Tactical Asset Allocation

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ADCB

Sunscreen applied: trimming active risks for summer

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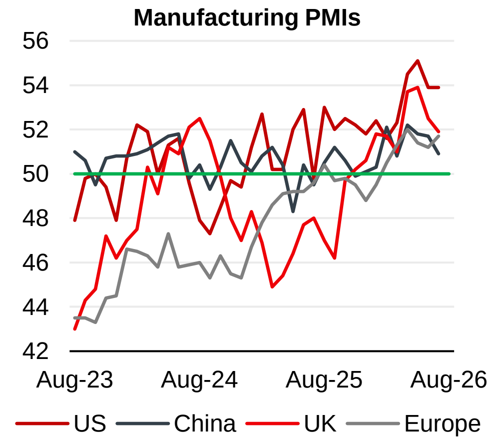
- **Growth remains 'slow-grind' while inflation risks linger; macro uncertainty is elevated and is feeding directly into higher risk premia.**
- **Resilient earnings against a backdrop of higher term premia continue to tilt the balance toward equities over fixed income.**
- **We stay risk-on for the medium term but adopt a summer-cautious stance by trimming active risks.**

Growth

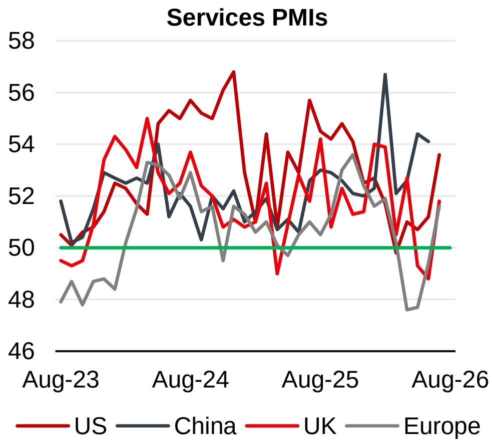
Global growth continues to expand, but only at a subdued pace, with PMIs signaling modest momentum rather than a robust upswing. The Global Composite PMI Output Index rose to roughly 52.0 in June, indicating continued but moderate expansion, while manufacturing remains slightly stronger than services even as the earlier manufacturing outperformance begins to ease. Emerging markets continue to expand at a strong pace, whereas Europe and the UK are hovering around flat GDP amid Middle East-related energy and confidence shocks. In the US, helped by capital expenditures in AI ecosystems, growth is running near a 1.0%-1.5% annualized pace, while Eurozone and UK PMIs point to broadly flat Q2 GDP. Overall, the global cycle resembles a "slow-grind" expansion: supportive enough for earnings but still vulnerable to energy-driven price shocks and confidence swings, consistent with the matured-early-cycle narrative outlined in our June TAA note ("Staying risk-on in a world of term-premiums", June 2026).

Exhibit 01: Manufacturing sector strength is beginning to moderate …



Sources: S&P Global, LSEG Workspace, and ADCB Asset Management

Exhibit 02: … while the services sector is recovering



Sources: S&P Global, LSEG Workspace, and ADCB Asset Management

Inflation

The global disinflation trend has stalled rather than reversed, with the Gulf conflict keeping a persistent geopolitical premium embedded in energy, shipping and food prices. Over the past few months, oil briefly spiked above USD120-125/bbl during the Strait of Hormuz crisis before easing toward USD75/bbl, but recent flare-ups have reintroduced a meaningful risk premium into energy markets. Headline inflation in advanced economies is drifting in the 3-4% range, with US CPI running around 3.5–4.2% YoY and euro area HICP re-accelerating to roughly 3.0–3.2%, driven largely by energy and food. Food inflation is also creeping higher again, with global vegetable oils and meat prices up about 5% from recent lows, and fuel-importing EMs experiencing renewed pressure as pass-through from energy intensifies. This leaves inflation behaving as a stop-start process, not the smooth glide path policymakers hoped for – keeping medium-term inflation expectations and term premia elevated, echoing the dynamic described in our June TAA note ("Staying risk-on in a world of term-premiums", June 2026). The mix has culminated into a stagflationary-lite environment in energy-importing DMs and vulnerable EM, raising the bar for aggressive monetary easing and favouring assets with inflation-linked cashflows. In short, stalled disinflation means geopolitics continues to keep the heat in prices and term premia.

Monetary policy

Global monetary policy has shifted from synchronized easing to clear fragmentation, with the ECB and BoJ continuing to hike, the Fed and BoE remaining on hold, and EMs very mixed in their monetary policy approach. This divergence reflects how the Middle East energy shock is transmitting unevenly across economies, reshaping FX dynamics, yield curve behavior and cross-border capital flows. The Fed is holding at 3.50–3.75%, balancing 4%-plus inflation against energy-driven uncertainty, while the BoE remains on hold near 3.75%. In contrast, the ECB has lifted its deposit rate to 2.25%, prioritizing inflation control despite near-stall growth, and the BoJ has raised rates to 1.00%, continuing its long-delayed normalization. As a result, policy paths have become increasingly idiosyncratic, reinforcing the need for regional differentiation in tactical asset allocation – fully consistent with our June note's observation that "*policy paths are increasingly idiosyncratic, reinforcing the importance of regional differentiation in tactical asset allocation*." This divergence supports higher FX volatility, steeper curves in select markets, and a premium for quality carry over pure duration exposure.

Fiscal policy

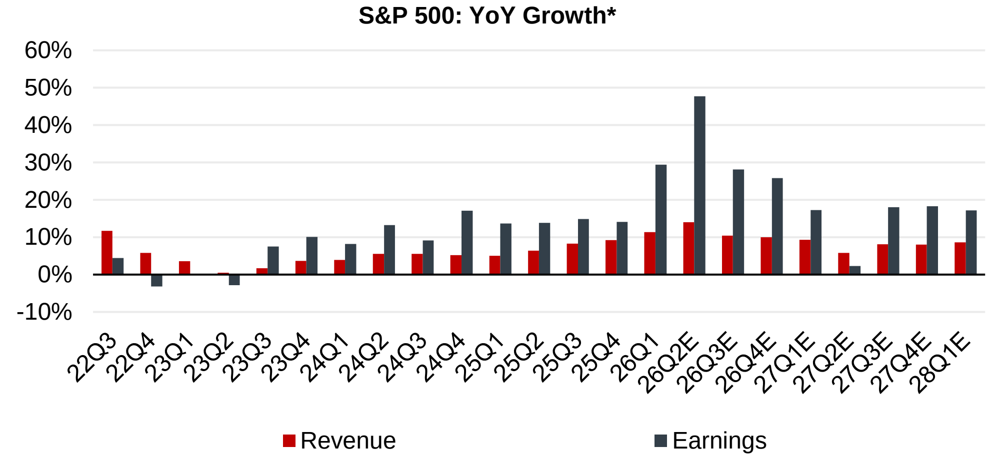
Fiscal policy remains a core macro driver, with global public debt hovering near post-war highs and deficits elevated across major economies. Governments are simultaneously absorbing energy shocks, higher defense outlays and social support commitments, all while operating with increasingly thin fiscal buffers – pushing term premia higher and tightening the link between sovereign risk and asset pricing. Global gross government debt stands near 94% of GDP and is projected by the IMF to approach 100% by 2029, with the global fiscal gap – the space to stabilize debt – now close to zero. The US is running a 7–8% of GDP deficit at near-full capacity, with debt projected by the IMF to exceed 140% of GDP by 2031, while China's deficit is near 8% of GDP and debt is trending toward c127% of GDP by 2031. Europe is activating fiscal escape clauses to accommodate persistent defense spending, whereas many EM and low-income economies face record interest-to-revenue ratios and increasingly constrained market access. As we noted in our June TAA, fiscal dynamics have become a primary driver of term structure and risk premia, not a background variable. Elevated debt levels and rising debt-service costs argue for integrating sovereign risk more tightly into portfolio construction – favouring quality credit and avoiding sovereigns with weak buffers.

Financial conditions

Global financial conditions remain relatively easy for risk assets despite higher long-end yields and elevated macro uncertainty. Equities – especially AI-linked markets – continue to climb a wall of worry, while credit spreads remain contained even as the cost of capital rises and non-bank leverage builds. Long-end yields in core markets are sitting near multi-decade highs, reflecting inflation, fiscal and policy credibility risks, and term premia have risen materially. At the same time, global equities – led by the US and AI-oriented Asia (Japan, Taiwan, and Korea) – have pushed to record highs before coming under pressure in July, and IG and higher quality HY spreads remain well anchored, underscoring the resilience of credit markets. Elevated financial stability risks stem from high sovereign debt, NBFI leverage, private credit expansion, and concentration risk in AI-related sectors, adding nuance to an otherwise supportive risk environment.

Overall, the regime resembles one of "higher cost of capital, but still risk-tolerant markets", a dynamic that supports selective risk-on positioning with a premium on balance sheet strength and cash flow durability – echoing our June TAA note that "*equity markets… are focusing on earnings quality and balance sheet strength rather than cheap liquidity*." In this backdrop, quality credit carry and equity exposures tied to structural themes such as AI and infrastructure continue to outperform pure duration or low-quality beta. In short, markets are paying more for capital but still chasing quality growth.

Exhibit 03: Strong earnings growth has underpinned the equity market performance



Sources: LSEG Workspace, I/B/E/S, and ADCB Asset Management | *Notes: *data as of July 31, 2026*

Tactical Asset Allocation

We stay broadly risk-on, but with a more cautious stance through the summer months, recognizing the seasonal dip in liquidity, elevated geopolitical risk, and increasingly rich valuations in several AI-linked segments. The macro mix – slow-grind growth, stalled disinflation, rate divergence, and fiscal-driven term premia – continues to favor equities and credit over duration, but it also argues for tighter risk-budgeting and more selective exposure. Seasonally, summer months tend to deliver lower equity returns and higher event risk, with thinner liquidity amplifying any surprises, policy headlines and geopolitical flare ups. AI-linked markets across the US, Japan, Taiwan and Korea have outperformed strongly (although they came under acute pressure more recently), creating concentration and valuation risks, even as broader indices still benefit from resilient earnings and cash-rich balance sheets. Term premia and long-end yields remain elevated, while fiscal and geopolitical risks – from the Middle East to tariff uncertainty and election-related noise – are skewed to the downside even as base-case growth holds.

Against this backdrop, we maintain an equity overweight, but tilt toward quality and diversification: reducing extreme AI concentration, favouring sectors with pricing power and balance sheet resilience, and keeping dry powder for dislocations.

In fixed income, we continue to prefer credit risk over duration, emphasizing IG, EM USD sovereign IG, and inflation-linked cash flow assets such as core infrastructure – fully consistent with our prior TAA note's guidance that "*this environment favors selective risk-taking, disciplined duration management, and a clear preference for assets that can* *sustain returns without reliance on ultra-low rates.*" In short, it is a summer risk-on with sunscreen applied: stay in the market, but being risk-aware.

Exhibit 04: We stay risk-on in our TAA (3-6M view) but turn slightly summer-cautious

	View				
Asset Class	**SUW**	**UW**	**N**	**OW**	**SOW**
Equities				●	
North America				●	
Europe			● →	●	
Japan				●	
APac ex Japan		●	← ●		
EM ex Asia			●		
Fixed Income		●			
DM Treasuries IG		●			
DM Corporate IG			●		
EM USD Sovereigns IG				●	
EM LCY IG			●		
EM Corporate IG			●		
Global HY				●	
Cash		● →	●		

Sources: ADCB Asset Management

Reducing active risks

While remaining overweight equities, we cut the active weight by 1ppt in our equity-bond balanced portfolios by trimming our overweight in US equities. We favor financials, industrials, and healthcare within the US but also globally. While we remain constructive on AI as a theme, we still see scope for further weakness in semiconductors space.

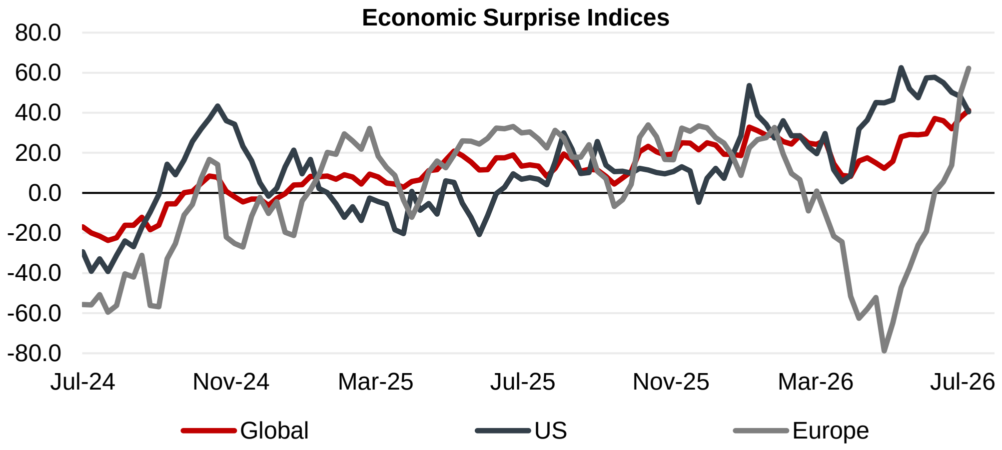
We hold the proceeds of trimming the US exposure as cash which we now move neutral. Cash acts as the dry powder for post-summer deployment.

Further rotation within equities

In June, we rotated out of Asia Pacific-ex-Japan into Europe. Now we extend that by cutting the former to an underweight and deploying the funds into Europe which now goes to an overweight. While Asia Pacific-ex-Japan equities have come under pressure in July as markets reacted to excessive AI-concentration risks, we see scope for further correction. Yet, we think large share of the sell-off is behind us and we may be close to the bottom than to the top when it comes to the recent sell-off in AI-related themes. However, we think we are not there yet. While we are moving underweight Asia Pacific-ex-Japan, we see scope for India and China equity markets to outperform.

Europe, on the other hand, has not benefited from the AI rally and is positioned well to benefit from any further rotation out of AI related themes. Moreover, the economic data have been improving across the board in Europe and this dynamic is likely to feed into positive risk sentiment. Euro has not strengthened materially and therefore is not expected to be a headwind for European assets. Thinking about the overall balance of risks, we overweight European equities in our portfolio now alongside Japan and the US (in the latter we trim our overweight).

Exhibit 05: Europe is now outperforming on the economic surprises



Sources: Citi Economic Surprise Indices, LSEG Workspace, and ADCB Asset Management

Cross-asset focus list

To our cross-asset focus list, we are making the following changes:

- We close our US small caps position (Russell 2000) after it hit its target 20% return on July 21, 2026. While we stay constructive on small cap equities in the US for the medium-term, we would take profits for now and look to potentially re-enter post-summer.
- On June 26, 2026, we launched a long trade on 2Y USTs which we think is the cleanest way to play the “peak hawkishness” narrative we describe in our note (“Cross Asset Outlook: Hawkishness peaks, opportunity speaks”, June 26, 2026).

Exhibit 06: Our high conviction tactical investment themes – open and closed positions*

New/Open positions	Asset class	RV?	Date opened	Current date	Performance	Target	Stop
Gold	Commodities		2-Feb-26	29-Jul-26	-13.8%	25%	-15%
Indian equities	Equities		11-Apr-25	29-Jul-26	-0.6%	20%	-10%
Global Core Infrastructure IG	Fixed Income		9-Jun-26	29-Jul-26	-1.2%	5%	-3%
UST 2Y Index	Fixed Income		26-Jun-26	29-Jul-26	0.2%	5%	-1%
Average					**-3.9%**		

Closed positions	Asset class	RV?	Date opened	Closed date	Performance	Target	Stop
Silver	Commodities		15-Oct-25	31-Dec-25	35.1%		
Silver	Commodities		22-Sep-25	15-Oct-25	20.4%	20%	-10%
Copper	Commodities		15-Jun-23	15-Oct-25	26.5%		
Silver	Commodities		10-Jun-25	22-Sep-25	20.6%	20%	-10%
Gold	Commodities		14-Nov-22	14-Jun-23	10.4%		
Commodities average					**22.6%**		
US Small Caps (Russel 2000)	Equities		6-Oct-25	21-Jun-26	20.2%	20%	-10%
US Large cap Innovation Growth	Equities		26-Mar-26	15-May-26	23.5%	20%	-10%
US Homebuilders	Equities		2-Sep-25	12-Mar-26	-11.0%	20%	-10%
US Small Caps (Russel 2000)	Equities		6-Mar-24	6-Oct-25	20.2%	20%	-15%
High dividend yielders index	Equities		6-Mar-24	10-Jun-25	15.1%	15%	-10%
Gold miner equities	Equities		17-Mar-25	2-Jun-25	20.8%	20%	-10%
SPW relative to SPX	Equities	Yes	6-Mar-24	10-Apr-25	-5.7%	15%	-10%
Gold miner equities	Equities		25-Nov-24	17-Mar-25	22.3%	20%	-10%
HK equities	Equities		14-Nov-22	13-Nov-24	13.3%		
Chinese hotels & leisure	Equities		14-Nov-22	13-Nov-24	-18.6%		
Chinese semiconductors	Equities		22-Mar-23	13-Nov-24	9.0%		
Dow Jones World Cons. Goods	Equities		25-Aug-23	6-Mar-24	1.5%		
Indian equities	Equities		22-May-23	6-Mar-24	31.3%		
Cybersecurity	Equities		22-Mar-23	6-Mar-24	26.9%		
Gold miner equities	Equities		14-Nov-22	14-Jun-23	13.1%		
US Div.banks over US Regional	Equities	Yes	13-Mar-23	13-Jun-23	24.8%		
Equities average					**12.7%**		
US Mortgage Backed Securities	Securitized credit		11-Apr-25	5-Sep-25	5.2%	5%	-5%
UK gilts over other DM Sov.	Rates	Yes	14-Nov-24	1-Sep-25	-2.5%	5%	-5%
UST (7Y-10Y) over other DM Sov.	Rates	Yes	5-Jul-22	13-Nov-24	-1.1%		
EU IG Corp over US IG Corp	Credit	Yes	9-Jan-23	13-Nov-24	6.0%		
Asia investment grade credit	Credit		9-Jan-23	14-Jun-23	1.8%		
Fixed Income average					**1.9%**		
USDJPY	FX		6-Mar-24	26-Apr-24	-6.0%		
GBPUSD higher	FX		15-Jun-23	20-Sep-23	-2.8%		
USDJPY lower	FX		9-Jan-23	14-Jun-23	-5.5%		
GBPEUR lower	FX		9-Jan-23	14-Jun-23	-2.9%		
FX average					**-4.3%**		

*Sources: Bloomberg, and ADCB Asset Management | Notes: *Data as of July 29, 2026.*

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