



STRATEGY UPDATE • AUGUST 2026

Building the future is inflationary, for now

KEY TAKEAWAYS

- We remain overweight equities and intend to buy weakness into the November mid-terms. The bull market is broadening, earnings are beating a record-high bar, and none of the conditions that end expansions, credit stress, collapsing breadth, an aggressive Fed, is yet in place.
- The defining question of this cycle, whether AI is inflationary or deflationary, has an answer: both, in sequence. The build phase absorbs capital, materials and power and is inflationary; the deployment phase delivers the productivity dividend later. We position for the phase we are in, not the one being promised.
- Our portfolios express this as a barbell: the inputs of the build-out on one side, power, grids, copper, uranium, and gold as the hedge on the deficits funding it all, and broad productive equity on the other side for the deployment payoff. The barbell is paid in either phase.
- We expect the inflation debate to stay alive into Jackson Hole and the September Fed meeting, and we hold no long-dated G7 government bonds in any scenario. Daily-liquidity equity market neutral strategies remain our preferred ballast.
- Regionally we favour Japan, Italy and Spain through banks, utilities and the strategic autonomy capex cycle, and we intend to modestly rotate emerging market exposure toward developed markets toward year-end, as the EM index has become a leveraged expression of a single trade.

July was a month in which the market travelled a great distance to end up roughly where it started, and the journey was the message. Renewed hostilities between the United States and Iran spread from the Strait of Hormuz to the Red Sea and drove Brent close to 100 dollars, before Washington called off what the President described as massive strikes and reopened talks with Tehran; crude promptly gave back the entire risk premium and now trades in the low 80s. Equities staged the mirror image. The Dow fell more than 800 points on the day of the Federal

Reserve meeting, then closed at a record high three sessions later, with the S&P 500 back above 7,600 and back at record highs. Beneath the whipsaw, the fundamentals did the quiet work: with most of the S&P 500 having reported, around 86% of companies have beaten estimates against the highest consensus bar on record, and Amazon crossed three trillion dollars of market value. A tug of war between geopolitics and earnings is not a comfortable spectacle, but it is worth noticing which side keeps winning.

RATES & INFLATION

The Federal Reserve held rates at 3.50% to 3.75%, and the vote is the story. Three regional presidents dissented in favor of a hike, **the most dissents in a single direction since 2016**, and Chair Warsh, who described the meeting as a good family fight, repeated that the committee has **no tolerance for elevated inflation**. Our July view that the peak of this inflation spike was behind us has held up on its own terms, the energy base effect is feeding through as expected, but the month also demonstrated the pattern we described in our recent Investment Alert: a single political event took oil up 40% and most of the way back down within weeks, and this is precisely the regime we expect, **inflation settling in a 2.5% to 3.5% range rather than at target**, punctuated by energy-driven spikes that arrive without an invitation. Rate hikes are still not our base case, and Friday's employment report argued our side of the case: the economy shed 23,000 jobs in July, the first monthly decline since February, with the two prior months revised down by over 100,000 and wage growth slowing. A committee cannot hike into a labor market that has stopped hiring, whatever the rhetoric, and the Treasury's interest bill argues loudly against it as well. But the risk is no longer negligible, and the market will spend August parsing every syllable from Jackson Hole. Our positioning does not require us to win this argument. We hold no long-dated G7 government bonds in either outcome, a stance the bond market vindicated again as the 30-year Treasury pushed through 5.2%.

AI BUILD-OUT

The deeper question, and the one clients ask us most often, is the one a veteran CIO posed this summer: **is this wave of innovation ultimately deflationary, through the productivity it promises, or inflationary**, through the vast quantities of capital, materials and power it demands? We think **the honest answer is both**, sequenced rather than simultaneous, and the sequencing is everything for a portfolio. Every general-purpose technology in history has followed the same arc. The railway manias of the 1840s and the electrification of the 1920s were ferociously inflationary while the tracks were laid and the turbines built, absorbing steel, copper, labor and capital on a scale that strained every market they touched; **the deflationary dividend arrived later**, and always later than the enthusiasts predicted. We are unambiguously in the build phase. Hyperscaler capital expenditure is running toward three quarters of a trillion dollars this year, AI investment is now contributing effectively all of the growth in US investment, and the costs are already reaching consumers, with Apple, Microsoft, Nintendo and Sony all raising hardware prices as memory and component costs surge. The productivity gains, meanwhile, remain mostly promissory. **Inflationary first, deflationary later**, and the market's recurring error is about timing rather than direction.

This is why our allocation takes the shape of a barbell. **On one side sit the inputs** of the build-out, power generation, grid equipment, copper, uranium, and gold as the hedge against the fiscal deterioration funding the whole enterprise, positions that are paid while construction runs. **On the other side sits broad, diversified productive equity**, which collects the deployment dividend whenever it arrives. Two great flows of capital are steering the system, one from G7 government balance sheets to households through deficits that no one intends to close, the other from hyperscaler cash flows into data centers, and the barbell is designed to be downstream of both. On that front, the ecosystem continues to reward the distinction we drew

months ago between check writers and check receivers, and the sharpest challenge to the AI trade actually reinforces it. **The rise of Chinese open-source models invites comparison with what Chinese electric vehicles did to the European car industry**, cutting-edge engineering at a price the incumbents cannot match. We think the analogy is about 70% right. If intelligence becomes a commodity, value migrates away from the model layer exactly as it migrated away from vehicle assembly, and anything priced as though model-layer margins are durable is fragile. Where the analogy breaks is that Western enterprises and governments will not run their core processes on Chinese model weights at any price; **security and regulation create a protected franchise that European carmakers never enjoyed**. The likely outcome is bifurcation, with open-source models crushing pricing in the global cost-sensitive market while US proprietary models keep the Western enterprise business at compressed margins. Note the irony for positioning: both branches of that tree require enormous compute and power, and cheaper intelligence tends to increase total consumption of it, the effect the economist William Jevons observed about Victorian coal. Commoditized intelligence is bearish for model-makers' equity and bullish for electrons and fabrication, which is to say, bullish for the side of the barbell we own. We are also watching the supply of paper: SpaceX has shed some 500 billion dollars of market value since its June listing, a useful reminder that the coming wave of mega-IPOs will test how much new equity this market can digest at valuations that, by some measures, now exceed every prior peak.

Politics will shape the build-out too. Roughly seven in ten Americans now oppose a data center in their neighborhood, an unusual point of bipartisan agreement, and the political response is predictable in its direction: no government racing for strategic autonomy will stop the construction, but legislators will increasingly force it to pay its own way, through bring-your-own-generation requirements, grid contribution charges and siting restrictions. Every one of those measures transfers value to the same places, generation capacity, grid equipment and nuclear power, which is the only answer that satisfies both the arithmetic of load growth and the politics of household electricity bills. This is precisely the **multi-year case behind our uranium position**, whose recent weakness we regard as the market testing our patience rather than our thesis, and behind our **European grid and utilities exposure**. Spain's abundant clean power continues to position it as an AI energy hub, and capital will keep flowing toward jurisdictions that welcome the machines.

REGIONS & DIVERSIFIERS

The core faces real headwinds, weak growth, a French budget saga and an export model under pressure, but the southern periphery is a different animal: **Italian and Spanish banks are compounding capital** at rates the core can only envy, the utilities carry contractual inflation linkage, and the strategic autonomy capex cycle, from defense electronics to grids, runs straight through both economies. We are underweight the core and overweight its best neighborhoods. **Japan remains a conviction**, with governance reform intact and a yen near its weakest since the Plaza Accord offering considerable optionality. **Emerging markets we hold with open eyes**: three semiconductor stocks account for virtually the entire gain in the EM index this year, which makes the asset class a leveraged expression of the AI cycle rather than the diversifier its label suggests, and we intend to rotate modestly toward developed markets toward year-end. Healthcare and consumer staples, unloved, lightly owned and genuinely uncorrelated to the AI complex, remain our preferred diversifiers within equities.

FIXED INCOME & OUTLOOK

In fixed income, nothing has changed. We avoid long-dated government paper across the G7, find little compensation in credit spreads this tight, and continue to use **daily-liquidity equity market neutral strategies** as ballast, a choice that looks better each time bonds and equities

sell off together. Gold has recovered above 4,100 dollars after testing its holders through the spring, and we repeat what we wrote in July: we do not own it as an inflation trade or a rate trade, but as insurance against fiscal deterioration and a fragmenting monetary order, and three dissenting votes at the Fed do not change the trajectory of the US deficit by a single dollar. The same logic extends through the hard-asset complex, where a single gigawatt-scale data center consumes some 27,000 tons of copper and a periodic table of critical minerals. The race for artificial intelligence is a commodities story wearing a software costume.

Markets enter August priced for a good outcome, and for once the earnings justify much of the optimism. But an election season, a hawkish minority at the Fed, a heavy IPO calendar and a Middle East that has changed direction twice in six weeks argue against aggressive positioning at this stage. **We expect volatility into the mid-terms**, particularly in the higher-beta corners of the market, and we intend to treat it as raw material rather than as a reason to retreat. The build phase of a technological revolution rewards those who own what it consumes and the patience to hold what it will eventually produce. We own both sides of that trade, and we are content to let the future be built around it.

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GENERAL CONTACT · Acumentum AG · Stadthausquai 1 · 8001 Zurich · Switzerland
Tel. +41 43 497 27 42 · Fax +41 43 497 27 43 · info@acumentum.ch · www.acumentum.ch