Summit Trail Advisors

Monthly Download

July 2026

Summary

- **Markets delivered** mixed performance for the 2nd straight month as investors rotated away from 2026 winners into more defensive areas of the market. 2nd quarter earnings reports provided a strong underpinning for the market but elevated investor expectations created choppy market reactions to company outlook and guidance. Markets were also pressured by higher interest rates and a greater likelihood the Federal Reserve will need to increase the Fed Funds rate before the end of 2026.

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Market Overview

- **Equity markets** posted mixed results as investors rotated from areas that had led 2026 performance like Semiconductors to more defensive areas of the market. The VanEck Semiconductor ETF (SMH) declined 18% during July as investors worried about how the memory and chip cycle would end. Technology stocks outside of software were pulled down in sympathy with chip weakness. Defensive market sectors like Health Care and Consumer Staples gained over 2% in July and Banks rose over 3% on strong earnings reports.
  - U.S. Large Cap stocks (S&P 500) declined 0.1% for the month with mixed results among the Mag8 names but poor performance from chip stocks that have become larger weightings in the index. Health Care, Energy, and Staples drove performance. Year-to-date gains remained at 10.1%.
  - U.S. Small Cap stocks (Russell 2000) dropped 3.0% as biotech sold off after recent gains while concerns grew over higher interest rates and Fed outlook pressured smaller companies. Small Cap stock gains were reduced to 18.9% for the year.
  - Non-U.S. stocks (MSCI EAFE Net) added 2.0% in July given less exposure to chip and Technology stocks that sold off during the month. Energy stocks were up over 10% in July and US Dollar weakness added about 1% to the EAFE index returns in USD. Year-to-date returns are now up 11.6%.
  - Emerging Markets (MSCI Emerging Markets Net) were the weakest area of equity markets in July falling 3.1% as China, Korea and Taiwan saw Technology-related selloffs. Losses were offset by more commodity-exposed markets in Latin America. Year-to-date gains still lead global markets at 20.0%.
- **Interest rates** moved higher in July with the return of the Iran conflict, higher energy prices, and market concerns on inflation and US government deficits. The 10-Year Treasury moved from 4.42% to 4.75% at the end of July, a level not seen since January of 2025. The Fed held rates steady at their FOMC meeting on July 29th but markets are increasingly expecting rate hikes at future Fed meetings.
  - High Grade Taxable bonds (Bloomberg U.S. Aggregate) dropped 1.3% on the interest rate spike as longer duration bonds were punished in July. July's losses erased 2026 returns, bringing year-to-date performance to -0.7%.
  - Municipal bonds (Bloomberg 1-10 Year Muni Bond) also suffered from the increase in rates, with declines for the month at 1.2%. Year 2026 performance remains better for tax-exempt bonds at a loss of 0.1%.

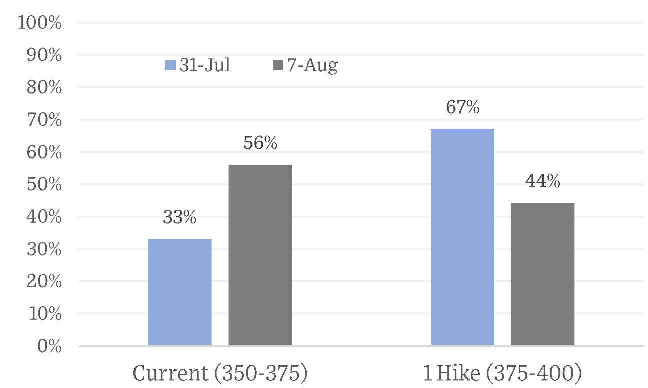
All market performance data are sourced from FactSet or Bloomberg.

- Investment Grade bonds (Bloomberg U.S. Corporate Investment Grade) and High Yield bonds (Bloomberg U.S. Corporate High Yield) diverged in July. Investment grade lost 1.7% given higher sensitivity to interest rates and concerns on hyperscaler debt issuance to fund AI capital expenditures. High Yield bonds demonstrate more correlation to equity markets and have higher exposure to Energy, both of which shielded much of the interest rate exposure, limiting losses to 0.3%. Year to date, Investment Grade bonds are now negative at -0.8% while High Yield remains in the green at 1.7%.

◆ **Commodities** (Bloomberg Commodity Index) jumped 7.5% in July given the return to hostilities in Iran and pressure on Oil prices. Oil jumped nearly $15/barrel in July, an increase of 22%. Precious metals found their footing and were modestly higher while Industrial metals like Copper provided stronger returns. Commodities are now up 23.0% in 2026.

Economic Commentary

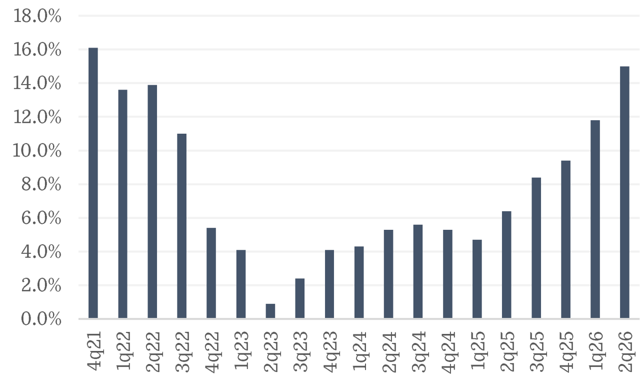
The Federal Reserve held the Fed Funds Rate steady at 3.50 to 3.75% at the Federal Open Market Committee (FOMC) Meeting on July 29th. The meeting was one of the first FOMC meetings in recent history where there was real debate from markets on what direction the Fed would follow. Entering the FOMC, the CME FedWatch Tool predicted a 60% chance of the Fed holding rates steady, where previous meetings markets often had certainty of 95% or higher on the action the Fed would be taking in the days before the meeting. Less certainty fits the theme from the Fed in removing forward guidance and the inflexion point currently in markets regarding inflation data. Markets sold off aggressively on the day of the meeting as Warsh's press conference comments were interpreted as more hawkish. The Dow Jones dropped over 1,000 points (roughly 2%) before quickly recovering in the days that followed. Expectations for a Fed hike in September moved as high as a 70% probability as a starting point for 2-3 hikes into early 2027. As we detailed in our 2nd quarter letter, Chair Warsh is embarking on substantial changes at the Federal Reserve, with immediate attention on communication and forward guidance. Markets have long been addicted to the Fed's accommodative monetary policy and efforts to make sure Fed actions are telegraphed clearly. Warsh seems focused on taking a far different approach: reducing the Fed's influence on markets, eliminating forward guidance, and resetting market expectations of Fed involvement in a market crisis. A weaker than expected (and negative) July jobs report on August 7th took the air out of the higher rate momentum and reversed the change in expectations for future Fed hikes that took place after the FOMC. While we agree with the market's realization of Chair Warsh as more hawkish, we are of the opinion he is less likely to favor a rate hike in the near-term given weak job growth and the factors driving inflation. Whether intentional or not, markets do appear to have less clarity on Fed direction in the current environment than any period in recent history.



Target Probabilities for Federal Funds Rate at 9/16 FOMC Meeting

Source: CME FedWatch

S&P 500 earnings growth continued to substantially exceed formal analyst expectations in the 2nd quarter according to FactSet data with 88% of S&P 500 companies reporting as of August 7th. Earnings growth year/year for the S&P 500 is now just above 50%, which is a historical outlier when earnings are not being compared to a recessionary period. Analysts entered the reporting season on June 30th expecting a robust 23% growth rate and actual earnings have now more than doubled expectations. Earnings growth has partially been amplified by a handful of companies like Google and Amazon that exceeded expectations both in operating performance and non-operating unrealized gains in securities. However, corporate performance has been strong broadly with and without the non-operating earnings while including both top-line growth and bottom-line margin improvement. S&P 500 revenue growth (top-line) reached 15% for the 2nd quarter, its highest growth rate since the 4th quarter of 2021. 8 of the 11 S&P 500 GICS sectors have delivered earnings growth greater than 10% and every GICS sector has seen growth higher than expectations as of June 30th. Markets, however, have been more mixed in the face of strong earnings compared to the 1st quarter earnings reporting season that drove markets from their Iran/oil/inflation concerns and delivered strong market performance for the 2nd quarter. Markets in July were essentially flat before rallying just over 3% in the first week of August but are well off the pace of the 2nd quarter. Sustained strong corporate performance appears to have increased investor expectations. Companies are not seeing the same market response for exceeding earnings estimates as past quarters. According to FactSet, earnings "window" performance periods for the 2nd quarter (2 days before and after their earnings report) is only running 0.4% on average for companies that beat earnings expectations. The historical 5-year average is a 1.0% return over the same window for positive earnings surprises. The blowout earnings quarter raises the question of "peak earnings growth" for markets and whether the environment can continue. 3rd quarter earnings expectations are increasing at 27% growth and Calendar Year 2027 earnings have steadily risen to $405. At 7,700 to 7.800 on the S&P 500 price, US large cap companies are trading at roughly 19x forward earnings, a level high by historical standards but not obscene. The question is whether markets can maintain that earnings multiple while growth inevitably declines from the current levels.



S&P 500 Year/Year Revenue Growth by Quarter

Source: FactSet Earnings Insight as of August 7th, 2026

Situational Awareness moved into the average investor's lexicon after selling its public stock portfolio to Citadel Securities at a discount in late July to unwind a reported 67% loss for the month. The latest hedge fund meltdown had all the makings of a perfect financial media story: ultra wealthy Silicon Valley investors, leverage, youth, hubris, and turtlenecks. Situational Awareness was admittedly not on our due diligence radar prior to the Wall Street Journal article in late July outlining its troubles. The fund was started by now 24-year-old Leopold Aschenbrenner who graduated college at 19 and had previously worked at FTX and OpenAI (what could go wrong?). Mr. Aschenbrenner became known for an eponymous 165-page essay on the transformational impact of AI and "superintelligence" and the projected impacts on society. The fund launched with modest assets in 2024 but quickly grew from performance and inflows to a peak of $45 billion according to the Wall Street Journal. The strategy for Situational Awareness was to invest in public and private companies that would benefit from the themes in Mr. Aschenbrenner's memo while also shorting companies that were vulnerable to AI displacement. The fund was reportedly levered 3 to 4 times its assets, meaning the net fund assets were likely closer to $10 to $15 billion. It is not clear from reporting how hedged the portfolio was in terms of its positions in public equities. Our guess from the size of the July losses would be "not very much". There are plenty of hedge funds that run with 3 to 4 times leverage (or higher) but if they have survived difficult market periods it is based on strong risk management and typically managing to a much lower "net" that is far less exposed to overall market direction. Situational Awareness was reportedly running their portfolio with a much greater long bias, meaning net exposure to the market was high, and not just the market but highly volatile concentrated positions in areas like semiconductors, energy, and technology hardware. Many of these names suffered steep losses at some point during July, which likely put the fund in a difficult position with its lenders. Running a fund with $40b of leverage on $10b of equity capital would only require a modest drawdown on a gross asset basis of 10% to wipe out enough of the equity capital to force deleveraging. We are surprised it did not happen sooner. This would be another opportunity to remind investors of the importance of performing proper due diligence. Situational Awareness was unique among large hedge funds in that it appeared to raise most of its capital from individual investors in Silicon Valley circles rather than institutions. It is unclear what due diligence may have been performed by these investors, but Mr. Aschenbrenner had no prior experience in financial markets or attributable track record. Regardless of the foresight of the memo, the fund was not something we would consider investable. Transparency and reporting also appeared to be an issue which is often the case when things go wrong. 13F holdings for Situational Awareness filed quarterly with the SEC were apparently closely followed by certain retail traders that would look to mimic the fund's positions. The filings, combined with the reported performance through June, up over 450% for the year, should have raised questions in our opinion. Yet, Bloomberg recently reported that many of the Silicon Valley investors are asking to put more capital in the fund after July's decline. Mr. Aschenbrenner also reported that the fund no longer has leverage. Maybe the events of July will turn Mr. Aschenbrenner into a grizzled trading veteran, but proper risk management is a skill that is learned over time. Investors who remain in the fund better hope those risk management skills are fully evolved if we enter an actual market downturn.

Important information