



# What We Are Watching: Mid-Year Update

Revisiting Our Four Themes Against a More Volatile Backdrop

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INVESTMENT  
COMMITTEE

Faith Daigneau

Ryan Farrell

Timothy Filla, CAIA, CSRIC

Richard O'Neill, CFA, CAIA

Dennis Rafferty, CFA

Larry Witt, CFA, CAIA

When we published, *What We Are Watching in 2026* in January, our framework centered on four themes: the outlook for the US economy, the Federal Reserve’s policy path, divergent global central bank cycles, and AI-driven concentration in US equities. While these topics are still important, the conversation has shifted, as a geopolitical shock in the Middle East has reintroduced inflation risk, the rate-cut narrative has been all but unwound, equity and bond markets are telling very different stories, and the AI rally has resumed with the conversation shifting from infrastructure spending to software disruption and debt financing. Our goal in this piece is to frame from our perspective what is still true, what has changed, and what is coming.

## The New Variable: Middle East Conflict and Oil

The defining macro event of the first half of 2026 has been the conflict in the Middle East and the resulting disruption to the Strait of Hormuz. The Strait carries roughly 20% of global oil and a comparable share of liquefied natural gas. In the days following the outbreak of hostilities in late February, daily tanker traffic through the Strait collapsed from approximately 135 vessels to fewer than 10.<sup>1</sup> This has led to elevated energy prices including crude oil, gasoline, diesel, and liquified natural gas. It has also influenced fertilizer and helium prices.<sup>2</sup>

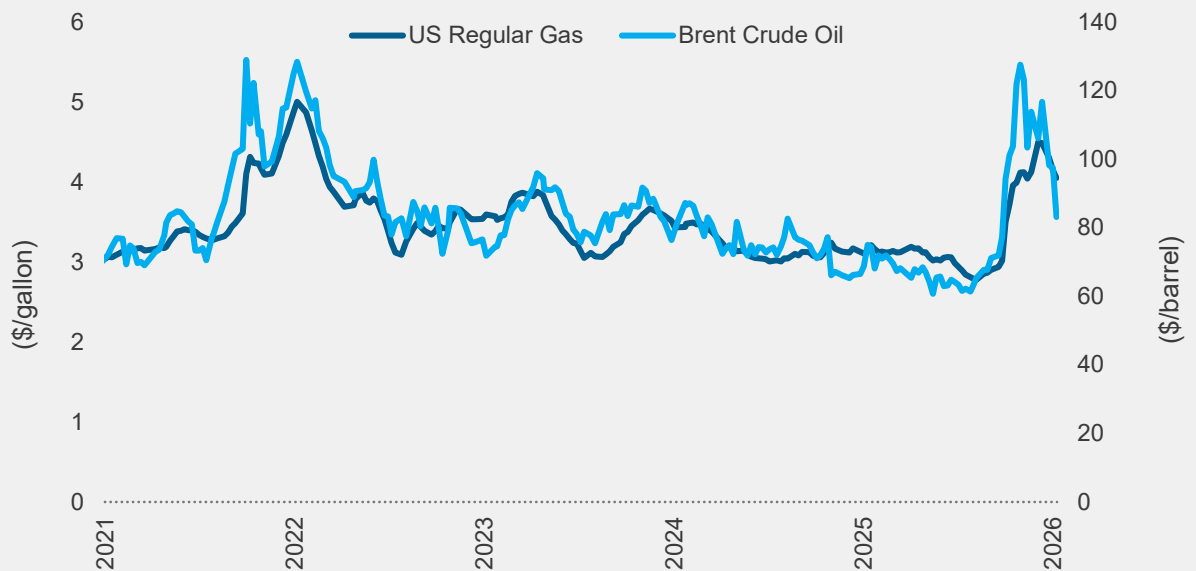
(See Figure 1)

Insurance dynamics have amplified the disruption. War-risk premiums surged to between 3% and 8% of

vessel value in the weeks following the strikes, up from historical levels around 0.25%, translating into \$3 to \$8 million in additional insurance cost per large tanker transit.<sup>3</sup> Even after normal traffic resumes, underwriters will likely require sustained incident-free transit before normalizing rates, meaning that elevated freight and energy costs are likely to persist well beyond any formal de-escalation.<sup>4</sup>

The impact has not been borne evenly. The United States, as a net energy exporter, has been relatively insulated. Europe, South Korea, China, and Japan, each heavily reliant on Gulf hydrocarbons, face more direct pass-through to gasoline, diesel, and food prices. Compounding the supply issue is the physical damage to regional energy infrastructure from missile

**Figure 1**  
Elevated Prices



Source: St. Louis Federal Reserve.

and drone strikes. These attacks have damaged Liquefied Natural Gas (LNG) facilities in Qatar that account for roughly 20% of global LNG supply, as well as energy facilities in the UAE, Kuwait, Iran, and Bahrain. Some of this infrastructure may take years to fully restore.<sup>5</sup> Even when the physical disruption eventually resolves, a return to normal flow is not a switch that can simply be flipped. Inventory drawdowns have helped balance physical markets so far, but the longer the disruption persists, the greater the risk of demand destruction and a measurable drag on global growth.

To that end, the IMF's global GDP growth forecast for 2026 was lowered from 3.3% in January to 3.1% in April. For the US, the forecast was downgraded from 2.4% to 2.3% for this year.<sup>6</sup> The expansion we discussed for the US in our last piece remains intact, though the growth narrative has become more nuanced. The labor market continues to remain relatively stable but energy price pressures stemming from the Middle East conflict are weighing on real purchasing power particularly for lower-income households. We have also seen the savings rate decline as spending outpaces income growth, suggesting the consumer tailwind, while still present, is becoming more selective.

On June 14, 2026, the United States and Iran announced an initial agreement to end the conflict and reopen the Strait of Hormuz, with the memorandum of understanding signed on June 17 following the G7 summit. As mediator, Pakistan confirmed on June 18 that Iran would promptly reopen the Strait and that the US naval blockade of Iranian ports would cease.<sup>7</sup>

Markets responded immediately with Brent crude falling below \$80 per barrel, its lowest level since early March and roughly 38% off the April peak, as more vessels began transiting the Strait again.<sup>8</sup> We would caution, however, against assuming a clean return to pre-conflict conditions. Underwriters will require sustained incident-free transit before normalizing war-risk premiums, physical infrastructure damage across the Gulf will take time (in some cases years) to repair, and the agreement leaves significant issues, including Iran's nuclear program and the Israel-Lebanon track, unresolved. A return to normal flow is a process, not a switch. Moreover, developments in the Strait remain highly fluid, and its operational status could shift rapidly in response to military, political, or diplomatic developments. As a

result, the risk of renewed disruption remains elevated, and market expectations should be calibrated to the possibility of continued volatility in shipping conditions and energy prices.

Against this backdrop, we frame the remainder of 2026 around three scenarios. Recent developments have moved us toward what we would characterize as the **base** case: a negotiated de-escalation in which the Strait reopens but energy prices and freight costs normalize only gradually, sustaining residual inflation pressure without a renewed growth shock. A more constructive **bull** outcome would see the agreement hold firmly, flows and insurance markets normalize quickly over the summer, and oil return to pre-conflict levels. The **bear** case, a breakdown of the agreement and a return to active disruption, would reintroduce sustained oil price pressure, broader demand destruction, and a stagflationary mix that constrains policy options. The speed and durability of the reopening is the single most important variable we are watching into the back half of 2026.

## The Fed: A New Chair, A New Reaction Function, and Rising Inflation Risks

Two key developments have happened related to the Federal Reserve since January. First, the Department of Justice dropped its criminal investigation of Chair Jerome Powell in late April. Second, Kevin Warsh was confirmed as the 17th Chair of the Federal Reserve in mid-May by a 54–45 Senate vote and chaired his first FOMC meeting on June 17.<sup>9</sup>

Warsh has signaled a preference for what he has described as “regime change” at the Fed, including a smaller balance sheet that he argues should allow for a lower policy rate. But Warsh is one vote on a twelve-member committee, and the pace of any shift will depend as much on his ability to build consensus surrounding his own convictions, a constraint markets may be underweighting as they price the transition. Warsh is also inheriting a divided Fed.<sup>10</sup> (See Figure 2)



steady, with the potential for hikes later in the year. The Bank of Japan remains on its own trajectory, continuing to normalize policy incrementally from a very different starting point.<sup>13</sup>

## AI in 2026: Disruption, Resilience, and a More Leveraged Buildout

The AI narrative has undergone a meaningful evolution in 2026. The capex-led framing that dominated entering the year that was focused on who was spending the most, building the most data centers, and scaling fastest has given way to a more unsettling question: Which businesses does AI take over? Recent model releases from leading labs triggered notable selloffs in software companies, as markets began pricing the possibility that capabilities once protected by data and distribution moats could be commoditized faster than expected. The disruption dynamic is self-reinforcing as each new release raises the capability ceiling, the window for incumbents to adapt narrows, compressing monetization timelines and making the earnings outlook for AI-exposed software increasingly binary.

After a period of rotation and concern in the first quarter, AI-related companies have reasserted market leadership through April and May, driven by stellar earnings from the hyperscalers and continued evidence of enterprise adoption at scale. The near-term narrative has shifted back toward execution and monetization, with the market rewarding companies that can demonstrate revenue tied to AI investment rather than simply proximity to it.

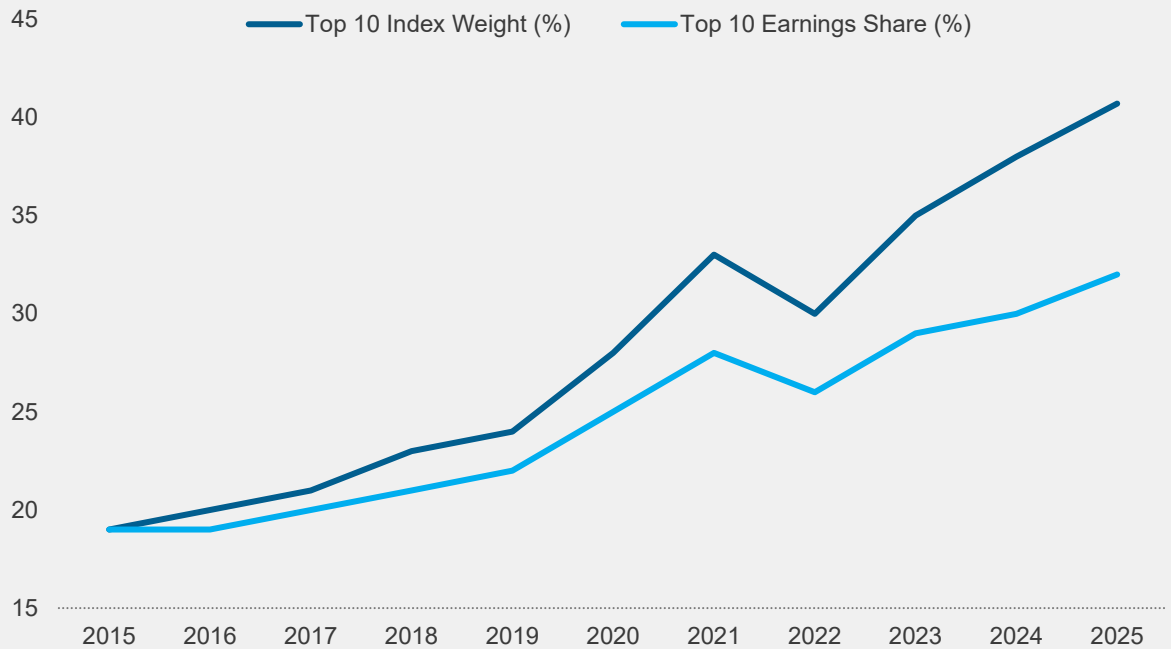
A third dynamic that now warrants attention is the fact that the AI buildout is increasingly debt-financed rather than funded from free cash flow, marking a structural shift from the early phase of this cycle. This puts upward pressure on rates, raises the sensitivity of valuations to financing conditions, and introduces a new transmission channel between AI capital spending and broader fixed income markets. The days of the hyperscalers self-funding infrastructure entirely from operations appear to be giving way to a more leveraged model with different implications for risk pricing across the capital structure.

## Looking Ahead: A Tale of Two Markets and Midterm Elections

The most striking feature of the first half of 2026 has been the divergence between equity and bond market behavior. Equity markets have been broadly constructive, recovering from a sharp drawdown in March as geopolitical risk spiked and supported thereafter by resilient earnings and the continued AI narrative. The recovery itself is notable as investors have demonstrated a willingness to look through sustained geopolitical uncertainty once the acute phase of the shock passed. Market breadth, however, remains unusually narrow. As we detailed in our February white paper, the ten largest companies in the S&P 500 now account for roughly 37% of total Index weight against about 32% of earnings, a gap that has widened materially since 2015.<sup>14</sup> (See Figure 3) As that paper argued, elevated concentration today rests more heavily on realized profitability and cash flow than in prior episodes such as the Dot-Com peak. That distinction makes it better understood as a feature of the current market structure than as an automatic fragility signal, though it does widen the range of potential outcomes.<sup>15</sup>

To read the February WHITE PAPER, [Market Concentration and the Case for Deliberate Exposure](#), or the January 2026 MACROECONOMIC NEWSLETTER, [What We are Watching in 2026: Four Themes Shaping the Economic and Market Regime](#), please visit the Thought Leadership section of our website or click the links [here](#) to learn more.

**Figure 3**  
 Top 10 S&P 500:  
 Weight vs.  
 Earnings Share



Sources: FactSet. Data is as of December 31, 2025. Index used is S&P 500.

Bond markets are telling a different story. Sovereign yields of G7 economies are near their highest levels in two decades, reflecting a combination of an inflation scare reignited by oil, expanding fiscal deficits, the gradual unwind of quantitative easing, and in the case of the US waning foreign demand for Treasuries. The result is a more risk-focused fixed income market where stagflation concerns (rather than just recession concerns) now sit at the center of investor conversations.<sup>16</sup>

As we move forward into the back half of the year, how the equity and bond markets track will be key with the November midterm elections adding another layer of uncertainty. Historically, midterm election years have been among the most volatile of the four-year cycle. Since World War II, the S&P 500 has experienced an average intra-year drawdown of roughly 18% to 19% in midterm years, though full-year returns have still been positive in the large majority of cases.<sup>17</sup> That volatility has typically been followed by strong post-election performance, with average gains of more than 16% in the twelve months following the vote. We are not predicting that pattern will hold in 2026, but it is one more reason to expect the second half to look different from the first.

## Conclusion: What is Still True, What has Changed, What is Coming?

What is still true is that we believe the four themes we laid out in January remain the right lens. What has changed is the prominence of geopolitical risk, the inversion of the rate-cut narrative in the US, and the maturation of the AI story from infrastructure to disruption. What is coming is a Fed transition, a midterm election cycle, and the potential for continued uncertainty around energy markets despite the recent US-Iran agreement. The combination of elevated geopolitical uncertainty, a new Fed chair whose reaction function is still being calibrated, and the strong recent equity run with higher valuations argues for maintaining strategic positioning likely including owning assets that can absorb a range of outcomes.

## End Notes

- <sup>1</sup> Source: S&P Global Commodity Insights, "Hormuz oil flows still at a standstill despite US insurance pledge," March 4, 2026.
- <sup>2</sup> Source: St. Louis Federal Reserve.
- <sup>3</sup> Source: Khaleej Times, "Strait of Hormuz reopening won't mean cheaper shipping as insurance premiums surge," May 12, 2026.
- <sup>4</sup> Source: Khaleej Times, "Strait of Hormuz reopening won't mean cheaper shipping as insurance premiums surge," May 12, 2026; Al Jazeera, "Maritime insurers cancel war risk cover in Gulf," March 4, 2026.
- <sup>5</sup> Source: Reuters, "Iran attack wipes out 17% of Qatar's LNG capacity for up to five years, QatarEnergy CEO says," March 19, 2026; CNBC, "Iran war damaged as much as \$58 billion of energy infrastructure, Rystad estimates," April 15, 2026.
- <sup>6</sup> International Monetary Fund, "World Economic Outlook Update: Global Economy – Steady amid Divergent Forces," January 2026; and "World Economic Outlook: Global Economy in the Shadow of War," April 2026.
- <sup>7</sup> Source: NPR, "U.S. and Iran announce an initial deal to end the war and reopen the Strait of Hormuz," June 15, 2026; Reuters / Pakistan Ministry of Foreign Affairs, June 18, 2026.
- <sup>8</sup> Source: Trading Economics, Brent Crude Oil, June 18, 2026.
- <sup>9</sup> Source: CNBC, "DOJ ends Powell probe, lifts hurdle for Trump's Fed chair nominee Warsh," April 24, 2026; CNN, "Kevin Warsh confirmed as Fed chair, succeeding Jerome Powell," May 13, 2026.
- <sup>10</sup> Source: Federal Open Market Committee, Summary of Economic Projections, June 17, 2026.
- <sup>11</sup> Source: Al Jazeera, "Kevin Warsh confirmed as new US Federal Reserve chair," May 13, 2026.
- <sup>12</sup> Source: CME Group, FedWatch Tool, December 2026 Federal Funds Futures contract; Meketa Investment Group internal analysis.
- <sup>13</sup> Source: European Central Bank, "Monetary policy decisions," June 11, 2026.
- <sup>14</sup> Source: Meketa Investment Group, "What We Are Watching in 2026: Four Themes Shaping the Economic and Market Regime," Global Macroeconomic Research Series, January 2026.
- <sup>15</sup> Source: Meketa Investment Group, "Market Concentration and the Case for Deliberate Exposure," February 2026.
- <sup>16</sup> Source: Federal Reserve, "Financial Stability Report - November 2025."
- <sup>17</sup> Source: State Street Global Advisors, "Sustaining momentum, strengthening resilience," December 2025; U.S. Bank Asset Management Group Research, "How Midterm Elections Affect the Stock Market," January 2026.

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