

2H 2026 Market Outlook

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SUMMARY

- The global economy enters the second half of 2026 with resilient growth but rising stagflation risks. This is driven primarily by energy supply shocks and geopolitical tensions.
- The United States (US) remains relatively strong, although persistent inflation is likely to keep monetary policy restrictive for longer, with the Federal Reserve (Fed) signalling limited room for easing.
- Europe faces the clearest stagflationary pressures, while China's recovery remains uneven and externally driven, with weak domestic demand offsetting robust exports.
- Equities remain supported by earnings and the Artificial Intelligence (AI) capex cycle, but elevated valuations, narrow market breadth, and oil-driven inflation risks increase vulnerability to corrections.
- The US and Asia ex-Japan remain preferred equity markets, while Europe is likely to stay range-bound in the absence of easing energy prices. Singapore offers a defensive, income-oriented investment opportunity within the region.
- In fixed income, higher-for-longer rates and term premium repricing limit upside from duration, favouring carry strategies and selective credit exposure.

MACRO ENVIRONMENT

The global economy enters the second half of 2026 at a precarious but resilient juncture, marked by a complex interplay between geopolitical shocks and underlying economic durability. Overlaying this macro backdrop is the ongoing geopolitical disruption stemming from the Middle East conflict. While a ceasefire between the US and Iran remains in place, the prolonged closure of the Strait of Hormuz has kept energy markets tight, exacerbating inflationary pressures globally. Central banks, particularly the Federal Reserve, have acknowledged these supply-side shocks, signalling a bias toward maintaining restrictive policy settings, with upside risks to rates should inflation remain persistent.

United States

In the United States, growth momentum remains intact despite mounting headwinds. The economy expanded at a 1.6% annualised pace in the first quarter, supported by resilient consumption, steady labour markets, and continued strength in services and manufacturing activity. Payroll growth has stabilised, unemployment remains contained at 4.3%, and wage gains are moderating but still positive. Consumer spending has held up despite rising gasoline prices, underscoring the underlying strength of household balance sheets.

However, inflation pressures have re-emerged as the dominant macro risk. Headline Consumer Price Index (CPI) accelerated to 3.8% year-on-year in April 2026, driven by higher energy prices and persistent housing costs, reinforcing concerns that the Federal Reserve may need to hold policy restrictive for longer. Consumer sentiment has deteriorated sharply, reflecting rising cost-of-living pressures, even as equity markets have continued to rally on strong earnings delivery.

The Federal Open Market Committee (FOMC) has reinforced this cautious stance. At its June meeting, the Fed held the policy rate unchanged at 3.5%–3.75%, while emphasising that inflation “remains elevated,” partly reflecting supply-side shocks, particularly in energy markets. Updated projections point to higher inflation and weaker growth alongside a still-tight labour market, underscoring the policy dilemma between maintaining price stability and supporting economic activity. Notably, the median rate outlook reflects an even split between holding rates steady and further tightening in 2026, signalling a high degree of uncertainty around the policy path. The Fed's communication bias remains firmly toward vigilance on inflation, suggesting policy is likely to stay restrictive for longer unless disinflation resumes more decisively.

Eurozone

The Eurozone presents a more fragile picture. Growth has slowed materially, with Gross Domestic Product (GDP) expanding just 0.1% in the first quarter and business activity slipping into contraction territory. At the same time, energy-driven inflation has pushed price pressures higher, resulting in an increasingly evident stagflationary dynamic. Weak consumer demand, declining retail sales, and contracting services activity point to a challenging macro backdrop, with limited policy flexibility for the European Central Bank.

China

By contrast, China has demonstrated relative resilience, particularly through the strength of its external sector. Export growth has rebounded sharply, supported by technology demand, although domestic demand remains weak. Investment and consumption continue to underperform, reflecting ongoing property sector drag and cautious household behaviour. Inflation pressures are building at the producer level, raising margin concerns for downstream industries.

INVESTMENT IMPLICATIONS

Equities

Equity markets continue to navigate a tension between resilient earnings fundamentals and macro headwinds driven by inflation and geopolitics.

Globally, equities remain supported by strong corporate earnings and the ongoing AI-driven capital expenditure cycle. Market leadership continues to be concentrated in technology and related supply chains, but the thematic impact of AI is broadening into adjacent sectors including utilities, power infrastructure, and construction.

However, valuations are becoming increasingly stretched, while market breadth remains narrow, leaving indices sensitive to shifts in interest rates and earnings expectations. Elevated oil prices introduce an additional layer of uncertainty, as they risk prolonging inflation and tightening financial conditions, potentially compressing equity multiples.

Regionally, the United States remains the preferred market. Strong earnings growth, high returns on equity, and sustained investment in AI-related technologies underpin the investment case. Importantly, the US economy's relative insulation from external shocks, coupled with resilient domestic demand, continues to support corporate profitability, even as concerns emerge around lower-income consumer segments.

Asia Pacific ex-Japan also presents selective opportunities, particularly in technology and semiconductor value chains. Structural demand for chips and AI infrastructure continues to benefit key markets such as Taiwan and Korea. However, the region's dependence on imported energy and global trade leaves it exposed to renewed commodity shocks and external demand weakness, amplifying volatility risks.

By contrast, Europe faces the most challenging outlook among developed markets. Energy sensitivity, weakening consumption, and structural growth constraints suggest equities are likely to remain range-bound unless energy prices ease meaningfully. While defence spending and relatively undemanding valuations provide some support, the macro backdrop remains unfavourable.

Japan's equity market remains supported by corporate governance reforms and yen weakness, although policy normalization introduces uncertainty around financial conditions.

Singapore equities remain relatively defensive within the regional mix, underpinned by financial sector resilience, stable policy settings, and ongoing safe-haven inflows. Banks continue to anchor index performance through solid earnings delivery, supported by higher net interest margins and disciplined capital management, while Real Estate Investment Trusts (REITs) and yield-oriented sectors offer a cushion against broader volatility. That said, the market's open and trade-dependent nature leaves it exposed to external shocks, particularly from elevated energy prices and softer regional growth. As a result, Singapore equities may remain range-bound in the near term, with upside contingent on improvements in global trade dynamics and a moderation in oil prices.

Overall, equities retain a structural bid from earnings and thematic drivers, but near-term performance will be increasingly contingent on inflation dynamics, interest rate expectations, and energy market developments.

Fixed Income

Fixed income markets are undergoing a repricing driven more by inflation uncertainty than by growth deterioration, creating a complex risk-reward landscape.

US Treasury yields have risen, and the yield curve has steepened, reflecting an expansion in term premia rather than optimism about economic growth. Markets have become more sensitive to persistent inflation risks, particularly those linked to energy prices and supply disruptions.

Despite more hawkish central bank rhetoric, implied policy rates suggest only modest expectations for further tightening, creating a disconnect between market pricing and underlying inflation risks. At the same time, volatility indicators such as the MOVE (Merrill Lynch Option Volatility Estimate) index remain subdued, while credit spreads are tight, pointing to complacency across fixed income markets.

Against this backdrop, portfolio positioning should remain cautious on duration. The balance of risks is skewed toward higher yields, particularly if inflation proves more persistent than expected. The return profile for extending duration appears increasingly limited, favouring shorter maturities and selective curve exposure.

Credit markets remain technically supported by strong demand and robust issuance, but tight spreads limit upside. The environment favours carry strategies over broad beta exposure, with a focus on credit quality and issuer resilience in a higher-rate environment.

In Asia, bond markets remain highly sensitive to global rate moves. China stands out as an outlier with a more accommodative stance and lower yields, reflecting weaker domestic demand conditions. Singapore dollar credit offers a relatively defensive positioning, supported by strong fundamentals, though further spread compression is limited and hedging costs remain elevated for USD exposures.

Overall, fixed income continues to offer positive but constrained total return potential, with elevated inflation risks limiting the scope for duration-driven gains.

KEY RISKS

- Energy market escalation: A prolonged Strait of Hormuz disruption could reinforce global stagflation.
- Persistent inflation and policy risk: Could drive higher volatility and tighter financial conditions.
- Equity valuation correction: Particularly within AI-driven sectors if growth expectations plateau.

All data are sourced from Lion Global Investors and Bloomberg as at 23 June 2026 unless otherwise stated.

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