Global Equity Insights

USD EDITION

QUARTERLY REPORT | **AUGUST 2026**

AI capex trade exhibits two-way risk, but the broad market shakes off concerns. Fed ends forward-guidance indicating a shift to higher volatility.

New Fed, but old policies and higher rates volatility
In his first FOMC as Chair, Kevin Warsh put an end to forward guidance from the Fed as well as indicating a tougher stance on inflation. Rate hike expectations have increased, and short-rates will likely see increased volatility.

Inflation expectations disconnected
US inflation expectations, measured by 1Y inflation swaps, are <2% and may have fallen too far, too fast. Oil prices may have come down from the July peak, but the price for refined product like gasoline remains elevated & sticky inflation is c. 2.8%.

Market volatility largely concentrated in AI and the market has broadened
The AI picks & shovels fell materially in July, but the All-World posted a +0.1% monthly return. Relative to 3M ago, the contribution-to-return from AI mega cap names is smaller. Industries like Financials are benefiting from higher volatility.

Defending the Yen by weaponizing volatility
The Japanese Yen had weakened through the key resistance level of 160. Rather than defending the level, the Ministry of Finance worked with the US Treasury on a large intervention which spiked intra-day volatility and the risk of macro trades.

AI capital expenditure is a two-way risk
AI adoption, at least via token usage, has grown exponentially and analyst estimates of hyperscaler capex were revised up in Q2, from already large numbers. This may support AI picks and shovels, but there are reasons the risk may be 2-way.

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Chart 1: Investors are concerned, as estimated free cash flow to sales has turned negative in 4 of the 5 largest US hyperscalers, as their projected spend on AI capex continues to grow.

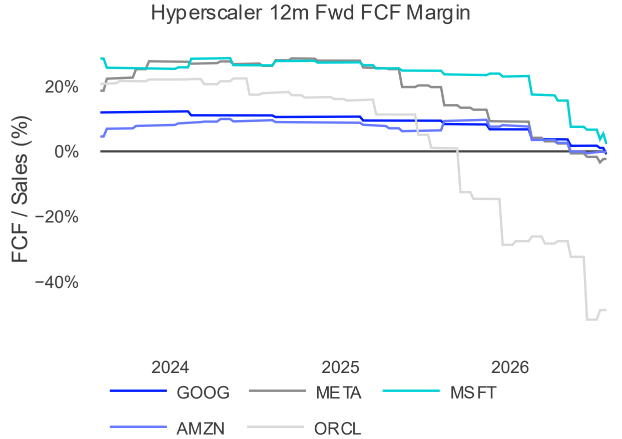
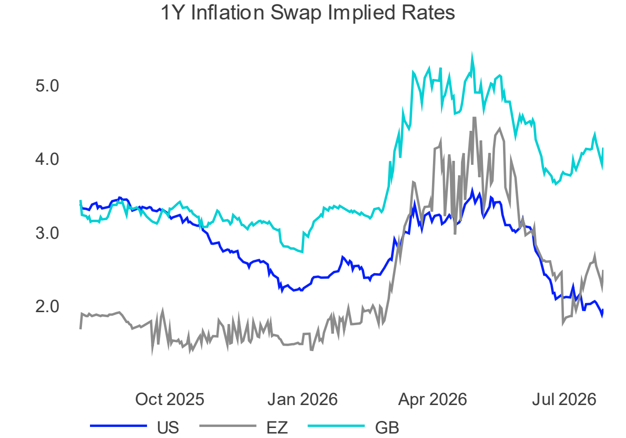


Chart 2: Implied inflation expectations have declined materially. US 1Y inflation swap are ~2.0%; European expectations have turned higher on renewed tensions in the Middle East in July.



Source: FTSE Russell and LSEG. Data as of July 31, 2026 unless otherwise stated. All returns in USD. Past performance is no guarantee of future results.

Key macro drivers – Warsh Fed: fewer words, more volatility

At the June FOMC the Fed removed language around an easing bias, and the revised dot-plot turned hawkish. Notably absent was the projection from the new Chairman, who remarked how forward guidance wasn't an appropriate policy tool. The objective being to make the Fed less beholden to markets and making each policy meeting 'live'.

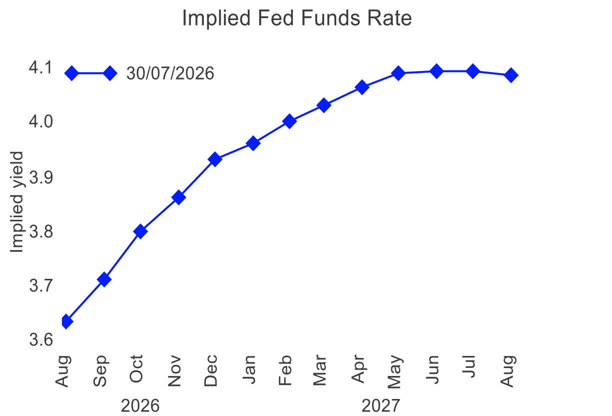
This is likely to lead to greater uncertainty in short-term rates, which may imply higher equity volatility – especially amongst growth stocks. We saw evidence of this with the May non-farm payroll which showed strong jobs growth in the US, which indicated less need for an accommodative policy stance, raised the probability of rate hikes and caused the sell off in tech names in early June.

Whilst the Fed's dual-mandate remains, comments from Chair Warsh indicate a bias toward the price stability side of the mandate. Market reaction was mixed: the UST 30Y yield rising to 5.3% and inflation expectations declining materially with US 1Y inflation swaps down to 1.9%; in Europe they are 2.4%. There is no August meeting, so September will be an important focal point.

The risk is inflation expectations have fallen too far, too fast. The Atlanta Fed Sticky inflation (c. 70% of the basket & the least volatile components) is at 2.8% YoY, which requires a very significant disinflationary impulse from the flexible components, mostly goods, to hit expectations.

Whilst vessels are transiting the Strait of Hormuz, numbers are low compared to pre-conflict which may not lead to the supply glut that had been anticipated. Closure of the Strait has led to less refined product being produced. Looking at the crack spread the wholesale price of gasoline relative to Brent Crude is approaching the post-pandemic peak from 2022, which may keep prices at the pump elevated.

Chart 1: The Fed dot-plot had moved to a hiking bias in June but that was already priced by markets. Fed Funds futures are pricing 1-2x hikes by the Fed by Dec '26.



Source: LSEG Datastream

Chart 2: Vessels have been passing through the Strait of Hormuz but ship count is likely to take a long time to normalize, if it ever does. Source IMF PortWatch, data to August 2, 2026.

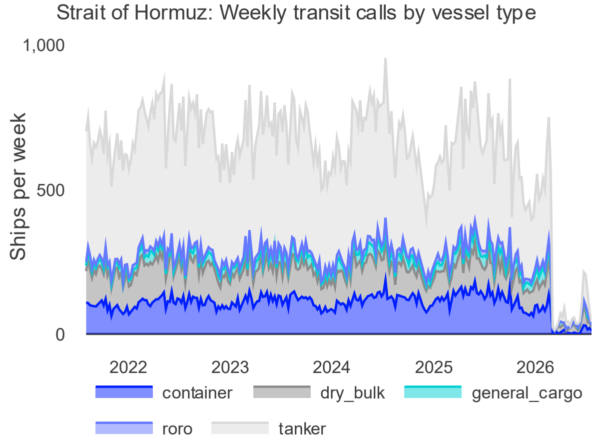


Chart 3: Oil disruptions from the Middle East have affected downstream refinement. Gasoline, a key measure for demand destruction, remains extremely elevated relative to oil prices.

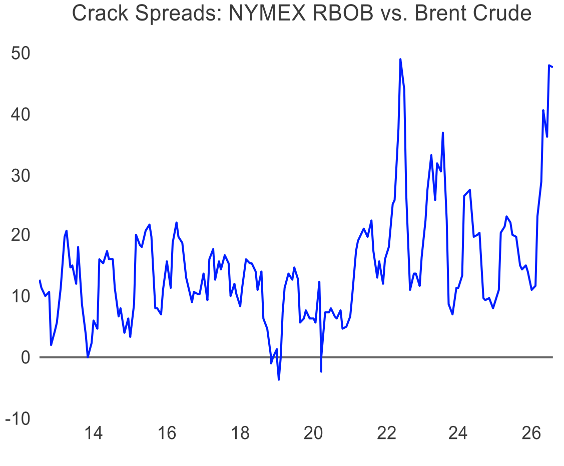
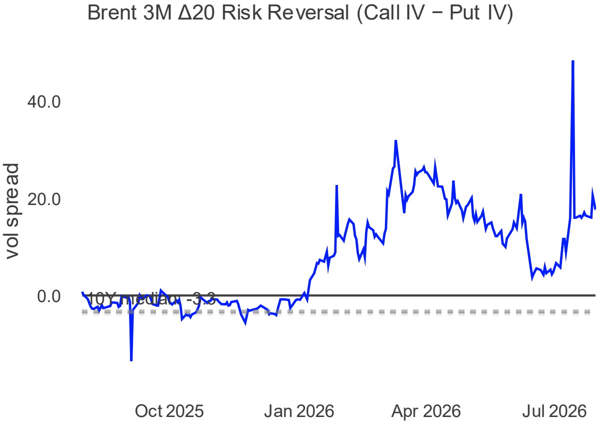


Chart 4: Call side skew on Brent crude contracts had fallen significantly after the MoU reflecting energy traders' conviction the ceasefire would hold; that conviction reversed at the end of July.



Source: LSEG Datastream

Source: FTSE Russell and LSEG. Data as of July 31, 2026, unless otherwise stated. All returns in USD. Past performance is no guarantee of future results.

Performance and Drivers – Leverage in the system

Despite a sell off in the AI picks and shovels names leading to a -16.7% return for the FTSE Korea index in July, the headline return for the FTSE All-World was +0.1%.

Over 3M the FTSE All-World returned 4.4% with less regional differentiation than we've observed in previous quarters: Emerging, the worst performer returning +2.4% & Dev APAC ex Japan, the top performer, returning 7.6%. We observe this broadening across industries as well as regions; where earlier in the year the majority of gains were attributed to a small number of mega cap AI related names, YTD contribution-to-return is better diversified.

Whilst the MoM return for FTSE Korea was -16.7% intra-month returns were very volatile, with an average 7.2% daily move and a peak intra-month drawdown of c. 31%; it was a rally of 21.5% on 31 July that saw Korea exit a bear market. That rally was supported by a strong earnings call from Microsoft, but it may also have marked the unwind of technical selling pressure as the Situational Awareness (SA) fund was forced to sell its public equity book.

Mechanically, a fund borrows money to invest more than 100% of its capital and lenders require margin against losses. When stocks fall, the margin account requires topping up and to do that the fund must sell liquid assets to raise cash; during a large drawdown that technical selling pressure can become self-fulfilling.

SA isn't the only geared fund investing in the AI theme; whilst granular data is opaque, aggregated statistics show an increase in hedge fund leverage, and the popularity of leveraged ETFs has allowed retail investors to participate. This may lead to further bouts of high volatility.

Chart 1: Over 3M and YTD equity returns between major regions have been relatively clustered – with the exception of Developed APAC ex Japan which remains the top performer.

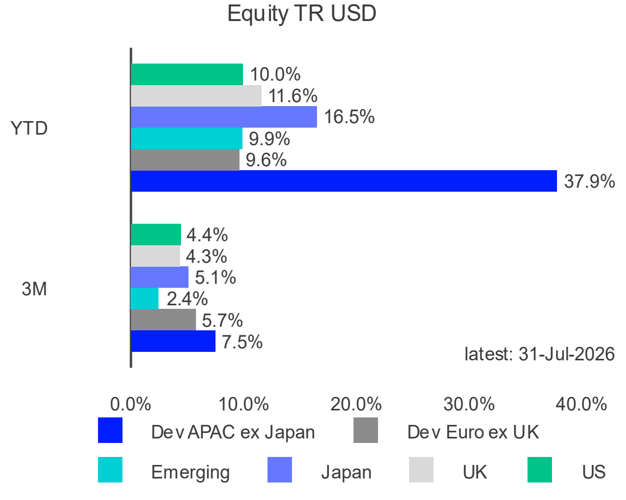


Chart 2: The contribution-to-return from mega-cap AI names**, as a proportion of the total return of the FTSE All-World, has declined since May in a sign of broader participation.

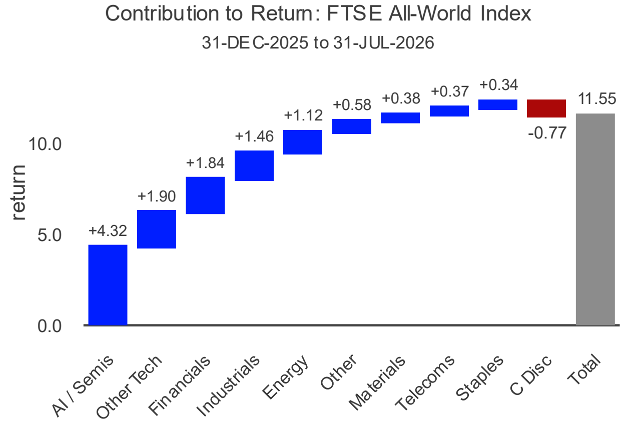


Chart 3: AI "picks & shovels" vol. was extremely high in Korea in July with an average daily move of >7%. It exited a bear market on the last trading day after posting a 21.5% gain.

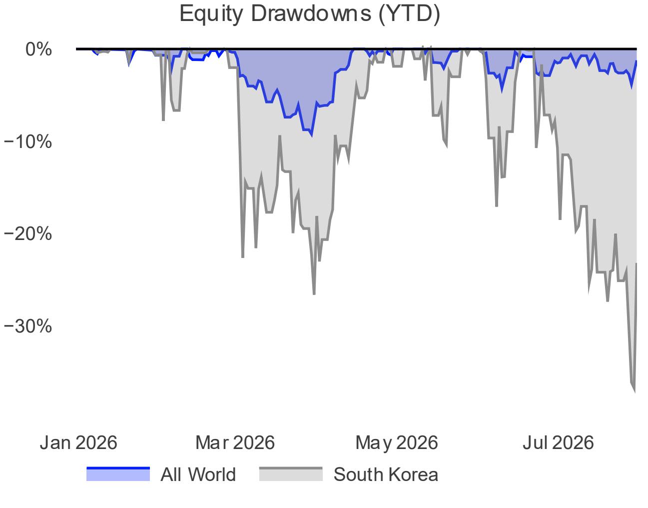
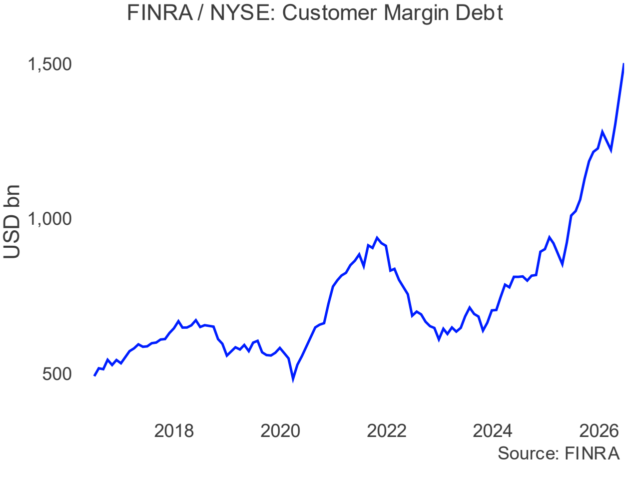


Chart 4: Leveraged trading is on the rise. As of the end of June the total debt balance used to buy securities that was reported to the regulator was $1.5 trillion. Source: FINRA



Source: FTSE Russell and LSEG. Data as of July 31, 2026, unless otherwise stated. All returns in USD. Past performance is no guarantee of future results.
** For a mega-cap AI / Semi proxy we use: AMD, Alphabet, Amazon, Apple, Broadcom, Intel, Meta, Micron, Samsung, SK Hynix, TSMC.

Fundamentals – Equities are no longer expensive

Looking at forward price-earnings multiples, equities have broadly de-rated YTD and moved from extremely expensive to slightly rich; FTSE All-World went from the 90th to the 57th percentile over 10Y. Developed APAC ex Japan and Japan are outliers but for different reasons: Japan has remained rich on pro-growth industrial policy & AI related earnings optimism. Meanwhile Dev APAC ex Japan is in the bottom decile over last 10Y, which is a function of extraordinary upgrades to forward earnings estimates. Despite the pace of upgrades having declined, 12M forward earnings have grown c. 19% over 3M.

The scale of EPS upgrades from Dev APAC ex Japan can overshadow robust upgrades globally. FTSE Developed earnings have been upgraded 5.5% in 3M, with the US and Japan being upgraded by 4.6% and 6.2% respectively. Considering the net number of companies being upgraded vs. downgraded the breadth suggests EPS upgrades aren't just from the largest companies.

Investors in Japan are faced with an important question about whether to hedge exposure to the Yen. Dollar-yen weakened through the psychologically important ¥160 resistance level to ~¥164 before appreciating to c. ¥159 on currency intervention. This purchase was firstly because it was a joint operation between the Japanese Ministry of Finance (MoF) and the US Treasury, and secondly it caused a sharp intra-day move potentially aimed a disincentivizing speculation. The MoF has stated "we will not hesitate to conduct further joint operations".

JPY is extremely cheap, but loose Japanese fiscal policy and divergent monetary policy with the US is pushing the Yen weaker. This setup augurs a wider JPY range and greater volatility which needs to be factored into the Japanese equity investment case.

Chart 1: Forward P/E multiples have broadly de-rated across the board, with Japan a notable outlier for trading richer YTD & FTSE Dev APAC ex Japan in the cheapest decile over 10Y.

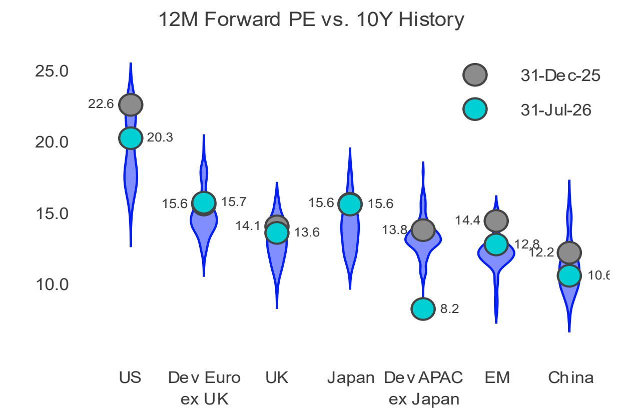


Chart 2: The pace of upgrades has slowed, but FTSE Dev APAC ex Japan has still had 12M earnings estimates upgraded by c. 19% over 3M. Source: LSEG I/BE/S Estimates

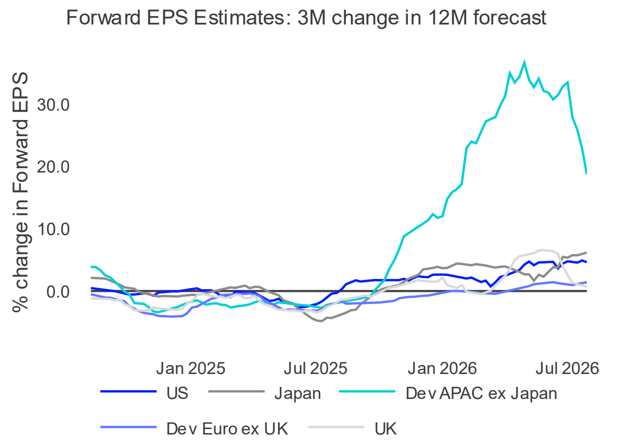


Chart 3: Breadth of earnings upgrades is also positive. Below we count the number of companies being upgraded vs. downgraded in the FTSE Developed index. Source: I/B/E/S Estimates.

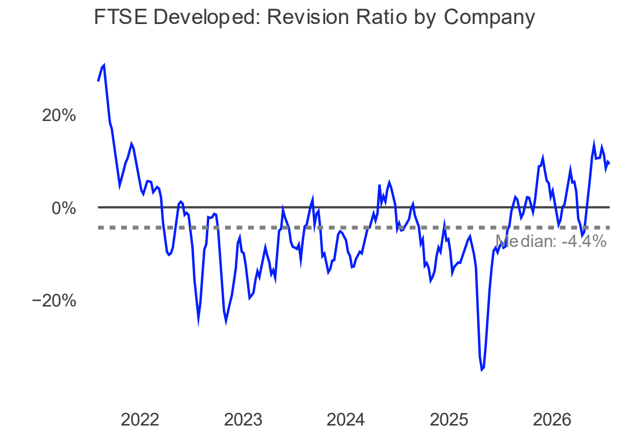
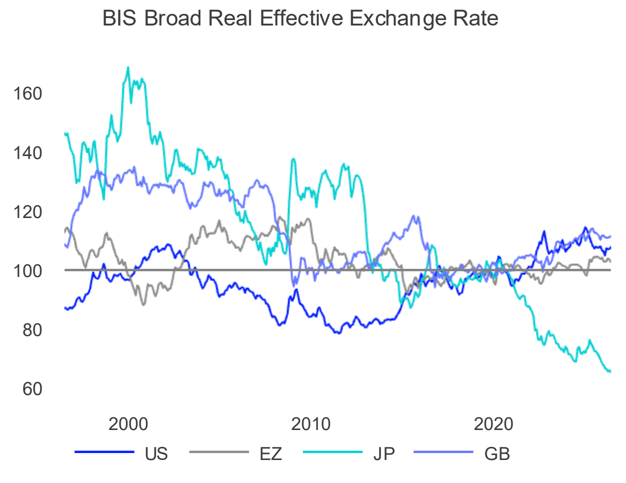


Chart 4: On a real effective exchange rate basis the Japanese Yen has fallen. Alternative valuation measures like purchasing power parity paint the same picture. Source: BIS



Spotlight – AI capex has two-way risk

AI adoption continues to grow at broadly exponential pace. Data from OpenRouter, the world's largest model aggregator, shows token use jumping from ~3.4 trillion per week to ~58 trillion per week between July 2025 & 2026. Importantly, a large proportion is now attributed to agentic AI, where agents can operate autonomously, making calls and communicating with other agents. The same data showed c. 1/3rd of token use (July 27, 2026) was agentic tasks, overtaking coding at 32.0%, of which only 9.1ppts was writing code; general tasks like conversation and summarization is now <28% of usage. The key takeaway is that your chat to your AI of choice is now only a small, and declining, proportion of total AI token usage.

As a result, the five largest hyperscalers in the US are anticipated to spend c. $780 billion on capex in 2026, an 85% jump year-on-year; I/B/E/S estimate project that number to grow to >$1 trillion next year. If those estimates hold then that may provide a structural tailwind behind the AI picks & shovels and AI enablers. However, it is important to recognize there is two-way risk around capex estimates. Rising utilities costs and water usage led to New York imposing a statewide moratorium on the building of data centres >50GW; with other areas following suit. Currently it is unclear if development is moving elsewhere in the US, or potentially to Europe, where the Cloud and AI Development Act is actively looking to triple data centre capacity in Europe over 5-7Y.

H1 earnings seasons highlighted that investors are more discerning and focusing on the utility of capex not just the quantum. At the Q1 earnings call Meta fell 8.6% after announcing 33% revenue growth as investors questioned how AI capex would drive greater sales; conversely, a Bloomberg report about a planned cloud business to sell excess compute led to an 8.8% intraday jump. Meanwhile Alphabet rallied 10.0% after their Q1 call explaining their cloud business had insufficient capacity to supply AI demand; after the Q2 call stocks fell despite an 82% YoY increase in Google Cloud revenue as AI capex led to negative free-cash flow at the firm. This FCF narrative reflects broader industry concerns about circular funding, which is where firms are increasingly financing both their customers and suppliers. This risk creates interdependence and potentially contagion risk.

Chart 1: Five US hyperscalers are projected to spend c. $780 billion on AI capex in 2026; that is set to grow to >$1,000 billion in 2028 but investors are becoming more discerning.

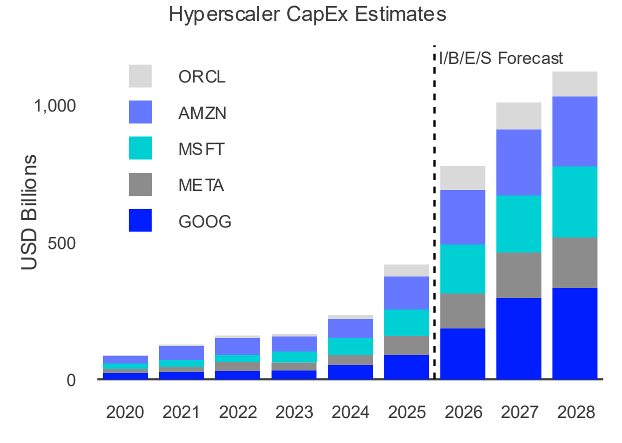


Chart 2: Looking at the daily move on the day after earnings calls highlights how the market has become more discerning about AI capex and how it may impact future revenue.

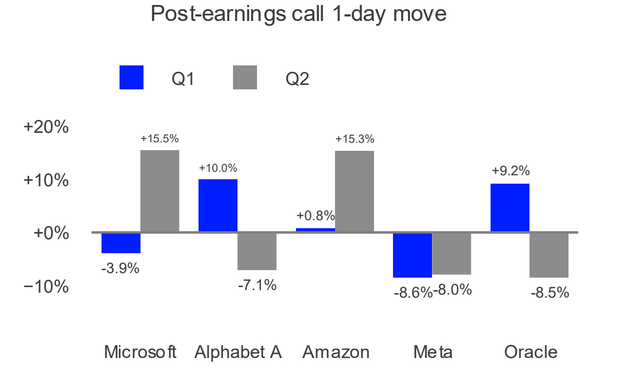


Chart 3: Despite the sell off in AI hardware in July, analyst expectations of capex grew in each of 2026-2028 (FY1-FY3); 2026 estimates increased by c. $150 billion over 3M.

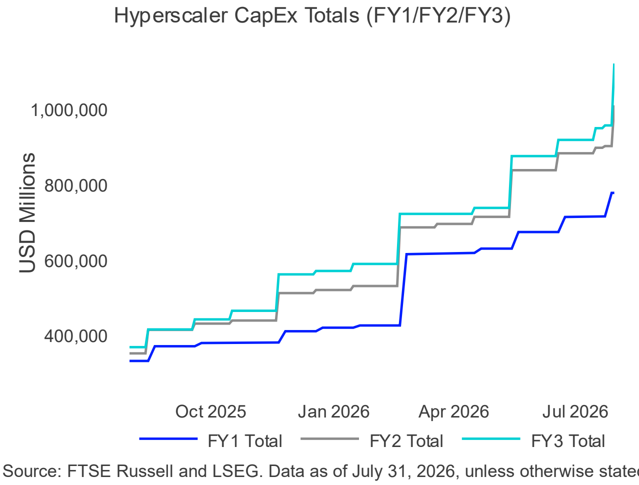
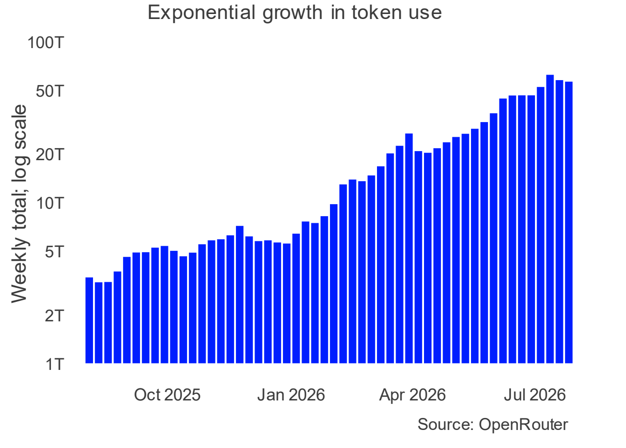


Chart 4: OpenRouter has seen a broadly exponential increase in AI token usage over the last 12M; only a small proportion of which is now chat. Source: OpenRouter, data to July 27, 2026.



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Spotlight – Breadth beneath AI hallucinations

The pullback in AI and semiconductor stocks from May to end-July remained largely confined to technology hardware rather than becoming a market-wide event. As we've noted, leverage in crowded positions may have amplified drawdowns. Importantly for markets, the weakness was largely contained within some AI names and did not spill materially into broad equity. Chart 1 shows a more benign picture beneath the hardware rout. By the end of July, for the FTSE All-World, 16% of hardware stocks were above their 50-day moving average, compared with 62% of the FTSE All-World excluding hardware.

Highlighting the resilience of the broad market, Chart 2 shows Industry performance in July, with 7 of the 11 ICB industries posting gains, despite the AI sell off; c. 57.8% of FTSE All-World. Energy gained 10.6% as renewed hostilities in the Middle East pushed oil prices higher; Financials rose 6% as strong Q2 bank earnings highlighted robust trading revenues and recovering investment-banking activity. Real Estate and Consumer Staples each returned 3%, extending the rotation into rate-sensitive and defensive areas. By contrast, Technology fell 4.8% and Telecommunications declined 4%, although we must remember that Samsung and Cisco Systems make up 41.1% of the Telecoms industry.

This broadening of the market helped absorb weakness in hardware and technology, which had driven much of the earlier rally in the year. Chart 3 shows cap-weighted performance recovering relative to equal weight from late March and moving into outperformance by May, as strong Q1 earnings revived enthusiasm around AI. When hardware weakened in July, that advantage narrowed from around 6% to 3%, before recovering to 4.5% by early August. Despite elevated hardware volatility, the Russell Volatility Index (RVX) traded in line with its long-term averages, implying the broad market is taking a sanguine view. This also matters because the US represents 61% of FTSE All-World market capitalization but only 11% of its constituents.

Part of the broadening theme has been a resurgence of small cap stocks. Most notably the Russell 2000 index has outperformed the Russell 1000 YTD, benefitting from industry breadth and diffusion of the AI infrastructure trade. Similarly the FTSE Developed Small Cap Index has also benefitted and has outperformed the FTSE Developed Index YTD.

Chart 1: By end-July, 62% of FTSE All-World ex Hardware constituents traded above their 50-day moving average, versus 16% of Hardware stocks – indicating a sector-specific rout.

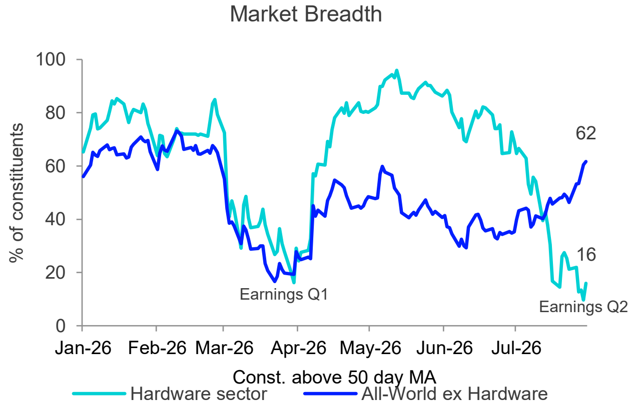


Chart 2: As tech underperformed FTSE All-World, gains in energy, defensives and cyclicals helped cushion the weakness and preserve the index's earlier gains.

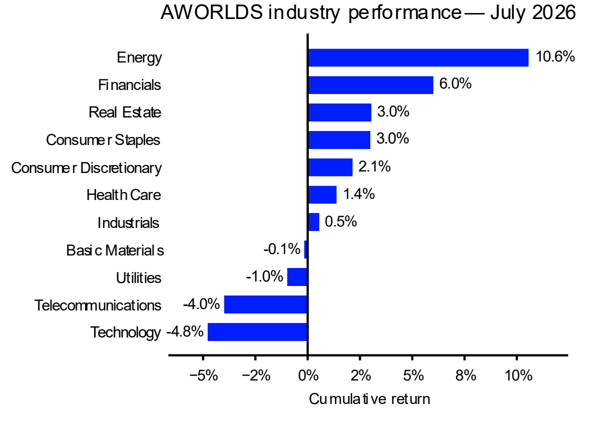


Chart 3: Broad indexing retained exposure to large-cap leadership, while gains across the wider market helped cushion the subsequent reversals in AI and Hardware.

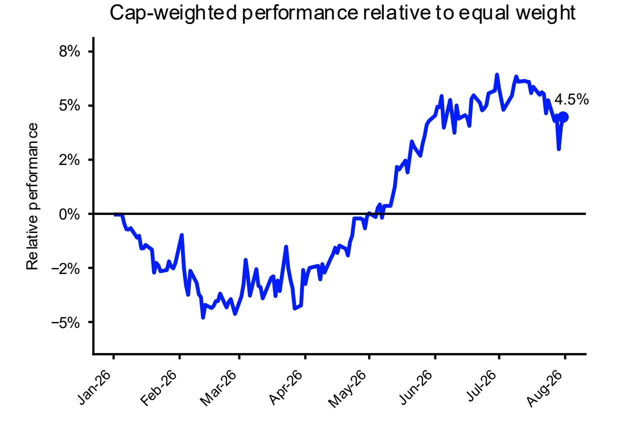
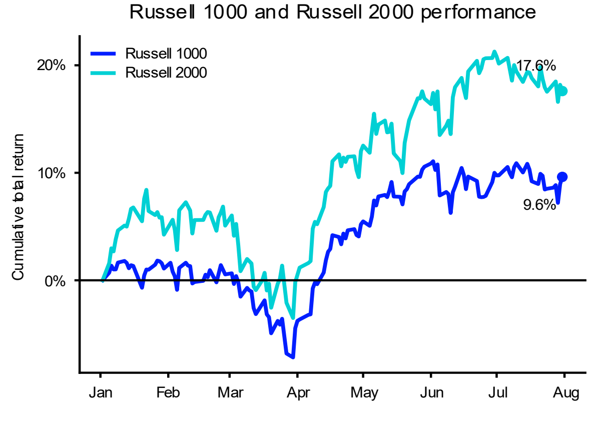


Chart 4: [Russell 2000 performance] was led by industrial support services, oil and banks, while its lower technology weight limited the drag from hardware.



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Appendix: List of indices used in report

Name	Mnemonic/Code
FTSE All World	AWORLDS
FTSE Developed	AWD
FTSE Emerging	AWALLE
FTSE Developed ex US	AWDXUS
FTSE Developed Europe	AWDEURS
FTSE Dev Europe ex UK	AWDEXUKS
FTSE APAC ex Japan	AWDPACXJ
FTSE North America	AWNAMERS
FTSE AUSTRALIA	WIAUS
FTSE BELGIUM/LUX	WIBEL
FTSE BRAZIL	WIBRA
FTSE CANADA	WICAN
FTSE CHILE	WICHL
FTSE CHINA	WICHN
FTSE COLOMBIA	WICOL
FTSE DENMARK	WIDEN
FTSE FINLAND	WIFIN
FTSE FRANCE	WIFRA
FTSE GERMANY	WIDEU
FTSE GREECE	WIGRC
FTSE HONG KONG	WIHKG
FTSE INDIA	WIIND
FTSE INDONESIA	WIIDN
FTSE ISRAEL	WIISR
FTSE ITALY	WIITA
FTSE JAPAN	WIJPN
FTSE MALAYSIA	WIMAL
FTSE MEXICO	WIMEX
FTSE NETHERLANDS	WINLD
FTSE NEW ZEALAND	WINZL
FTSE NORWAY	WINOR
FTSE POLAND	WIPOL
FTSE SINGAPORE	WISGP
FTSE SOUTH AFRICA	WIZAF
FTSE KOREA	WIKOR
FTSE SPAIN	WIESP
FTSE SWEDEN	WISWE
FTSE SWITZERLAND	WICHE
FTSE TAIWAN	WITWN
FTSE THAILAND	WITHA
FTSE TURKIYE	WITUR
FTSE UK	WIGBR
FTSE UNITED STATES	WIUSA

All the country indices used above are from the FTSE GEIS index family.

For more details regarding Index Construction for these and related FTSE Russell indices, and for ETFs and Mutual Funds linked to these FTSE Russell Indices, please reach out to your FTSE Russell Sales contact.

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