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EQUITIES MARKET OUTLOOK THIRD QUARTER 2026

To balance risk, look beyond the obvious

Amid the most consequential IPO wave in years and transformative generational demand for electricity in the infrastructure space, the divergence of equity market narratives and intrinsic value makes disciplined active management a powerful tool for balancing risk.

Key takeaways

- **In the U.S., the historic wave of frontier artificial intelligence (AI) and space technology IPOs entering public markets presents both opportunity and risk. Investors most likely to be rewarded are those who can distinguish between durable, asset-heavy business models and companies whose valuations rest on model-centric assumptions vulnerable to becoming obsolete.**
- **Among non-U.S. developed markets, we favor defensive European stocks, particularly financials, defense and select income-oriented sectors as a compelling valuation counterweight to elevated price/earnings (P/E) multiples for U.S. tech shares. Japanese equities also warrant attention, as they have benefited from corporate governance reform, a favorable currency backdrop and increased AI-adjacent investment.**
- **In emerging markets (EM), we believe the opportunity set remains narrow but meaningful, concentrated in the AI hardware supply chain. We also believe in leaning into the HALO theme (heavy assets, low obsolescence), most notably through regulated utilities and other power generators positioned to meet a seemingly limitless surge in electricity demand. These companies can offer a durable, infrastructure-backed complement to high-growth AI exposure.**

Willis Tsai
Head of Global Equities

The Nuveen Equities Investment Council (EIC) includes the firm's senior equity portfolio managers, with an average of three decades of investing experience. The EIC brings global expertise across different equity styles and provides value-added insights to Nuveen's investment process by refining and delivering the firm's collective equity market outlook to clients.

Navigating a generational transition

Entering the second half of 2026, we see global equity markets are in the midst of a significant transition, as massive, capital-intensive corporations execute historic public stock offerings. Market volatility remains a constant companion, geopolitical shifts continue to reshape supply chains and trade relationships, and AI is accelerating the transformation of business models and entire industries at a pace that rewards intellectual curiosity and punishes complacency. Within this environment, we continue to prefer balancing the risks of concentrated AI exposures with (1) high-quality, attractively valued defensive European stocks or (2) companies whose underappreciated durable earnings power derives from providing the physical infrastructure the AI revolution demands.

AI return on investment: distinguishing hyperscalers from enterprises

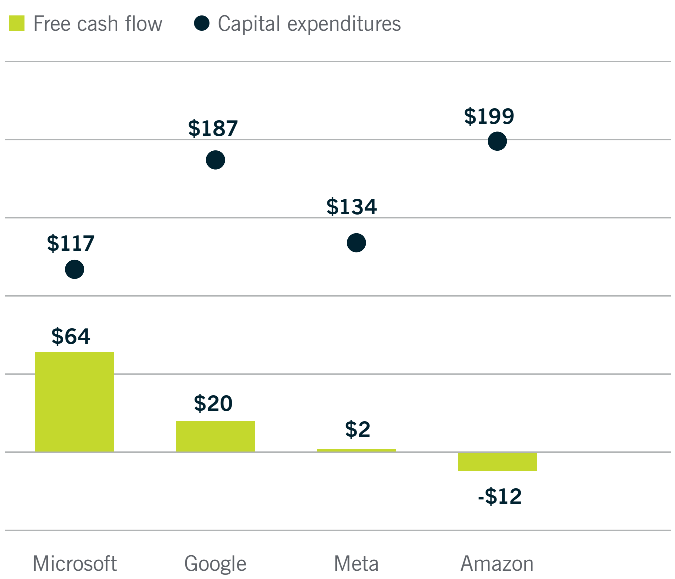
Evaluating AI capital deployment requires separating two fundamentally different investment frameworks: one for massive cloud computing and data management providers known as "hyperscalers," and one for business enterprises. Conflating the two leads to analytical error.

Hyperscalers like Google, Meta and Microsoft are spending big on AI (Figure 1) to combat the threat of obsolescence. For them, AI investment is an existential imperative that makes traditional return on investment (ROI) frameworks secondary to staying relevant in the competition to meet the technology demands of businesses and consumers. The tech industry offers a number of cautionary precedents: Yahoo, Kodak and BlackBerry each failed to sustain their well-established presence and were forced to reinvent themselves, not because they mismanaged their core businesses but because they underinvested in the transition that mattered most.

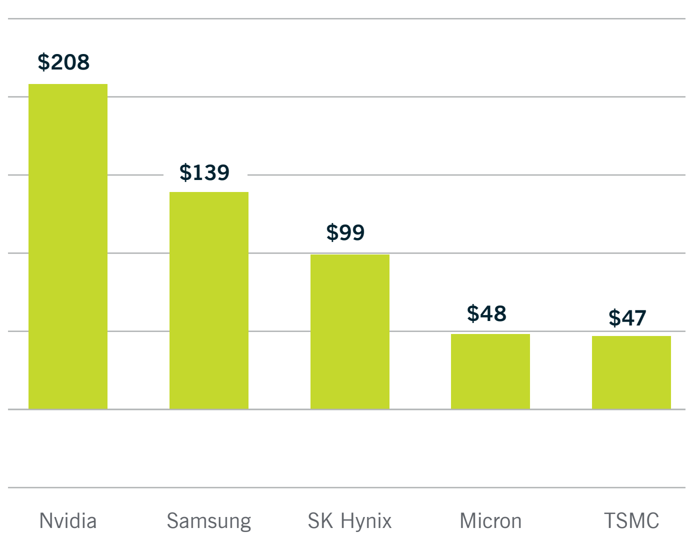
Today, every major hyperscaler faces a specific version of this threat. Google, for example, may risk losing its monopoly on traditional search if consumers continue migrating to ChatGPT or Claude. The stronghold on free consumer entertainment that Meta and Google's YouTube enjoy may be in jeopardy if OpenAI, whose huge, built-in audience is already at one billion monthly users, builds an AI-supplemented alternative for user-generated content. Microsoft, one of the world's largest "seat-based" (i.e., per-user pricing) software model, faces a dual threat: (1) fewer seats in the near term as AI automates workflows and (2) a structurally more competitive landscape down the road as AI lowers the barriers to enterprises writing their own software altogether.

Figure 1: Capital expenditures to stay in the game, not run up the return on investment score (US$ billions)

Hyperscaler consensus estimates
2026 free cash flow & capital expenditures



Semiconductor consensus estimates
2026 free cash flow



Source: Bloomberg, June 2026

Because the downside in these scenarios is obsolescence, it's reasonable to argue that the market should extend more grace to hyperscalers than it currently does when it comes to near-term ROI. Discipline still matters, of course, but "what does it cost to stay in the game?" is a more urgent query than "what is the payback period?"

For enterprises, the calculus is meaningfully different, in our view, and in some ways more interesting. Capital expenditure (capex) on AI is transitioning from a focus on enhancing productivity to driving competitive differentiation. The former is an operating leverage story that is incremental and margin-enhancing, but bounded. The latter can be a genuine game-changer, potentially transforming the competitive position of the business, not just its cost structure.

Compared to hyperscalers, enterprises in pursuit of this goal generally have a higher bar for justifying AI investment. Their managements answer to boards that tend to have less appetite for risk and demand tangible proof of ROI before they embrace significant increases in AI capex. And it's true that deploying AI without disciplined oversight can present real risk, not just theoretical ones.

Not every company succeeds in this effort. In our view, success often comes down to the focus and intentionality of the enterprise leader. Enterprise success stories, however, do share a common thread in the use of AI to compress specialized, labor-intensive technical processes in which the labor displaced is both expensive and scarce. At Applied Materials, a supplier of complex equipment used to manufacture semiconductors, the CEO described a new hardware product as impossible to develop without AI. Novanta, a maker of robotics and other advanced automation tools, used Claude to streamline a medical device regulation process that required only six hires, instead of the 50 to 60 typically needed. Bottom line: the highest ROI enterprise applications tend to focus on narrow, expert-heavy, document- or design-intensive workflows. This emphasis is worth watching as enterprise AI adoption continues to grow.

Expect a cycle, not a straight line

Improving capability and cost deflation should drive strong secular growth in AI consumption over time, but the trajectory may not be perfectly smooth given consumption-oriented business models and enterprise adoption, learning and optimization curves.

We're seeing early signs of this now. Enterprises are becoming more focused on efficiency, right-sizing model usage, shifting to lower-cost options and introducing guardrails. These actions can slow the pace of AI growth in the near term, even as underlying demand remains intact. This is a natural phase of technology cycles, similar to the experience of prior infrastructure cycles such as cloud computing: early overconsumption gives way to optimization, creating a saw-toothed pattern of growth and digestion before reaccelerating.

The combination of rapid innovation, cost deflation, and a large and expanding market for intelligence and automation supports a durable demand backdrop. There's already evidence of real value creation, and the range of viable use cases should continue to broaden over time.

However, returns will not accrue evenly across the ecosystem. Spending is being driven by a mix of strategic necessity and economic return, value is likely to concentrate in higher-ROI applications, and the redistribution of profit pools introduces both opportunity and risk. Timing could be uneven as well. Consumption-based models and enterprise optimization cycles may create periodic slowdowns but are unlikely to derail the long-term trajectory.

In our view, the most appropriate focus should remain on where AI is driving measurable outcomes and durable competitive advantages. For equity investors concerned about the volatility that may accompany AI's expected cyclicality, we believe HALO investments can serve as an effective counterbalance to high-growth AI exposure. HALO companies are distinguished by unique physical infrastructure assets that cannot be easily replicated or replaced, and which support structurally durable demand, regardless of which platform or hyperscaler model ultimately prevails.

Strategic balance: On HALOed ground with frontier AI

The arrival of landmark IPO listings crystallizes a tension that has been building throughout 2026: how do investors participate meaningfully in the AI revolution without becoming overexposed to the valuation and obsolescence risks embedded in model-centric software and frontier AI names?

One of the most compelling expressions of the HALO theme, in our view, is the regulated utility and power generation sector. The AI infrastructure buildout is driving a structural transformation of the demand curve for electricity, not merely a cyclical uptick. According to McKinsey & Company, electricity demand from U.S. data centers alone is expected to increase by more than 400 terawatt hours, or 240%, between 2024 and 2030. And total U.S. power demand is projected to grow approximately 60% over the next two decades, roughly six times the growth rate of the prior two decades.

For utilities with meaningful exposure to new generation capacity, this dynamic is particularly attractive. As regional energy markets tighten and electricity prices move higher, companies positioned to invest aggressively in new generation have the potential to expand their rate bases and compound earnings growth over a long capital deployment cycle. That said, disciplined selectivity matters when investing in these companies. We prefer operators in constructive regulatory environments, particularly in the South and Midwest. Existing residential electricity rates in these regions are among the lowest in the country, which offers greater latitude for capital investment, and permitting conditions tend to be favorable. These regions also happen to be where new data center construction activity is accelerating most rapidly, creating a natural alignment between load growth, generation investment and regulatory goodwill.

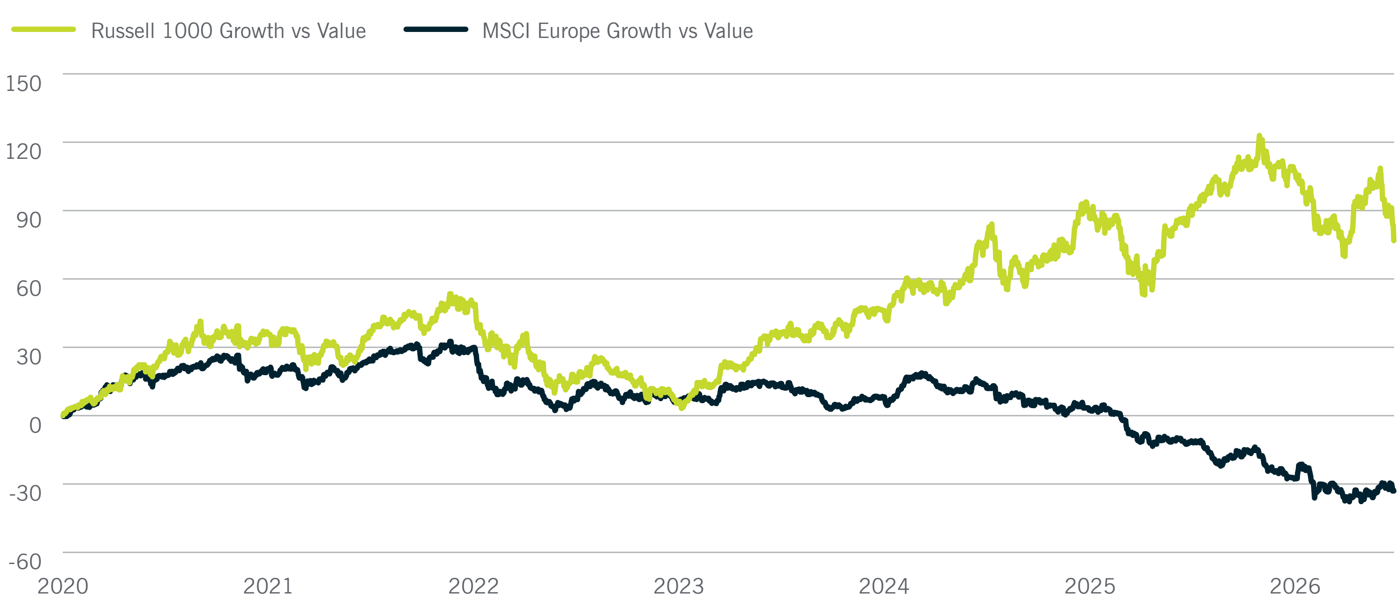
European equities: defensive value to balance the barbell

The global equity landscape has reached a point of extreme concentration. A parabolic AI narrative has driven index performance into the hands of a small number of U.S. technology giants, creating a market structure that lacks breadth, looks increasingly fragile and is vulnerable to mean-reversion. While selective exposure to the structural AI theme remains warranted, the risk-reward profile has evolved, and the case for balancing that AI exposure with a European defensive value barbell has rarely been more persuasive.

The divergence in growth versus value performance (Figure 2) across geographies is a powerful argument for this positioning. Based on respective Russell indexes, U.S. large cap growth has outperformed U.S. large cap value by about 106 percentage points since January 2020 through May 2026. European style-based index performance tells a different story, with the MSCI Europe

Figure 2: A tale of two trajectories: Growth versus value in the U.S. and Europe

Russell 1000 and MSCI Europe Growth vs Value Total Return, Index = 0



Data Source: Morningstar Direct. 01 Jan 2020 through 25 June 2026. **Performance data shown represents past performance and does not predict or guarantee future results. Please note, it is not possible to invest directly in an index.**

Value benchmark besting its growth counterpart by approximately 31 percentage points over the same period. This U.S.-European dynamic reflects fundamentally different macroeconomic forces at work on either side of the Atlantic and is precisely what makes the barbell so structurally elegant.

In Europe, value's outperformance has been broad and persistent, bolstered by sticky inflation, hawkish central bank policy and elevated commodity prices. Value outperformed the broader European market by 13 percentage points in U.S. dollar terms during 2025 alone, with European banks accounting for nearly 40% of sector outperformance while still trading at a 32% discount to the broader market. Critically, value-growth valuation spreads remain below their long-run historical average, suggesting the opportunity is not yet exhausted.

The European defensive barbell extends beyond the financials sector. Health care trades at a significant discount to its U.S. counterpart while offering solid 2026 earnings growth and substantial dividend income. With strong yields and high-quality franchises looking inexpensive, consumer staples are also appealing. And utilities are entering a multiyear capital expenditure supercycle, combining attractive valuations with robust dividends. Together, these value-oriented sectors may serve as sources of relative predictability versus U.S. large cap tech holdings.

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We think the primary headwind outside the U.S. remains the Middle East conflict. Although the announcement of a June peace deal between the U.S. and Iran helped soothe market volatility, with global oil prices retreating well below $80 per barrel (their lowest level since before the outbreak of hostilities at the end of February), the implementation of the agreement still faces challenges. That said, a true de-escalation in the Middle East could potentially accelerate the eurozone's modest +0.6% forecasted GDP growth trajectory. Were this to occur, it would likely be the single most constructive near-term catalyst for European equities as a whole, and provide further support for a defensive European weighting to balance the barbell with U.S. tech.

Japan: corporate reform meets the AI moment

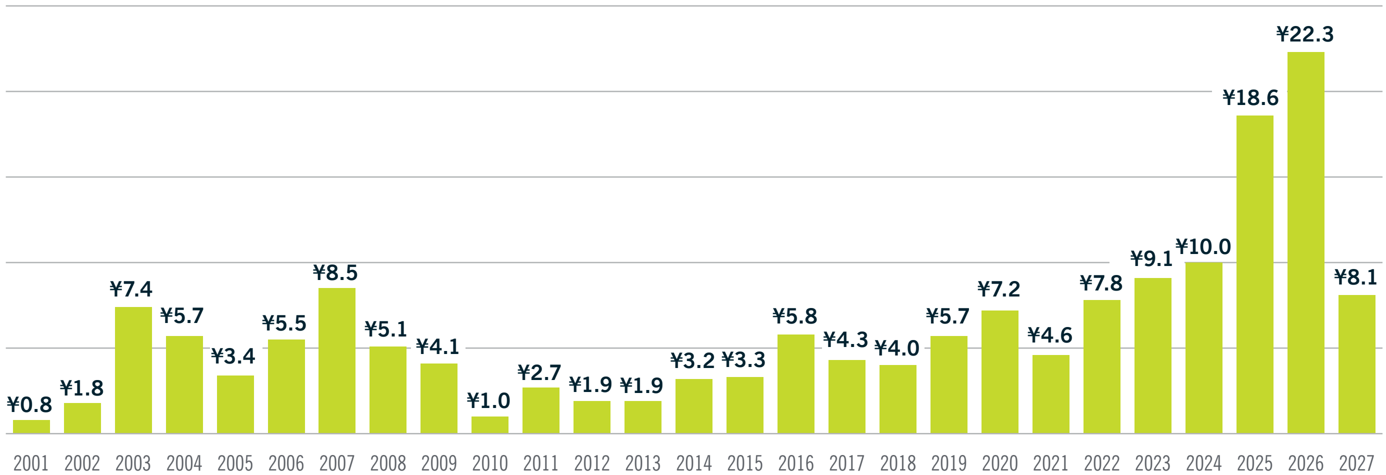
In our view, the long-term investment case for Japanese equities remains intact, underpinned by favorable currency dynamics, structural reforms and growing exposure to the global AI buildout. Moreover, in our opinion the fundamental drivers of Japan's 18-month bull market show little sign of running out of steam. We believe corporate earnings growth, for example, has room to broaden from here.

We believe a weaker yen continues to provide a powerful tailwind for Japanese exporters, boosting the yen-denominated value of overseas earnings and keeping Japanese goods competitive globally. Approximately 44% of Japan's corporate revenues are derived from outside the country, with the United States representing the largest share. Any sustained softness in the yen, which is a trend we think will persist as long as the Bank of Japan maintains its gradual approach to policy normalization, would likely translate into continued upward earnings revisions for Japanese companies. At the same time, Japan's monetary policymakers are mindful that roughly 70% of the domestic economy revolves around small and medium-sized enterprises that tend to be sensitive to rising borrowing costs.

Corporate governance reform may be an important yet underappreciated catalyst for Japanese equities. Activist pressure is accelerating the unwinding of cross-shareholding structures, and announced share buybacks across the Tokyo Stock Price Index (TOPIX) universe are tracking at their highest level in over two decades,

Figure 3: A boom in buybacks from Japanese companies

TOPIX Index announced buyback (¥, trillions)



Data source: Bloomberg, 05 June 2026

with activity surging from roughly ¥9 trillion in 2023 to an estimated ¥22.5 trillion ($139.5 billion) in 2026, as shown in Figure 3. With approximately 40% of TOPIX 500 companies still carrying net cash on their balance sheets, there's ample runway for further capital returns to shareholders.

On the AI front, Japan has positioned itself as a key participant in the regional semiconductor and data infrastructure buildout. Domestic technology conglomerates plan sizable investments in data centers and related infrastructure, which should drive sustained demand for Japanese-made components. These investments align with the government's broader ambition to elevate Japan's standing as an advanced semiconductor production hub.

Equity valuations in Japan have risen alongside the market rally, warranting a degree of caution. Still, the valuation of the MSCI Japan Index remains one standard deviation below that of the MSCI World. And Japan's index is far less concentrated from a sector perspective than other developed equity markets, supporting broader stock selection opportunities. Financial shares have outperformed year to date but have appreciated less than earnings growth would imply, suggesting further upside potential. On balance, our outlook for Japanese equities is constructive.

Emerging markets: AI dominance reshapes the EM landscape

The EM narrative heading into the second half of 2026 consists largely of a single chapter on AI. In our view, investors in these markets are laser-focused on countries, sectors and companies that stand to benefit from AI, and those that lack a compelling AI hardware story are likely to be left behind. The earnings upgrade cycle has been dominated by advanced memory semiconductors, with select Korean chipmakers driving the bulk of index-level revisions. We expect this trend to persist as the global AI infrastructure buildout accelerates. Broader semiconductor and technology hardware names should continue to perform well, although the risk that AI will crowd out liquidity from most other areas of the EM equity asset class is an important consideration in portfolio construction.

Performance dispersion across EM is likely to remain wide. Year to date through 30 June 2026, the MSCI Emerging Markets Index returned +23.8% with six of 24 constituent countries outperforming the benchmark as a whole. South Korea (+118.6%) and Taiwan (+62.4%) have dominated, and we see few if any near-term catalysts to meaningfully broaden that market leadership. In fact, returns for the two largest EM economies — China (-15.0%) and India (-9.9%) — illustrate how narrow the non-AI hardware opportunity set has become.

Index concentration will likely persist as a structural feature of EM over the medium term. The top three index countries by market capitalization now make up 70% of the benchmark, while the world's leading advanced semiconductor manufacturer (based in Taiwan) and the two dominant Korean memory chipmakers collectively represent 30.1%. Overall, the information technology sector has expanded to 45.3% of the benchmark, from 28.3% at the start of the year. Further upward drift is plausible if AI-driven earnings momentum continues.

Beyond AI, inflation and central bank policy are the other variables likely to influence EM returns through year-end. Several countries, such as Brazil, India and South Africa, entered 2026 anticipating substantial rate relief, but surging oil prices due to the U.S.-Iran conflict remapped those trajectories. Assuming oil prices settle amid signs of cautious optimism for a resolution, we believe the conditions for renewed monetary easing could re-emerge and provide a tailwind for rate-sensitive EM economies.

Lastly, the outcome of the May bilateral summit between the U.S. and China leaves their relationship in a state of tentative equilibrium for now. While the friendlier tone and agreed-upon AI hardware details are encouraging, the overall lack of concrete specifics suggests that this year's lagging Chinese equity market is unlikely to rally meaningfully in the near term. South Korea presents a different set of forward-looking risks. Surging retail investor participation and a proliferation of leveraged ETFs tied to Korean memory semiconductor names have introduced speculative dynamics. How these play out, particularly around the expected U.S.-listed share offering from one of Korea's leading memory chipmakers later this summer, bears watching.

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