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Investment Perspectives

August 2026

Welcome to our summer edition of *Investment Perspectives*. Much of the turbulence that characterised the first quarter has continued, with heightened geopolitical and market volatility amid the ongoing US-Iran conflict.

Despite this instability, it was a strong second quarter for 'risk' assets, as concerns around global growth and rising inflation faded. A strong earnings season for technology behemoths and easing inflation expectations supported both equity and credit markets. The FTSE All-World Index rose 15.2% in Q2, while credit spreads tightened towards historically low levels.

Against this backdrop, we're sharing a handful of our latest investment ideas to guide you through the second half of the year.

Here's what's lined up in this edition:

Active versus passive equities – Andrew McCollum, investment research analyst, discusses the respective merits of active and passive equities, exploring how to build a resilient portfolio.

Private equity mid-year outlook – from our research team, Asad Rashid and Daniel Boulton-Jones give a forward-looking perspective on the key themes in private equity markets.

Questions to ask your impact manager – senior RI consultant Sanjay Joshi outlines some big questions asset owners can pose to impact managers in an environment increasingly focused on sustainability objectives.

Capital markets update – our capital markets team look at Q2's market drivers and give their medium-term outlooks on government bonds, credit, equities and property.

Fireside chat – this quarter, we're sitting down with our Head of Charities, Endowments and Foundations, Chris King.

Contacting us

As always, we're eager to hear how we can help you achieve the best investment outcomes for your pension scheme members. Please get in touch for a one-to-one conversation on any of the themes raised in our articles.

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Engaging with markets: active versus passive equities

Active and passive equity strategies are two fundamentally different ways of engaging with markets. Passive approaches aim to capture market returns by tracking an index, offering exposure to market beta at low cost and with minimal intervention. Active management seeks to outperform the market through security selection, top-down views or both, on the basis that markets are not fully efficient and that mispriced opportunities can be exploited. For the purposes of this discussion, we're referring to market-cap passive equities, rather than systematic/alternative index-based approaches.

Over time, indices have become more than just tools for implementation. They now shape how investors understand markets, allocate capital and judge performance – a role reinforced by the rapid growth of passive investing. Passive strategies now account for more than half of global equity mutual fund and exchange-traded fund (ETF) assets, up from around 25% in 2012.[1]

Higher demand for low-cost alternatives drives demand for passive strategies

Strong passive performance over the past two decades has influenced the decline in active strategies' popularity. But this decline also reflects deeper structural changes in the investment landscape. The shift from defined benefit (DB) to defined contribution (DC) schemes has transferred investment responsibility from trustees to individuals, increasing demand for straightforward, low-cost options. At the same time, ETFs emerged as a more transparent, liquid and tax-efficient alternative to traditional mutual funds, enabling investors to sidestep the higher-fee, less transparent model often associated with active management. The rise of digital brokerage platforms has made it easier for retail investors to build diversified portfolios using low-cost ETFs, by lowering costs and barriers to entry.

Changing market dynamics

The increased use of passive investing has important implications for market mechanics, as capital flows play a growing role in shaping prices. As more capital tracks market-cap-weighted indices, flows become increasingly aligned with recent winning stocks, reinforcing momentum and strengthening leadership by the largest names. It also means share prices move more in tandem, reducing the influence of company-specific fundamentals on relative valuations.

By design, passive investing reflects the market as it stands, including its valuations, sector biases and stock-level concentration. In contrast, active strategies offer the flexibility to deviate from the index, whether to manage risk, exploit inefficiencies or build more balanced portfolios. Although this can be valuable and offers active managers the opportunity to add alpha, it comes with higher fees.

How have active funds performed?

Active mandates are ultimately judged on whether they can justify higher fees by delivering alpha (outperformance of the relevant market index) over the long term, while staying true to their specific investment style. In practice, consistently outperforming market indices has proved challenging. Our research[2] on global large-cap equity funds suggests that, since the turn of the century, only around half of global active funds have outperformed broader global indices in any given year (gross of fees). More recently, the picture has deteriorated: in the first 16 years, roughly 60% of funds beat the indices in a typical year, compared with closer to 40% over the past decade. Across our sample, the average shortfall in years of underperformance was slightly larger than the average excess return in years of outperformance. As a result, relatively few funds delivered consistent alpha over time, with only around 30% of active funds beating the indices over five- and 10-year periods. Net of fees, this performance would be lower still. Our equity researchers can provide the market insight and expertise to help trustees make well-considered decisions.

[1] Passive Investing Continues to Grow – Apollo Academy

[2] Source for this research: eVestment

> Our research suggests active managers have been significantly more effective at limiting downside than keeping pace in strongly performing, concentrated markets.

Are active managers better at limiting risk in falling markets than participating in gains?

Rising market concentration has posed a significant challenge too. Index returns are increasingly driven by a narrow group of very large companies. Because market-cap-weighted indices automatically allocate more to these stocks as they rise, passive strategies have benefited disproportionately, and active portfolios have struggled to keep pace. But our research suggests active managers have been significantly more effective at limiting downside than keeping pace in strongly performing, concentrated markets. Looking at average returns over the past decade, only around a quarter of funds outperformed global indices during rising markets. By contrast, in falling markets, almost the entire active sample outperformed global indices.

The changing fortunes of growth and value stocks

We also found noticeable differences in performance within the sample between different investment styles. Growth-oriented funds beat the 10-year return of global indices around half the time, while fewer than 10% of value-oriented funds did the same. However, when judged against style-specific benchmarks, the picture changed materially, with the active value sample performing much better relative to global value indices than the growth sample did against global growth indices. This is consistent with the idea that recent market leadership, and the concentration of returns in a narrow group of large growth stocks, has shaped the ability of different styles of active management to beat broad market indices.

Looking at index performance, leadership between value and growth has swung sharply over time. Value dominated from 1996 to 2006; only the final years of the dot-com boom broke that trend, as growth surged in 1998 and 1999. That proved short-lived. When the bubble burst, the reversal was stark – global growth indices fell by around 25% in 2000, while global value indices were broadly flat. In recent years, the balance has flipped. Since 2017, growth has comfortably led, with annual returns of around 18% compared with 10% for value.

Mixed medium-term performance

We noted earlier that only around 30% of active funds beat global indices over five- and 10-year periods. At first glance, that might suggest that a meaningful number of managers do have the skill to outperform consistently. Persistence data suggests this may not be the case, with research showing that top-quartile managers in one period often fail to remain there in the next, implying that luck, factor exposures and changing market conditions matter alongside manager skill. The eVestment Global Equity peer group illustrates this well: on average, just over 25% of managers in the top quartile in one year (measured by active return against their respective style benchmark) remain there the following year.

Looking forward

While the last decade has been challenging for active management, current market conditions – marked by high concentration and elevated valuations – may create a more favourable environment for active strategies, consistent with historical trends.

Global equity valuations have continued to climb, with cyclically adjusted price-to-earnings ratios at the end of May reaching levels last seen during the dot-com bubble. While corporate earnings and forward forecasts are strong, equity prices are outstripping them as investors aggressively price in the revolutionary potential of AI. This speculative fervour is captured by SpaceX's June IPO, which raised $85.7 billion at a $1.77 trillion valuation. Measured against its 2025 revenue of $18.7 billion, the company debuted at an astronomical price-to-sales multiple of roughly 96, underlining just how decoupled its valuation is from current fundamentals. The depth of investor interest will be tested further over the next 12 months, as peers OpenAI and Anthropic explore potential listings at near-$1 trillion valuations. Even if those listings come at lower multiples, all three businesses remain, for now, heavily loss-making.

In an increasingly expensive market, active equity funds may offer a way to reduce exposure to the most expensive and crowded parts of the market through more selective allocation to less richly valued areas. Earnings expectations and valuations both look stretched, and any reversal in either could create a meaningful challenge for medium-term returns. We're currently cautious in our stance on equities, especially as geopolitical risks could reignite inflation, push up discount rates, and weigh on global growth and earnings. If valuations or earnings begin to mean revert over the medium term, active managers may face a more supportive backdrop than in recent years, particularly given their tendency to perform better in weaker markets.

Furthermore, passive funds have often been associated with broad diversification, while active funds have been seen as more concentrated. But that distinction is becoming harder to sustain as equity indices have become more concentrated. Geographic and sectoral concentration within global benchmarks has intensified dramatically. Over the past decade, North America's allocation within global indices climbed from the low 60s to around 75%.

Changing sectoral leaders

Simultaneously, global indices' sectoral leadership has shifted entirely: financials, which was the biggest sector in June 2016 with a near 20% weight, has been overtaken by technology, which now commands a massive 30% share. The weight of the top 10 largest companies has also increased significantly, from under 10% to over 25%. When returns are driven by a narrow group of dominant stocks, passive strategies are likely to benefit. But if momentum behind those leaders fades, that same concentration can quickly become a headwind. Active management may therefore appeal to investors seeking to reduce exposure to concentration risk and the volatility that can come with it.

The unknown quantity: AI

Market outcomes, including the relative performance of active and passive strategies, are likely to depend heavily on how the AI story unfolds. A small group of mega-cap 'hyperscalers' currently sits at the centre of that narrative, committing vast capital to AI infrastructure and driving index returns. However, the sustainability of their dominance depends on whether demand and monetisation ultimately justify this investment. At the same time, while AI adoption is quickly advancing, its benefits are uneven and concentrated – broader economy-wide productivity gains are still emerging and uncertain in both scale and timing. If these dynamics persist, concentration is likely to stay elevated, continuing to favour passive strategies that capture the largest winners. If returns broaden as adoption diffuses across sectors, increasing dispersion and reducing reliance on a handful of names, the opportunity set for active managers should improve materially.

Summing up

In our view, the choice between active and passive management shouldn't be treated as binary. Passive strategies offer a simple, cost-effective way to capture market returns, while active management provides flexibility and the potential to generate alpha. Both approaches have distinct strengths: recent market performance highlights the benefits of passive investing while also bringing some of the associated risks into focus. Rather than choosing one, investors can use active and passive strategies together to build more balanced and resilient portfolios.

If you'd like to discuss any of the themes raised in this article, get in touch with the author or your usual Hymans consultant.

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Private equity mid-year outlook

The private equity industry doesn't like uncertainty. Financial models must be re-calibrated, new discussions are warranted, and buyers and sellers might view an asset's future value (and current price) differently. But geopolitical conflicts, tariff turbulence, interest- and inflation-rate volatility, and AI as a disruptor indicate that economic instability is here to stay. Private equity is slowly learning to live with this.

Uncertainty is challenging and adjusting to changing conditions takes time. This is reflected in reduced new transactions, exits and fundraising across private equity, which have reverted to levels similar to those seen in 2020. But unlike the post-pandemic bounce back, the current recalibration seems slower. In these periods, private equity investments require patience, good judgment and steady hands. And because returns historically rebound after challenging periods, these are arguably some of the best periods in which to invest.

For long-term investors, this is positive news: future returns will depend on your investment strategy's consistency and a diversified mix of managers and investments across different vintage years. We believe investors should focus on maintaining their investment strategy and sticking with skilled managers who know their industries well and can deliver value through operational business improvements. We're also positive on increasing allocations to secondaries and co-investment funds in a controlled way. In a market where investors and private equity funds are willing to forgo future value to generate liquidity today, secondary funds can capture this illiquidity premium. Co-investment funds are also likely to perform well, as primary funds look for trusted partners for their best companies but can be subject to concentration risk.

How do the fundamentals look?

Despite the uncertain environment, the fundamentals of private equity investing are the same: improving a business operationally or financially before selling it can generate value over the long term. Private equity's control-oriented investment approach is advantageous during challenging conditions; companies can execute long-term strategic initiatives without the quarterly earnings pressures or market noise affecting public companies.

In contrast to last decade, debt is now more expensive, assets are harder to buy cheaply, revenue growth is uneven across sectors and exits require more effort. The opportunity set is still large, with companies preferring private ownership over public in the long term. Private equity investment offers exposure to attractive sectors and access to businesses at various stages of maturity. In contrast, public equity indices tend to be dominated by mature businesses and a few large sectors.

Overall, we believe the current uncertainty and reduced market activity favours sector specialists who can source proprietary deals and exits, managers with a disciplined investment approach who can cut costs and maintain operational discipline, and secondaries/co-investment funds that can provide exit options in an illiquid market.

Structurally, we're seeing a potential shift in the private equity investor base. Recent regulatory easing has led to private equity firms expanding into DC schemes and private wealth investors. They're setting up evergreen, semiliquid fund structures for these investors, offering continuous fundraising, periodic liquidity and simplified management. Such vehicles might be better suited to the underlying private equity-backed companies, given private companies are choosing to stay private for longer.

Valuations – slightly above long-term levels

Public market valuations adjust quickly to market conditions, but private market valuations are slower. This is partly due to the reluctance of general partners (GPs) to write up investment values in strong markets or to mark down investment values in falling markets.

Average private equity valuation multiples are slightly above long-term averages and have remained stagnant over the last year or so, with only the best companies seeing a rise in valuations. With trillions in unrealised value sitting in ageing buy-out funds, managers might conclude it's better to realise value when market conditions allow, even if it's at a lower level than current valuations. There's an estimated backlog of seven to eight years' worth of companies waiting to exit; it's unlikely these are all market leaders, so some realism may be required to realise value. The longer a company's holding period, the greater the risk that any operational underperformance or change in sector outlook could destroy its value.

Typically, we expect company valuations to revert to mean values over the long term. However, with AI increasingly able to disrupt established models overnight, we're more cautious. We favour managers who maintain a disciplined investment process by avoiding overpaying for assets and factoring in disruptions when estimating assets' exit values.

What about the technical factors?

The slowdown in distributions from existing funds has led to reduced appetite for new capital commitments and a fundraising downturn. We've seen managers trial innovative solutions to generate liquidity such as selling minority stakes in companies, secondaries (especially continuation funds), loans secured by the fund's net asset value, and dividend recapitalisations. But these tools can't fully replace exits, and some are unpopular with limited partners (LPs).

There's much new capital and secondary fund capital waiting to be deployed, and private credit is readily available, but high valuations are impeding transaction activity. Both new deals and exits gained momentum in the second half of 2025 but have slowed in early 2026. The vital technical factor seems to be momentum. Currently, periodic bouts of uncertainty are interspersed with some activity. Sustained momentum could lead to better negotiations between buyers and sellers (particularly on pricing), greater transactions, more distributions and higher capital deployment into new investments.

In current market conditions, continuous activity has only been seen in transactions for high-quality companies (those producing strong cash flow and a predictable revenue stream), the lower- and mid-markets (where companies tend to be smaller), and sectors with strong structural support for growth (climate tech, AI or healthcare).

Where holding periods are increasing, investors (and fund of fund managers) are generating liquidity by participating in more secondary transactions and limiting new allocations to a smaller set of managers. We believe this is the positive part of the recalibration period, set to move private equity towards the most capable managers, the investment strategies that have consistently created value over time, and an improved model of creating value to justify the asset class's high fees.

Primary investments

Our view on primary funds stays consistent. We believe clients should aim to maintain strategic exposure and ensure vintage year diversification, which is likely to get the blended investment return expected from private equity investments. We continue to favour the small- to mid-market, where the effect of global shocks is less pronounced, value creation is generated from operational rather than financial improvements, and there's more flexibility on exit options. We favour managers who can maintain a disciplined investment process and are specialists in their areas, both of which should give them an advantage in being able to generate returns over the long term.

Secondary investments

Secondary funds have benefited from uncertain market conditions by providing liquidity. These are counter-cyclical investments, and we believe they're becoming more structural by providing solutions to both investors (LPs) and managers (GPs).

Given current market dynamics, we're supportive of increased allocations to secondaries. As demand for secondary market solutions grows, the limited supply of dry powder means these funds are best placed to take advantage of opportunistic deals.

Over the last few years, we've seen an increase of continuation vehicles, which allow GPs to keep control of some companies or funds. Despite getting bad press, these vehicles allow existing investors to exit within the fund's timeframe or to continue holding the investment in the new vehicle. With many companies choosing to stay private for longer, continuation vehicles are an organic way to exit while the management team remains. Contrary to the assertion that private equity firms are selling to themselves, external investors are the majority (98%+), while the manager retains their stake (typically 1–2% of the fund) to ensure alignment of interests.

Overall, we're supportive of continuation vehicles – they help existing investors get distributions. However, we've seen examples where managers haven't been transparent on the potential returns available by exiting promptly or entering the new vehicle, which deters some investors. We think continuation vehicle usage should be assessed on a case-by-case basis.

Co-investments

Co-investments have become a standard portfolio tool, attractive due to their lower fees. They rely on strong relationships with private equity managers, which is crucial during turbulent periods. Funds with the closest relationships and the most proven execution skills will be able to convince GPs to open co-investments in some of their highest-quality companies. We're cautiously positive on co-investments. While lower fees and the ability to cherry-pick the best investments are attractive features, they increase concentration in a portfolio. We prefer managers who can demonstrate quality company analysis and strong portfolio construction reasons for including co-investments over those using co-investments to target higher returns or lower fees, without considering the concentration and execution risks.

Summing up

While uncertainty continues to weigh on private equity, it's also creating opportunities for patient, disciplined investors. A consistent long-term strategy, backed by skilled managers and selective exposure to areas such as secondaries and co-investments, should leave investors well placed to benefit as markets adjust to ongoing economic instability.

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Selecting impact managers – questions every investor should ask

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Ask an asset manager how they assess impact, and you'll usually get a confident answer. But as an investor, it's worth going a step further and digging below the surface. For the avoidance of doubt, we define impact as the outcome achieved when you materially and measurably make the world a better place as a result of the investment process.

Asking about impact matters. For asset owners with net-zero ambitions and wider sustainability objectives, impact investing is no longer a niche allocation or a 'nice to have'. We need to be comfortable, not just with the stories we're told about impact, but with how well they stand up to scrutiny.

This is especially important when it comes to manager selection. Investors need to understand not only whether a manager talks convincingly about impact, but whether their process can distinguish between credible claims, weak evidence and genuinely meaningful real-world change.

This article sets out a small number of practical questions you can use to deepen those conversations with managers. Here's an initial starter question:

How do you assess impact?

Most managers will start by pointing to a recognised framework. The ABC (or ABCD) framework. The five dimensions of impact (What, Who, How Much, Contribution, Risk). The OPIM principles. None of these are wrong. In fact, the widespread adoption of common frameworks has been a positive. They've given the industry a shared language and helped move conversations far beyond vague claims about 'doing good'.

But frameworks are only a starting point. Different managers can approach the same framework in very different ways. And some of those approaches are more impactful than others.

To help you have a more insightful conversation, here are some follow-up questions you can ask:

- What are the weaknesses in your impact approach?
- How do you compare the impact of different investments?
- When you report on impact, is it clear what's gone well – and what's gone wrong?

What are the weaknesses in your approach?

We find this question really illuminating.

At its best, responses to this question show a manager who's thought seriously about where their approach falls short; it therefore shows that they deeply understand their impact. A good answer will show honesty, self-awareness and evidence of reflection. Moreover, it'll help you understand their approach to impact better. If the manager is unable to articulate any weaknesses, or if the answers align slightly too conveniently with a marketing message, that's usually a sign to engage further with the manager to elicit a clearer response.

How do you compare the impact of different investments?

Imagine two impact investment opportunities. Both tick all the boxes under standard impact frameworks. Both align with your objectives. But one delivers 10 times more impact per £1 million invested than the other. Can the manager's methodology tell the difference?

Most frameworks can't. Unlike financial markets, there's no 'efficient market hypothesis' for impact, so it's actually common for one impact investment to have lots more impact than another. But assessing this properly requires managers to quantitively address a tricky topic: additionality. Or, for those who prefer more philosophy-flavoured jargon: the counterfactual.

Impact, when properly defined, isn't just about what happened. It's about what happened compared with what would have happened otherwise. That 'otherwise' is the counterfactual. And the impact you achieve above and beyond what would have happened otherwise is additional. Without it, you're measuring activity, not impact.

The conversation around additionality in qualitative terms is normally pretty straightforward. But when conversation with managers turn to quantifying the impact, a common response is to explain why this is hard, due to the counter-factuals being impossible to observe, prove or quantify. In a narrow sense, they're right. But in practice, investors form views about alternative outcomes all the time – think about scenario testing, forecasting and asset modelling.

Quantifying impact matters because, in the absence of an 'efficient impact market hypothesis', one legitimate impact investment might achieve 10x, or even 100x more impact than another. And if you can achieve 100x more impact without finding 100x more capital, that's a win.

When you report on impact, is it clear what's gone well – and what's gone wrong?

Reporting can be a source of weary frustration for asset owners. Impact reports often contain pages of data – carbon avoided, jobs supported, households reached – without any sense of whether those numbers are good or bad. You're left asking the most basic question: should I be satisfied with this, or not?

There's a simple way to resolve this: if you explicitly ask upfront for forecasts or expected outcomes, most managers can provide them. This mirrors what frequently happens when monitoring investment returns against a return target – you look at the actual, you compare it with what was expected and you get some indication of whether you're satisfied. Interpreting those comparisons requires analytical care, and a naïve comparison can sometimes be misleading. Thus effort is needed, both to get the comparison in the first place and to interpret it.

That effort is worth it. Because until impact reporting helps you decide whether something has gone well, it remains closer to marketing than measurement of real-world outcomes.

Summing up

Effective impact manager selection isn't about catching managers out. It's about asking questions that reveal the extent to which their process is robust – how clearly they measure impact and how willing they are to learn from mistakes. This gives investors greater confidence that their capital isn't just labelled as impactful, but is actually helping to create meaningful change.

To find out more about how to make impact more meaningful in your portfolio, reach out to the author or your usual Hymans consultant.

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Capital Markets Update

Downside risks to global growth and upside risks to inflation eased in Q2. Continued investment in AI and related supply chains supported economic activity, while easing US-Iran tensions reduced energy-driven inflation concerns.

Strong earnings growth, particularly among major technology companies, and easing inflation expectations supported equity and credit markets. The FTSE All World Index rose 15.2% in Q2, while credit spreads tightened towards historically low levels.

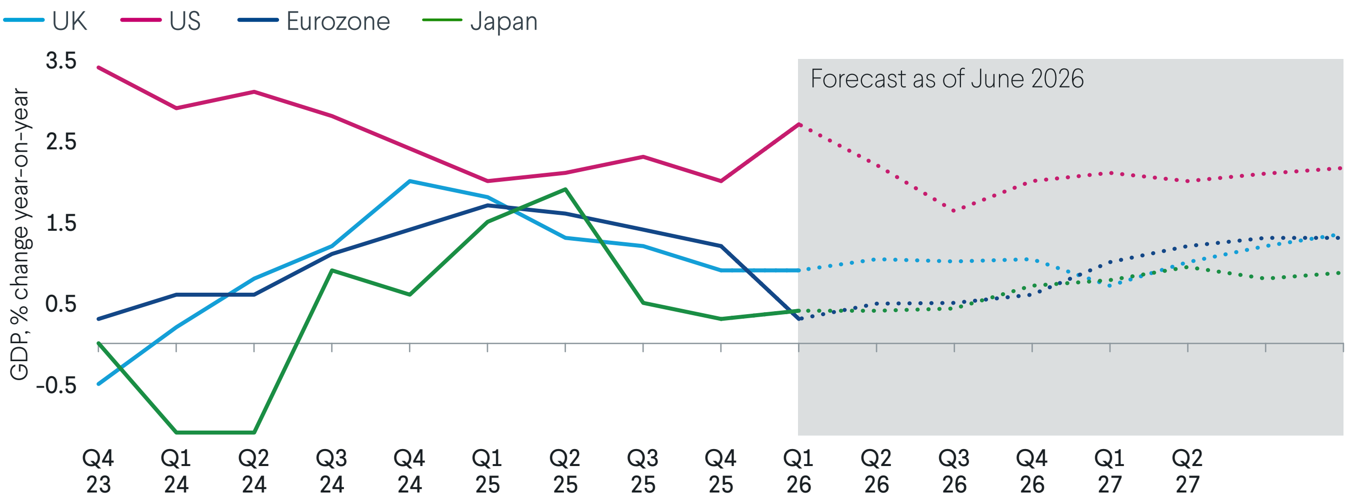
Global themes

Global growth forecasts for 2026 are at 2.5% – below the 2.7% expected at the start of the year. However, economic activity has remained relatively resilient, while downside risks to growth and upside risks to inflation have eased following the recent US-Iran détente.

Oil prices rose by less than anticipated, reflecting supply from other producers, weaker demand in some economies and the release of strategic inventories. The US-Iran ceasefire extension and the Strait of Hormuz's reopening have materially reduced the risk of a severe supply shock. Against this backdrop, oil prices have fallen around 38% from their recent peak to approximately $73 per barrel; however, they're 20% above levels at the start of the year.

The AI-led investment cycle remains an important support for global growth, driving demand for semiconductors and data infrastructure, supporting a tentative recovery in manufacturing and helping cushion the impact of tariffs on global trade. This has supported equity markets – particularly among Asia's and Japan's AI-exposed sectors – and is impacting divergence in regional economic performance. The US is expected to continue outperforming its major advanced-economy peers (Chart 1), while China's strong export growth is helping to offset weak domestic demand.

Chart 1: US growth looks set to continue to outperform that of its major advanced economy peers



Source: Bloomberg

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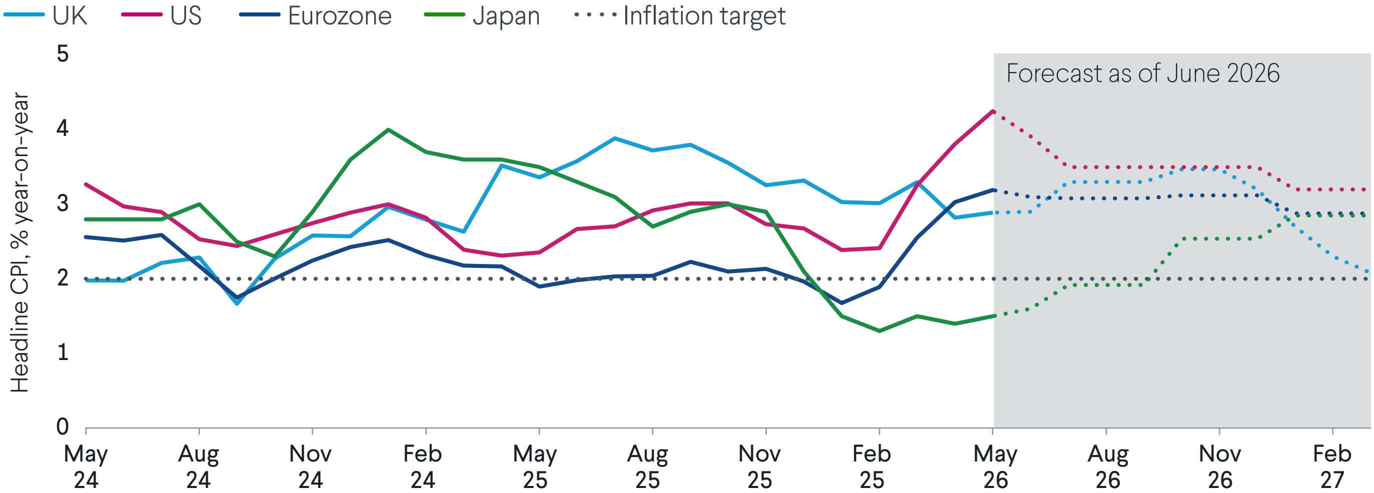
Chart 2: US-Iran ceasefire makes forecasters more confident that inflation will fall back in 2027



Source: Bloomberg

However, the increasing concentration of growth in a single theme may also increase economic fragility and dependence on equity market strength. Any market weakness, particularly if investors begin to question the returns on AI-related investment, could impact business investment and consumption, both of which have been supported by rising asset prices.

Higher energy costs are already feeding through to major advanced economies. Despite the US-Iran ceasefire extension and the Strait of Hormuz's reopening, headline CPI is likely to remain elevated in the near term (Chart 2). However, recent oil and gas price declines suggest a lower inflation peak than implied by consensus forecasts, which had risen materially earlier in the year. The ceasefire extension reinforces our view that any inflation shock should be more contained than in 2022, reflecting weaker growth, softer labour markets and less pervasive supply-side disruption.

Recent developments may refocus central banks on domestic, demand-driven inflation rather than energy-led moves in headline CPI. Here, the picture is less concerning but not entirely benign. US core inflation rose to 2.9% in May, while UK and eurozone measures remain above target at 2.6%. While concerns around energy-driven inflation have eased since March, markets have shifted from pricing a series of rate cuts at the start of the year to assigning a greater probability to rates remaining higher for longer. We continue to believe a prolonged pause is more likely than further rate hikes across the US, UK and Europe.

Actionable insights

Strong earnings growth remains a key support for equity and credit markets; it could drive equities higher while helping credit spreads stay near current levels. However, a normalisation in earnings growth towards more sustainable long-term rates may present a headwind to medium-term equity returns. Valuations also point to more muted future returns, and earnings yields suggest prospective returns may be below historical norms.

Meanwhile, sovereign bond markets appear to be pricing a more persistent inflation regime than our medium-term outlook suggests, given the supply-driven nature of recent inflation shocks. As a result, nominal yields look attractive relative to our expectations for growth and inflation.

Comparing cyclically adjusted earnings yields with materially positive real bond yields – our proxy for the equity risk premium – suggests investors are receiving relatively limited compensation for bearing equity risk, with fixed income offering better relative value.

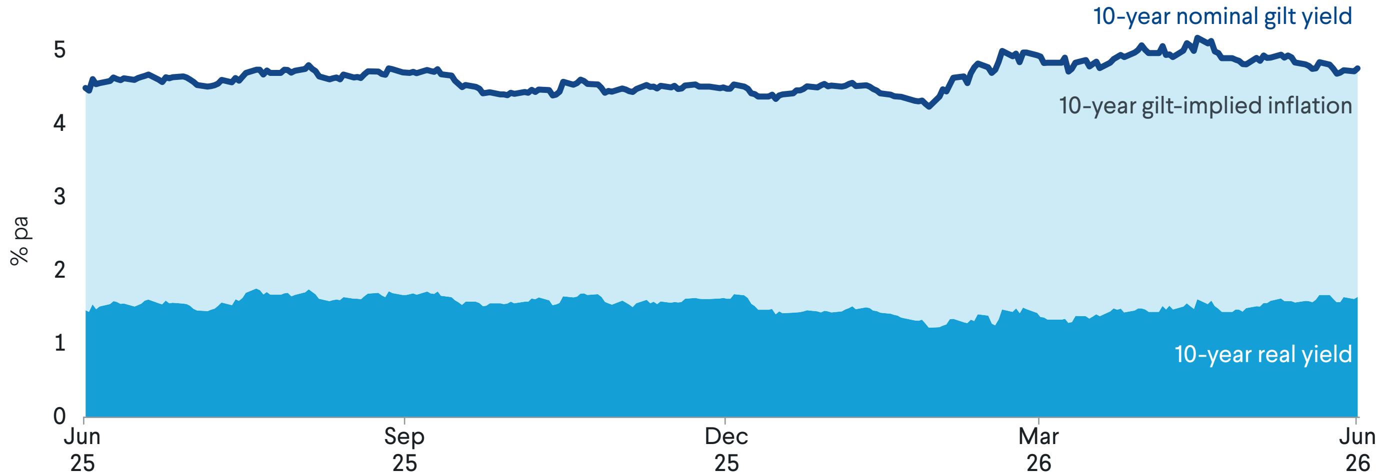
Within fixed income, we prefer sovereign bonds to credit, given tight spreads. Credit valuations remain rich by historical standards, offering limited compensation for risk. Investment-grade credit still provides reasonable medium-term return potential, but modest spread widening could result in underperformance relative to gilts. We are more cautious on speculative-grade credit, where more volatile spreads may create attractive entry points.

High equity valuations, particularly in the US, support a reducing reliance on market-cap-weighted US equity exposure and increasing diversification across regions, styles and sources of return.

Government bonds

UK nominal government bond yields fell modestly in Q2, declining by 0.1% pa, to 4.9% pa. The UK growth outlook weakened and May's headline CPI inflation was below expectations, at 2.8% year-on-year. Markets, therefore, pared back expectations for Bank of England (BoE) rate hikes that had emerged following the start of the US-Iran conflict. Meanwhile, easing concerns over energy-driven inflation pushed implied inflation down by 0.4% pa, to 3.2% pa.

Chart 3: A substantial inflation risk premium remains priced into UK gilts markets, despite recent declines



Source: Bloomberg

Combined with the modest fall in nominal yields, this led real yields to rise by 0.3% pa to, 1.7% pa.

Gilt markets appeared largely unmoved by Prime Minister Starmer's resignation, and concerns around debt affordability seem overstated. However, several factors could keep the term premium – ie the additional yield to compensate for the greater uncertainty associated with holding longer maturities – elevated on long-dated gilts. Heavy issuance, greater inflation uncertainty, reduced demand from traditional DB pension scheme buyers and ongoing BoE gilt sales all point in that direction. As a result, long-term gilt yields could remain high even if the bank rate falls.

For investors, however, this creates an opportunity. Gilt yields look attractive relative to our medium-term expectations for growth and inflation, while offering compelling risk-adjusted return potential from income alone. Although the current backdrop of weak growth and above-target inflation would normally favour index-linked gilts, elevated inflation risk premia suggest nominal gilts are more attractive from a valuation perspective.

For liability-driven investors, current yields provide an attractive opportunity to increase hedging. For absolute-return investors, short- and medium-dated gilts may offer a more attractive balance of risk and return, given the factors supporting an elevated term premium at longer maturities and the relatively modest current reward for taking additional duration risk.

Long-term gilt yields could stay high, even if the bank rate falls.

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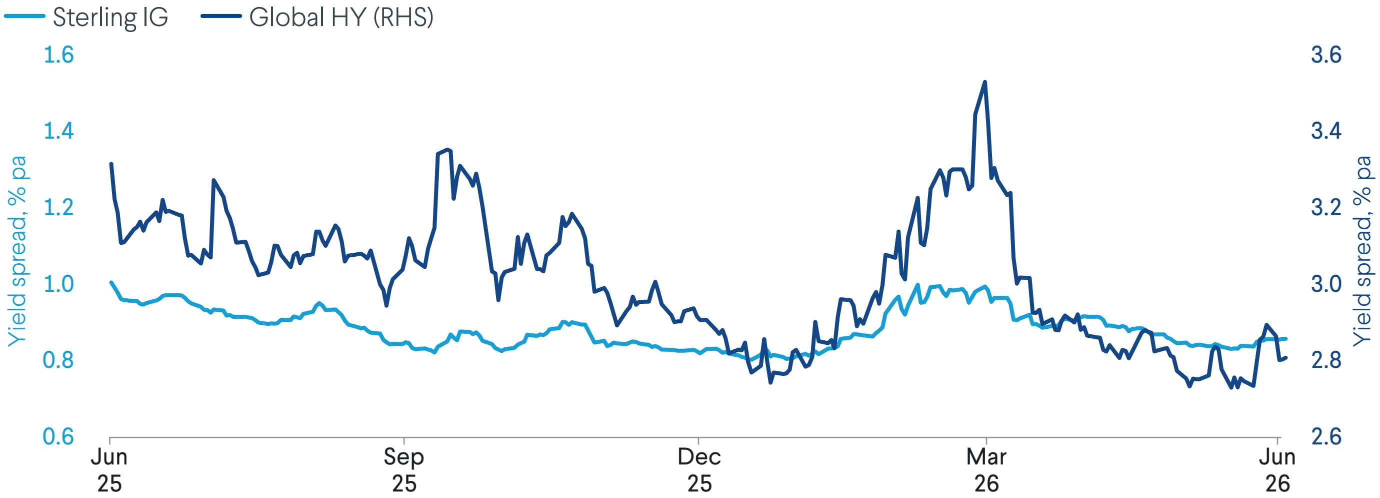
Credit

Global corporate credit spreads tightened in Q2, reversing the widening in March following the onset of the Middle East conflict, and are now broadly unchanged over the year to date. As a result, spreads have returned to historically low levels, suggesting limited compensation for credit risk, particularly in speculative-grade markets.

Corporate leverage is higher than when yields were last at these levels, but strong earnings growth has helped support interest coverage. As maturing debt is refinanced at higher rates, borrowing costs are rising. However, stronger earnings have largely offset the effect on debt-servicing capacity, helping to support credit fundamentals and contain spreads.

The level of hyperscaler investment and associated debt issuance is an important area to monitor. While these issuers generally retain strong balance sheets, the surge in AI-related capital expenditure has reduced free cash flow and, in some cases, contributed to higher borrowing. Over time, credit fundamentals will depend on the extent to which these investments generate sustainable revenues and return. A material shortfall in AI monetisation or end-user demand could lead investors to reassess the strength of these balance sheets, but hyperscalers currently represent a relatively small share of the broader corporate bond market.

Chart 4: Credit spreads have retraced earlier widening



Source: Bloomberg

Investors with short investment horizons should be cautious at current spread levels, as modest spread widening could outweigh income and lead to underperformance relative to sovereign bonds. However, for longer-term investors, spreads still provide compensation for long-run expected credit losses. Combined with elevated sovereign yields, this supports reasonably attractive medium-term return expectations for investment-grade credit.

We remain more cautious on speculative-grade credit. Valuations appear richer, with spreads tighter relative to their own history and offering less compensation for risk. While current spread levels may be supported by resilient fundamentals, more attractive entry points could emerge if volatility increases.

> Spreads have returned to historically low levels, suggesting limited compensation for credit risk, particularly in speculative-grade markets.

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Equities

Amid robust earnings growth and sustained investment by AI hyperscalers, global equities delivered a strong Q2, more than reversing Q1's modest declines and leaving markets up over 12% over the year to date. The AI supply chain was a key driver of regional performance: Asia Pacific ex Japan led returns due to its semiconductor and electronic hardware exposure, while Japan benefited from its high-tech manufacturing base. Market leadership has also broadened, with semiconductors, technology hardware and electrical equipment – key beneficiaries of hyperscaler spending – outperforming on both earnings growth and returns. By contrast, the 'magnificent seven' stocks have underperformed over the year to date.

Chart 5: Global, and in particular US, cyclically adjusted valuations look elevated relative to history

Source: Bloomberg and Hymans Robertson

Strong earnings growth and continued upward revisions to forecasts remain important near-term supports for equities. MSCI ACWI earnings forecasts were revised sharply higher in Q2: earnings are now expected to grow by 28% in 2026 and 16% in 2027, up from 17% and 15%, respectively, at the start of the quarter. AI-related capital expenditure remains central to this support. However, while investment is picking up pace, there's still uncertainty around the eventual monetisation of AI, reflected in the relatively subdued performance of the hyperscalers this year. Given the sector's contribution to expected earnings growth, any deterioration in sentiment towards AI adoption, productivity gains or monetisation could lead to meaningful downward revisions.

Valuations remain demanding, particularly in the US, and earnings expectations continue to rely heavily on a relatively small number of companies delivering exceptional outcomes. This may present a headwind to medium-term returns. As a result, we see a case for reducing reliance on market-cap-weighted US equity exposure and increasing diversification across regions, styles and sources of return.

While investment is picking up pace, there's still uncertainty around the eventual monetisation of AI, reflected in the relatively subdued performance of hyperscalers this year.

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Property

The UK property market delivered a total return of 6.1% over the 12 months to May, driven largely by income returns of 5.7%, with capital growth contributing just 0.5%. Capital appreciation was strongest in the industrial and retail sectors, at 1.7% and 1.5%, respectively; however, this was largely offset by a 2.8% decline in office capital values.

Rents rose by 3.1% over the year, although growth has moderated. Demand remains strongest for high-quality, energy-efficient buildings in prime locations, while elevated construction costs continue to constrain new supply. This may support rents, but industry surveys suggest rental growth is likely to soften.

Vacancy rates are gradually normalising from last year's elevated levels. Office vacancy has fallen to 21% from a peak of 26%, while retail vacancy has declined to 5.1% – close to its long-term average. Industrial vacancy remains above its historical norm at 10%.

Net initial yields were broadly unchanged at 5.3%, while gross reversionary yields compressed from 7.3% to 7.1%. The remaining yield gap suggests scope for rental reversion, but significant capital expenditure may be required to realise this potential, particularly within the office sector.

Investors continue to withdraw capital from core property funds, creating ongoing selling pressure. Buyer demand remains highly selective, resulting in patchy liquidity and transaction volumes below both five- and 10-year averages. Consolidation within the pooled fund market has continued, with mergers helping to facilitate redemptions while maintaining exposure for long-term investors. Further consolidation appears likely as managers seek to improve scale and liquidity.

Limited supply and strong demand for high-quality assets should continue to support rents, despite the UK's weak growth outlook. While rental reversion offers some scope for capital appreciation, realising this potential may require significant asset management and capital expenditure. Overall, relatively low yields and ongoing sector challenges lead us to expect slightly below-neutral medium-term returns.

There's often a mismatch between buyers and sellers, in both pricing expectations and asset quality.

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A fireside chat with Chris King

In this quarter's fireside chat, we sit down with Chris King, our head of Charities, Foundations and Endowments. He chats us through his career to date and life outside work, from his newly acquired allotment to volunteering at his children's school. And if you've ever wondered what it's like dealing with drunk celebrities on a credit card hotline, Chris gets into that too!

What attracted you to the pensions industry?
I've always had an interest in investments and markets – my job allows me to put that into practice, which is great. I also love having the ability to improve people's lives by making them more financially secure.

Where can you be found when you are not at work?
I just got an allotment, so I've been spending a fair bit of time there recently. It hadn't been cultivated for a while and was just a field of grass, but I've got big plans!

What's an unusual/interesting fact about you that not many people know?
I'm a school governor, which means I can use my financial experience to help my kids' school make the most of their resources.

If you could introduce one innovation to the UK pensions system, what would it be?
I'd be doing everything I could to encourage collective defined contributions (CDC) to get off the ground. DB isn't coming back in the private sector, sadly, but CDC at least addresses some of DC's shortcomings, and will mean people can have better retirements.

In your view, what are the top qualities needed to be a successful investment consultant?
The best consultants are those who can communicate complicated ideas simply. That's the key to building good relationships with clients.

What advice would you give to young staff just starting out at Hymans?
Try to look for opportunities to make a difference. If you notice something that could be done better, try to see what you can do to change it. And don't be afraid to ask for help!

What's your biggest client win (in terms of a win for the client, not a new business win)?
There have been quite a few, but one I remember was finally getting a client to agree to de-risk after mulling it over for a long time just before Covid-19 hit. They came through the pandemic in a much better place than they would've been had they not implemented what I recommended.

What's the most unusual job you've ever had?
While I was at university, I worked the night shift on the credit card hotline for Coutts, the private bank. I once had a very drunk Cilla Black and Dale Winton ring up together from Spain after she'd lost her card!

What's the best work perk you've ever had?
I've had tangible perks like company cars and share schemes before, but I think the flexibility to start and finish the day at a time that fits in with family life is fantastic. It means I can take the kids to school quite a lot, which is great while they're little.

What's your guilty pleasure TV show?
I absolutely love *Peacemaker*. It's silly and over the top, but it's so much fun. It's definitely one to watch on the rare occasion I have the house to myself.

Can you share a podcast recommendation with us?
I listen to quite a few podcasts. My favourite is ArsenalVision.

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Sunday roast or Saturday night takeaway?
Sunday roast is among Britain's best dishes and one of our many gifts to the world. I love cooking it for family and friends, so hands down it's a Sunday roast. A home-cooked one, too – pub/restaurant roasts aren't as good as those done at home.

Football or rugby?
Football. I'm a huge Arsenal fan – I live close to the stadium and try to attend as many games as I can get tickets for.

Early bird or night owl?
I've always been more of a night owl and I'm quite happy staying up late. But with two young kids, I also have to get up early!

City life or countryside?
City life, for sure. I like being around people and I'm very happy living in London. I grew up in the North Yorkshire countryside and got frustrated with the lack of things to do.

Comedy or drama?
I'd say drama. Making a really good comedy is hard and they're few and far between. That's why people are still watching old stuff like *Fawlty Towers*. There's so much good drama on TV these days. I've recently enjoyed *Le Bureau des Légendes* and *La Maison*.

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