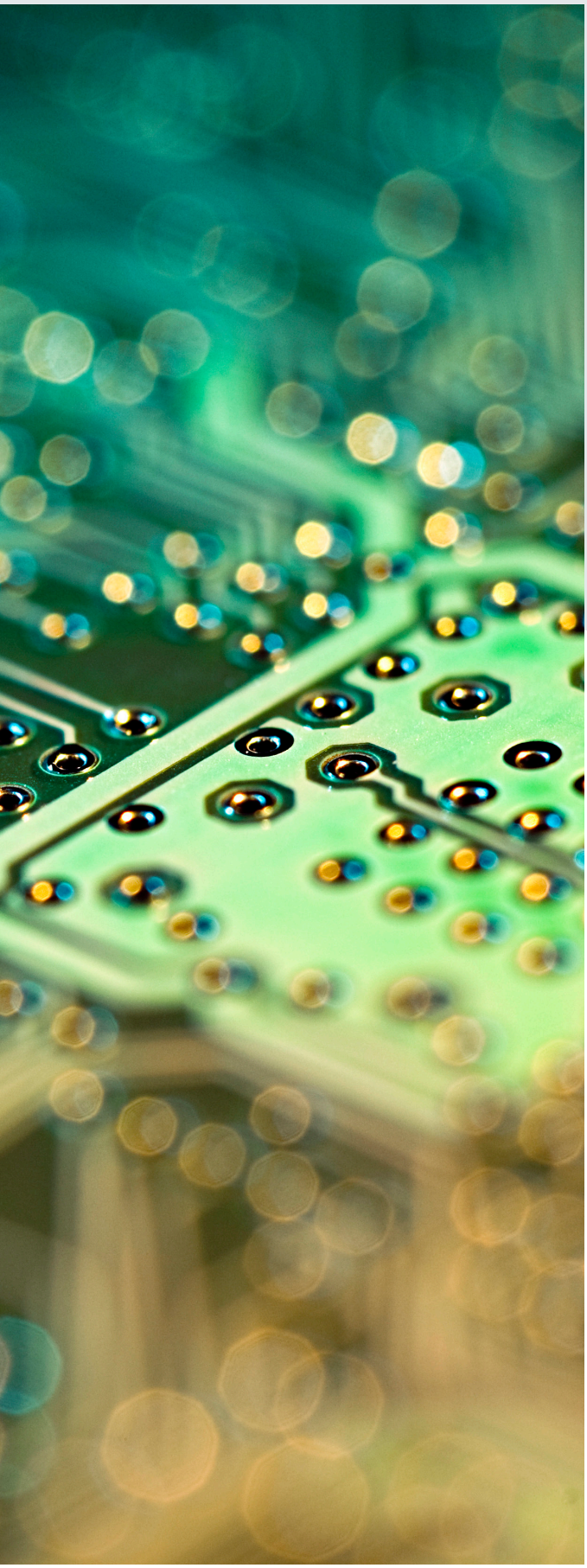

BARINGS

MULTI ASSET

Replacing Equity Beta with High-Carry Credit

INSIGHTS

With U.S. equity valuations elevated and fixed income yields attractive, investors may be better served replacing portions of broad equity exposure with high-carry credit over the next three to five years.

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The following views are those of the Barings Multi-Asset Team as of June 25, 2026 and are subject to change at any time without notice.

A Secular Change in Portfolio Construction

Attractive opportunities for tactical asset allocation tend to emerge three to four times a year. Constant evolutions in economic momentum, policy stances and/or geopolitical tensions often catch market positioning offside, creating a window for tradable swings in rates, FX or risk assets that can make or break active performance for the year.

But we believe the need for holistic, secular changes in asset allocation may only arise once a decade.

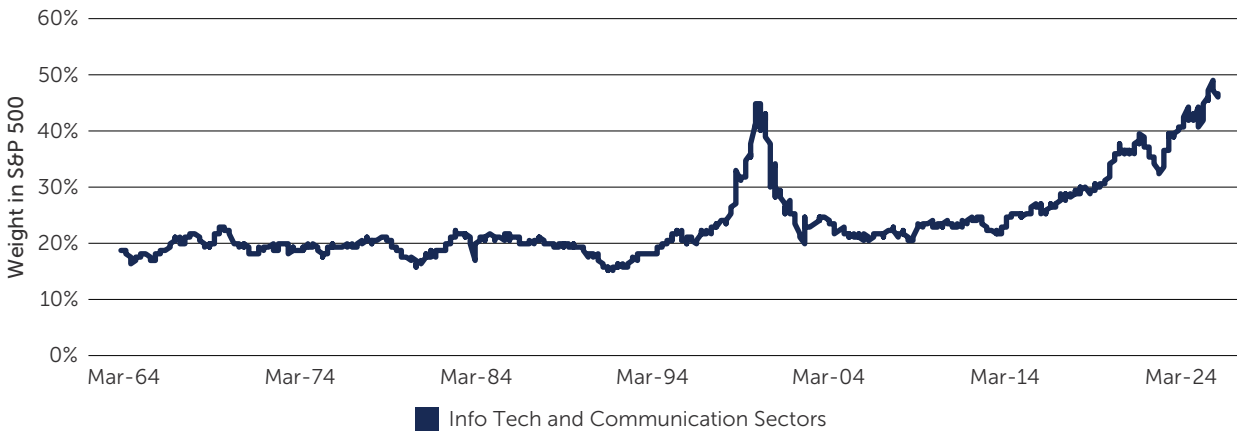
Today, we are seeing conditions build toward a major rethink of portfolio construction for the years ahead, **specifically the potential for high-carry credit to outperform generic equity beta over the next three to five years, especially on a risk-adjusted basis.**

The Last 15 Years Have Been Goldilocks for Equities

Portfolio managers are always looking to optimize carry versus total return potential, and the last 15 years have been a near-perfect environment for equity total returns. For most of this period, interest rates were well below the Fed's long-run neutral rate, the Fed expanded its balance sheet by several trillion dollars, corporate tax rates were lowered from 35% to 21% and companies leveraged cheap debt to finance trillions in stock buybacks.

But no tailwind has been more significant for equity returns than the emergence of asset-light, internet-enabled and otherwise tech-oriented businesses. Companies like Apple, Microsoft, Alphabet, Meta, Amazon and, more recently, Nvidia have rewritten the rules of corporate profitability and scalability. The Tech sector has delivered historic earnings growth, making equity beta one of the most important allocation decisions of the past decade. As seen in **Figure 1**, a sector that accounted for just 21% of the S&P 500 in 2013 now represents nearly 50% of the index when combined with the Communications sector, led by Meta and Alphabet.

Figure 1: Weight of Technology in the S&P 500



Source: Compustat; Morgan Stanley Research. As of December 31, 2025. PAST PERFORMANCE DOES NOT GUARANTEE FUTURE RETURNS.

And while earnings growth has been impressive, total returns have been even stronger, as record profit margins have contributed to higher P/E multiples. If the current trajectory continues, the S&P 500 is on-track to deliver annual EPS growth of 9.0% dating back to 2010, one of the strongest 15+ year periods on record. Yet P/E multiple expansion from 14x to 22x has helped drive annualized returns of 14.6% over that period, far better than the 8.5% annual returns of the preceding 20-year period.

But two observations on valuations call the outlook for future returns into question.

First, while some EM markets currently offer reasonable valuations, buying U.S. equities at today's starting P/E multiples tends to coincide with a significant drop-off in forward returns, as seen in **Figure 2**. Simply put, the odds of further multiple expansion decline, and any moderation in valuations can meaningfully counteract whatever earnings growth is delivered over the period.

Figure 2: P/E Multiples Tend to Coincide With a Drop-Off in Forward Returns

Starting Level of S&P 500 Fwd. P/E	S&P 500: Median 5yr Fwd. Annual Returns
12.0x	14.6%
14.0x	15.1%
16.0x	11.8%
18.0x	11.0%
20.0x	1.7%
22.0x	0.5%
24.0x	-1.8%
Current Fwd. P/E	
22.0x	

Source: Bloomberg. As of May 29, 2026.

The second major evolution is the return of attractive yields in fixed income. For the first time since 2002, Treasury yields are competitive with equity earnings yields, as shown in **Figure 3**. The S&P 500 earnings yield sits at the 4th lowest percentile of the last 20 years, while 10-year Treasury yields are at the 89th percentile highest yield. These elevated Treasury yields come at a time when labor market growth and household income growth are running at their lowest levels in years. So not only do we believe these higher yields embed a more attractive level of ongoing carry, but they also present an attractive asymmetry of total return potential across a range of economic outcomes.

Figure 3: Equity Earnings Yield vs. 10-Year Treasury Yield

Source: Bloomberg. As of May 29, 2026.

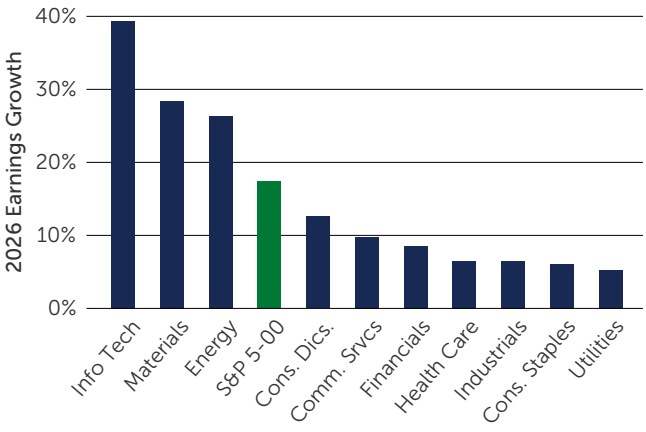
But couldn't we be in a "new normal" of sustained Tech-oriented earnings growth driven by the AI infrastructure build-out? Some of the world's largest companies are delivering 30%, 50% and even 70% earnings growth, supported by booming multi-year backlogs. After all, equities are a growth asset class, and more growth is certainly better than less, as companies can reinvest those expanded profits into larger-scale capital projects, expanding their market reach and competitive advantages.

Yes, sustained, disproportionate growth is certainly a possibility. However, while equities are delivering incredible earnings growth today, there is a growing list of concentration risks that warrants a more nuanced perspective on how to structure equity risk in portfolios for the years ahead.

Concentration Risks Likely Mean Greater Volatility Ahead

While the S&P 500 is enjoying its best period of sustained earnings growth since the dot-com recession, that growth is highly concentrated in the largest Tech companies. As seen in **Figure 4** below, the Tech sector is far outpacing all others, with nearly 40% earnings growth in 2026. Even more striking, the "Mag 7" alone is set to contribute nearly 35% of all S&P 500 profit growth this year. While total EPS growth is alluring, the high degree of Tech concentration brings into question the total return potential of non-Tech sectors.

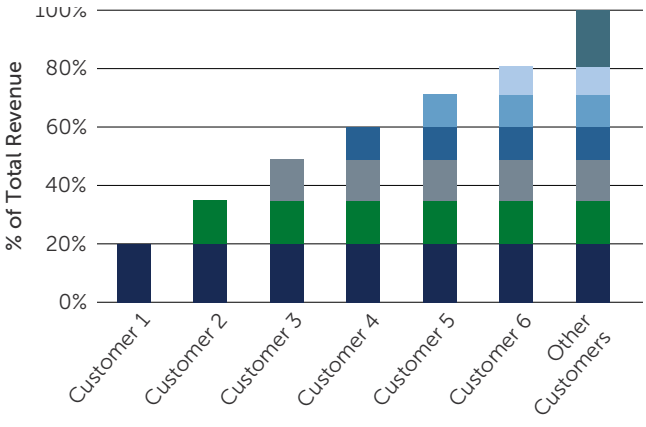
Figure 4: 2026 EPS Growth by Sector



Sources: Bloomberg; Morgan Stanley. As of April 6, 2026.

Within Tech, there is admittedly some customer concentration risk, or circularity risk, as well. As shown in **Figure 5**, the largest company in the world, Nvidia, generates more than 80% of its revenues from just six customers, including at least four members of the Mag 7. The immense profitability of each is helping to drive investment in the others. While this dynamic fueled the rally of the last three years, the competitive nature of the AI race increases the risk of overbuilding, and when momentum slows, circularity can work in reverse.

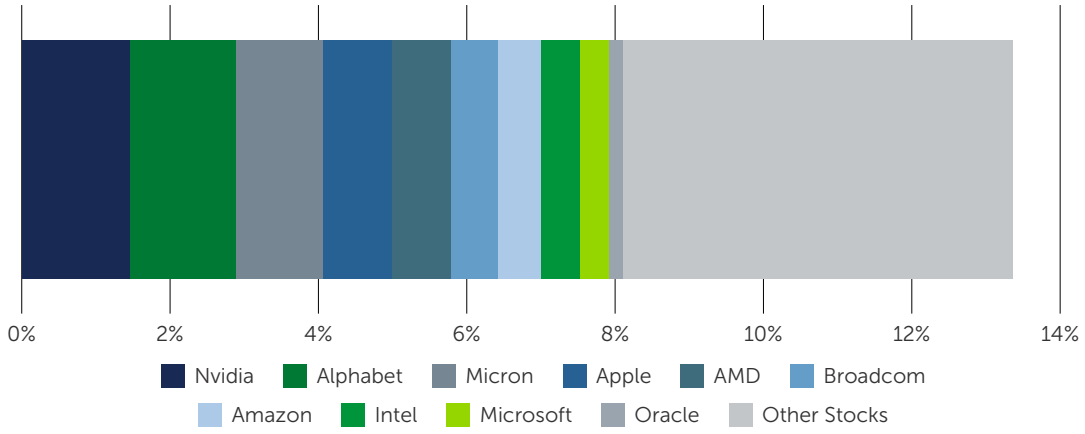
Figure 5: Nvidia's Customers as % of Total Revenue



Sources: Nvidia; Bloomberg. As of May 2026.

Concentration is showing up in price action as well. From the end of March to early June, U.S. equities have risen 13.4%, but 60% of those returns have been generated by just 10 Tech companies, as seen in **Figure 6** below. In fact, over the last three years, these same 10 stocks have contributed 38% of all the gains in the S&P 500.

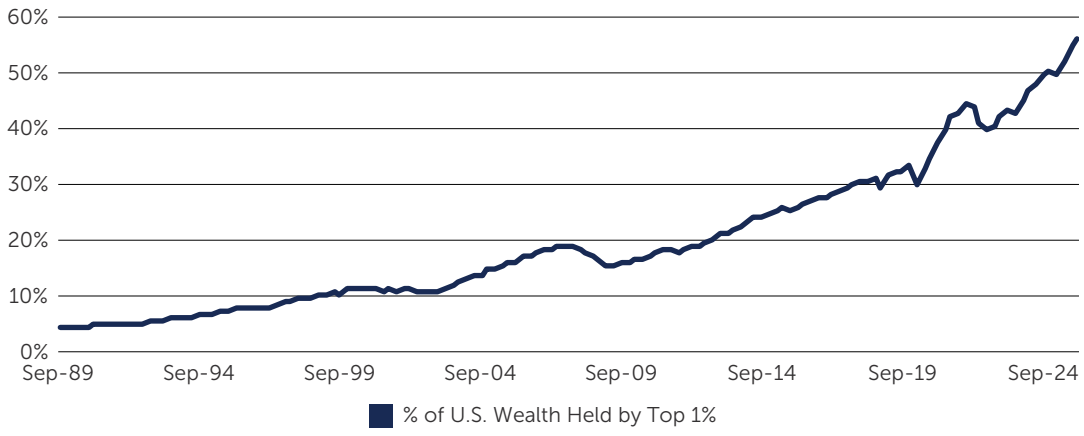
Figure 6: Contribution to S&P 500 Return Since March 2026



Sources: Compustat; Aladdin. From March 31, 2026 to June 9, 2026.

Other concentration risks could also drive higher volatility. Nearly 60% of U.S. wealth is now held by the top 1% of households, as seen in **Figure 7**. With midterms approaching this fall in the wake of three trillion-dollar, AI-centric IPOs, we expect to hear a growing chorus of proposals for new taxes on wealth or on AI, especially given corporate tax rates are the lowest since the 1930s. If any of these tax proposals gain traction, equities could bear the brunt in a more volatile way than credit.

Figure 7: Percentage of U.S. Wealth Held by the Top 1%



Source: Federal Reserve. As of December 31, 2025.

Finally, there is the quantitative step-up in volatility that comes from valuing companies like SpaceX, Anthropic or OpenAI on cash flows 10 to 15 years into the future. Again, more earnings growth is better than less, but when valuations rely on a multi-decade run of sustained growth, enterprise value becomes increasingly concentrated in the out-year terminal value.[1] As shown in **Figure 8**, that terminal value[1] is highly sensitive to any change in those growth expectations, resulting in potentially more volatile swings in sentiment.

Figure 8: Terminal Value is Highly Sensitive to Changes in Growth Expectations

Earnings Growth	% of Equity Value Embedded in "Terminal Value" (Year 15)[1]
2.0%	29.6%
4.0%	35.9%
6.0%	42.8%
8.0%	50.3%
10.0%	58.2%
12.0%	66.5%
14.0%	74.9%

Earnings Growth	Change in Equity Value for 1% drop in Projected Growth[2]
14.0%	-20.8%
12.0%	-17.5%
10.0%	-15.3%
8.0%	-13.6%
6.0%	-12.2%
4.0%	-11.0%
2.0%	-10.0%

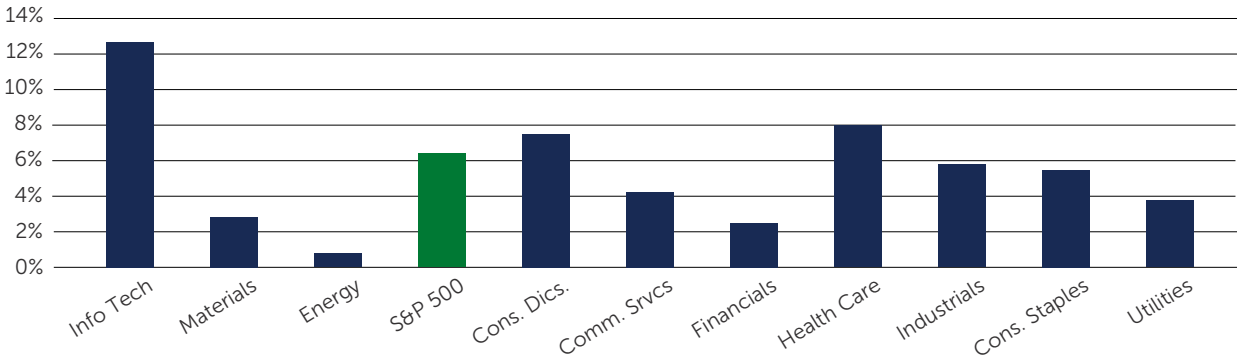
Sources: Barings; Bloomberg (forward looking statements). As of May, 2026.

Re-thinking Equity Exposure

Despite these concentration risks, the Tech sector remains the dominant source of earnings growth, and therefore, returns.

We highlighted technology's impressive 2026 growth, but as seen in **Figure 9,** disproportionate growth has been a feature for much of the last 20 years. Perhaps even more noteworthy, **most other S&P sectors have only delivered 2–6% long-term earnings growth**—not exactly ideal for total return prospects, especially relative to current yields in credit or relative to today's elevated P/E multiples.

Figure 9: 2005–2025 EPS Growth by Sector



Sources: Bloomberg; Morgan Stanley. As of December 2025.

1. Terminal Value is the estimated value of a company's equity beyond the period of projected cash flows, in this case, 15 years.
2. If the projected growth rate of a company's cash flows is 12%, and that declines by -1% to 11%, the projected equity value declines by 17.5%.

The earnings growth divergence helps illustrate why lower-volatility, high-yielding credit may be more attractive today than lower-growth, generic equity beta.

For example, if the Russell 2000 or MSCI World were to deliver only 5–8% earnings growth while adding 20% volatility to a portfolio while secured credit offered a 7% yield with 5–7% volatility, the relative attractiveness of secured credit may appear like the more compelling allocation.

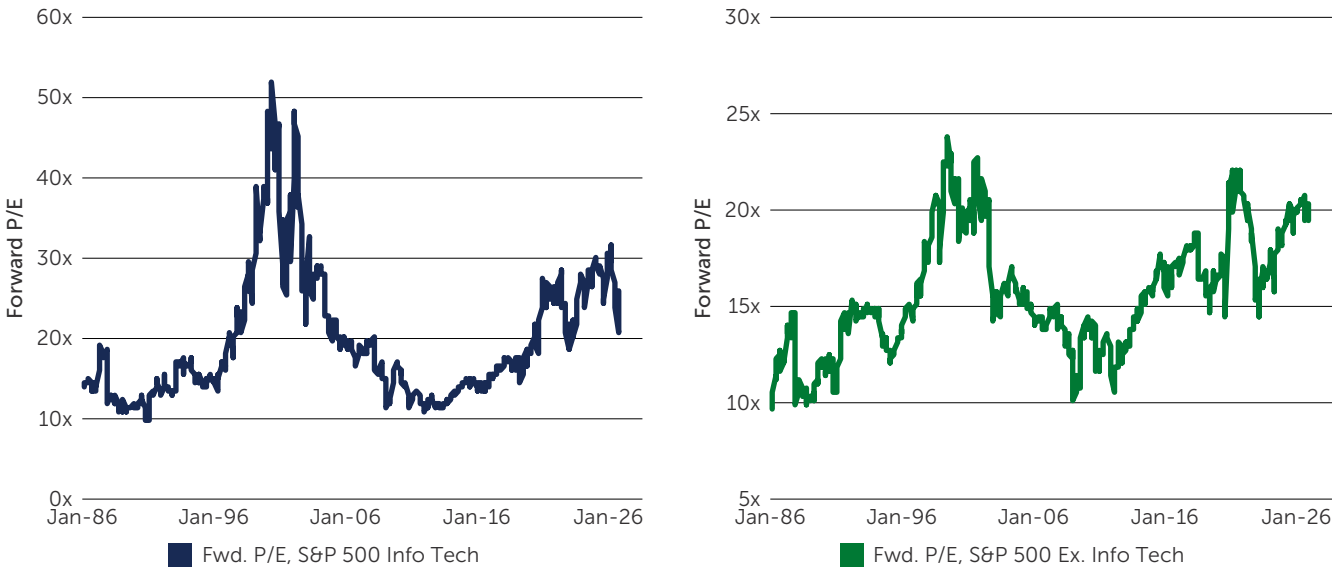
And while Tech shares may exhibit more volatility going forward, if the sector can deliver 20–40% profit growth, can't investors generate a strong equity contribution to portfolio returns through a smaller allocation to equities but concentrated in high growth Tech?

For illustrative purposes only, a 5%–8% return on a 60% allocation to a broad equity index like the Russell 2000 contributes 3.0%–4.8% to portfolio returns. By contrast, under the same assumptions, a 20% allocation to high-growth Tech returning 25%–30% contributes 5.0%–6.0% to portfolio returns. In this illustration, investors are able to free up significant capital to reallocate into lower-volatility, high-yield credit without sacrificing the return contribution from equities.

Not to mention, while the Nasdaq has delivered nearly twice the annual returns of the Russell 2000 over the last 10 years (+22.2% vs. +11.3%), this Tech-heavy index has actually come with lower volatility than the Russell (18.7% vs. 20.8% annualized volatility).[3]

And underneath the surface of the elevated P/E headlines, we see a significant advantage for Tech exposure. As seen in **Figure 10**, Tech multiples are a full 20–25x below the late-1990s peak, whereas non-Tech multiples are only 3–4x handles away.

Figure 10: Tech vs. Non-Tech Multiples



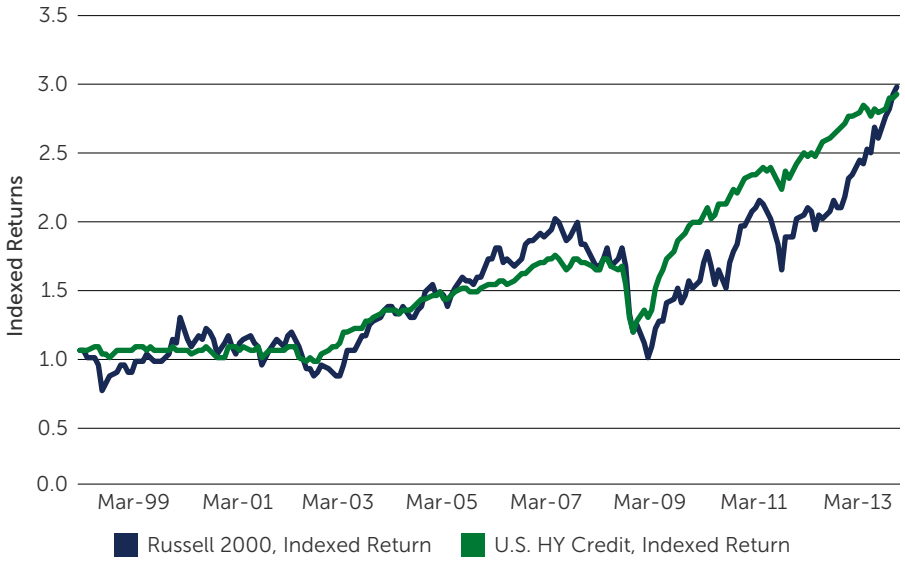
Source: Bank of America. As of May 29, 2026.

3. Source: Bloomberg. As of June 16, 2026.

The late 1990s comparison provides relevant context on two other fronts. First, from March 1998 to the peak in March 2000, the Russell 2000 appreciated 24%, while the Nasdaq rose an incredible 280%; a small allocation to Tech equity dramatically outperformed a full allocation to generic equity beta.

Second, as seen in **Figure 11**, U.S. high yield credit outperformed the Russell 2000 by over 25% over the five years following March 1998. In fact, high yield credit outperformed for much of the next 15 years, through 2013.

Figure 11: U.S.High Yield Credit vs. Russell 2000 Equity



Source: Bloomberg. As of June 17, 2026.

Investors may not require full equity market allocations when much of the exposure outside of Tech offers relatively modest long-term earnings growth alongside similar levels of volatility. **In this context, investors may wish to re-evaluate the relative roles of Tech exposure, broader equity beta, and high yield credit within portfolio construction.**

Seeking a More Resilient Portfolio with Credit

If we retain Tech exposure and replace the remaining equity beta with high yield bonds, we believe we can build a potentially more resilient portfolio with higher return potential and lower volatility. We compare a traditional 60/40 portfolio to an alternative portfolio that builds exposure to Tech equity and high yield credit.

Figure 12: Traditional vs. Alternative (Tech Equity) Portfolio

Traditional 60/40 Portfolio	Weight	Historical Return[4]	Historical Drivers of Return[5]	Historical Volatility[6]
Equity (Equal-weight S&P)	60%	10.0%	8.5%	16.6%
Fixed Income (U.S. Agg)	40%	1.6%	4.7%	5.1%
Weighted Portfolio	**100%**	**6.6%**	**7.0%**	**12.0%**

Alternative (Tech Equity)	Weight	Historical Return[4]	Historical Drivers of Return[5]	Historical Volatility[6]
Equity (S&P Tech Sector)	30%	24.9%	18.4%	21.2%
High Yield (USD)	30%	5.8%	7.2%	7.1%
Fixed Income (U.S. Agg)	40%	1.6%	4.7%	5.1%
Weighted Portfolio	**100%**	**9.9%**	**9.6%**	**10.5%**

Sources: Barings; Bloomberg. As of June 2026. PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS. Hypothetical portfolios are being shown for informational purposes only. They do not represent actual portfolio, recommendations, or investment advice. Actual results will vary, potentially materially, depending on market conditions and individual circumstances.

The results are compelling: more than 200 bps of higher expected returns alongside significantly lower overall portfolio volatility.

We believe adding high yield bonds may offer several advantages. Current yields are highly competitive with the long-term growth potential of many non-Tech equity sectors, while returns have historically been driven by carry, which may provide a more stable volatility profile. Today's high yield bond market also exhibits several characteristics that may support resilience: duration has fallen from 4 years to just 2.9 years, and the ratings mix is the most favorable it has been in years. To the extent there is a sharp slowdown in Tech growth, the sector accounts for only 5% of the high yield bond market.

And if investors are willing to give up some liquidity in their fixed income allocations, private direct lending is another asset class offering equity-like returns alongside lower volatility and significant credit protections.

4. Historical Return = annualized returns over the last 10 years ending in June 2026.
5. Historical Drivers of Return = the last 10 years of annualized EPS growth for Equity, and the current Yield to Worst for High Yield, Direct Lending, and Fixed Income.
6. Historical Volatility = observed annualized volatility over the last 10 years ending in June 2026.

Figure 13: Less Liquid Portfolio

Less Liquid Portfolio	Weight	Historical Return[7]	Historical Drivers of Return[8]	Historical Volatility[9]
Equity (S&P Tech sector)	30%	24.9%	18.4%	21.2%
High Yield (USD)	20%	5.8%	7.2%	7.1%
Private Credit	20%	9.4%	9.0%	2.7%
Fixed Income (U.S. Agg)	30%	1.6%	4.7%	5.1%
Weighted Portfolio	**100%**	**11.0%**	**10.2%**	**9.8%**

Sources: Barings; Bloomberg. As of June 2026. **PAST PERFORMANCE IS NOT NECESSARILY INDICATIVE OF FUTURE RESULTS.** Hypothetical portfolio is being shown for informational purposes only. It does not represent an actual portfolio, recommendation, or investment advice. Actual results will vary, potentially materially, depending on market conditions and individual circumstances.

Further diversifying the fixed income allocation to include private lending could hypothetically add another 60 bps of annual returns on even lower volatility. If we remain in a higher-for-longer rate environment with sticky inflation, these private credit yields could make even more sense, particularly relative to today's elevated equity multiples.

Conclusion

Portfolio construction is ultimately a process for optimizing outcomes by assessing carry and total return potential relative to volatility. If we think of high yield bonds and generic equity beta as fungible sources of return, the attractiveness of high-carry credit today can be incredibly compelling relative to holding lower-growth equity exposures.

As noted, equity volatility is likely to increase over the next few years as concentration and circularity risks drive significant swings in sentiment. But while the AI CapEx cycle may be at the center of this volatility, it is also the source of dramatically higher earnings potential. Owning smaller equity allocations concentrated in the areas with the strongest earnings growth can be a very efficient portfolio lever.

And while we take a multi-year view in this piece, we believe the record equity rally in April and May has created an attractive opportunity to implement such a reallocation, especially alongside the recent back-up in sovereign yields.

Ultimately, this framework challenges the traditional assumption that diversification requires broad equity exposure. Instead, investors can adopt a more efficient approach: concentrate equity allocations in sectors with strong structural growth and use high yield credit as the diversifier.

For perhaps the first time in 10–15 years, re-weighting the allocations between equities and credit could potentially offer a much more resilient path to achieving long-term investment objectives over the coming three to five years.

7. Historical Return = annualized returns over the last 10 years ending in June 2026.
8. Historical Drivers of Return = the last 10 years of annualized EPS growth for Equity, and the current Yield to Worst for High Yield, Direct Lending, and Fixed Income.
9. Historical Volatility = observed annualized volatility over the last 10 years ending in June 2026.

Definitions

VOLATILITY

"Volatility" measures the magnitude of the changes in the price of an investment or security. Higher volatility implies larger, more significant movements in price over a given period of time.

BETA

"Beta" represents the risk that an investment or security adds to a portfolio. Beat measures the volatility of an investment or security relative to the broader market.

TERMINAL VALUE

"Terminal value" is the estimated value of a company's equity at a hypothetical future date. If analysts project the cash flows of an investment for a period of time, for example 10 years, the terminal value represents the estimated equity value of all future cash flows beyond that initial 10 year window.

CARRY

"Carry" for fixed income investments is often synonymous with the stated yield of that investment. Carry equates to the expected return of a bond assuming current market conditions remain unchanged throughout the holding period.

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