2026 OUTLOOK • MID-YEAR UPDATE

The Second Movement

July 2026

In January we published our 2026 outlook titled The Market's Reprise, organized not around forecasts but around four themes we thought would shape how we managed portfolios this year: AI's ubiquity, the democratization of private markets, biotech's resurgence, and a healing real estate market. (A little more than) six months later, each of these themes continues to develop—along many of the vectors we anticipated, but also on some novel ones. Below we take stock of the evolution and reset on the opportunities and risks we're watching from here.

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AI's Ubiquity

Still the Middle Innings

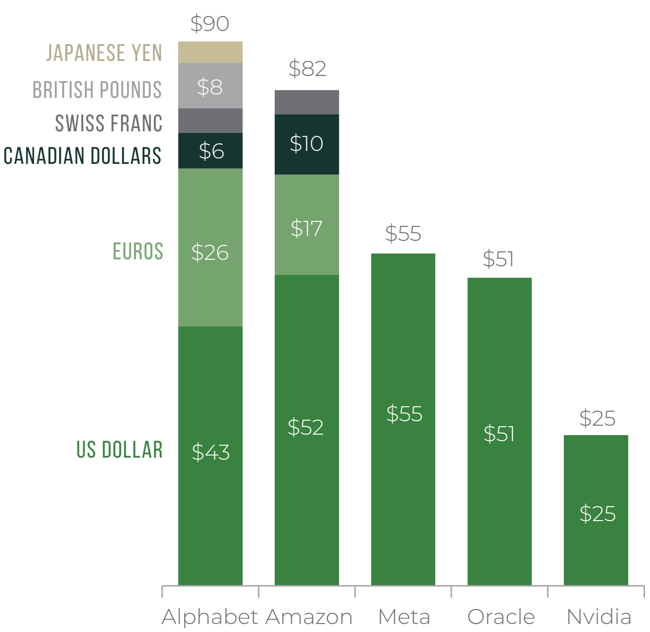
We argued in January that the AI capital cycle was in its middle innings, and we still think so. The hyperscalers continue to hyperspend, revising up their capex estimates at every opportunity. That deluge of free cash flow out of their coffers has found its way to the component suppliers—the semiconductor manufacturers, memory makers, data center developers, and other related infrastructure businesses—who can't ramp production as fast as their customers can ramp spending.[1] AI hardware investment in the US national accounts has increased by $425 billion since 2022 on a three-month annualized basis, and that figure continues to climb quickly.[2]

Through June of this year, the market has followed the money: punishing the spenders and rewarding the recipients. A basket of data center and equipment stocks is up more than 80% year to date, and semiconductor stocks specifically are up close to 60%—all driven by profound earnings growth—while the hyperscalers are down.[3]

There are some risks on both sides. The durability of contracted demand is a key one for the hardware companies. The spending beneficiaries are increasingly seeding demand through prepayments, offtake commitments, financing support, and contract-backed borrowing structures. These interlinkages accelerate a buildout, but they also introduce circularity. As PIMCO frames it, induced demand underwritten by the ecosystem itself is not organic demand from enterprises that have decided the product is worth paying for. "The former can sustain momentum for a time; only the latter can validate it." [4] We are once again seeing diagrams like the one below after a spate of announced Nvidia deals reported to be worth more than $750 billion.

US Big Tech Companies Tap Debt Markets

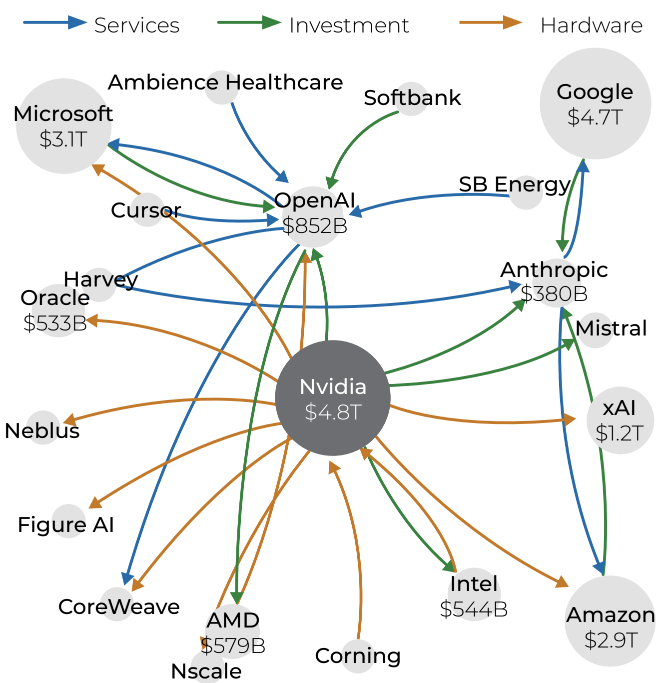
USD-Equivalent at Debt Issuance (2025-2026)



Source: Bloomberg as of 7/27/2026.

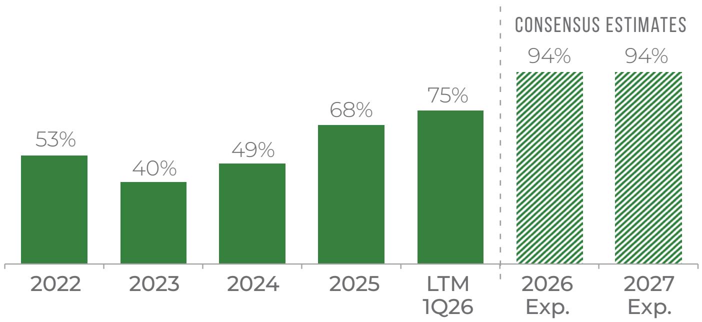
AI Deal Web, with Nvidia at the Center

Companies by Valuation



Source: Bloomberg as of 5/6/2026.

AI Hyperscaler Capex as a Share of Operating Cash Flow



Source: Bloomberg, S&P Capital IQ, PIMCO as of 5/56/2026.

On the hyperscale side, a primary risk is debt, and here the math has moved quickly. Capex is now expected to absorb 94% of hyperscaler operating cash flow in both 2026 and 2027, against just 40% in 2023—an inflection that has fundamentally altered the funding equation.[1] Index-eligible hyperscaler issuance has reached roughly $136 billion year to date, already eclipsing full-year 2025, on top of another $58 billion tied to data centers across investment grade and high yield.[1] Recent Form 10-Qs point to $822 billion of future undiscounted lease commitments not yet on hyperscaler balance sheets, up from $675 billion in February.[1] Zoom out and Barclays now expects total US investment-grade supply of $1.9 trillion this year, above the $1.6 trillion Covid-era record, with net issuance approaching double last year's.[5] The price of protection via credit default swaps for all of the hyperscalers (and some of the hardware companies) have reflected these financing jitters: up mostly between 50% and 80% year to date.[6]

Just as we flagged in January, **we believe this is a fragility—not because the spending is obviously unproductive, but because it narrows the margin for error if returns on invested capital are underwhelming, if obsolescence speeds up the capex treadmill, or if markets get anxious about credit conditions generally.**

As token prices fluctuate and the frontier models face increasing pressure on market share from open-sourced Chinese models, we're increasingly looking at adoption curves and labor data to determine capex durability. For now, use cases for AI are broadening, albeit in a linear (not exponential) fashion: 20.6% of firms report using AI in regular business functions, with 23.9% expecting to within six months.[7] Moreover, against the questionable unit economics of the models and the hyperscalers, the bottlenecks upstream are real. High Bandwidth Memory shortages are now forecast to persist until 2030,[8] in a market where Samsung, SK Hynix, and Micron hold roughly 95% of supply and where each chip generation consumes materially more memory than the last.[9]

So, going forward, where will value accrue in the AI ecosystem and how is capital optimally deployed within the theme? Nobody knows. PIMCO summarizes this well: "At the bottom sits the semiconductor layer, where pricing power has been extraordinary but remains tethered to the durability of the capex cycle itself. Above that is the infrastructure and cloud layer, where hyperscalers are projected to spend trillions on data centers even as the useful life of AI hardware shortens with each new generation of chips and architecture. Then comes the model layer, where training costs are enormous, differentiation is fleeting, and developers are locked in a costly arms race with uncertain pricing power. At the top sits the enterprise and application layer—the ultimate source of demand that must validate the entire chain—where adoption curves remain early-stage and willingness to pay is still being tested...As it stands, no one knows with confidence which layers will capture the lion's share of value—or whether today's infrastructure buildouts will even be met with sufficient demand."[1]

> **We continue to favor diversification up and down the AI stack.** Voltaire, who so far as we know never day traded tech stocks, once wrote: *"Uncertainty is an uncomfortable position, but certainty is an absurd one."*

Privates for the Public

More Complex Plumbing

We flagged two inversely related dynamics in January. First, interval funds and other oversold vehicles were driving a wave of secondary activity that could help institutional LPs like us manage private exposure. Second, the depth of private markets was allowing companies—venture-backed ones, in particular—to avoid public markets altogether, lengthening duration and making pacing management more important than ever. Both dynamics have largely persisted.

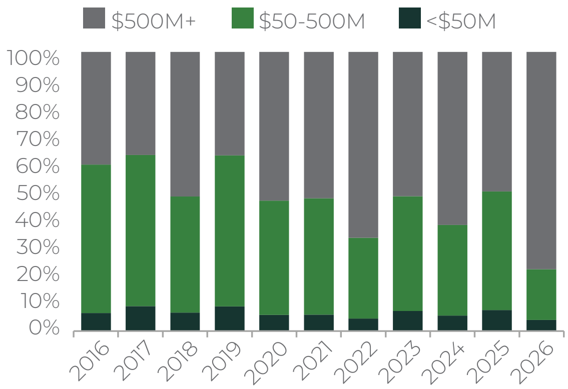
Evergreen vehicles remain popular despite the headline difficulties in the private credit space. The US evergreen market grew to $607 billion across 567 funds as of the first quarter,[10] from $590 billion a year earlier, with wealth investors now roughly a fifth of AUM—a shift that MSCI declares is one of the "most significant structural changes in private markets in decades."[11] Direct lending and alternative credit are the largest slices at $236.5 and $55.0 billion, real estate second at $115.5 billion, private equity $99.3 billion, and venture the smallest at $13.9 billion, or 3.2% of funds.[5] The retail appetite, so far, is for (purported) yield rather than duration. Close to $150 billion of the total $607 sits with secondaries-focused firms.[5]

The other structural demand driver is the Department of Labor's proposed rule from March 30, establishing a fiduciary's process for selecting private market alternatives in 401(k) plans. The rule creates safe harbors for fiduciaries who consider performance, fees, liquidity, valuation, benchmarks, and complexity. That certainty should unlock activity with plan sponsors. More than 90 million Americans participate in DC plans, and the entry point is likely to be target-date funds, meaning the exposure arrives passively, without participants making an active choice.[12] Democratization, it turns out, may be foisted upon us, and the first lawsuits will set some important precedent.

On the second dynamic, the evidence is mixed. On the one hand, the SpaceX IPO revealed that public markets will absorb a $1 trillion plus company—at least a portion of its float—which suggests that there is a plausible offramp to liquidity-starved LPs as companies scale. On the other hand, venture funds continue to raise increasingly larger vehicles with tighter frequency, so there is more industry capital available to fund the ambitions of competent founders in Silicon Valley and elsewhere. The prospect that the largest companies in one's venture portfolio may be the oldest is a difficult phenomenon for those of us insisting on allocation discipline and broad portfolio diversification.

$500M+ Funds Capture a Record 77.9% of Capital Raised in H1 2026

Share of venture capital raised by size bucket



Source: Pitchbook as of 6/30/2026.

These two dynamics are related, though, in that venture secondaries can be an attractive access point for funds and specific company exposures. There will always be LPs who overdid it—committing more than they wish they had to a particular fund at a particular time, and who may be willing to part with that interest.

> In our opinion, **ensuring we pace prudently so that we can capitalize on that secondary deal flow as a buyer, while acknowledging from time to time our capacity to be a seller** (as we were to manage our SpaceX exposure) **is a critical tool in management of private portfolios.**

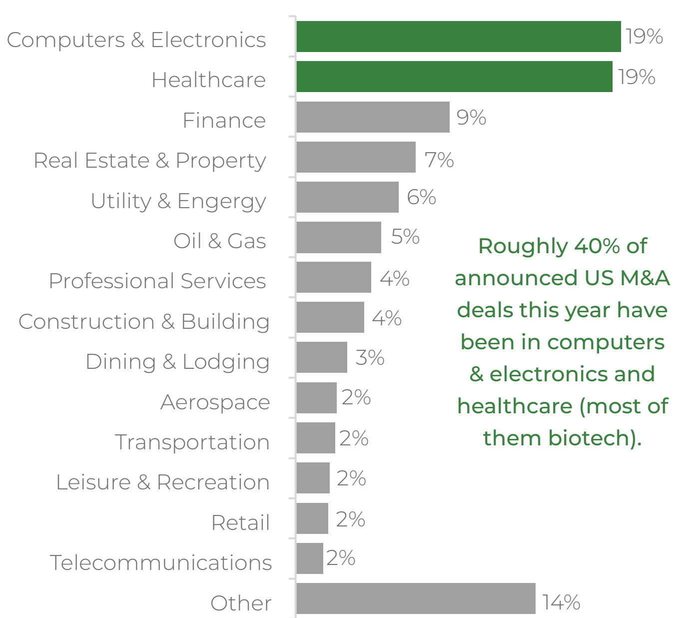
Biotech as an Exception

Tailwinds for Now

Biotech was our most bottom-up oriented theme and, so far, our best performing in the first half of the year. Our expectation that momentum in the sector would continue into 2026 and offer alpha opportunities to the best stock pickers has shown itself to be correct. XBI, the equal-weighted small cap biotech ETF, is up almost 30% year to date. Of the 141 constituents in the index, 36 are up more than 50% and 15 have more than doubled.[3]

Some of that has been the result of a more favorable M&A environment, and activity year to date has been robust: there have already been 33 biotech deals above $1 billion, worth $134 billion in total, against 26 for all of 2025 at $112 billion.[13] Within Goldman Sachs' "M&A candidate index," a thematic basket meant to capture those companies most likely to be acquired, biotech companies now account for 16 of the 71 names in index, a 21% weight.[14] Recent transactions—Merck and Terns, Novartis and Avidity, AbbVie and Apogee, Lilly's purchases of Ajax and Kelonia, Gilead's oncology acquisitions of Arcellx and Tubulis—underscore the extent to which the buying is aimed at innovation in key or novel therapeutic areas.

YTD Share of Announced US M&A Deals by Industry



Source: Goldman Sachs as of July 1, 2026.

The IPO window has been open not just for SpaceX and mega-cap AI companies, but for biotech too. A baker's dozen of venture-backed biotechs have priced IPOs in 2026, two of them—Parabilis Medicines and Kailera Therapeutics—eclipsing Moderna's record for most raised in an initial share sale. Eleven of the 13 raised at least $250 million, already more than most years since 2018, and 22 more sit in the queue. IPOs have historically been this sector's lifeblood.[15]

We hoped for a clearer regulatory environment, but all of this industry activity has come amid a foggy one. There have been several reversals of regulatory decisions, including for uniQure, Capircor, Biohaven, and others, and occasionally reversals of the reversals. That level of dysfunction suggests issues with current FDA governance rather than anything company specific.

Midterm elections will likely matter here, through agency confirmations and drug pricing policy. But in our view the patent cliff has not budged: it remains the structural driver, M&A is expected to continue, and equity dispersion within the healthcare sector is elevated, continuing the **ripe conditions for well positioned stock pickers**.

Real Estate Healing

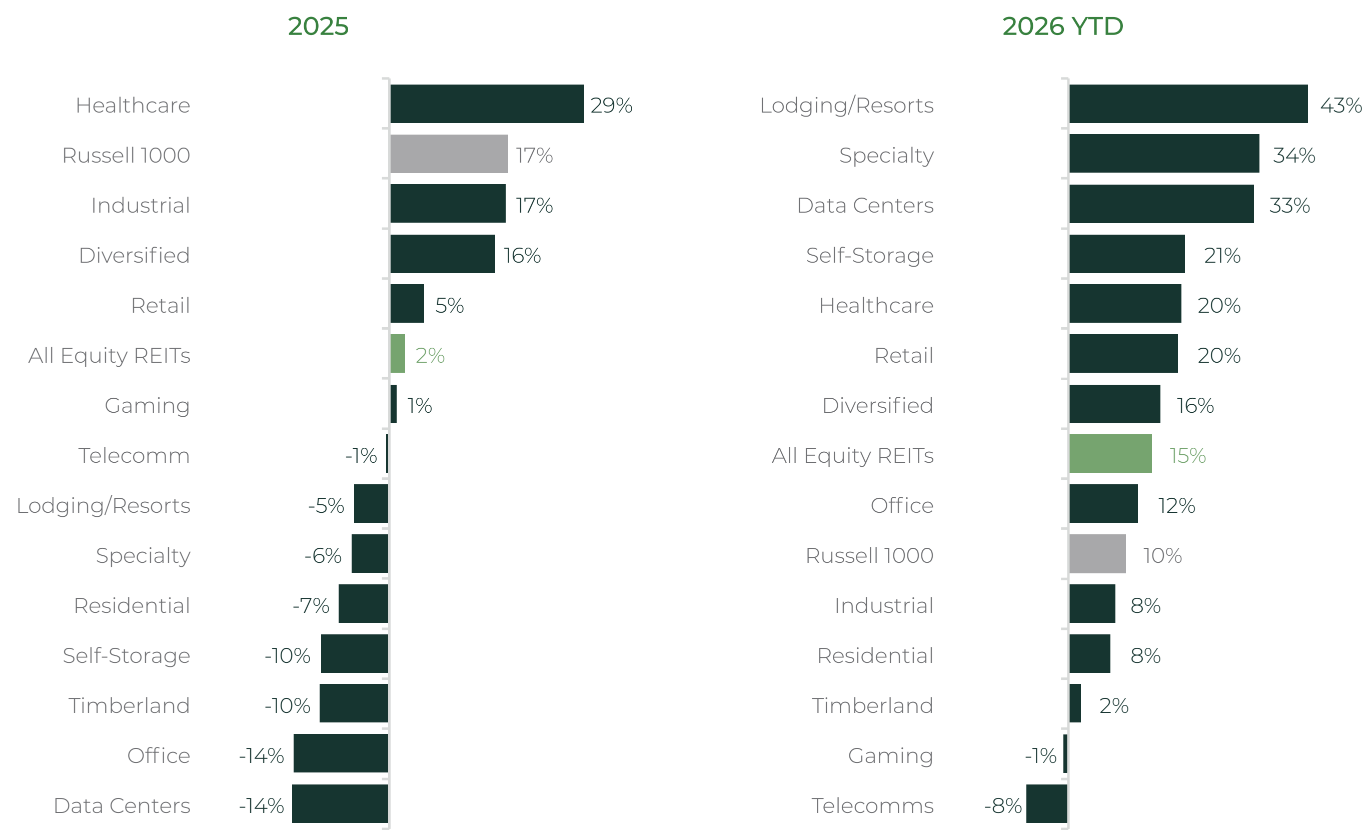
Normalization, Not Heroics

In January we closed our underweight to Real Estate and rebalanced to neutral, arguing the sector did not need heroics, only normalization, and that the strongest forward returns historically arrive after inventory pressure begins to abate and before sentiment recovers. Six months in, that has been right for the reasons we gave, with one complication.

REITs delivered strong performance through mid-year, outperforming the broad equity market by a sizable margin and reversing their 2025 trend. The case never depended on rate cuts, and it has not received any.

The complication is concentration: much of the year-to-date index-level result has been driven by a handful of dominant names—Welltower, Simon, Equinix—in an index whose top ten is roughly half the weight. The second quarter was considerably broader than the first, though, with lodging, cold storage, office, billboards, and single-family rental all up more than 20%, and shorter-lease-duration sectors reporting unexpected and growing rental strength.[16]

All Equity REIT Sector Total Returns



Source: FactSet, Nareit. 2026 YTD as of 6/30/2026.

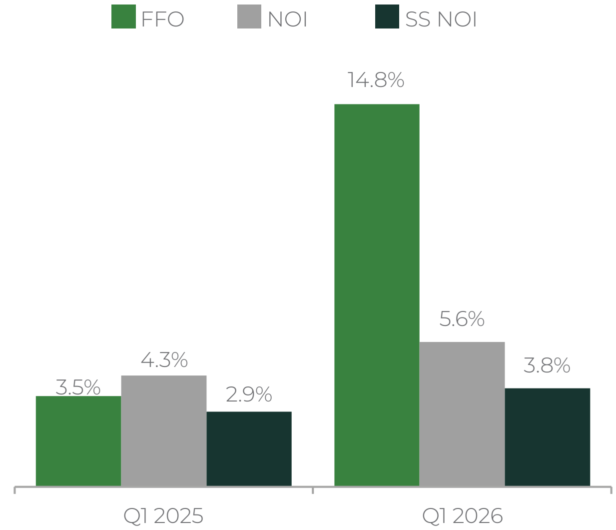
Supply is abating across most of the problem areas, with completions as a share of existing stock set to fall well below their recent run-rate in nearly every property type. Office recorded its fourth consecutive quarter of positive absorption. Debt availability has improved and monthly transaction volume also continues to recover.

Most importantly, fundamentals are cooperating. Average annual funds from operations growth ran 14.8% in the first quarter against 3.5% a year earlier, with NOI and same-store NOI up 5.6% and 3.8%.[17]

Valuation still favors the public route for real estate exposure. REITs are cheaper than equities on a P/FFO versus P/E basis, and private appraised values continue to lag the market: Nareit-implied cap rates have exceeded (i.e., are cheaper than) appraisal cap rates for seventeen consecutive quarters, currently a spread of 1.5%.[18] As appraised values on private assets are marked to market, REITs should continue to enjoy relative outperformance.

REITs Post Strong Operational Performance

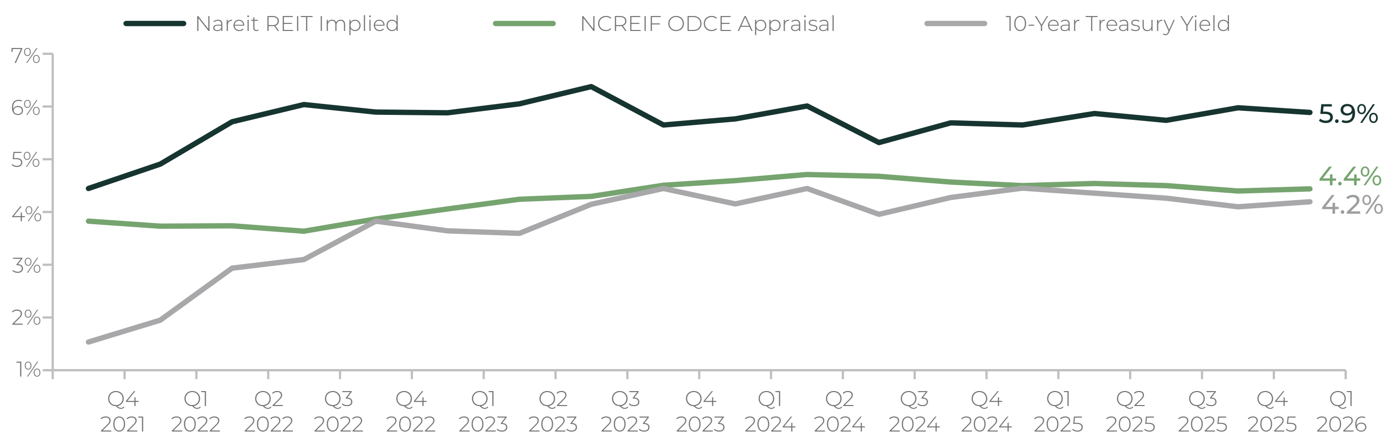
Average Annual REIT Operational Performance Growth



Source: S&P Capital IQ Pro, Nareit REIT Industry Tracker as of 3/31/2026. FFO is Funds from Operations, NOI is Net Operating Income, SS NOI is Same-Store NOI.

Private Real Estate Valuations Stuck in 2021

Real Estate Cap Rates and 10-Year Treasury Yield



Source: FRED, Federal Reserve Bank of St. Louis, S&P Capital IQ Pro, Nareit REIT Industry Tracker, NCREIF as of 3/31/2026.

> Despite that, **we are investing selectively in private assets where we believe capital structures and cash flows are durable, and where income growth can help drive gains,** including niche sectors such as marinas and industrial outdoor storage. Global real estate manager Hines captured the spirit well: "Selective deployment is warranted, but broad risk-on behavior is premature."[19]

Keeping Score

Theme	January call	Mid-year read	Positioning[20]
AI's Ubiquity	Capex cycle in the middle innings; broadest cross-asset theme in decades.	Intact, but financing has shifted from cash flow to debt and contracted demand.	Overweight Equities maintained, but exposure deliberately spread across asset classes and across layers of the AI stack.
Privates for the Public	Illiquids becoming tradable; quality companies may never list.	Both occurring faster than expected. Evergreen AUM $607B; DOL rule opens DC plans.	VC pacing reduced; active on both sides of secondaries; LMM buyout and seed/micro emphasis unchanged.
Biotech as an Exception	Renewed momentum; dispersion can reward specialists.	Working. XBI +30% YTD, record M&A and IPO activity, but regulation is personnel-contingent.	Public over private, with aggregate exposure actively managed.
Real Estate Healing	Close the underweight; the sector needs normalization, not heroics.	Right for the right reasons. REITs leading equities without rate cuts, operations inflecting; private marks still lagging.	Modestly underweight today, largely crowded out by Commodities rather than a change of view; public preferred, selective in private.

Final Word

Six months is not long enough for robust scorekeeping, but all four themes remain intact. However, the progress we anticipated is moving at distinct speeds for each of them: AI's spending is increasingly financed rather than funded, private market access continues to spread and its mechanisms for trading continue to deepen, biotech's regulatory uncertainty lurks behind what is an otherwise favorable and active industry environment, and real estate continues to heal, albeit slowly. We don't need to predict these themes precisely to position around them well in our diversified, actively managed portfolios. Being approximately right can allow us to lean into what's working, guard against what isn't, and adjust as the picture sharpens.

Endnotes

[1] Bank of America Merrill Lynch as of June 30, 2026.

[2] Goldman Sachs as of July 1, 2026.

[3] Bloomberg as of June 30, 2026.

[4] PIMCO, AI Credit Expansion: Assessing the Micro and Macro Risks, May 22, 2026.

[5] Grant's Interest Rate Observer, January 2026.

[6] Bloomberg, PIMCO as of May 2026.

[7] Goldman Sachs as of July 12, 2026.

[8] Reuters, SK Hynix CEO sees worst memory shortage in 2027, demand to outstrip supply beyond 2030, July 10, 2026.

[9] Mordor Intelligence, High Bandwidth Memory Market Size & Share Analysis – Growth Trends and Forecast (2026-2031).

[10] Morningstar PitchBook as of March 31, 2026.

[11] MSCI, State of Private Markets 2026 Report, May 12, 2026.

[12] Congressional Resource Office.

[13] Stat News, Pharma goes on a spending spree, snapping up biotechs in a hurry, June 22, 2026.

[14] Bloomberg, Goldman Sachs as of June 30, 2026.

[15] Biopharma Dive as of June 30, 2026.

[16] FactSet, Nareit, 2026 year to date as of June 30, 2026.

[17] S&P Capital IQ Pro, Nareit REIT Industry Tracker.

[18] FRED, Federal Reserve Bank of St. Louis, S&P Capital IQ Pro, Nareit REIT Industry Tracker, NCREIF as of March 31, 2026.

[19] Hines, 2026 Midyear Outlook (The Scarcity Advantage), July 16, 2026.

[20] GEM reserves to modify its current investment strategies and techniques based on changing market dynamics or client needs.

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EF POLICY PORTFOLIO WEIGHTS & BENCHMARKS

Return Factor	Target	Range	Benchmark
Growth-Oriented	60%	30-75%	
Equity	53%	30-70%	MSCI ACWI
Credit	7%	-5-20%	Bloomberg High Yield Index
Inflation-Oriented	15%	5-30%	
Commodities	3%	0-15%	Bloomberg Commodity Index
REITs	12%	0-20%	MSCI US REIT Index (gross)
Income-Oriented	25%	10-40%	
Treasuries	15%	5-30%	Bloomberg US Treasury Index
TIPs	10%	0-30%	Bloomberg US Tsy Inflation Notes Index

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