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Global Mid-Year Outlook 2026

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Overview

US dollar weakening, steepening yield curves in developed markets, and a narrowing gap between US and non-US equity market performance may define the years ahead.

United States

Underlying weakness

- AI-driven tailwinds continue to prop up US equity market performance, but the country's underlying economic strength is questionable.
- Job market uncertainty and the fragility of the K-shaped economy could pose significant risks to growth.
- Consumer demand may soon come under pressure as lower-income households lose spending power.

China

Government reform needed

- The housing crisis remains unresolved, anchoring consumer confidence near record-low levels.
- China's export engine has become a key driver of growth as domestic consumption lags behind growth in industrial production.
- As China's own K-shaped economy becomes increasingly fragile, I do not expect the economic outlook to improve without meaningful government intervention.

Eurozone

Defense-driven stimulus

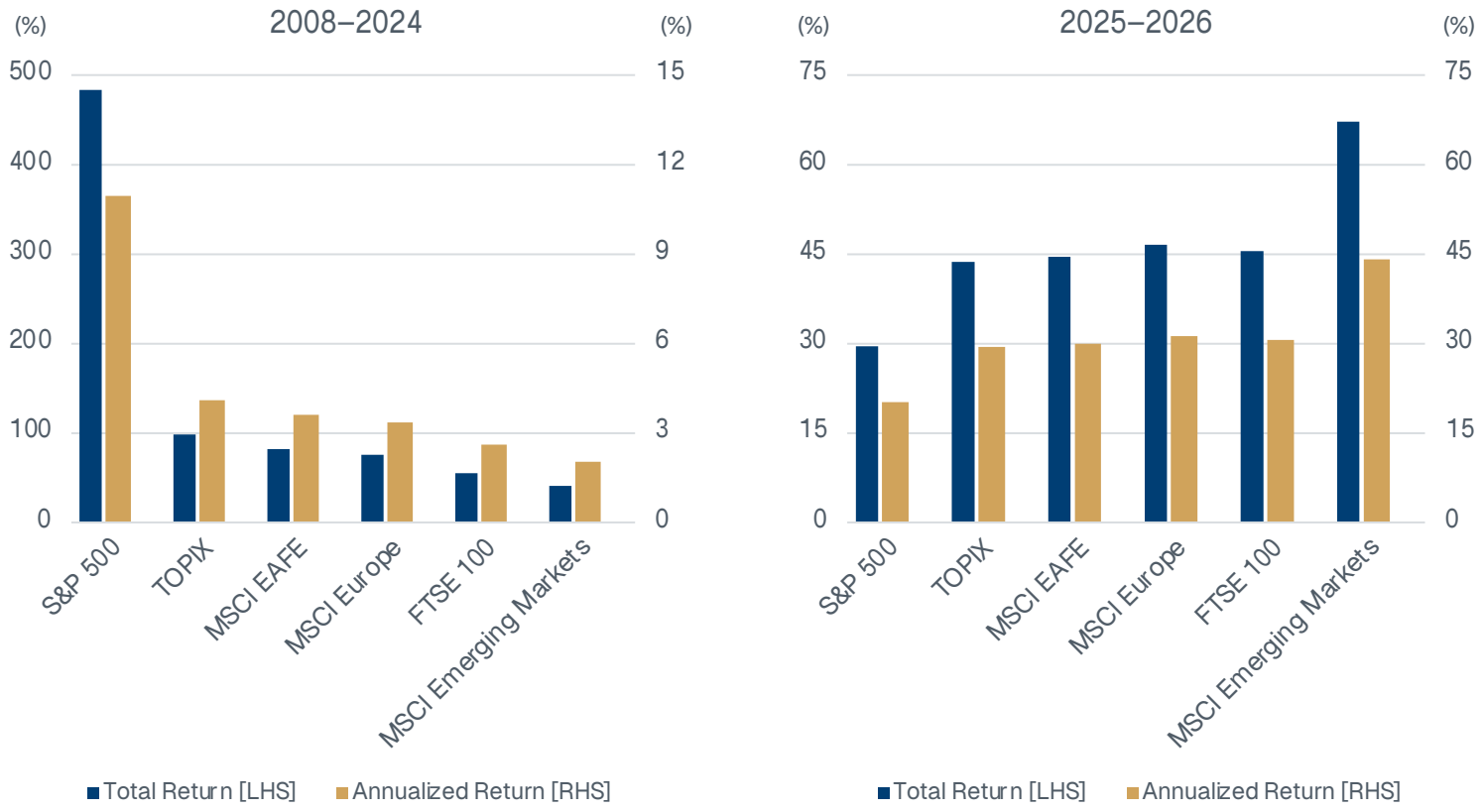
- Iran-related energy price surges hit Europe harder than other regions, temporarily derailing optimism over its economic revival.
- But as energy prices normalize and inflation subsides, real wages are likely to grow, lifting consumer confidence and spending.
- Increased defense spending will likely boost industrial activity in the near term; over time, it could drive technological innovation and productivity growth.

Japan

Policy normalization

- The Bank of Japan will likely continue raising rates to help tame inflation.
- Prime Minister Sanae Takaichi remains focused on relieving inflationary pressures on households.
- Ongoing corporate governance reforms should continue to boost returns on capital for select Japanese companies.
- Rising Japanese Government Bond yields could have significant implications for the global investment landscape.

The Gap Between US and non-US Equity Market Performance Is Narrowing

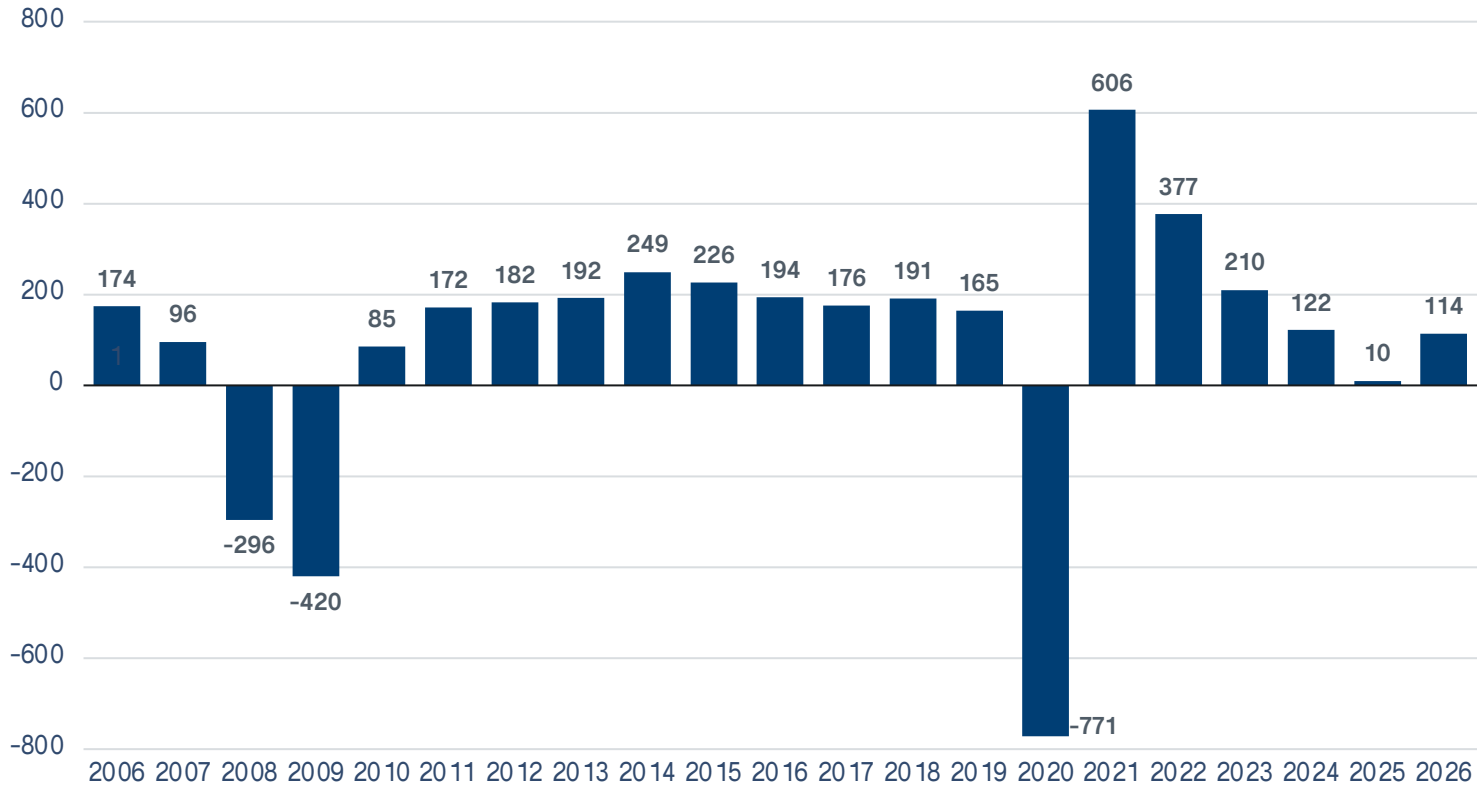


- For more than 15 years, S&P 500 returns far outpaced those of non-US indexes.
- The tables have turned since the beginning of 2025, with non-US markets significantly outperforming the S&P 500.
- I expect non-US relative performance to remain competitive as investors re-think their outsized US asset exposure—and as non-US regions like emerging markets and Japan offer improved earnings growth.

As of 28 May 2026
Left chart covers 4 January 2008 to 30 December 2024. Right chart covers 30 December 2024 to 28 May 2026.
Source: Bloomberg

Payroll Growth Has Improved Significantly, but Job Market Stability Is Questionable

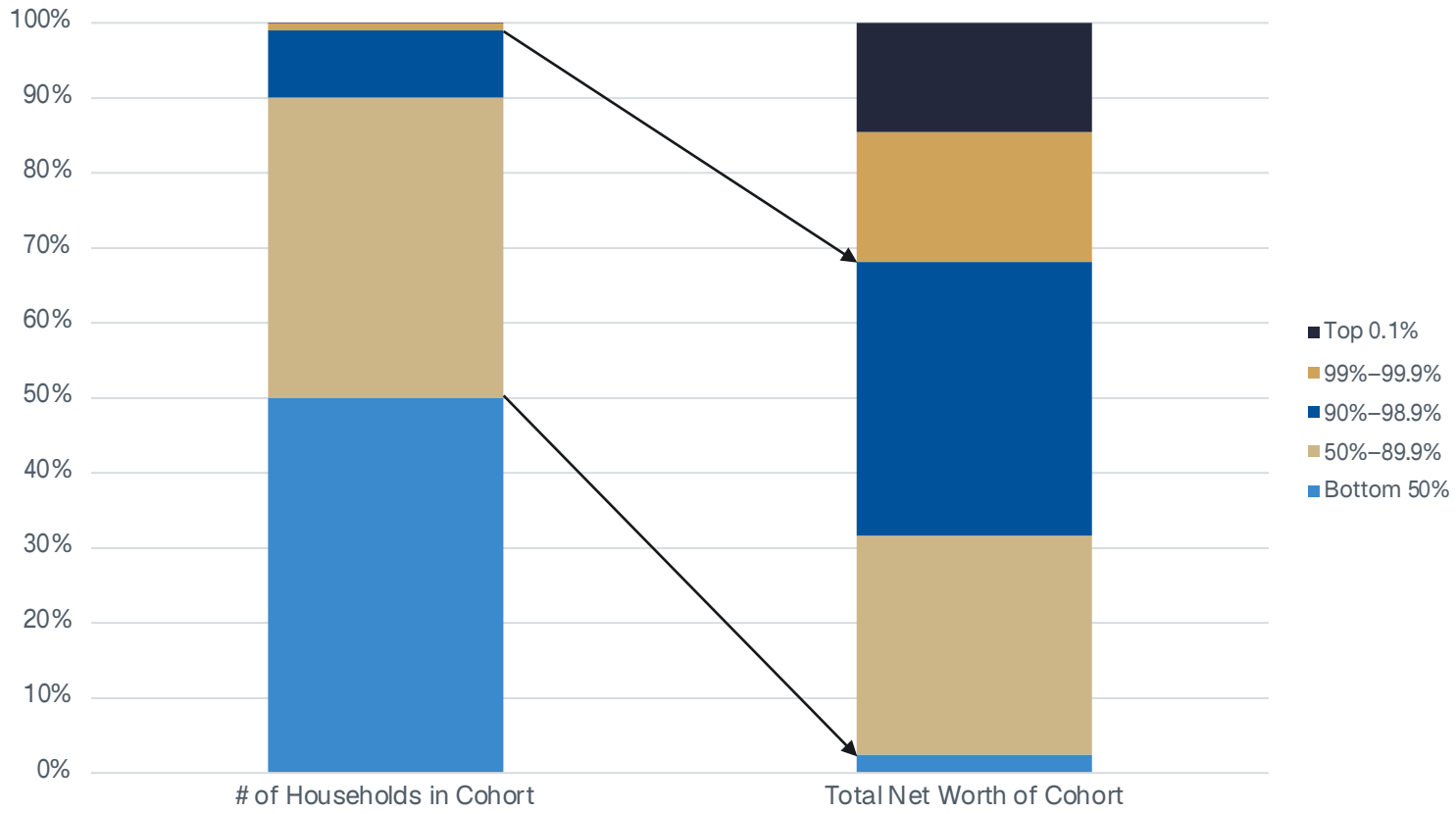
Average Monthly Nonfarm Payroll Growth (Thousands)



- Job growth in 2026 improved significantly relative to 2025, but the outlook for overall labor market stability is not encouraging.
- The breakeven rate between nonfarm payroll growth and a stable unemployment rate has decelerated, but it is not clear to what degree.
- AI automation was cited as the top driver of job cuts from March to May, and workers fearful of displacement are unlikely to demand higher wages or switch jobs.

As of May 2026
Source: Bureau of Labor Statistics, Haver Analytics

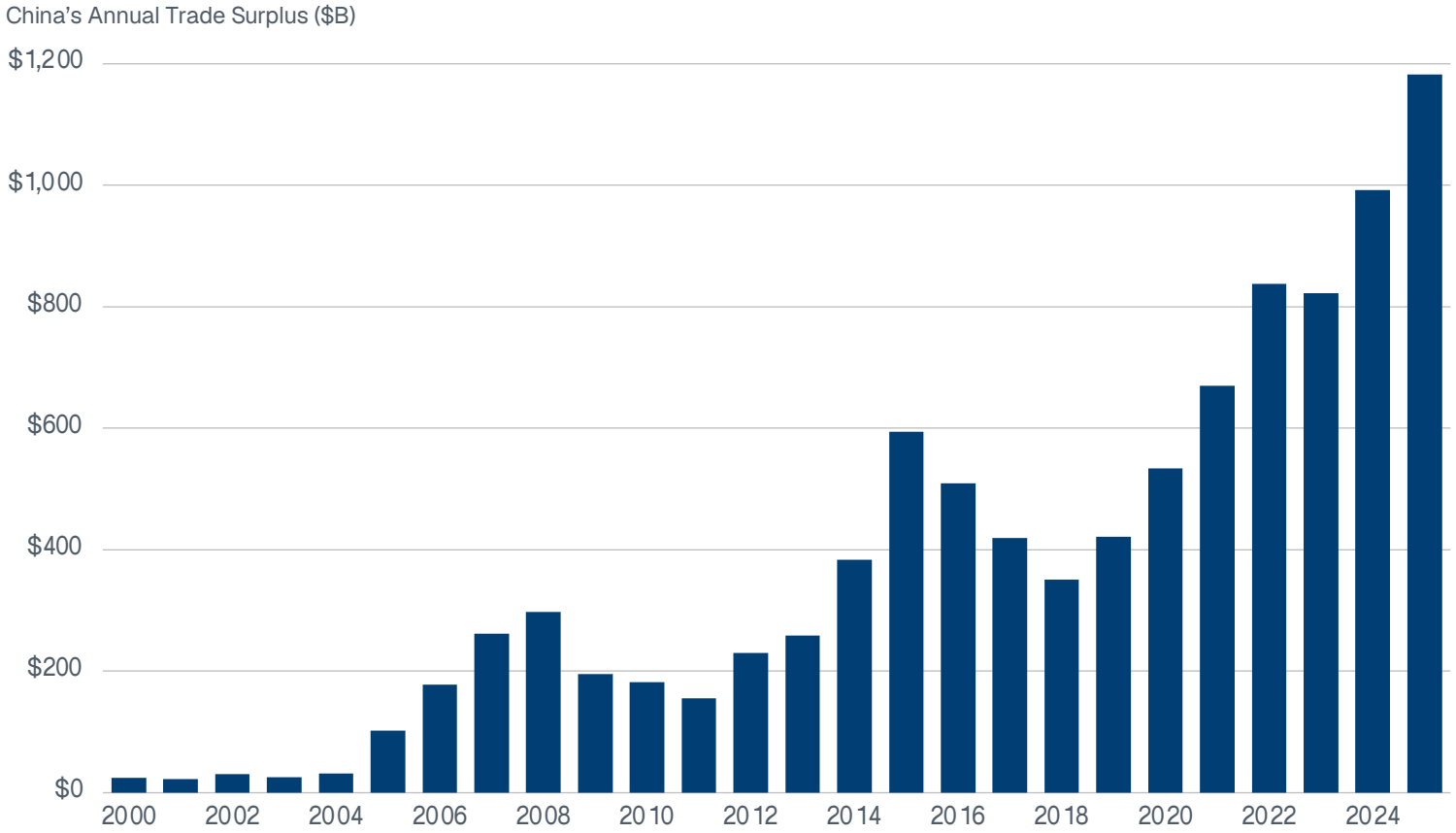
The K-Shaped Economy Poses a Threat to Economic Growth



- The K-shaped economy looks increasingly fragile, with the top 1% of households having 13x the net worth of the bottom 50%.
- High-net-worth households have driven a disproportionate share of retail spending in recent years,[1] while Americans on the lower part of the "K" continue to lose spending power.
- If the cost of living continues to rise while AI-related job cuts worsen, we could have a recipe for consumer retrenchment.

As of December 2025
LHS of chart approximates the total number of households in millions. RHS represents each segment's total net worth.
Source: Lazard, Federal Reserve, Haver Analytics
1. Explaining the K-Shaped Economy: What's Behind the Divide? and Tracking the K-Shaped Economy: Who's Driving Spending? (Liberty Street Economics, part of the Federal Reserve Bank of New York)

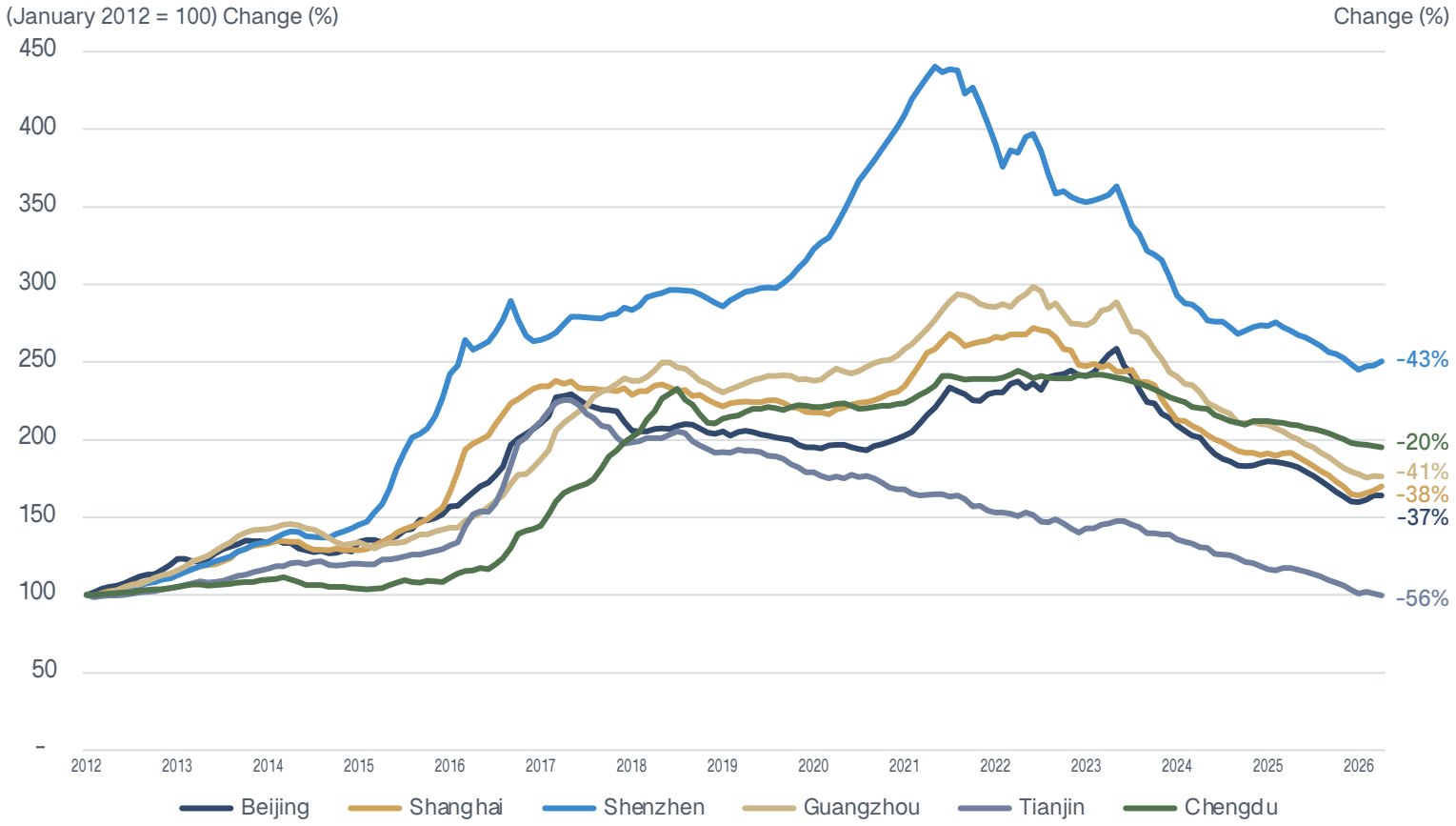
China's Trade Surplus Has Reached $1.18 Trillion—but Domestic Demand Is Lacking



- In recent months, industrial production has grown by 4%–6% year over year, while May retail sales fell year over year for the first time since the COVID pandemic. China has increasingly relied on exports to absorb the excess supply of goods.
- This export engine has become an increasingly important growth driver, accounting for approximately 33% of real GDP growth in 2025—the highest level since 1997.
- With trade tensions between China and Europe likely to escalate, China could be left with fewer options to export excess production.

As of December 2025
Source: China Customs General Administration, Haver Analytics

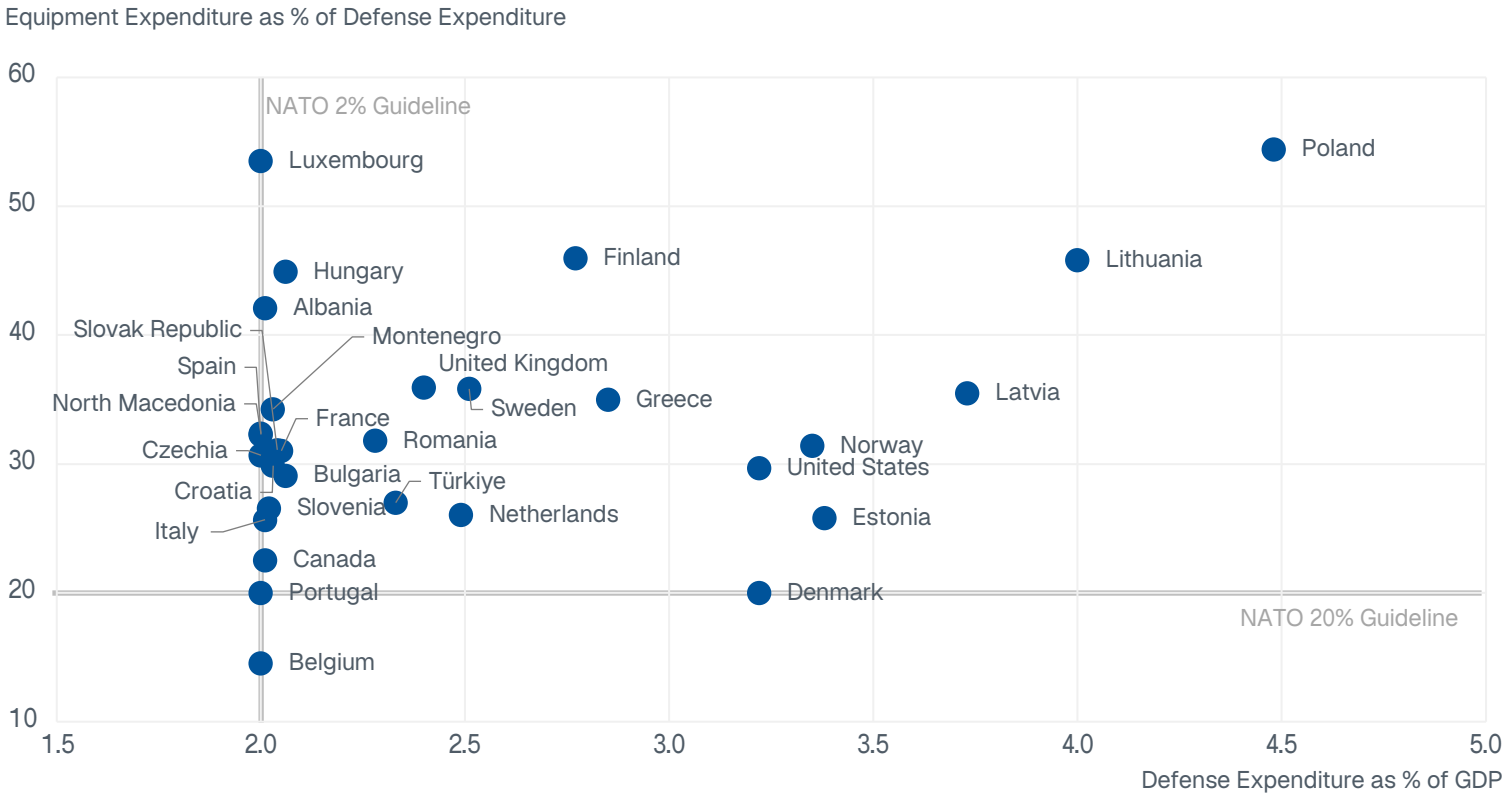
Private Sector Housing Data Suggest Sharp Home Price Declines



- Prices for previously occupied homes have declined anywhere from 20% to 56% across China's top six cities.
- Given that the median household in China has about 60% of its assets invested in housing, these declines weigh heavily on consumer confidence, which remains near record-low levels.
- Against this backdrop, the lack of structural reform on the part of the Chinese government remains my top concern.

As of April 2026
Source: Centaline, Morgan Stanley

Europe Could Benefit from Increased Defense Spending



- A bright spot for Eurozone growth is the increase in defense spending, which can absorb underutilized industrial capacity in the near term.
- Longer term, rising defense and related infrastructure spending can increase technological innovation and drive productivity growth.
- Non-US NATO defense spending rose 37% in real terms from 2023 to 2025. Going forward, spending could more than double from current levels to over $1 trillion over time if members comply with commitments to spend 5% of GDP on defense and related infrastructure.

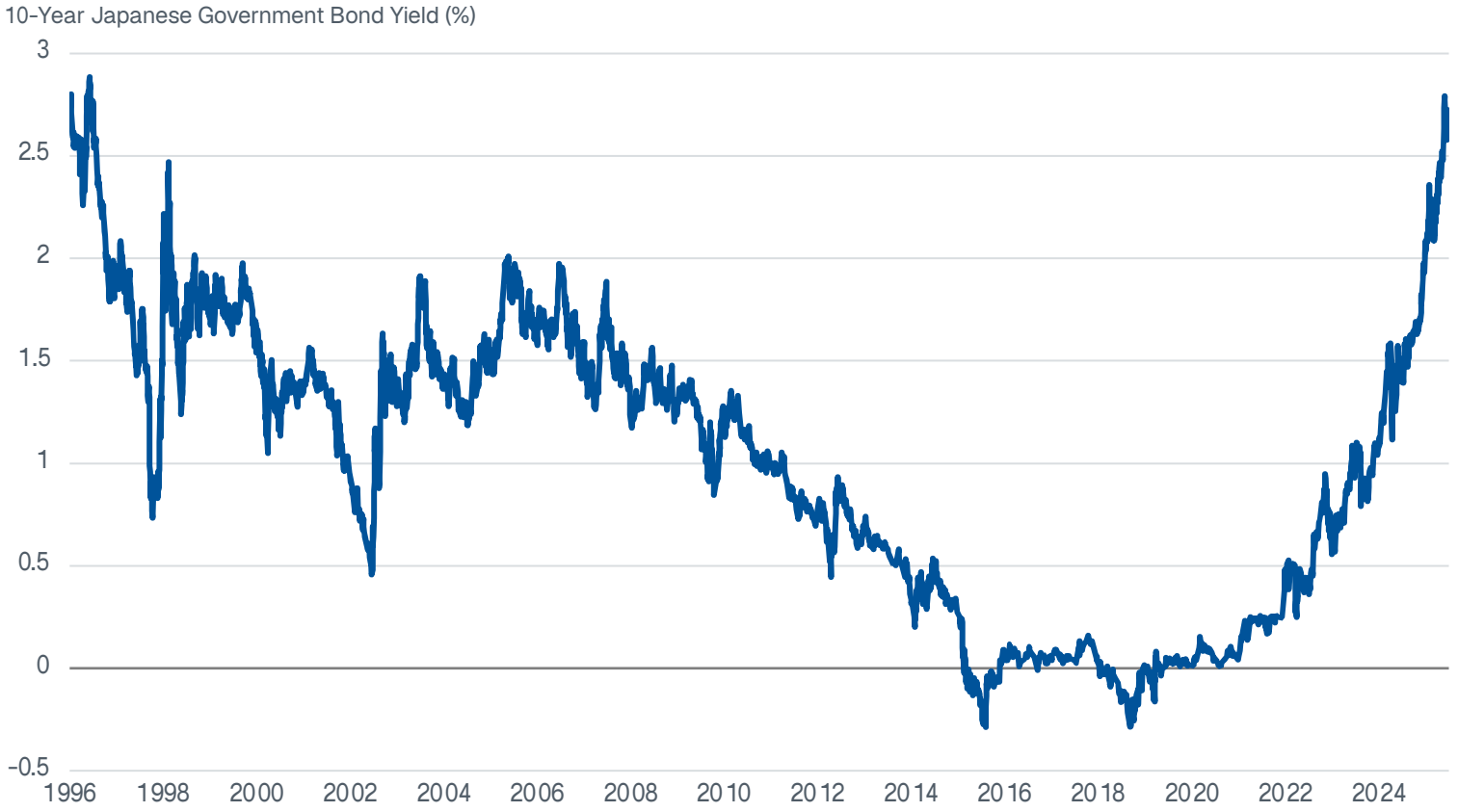
As of 3 June 2025

Figures are based on 2021 prices and exchange rates. Figures for 2025 are estimates. For those Allies that have national laws or political agreements that call for 2% of GDP or more to be spent on defense annually, but that did not declare figures for 2025, it has been assumed that they spent 2% of GDP on defense.

* Denmark has declared that it has allocated more than 20% of defense expenditure to major equipment.

Source: Lazard Geopolitical Advisory

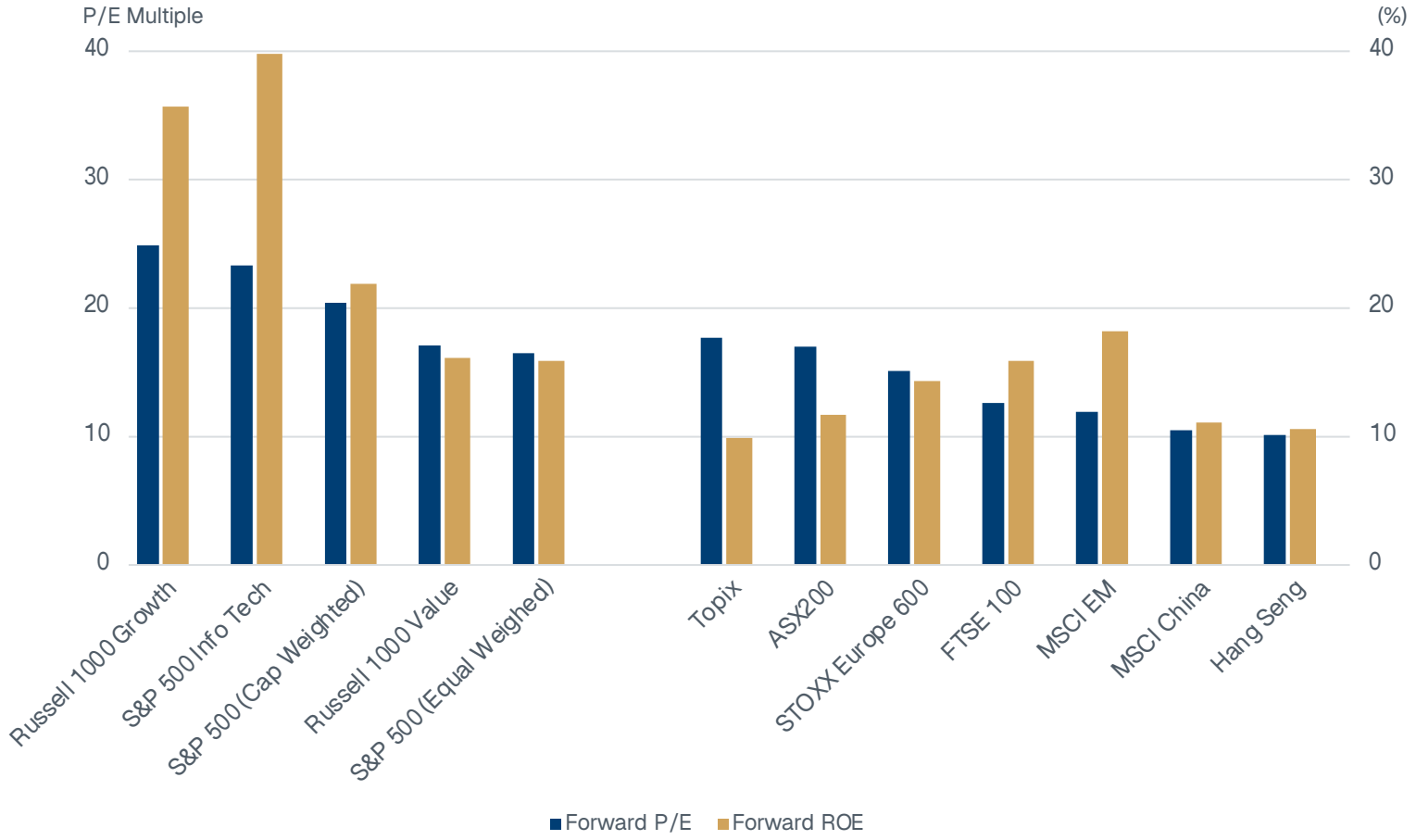
Japanese Government Bond (JGB) Yields Could Be a Catalyst for Developed Markets Curve Steepening



- For decades, JGBs offered some of the lowest yields globally—but this is changing as inflation and interest rate expectations normalize.
- JGB yields could soon reach levels that entice Japanese investors to repatriate capital that was previously invested in overseas markets to domestic alternatives.
- If this happens for a sustained period, it could upend decades of investment logic—potentially driving yen strengthening and yield curve steepening outside of Japan.

As of 22 June 2026
Source: Lazard, Bloomberg

Though Expensive, US Equities Have Delivered Higher Returns on Capital than Other Markets



- Some drivers of US outperformance may be fading in global markets—but this is not a call to short US equities.
- While US equities remain expensive relative to global peers, they also continue to offer higher returns on capital compared to markets.
- A key question going forward is whether the biggest underlying driver—AI enthusiasm—can deliver on its promises.

As of 22 June 2026
Source: Bloomberg

Investment Implications

AI skepticism, a weakening US dollar, and broader macroeconomic uncertainty could drive new risks and opportunities for investor portfolios.

Equities

- As investors seek diversification beyond US equities, I expect to see more interest in emerging markets (EM) and Japanese equities.
- EM equities offer a more diverse set of earnings growth drivers across sectors and countries at lower valuations than US equities—while not sacrificing AI exposure.
- Select Japanese equities offer strong return prospects due to ongoing corporate governance reforms and policy support for domestic consumption.

Fixed Income

- Rising fiscal deficits in the United States, Europe, and Japan could lead investors to demand higher term premia for bonds with longer maturities, leading to steepening yield curves.
- Investors will increasingly seek alternative safe-haven assets in more fiscally prudent developed markets and in emerging markets.
- Many EM countries offer lower debt-to-GDP ratios, more orthodox monetary policies, and FX appreciation potential.

Alternative Assets

- With traditional safe havens in question, real assets could gain traction.
- Infrastructure assets that offer contractual pricing power and inflation-fighting characteristics are particularly appealing.
- Convertible arbitrage strategies are another strong contender as they can monetize volatility using a variety of tools.

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