REYL OVERSEAS
Intesa Sanpaolo Group

STRATEGY OUTLOOK

AUGUST 2026

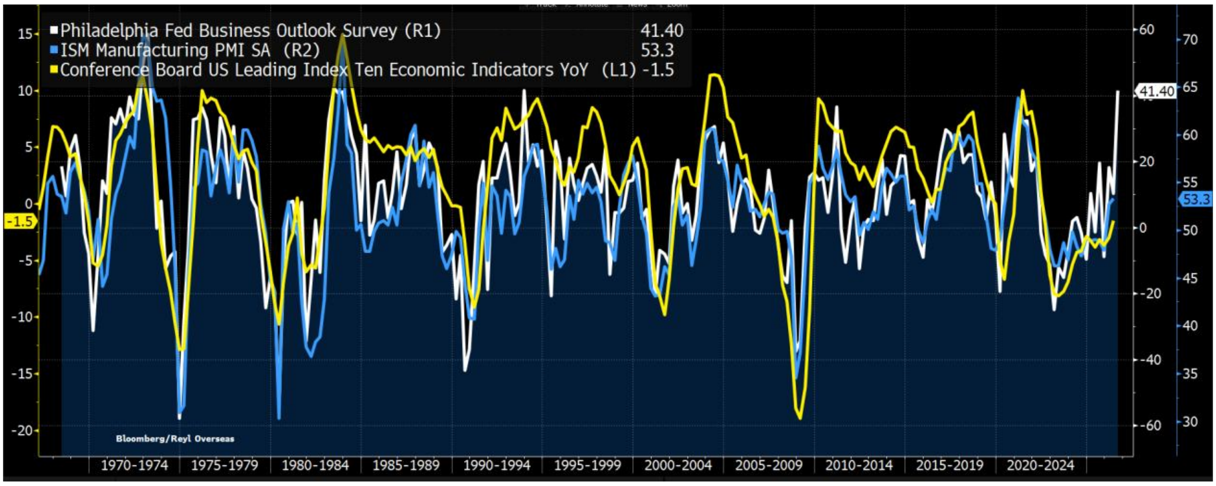
Froth, Fundamentals and Fragility

On the surface July saw some froth come out of markets, particularly in Tech, despite weaker inflation easing rate-hike expectations. The Straits of Hormuz remained unresolved, yet the economic picture remains robust and earnings are buoyant.

However, it was a turbulent month beneath the surface perhaps the most we have seen in decades. The most visible pressure came from a rotation out of AI and high-momentum growth, with crowded positioning exposed quickly. South Korea captured the mood: the Kospi fell 11%, only to rebound 18% in its largest single-day move in the same week. **A hedge fund implosion** added to the sense of fragility, even as Europe quietly pushed to a new all-time high. Central banks offered little comfort: the Fed remained on hold but gave no forward guidance and retained a hawkish lean, while the Bank of England and Bank of Japan left policy unchanged. Japan also saw the **largest Yen intervention since 1980**, another reminder that currency and bond-market stress remain the canary in the coalmine.

	July	YTD
S&P	-0.1%	10.1%
Rest of the World	2.1%	11.9%
US Treasury	-1.1%	-0.8%
Gold	1%	-6.3%
Bitcoin	7.3%	-28.2%
WTI Crude	23.5%	47.5%
USD Index	-1.3%	1.6%

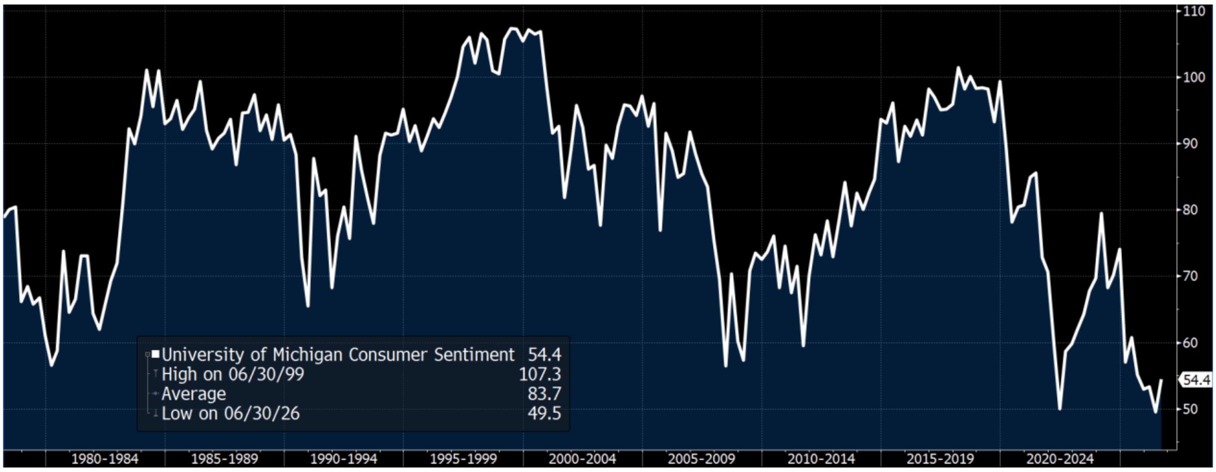
Yet fundamentals remain supportive (first graph highlights three forward looking indicators), both economically and on the corporate side. Forward earnings estimates are growing 21% yoy and margins have reached a new cycle high of 16%. At some stage earnings will disappoint, and that is one key risk. The first signs of disappointment may help show **who ultimately takes the honours in the AI race.** The broader risk is the potential damage, given how much money has left other geographies and asset classes to chase this trend. Alphabet is projecting a $200bn capex spend this year hitting free cash flows to the tune of $5.9bn in Q2, the first time in the company's history that FCF went negative. They aren't alone, this **AI race is getting expensive**. Tesla's stock was hit 15% when the firm announced respective capex forecasts.



Interest rates, politics and bubble signs

The market prices a 65% chance of a Fed rate hike in September. US inflation assets are however not expensive, with inflation swaps at 2.4%, suggesting confidence that headline CPI will fall from 3.5% yoy. **A hike into the Midterms would clearly not be on Mr. Trump's wish list** and, unless followed by a very dovish message, would not help US fiscal deficits or tax receipts.

Bank of America's fund manager survey shows 83% expect no rate hikes before the midterm elections. Yet the economy is expanding, while **consumer confidence remains frighteningly weak** (see below graph). Maybe we are simply better at complaining these days, but given employment and stock markets levels, the confidence data is worrying. This is probably the Republicans' Achilles heel into the Midterms: people are struggling and worried about jobs. AI and rising food prices will likely become major political hot potatoes.



IPOs are one sign to watch when assessing possible bubble conditions. So far, we have only had SpaceX, which is weaker (-16%), perhaps unsurprisingly given the market direction. We also note OpenAI leaning towards an IPO next year. Parts of the cycle depend on ever-rising AI equity prices to refinance debt, with many players cash flow negative. Add in competition, or war, between companies and between the US and China, and the **stakes are high**. OpenAI has no clear path to positive cash flow this decade and even proposed the Trump Administration take a 5% stake. The concentration of risks and leverage between these players, and increasingly into the broader economy, must be highlighted. AI spending is now contributing to >25% of US GDP growth, which also helps explain a stronger USD this year as inflows hit records.

AI is a clear exponential trend and is bringing about an industrial revolution. But this needs to be married with valuations and reality. No mean feat.

Against the bubble argument, **market breadth has widened.** This is no longer only the Magnificent Seven. The "other" 493 S&P 500 firms are growing earnings at 25%, while 2027 estimates point to 17% growth, including negative guesstimates for energy that I think look too bearish. Perhaps the market is moving from the providers of AI to the beneficiaries.

Gold – still a long-term bullish environment

We remain gold bulls and continue to hold exposure. Our horizon is 5 years plus, with price targets well above today's levels. Gold has underperformed after 3 strong years, hurt by higher real rates, AI-related flows away from precious metals, a stronger dollar and reduced geopolitical risk premium. **Yet gold remains under-owned and finite,** with around 2% supply growth. In a world where money supply grows around 8% a year, inflation is 2-3%, and governments cannot stop spending, the fundamentals remain strong. We remain holders and will likely add upon further falls.

Japan – the canary in the coalmine.

The chart on Japanese yields and currency helps highlight the bull case for Gold. Japanese government bond yields have moved higher (prices lower) and their currency has depreciated hence the intervention. **For the US the option was support the Yen or face Japanese selling of US Treasuries**. At current yields and debt levels the US interest expense is around 25% of federal budgets. This too is coming to the UK, France and others. The UK has another Prime Minister committed to bigger state and more left-leaning politics. Great, if that's what the electorate wants but it needs to be paid for and that's the issue. A near 30% of the British population receive some form of State benefit. This has nothing to do with left vs right or republicans vs democrats. This is government spending more than they make in a market where there are **less buyers of government bonds.**

The biggest risk to gold and stocks remains the bond market and the speed of rising yields. Bond yields look too low. We are also watching base metals: if growth accelerates, money could leave financial assets and move into the real economy as capex plans move to order books. Energy remains a good diversifier if inflation proves stickier than expected.

Portfolio positioning and conclusions.

Our conclusion. There are areas of clear strength and weakness. Within this industrial revolution, we are early. AI on our phones is just the start. AI agents will increasingly manage and control areas of business and life. Crypto is building the infrastructure to transact,

establish ownership, verify identity and operate within limits. Stripe's reported bid for PayPal is one example of preparing for a world run via software rather than humans. **AI brings intelligence; crypto brings the guardrails.**

We stay invested in our long-term themes: energy transition, digitalization, hard money, changing demographics and indebtedness. We want to add gold and silver in portfolios, while bonds may continue to struggle and stocks can continue to perform. Volatility is likely into the Midterms and, with earnings season beginning again, we will see whether lofty expectations are met.

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