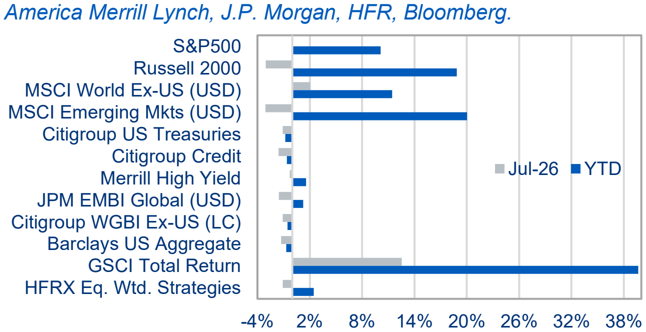
Global Market Review

The U.S. equity market fell slightly in July amid a major momentum reversal. Questions surrounding AI winners and losers appeared to be the main market driver. Chip producers suffered an especially large reversal in fortune. Developed non-U.S. equity markets rose, while emerging equities declined, dragged down by sharp falls in the share prices of Korean and Taiwanese chip producers. The BoE, BoJ, ECB, and the Fed kept rates unchanged, decisions seen as hawkish holds by the market. The U.S. Treasury yield curve steepened as rising risk premiums sent the 30-year yield to its highest level since 2007. The on-again off-again Iran war continued to play havoc with oil markets. Oil prices rebounded sharply in July, after a steep drop in June. They are up 47.5% so far this year. The U.S. dollar index fell. With the Japanese yen near 40-year lows against the dollar, Japan and the U.S. took the unusual step of a concerted intervention to support the yen's price, resulting in a large appreciation at month end.

Performance of Major Market Indices

Sources: S&P, MSCI, FTSE Russell, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, HFR, Bloomberg.



U.S. equities fell slightly in July. Oil prices surged.

"Too Much of a Good Thing Can Be Wonderful"

"This time is different" – a more prosaic version of Mae West's justification for excess – is often trotted out to rationalize markets that are running hot for the next new thing. Silicon Valley's latest variant on this theme argues that bubbles are good because without the "good bubble" transformative productivity gains from AI investments would not be realized.

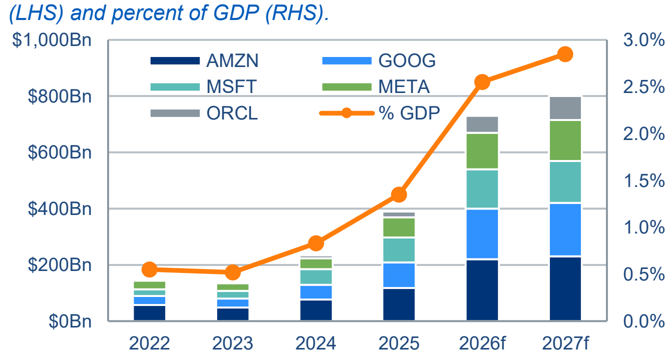
This blinkered and self-referential argument ignores the costs of a financial bubble, which history suggests typically include deep and protracted asset price declines, large falls in output and employment, and massive increases in fiscal deficits and debt. It typically has taken between 3-5 years for asset prices, output, and employment to recover fully from the financial crisis that follows a burst bubble.

Whether the massive investment in AI infrastructure yields hoped-for revenues and productivity gains depends on the useful life of that infrastructure and the speed with which AI can be put to effective use across the economy. Whether AI-enabled productivity gains outweigh the costs of a bubble-induced crisis, if one materializes, depends on the depth and duration of the ensuing downturn.

Whatever the eventual balance, the pace of data center construction by the main hyperscalers is breathtaking (Exhibit 1). How long this pace can last and what factors – financial or physical – ultimately constrain further expansion are also open questions.

Exhibit 1. Hyperscaler Capital Expenditure Accelerates

Source: Bloomberg. Hyperscaler capital expenditure in USD billion (LHS) and percent of GDP (RHS).



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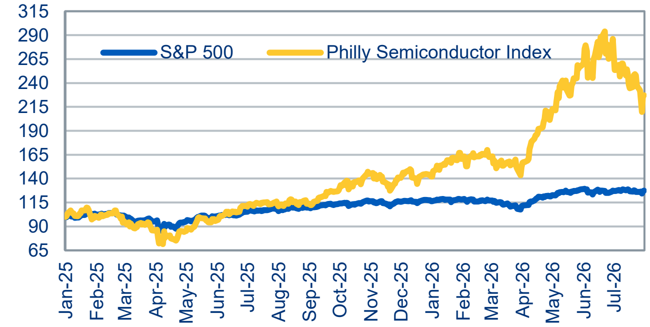
Major Momentum Reversal in U.S. Equities

Recent equity market dynamics reflect a market wrestling with the questions raised in the previous section, notably will the massive AI-related capital expenditure be vindicated by a commensurate jump in revenue and productivity and which firms are best placed to reap these rewards. While the S&P 500 was little changed in July, chip producers suffered a major reversal of fortune, partially giving up previous massive gains (Exhibit 2). This sell-off represented one of the largest ever one-month momentum reversals.

Exhibit 2. Chip Stocks' Momentum Reversal

Source: Bloomberg. Index January 1, 2026 = 100.



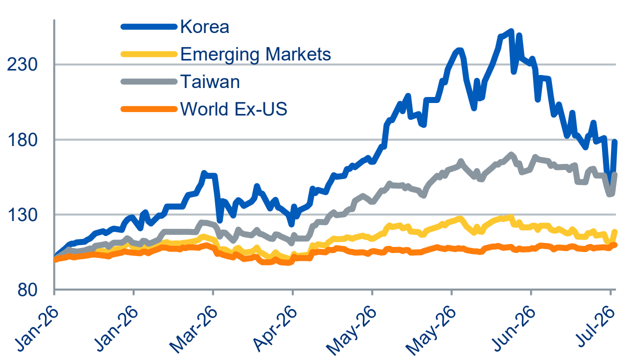
For the year as a whole, the S&P 500 remains up 10.1%, despite the minor declines of the past two months. Over this period, growth stocks are up a modest 0.8% while value stocks are up 20.8%. Small cap stocks have outperformed large, gaining 18.8% versus 9.9%. Strong corporate earnings growth has helped underpin these gains. With 61% of S&P 500 firms reporting, second quarter earnings are estimated to have risen by 47.4% yoy, with 86% of reporting firms recording positive earnings surprises.

Chip Producers Drag Down Emerging Equity Markets

Emerging equity markets declined 3.1% in July but nevertheless remain up 20% so far this year. Korean and Taiwanese chip producers have been a dominant force in emerging equity markets this year. Their sharp reversal of fortune in July was the main driver of the decline in the emerging equity market index, while their previous stellar gains had been a prominent factor supporting the broader index's gains (Exhibit 3).

Exhibit 3. Chip Producers Roil Emerging Equity Markets

Source: Bloomberg. Index January 2026 = 100.



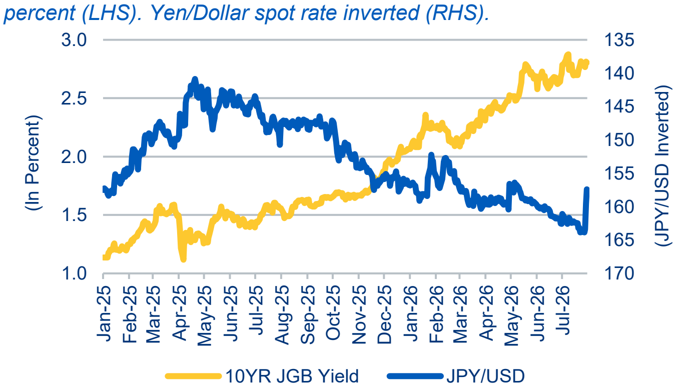
The MSCI World ex-US index of advanced non-U.S. equities rose 2.1% in July, bringing its return for the year to 11.4%. European and Japanese equities contributed to the gains in July, rising 1.6% and 1%, respectively. So far this year, Japanese equities have enjoyed especially strong returns in both local currency and U.S. dollar terms, notwithstanding the depreciation of the yen. The combination of yields held artificially low by massive central bank bond purchases and a gross government debt ratio of 240% of GDP has contributed to yen weakness while also boosting the stock market.

High Debt, Low Yields, Collapsing Yen

Japan and the U.S. undertook a highly unusual, concerted intervention to support the yen in July as it hovered near 40-year lows (Exhibit 4). The way in which the U.S. intervened was also unusual. Instead of selling dollars to buy yen, the U.S. used euros as the funding currency. This move was widely seen as a way to support the yen, without also putting pressure on U.S. Treasury yields.

Exhibit 4. Yen Weakness Sparks Concerted Intervention

Source: Bloomberg. 10YR Japanese Government Bond yields in percent (LHS). Yen/Dollar spot rate inverted (RHS).



Although long-term Japanese yields have risen, they remain too low relative to the magnitude of Japan's debt. By keeping yields low, the BoJ is in effect transferring fiscal stress to the yen. Since interventions to support the yen entail the sale of Japan's massive holdings of U.S. Treasuries, Japanese intervention to support the yen puts pressure on Treasury yields, worsening the U.S.' already dangerous debt dynamics. Until the fundamental imbalance of artificially low Japanese yields and massive debt is resolved, the yen will remain under pressure, and the risk to Treasury yields will persist.

Performance of Major Market Indices through 07-31-2026

Sources: MSCI, FTSE, Barclays, Citigroup, Bank of America Merrill Lynch, J.P. Morgan, S&P GSCI, HFR, Bloomberg.

	1-Month	QTD	YTD	1-Year	3-Year	5-Year
S&P500	-0.1%	-0.1%	10.1%	19.6%	19.3%	12.9%
Russell 2000	-3.0%	-3.0%	18.9%	34.2%	15.1%	7.1%
MSCI World Ex-US (USD)	2.1%	2.1%	11.4%	25.0%	16.5%	9.6%
MSCI Emerging Mkts (USD)	-3.1%	-3.1%	20.0%	36.4%	19.3%	8.0%
Citigroup US Treasuries	-1.1%	-1.1%	-0.8%	2.0%	2.9%	-0.9%
Citigroup Credit	-1.6%	-1.6%	-0.6%	2.7%	4.7%	-0.2%
Merrill High Yield	-0.3%	-0.3%	1.6%	5.0%	8.2%	4.0%
JPM EMBI Global (USD)	-1.5%	-1.5%	1.3%	7.7%	8.3%	2.1%
Citigroup WGBI Ex-US (LC)	-1.1%	-1.1%	-0.6%	-0.6%	1.2%	-2.4%
Barclays US Aggregate	-1.3%	-1.3%	-0.7%	2.7%	3.7%	-0.4%
GSCI Total Return	12.6%	12.6%	39.7%	41.6%	15.2%	15.7%
HFRX Eq. Wtd. Strategies	-1.1%	-1.1%	2.4%	6.7%	5.9%	3.0%