CAIM CROWN AGENTS INVESTMENT MANAGEMENT

Capital Markets Monthly
FIXED INCOME

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The Iranian conflict continues to be the main driver of bond yields

US Treasuries weakened over July, with yields rising across the curve as investors priced in firmer inflation risks and a more hawkish Federal Reserve. Longer-dated yields underperformed, resulting in a steeper yield curve, reflecting concerns that higher oil prices following the resumption of military action in Iran could feed through to inflation expectations. The front end also remained under sustained pressure, with the 2-year Treasury yield rising for a fifth consecutive month, increasing by around 92 basis points since the end of February (from 3.37% to 4.29%), underscoring the market's reassessment of the likely path for US monetary policy. Against this backdrop, markets increased expectations for further policy tightening, extending the sell-off in government bonds. Following the July 29 FOMC meeting, Chair Kevin Warsh maintained a hawkish tone, stressing that the Federal Reserve's inflation target remains 2% and has not shifted higher. He emphasised that policy would remain data dependent and that the FOMC stands ready to raise rates if inflation proves persistent. The message reinforced the Committee's commitment to restoring inflation to target.

UK Gilts also came under pressure during July, with the yield curve steepening as 30-year gilt yields rose by around 30 basis points over the month. At its 30 July meeting, the Bank of England's Monetary Policy Committee maintained a cautious stance, although the voting split shifted to 6–3, with Catherine Mann joining the hawks in favour of tighter policy, highlighting continued concern over underlying inflationary pressures. While UK CPI inflation eased from 2.8% to 2.6%, this improvement is likely to prove temporary, with a renewed acceleration later this year appearing all but inevitable as energy base effects reverse. Markets nevertheless interpreted the Bank's communication as marginally less hawkish, leading to a substantial decline in the implied probability of a September rate hike. Politically, the appointment of Burnham as Prime Minister was broadly well received by markets, with the decision to appoint Healey, rather than Ed Miliband, as Chancellor viewed as supportive of fiscal credibility and therefore relatively constructive for the gilt market going forward.

European government bonds also weakened during July, with German Bund yields moving higher across the curve. The 2-year Bund yield rose by around 30 basis points, reflecting a marked reassessment of the ECB policy outlook, with markets now assigning a very high probability to a further rate increase at the Governing Council's 10 September meeting. Although the latest euro area headline inflation reading surprised modestly to the downside, the improvement is likely to prove transitory, with energy base effects expected to push inflation higher later this year. Political risk remained an important differentiator within the region, with the 5-year French government bond spread over Germany holding at an elevated 50 basis points—wider than both Italy and Greece—highlighting persistent investor concerns over France's fiscal outlook. Meanwhile, peripheral spreads were generally well contained, reflecting continued confidence that the ECB's policy framework remains effective in limiting broader fragmentation risks across the euro area.

Japanese government bonds continued to weaken during July as investors priced in further monetary policy normalisation by the Bank of Japan. The 5-year JGB yield briefly reached 2.05% on 24 July, its highest level since the 1990s, underscoring the scale of the repricing in the Japanese rates market. We increasingly expect the BoJ to deliver a further 25 basis point rate increase before year-end, supported by persistent inflation and stronger wage growth. The Japanese yen was also highly volatile in July, strengthening to around JPY 157 per US dollar at month-end from a low near JPY 164. The move fuelled market speculation that Japanese authorities may have intervened in the foreign exchange market, following reports of official rate checks—often viewed as a precursor to intervention—and comments from US Treasury Secretary Scott Bessent that the yen appeared very undervalued. While higher domestic yields are improving the relative attractiveness of JGBs for Japanese investors, we remain cautious on the asset class given the prospect of further policy tightening and continued upward pressure on longer-dated yields.

Chinese government bond yields were broadly unchanged during July as markets balanced subdued inflation against a still-challenging economic backdrop. While growth indicators remained mixed, stable government bond yields reflected expectations that the authorities would continue to provide targeted policy support while avoiding large-scale monetary easing.

In foreign exchange markets, the renminbi strengthened modestly over the month, with the USD/CNY exchange rate falling from 6.79 to 6.75, supported primarily by a softer US dollar and improving sentiment towards Chinese financial markets.

Emerging market debt weakened during July, with the JPMorgan EMBI Global Index returning -1.5%, reflecting the broader sell-off in global government bond markets. Credit spreads also moved modestly wider, with the JPMorgan EMBI Global spread increasing from 217 basis points to 227 basis points. Despite this widening, spreads remain broadly unchanged on a year-to-date basis, suggesting that the weakness in July was driven primarily by higher underlying US Treasury yields rather than a material deterioration in emerging market credit fundamentals. While valuations remain relatively full by historical standards, carry continues to provide an important source of return for investors.

The following chart shows the yield on 5-year Japanese Government bonds and the JPY exchange rate.

5-Year Japanese Government bonds and the JPY exchange rate

Source: Bloomberg Finance L.P., 31 July 2026.

Capital Markets Monthly
FOREIGN EXCHANGE

August 2026

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The Yen's divine wind

July's events are likely to leave a lasting and profound impact on the global financial market infrastructure. The developments in question were not directly related to geopolitics, despite the breakdown of the fragile truce in the Middle East, nor were they driven by the unprecedented repricing and sell-off in AI-related equities. Instead, the focus was on the foreign exchange market, where Japanese authorities conducted the largest intervention operations ever seen in an effort to support the Japanese yen.

While Japanese authorities have intervened in currency markets before, what made the events of the final week of July truly exceptional, and arguably once-in-a-generation developments, was the reported participation of US authorities.

The yen entered July close to four-decade lows, with 'fast money' holding most bearish positioning since 2007, amounting to nearly 138,000 net short contracts. Carry trade conditions were described by some of the market's key participants as the most attractive since 2000. On 30 July, the yen surged more than 3.3% intraday against the US dollar, reaching 157.98 and recording its largest single-day gain since December 2023, amid reports of Japanese authorities intervening to purchase yen. Subsequent Bank of Japan data suggested that approximately ¥8.45 trillion (around $53 billion) was spent on 30 July alone, likely representing the largest single-day currency intervention on record.

Reports indicated that Japanese authorities intervened again on 31 July, marking a second consecutive day of market action. Most notably, the US Treasury was reported to have sold euros and purchased yen through the Federal Reserve Bank of New York, representing an unusual degree of bilateral coordination that some market participants described as a potential "new normal" in foreign exchange intervention.

Turning to the US dollar, it entered July following a strong June. The Bloomberg Dollar Spot Index had risen by 2% during June, its strongest monthly performance since the outbreak of the Iran conflict, driven largely by expectations of further Federal Reserve tightening under Chairman Kevin Warsh. However, that momentum faded rapidly as investors reassessed the Federal Reserve's willingness to continue tightening policy.

This reassessment was reinforced at the Federal Open Market Committee meeting, where interest rates were left unchanged at 3.50%-3.75% following a 9-3 vote.

The decision disappointed dollar bulls, with speculative long US dollar positions having reached their highest level since 2014 ahead of the meeting. Consequently, the Bloomberg Dollar Spot Index recorded its worst weekly performance in more than three months, falling 1.3% during the final week of July.

Sterling, by contrast, was one of the month's relative outperformers. The Bloomberg British Pound Index reached a one-year high in the middle of July. Reports that incoming Prime Minister Andy Burnham would appoint a market-friendly Chancellor of the Exchequer were widely cited as a catalyst for the pound's broad-based strength.

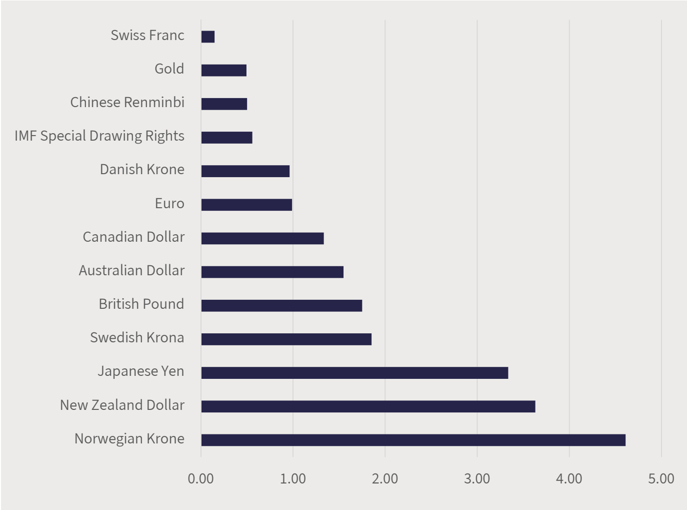
In summary, July was a highly volatile month for foreign exchange markets, characterised by a weakening US dollar, a dramatic intervention-driven recovery in the yen, and persistent inflation-related uncertainty surrounding central bank policy. The UU Dollar Spot Index (DXY) declined 1.26% over the month and closed below the 100.00 level. Among G10 currencies, the Norwegian krone was the top performer, followed by the New Zealand dollar and the Japanese yen. Both major European currencies fared well against the US dollar, with EUR/USD rising 0.99% and GBP/USD advancing 1.75%.

Nevertheless, they finished the month in the middle of the performance rankings (please refer to the accompanying table for details). Meanwhile, the Chinese renminbi recorded another stable and positive month, appreciating to levels (USDCNH closed the month at 6.7500) the level not seen since March 2022!

foreign exchange cont ...

Looking ahead, it remains extremely difficult to assess the full implications of the recent developments in the yen. For many years, the yen has served as the primary funding currency for a wide range of leveraged investment strategies across asset classes. Given that the credibility of both Japanese and US authorities now appears to be directly linked to the success of these interventions, investors who previously viewed betting against the Bank of Japan as a one-way trade may be forced to reassess their strategies and adjust risk exposures accordingly. Such repositioning would likely add to what is already an elevated level of uncertainty across global financial markets.

July performance vs. USD (%)



Source: Bloomberg Finance L.P., 31 July 2026.

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Capital Markets Monthly
EQUITIES

August 2026

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United States

AI Pullback Masks Improving Market Breadth

U.S. equities consolidated over the period despite renewed US-Iran tensions. The jump in oil prices revived familiar fears about stagflation. The reflationary backdrop weighed on global bonds, while the light-on-detail Fed decision added curve steepening pressure, leading the 30yr Treasury yield to end July at a post-2007 high. The AI trade suffered a sharp setback, with semiconductors seeing selling pressures. However, the strong 2Q corporate earnings data so far have meant it was a rotation trade and not a risk-off trade.

As widely expected, the FOMC left the federal funds rate unchanged, although three regional Fed presidents favoured a rate increase. The policy statement was largely unchanged and Chair Warsh, consistent with recent communications, provided limited forward guidance. With markets assigning a modest rate hike probability ahead of the meeting, the decision to remain on hold prompted a dovish repricing of Fed expectations, which gathered further momentum during Warsh's press conference. This partly offset the hawkish tone of the previous FOMC minutes, which indicated broad agreement that inflation would moderate as lower energy prices and temporary tariff effects faded, while also acknowledging concerns that underlying inflationary pressures could prove more persistent.

Recent macroeconomic data have provided policymakers with scope to remain patient. The US core CPI inflation eased in June, supported by falling core goods prices and continued moderation in shelter inflation. Meanwhile, a softer-than-expected PPI release reinforced the market's dovish repricing of the Fed path. The latest employment report also struck a favourable balance for investors: payroll growth remained positive, prior month gains were revised lower, and the unemployment rate fell to a one-year low of 4.2%. Taken together, the data pointed to a gradual cooling in economic activity rather than a material deterioration in labour market conditions, supporting expectations for slower consumer spending without raising immediate recession concerns. Nevertheless, inflation risks are unlikely to disappear entirely. Rising geopolitical tensions, firmer oil prices and the potential for renewed supply chain disruption could yet keep underlying price pressures elevated and complicate the disinflationary process.

Market support has come from a strong Q2 earnings season, with both the proportion and magnitude of earnings beats running above recent averages, even excluding the outsized surprises from Alphabet and Amazon. Financials reported steady loan growth, while firms with investment banking and markets exposure delivered particularly strong results. Technology earnings were more mixed. Microsoft reported strong cloud revenue growth and guided to continued growth in the current quarter as demand exceeds supply. Amazon shares rose after AWS growth accelerated ahead of expectations, while the company increased its 2026 capex guidance from $200bn to $220bn. Alphabet delivered strong earnings and cloud revenue growth, but higher capex guidance weighed on sentiment. Meta raised its capex outlook while providing softer Q3 guidance, prompting questions around AI-related spending. Apple shares fell after issuing weaker-than-expected sales guidance, citing supply constraints and higher input costs.

Equities were essentially flat in July in total return terms, with the dominant theme, the reversal in the AI and semiconductor trade. US equity market breadth was more balanced than the headline tech sell-off suggested, with the equal-weighted US equities reaching a fresh record high on July 28 amid the rotation into non-tech sectors, before falling back at the very end of the month. Concerns over valuations in the context of Chinese AI competition, capex intensity and supply constraints weighed on the technology sector. In contrast, energy stocks benefited from firmer oil prices driven by heightened geopolitical tensions, while financials extended their recent outperformance on the back of robust earnings results and a supportive interest rate backdrop.

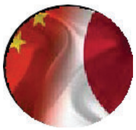
Europe

A beneficiary of the US AI rotation trade

European equities advanced on the back of diversification out of US technology stocks and a supportive earnings season. Financials led the advance as positive earnings revisions supported sentiment. Energy also outperformed on higher oil prices, while Retail benefited from resilient economic conditions. In contrast, Information Technology lagged, with ASML pressured by concerns over Chinese competition, and Telecoms underperformed following weaker-than-expected results from Telefónica.

Rising oil prices remained key areas of concern, leading the ECB to leave the door open to another hike at the September meeting. While keeping their deposit rate at 2.25% as widely expected, the ECB implied that further hikes were still likely.

In contrast, the Q2 real GDP print indicated support for the resilience theme. Similarly, the latest Euro area flash CPI print also surprised on the downside on both headline and core.



Developed Asia

AI Rotation Weighs on Japan

Developed Asian markets delivered mixed returns in July as concerns over AI monetisation, hyperscaler capex spending and rising Chinese competition prompted a rotation away from recent focused AI-related trades, benefiting Hong Kong equities at the expense of Japan and EM Asia.

Japanese equities lagged as investors unwound crowded AI positions and export-oriented stocks came under pressure. Sentiment was further dampened by expectations of further BoJ policy normalisation and the execution of yen-support intervention, which weighed on sectors that had benefited from a weaker currency.

Emerging Markets

Equity

Emerging markets underperformed developed markets in July, primarily due to the sell-off in AI and technology stocks, particularly in South Korea and, to a lesser extent, Taiwan. The decline was exacerbated by a sharp positioning unwind among hedge funds and leveraged investors in Korea.

Regionally, performance was more mixed. Latin America posted gains, while CEEMEA recovered from its June weakness. EM Asia declined overall, weighed down by Korea and Taiwan, although strong returns from China and ASEAN markets helped offset some of the weakness.

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