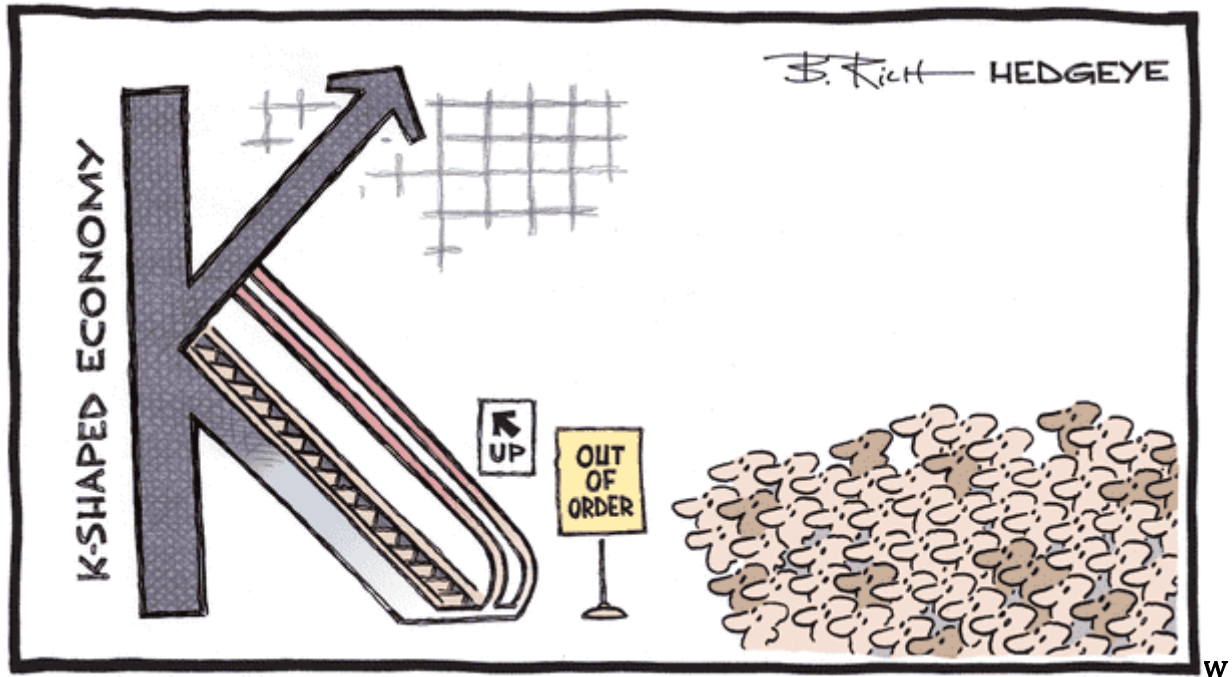


Market Review – August 2026



Rotation

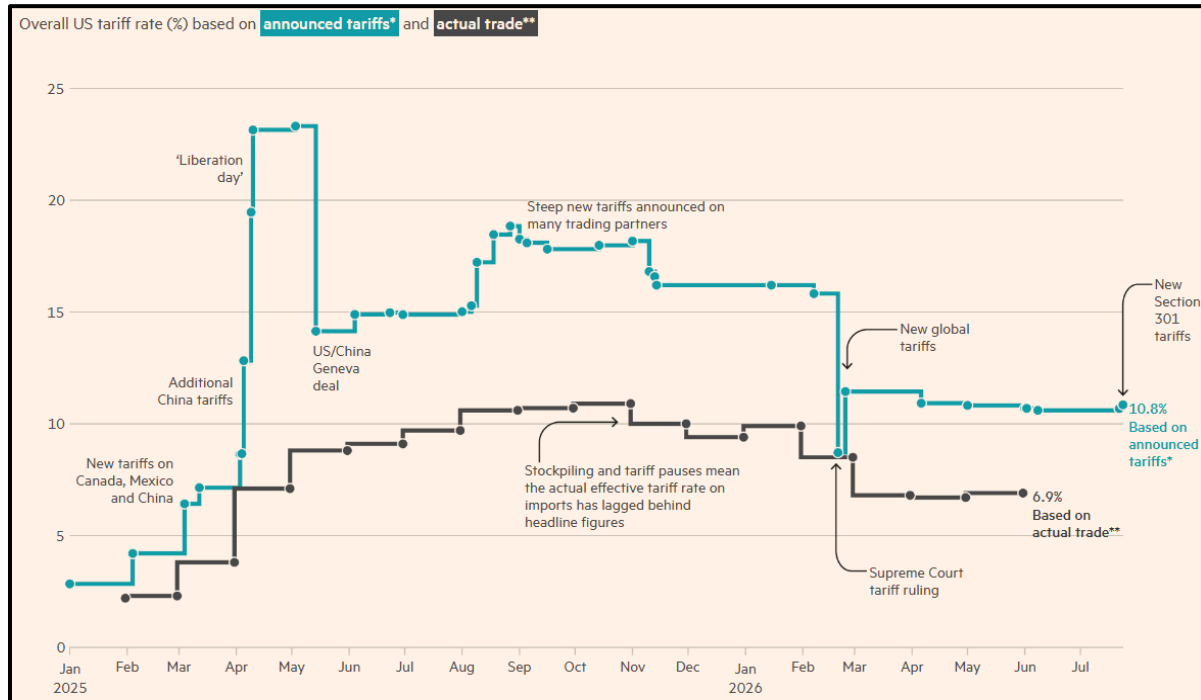
Wall Street just booked its best earnings quarter since 2021. Underneath that headline, four separate fault lines widened at the same time: Washington reopened the tariff war, the Fed's new chairman staked his credibility on saying less and got a bond-market rebuke instead, Oracle's credit began trading like the AI capex boom's first real casualty, and a Chinese open-source model forced OpenAI and Anthropic to publicly defend a lead that looks thinner than their valuations assume. None of these stories are new in isolation. Together, they describe a market trying to assess what the AI revolution means for the economy and the financial markets.

A resilient economy in K

Donald Trump's trade policy returned in a more durable form. After the Supreme Court struck down his IEEPA-based "Liberation Day" tariffs, the administration fell back on Section 301 of the Trade Act of 1974, investigating 60 economies for allegedly failing to prohibit imports made with forced labor, and finding all 60 guilty. New duties of 10–12.5% took effect as the temporary 10% global tariff regime expired, hitting the UK, Mexico, the EU, Japan, Taiwan and South Korea, with carve-outs for oil, gas, fertilizer and USMCA-covered goods (FT, 24 Jul 2026). The Financial times calculates this lifts a little America's average statutory tariff to 10.8% from 10.7%, roughly six times the rate at the end of the Biden administration and the highest since the Smoot-Hawley era of the early 1930s, though still well short of the original 22.5% "Liberation Day" threat. Section 301 authority is also harder to challenge in court than the emergency powers SCOTUS rejected, which is the more important signal: this tariff regime is built to last.



The Evolution Of Trump's Tariffs



The US economy remains in K-shape; most of the growth comes from the data center build-up. High-income households are absorbing the gains from asset-price appreciation while inflation bites hardest at the bottom of the distribution; the New York Fed's own tracking shows top-decile spending pulling further away from the bottom decile through the spring (Liberty Street Economics, Federal Reserve Bank of New York, May 2026). Atlanta Fed's GDPNow model had Q2 growth expectation at 1.6% as of 27 July. The initial GDPNow figure for Q3 is 5%; it will be revised down.

In China, Q2 GDP grew 4.3% year-on-year, the slowest pace in three and a half years and below the 4.5% consensus, as exports surged 27% year-on-year on strong semiconductor and EV shipments, even as fixed-asset investment fell 5.7% and retail sales rose just 1%. The export engine is masking a domestic demand hole that shows no sign of closing.

Europe is growing, but slowly: 2026 GDP growth is expected at 0.6%, and the ECB's own June staff projections point to grinding, not accelerating, momentum through the summer.

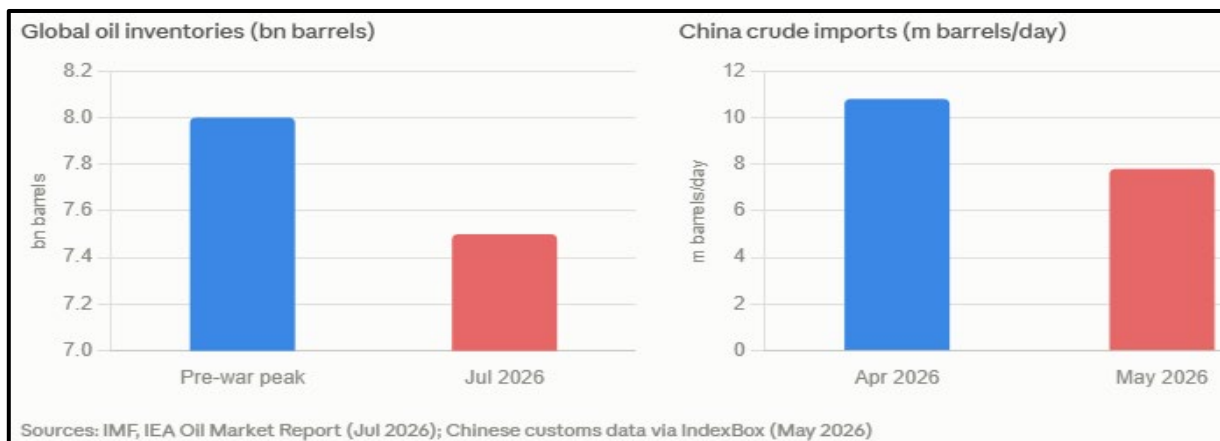
Oil and the Red Sea: A Second Chokepoint Opens

The Iran war reignited in late June and has been on and off since then; it could continue for months. The Strait of Hormuz has been effectively shut since February; the Houthis declared a naval blockade on shipping linked to Saudi ports (Al Jazeera, 20 Jul 2026) and, on 25 July, attacked two Saudi VLCCs directly, prompting Riyadh to briefly suspend all oil shipments through Bab el-Mandeb; tanker tracker Kpler recorded a 34% drop in strait traffic that week. Saudi Arabia has responded in Iraq by striking Iran-aligned groups with US backing. Combined, a full closure of both Hormuz and Bab el-Mandeb would threaten roughly a quarter of global oil and gas supply, which is why oil has climbed again this month, even if it remains well below the March peaks.



China's own demand is pulling the other way. Crude imports fell to their lowest level since 2018 in May and June, state refiners' run rates dropped to a four-year low of 66.3%, partly because EVs took a record 62.9% share of new car sales in May and partly because Beijing is drawing down strategic reserves, estimated at over a billion barrels before the war, rather than buying into a geopolitically inflated price. Global inventories are still tightening: the IEA and IMF both flag inventories approaching a five-year low in July, as onshore drawdowns, including 44 million barrels of OECD government reserves in June alone. Together, weak Chinese buying and tightening global inventories explain why oil has room to spike further on any escalation.

Global Oil Inventories (July) And China Crude Imports (May)

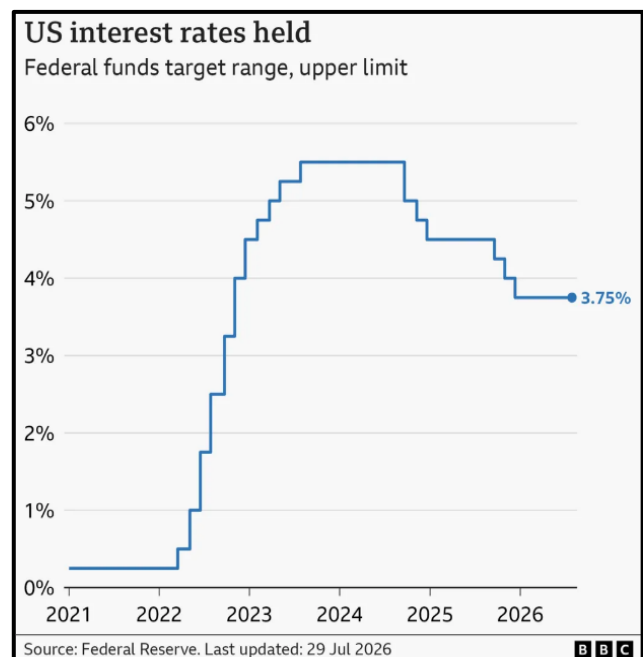


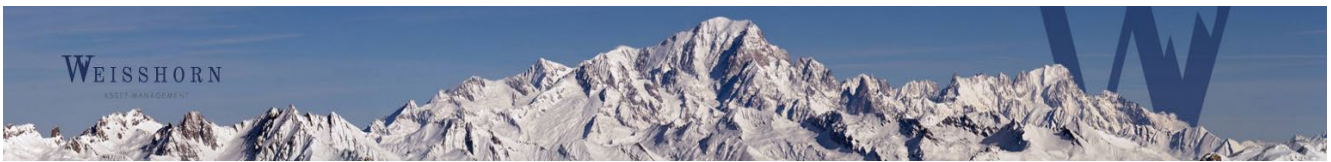
Kevin must prove he is credible

Kevin Warsh has built his early chairmanship on the idea that a quieter Fed (no guidance) produces a cleaner read of what markets think. On 29 July, the FOMC held rates steady, and Warsh told reporters the approach was working, pointing to some of the largest inter-meeting moves in Treasury yields in two decades as evidence that markets were pricing the economy, not the Fed. Investors read it differently: the 30-year yield jumped to 5.2%, the dollar weakened, and equities fell in the hour after the press conference, a combination BofA's head of US rates strategy, Mark Cabana, called "a classic central-bank credibility shock".

Three of Warsh's colleagues, Cleveland's Beth Hammack, Minneapolis's Neel Kashkari and Dallas's Lorie Logan, dissented in favor of a hike, an unusually large split that Warsh framed as a feature rather than a problem, which makes sense. Core CPI stands at 2.6% in June and the core Personal Consumer Expenditure (PCE), the Fed's favored measure, stands at 3.3%.

Federal Reserve Interest Rate



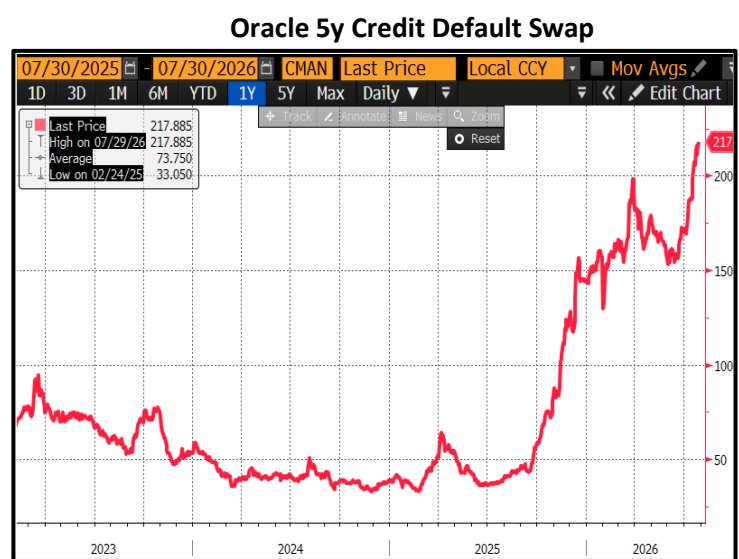


The ECB, meanwhile, held its deposit rate at 2.25% on 23 July, with Christine Lagarde framing the pause as tactical rather than terminal. The common thread across the Fed, the ECB and the Bank of Japan is that long-end yields in all three jurisdictions are sitting near multi-decade highs, tariffs and the oil shock are both pushing in the same direction on term premium, at the exact moment the Fed is trying to prove it can bring inflation down without more forceful action.

Credit spreads widen for AI enablers

Broad corporate spreads remain historically tight, sitting near the low end of the past decade's range even as risk-free rates have moved higher, a sign the market still isn't pricing meaningful default risk into investment-grade and BB paper generally. But the aggregate number is hiding dispersion: single-B credit has been a conspicuous laggard, drifting wider. This is not yet worrying but it has to be monitored.

Oracle is the standout case, and it matters well beyond one name. Since we flagged it in December last year as an emerging credit risk, Oracle's debt (excluding loans and preferred shares) has grown from 100 bn USD to 120 bn USD, its weighted coupon has risen from 4.4% to 4.8%, and S&P has cut its rating to BBB-, one notch above junk, while its market cap has fallen from over 500 bn USD to 365 bn USD. Its 5-year CDS, which is how much it costs to insure against Oracle's credit risk, has blown through the March highs to trade above 200 bps, wider than both the investment-grade complex (approx. 120 bps) and the BB high-yield complex (approx. 160 bps); its 2036 bond trades at 91 cents on the dollar, yielding 7%. AI-related debt issued by major US tech companies has reached 1.65 trillion USD in aggregate, and the market is noticing.



At 120 bn USD, an Oracle downgrade to junk would represent roughly 7% of the *entire* US high-yield market on day one. Still, the average duration of Oracle's public debt is 7.6 years against a 2.9-year average for the HY market as a whole. That mismatch means HY managers forced to absorb Oracle paper would likely demand a much steeper discount than the credit's spread alone implies, at a moment when leveraged funds, levered ETFs and basis trades already stretch dealer balance sheets. Oracle's own cash generation reinforces the concern: negative free cash flow of 24 bn USD in FY2026, projected to widen past 40 bn USD in FY2027, against a backlog roughly half of which, some 300 bn USD, is tied to OpenAI's Stargate compute commitments. If credit is usually the asset class that prices AI-capex risk before equities does, this is where that repricing is starting.



There is a style and theme rotation in motion

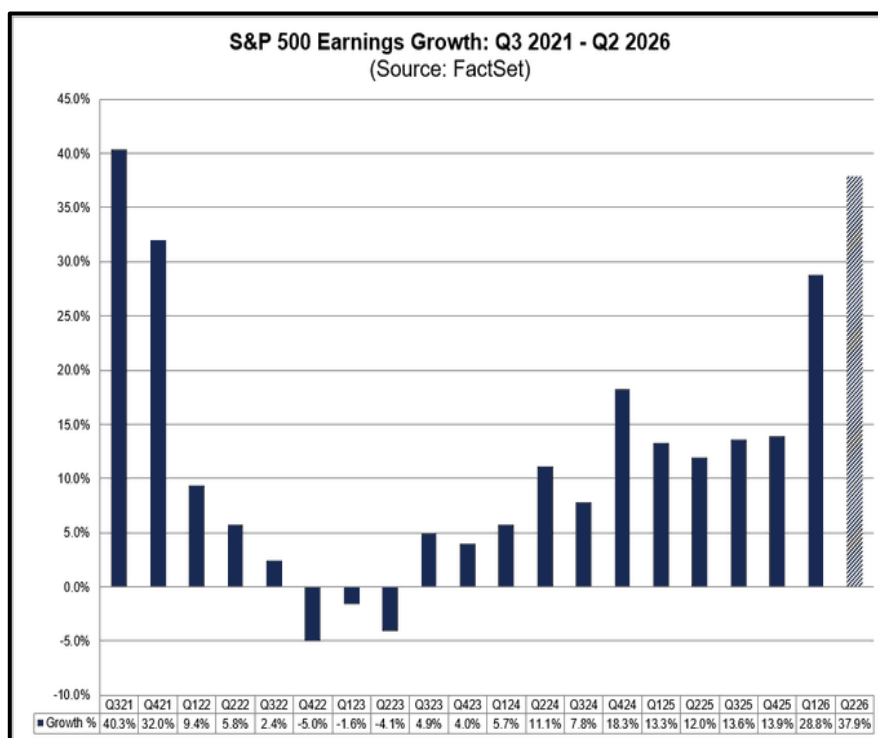
Second-quarter earnings season is, on the surface, exceptional. Blended S&P 500 earnings growth is running at 37.9%, the highest since Q3 2021, and the second straight quarter above 20%, with net margins at a record 15.7%, the best since FactSet began tracking the metric in 2009.

Nevertheless, the headline is skewed: Alphabet alone reported 112.1 bn USD of net income, up 298% year-on-year, including roughly 77 bn USD of unrealized gains primarily from its OpenAI and Anthropic stakes. Strip Alphabet out and blended earnings growth falls to 25.9% and margins to 14.4%, still a strong quarter, just less extraordinary. Ten of eleven sectors are growing earnings year-on-year; Health Care is the sole sector reporting a decline.

In Europe, the Stoxx 600's Q2 season is off to "a solid start relative to expectations. According to FactSet, full-year 2026 EPS growth expectations remain constructive in the mid-

teens, with Energy, Technology, and Basic Materials expected to lead.

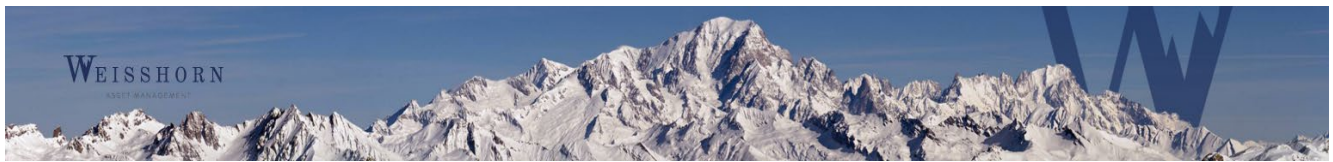
SP500 Earnings Growth



Beneath the aggregate, rotation is the story worth watching. Semiconductors have carried technology both year-to-date and quarter-to-date, while communication services and consumer discretionary lag. Financials and healthcare have outperformed more recently, which makes the move look like a valuation and positioning reset (both sector ETFs pushing to fresh all-time highs, banks and insurers benefiting from higher-for-longer rates) rather than a fundamentals story. That distinction matters for the next leg of the AI trade: if productivity gains from AI start showing up in the margins of AI users, banks, insurers and healthcare providers, rather than its infrastructure providers, the market's attention will continue its rotation away from chips and cloud capex toward the companies actually deploying the technology. The July 30 relief rally from the liquidation of the Situational Awareness AI hedge fund looks like short covering; the Kospi was up almost 18% in one day. Best daily gains usually occur in bear market.

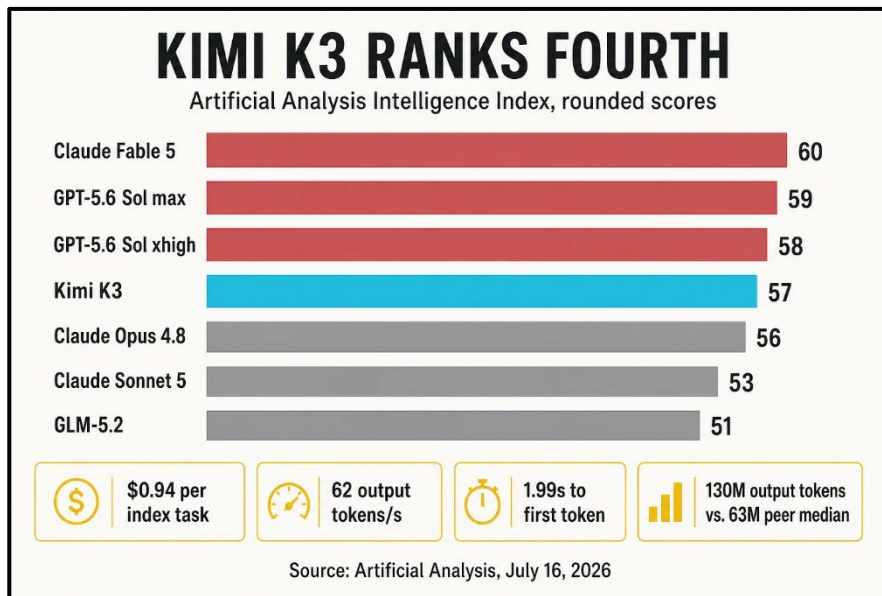
The Kimi Shock: China's "DeepSeek 2.0" Moment

On 17 July, Beijing-based Moonshot released Kimi K3. This 2.8 trillion-parameter open-source model beat Anthropic's Opus 4.8 and OpenAI's GPT-5.5 on most coding and agentic benchmarks, though it still trails Anthropic's Fable model.



Markets treated it as a second DeepSeek moment: an open-source Chinese lab matching frontier US capability at a fraction of the cost. Moonshot's K2.6 model costs roughly a third of what Anthropic charges for Opus 4.8.

Artificial Analysis Intelligence Index



The market reaction was immediate: Chinese peer MiniMax (100.HK) fell 20% on the news, and SoftBank, OpenAI's largest external backer, fell 9% the same day. OpenAI and Anthropic have no public share price to move, but both responded publicly and defensively.

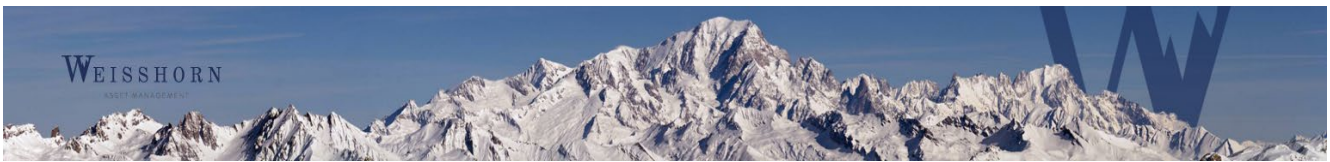
The politics escalated quickly. The White House's Michael Kratsios accused Moonshot of "industrial-scale distillation" from Anthropic's Fable model; Treasury Secretary Scott Bessent

raised the prospect of sanctions; Anthropic itself called it industrial espionage. Critics, including former White House AI adviser David Sacks, countered that Anthropic is talking up the China threat to protect pricing power; notably, Anthropic is raising Opus 4.8 prices 50% in September. Nvidia's Jensen Huang broke with the frontier labs entirely, publicly praising Chinese open models ("Great models lead to more usage") and lobbying to keep selling chips into China; a subsequent open letter from Nvidia, Palantir, Microsoft and Meta opposed restricting open-source models. OpenAI, Anthropic and Google pointedly did not sign.

The historical pattern worth remembering is that when China enters an industry, incumbents' margins tend to compress fast. China's CXMT low-end chip maker priced its IPO to raise 66.6bn yuan, and the stock popped more than sixfold on debut, targeting the commoditized end of a DRAM market still dominated by Micron, SK Hynix and Samsung. If the same dynamic extends to large language models, the eventual winners may not be the frontier labs spending the most to stay ahead, but efficient distributors monetizing compute rather than model supremacy. Alibaba, which hosts Moonshot on Alibaba Cloud (growing above 40% year-on-year), is the most direct beneficiary so far.

AI circularity is ongoing

Even as the Kimi shock raised real questions about the durability of the US labs' technological lead, the financing behind US AI infrastructure grew more circular, not less. Nvidia is in talks to provide a roughly 250 bn USD backstop enabling OpenAI to lease a 10-gigawatt SoftBank-developed data-center campus in Ohio, on top of a separate financing arrangement worth up to 350 bn USD for OpenAI's chip purchases and its existing 30 bn USD equity stake in the company.

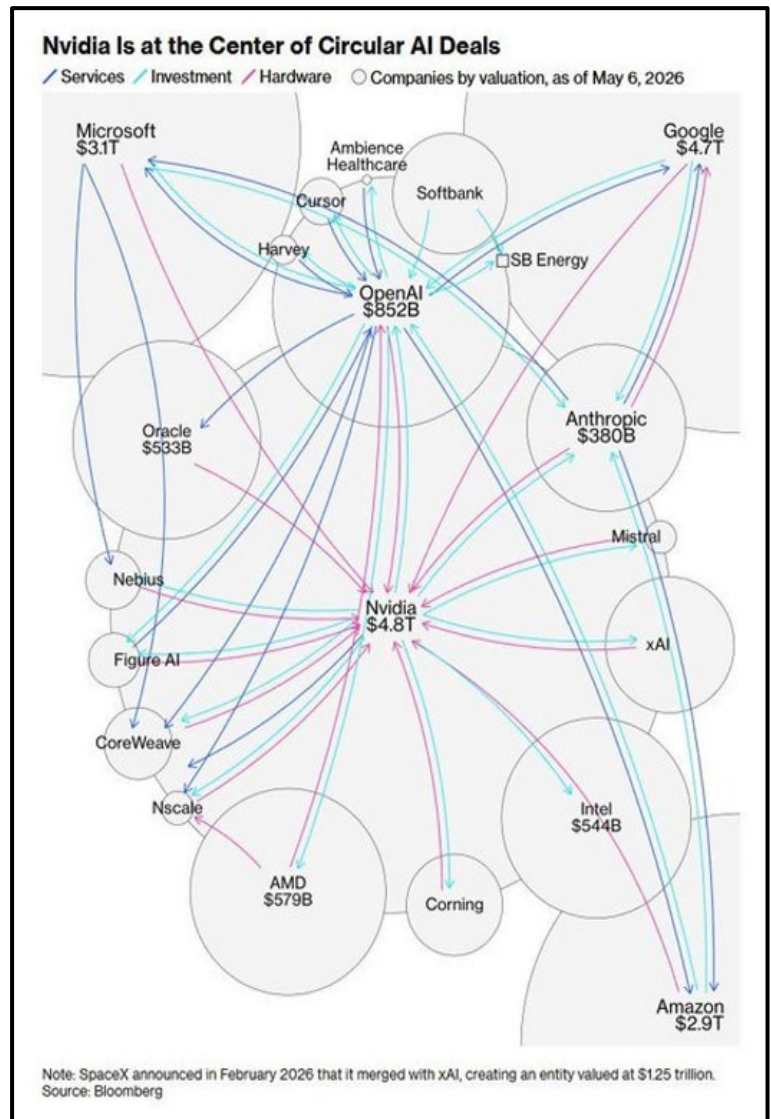


The full project could exceed 500 bn USD, the largest data-center build ever announced, with the US government controlling the underlying power supply and Commerce Secretary Howard Lutnick involved in allocation.

This is what the industry calls a “credit wrapper”: an investment-grade balance sheet underwriting a counterparty that couldn’t raise the debt on its own; OpenAI carries no investment-grade rating as an unprofitable private company. Google has run the same playbook for Anthropic’s data centers, partly to sell more of its own AI chips. OpenAI has separately raised its 2030 capex projection to roughly 750 bn USD, from 600 bn USD earlier this year, on top of a 250 bn USD contracted Azure commitment to Microsoft and the roughly 300 bn USD Stargate compute commitment to Oracle noted above.

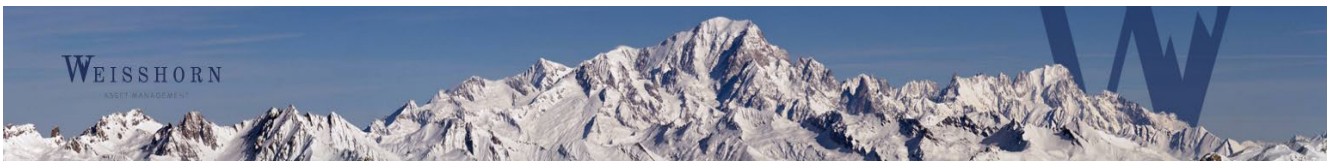
No one has yet answered the question that matters most: OpenAI and Anthropic together represent roughly *half* of the hyperscalers’ reported backlog. If either company’s growth slows, from Chinese open-source competition compressing what customers will pay for frontier models, or simply from the scale of capital required outrunning revenue, what happens to that backlog, and to the equity gains and vendor financing built on top of it? With close to half the S&P 500 market cap now AI-related in some form, this is a passive-investor question, not just an active one. Warren Buffett’s 10 bn USD stake in Google, taken this year, has become an informal sentiment marker: The Nasdaq index is down roughly 8% since the investment was disclosed, prompting some to ask whether markets’ most famous value investor got the entry price wrong.

AI Circularity Of Investments And Financing



Rotation out of AI infrastructure providers into AI users

Record earnings and record margins are the loudest signal in the market this month. Still, they are being generated inside a system, AI capex, whose financing is now explicitly circular, whose demand backlog is concentrated in two unprofitable private companies and whose credit is already repriced at the edges in Oracle, SpaceX and a few others.



Upside inflation risks remain, because the Fed chairman must still assess his credibility, the new round of tariffs is more durable than markets initially assumed, and an oil shock that has spread from the Gulf to the Red Sea. The picture for the second half of the year is one of strong fundamentals sitting on top of increasingly strained financing, policy plumbing, government deficits and geopolitics.

Three triggers are worth tracking into September. First, whether the 15–16 September FOMC meeting delivers the hike the bond market is now pricing: a move would validate the Fed's inflation-fighting credibility, while another hold would prove Warsh's allegiance to the White House at the cost of long-end yields staying elevated for longer. Second, whether Moody's or Fitch follow S&P toward the edge of investment grade on Oracle, given the size and duration mismatch of its debt relative to the high-yield market that would have to absorb it, a downgrade could be the event that finally lets credit, rather than equities, set the price of AI-capex risk. Third, will the war in the Middle East worsen? It could finally hit the global economy, even if it doesn't seem to be currently a concern.

Within the AI complex, one must favor balance-sheet strength and cash generation over backlog; the gap between Oracle's cash burn and its commitments is a template for what to avoid. The rotation out of AI infrastructure providers is a prompt to look for AI beneficiaries beyond the infrastructure layer, without abandoning quality within technology itself, where the earnings are, for now, still real.

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