Daily: Higher yields are testing the equity thesis, not breaking it

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From the studio

Podcast: Signal over Noise with Ulrike Hoffmann-Burchardi, on Apple or Spotify (6 mins)Video: Market Playbook | James Cheo on fixed income (5 mins)Video: The AI Show | China tech earnings update and what's next (3 mins)

Thought of the day

Even as this week's rise in global bond yields begins to stabilize, equities have continued to show signs of discomfort. On Tuesday, the Nasdaq and Philadelphia Semiconductor Index fell 1.7% and 5%, respectively. That followed into Wednesday, with the 5.8% sell-off in South Korea's memory-heavy Kospi and a 3.2% decline in Japan's Nikkei 225. In Europe, the Stoxx 600 fell 0.7% on Tuesday, posting its fifth consecutive decline for the first time so far in 2026, before trading flat at the time of writing. Adding to the unease, Brent crude oil stood roughly 1% higher at USD 89/bbl amid persistent tensions in the Middle East.

At first glance, these moves combine several factors that have historically challenged risk assets: higher bond yields, higher oil prices, and weakness in the technology and AI-linked shares that have led much of the equity rally. Concerns about AI monetization, ongoing debate over AI financing structures, and questions around the sustainability of investment spending have added to uncertainty around one of the market's most important themes.

While these risks deserve attention, we do not believe recent market moves undermine the core case for equities:

AI fundamentals remain intact. The latest sell-off has been concentrated largely among some of the market's strongest performers, adding to evidence that recent weakness reflects profit-taking and a momentum unwind rather than a broad deterioration in fundamentals. AI-related companies continue to report robust demand trends, with major hyperscalers posting average cloud revenue growth of 48% in the second quarter, up from 40% in the first quarter. While positioning may again be resetting, the underlying AI investment cycle still appears healthy, in our view.

Earnings growth remains the market's anchor. Strong earnings growth has been one of the defining features of 2026. S&P 500 companies delivered nearly 35% year-over-year underlying earnings growth in the second quarter, and close to four out of five exceeded expectations. Just as importantly, earnings strength is no longer confined to a narrow group of technology companies. We are seeing broader participation from sectors such as industrials, financials, and consumer discretionary. In Europe, earnings momentum has improved after several years of stagnation, while Asia continues to benefit from resilient growth trends.

The inflation-shock narrative is not yet showing up in the data. Oil prices have risen, and market-based inflation expectations have moved higher in recent weeks as concerns over Middle East tensions intensified. However, the broader inflation picture remains more balanced than recent market moves suggest. US import prices unexpectedly fell in July, while headline and core inflation remain softer than a year ago. At the same time, softer housing activity, weaker industrial production, and a lower Atlanta Fed GDPNow estimate point to moderating rather than overheating growth. While higher energy prices are a risk to monitor, they do not necessarily imply a sustained inflation shock or a materially different policy path, in our view.

So while periods of elevated volatility can be uncomfortable, they do not necessarily invalidate the underlying investment case. In our view, investors should remain focused on the factors most critical to the medium-term outlook: the durability of AI investment, the breadth of earnings growth, and the path of inflation. Across all three, our base case remains constructive.

We continue to think equities are Attractive and favor a diversified approach that balances targeted allocations to structural growth opportunities with other sectors that stand to benefit from a broadening earnings cycle. It can be tempting to position more heavily in some of the faster-gaining AI beneficiaries after their rapid rise, but we think this move is a reminder to avoid becoming overly reliant on a narrow group of stocks. Instead, we would use periods of volatility as an opportunity to review diversification and to put excess cash to work across portfolios. With yields now trading at fairly elevated levels, we would also reiterate the role quality fixed income can play in strengthening portfolio resilience should growth slow more than expected.

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