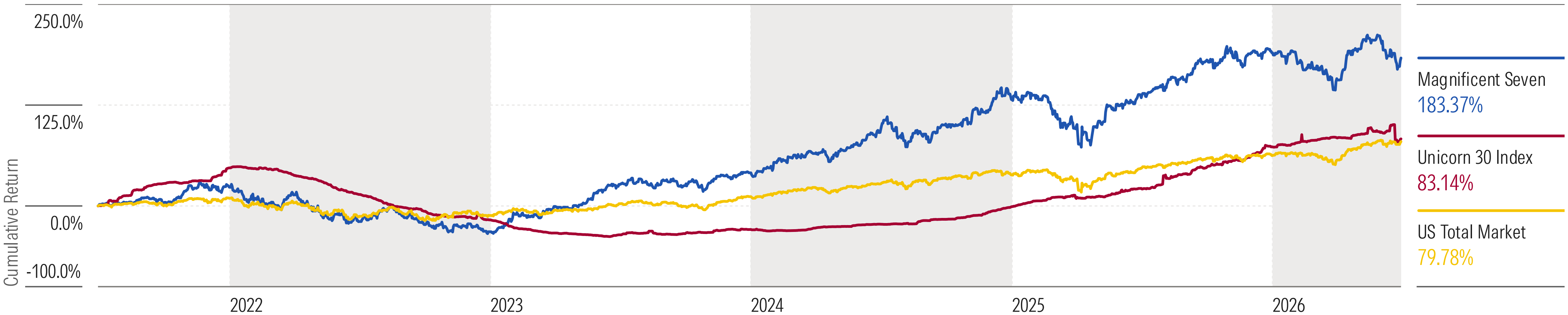
QMF36

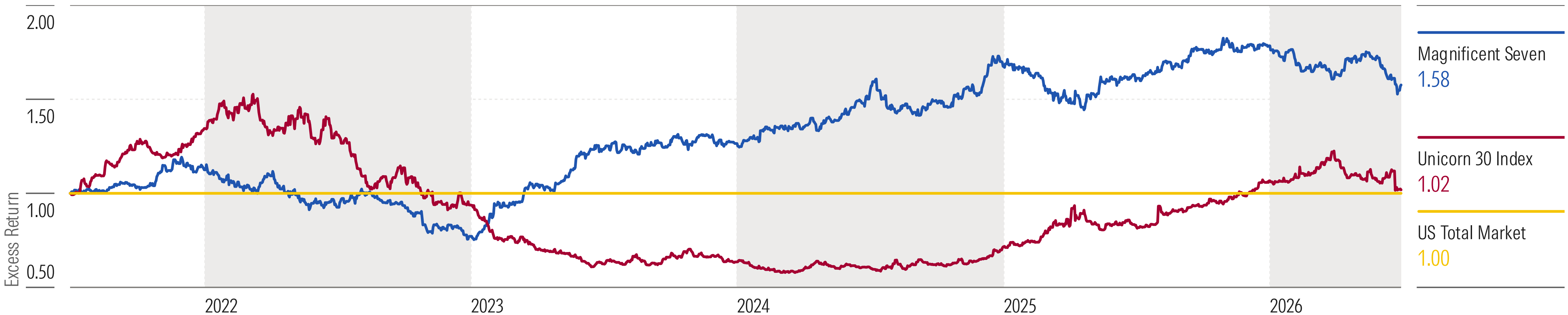
Source: Morningstar Direct. Value—Morningstar US Value Factor Index, Yield—Morningstar US Yield Factor Index, Momentum—Morningstar US Momentum Factor Index, Quality—Morningstar US Quality Factor Index, Low Volatility—Morningstar US Low Volatility Factor Index, Size—Morningstar US Size Factor Index Market—Morningstar Market Index. Data as of June 30, 2026.

The Magnificent Seven Moderates, While Unicorns Catch Up

The Magnificent Seven—Alphabet, Amazon.com, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla—powered markets forward since 2023 thanks to AI optimism and resilient earnings. However, that advantage narrowed in late 2025 and 2026 as market leadership broadened beyond mega-cap tech. The Unicorn 30 Index—consisting of the largest late-stage venture capital-backed companies—meanwhile, rebounded sharply in 2025 and early 2026 as AI optimism shifted from public stocks to large private companies like OpenAI, Anthropic, and SpaceX. SpaceX went public in June 2026.

Cumulative and Excess Returns





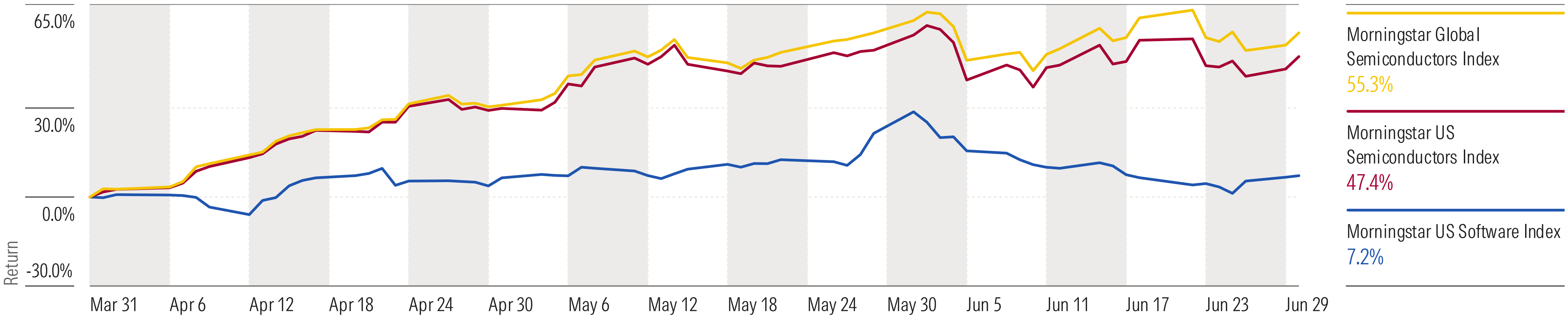
QE73

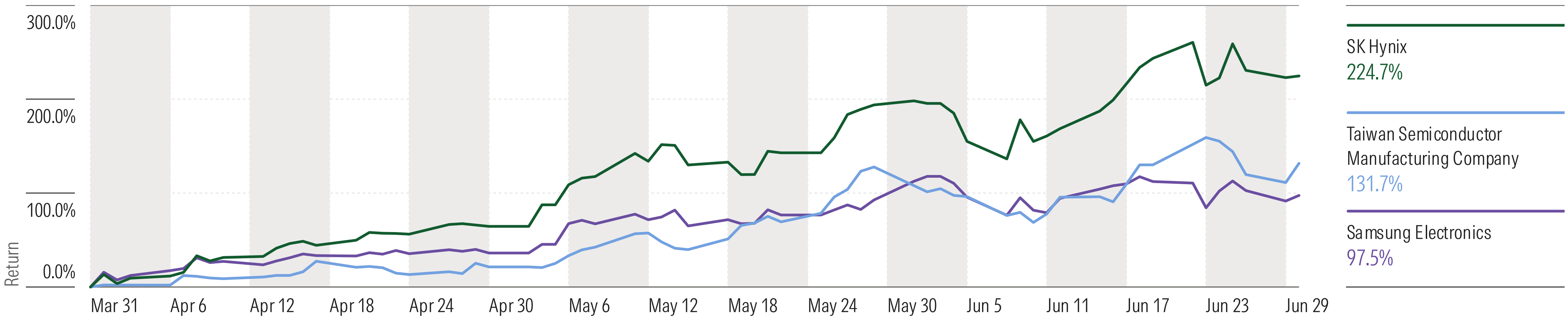
Source: Morningstar Direct. Magnificent Seven—Equal-weight composite of the seven Magnificent Seven stocks, Unicorn 30 Index—Morningstar PitchBook Unicorn 30 Index, US Total Market—Morningstar US Total Market Index. Excess return measures the cumulative return the Magnificent Seven composite and Morningstar PitchBook Unicorn 30 Index relative to the Morningstar US Total Market Index. Values above 1.0 and a positive slope indicate outperformance. Values below 1.0 and a negative slope indicate underperformance. Data as of June 30, 2026.

Semiconductor Stocks Race Higher on Relentless Chip Demand

Software continued to lag semiconductors in the second quarter, but it showed signs of recovery, rebounding from its April 2026 lows to finish modestly higher. US semiconductors were far from the only game in town, though, with the Morningstar Global Semiconductors Index surging over 50%, led by AI supply chain leaders Taiwan Semiconductor Manufacturing Company and Korea-based SK Hynix and Samsung Electronics. That's even better than the US index, which was up 47.4% for the quarter.

Software and Semiconductor Returns





QE74

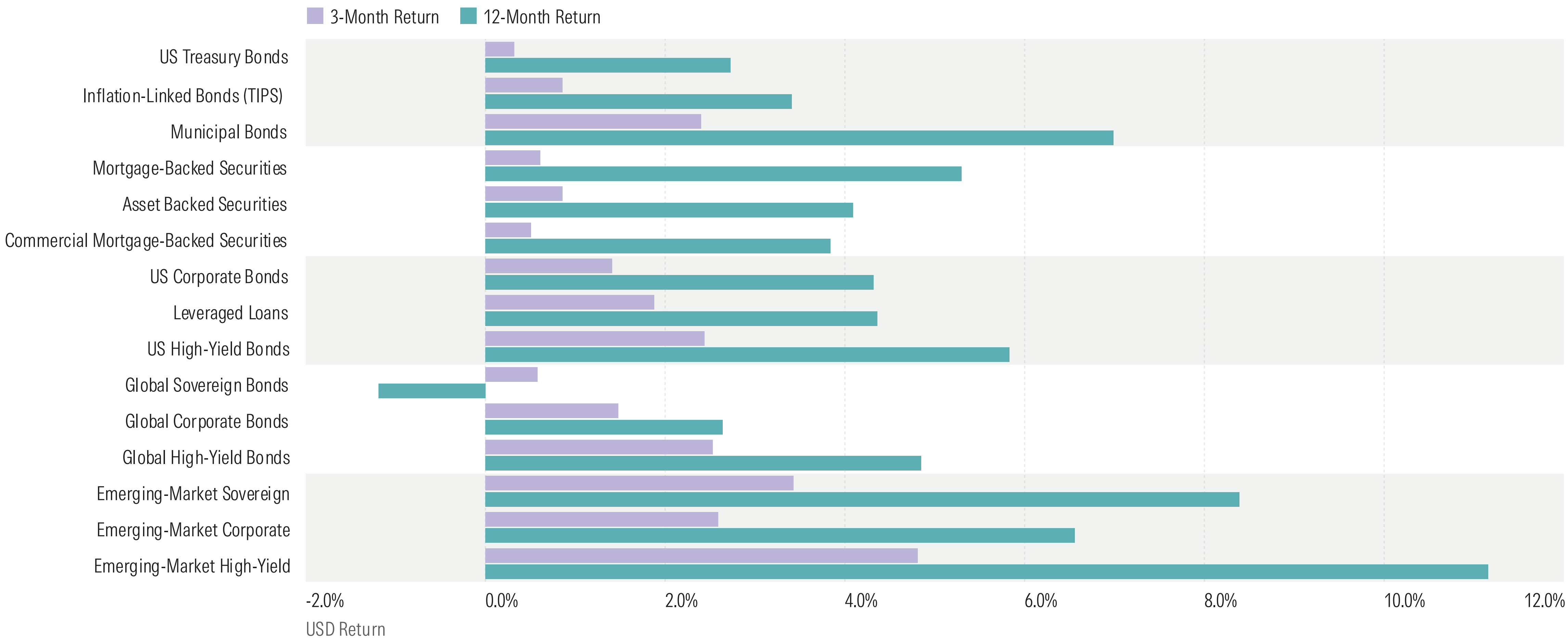
Source: Morningstar Direct. Data as of June 30, 2026.

Fixed Income

Credit Risk Pays Off in an Eventful Second Quarter

Amid geopolitical uncertainty and inflationary worries throughout the quarter, most fixed-income sectors eked out positive gains. Credit-sensitive sectors such as emerging-market debt, municipal bonds, and high-yield credit outperformed high-quality and long-duration bonds, like US Treasuries and agency mortgage-backed securities. Strong corporate fundamentals and a healthy economy continued to provide tailwinds for credit-focused strategies as spreads tightened further during the quarter.

Fixed-Income Returns in USD

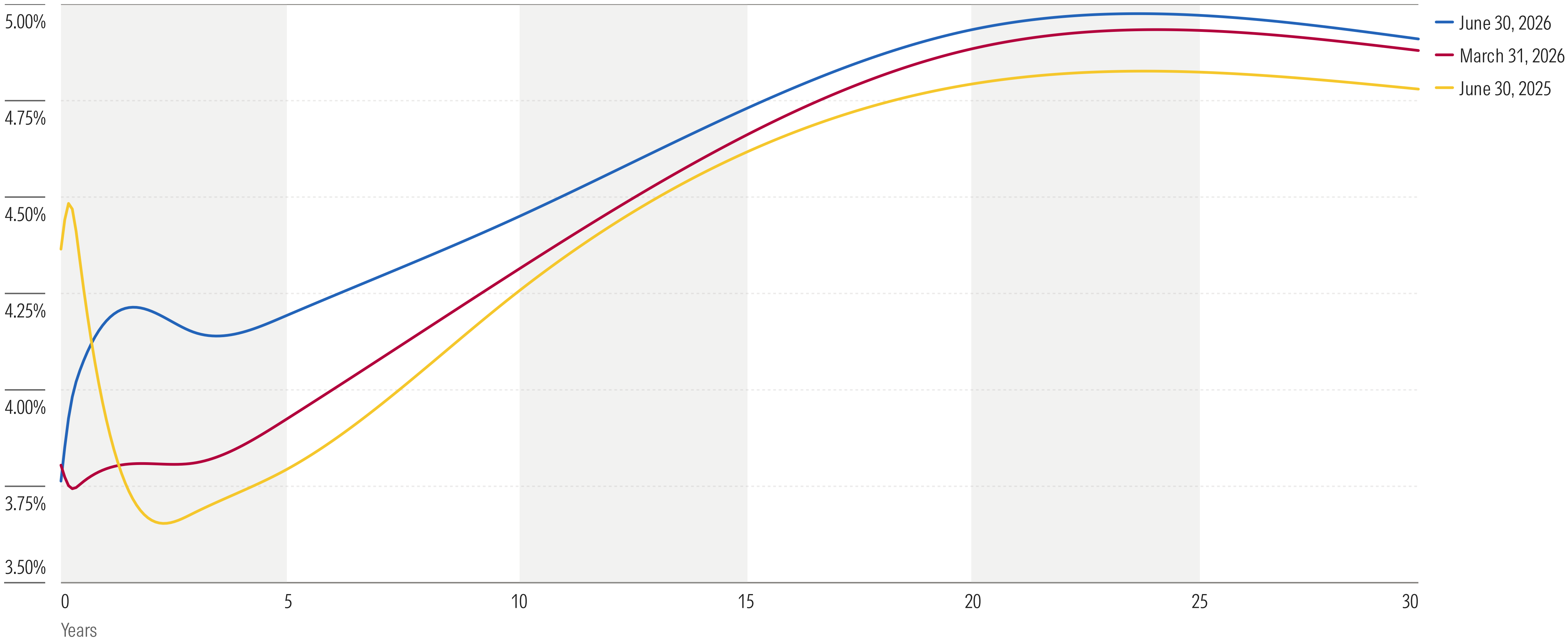


QFI36

The Yield Curve Shifted Higher in the Second Quarter

Interest rate volatility persisted during the quarter, and inflation concerns due to rising oil prices pivoted market expectations from multiple interest rate cuts in late 2026 to pricing in the probability of further tightening and federal-funds rate hikes. Treasury yields increased, with the short end of the curve increasing more than the long end, causing the yield curve to flatten.

US Treasury Yield Curve

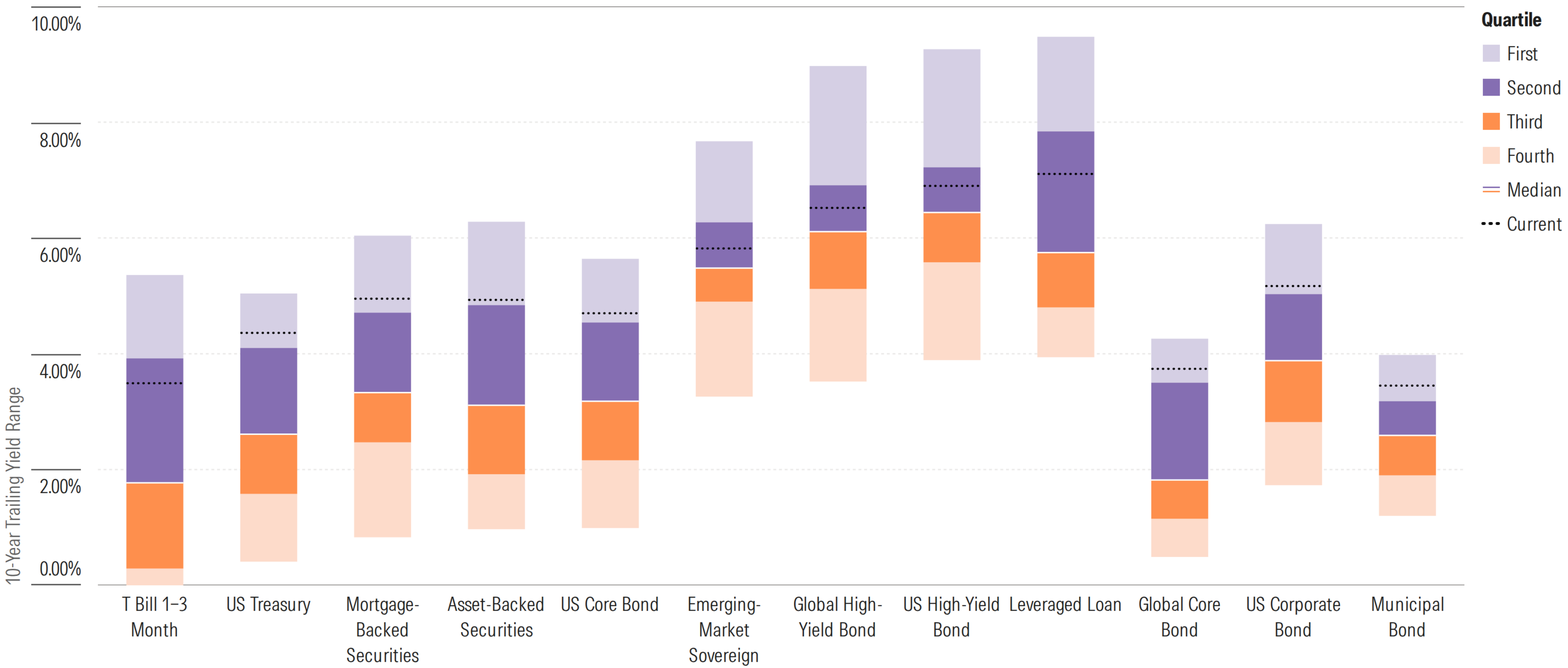


QFI6

Yields Across Fixed Income Remain Attractive

Yield changes across fixed-income sectors were a mixed bag in the second quarter. Investors' risk appetite was relatively strong, which drove yield levels in riskier sectors, like high-yield bonds and emerging-market sovereign debt, lower during the quarter. However, heightened inflation readings and increased expectations of rate hikes in 2026 caused Treasury yields and other rate-sensitive parts of the market, like US core bonds and mortgage-backed securities, to rise. Still, yields are above 10-year median levels across sectors.

Morningstar Index Yields: 10-Year Trailing Range



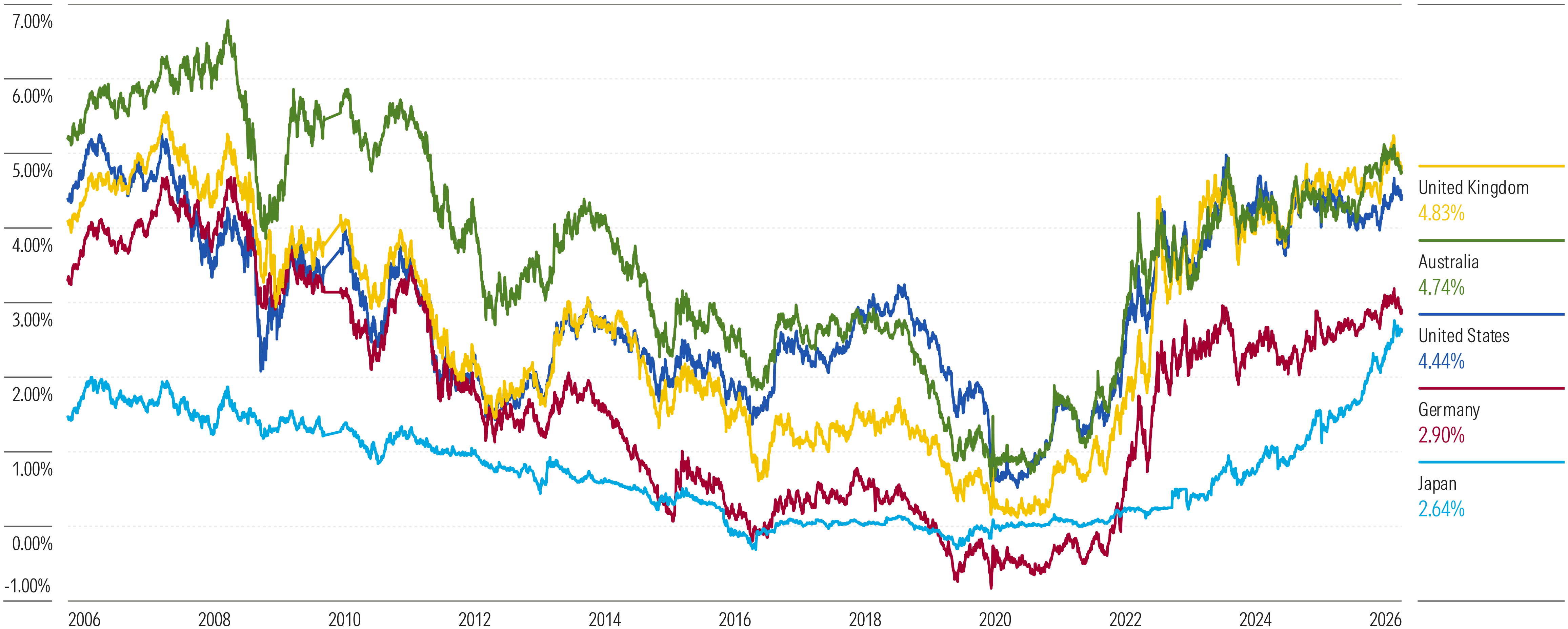
QFI49

Source: Morningstar Indexes. Data as of June 30,2026.

Global Yields Continued to Climb

After a prolonged period of low interest rates following the global financial crisis, government-bond yields climbed in 2022. The onset of the Iran war in February 2026 brought inflation risks to the fore. Central banks reinforced the "higher for longer" message at their June meetings. The European Central Bank raised its key rates by 25 basis points, while the Bank of Japan hiked to 1%, its highest policy rate since 1995. Under new Chair Kevin Warsh, the US Federal Reserve's projections shifted to signal hikes this year rather than the cuts the markets had expected, elevating 10-year yields.

Global Sovereign Bond 10-Year Yields

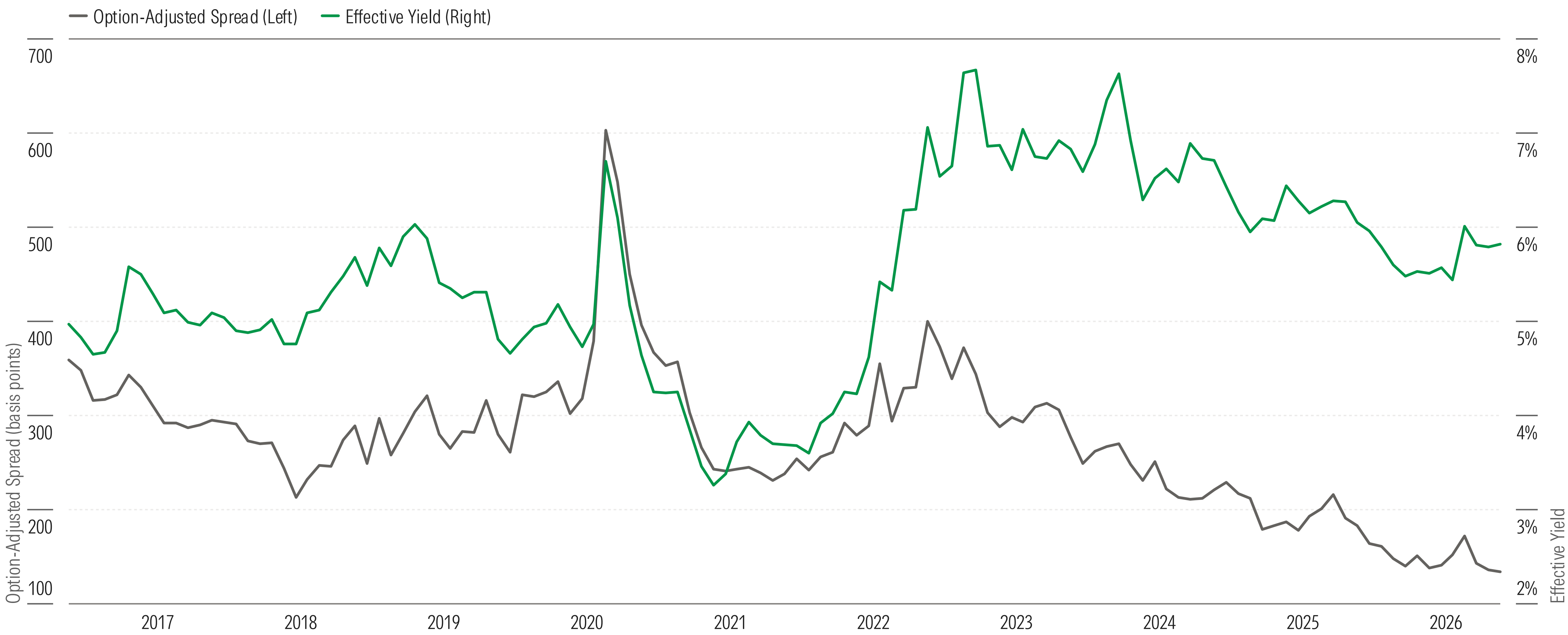


QFI10

Emerging-Market Debt Bounces Back

After a turbulent March caused by the onset of the Iran war, emerging-market sovereign debt rebounded well and was the leading performer among fixed-income sectors in the second quarter. Emerging-market sovereign bond spreads narrowed to near 15-year record lows. Despite this, absolute yield levels remain attractive relative to the past decade. Many countries have curbed inflation effectively, experienced credit rating upgrades, and offered high real yields with their debt, contributing to the sector's standout performance.

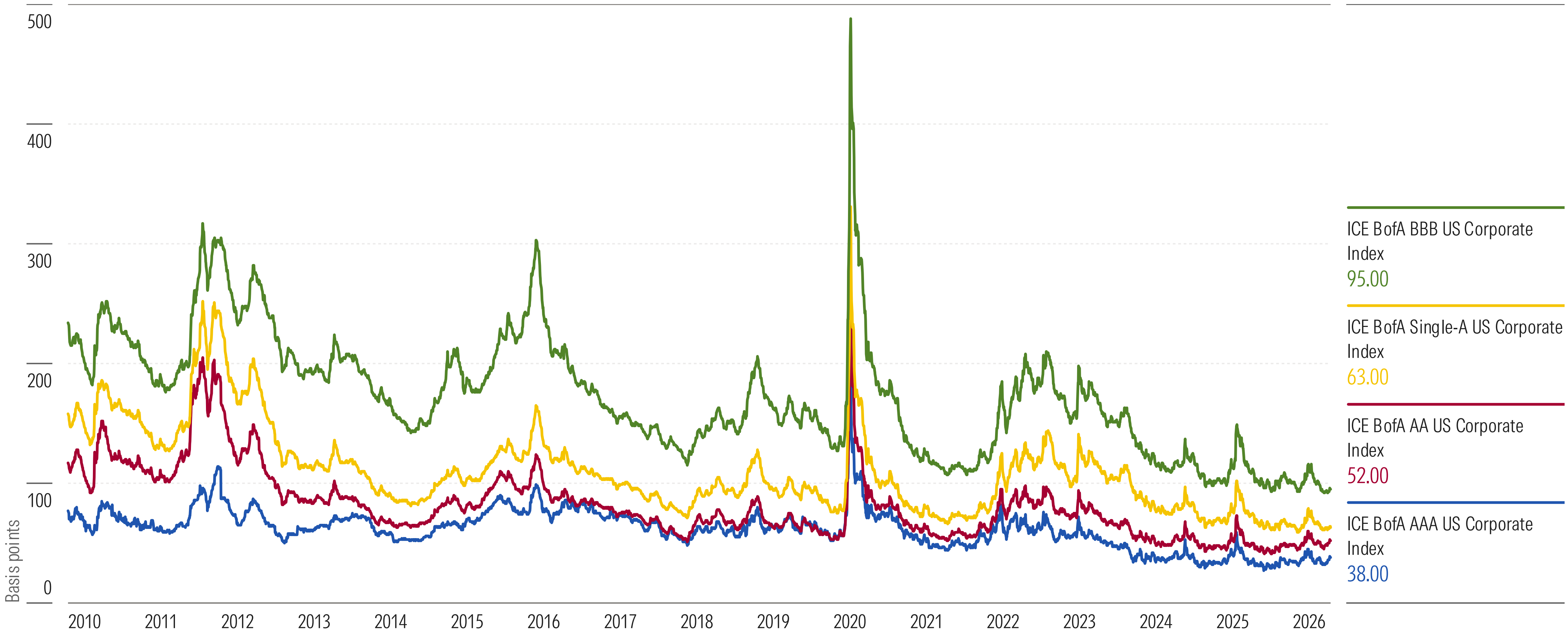
Emerging-Market Sovereign Bonds Spread and Yield



Corporate Credit Spreads Remained at Historically Tight Levels

Despite elevated market uncertainty, corporate credit spreads, an indicator of the broader economy's health and investors' confidence in credit markets, remained at historically tight levels on account of continued economic stability and strong corporate fundamentals. Corporate bond issuance has also slowed as the rise of private credit has diverted capital away from public bond markets. Meanwhile, investor demand for yield remains strong as investors have poured into high-quality bonds. This supply/demand imbalance has been a key driver of spread compression.

Option-Adjusted Spread



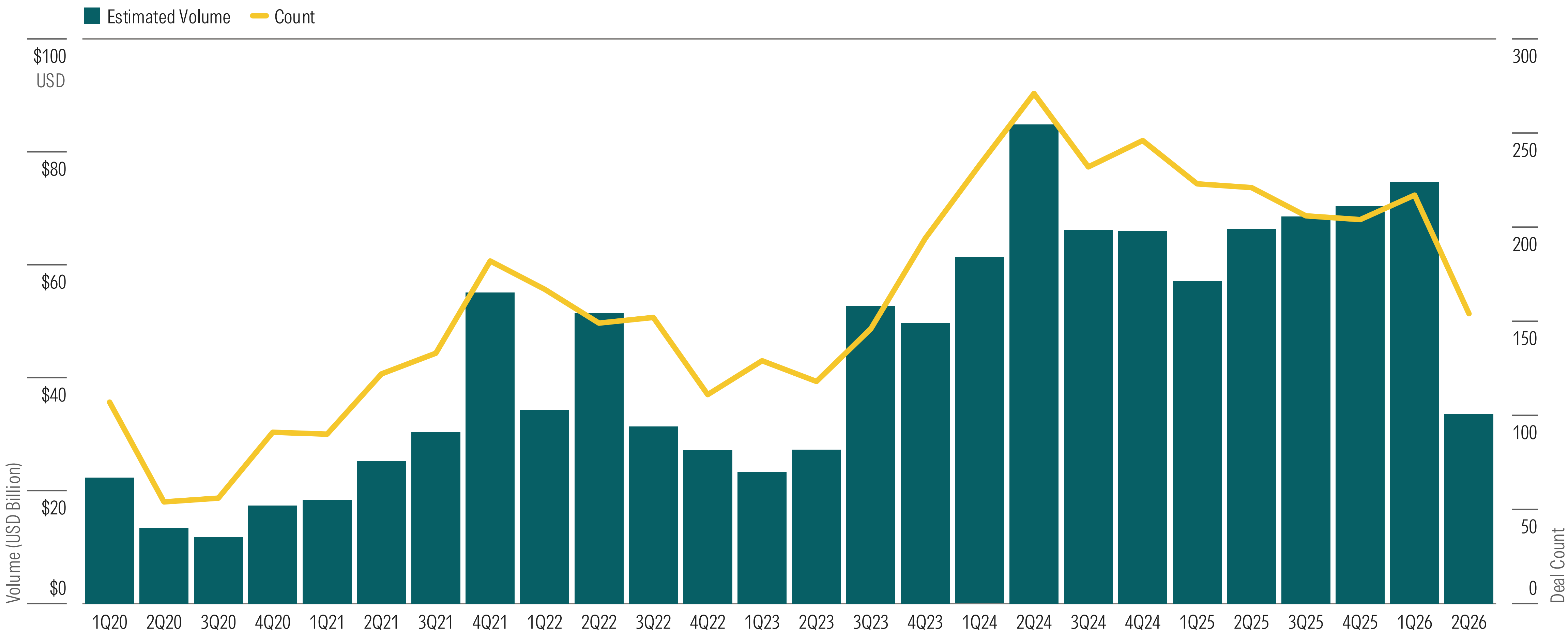
QFI77

Source: ICE Indexes. Data as of June 30, 2026.

Direct Lending Activity Slows During the Quarter

Direct lending volume and deal count dropped to three-year lows. Uncertainty spurred by a volatile market backdrop, geopolitical upheaval, and net outflows from retail products further slowed lending activity. Direct lenders provided an estimated USD 33.6 billion of new loans during the quarter, the lowest level since the second quarter of 2023 and down 55% from the first quarter of 2026. Deal count retreated to 154 transactions, the lowest since third-quarter 2023 and down 29% from 2026's first quarter.

Direct Lending Deal Count and Estimated Volume



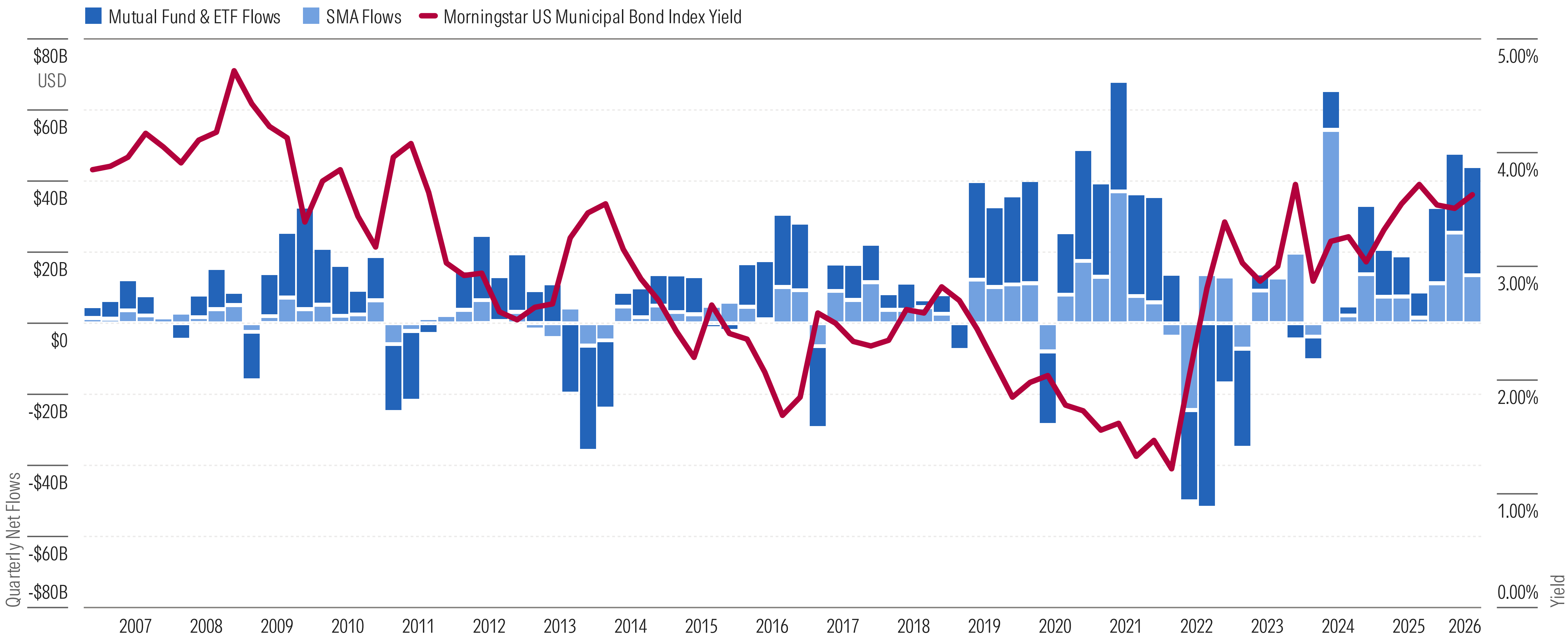
QFI76

Source: PitchBook. Data as of June 30, 2026.

Attractive Municipal-Bond Yields Drive Strong Demand

Municipal-bond yields, which have historically been an important driver of total returns, remain near their highest levels over the past decade. Investors seeking the benefit of tax-free income have taken notice, as municipal-bond vehicles (including separately managed accounts, exchange-traded funds, and mutual funds) have gathered assets at a near-record pace over the past 12 months through March 2026. While the flow cycle can quickly reverse, municipal bonds remain a good option for investors looking for attractive tax-free income, diversification, and high-quality assets.

Municipal-Bond Flows and Yield



QFI75

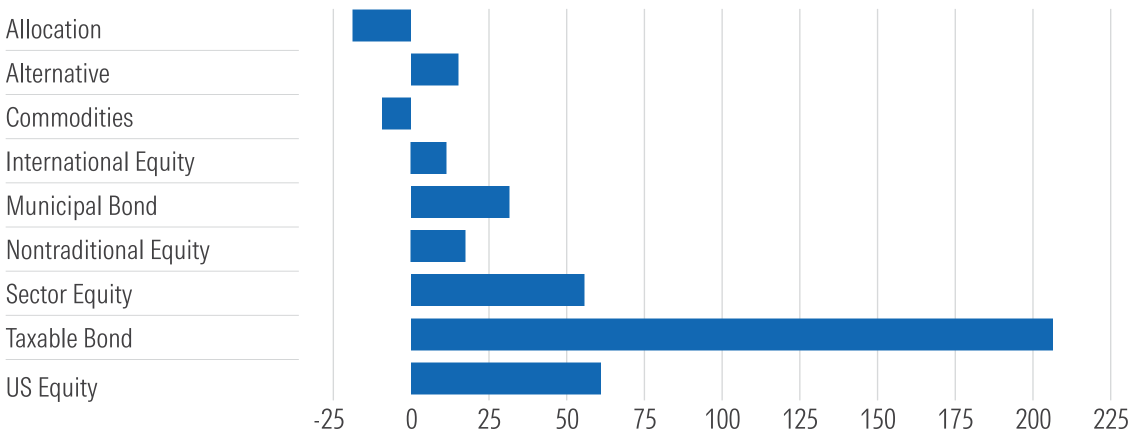
Source: Morningstar Direct, Morningstar Indexes. Data as of March 31, 2026.

Funds

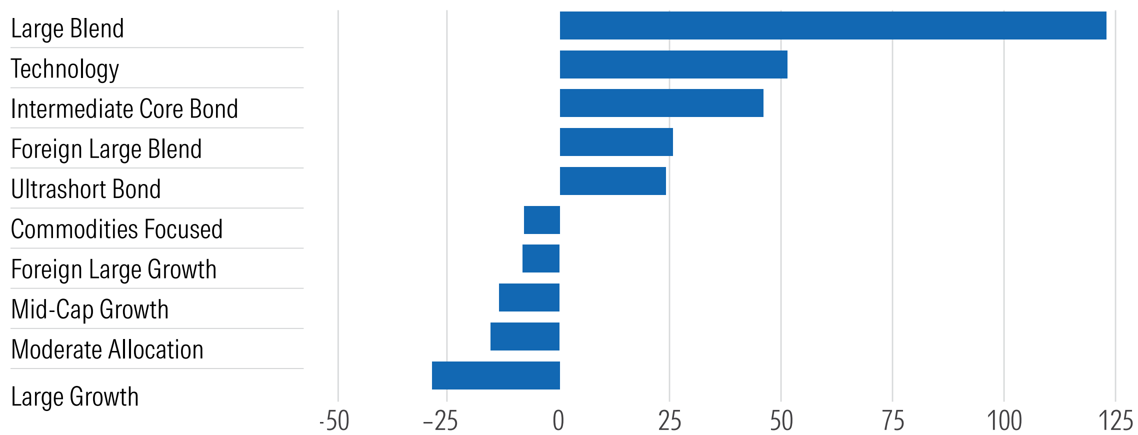
Top- and Bottom-Performing Morningstar Categories

The technology Morningstar Category surged in 2026's second quarter, far outpacing the returns of the next-best performers, such as small-growth, Pacific/Asia, and diversified emerging markets. On the flip side, equity precious metals and digital assets were the worst performers. Equity energy experienced one of the sharpest reversals, falling from the top-performing category in the first quarter of 2026 to one of the weakest performers in the second. From a flows perspective, taxable-bond funds saw the largest inflows, while allocation and commodities funds were in outflows.

Trailing Quarter Flows by Category Group (USD Bil)



Top and Bottom Trailing Quarter Flows by Category (USD Bil)



Top-Performing Morningstar Categories	US Category Group	Return (%) Trailing Quarter	Return (%) Trailing 1 Year	Quarterly Flow (USD Mil)
Technology	Sector Equity	39.9	47.8	51,117
Small Growth	US Equity	24.4	32.8	–4,880
Pacific/Asia ex-Japan Stk	International Equity	23.5	43.5	281
Diversified Emerging Mkts	International Equity	20.7	41.0	1,222
Small Blend	US Equity	19.6	33.4	–7,146
Large Growth	US Equity	18.8	17.8	–28,823
Mid-Cap Growth	US Equity	17.4	19.0	–13,562

Bottom-Performing Morningstar Categories	US Category Group	Return (%) Trailing Quarter	Return (%) Trailing 1 Year	Quarterly Flow (USD Mil)
Equity Precious Metals	Sector Equity	–14.9	55.3	–3,095
Digital Assets	Alternative	–14.0	–38.1	–3,664
Commodities Focused	Commodities	-8.9	30.3	–8,006
Equity Energy	Sector Equity	-7.5	35.1	–5,639
Commodities Broad Basket	Commodities	-6.1	25.3	–1,202
Natural Resources	Sector Equity	-2.1	35.5	2,712
Equity Market Neutral	Alternative	-0.5	4.2	2,727

>20
10 to 19.9
0 to 9.9
–9.9 to 0
–19.9 to –10
<–20

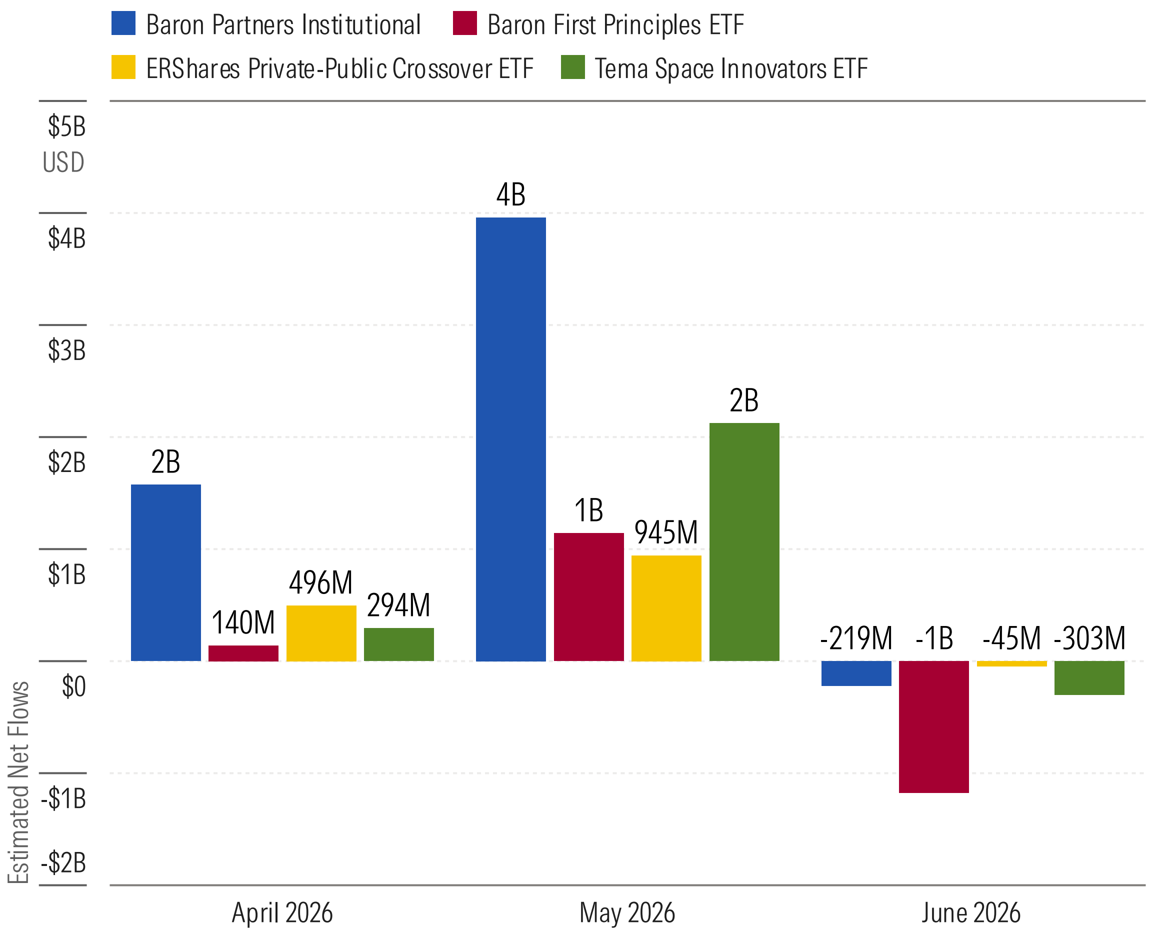
QMF10

Source: Morningstar Direct. Data as of June 30, 2026.

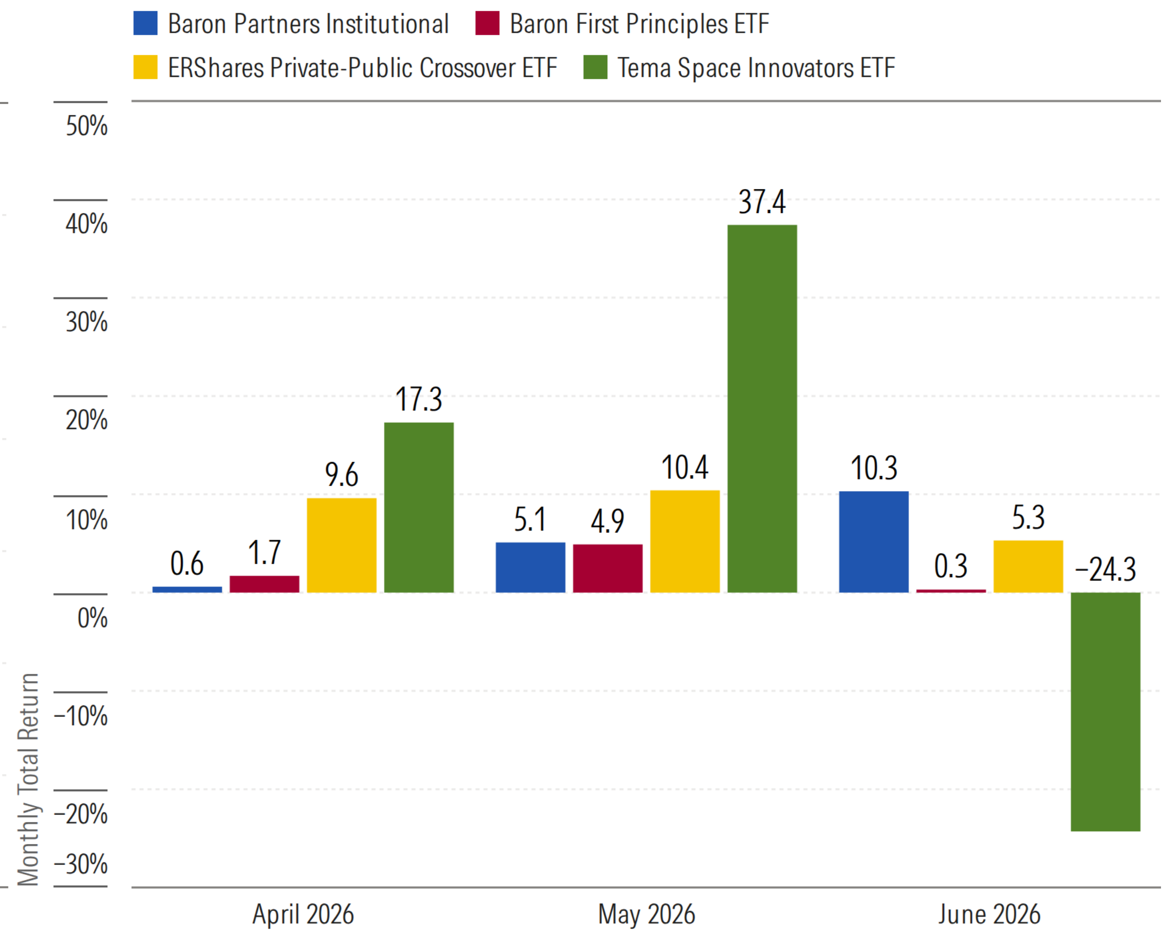
Funds Holding SpaceX Prior to IPO Saw Strong May Inflows, June Outflows

The second quarter saw a frenzy of interest in mutual funds and exchange-traded funds with exposure to Space Exploration Technologies Corp. Four notable funds built up massive stakes via private equity before the stock went public, enticing May inflows. The four funds raked in nearly USD 8 billion in that month alone, with monthly returns similarly spiking for the period. But just as quickly, those funds saw outflows, and returns varied greatly in June.

Q2 Estimated Net Flows of Funds With High SpaceX Exposure



Q2 Monthly Total Returns of Funds With High SpaceX Exposure



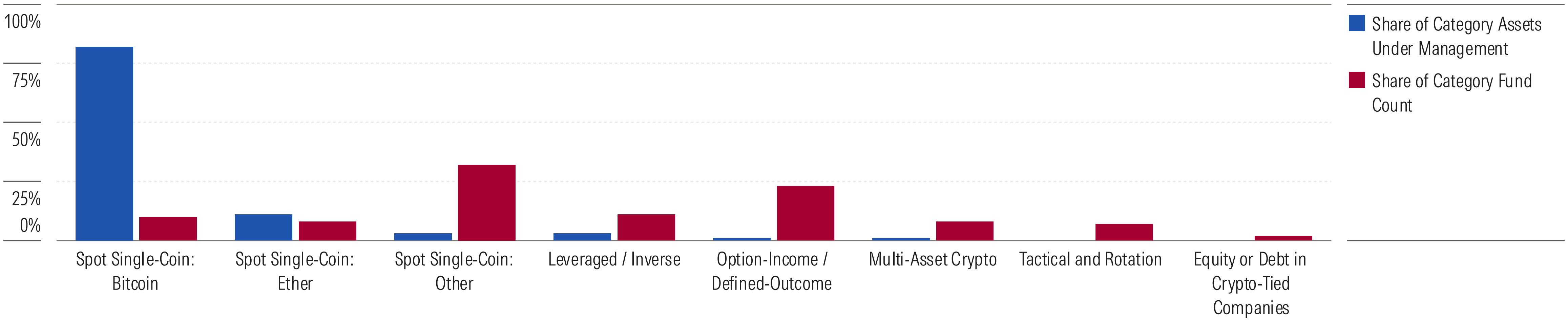
QMF98

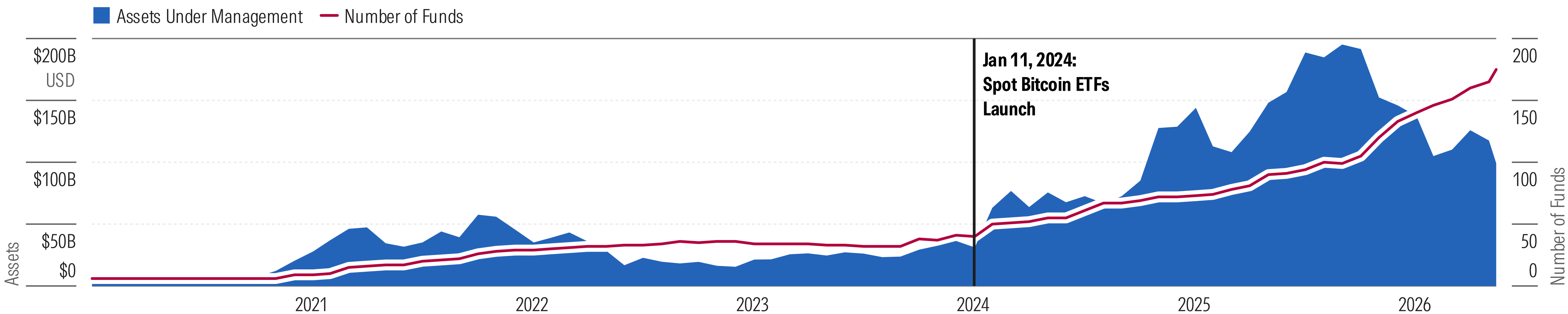
Source: Morningstar. Data as of June 30, 2026.

The Number of Digital Assets Funds Soars Despite an Asset Decline

The number of cryptocurrency products ballooned since regulators approved funds directly holding bitcoin in January 2024. More than 30 new funds launched in the digital assets Morningstar Category in the first half of 2026 alone. However, assets are unevenly distributed and broadly declining. ETFs holding bitcoin account for 82% of the category's assets but represent just 10% of its funds. It's a complicated landscape, with a long tail of offerings spanning other altcoins as well as leveraged or inverse products. Investors should expect substantially different outcomes across the category.

A Few Digital Assets ETFs Claim Most of the Market





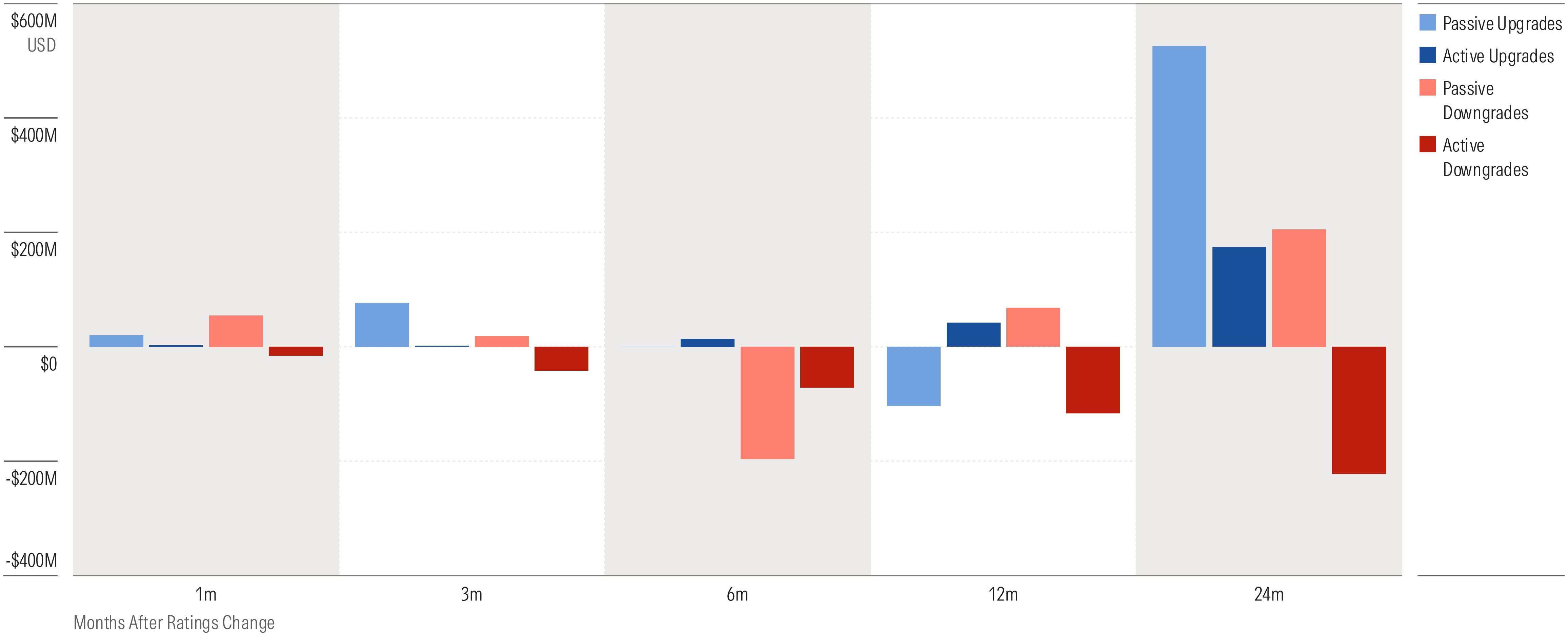
QMF96

Source: Morningstar's Guide to Digital Asset Funds. Data as of May 31, 2026.

Active Funds Show Stronger Link Between Flows and Ratings Changes Than Passive Funds

A recent Morningstar study looked at US fund Morningstar Medalist Rating changes and their effect on fund flows from Jan. 1, 2011, to Dec. 31, 2025. Upgraded actively managed funds averaged net inflows of USD 42 million in the 12 months following a ratings change, and USD 174 million after 24 months. Outflows following downgrades were larger, at USD 116 million and USD 222 million over the same periods, respectively. Passive funds showed a less consistent link, but upgraded passive funds had more than twice the inflows of downgraded peers two years after a ratings change.

Average Net Flows After Ratings Change



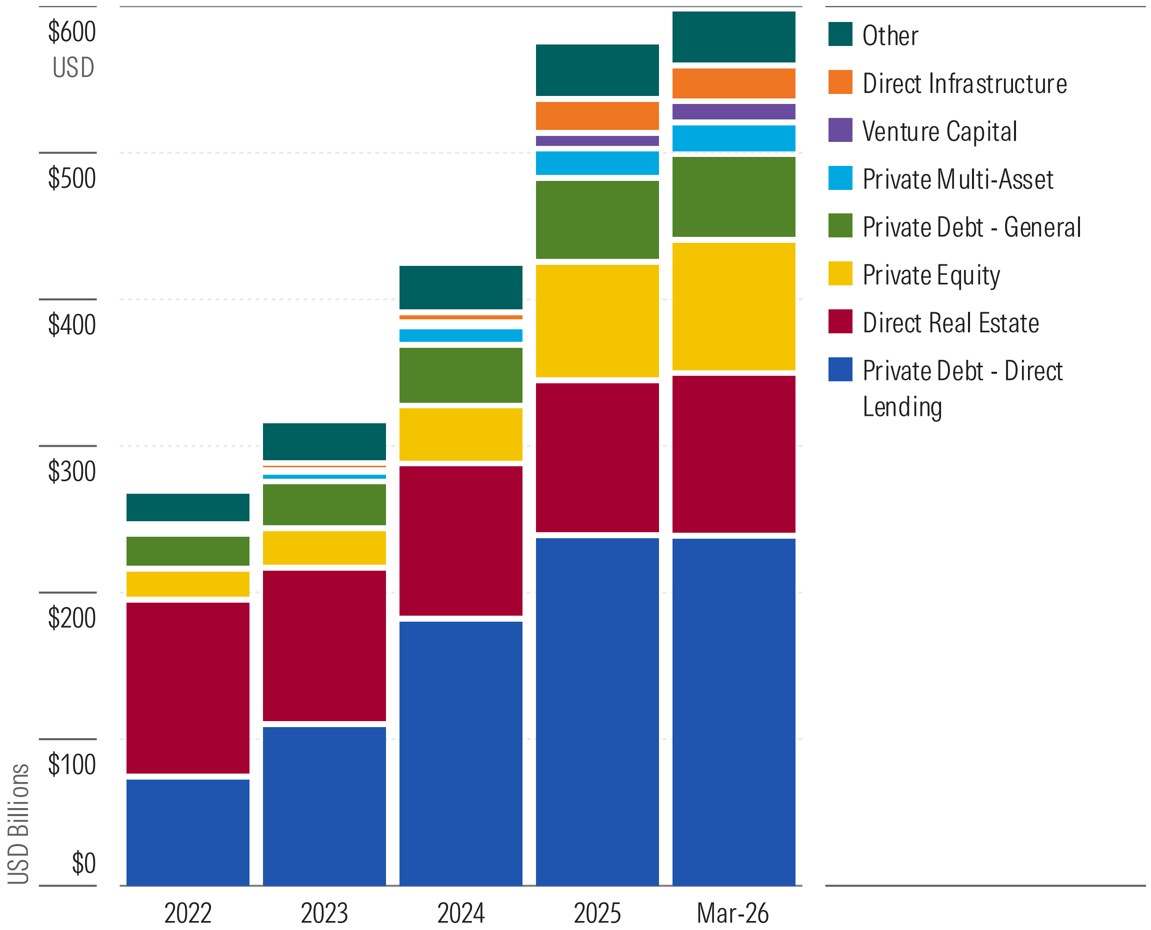
QMF97

Source: The Link Between Morningstar Ratings and Fund Flows. Data as of Dec. 31, 2025.

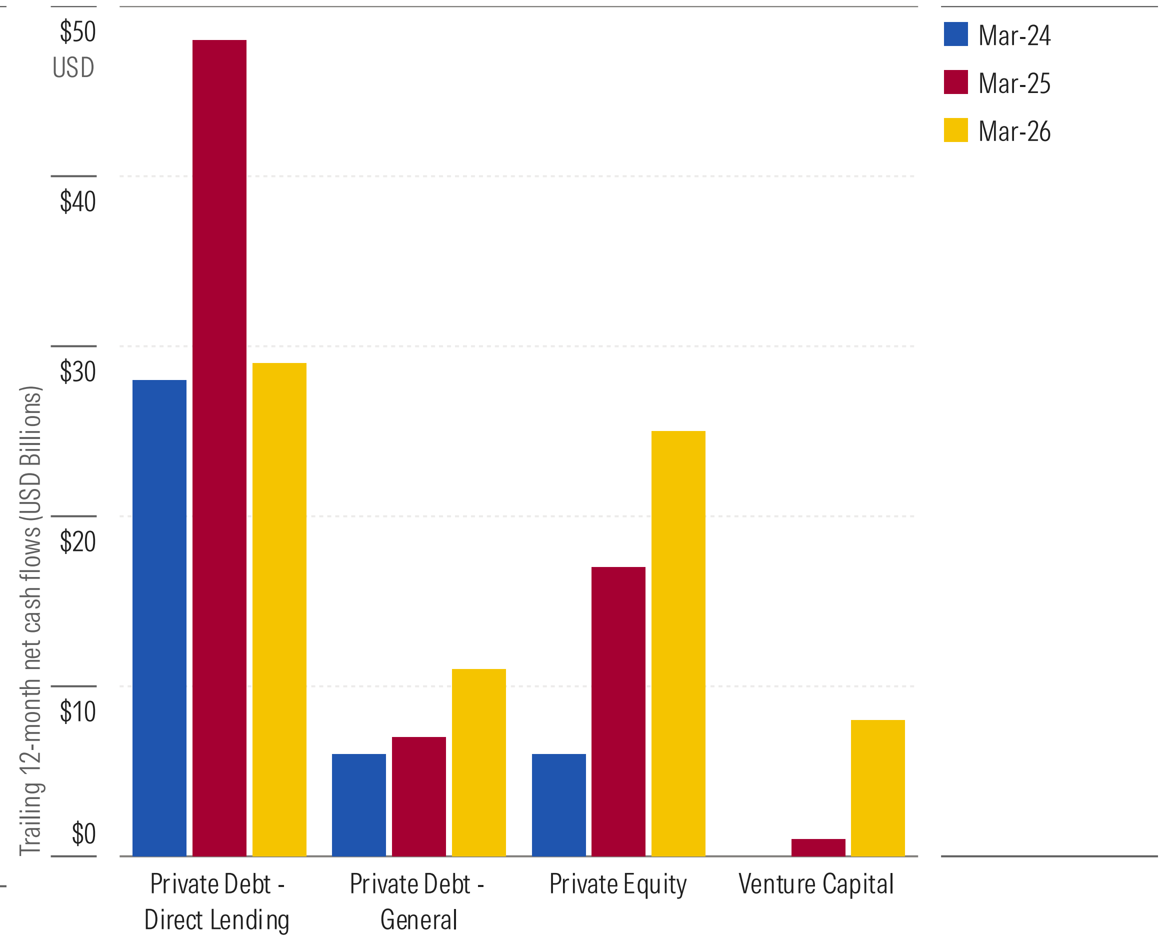
Semiliquid Fund Assets and Net Inflows by Morningstar Category

Direct lending continues to be the largest semiliquid Morningstar Category despite weakening demand compared with March 2025. The venture capital category saw net inflows of approximately USD 8 billion over the 12 months through March 2026 as investors scrambled for pieces of companies like SpaceX, Anthropic, and OpenAI. That's up from almost zero two years ago. SpaceX made its public market debut in June 2026 with a valuation near USD 2 trillion. Anthropic and OpenAI are also expected to go public in 2026 with valuations north of USD 1 trillion.

Semiliquid Fund Assets by Morningstar Category



Trailing 12-Month Net Inflows by Morningstar Category



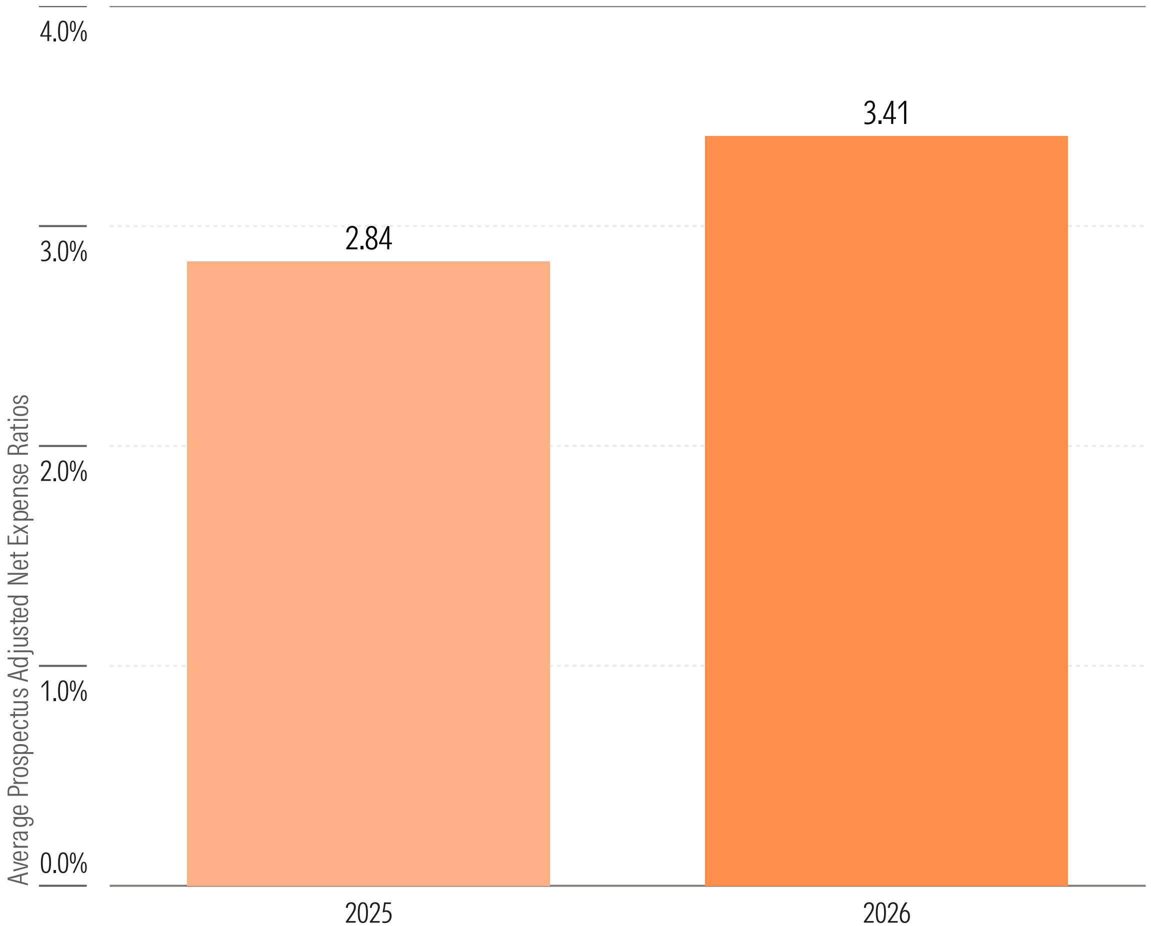
QMF86

Source: Morningstar Direct, Securities and Exchange Commission filings. The State of Semiliquid Funds 2026. Data as of March 31, 2026.

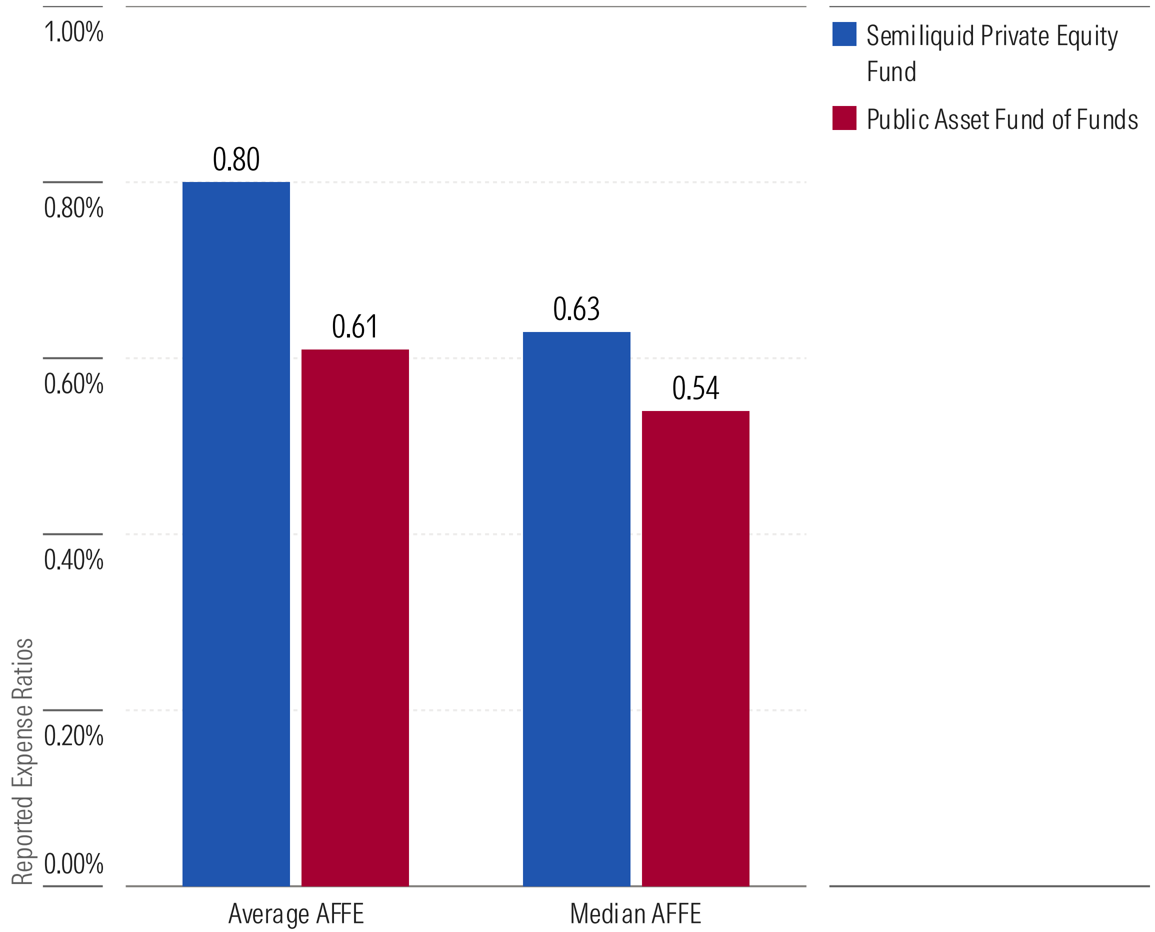
Greater Disclosure Means Higher Fees

More private credit funds, particularly unlisted business-development companies, have begun disclosing incentive fees in their prospectus fee tables after Morningstar pushed for better transparency in early 2026. As a result, reported fees have risen, making comparisons with other funds more meaningful. However, acquired fund fees and expenses, or AFFE, disclosures remain inconsistent, causing some private market fund of funds to appear less expensive than they actually are. For these vehicles, fund fees are likely much higher than is reported.

Unlisted BDC Fees Are Rising, Greater Disclosure Is Why



Semiliquid Funds' Acquired Fund Fees vs. Public Funds of Funds



QMF95

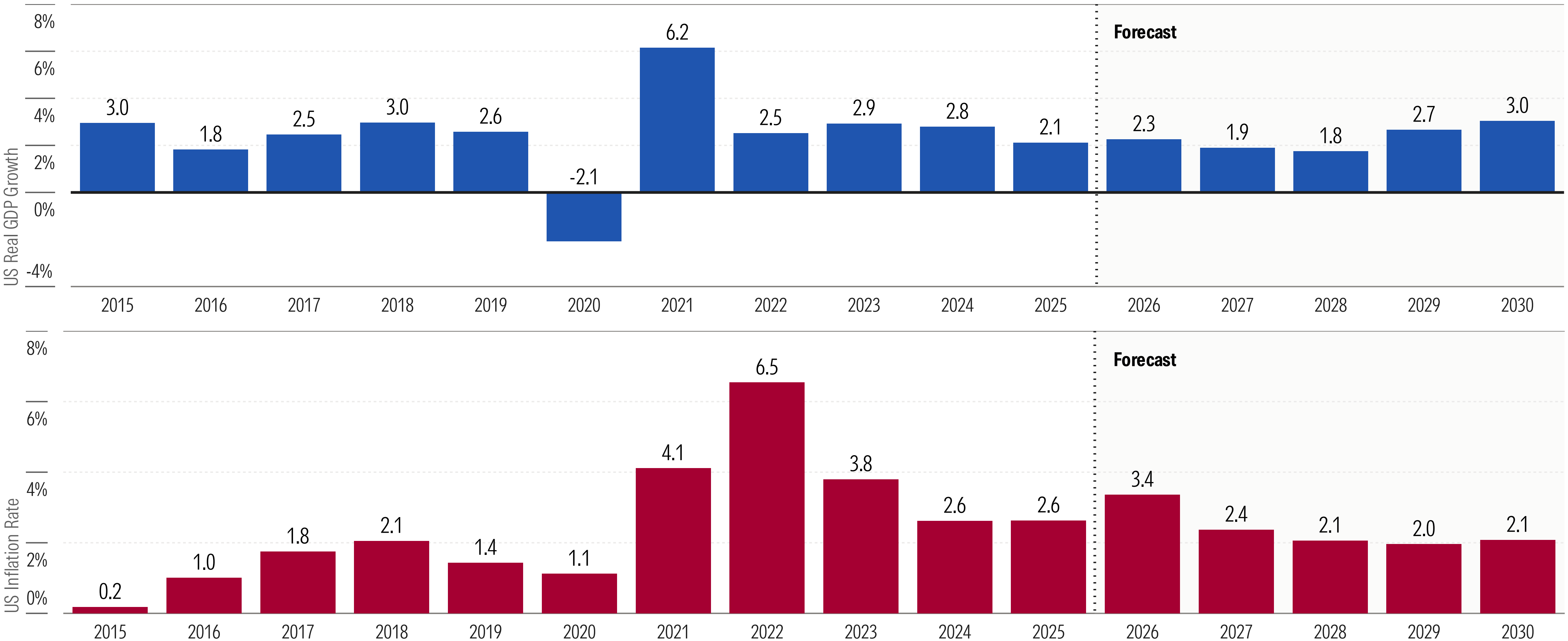
Source: Morningstar Direct; SEC filings. The State of Semiliquid Funds 2026. Public asset cohort includes funds with 75% or more of assets in actively managed underlying strategies. Funds with 0.1% AFFE or lower excluded from each group to account for potentially low fund ownership on the private equity side and to account for public fund of funds that own zero-cost share classes in order to charge fees at the fund level. The AFFE is intended to capture the operating expenses of underlying funds that parent funds pay.

Economic Indicators

US Gross Domestic Product Growth to Reaccelerate in Later Years of Our Forecast, While Inflation Recedes

We're still expecting US GDP growth to slow a bit further through 2028, owing to decelerating AI spending, slower population growth, the ongoing drag from high interest rates, and other factors. Inflation should recede given the fading oil and tariff shocks as well as meager wage growth. Monetary easing is expected to drive a rebound in GDP growth over 2029-30.

US Real GDP Growth (top) and US PCE Inflation Rate (bottom)

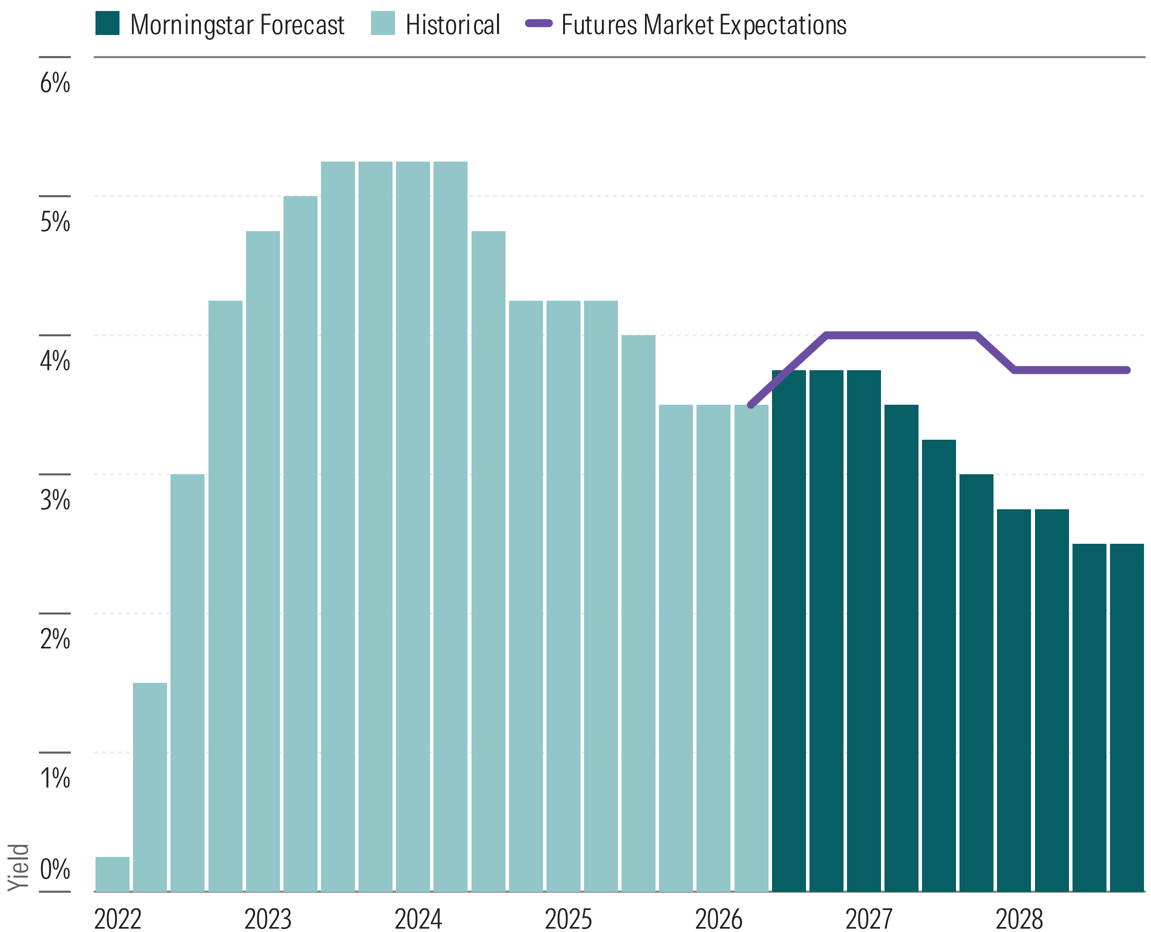


Source: US Bureau of Economic Analysis, Morningstar.

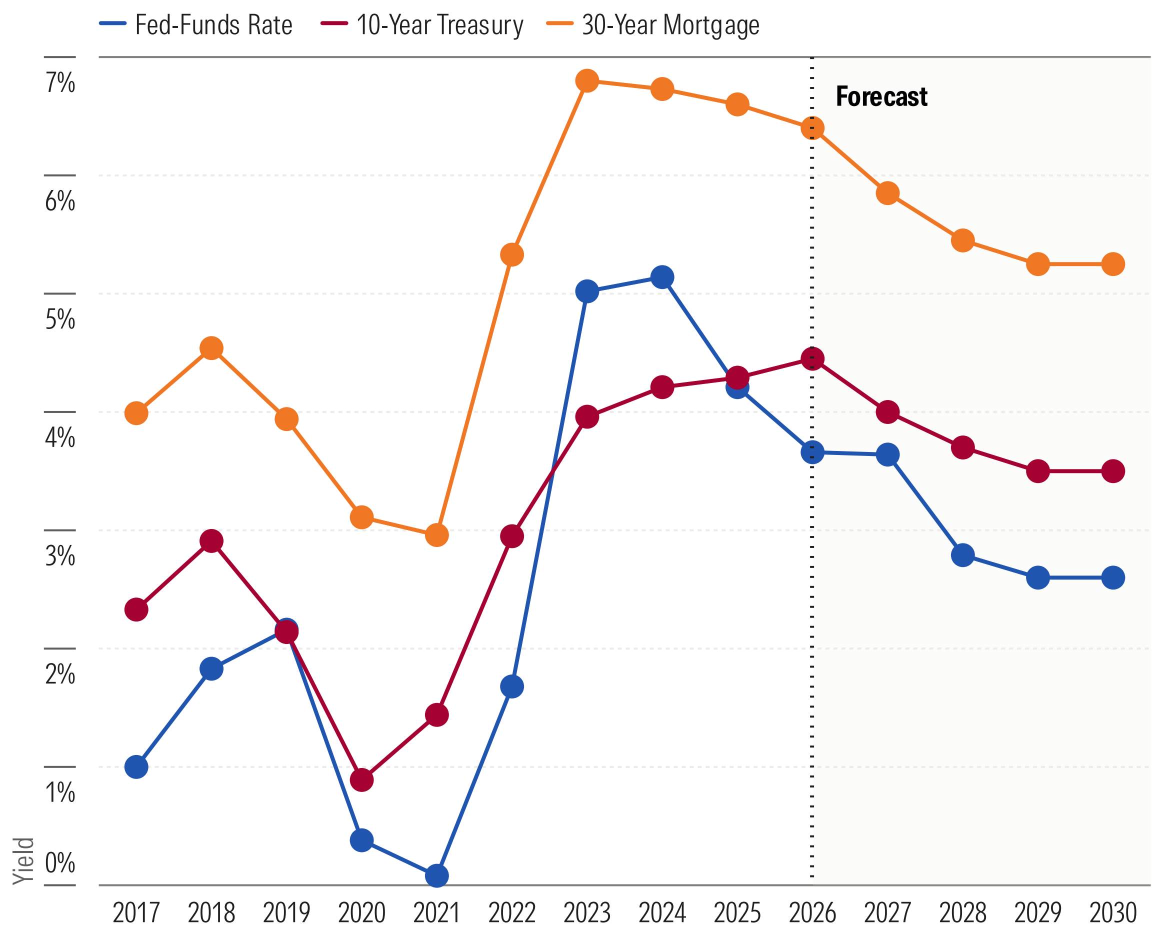
Federal Reserve to Hike Once This Year, but Resume Cutting in 2027

Fed officials' thinking has pivoted in a hawkish direction, and we now expect one federal-funds rate hike this year. But we expect five rate cuts over 2027-28, driving the federal-funds rate down to 2.50%-2.75% by the end of 2028, a net 1-percentage-point lower than current levels. This should help push longer-term interest rates down further, with the 10-year Treasury yield dropping to 3.25% by 2029. Lower rates will be needed to support continued healthy economic growth.

Federal-Funds-Rate Expectations (Bottom of Target Range)



US Interest Rates Forecasts (Annual Averages)



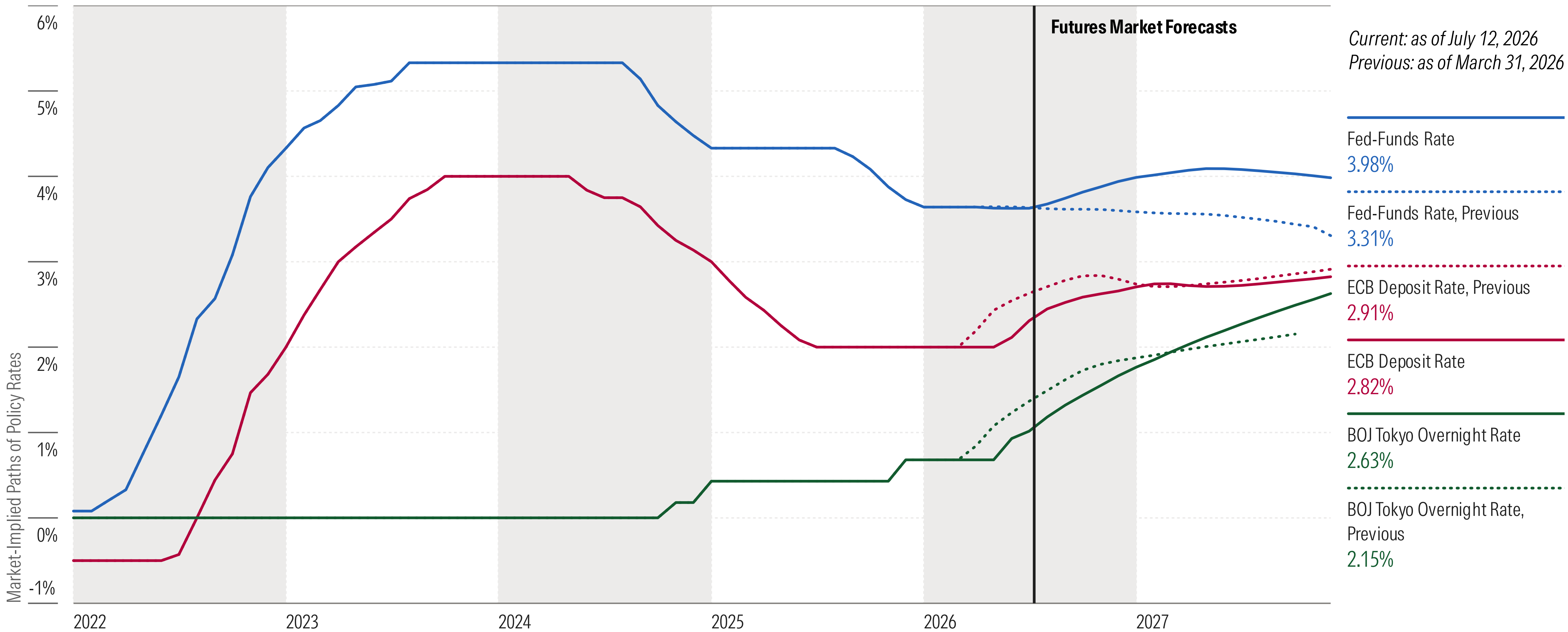
QEI237

Source: Federal Reserve, Chicago Mercantile Exchange.

Monetary Policy Becoming More Restrictive in Major Economies

The market now expects two federal-funds rate hikes (0.5 points total) in 2026. In parallel, the European Central Bank and Bank of Japan are expected to continue their rate hike campaigns. The oil price shock is only one contributor among several fueling expectations of rate hikes. Hence, oil prices easing off their April/May highs hasn't much altered expectations for key policy interest rates.

Federal Reserve, European Central Bank, and Bank of Japan Market-Implied Paths of Policy Rates



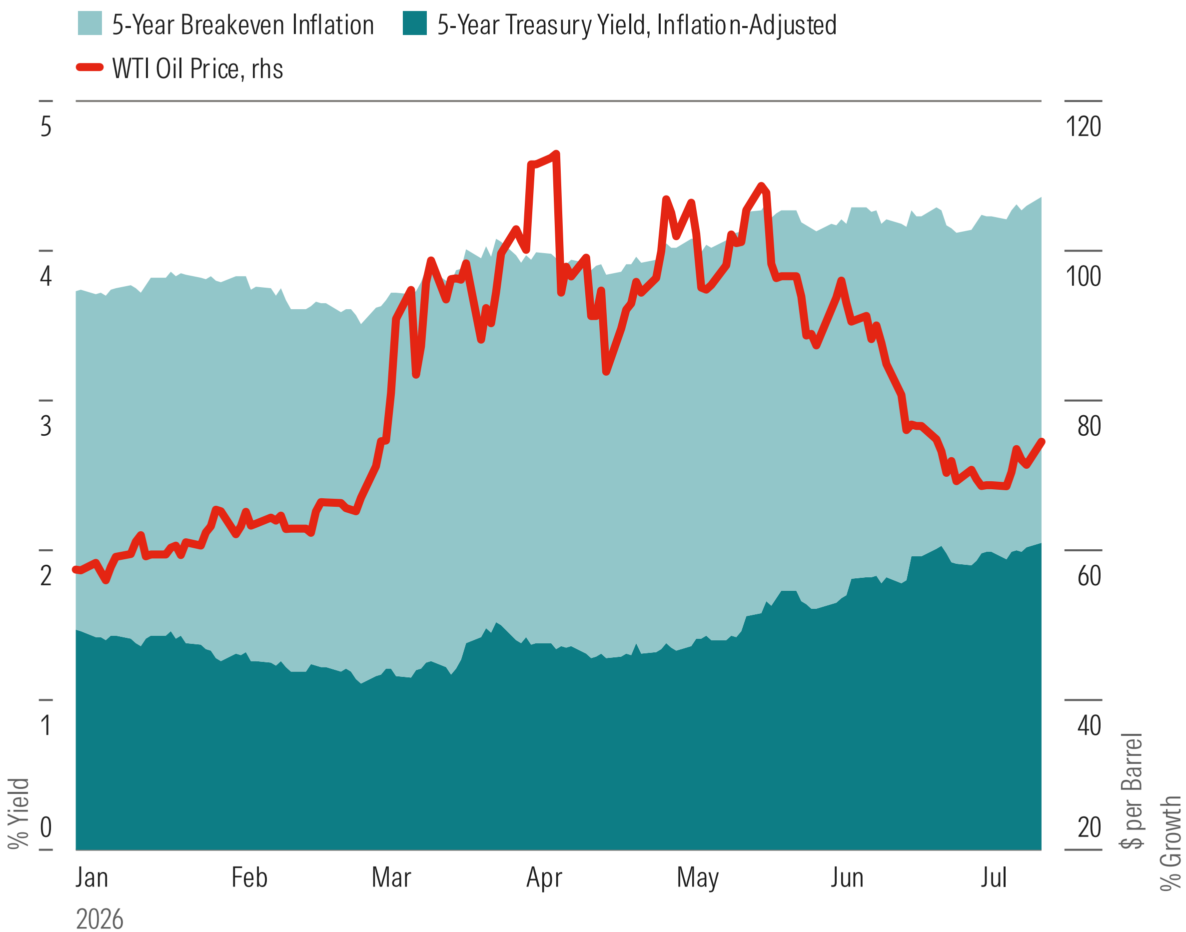
QEI213

Source: Chicago Mercantile Exchange, Eurex Exchange, Japan Exchange Group.

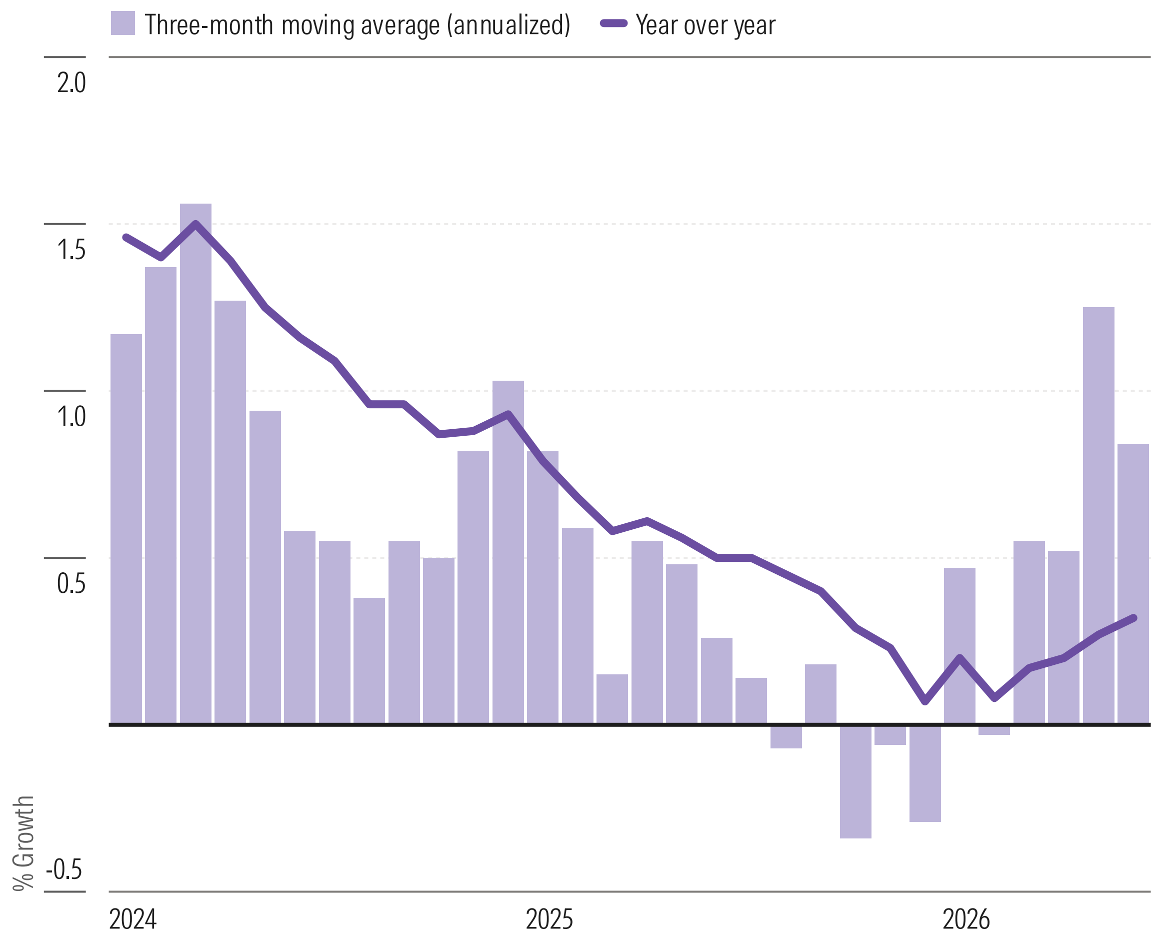
Oil Prices No Longer Driving Elevated Bond Yields

When oil prices spiked in March, bond yields moved up as well, reflecting evaporating hopes of Fed rate cuts in 2026. But oil has moved to the backseat as a driver of interest rates. The drop in oil prices in June did compress breakevens, but this was more than offset by higher real yields, now up more than 80 basis points since March altogether. The latter reflects a view that the economy can handle tighter monetary policy than previously thought, partly driven by (in our view) an overreaction to recent strength in the job growth figures.

5-Year US Treasury Yields and Oil Prices



Nonfarm Payroll Employment Growth (%)

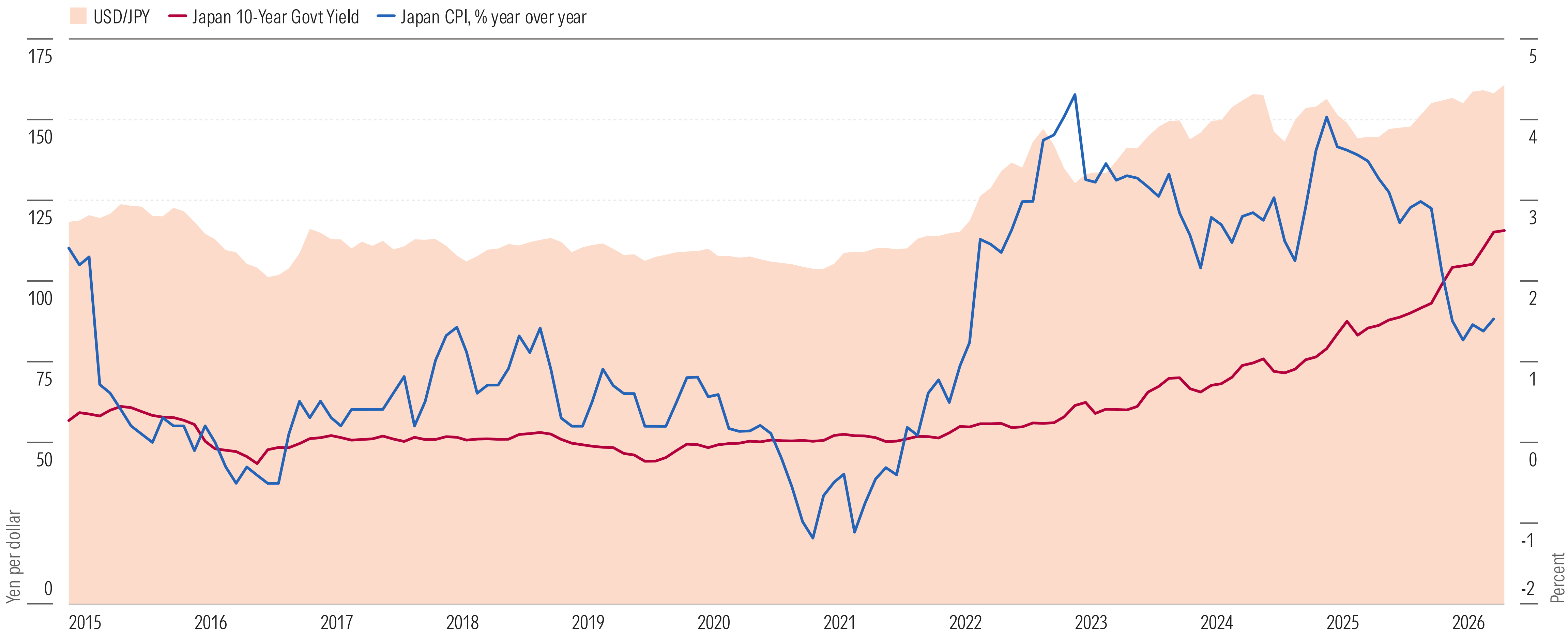


QEI267

Japan’s Era of Near-Zero Interest Rates Is Over as Currency Pressures Mount

Inflation isn’t the spur for rate hikes in Japan, as inflation there has dipped below 2% in 2026. But the Japanese yen sold off massively over 2022-24, and the Bank of Japan was only able to ease the downward pressure on its currency by committing to a campaign of monetary policy tightening, starting with balance sheet reduction and now moving to policy rate hikes. That’s pushed the 10-year yield up to 2.8%, a 30-year high.

Japan Economic Indicators



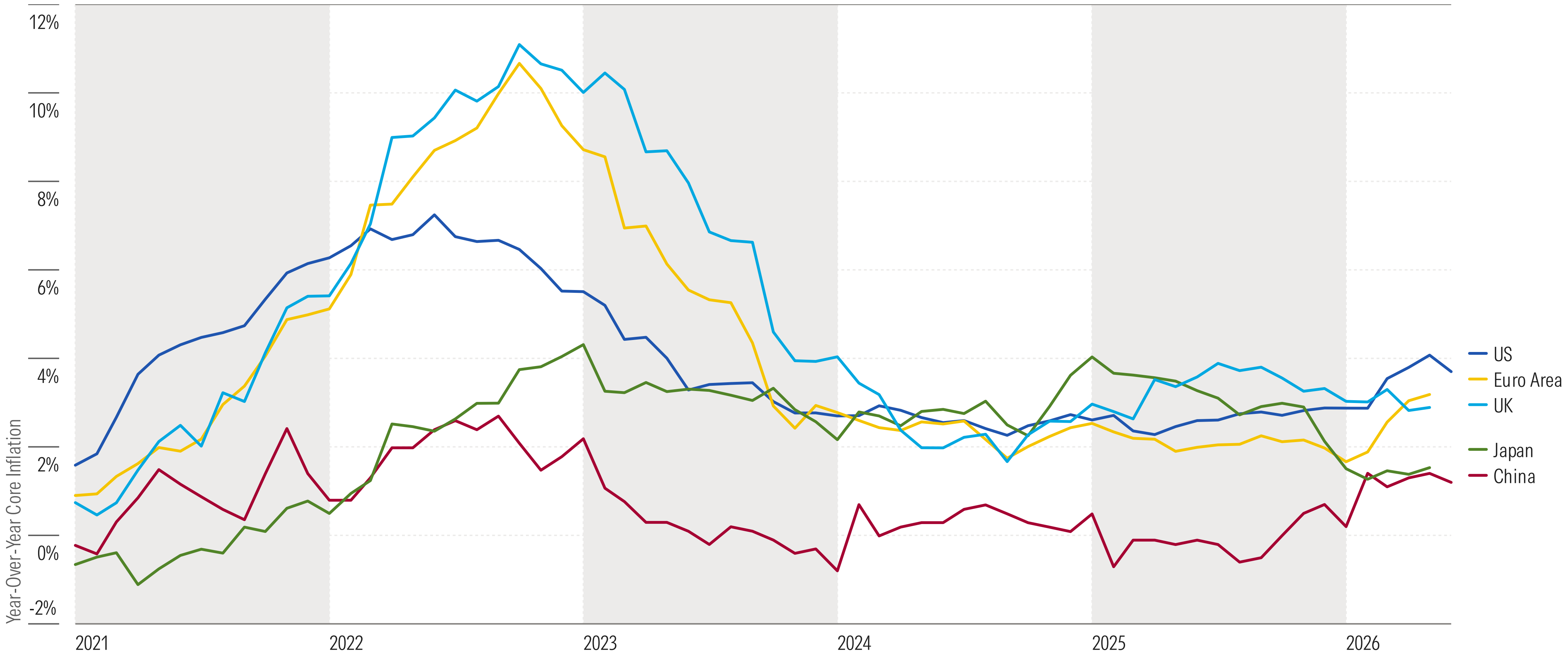
QEI271

Source: Bank of Japan, Statistics Bureau of Japan.

Inflation Has Increased, but Has Been Dwarfed by 2021-22 Surge

Overall inflation has generally moved up in major economies as a result of the energy price shock in 2026, but the impact has been tiny compared with the inflationary surge over 2021-22. This is partly because a number of other inflationary shocks (both demand and supply) were in play over 2021-22. But the energy shock itself also has been smaller, particularly in Europe, where natural gas prices increased more than 10-fold from the start of 2021 through the mid-2022 peak.

Consumer Price Inflation (% Year Over Year)



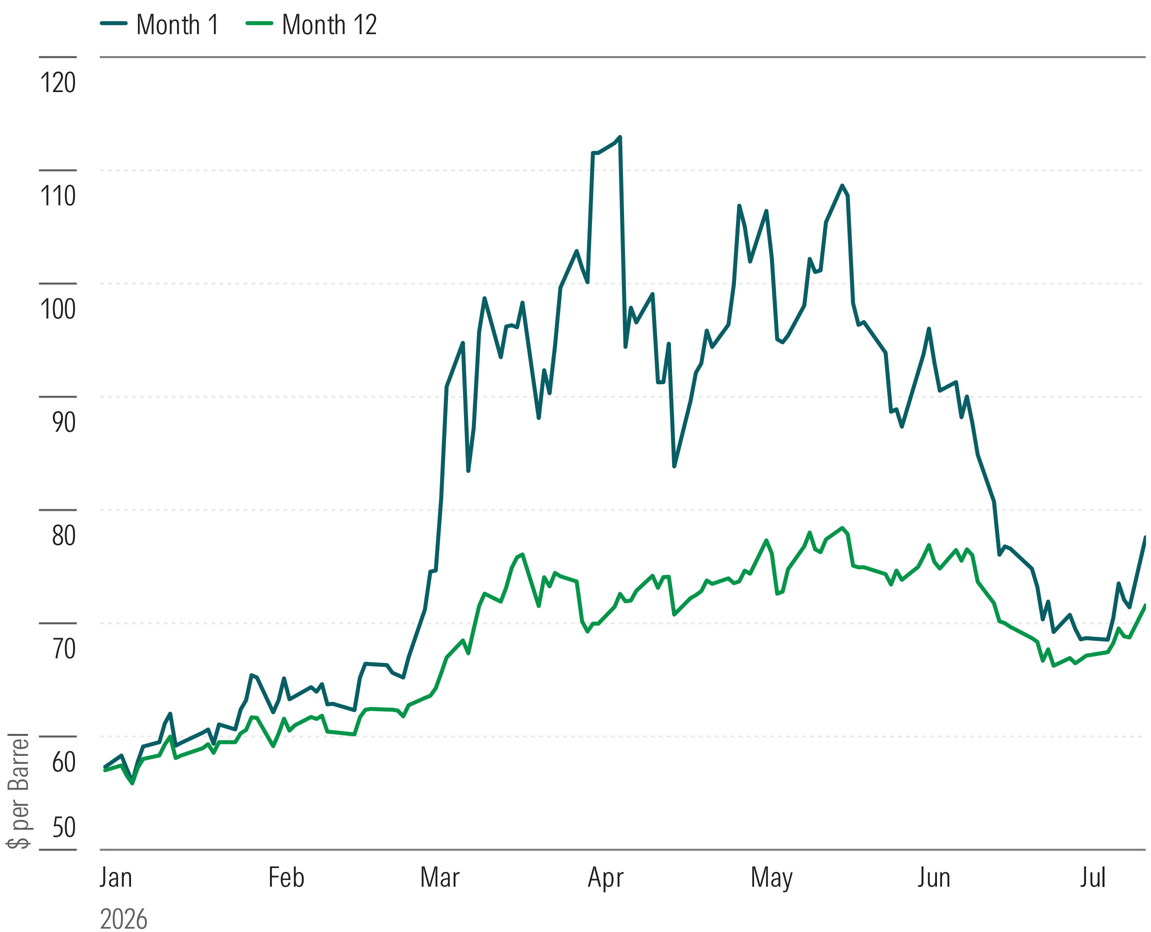
QEI246

Source: Macrobond. Data as of June 30, 2026.

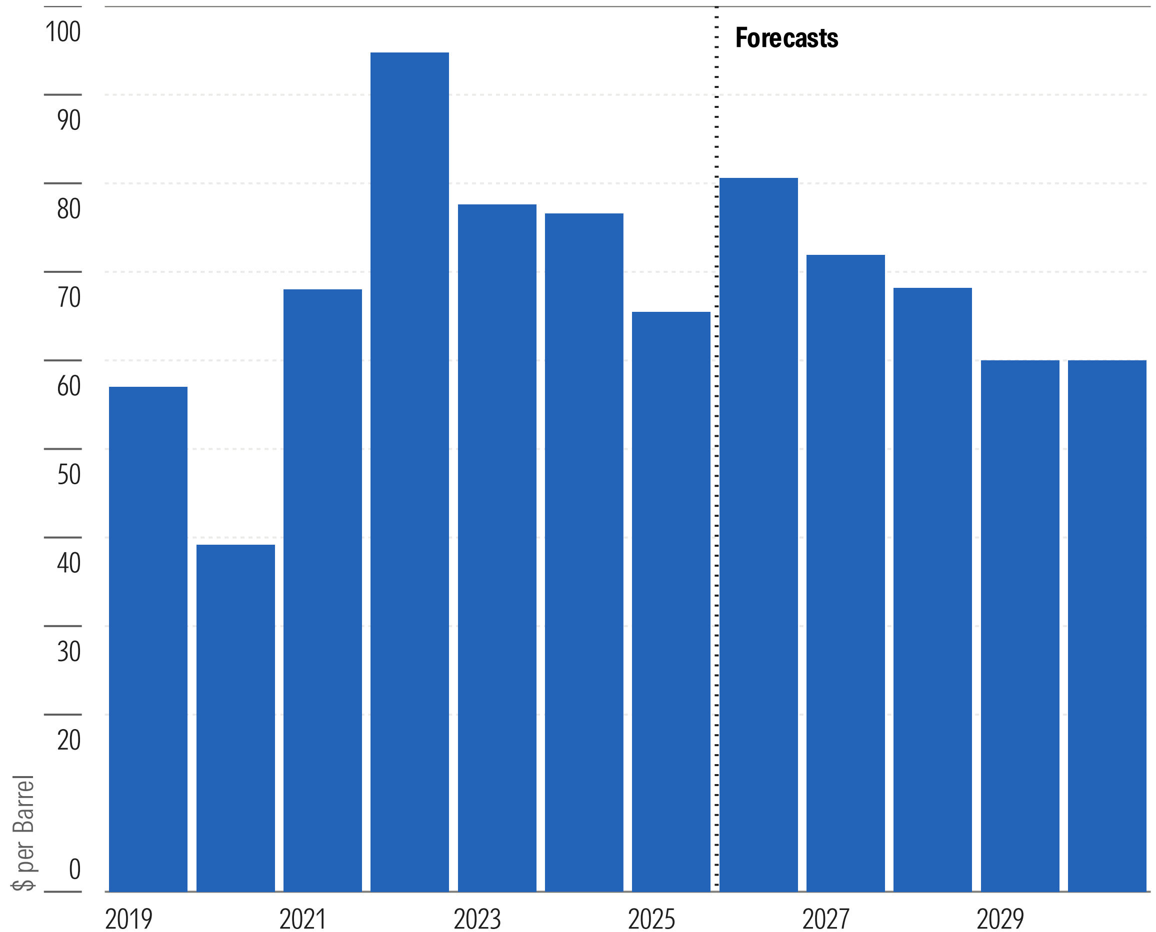
Oil Investors Still Optimistic That Tensions Will Defuse

Oil prices have rebounded recently by some USD 10 per barrel (West Texas Intermediate), as renewed fighting and ship attacks have curbed traffic in the Strait of Hormuz. But prices are still well below their April/May peaks. Investors have expected a limited-duration conflict since the outbreak of hostilities, as 12-month-out futures never touched USD 80 per barrel. The futures curve implies prices will average USD 81 per barrel in 2026 and USD 72 in 2027. We expect prices to fall further to USD 60 by 2029.

WTI Oil Futures Price



WTI Oil Price Forecast



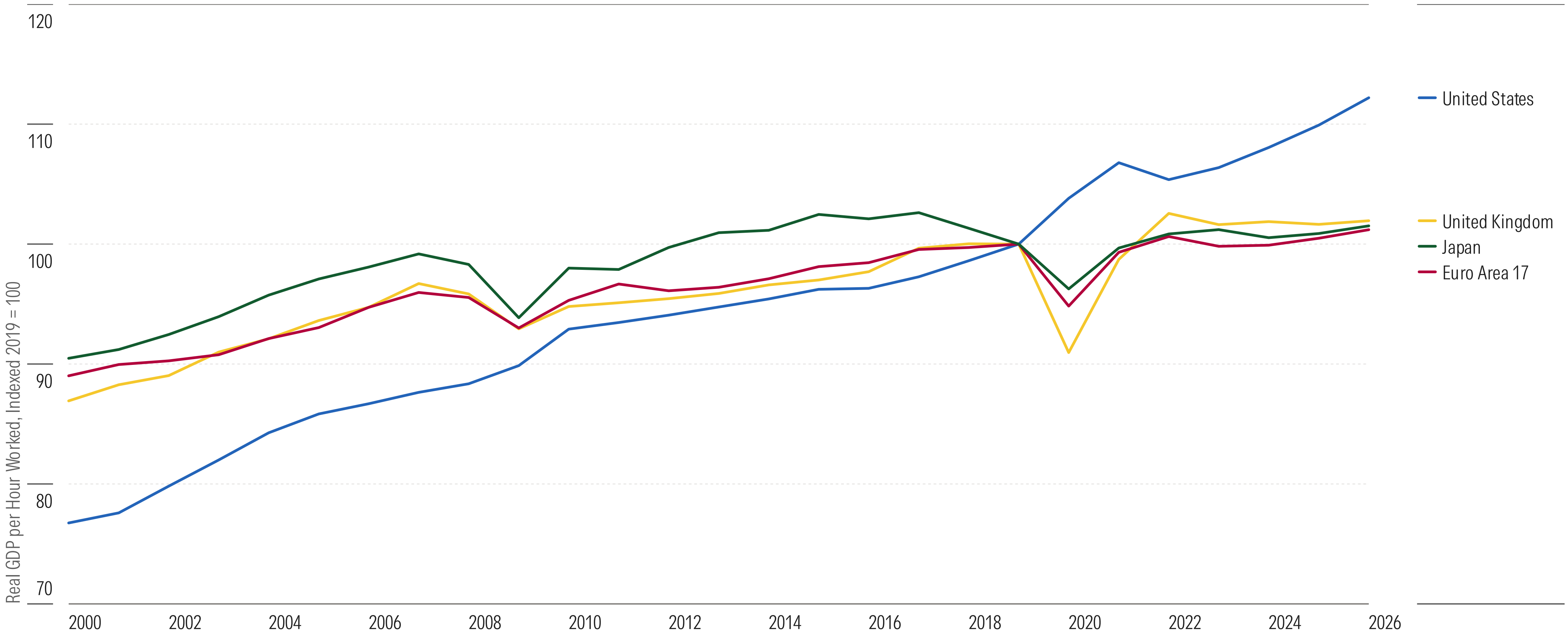
QEI268

Source: Chicago Mercantile Exchange, Morningstar.

US Growth Exceptionalism Underpinned by Productivity

The US has been by far the star performer among major advanced economies in terms of economic growth since the pandemic. That's been underpinned by superior productivity growth, where a disparity has existed for decades but has been magnified in recent years. US productivity growth has averaged about 1.9% per year since 2020, while the UK, Japan, and the Euro area have each seen growth at a mere 0.2%-0.3%. As AI use percolates into the broader economy, this gap may only widen.

Labor Productivity (Real GDP per Hour Worked), Indexed 2019 = 100



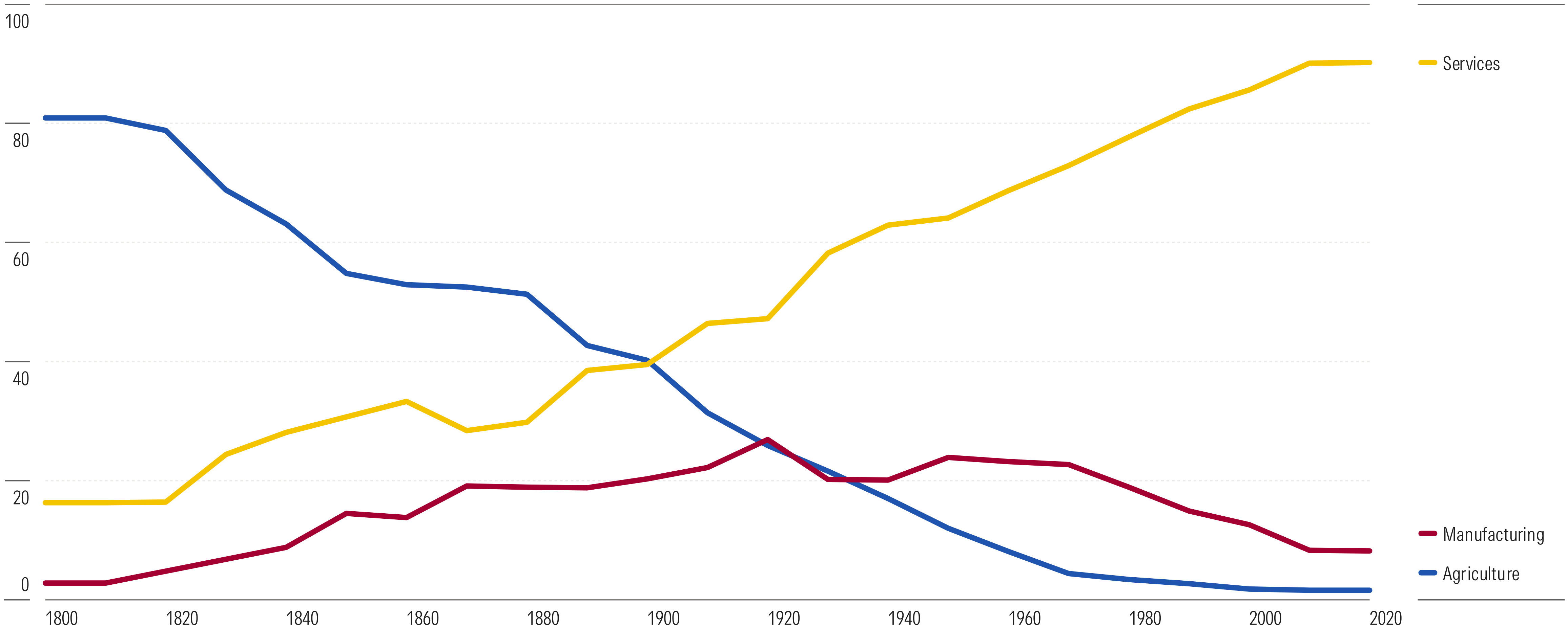
QEI269

Source: Organisation for Economic Co-operation and Development.

AI's Success Doesn't Doom Workers

There's a view that if widespread AI automation happens, the share of GDP captured by labor will inevitably collapse. But history says differently. Two centuries ago, most workers were farmers. The automation of agriculture didn't lead to immiseration. Rather, workers moved to other sectors, while the relative price of food collapsed, benefiting consumers. For more on this and other myths about AI's economic impact, see our latest US economic outlook.

US Employment by Industry Group, % Share



QEI270

Source: US Bureau of Labor Statistics. "Labor Force and Employment: 1800-1960" (Lebergott, 1966).

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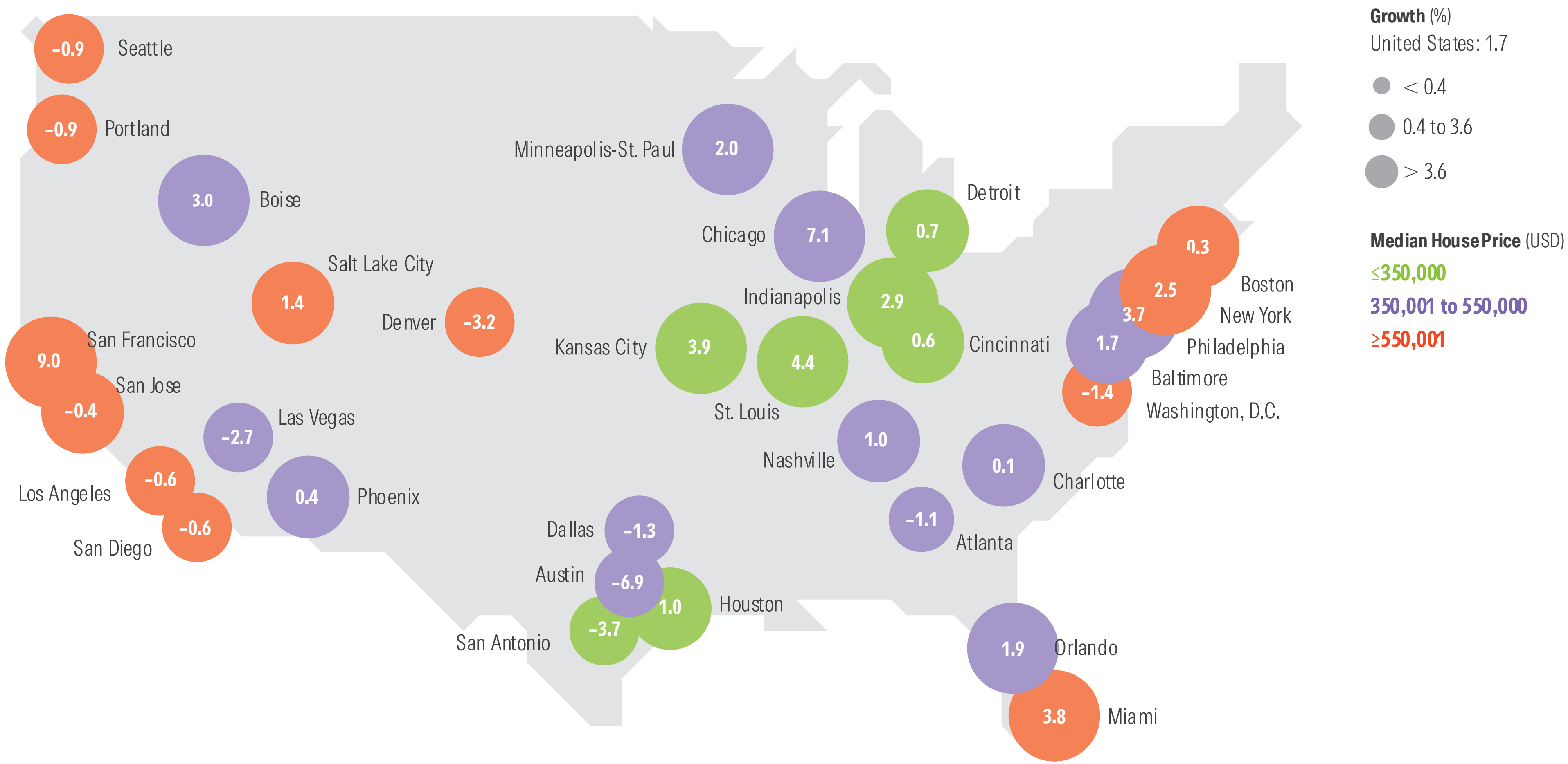
US Home Price Appreciation Remaining Weak

Home price growth has continued to weaken, standing at 1.7% year over year as of first-quarter 2026, down from 2.9% average growth in 2025 and 5.4% in 2024. The deceleration in home price growth has been broad, while Midwestern markets were more resilient. Sunbelt markets continue to see weak or negative growth, owing to vigorous building in response to the postpandemic runup in prices.

Year-Over-Year Price Growth (%) Q1 2026



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