Citizens PRIVATE WEALTH™

FROM THE OFFICE OF THE CIO

Quarterly Market Commentary

Q2 2026 Review

KEY TAKEAWAYS

- Global markets remain sensitive to geopolitical developments and energy prices. Although Middle East tensions eased late in the quarter, geopolitical risks continue to influence inflation expectations, growth prospects and investor sentiment.
- The U.S. economy proved resilient, though its benefits were unevenly shared. Business investment and a steady labor market sustained growth, even as the K-shaped divide widened. Higher-income households supported spending, while inflation and affordability pressured lower- and middle-income households.
- Global central banks remained focused on bringing inflation back to target, supporting our view that interest rates will stay higher for longer. Lower energy prices at the end of the quarter provided some near-term relief, but central banks appeared poised to keep policy restrictive until inflation progress is clearer and more durable.
- Strong corporate earnings, fueled in part by sustained investment in AI infrastructure, supported gains across equity markets and pushed several major indices to new highs. However, elevated valuations and increasingly narrow leadership reinforced the need for diversification by sector and style to mitigate portfolio risk.
- Fixed income delivered attractive income and diversification benefits. Despite rate volatility, U.S. bond markets delivered positive returns supported by attractive yields and solid credit fundamentals, reinforcing the importance of allocating to high-quality fixed income.
- Within alternatives, select private market strategies continue to generate positive returns with relatively low correlation to public markets.

Introduction

Geopolitics emerged as the defining theme of Q2, with the ongoing conflict involving Iran influencing both the global economic backdrop and investor sentiment. The extended disruption to the Strait of Hormuz, one of the world's most important shipping routes, kept global energy prices elevated. This uncertainty added pressure to already strained supply chains and contributed to higher inflation, as the flow of goods and energy slowed.

Encouragingly, progress emerged late in the quarter. A memorandum of understanding between the United States and Iran led to an extended ceasefire and the gradual reopening of the Strait. While this development initially eased pressure on oil prices and expectations of inflation, the recovery in shipping activity was slow. It will likely take time before trade flows return to prewar levels. We believe the path forward for energy prices, inflation and broader economic growth remains closely tied to how this situation evolves.

As we move into Q3, markets are balancing a mix of economic stabilization and uncertain signals. Easing geopolitical tensions offer some hope for lowering inflation. At the same time, strong investment in AI continues to support corporate earnings growth. However, the broader economic picture appears uneven. The gap between higher- and lower-income households in the K-shaped economy continues to widen making the issue of affordability a powerful political theme as we head toward the U.S. midterm elections. Within markets, leadership across several U.S. and select global equity indices has become more concentrated among the beneficiaries of the AI buildout. U.S. interest rates appear to be range-bound for the near term while the "higher for longer" narrative persists, putting additional pressure on borrowing costs for an already-stretched consumer.

In this environment, discipline matters most. Staying invested, limiting concentration and diversifying across asset classes remain our guiding principles as markets weigh opportunity against uncertainty.

Economic backdrop

The U.S. economy grew steadily, though unevenly, through the first half of 2026. Real GDP rose at a 2.1% annualized rate in Q1, up from 0.5% in Q4 2025, supported by business investment, exports, government spending and consumer demand. Early Q2 estimates point to growth near 2%, suggesting continued expansion despite higher borrowing costs and persistent inflation.

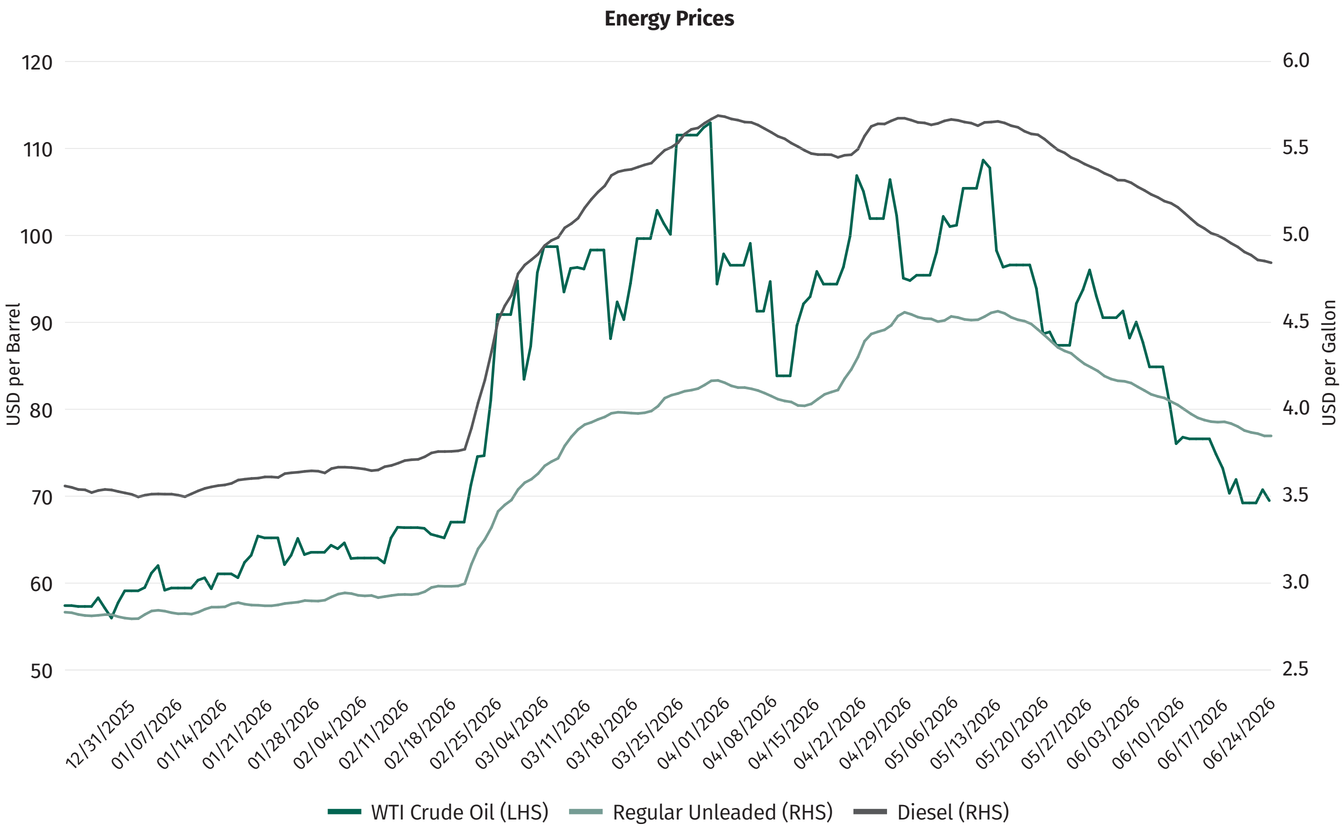
The labor market was a key support as job creation improved in Q2, with May payroll gains following upward revisions to prior months. Hiring broadened across leisure and hospitality, local government and healthcare, though some strength may have reflected temporary factors such as the World Cup. Still, conditions are choppy. Hiring slowed sharply in June even as unemployment fell to 4.2%, while participation changed little and wage growth remained subdued. The labor market is steadying growth, not accelerating it.

Consumer conditions are increasingly uneven. Higher-income households continue to benefit from rising asset values, while middle- and lower-income households face higher living costs, debt burdens and limited real income growth, reinforcing the K-shaped economy narrative. Recent data underscores the pressure as the savings rate is near multi-year lows, tax refund support has faded, and real disposable income is flat YoY. We see spending as increasingly dependent on higher-income households, raising questions about economic durability. Oil prices fell sharply in June, and gasoline prices have started to decline, offering a potential boost to purchasing power. (See Figure 1, on the next page.) However, fuel prices remain above pre-conflict levels and the impact on inflation will take time to appear.

Still, inflation levels remain above the Federal Reserve's target. May consumer price data rose notably, partly due to higher energy costs. Core inflation has been more contained but still reflects ongoing service-sector price pressures, while the Fed's preferred measure, the Personal Consumption Expenditure Index, remains above desired levels on both a headline and core basis.

Global central bankers are responding cautiously. Although traditional inflation measures remain elevated, some alternative gauges that filter out short-term volatility suggest underlying inflation may be lower than headline figures imply, underscoring the complexity of the current environment.

Figure 1: U.S. Energy Prices



Source: FactSet.

Looking ahead, the economic outlook is still positive, but the imbalances may lead to an environment of less certainty. Growth has proven more durable than expected, supported by a stable labor market and pockets of strength in both public and private spending. At the same time, inflation pressures, uneven consumer health, and the effects of higher interest rates continue to pose risks.

U.S. Federal Reserve

Global central banks remained focused on inflation in Q2. In the U.S., the Federal Reserve held rates steady in June, keeping the federal funds target range at 3.50%–3.75%. While expected, the unanimous vote marked a shift from April's more divided meeting.

June was also the first meeting led by Fed Chair Kevin Warsh. Under his leadership, the Fed's shorter post-meeting statement struck a cautious, inflation-focused tone, and acknowledged lingering uncertainty and geopolitical risks, while providing little guidance on future policy moves. This suggests a shift away from forward signaling and toward retaining flexibility as conditions evolve. Warsh further reinforced this shift by announcing task forces to review the Fed's communication, balance sheet management, use of economic data, and approach to inflation and the labor market. As shown in Figure 2 (see next page), the Fed's updated projections point to continued growth but at a slightly slower pace, with inflation expected to remain higher for longer. Many policymakers now see rates staying elevated through 2026 and beyond, while a wider range of views highlights uncertainty around the policy path.

Figure 2: FOMC Summary of Economic Projections – June 2026

Variable	Median			
	2026	2027	2028	Longer Run
Change in real GDP	2.2	2.3	2.2	2.0
March projection	2.4	2.3	2.1	2.0
Unemployment rate	4.3	4.3	4.2	4.2
March projection	4.4	4.3	4.2	4.2
PCE inflation	3.6	2.3	2.0	2.0
March projection	2.7	2.2	2.0	2.0
Core PCE inflation	3.3	2.5	2.1	
March projection*	2.7	2.2	2.0	
Federal funds rate	3.8	3.6	3.4	3.1
March projection	3.4	3.1	3.1	3.1

*Longer-run projections for core PCE inflation are not collected.
Source: Federal Reserve.

Warsh's first meeting hints at a Fed that may guide less and react more. For many years, monetary policy leaned heavily on clear communication and gradual adjustments to interest rates. That framework may now be evolving toward one that relies less on signaling and places more emphasis on real-time economic conditions. The Fed may also consider a broader set of policy tools, including balance sheet management and liquidity conditions alongside traditional rate changes.

For investors, the near-term message stays relatively straightforward: Inflation is still above target, and that remains the Fed's primary concern. (See Figure 3). While rate increases are being priced in by market participants, our base case is that rates stay at current levels for some time, reinforcing a "higher-for-longer" environment.

Global central banks take divergent paths

Global central banks are balancing elevated inflation against slowing growth. In Japan, the central bank raised rates to 1.0%, the highest level in more than three decades, marking a meaningful step toward policy normalization after years of extremely low rates. The European Central Bank also shifted direction, raising rates for the first time since 2023 and revising its outlook to reflect slower growth and more persistent inflation. The Bank of England held rates steady despite some internal division, while policymakers in other developed markets emphasized a data-dependent path.

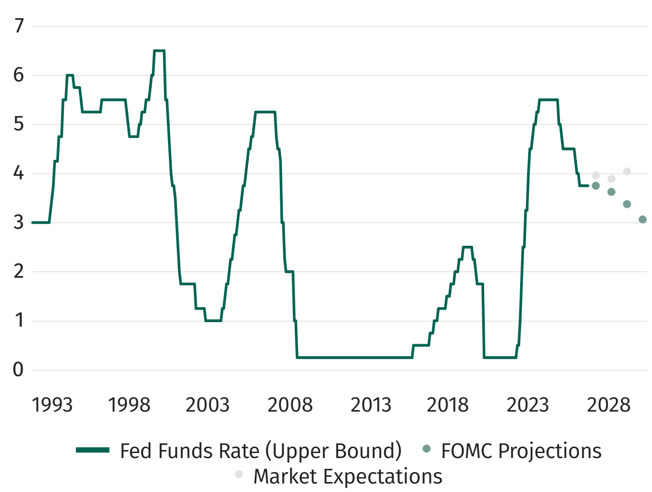
Should energy prices ease and inflation moderate, policymakers may face pressure to avoid overtightening. But should inflation persist, restrictive policy may need to remain in place longer. This tension raises the risk of policy missteps and keeps global central bank decisions central to the market outlook.

Global equities

U.S. equity markets

U.S. equities rallied in Q2 after a choppy first quarter. Earnings estimates climbed and AI hyperscaler spending plans increased, boosting the forecast for U.S. equity earnings growth. Leadership was narrow with information technology the only sector in the S&P 500 to outperform the broader index, as shown in Figure 4 (on the next page). From a style perspective, growth and momentum were favorable while semiconductors, memory and AI infrastructure related names were significant contributors to the performance of the IT sector. All the while, traditional value oriented segments of the market lagged. Small cap equities outperformed large caps as the Russell

Figure 3: Fed Funds Rate and Projections



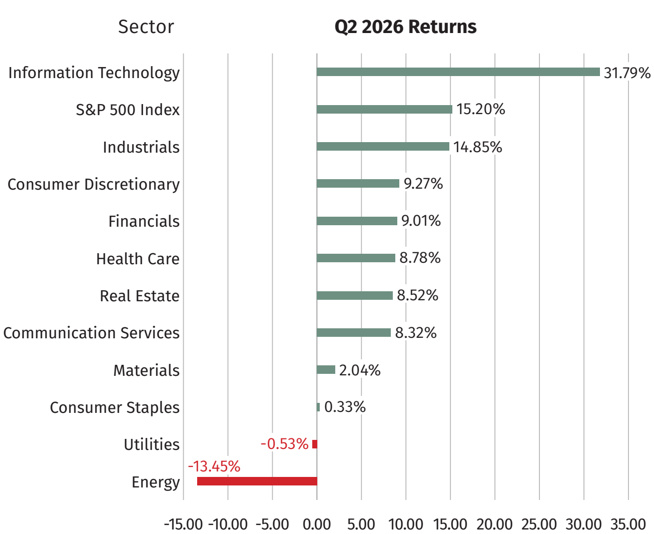
Sources: FactSet. Federal Reserve June 2026.

2000 index has meaningfully outperformed the S&P over the near term and trailing one year. The strong, broad performance of small caps reflects the undertone of increased risk appetite in the market, even with geopolitical and inflation headwinds. Still, Information Technology was the strongest performing sector within Russell 2000 reflecting the continued optimism for growth emanating from AI.

Earnings growth did the heavy lifting for U.S. equity investors. Q1 S&P 500 earnings grew 29%, well above the 13% expected. IT led, with semiconductors growing 55%. With hyperscaler capital spending now tracking near $738B for 2026, consensus estimates have moved meaningfully higher. The S&P 500 is now expected to grow earnings 23% in Q2, 27% in Q3, and 24% in Q4, for full-year growth near 24%. IT is the central driver of earnings growth contributing 47% to the projections.

Mid-cap earnings expectations for 2026 have been revised up to 17%, above the 14% pace expected at the start of 2026. This trend signals that profit participation is broadening. Small-cap estimates, by contrast, edged lower to 10%, leaving the recovery uneven beneath the headline and leading some to question its outperformance relative to large caps.

Figure 4: S&P 500 Performance by Sector



Source: FactSet, as of June 30, 2026. All index data in USD, Total Return.

AI spending is broadening beyond chips. Computer, memory, networking, power and data-center capacity all have a meaningful impact on the earnings picture as market leadership stayed tightly tied to that single theme. Forward valuations look more reasonable than the rally suggests, with the S&P 500 trading at 20.3x forward earnings versus its 20-year average of 16.4x. That comfort, however, reflects a strong cyclical step-up in earnings rather than a normalization in price. It supports current levels but sets a higher bar for what comes next. If spending plans slip or the earnings outlook weakens, leadership could shift quickly.

U.S. Equity Performance by Market Capitalization

Index	Q2 2026	Total Return YTD	Total Return Trailing 1 Year
S&P 500	15.20%	10.21%	22.32%
S&P 500 Value	8.00%	8.03%	18.40%
S&P 500 Growth	21.89%	12.01%	25.71%
S&P MidCap 400	14.47%	17.34%	25.89%
Russell 2000	21.49%	22.57%	40.78%

Source: FactSet, as of June 30, 2026. All index data in USD, Total Return.

We stay constructive on U.S. equities, but 24% expected earnings growth leaves little room to miss expectations. Earnings trends are supportive, and AI infrastructure demand should keep helping the names delivering results. With sector leadership narrow and earnings expectations this high, we prefer a selective approach over broad risk-on positioning. We are also rebalancing outsized positions where warranted as we believe the next phase of the AI ecosystem will depend more on execution.

International developed markets

International developed equities rebounded in the second quarter, though higher energy costs and tighter monetary policy kept returns behind U.S. markets. The MSCI EAFE NR USD returned 10.8% in Q2, lifting the YTD gain to 9.4%, as shown in Figure 5 on the next page. The quarter opened under strain as the Iran conflict sent Brent Crude briefly above $120/barrel. Eurozone headline inflation climbed from just above the ECB's 2% target to 3.2%, its highest in over a year. In addition, Eurozone Composite PMI slipped into contraction below 50, and 2026 GDP growth forecasts were cut. Sentiment reversed in mid-June once a U.S.-Iran framework agreement reopened the Strait of Hormuz, pushing European equities to fresh highs. At the same time, rate hikes to stem inflation from major central banks were seen as a headwind for their respective equity markets.

Figure 5: Performance of U.S. versus International

Index	Q2 2026	Total Return YTD	Total Return Trailing 1 Year
S&P 500	15.20%	10.21%	22.32%
MSCI EAFE	10.82%	9.44%	20.23%
MSCI EM	24.05%	23.85%	43.51%

Source: FactSet. All returns USD. EM and EAFE are Net Return.

Corporate earnings helped, but the recovery remained narrow and estimates moved opposite relative to U.S. markets. Q1 EPS growth for the MSCI EAFE finished at roughly 10% YoY, down from expected growth of 14% at the start of the quarter. Energy was the standout as profits surged by over 50% on elevated oil prices. Technology posted firm results, but sits at a much smaller index weight than in the United States. That leaves international without the same AI engine and keeps the earnings gap wide when compared to the U.S. Even so, defense spending, governance reform and Japan's exit from negative rates offer distinct return sources and useful diversification from U.S. AI concentration.

We stay constructive on international equities, but investors should expect a bumpier path. Lower relative valuations, the removal of the tariff threat under the new EU-U.S. trade agreement and improving shareholder returns provide support. Energy is still an overhang given the region's import dependence and vulnerability to renewed price spikes. Japan's policy normalization, while necessary, introduces new exposure to the yen and rate volatility that calls for monitoring. A durable resolution of trade and geopolitical overhangs would help. For now, the environment favors investing in quality names and focused secular themes rather than implementing broad regional exposure.

Emerging markets

Emerging markets delivered exceptional performance in the second quarter, led by Asia's tech-heavy benchmarks. The MSCI EM NR USD returned 24.1% in Q2, outperforming other broad measures of international and U.S. equity performance, as shown in Figure 6. Earnings were the story, driving returns higher while keeping price multiples stable. Q1 growth across Asia came in nearly 40% YoY, one of the strongest quarters in recent memory. Strong AI-related demand and firm results across the semiconductor complex led to the advance. Resilient economies and steady policy left the asset class better positioned than in prior cycles.

Emerging market central banks stayed cautious as higher fuel costs and a firmer dollar pressured emerging market currencies. That effort was complicated by a reversal in the U.S. dollar, which gained roughly 1.3% in the quarter after weakening earlier in the year. The combination of a firmer dollar and higher energy costs tested policy credibility across the region. Central banks that responded quickly generally saw currencies stabilize into quarter-end, creating a positive tailwind for returns in select countries.

Performance gaps between regions became more visible as the quarter progressed. North Asia led by a wide margin, with Korea and Taiwan benefiting from their leading position in the AI hardware supply chain, and

Figure 6: Performance of International Developed and Emerging Markets

Index	Q2 2026	Total Return YTD	Total Return Trailing 1 Year
MSCI EAFE	10.82%	9.44%	20.23%
MSCI Europe	10.93%	7.81%	18.64%
MSCI Japan	14.21%	15.78%	29.11%
MSCI United Kingdom	4.11%	6.21%	20.32%
MSCI Emerging Markets	24.05%	23.85%	43.51%
MSCI China	-6.63%	-14.97%	-4.94%

Source: FactSet. All returns USD and Net Return.

continued hyperscaler/CapEx momentum. Chinese equities drifted lower, as large-cap internet and IT companies faced high CapEx bills and a weak consumer. Those crosscurrents reshaped the benchmark itself. Taiwan and Korea now make up roughly half of the MSCI EM Index, with Taiwan surpassing China as the largest country weight for the first time in nearly two decades.

Calendar year 2026 earnings expectations have moved meaningfully higher, helped by the same narrow set of AI hardware names. June brought the first real test of the rally. Valuation concerns and event-driven catalysts triggered sharp selloffs and sent regional volatility higher. The memory upcycle appears rooted in real end demand and should continue to reinforce earnings across the semiconductor complex. The more important question is whether leadership can broaden beyond hardware.

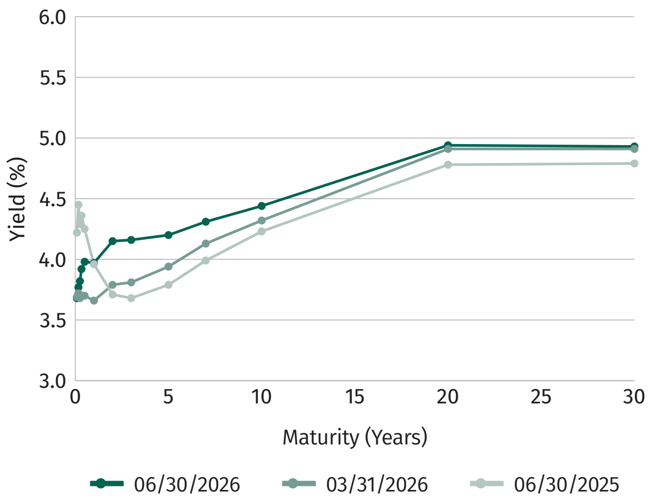
The emerging market opportunity is attractive, but selectivity matters more after the strong rally. A friendlier commodity backdrop, improving earnings and steadier investor flows provide support. Offsetting those tailwinds are a firmer dollar, hawkish global central banks and increasingly concentrated index leadership. We favor countries with credible policy frameworks and individual names with clear earnings growth rather than taking broad index exposure.

Fixed income

Fixed income markets delivered modest but positive returns in Q2, navigating a complex environment shaped by steady economic growth, persistent inflation concerns and a more cautious tone on inflation from the Fed. Interest rates moved higher overall, particularly at the shorter end of the yield curve, reflecting expectations that policy rates may remain elevated for longer.

Yields on shorter-term U.S. Treasury securities rose meaningfully, with the largest increases seen in the one- to five-year range. (See Figure 7.) In contrast, longer-term yields were relatively stable and, in some cases, moved slightly lower. This dynamic resulted in a flatter yield curve, a pattern that often reflects a market balancing near-term inflation risks against expectations for slower growth over time.

Figure 7: Change in U.S. Treasury Yield Curve



Source: FactSet, as of June 30, 2026.

The broad fixed income market posted a positive return as the Bloomberg U.S. Aggregate Bond Index gained 0.67% bringing its YTD return to 0.62%, as shown in Figure 8 on the next page. Within that, U.S. Treasury securities lagged somewhat, as rising yields in the front end of the curve weighed on performance. Treasury Inflation-Protected Securities (TIPS), which are designed to help guard against inflation, held up better and slightly outperformed traditional government bonds.

Spread sectors were a key source of strength for taxable fixed income markets. Both investment-grade and high-yield corporate bonds outpaced the broader market, supported by improving investor confidence and solid corporate fundamentals. Stronger-than-expected economic data and resilient company earnings helped narrow credit spreads, which boosted returns even as interest rates moved higher.

Figure 8: Fixed Income Market Performance

Index	Q2 2026	Total Return YTD	Total Return Trailing 1 Yr
Bloomberg U.S. Aggregate Bond	0.67%	0.62%	3.79%
Bloomberg Municipal 1-10 Blend 1-12	1.34%	1.11%	4.48%
Bloomberg U.S. Treasury TR	0.32%	0.28%	2.71%
Bloomberg U.S. Treasury TIPS	0.89%	1.15%	3.42%
Bloomberg U.S. Corporate Bond	1.40%	0.86%	4.34%
Bloomberg High Yield Corporate	2.47%	1.96%	5.91%
FTSE WGBI Non-USD	0.96%	-0.82%	-2.08%

Source: FactSet. All Index data is USD TR

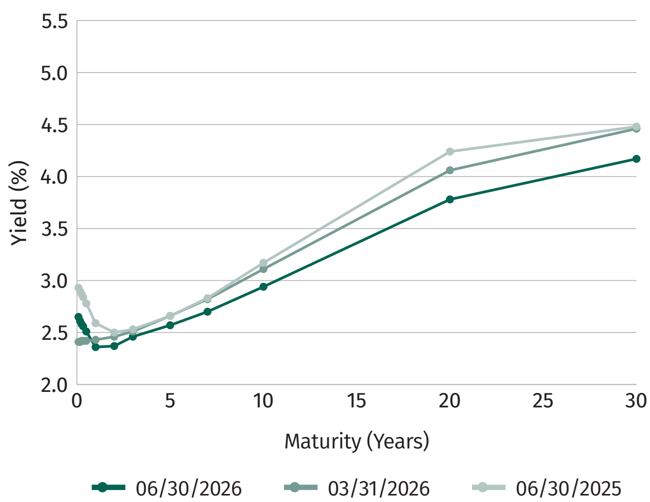
Leveraged loans generated positive returns, though they trailed high yield bonds. While loans tend to be less sensitive to interest rate changes, performance was held back in part by exposure to sectors such as software, where results have been mixed. Meanwhile, mortgage-backed securities delivered another steady quarter, outperforming Treasuries but lagging corporate credit.

A strong quarter for municipal bonds

Despite a challenging environment that included rising inflation concerns, heavy new bond issuance and seasonal tax-related selling pressure, the municipal market generated returns which outpaced most other sectors. The Bloomberg Municipal Index** returned 2.50% during the quarter, bringing its YTD gain to 2.32% and trailing 1-year total return to 7.03%, outpacing several sectors of the investment grade market.

One of the more notable developments within fixed income markets was the divergence between municipal bonds and U.S. Treasuries. While Treasury yields generally moved higher as investors adjusted expectations for inflation and Fed policy, municipal bond yields moved lower across much of the curve, as shown in Figure 9. This unusual pattern was driven largely by strong investor demand for tax-exempt income. Demand from individual investors, mutual funds and separately managed accounts remained healthy and was sufficient to absorb a significant amount of new issuance entering the market.

Figure 9: Change in U.S. Municipal Yield Curve



Showing S&P AAA Municipal Index
Source: FactSet, as of June 30, 2026.

Looking ahead, the balance between supply and demand will likely be the key driver of municipal market performance. New issuance is expected to remain elevated as state and local governments continue to finance infrastructure projects and refinance existing obligations. Continued investor demand and credit quality will set the pace for municipals from here; we expect both to support positive returns.

Outlook

The economic backdrop continues to support a focus on high-quality fixed income that emphasizes income generation, rather than relying on falling interest rates. Periods of uncertainty around policy can also create opportunities. We anticipate there may be opportunities to capitalize on mispricing through tactical shifts when markets overreact to headlines.

Overall, the second quarter reinforced the importance of maintaining an allocation to fixed income within a broader portfolio. While rising rates created headwinds for some segments, income generation and improving credit conditions

**The Bloomberg Municipal Index is a flagship benchmark for the overall U.S. long-term tax-exempt municipal bond market.

supported returns. With rates likely to stay elevated, we favor high-quality bonds for reliable income — and keep enough flexibility to move when the market overreacts.

Alternatives

Alternatives delivered constructive results in Q2, supported by improving realizations in private markets, resilient credit fundamentals and steady performance in real assets. As the "higher for longer" environment persists and public market leadership stays narrow, alternatives continue to play an important role in diversified portfolios by expanding the opportunity set and potentially reducing downside risk during periods of public market stress. Within private market strategies, we currently see attractive opportunities across private equity, with secondaries as a particular area of emphasis. Within private credit, asset-based lending is an area of interest. At the same time, we expect selectivity across managers and strategies to remain the primary driver of results in the quarters ahead.

Real estate

U.S. REITs delivered strong Q2 results, supported by a more stable economic backdrop and solid property fundamentals. The FTSE Nareit All Equity REITs Index returned 10.73% for the quarter, lifting YTD gains to 14.90%. (See Figure 10.) Performance was broad-based, with 11 of 12 REIT sectors posting positive returns. Lodging/resorts led at 36.30%, followed by office at 34.71% and specialty at 19.62%. Infrastructure was the weakest sector at -3.13%, followed by timber at 0.29% and industrial at 5.70%.

The strength within the sector was notable given elevated interest rates, which typically pressure borrowing costs and valuations. However, conservative balance sheets, lower leverage, more fixed-rate debt, and longer maturities helped limit the impact. Resilient occupancy, steady rental income, and disciplined cost management also supported cash flows. In short, REITs earned their place — as steady income and real diversification — while the economy split along K-shaped lines.

Figure 10: Public Real Estate and Commodity Performance

Index	Q2 2026	Total Return YTD	Total Return Trailing 1 Year
FTSE Nareit All Equity REITs	10.73%	14.90%	15.43%
Bloomberg Commodity	-8.08%	14.36%	25.46%

Source: FactSet. All Index data is USD TR.

Commodities

Commodity markets were driven by Iran-related supply disruptions in Q2. Prices surged early as the conflict stretched beyond 100 days, then pulled back after tensions eased as the U.S. and Iran reached a memorandum of understanding. By quarter end, the Bloomberg Commodity Index was down 8.08%, leaving its YTD return at 14.36%, as shown in Figure 10.

Performance was mixed across sectors. Four of six declined, with only soft commodities and industrial metals posting modest gains of 3.91% and 1.94%, respectively. At the index level, precious metals and energy fell the most, down 14.89% and 13.35%, underscoring a market driven more by supply disruption and geopolitics than synchronized global demand.

WTI and Brent Crude fell 31.45% and 29.83%, respectively, returning near pre-hostility levels but remaining above January lows as shipping routes began reopening and geopolitical risks moderated. Precious metals also weakened, with gold and silver down 13.68% and 20.02%, respectively. Higher interest rates reduced the appeal of non-income-producing assets, while a stronger U.S. dollar further pressured global demand.

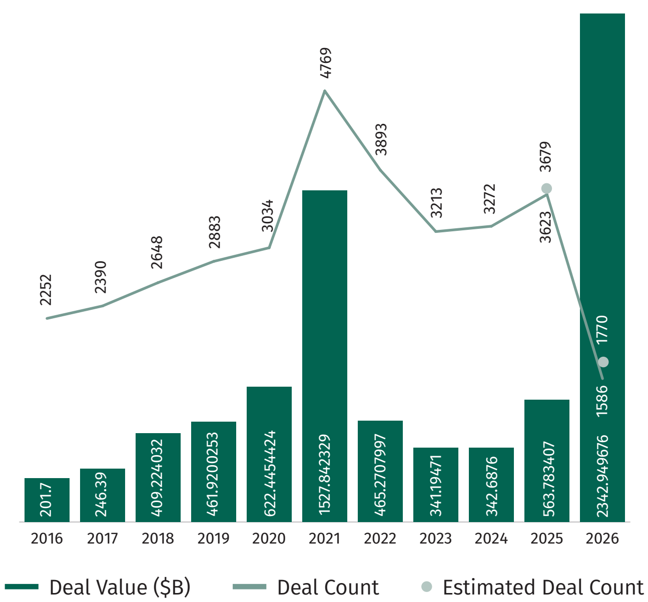
These trends highlight a shift in how commodity markets are behaving. Rather than moving in response to broad-based economic growth, prices are increasingly shaped by supply-side disruptions and geopolitical events. While energy markets continue to dominate headlines, the more significant changes are happening across the broader commodity system, where inputs, trade flows and production dynamics are becoming more fragmented.

Private equity

Private equity results split sharply in H1 2026. Overall inflows into the market are positive, but capital continues to concentrate in fewer, larger funds. Exit values reached record levels, although the totals were driven by a small number of large firms while overall deal count lagged. Near-term, tailwinds from a resilient U.S. economy remain intact, offset by uncertainty around energy prices, geopolitics, and consumer disparities.

The more important story, however, is long-term potential upside, and the second quarter may prove to be a harbinger of what lies ahead (see Figure 11). June's large-scale SpaceX IPO was successfully absorbed by public markets, and additional high-profile listings from names such as Anthropic and OpenAI could follow. Beyond these headline names sits a long list of maturing private companies. We expect the IPO window to open more broadly, pulling exit horizons forward across private equity and venture capital portfolios, potentially driving a rising tide of realizations over the next several years.

Figure 11: Deal value is up, but number of deals is still well below peak



Source: Pitchbook June 2026

We stay constructive on private equity broadly, with a particular emphasis on secondaries. Shortening exit timelines should boost internal rates of return for these funds, while managers are still able to acquire mature assets at attractive prices from primary investors seeking liquidity. Pre-IPO funds, which focus on later-stage companies whose paths to public markets may be accelerating, are another area we view favorably.

Private credit

Private credit news abated in Q2 following a more turbulent Q1 when direct lending strategies came under scrutiny amid investor withdrawals from prominent funds. Redemption pressure is likely to persist for the impacted managers, though underlying credit fundamentals remain stable in aggregate. Interest income continues to be attractive, non-accruals remain well below historical averages, and spreads have widened only modestly.

Our outlook for direct lending is neutral, as we anticipate meaningful dispersion across managers in how well redemption pressure is managed. Our base case is that direct lending continues to provide stable yield, though we remain vigilant for signs of broader weakness.

We are more enthusiastic about opportunities in asset-based lending given its broad scope. ABL's range spans corporate and consumer borrowers secured by hard assets such as equipment, aircraft, infrastructure and real estate. For investors seeking diversified sources of premium yield beyond direct lending, we view this as one of the more compelling areas within private credit today.

Private real assets

Private real estate continues to see muted but positive performance, with the U.S. market posting its seventh consecutive quarter of positive returns. Valuations have ticked up gradually from 2024 trough levels, but returns are still driven primarily by operating income. Revaluation remains a longer-term story rather than a near-term rebound.

Dispersion across markets and property types remains wide. Net operating income growth is near zero in some sectors including office and apartments, stable in retail, and increasing in data centers. Manager insight emphasized the need for selectivity, favoring high-quality assets supported by secular demand tailwinds. From our perspective, the outlook for real estate is improving and we are monitoring select opportunities.

Infrastructure tailwinds continue to build. Beyond data centers, which are attracting significant investor attention amid burgeoning demand, there is a growing need for capital across the energy systems that power them, spanning traditional and alternative sources. We view infrastructure as an increasingly important source of long-duration cash flow and inflation-sensitive return.

Hedge funds

Hedge funds performed well in the first half of 2026, posting mid-single-digit gains that compared favorably to a balanced public market portfolio. The positive performance demonstrated hedge funds' ability to deliver returns during periods of market volatility, though the bulk of the upside was generated in months when equity markets rallied. Notably, hedge funds rebounded sharply in April alongside public equities, their second strongest month in more than 15 years.

Strategy-level results were mixed. Equity-oriented strategies including hedged, long-biased and event-driven led performance, while select macro strategies also delivered. We remain interested in macro funds as long-term diversifiers that tend to perform well when other asset classes are challenged. Looking ahead, we expect hedge funds as a group to see mixed success reflecting their underlying diversity, with a base case of modest positive returns.

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