Current Positioning
August 2026

The past month summed up

An essentially flat month for equities belies a bumper quarter for corporate earnings. The artificial intelligence (AI) revolution might not be an illusion but the interconnectedness of markets with the economy and vice versa means it is increasingly becoming the loadstone of this cycle.

The rationale

Our core view remains that the economy remains in reasonable shape and that the AI revolution has both the potential to boost the economy now through capital investment and in the future through a step change in how we all work, boosting productivity. The risk, however, is that the prevalence of AI spending throughout the economy and markets ties everything together which means any blip could rapidly cause contagion throughout markets. That blip could be related to inflation, Iran or AI itself.

As of now there really is little bad news in the US which remains the most powerful engine driving the global economy. US GDP expanded at an annualised 1.5% in the second quarter – while that was below analyst expectations of 2.1% it's worth noting that this is after absorbing the braking effect of the war in Iraq and resultant higher gas prices. Reassuringly, personal consumption, which makes up more than two thirds of US GDP, increased to 3.2% from just 0.5% in the first quarter boosted by the tax refunds of the Trump administration and individuals giddy on an ever-advancing stock market.

Concurrently manufacturing now appears to be extremely healthy with the Institute of Supply Management's manufacturing PMI report climbing to its highest level since May 2022. And while Labour figures seemed subdued in July, with 23,000 jobs taken out of the economy, that was more to do with a lack of new jobs being created as monthly job cuts fell to their lowest in two years. Importantly, US inflation remains steady, if above target, as fading concerns about the oil supply in the Middle East war helped lower gasoline prices.

High earners

The most significant statistics of all were to be found in the corporate world where company earnings have been racing ahead. Of the 90% of S&P 500 companies who have reported earnings thus far more than 85% have posted figures that exceed analyst expectations. Compared to the second quarter of last year earnings growth stands at an astonishing 50%. Of course, the folks in Silicon Valley are the ones reporting the biggest earnings, with Apple saying its revenue reached a record $109 billion in the quarter. Among those dominating the provision of infrastructure to support the AI revolution, Amazon’s cloud business grew 37%, Microsoft’s expanded 43% and Google’s soared 82%.

And more is set to come for those most closely associated with rampant technology investment. Bank of America's earnings revision data showed that the ratio for the semiconductor sector has surged to a 54-month high of 2.72, meaning nearly three times as many chip companies have had their earnings revised upwards as compared to downwards.

That earnings success hasn’t stopped significant swings in technology and specifically semiconductor share prices which swooned in July before staging a partial recovery into month end. Analysts are suggesting that one of the factors that dented technology shares over July – the Nasdaq slipped almost 7% – was concern about the challenge from Chinese AI start ups such as Moonshot, which released a model whose capabilities were supposedly close to that of current AI superstar Anthropic. Others have suggested more technical reasons for weakness over the period – with expectations high some investors were profit taking in advance of second-quarter earnings whilst some hedge funds and leveraged players unwound exposure to what they felt were overinflated stocks.

Wider gains

An important aspect though is that the aggregate of share performance is little changed. Falls in technology have been offset by gains that have spread more widely across stock markets, an important development for those of us looking more broadly to identify longer term beneficiaries of the AI race. This broader advance has analysts such as Yardeni Research predicting that the S&P 500 index could climb from its present level of about 7,500 to 8,250 by the end of the year.

There's no doubt though that much of the gains in markets and earnings have come from the bonanza of investment in AI — $2.6 trillion estimated for 2026. The good news that we have highlighted before is that there are already indications that this spending is beginning to generate a return for those footing the bill as opposed to just generating profits for those building out the infrastructure.

A risk we are watching is whether there is a quasi-circular nature to this investment super cycle with corporate earnings being boosted as companies mark to market their investments in other businesses – in other words investment gains are responsible for some of the earnings gains, which are responsible in turn for some of those stock market gains. Add in the fact that those earlier cited manufacturing numbers are due in no small part to the same phenomena, along with GDP and job figures, then the risk of contagion – of one small event spreading more widely – increases.

Irony awareness

There are without doubt signs of giddiness across the market. Bank of America's July global fund manager survey shows cash levels have fallen to an extremely low 3.6% and investors are overweight US equities by the biggest amount since December 2024. The company's Bull and Bear indicator, which uses a combination of statistics to show how positive or negative the market is, reckons we are an extreme bull situation at present. A case in point might be the recent difficulties experienced by the fabulously-named Situational Awareness fund run by the 24-year-old Leopold Aschenbrenner, who with little investor experience prior to this role is reported to have been overseeing $45 billion. His fund, which focuses on the potential of AI, posted a loss of 67% in July.

With the economy and markets currently on a sound footing, but with expectations high we are conscious that any disruption could tip markets lower. The most immediately obvious risk remains geopolitical – should the tussle between the US and Iran spiral further downwards, this would put additional pressure on oil supplies, raise energy prices higher and strangle economic progress whilst undermining confidence. Alternatively, some corporate accident or piece of news that upsets the narrative around AI could also be its undoing – witness the initial shudder when the news of Moonshot was released. Another prevalent risk is that those inflation figures, which last month appeared under control, could inflect higher due to war-related energy and fertilizer costs, or indeed record warm weather in Europe hampering crop yields. Rising yields and rates, especially in response to a shock, have a history of upsetting equity and bond markets

In relation to the third risk, the news has actually been more positive recently as the benefits from the technological gains filter through our economy, with US labour productivity advancing 2.2% in the second quarter. This may not only may vindicate some of what we are led to believe about the benefits of AI but also feeds into the narrative that some had attributed to new Fed Chairman Kevin Warsh, holding that productivity increases would help downplay the need for any hike in interest rates.

Conclusion

While acutely aware of the risks at present, the good news around the continuing economic resilience alongside near record rates of growth in corporate earnings are driving stock markets and support a positive view. Most importantly those advances in the market have begun spreading out more widely. This helps those of us eager to maintain diversification both through a wider perspective on the potential beneficiaries of AI, as well as looking to ensure portfolio balance beyond a single bet on a technological revolution in its early stages where even those at the vanguard are unsure of its eventual destination.

In terms of balance, we are maintaining our exposure to the shorter end of fixed income given the continuing concerns about higher inflation leading to elevated interest rates while our investments in hedge funds add a robust element to the portfolio in the event markets become more choppy in coming weeks and months.
