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SIMON PRICE
Senior Equity Fund Manager

simon.price@caiml.com

United States

US- 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.

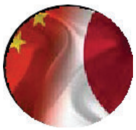
Europe

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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CAIM | CROWN AGENTS INVESTMENT MANAGEMENT

3 More London Riverside, London, SE1 2AQ, United Kingdom

+44 (0)20 7489 7223

www.caiml.co.uk | CAIMinsights@caiml.com