Wood for All Seasons

Weekender

August 1, 2026

A true achievement is to make a fine cabinet--elegant, graceful, one with character--and fit it with drawersx and doors that work properly the year round.

James Krenov (Renowned Cabinetmaker)

Nothing endures but change.

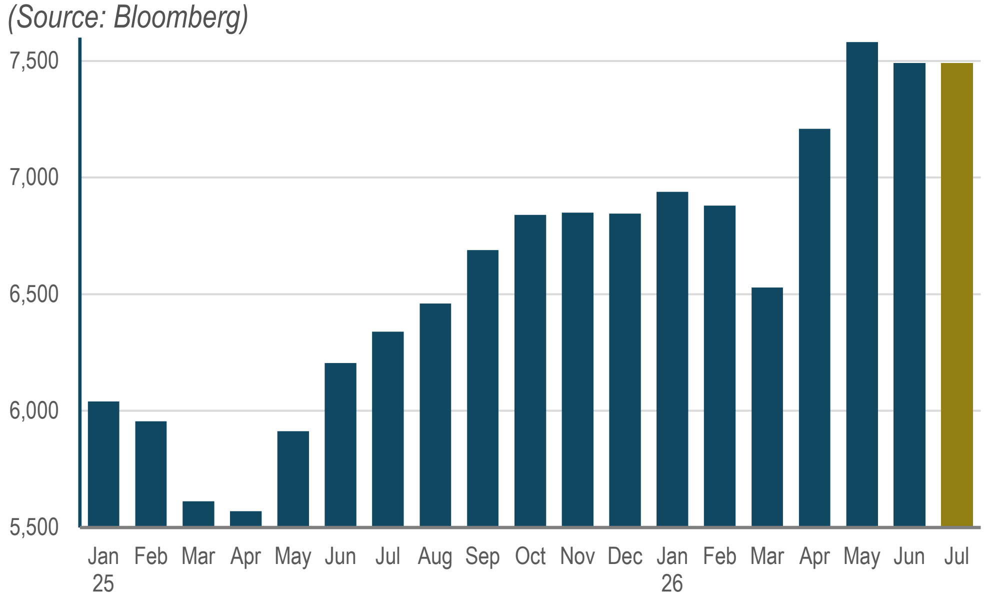
Heraclitus

Good morning and welcome to the *Weekender* for Saturday, August 1, 2026. Equity markets, as measured by the Standard and Poor's 500, were higher by 1.0% on the week, closing July at 7,489.72. For the full month, the index fell by one-tenth of one percent. On a total return basis, including dividends, July rounds to zero for US equity markets.

A flat month for July is not remarkable after the stellar returns of the first half of the year. But, despite tranquility on the outside, market internals were aflutter. July delivered one of the most violent months of repositioning in a decade. Semiconductors fell 20.6%. Software as a service rose 18.0%. Crude oil rose 21.8%. The ten-year Treasury yield climbed twenty-seven basis points to its highest level of the year, and the thirty-year bond reached a yield unseen in nineteen years. The equal-weighted S&P 500 set a record high on July 28, the same afternoon the large tech-tracking Nasdaq 100 was flirting with a correction. And Bloomberg's measure of aggregate free cash flow across the artificial intelligence value chain is now deeply negative. A feat unachieved over the whole fifteen years free cash flow has been tracked. Perhaps the most revealing tell of financial markets over the last month was the migration of the artificial intelligence trade from being priced by equities alone to a full reveal in fixed income.

S&P 500 Index Levels

(Source: Bloomberg)



In this *Weekender,* we attempt to unpack the month of July starting with three forces- oil, rates, and the bill for AI capital expenditures- then walk the month through our five-bucket lens: countries, instruments, sectors, themes, and special situations. As always, please consult a qualified financial advisor before making any meaningful financial decision. If you would like to speak with someone at Keeler Thomas, please reach out and set an appointment through our website, www.keelerthomas.com.

Market Narrative

Oil

In our June 27 *Weekender,* we noted that a resolution to the Iran conflict had already returned crude to pre-war levels and that lower rates were therefore plausible by year-end. The ceasefire was breached on July 7 and 8. The United States launched fresh strikes on Iranian targets in response to attacks on American assets across the region, and the diplomatic track that looked so promising a month ago is now closed for the foreseeable future. West Texas Intermediate went from $68.69 on July 3 to $89.31 on July 24 before settling the month at $84.67. That is a 21.8% monthly gain and a 47.5% gain for the year to date. A Ukrainian strike on the Volgograd refinery and shrinking US oil inventories are adding to the oil market jitters. In terms of real impact, higher oil prices that began with the first incursions in Iran are only beginning to be felt in earnest since the contract nature of most oil deliveries creates a delayed impact.

US Crude Oil Price per Barrel

January 1 2024 - July 31, 2026

(Source: Bloomberg)

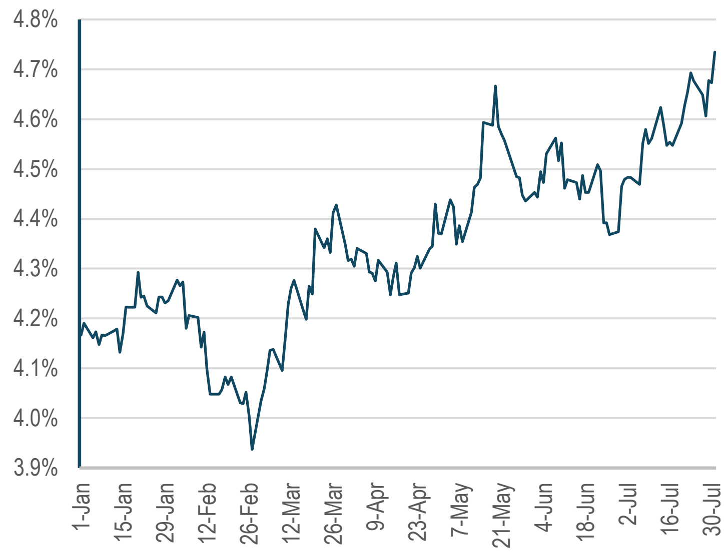
Money for Nothing is Gone Until the Next Recession

The ten-year Treasury yield began 2026 at 4.167%, bottomed out at 3.9375% on February 27 when weak labor data had the market pricing two cuts, and finished July at 4.7347%, the high for the year and the highest since January 2025. That is eighty basis points off the February low and fifty-seven basis points for the year. The long end moved further: the thirty-year bond pushed above 5.20%, its highest yield in nineteen years.

US Treasury 10-Year Yield

January 1 - July 31, 2026

(Source: Bloomberg)



On July 29, the Federal Open Market Committee held rates steady on a nine-to-three vote. The three dissents wanted to hike. Read that again. Six months ago the debate was over the pace of cuts; the market now prices roughly a 63% probability of a twenty-five-basis point increase in September.

Chair Warsh declined to specify what would cause him to raise rates, consistent with his stated move away from forward guidance, and observed that it is a healthy thing for the bond market to respond to economic data rather than to the central bank. The bond market took him at his word. The two-year yield fell four basis points on the day while the ten-year rose seven and the thirty-year rose twelve. That is not a market repricing policy. That is a market repricing of inflation and term premium, which is a more expensive thing to be wrong about.

We have some sympathy for the position. A central bank staring at a 21.8% monthly move in crude, driven by a supply shock it cannot influence, is choosing between validating an inflation impulse it did not cause and ignoring one that consumers can feel at the pump. Neither choice is good. But the absence of forward guidance has a cost, and the cost showed up in the long end within ninety minutes. Credibility is a balance sheet item. It is expensive to accumulate and cheap to spend.

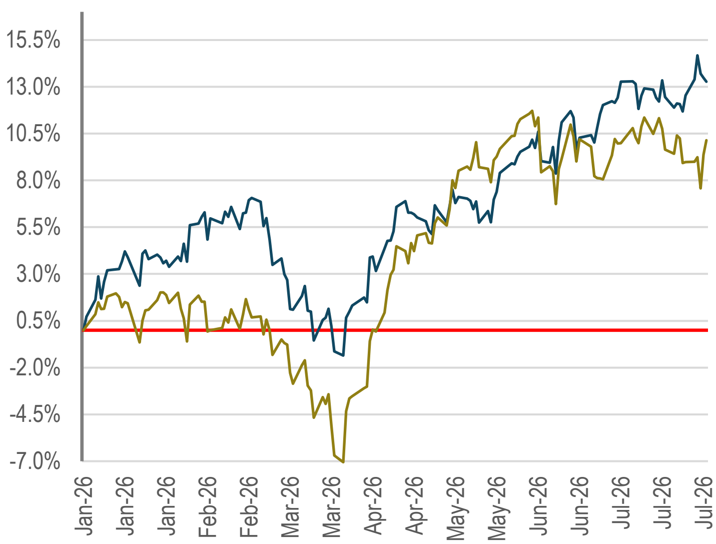
Market Momentum Broadens

The S&P 500 has two versions: a market value-weighted version and a version where each company receives a unitary weight. Most investors and traders use the market value-weighted index, but comparing the two can generate some very instructive insights. Through July 31, the equal-weighted S&P 500 has returned 13.3% for the year. The capitalization-weighted index has returned 10.1%. The average stock is beating the index by 312 basis points, and the equal-weighted index set a record high on July 28 while the cap-weighted index remained below its June 2 peak.

S&P 500 Market (Gold) vs Equal (Blue) Weight

January 1 - July 31, 2026

(Source: Bloomberg)



For three years as the AI trade took over market leadership, the entire architecture of US equity returns was supported by a handful of names. Not anymore. The Magnificent Seven, as a basket, are up 0.3% for the year. The S&P 500 excluding those seven names is up 12.6%. Small capitalization stocks are up 20.5% and mid caps 13.7%, against 9.4% for the S&P 500. Value has returned 19.4% year to date while growth has returned six thousandths of one percent. The not-so-magnificent seven have contributed almost nothing to 2026. Everything else has contributed everything.

This is the broadening that strategists have promised every January since 2023, and that has never arrived. We have been expecting it for two years. At last it's here. Perhaps a few cautions would be advisable.

First, breadth this pronounced is generally a late-cycle phenomenon rather than an early one. While capital rotating out of leadership and into laggards can mean the market is healing. It can also mean the market is looking for somewhere to hide without leaving the room. This is especially true in a market where retail participants are true believers with no memory or experience with past downturns.

Second, the spread has been wider. Equal-weight led cap-weight by 638 basis points in late February, gave nearly all of it back by early June, and has rebuilt to 312 basis points. This is not yet a trend with a track record. It is a two-quarter divergence that could resolve either way, and in our May *Weekender* we noted margin debt looked contained at roughly 1.8% of market capitalization. That ratio remains moderate. The absolute figure does not: FINRA reported record margin debt of $1.42 trillion in May, more than double a year earlier. Contained leverage that doubles in twelve months deserves a second look.

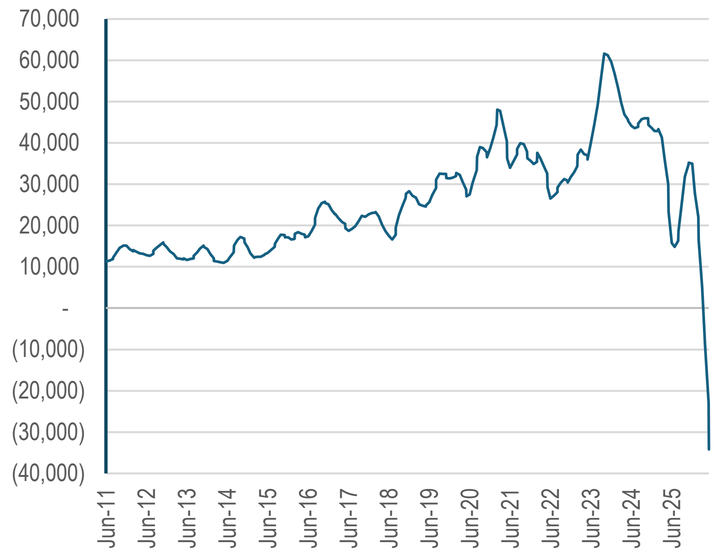
The Bill Arrives

We have written for three years that artificial intelligence is real, that it will prove the most consequential advance since the Industrial Revolution, and that the near-term financial results will fall short of expectations while the long-term effects exceed them. July produced the first hard evidence for the middle of that sentence, and it did not come from a stock price. It came from a cash flow statement. Railroads created enormous value and destroyed enormous capital at the same time, and the people who did the building were not people who kept the returns. We do not think this rhymes by accident.

AI Free Cash Flow

June 2011 - June 2026

(Source: Bloomberg)



The series peaked in September 2023 at roughly $66.7 billion. It ran between $25 billion and $50 billion through 2025. It closed last year at $25.1 billion, printed $8.3 billion in February, and then fell off a cliff: negative $30.9 billion in March, negative $44.6 billion in April, negative $56.7 billion in May, and negative $61.3 billion in June. In fifteen years of history, the prior low was a positive $9.4 billion. There is no precedent in this data for what is happening now.

The single-company evidence tells the same story. Alphabet reported second quarter capital expenditure of $44.9 billion, roughly double the prior year, and free cash flow of negative $5.9 billion. The first negative quarter in the company's history as a public company, going back to 2004. Management raised 2026 capital spending guidance to as much as $205 billion from a prior range of $180 to $190 billion. Amazon's first quarter free cash flow fell 95%, to

$1.2 billion from $25.9 billion a year earlier, and carries roughly $200 billion of 2026 capital commitments. Analyst work circulating late in the month projects combined 2026 net income for the five largest hyperscalers rising 25% to approximately $506 billion while their combined free cash flow falls 91% to roughly $16 billion. Those are estimates, not actuals. The Alphabet print is not an estimate.

Two things follow, and they matter more than the monthly return figures elsewhere in this letter.

The first is a change in what investors are looking at. For three years the market rewarded reported earnings and revenue growth. In July it began reading the cash flow statement. Alphabet's headline second quarter earnings were up 294%; strip out roughly $99 billion of paper gains on stakes in Anthropic and SpaceX, and core earnings per share came in at about $2.85 against a $2.88 estimate. A market that pays for headline earnings and a market that pays for free cash flow are two different markets, and the transition between them is where multiples get repriced.

The second is a change in how the buildout gets funded. Incremental annual debt has risen from 9% of hyperscaler capital expenditure in fiscal 2024 to 32% on a trailing twelve-month basis by mid-2026. Alphabet priced an $84.75 billion equity raise in June. Oracle plans $40 billion of combined debt and equity for its coming fiscal year. Aggregate cash capital expenditure across the five largest hyperscalers is expected to exceed $690 billion. These are extraordinarily well-capitalized companies with low leverage, and none of this is a solvency question. It is a returns question. Self-funded capital expenditure answers to a board. Externally funded capital expenditure answers to a market, and markets change their minds.

Up to now, equities have been the primary voice dictating the magnitude and cadence of the artificial intelligence buildout. Not anymore. Given the magnitude of the task, hyperscalers are going to debt markets with hat in hand for the capital needed to fund the future. For most of this year, fixed income investors have been willing to oblige. But the ask is getting too large for markets to support, resulting in a re-rating of hyperscaler risk. Even with Nvidia, perhaps the most creditworthy of the sector, five-year credit default swaps, the cost of insuring an issuer's debt against default, have been skyrocketing.

None of this makes artificial intelligence a mirage. Microsoft reported commercial remaining performance obligations of $625 billion and Azure growth near 40%. Demand is not the problem. The problem is that the arithmetic of building supply against that demand has, for the first time, consumed more cash than the industry generates. Track gets laid before the freight arrives. The question is who is holding the paper when the two schedules fail to meet.

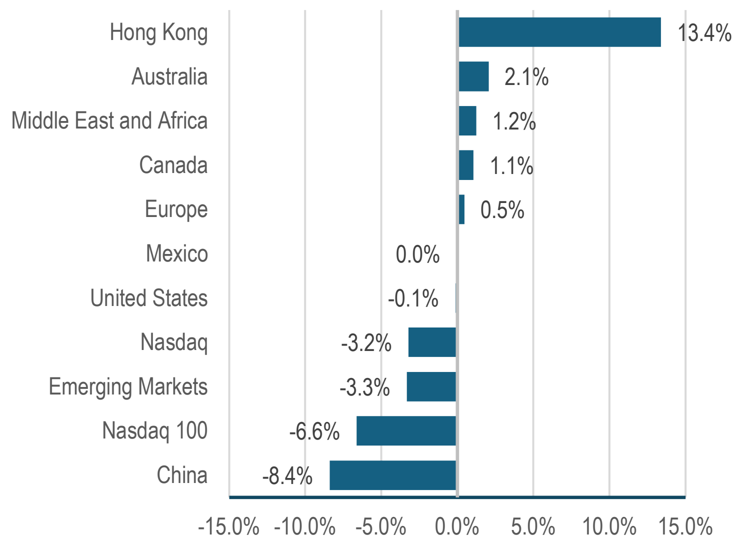
Five Buckets Review

We organize portfolio thinking around five categories — countries, instruments, sectors, themes, and special situations. What follows is a description of July market returns through this lens.

Countries

Hong Kong led the world with a 13.1% monthly gain, which is remarkable given the Hang Seng is up only 1.0% for the year — nearly the entire annual return arrived in four weeks. Australia added 2.3%, the Middle East and Africa 1.2%, Canada 1.1%, and Europe 0.5%. The United States was flat. The losers were the technology proxies and, curiously, China: the Nasdaq 100 fell 6.6%, emerging markets 3.3%, and China's CSI 300 fell -7.9%.

Country Returns
July 2026
(Source: Bloomberg)



That last pairing deserves attention. Hong Kong up 13.4% and mainland China down -8.4% in the same month is not a China call; it is a composition call. The Hang Seng carries financials and internet platforms while the CSI 300 carries onshore industrial and technology manufacturing. On July 27, The Information reported that China has begun mass-producing domestic immersion deep-ultraviolet lithography machines. That news is bearish for the incumbent semiconductor complex globally, and it is not obviously bullish for onshore Chinese manufacturers competing on price with newly abundant tooling. We are watching, not concluding.

Year to date, emerging markets lead at 18.6%, followed by Canada at 11.1%, Europe at 9.8%, the United States at 9.4%, and Mexico at 4.1%. China is the only market in the group down for the year, at negative 0.9%. The multi-year habit of overweighting the United States and underweighting everywhere else has now been bad for two consecutive years. Still, the most notable shift has been to add emerging markets, particularly democracies. At first glance, this seems to be a protective currency move. But there is also an AI angle. Emerging markets, in relative terms, are likely to experience the greatest changes from implementing artificial intelligence. Most emerging market democracies are moving toward restructuring and reform, which draws investor dollars their way compared to the countries of tomorrow that forever will be. We believe this trade will be enduring. It's a low-risk trade given the valuation discounts of most democratic emerging markets.

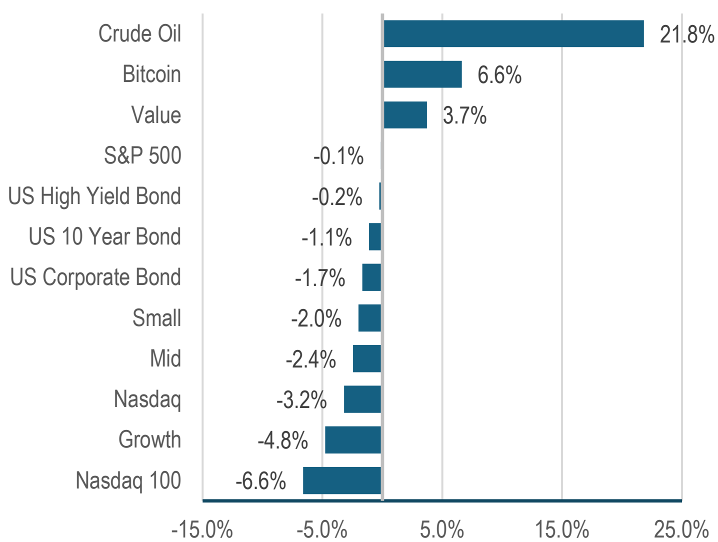
Instruments

Crude oil was the month's best instrument at 21.8%. Bitcoin gained 6.6%, though it remains down 28.7% for the year — a reminder that a monthly bounce and a thesis are different things. Value gained 3.7%. Everything else fell. Growth lost 4.8%, the Nasdaq 100 lost 6.6%, and small and mid capitalization stocks gave back 2.0% and 2.4% after leading all year.

Instrument Returns

July 2026

(Source: Bloomberg)



Fixed income deserves a note, because it was not a haven. The US corporate bond index lost 1.7%, and the ten-year Treasury index lost 1.1% on the month, both now negative for the year at roughly negative 0.8%. High yield outperformed investment grade, losing only 0.2% and holding a 1.7% gain for the year. When credit outperforms duration in a risk-off month, the market is telling you the problem is rates, not defaults. That is the right read of July. We use fixed income for clients who cannot tolerate the volatility of stocks or who need consistent, regular payments. In general, the price of fixed income, up or down, does not cause us concern since we plan to hold them to expiration.

However, we believe investors who are dipping into fixed income for capital gains are in for a reckoning. Credit spreads are far too tight and likely to blow out given the perceived stress caused by the mountains of AI debt issuance on the horizon.

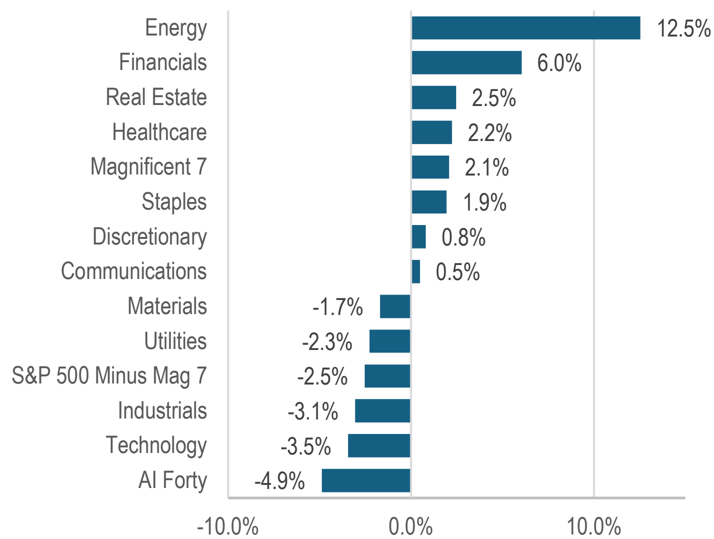
Sectors

For July, energy gained 12.5%, which requires no explanation beyond the oil chart, and is now up 32.8% for the year. The best sector in the index by a wide margin. Financials added 6.0% on a steepening curve. Real estate, healthcare and staples each gained roughly 2%.

Sector Returns

July 2026

(Source: Bloomberg)



The declines are more interesting. The AI Forty lost 4.6%, technology 3.5%, and industrials 3.1%. The Magnificent Seven gained 2.1%, but the software-heavy members carried it while the S&P 500 excluding those seven names lost -2.5%. For one month, the mega caps outperformed the average stock even as the market rotated away from artificial intelligence. Those two facts are only compatible if the market is discriminating within technology rather than exiting it, which is precisely what happened.

Themes

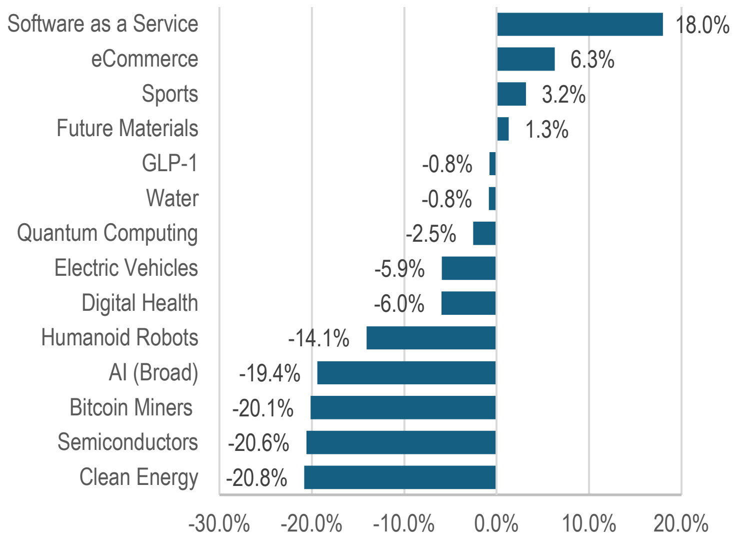
No bucket captures the month more than themes. On one end: software as a service, up 18.0%. On the other: clean energy down 20.8%, semiconductors down 20.6%, bitcoin miners down 20.1%, broad artificial intelligence down 19.4%, and humanoid robots down 14.1%. eCommerce gained 6.3% and sports 3.3%.

Regular readers will recognize this as the trade we flagged as unsustainable five weeks ago. On June 27, we wrote that equity markets were trading hardware as if it were a boom town and software as a cemetery, that both positions were untenable over the medium term. That software with real operating leverage would eventually convert artificial intelligence from a threat into a margin. We did not expect the correction to begin four weeks later, and we take no particular credit for timing we did not have. But the mechanism is exactly the one we described.

Theme Returns

July 2026

(Source: Bloomberg)



The catalysts were specific. Taiwan Semiconductor reported strong revenue in mid-July and simultaneously raised full-year capital spending guidance to $60 to $64 billion; the market read the increase not as confidence but as margin compression working its way down the supply chain. The Chinese lithography report followed on July 27. The Philadelphia Semiconductor Index fell 4.5% on July 28 after being down as much as 6.5% intraday. Korea's Kospi fell 10.8% and triggered its eighth circuit breaker of 2026, with SK Hynix down 14.65% and Samsung down more than 13% — this on the same day Samsung reported second quarter operating profit up more than 1,800% year over year. Meanwhile, Salesforce, ServiceNow, Workday, Adobe, and Palantir all rallied hard, and the VIX slipped to 18.21. Capital rotated. It did not leave.

Set against the year, the reversal is smaller than it feels. Semiconductors remain up 59.7% year to date even after a 20.6% month. Bitcoin miners are up 46.4% and broad artificial intelligence up 43.2%. Software as a service, despite gaining 18.0% in July, is still down 22.7% for the year. The gap has narrowed. It has not closed. If our thesis is right, there is considerably more of this to come, and it will not travel in a straight line. We expect hardware to eventually satisfy demand and return to ordinary margins and ordinary multiples. Software that genuinely embeds artificial intelligence will use its operating leverage to expand both. July was the first month markets voted that way.

Special Situations

Our special situations bucket is where we hold positions that do not belong to a country, an instrument, a sector, or a theme — event-driven exposures, dislocations, and structures whose return profile is idiosyncratic by construction.

With hyperscaler capital expenditure increasingly debt- and equity-funded and anticipated public offerings from Anthropic and OpenAI, an enormous quantity of paper is queued to reach markets over the next eighteen months. Alphabet's June equity raise looks less like opportunism and more like getting ahead of the line. Supply of that magnitude reprices everything adjacent to it.

The memory and foundry complex following the Chinese lithography report. If domestic immersion deep-ultraviolet production is real and scales, the export-control architecture that has underpinned semiconductor valuations since 2022 becomes considerably less load-bearing. That is a structural question dressed up as a news item, and it will take quarters rather than weeks to resolve.

Additional special situations areas we are focusing on include what we believe will be a rekoning in the private credit market where the baby will certainly be thrown out with the bathwater befor a reconciliation occurs.

The carry trade, borrowing yen to invest aborad, has been a primary funding mechanism for equity and debt investing in developed countrries. It is ending.

Finally, we are watching and preparing for a scale adjustment of two market perspectives on AI. One is that the payoff is coming and investors need to be patient. The other is that the asset lite era is over and returns will be modest in the new world created by artificial intelligence.

One More Thing

One more thing. Wood moves. Growing up, I watched my father make things from wood. He was a dentist by profession but a creator by impulse. As a child, he made our kitchen table, which was designed for the realities of six children with a slope to the middle of the table creating a channel for inevitable spills and delivering to the unwitting occupant of the seat at the end. He retired at 47 and pursued a life painting, cooking, cabinetry, gardening, and a host of other endeavors. He and my mother were good at everything. Which is annoying for those with no natural ability. But to this day, I love working with wood.

Understanding wood helps explain why we are active managers, especially with asset allocation.

Consider this. Take a thirty-six-inch white oak tabletop, flatsawn, in a house that sits at six percent moisture content in February and ten percent in August. The arithmetic is not hard, and every furniture maker carries it around: width, times the species coefficient, times the change in moisture.

$$36 \text{ in.} \times 0.00365 \times 4 \text{ points} = 0.53 \text{ in.}$$

That top is half an inch wider in August than it was in February. Not a hairline. Half an inch, every year, for as long as the table exists, in a piece of furniture that appears to be sitting perfectly still in a dining room.

Now cut the same log differently. Quartersawn, growth rings running edge to edge rather than across the face, the coefficient falls to 0.00180, and the identical top travels a quarter inch instead of a half. Same tree, same width, same room, half the movement — and all of it decided at the sawmill, before anyone touched a plane. It is also bought rather than found: quartersawing yields fewer usable boards per log, so the lumber costs more per foot. Stability is not a property you discover in the material. It is a thing you pay for in yield, up front, and the invoice arrives long before the benefit does.

Then there is the fact that the board does not care where it came from. A kiln-dried plank leaves the mill at seven percent and holds that number precisely until the moment it enters a room, at which point it ignores the kiln entirely and begins equilibrating to the room. Wood has no memory of its own manufacture. It responds only to the conditions it currently occupies. The most carefully processed board in the world, moved into a humid house, becomes a humid-house board inside of a month.

Every one of those sentences is also a sentence about a portfolio, which is roughly why I spent this week looking at a flat index with a woodworker's suspicion.

A portfolio is a wide panel. The parts move constantly, and they do not move together, which is the entire reason for owning more than one of them. July's index finished more or less where it started. Underneath it, semiconductors sold off hard, software ran, the equal-weighted index and the cap-weighted index went separate directions, and oil reopened a question we had all agreed was closed. The panel sat still because the movement canceled, not because the movement stopped. Stillness at the aggregate is an arithmetic result, not a description of the material.

There are two ways to get this wrong, and beginners find both. The first is to glue the panel down hard — to read a flat index as an all-clear, fasten everything tight, and treat the composure of the aggregate as evidence that nothing underneath requires attention. The seasons turn, the wood tries to move, the joinery refuses, and the top splits. The second error looks like its opposite and is the same mistake in different clothing: to watch the movement underneath and try to clamp each piece of it as it happens, chasing the semis out and the software in, re-fastening the whole assembly against a future that has not been announced. One error denies that wood moves. The other tries to stop it. Both end with a cracked panel and a client asking what happened.

What a joiner actually does is more precise than either, and the clearest example is the breadboard end — the cross-grain strip capped onto the end of a tabletop to hold it flat. The top wants to travel across its width. The breadboard, oriented ninety degrees to it, does not. Glue that joint along its length and the top will split, not as a risk but as a schedule. So the joiner does something better than gluing and better than floating: he glues and pins the center only, and cuts the outer pin holes into elongated slots. The middle is fixed. Everything outboard of it is free to travel, inside a gap he sized in advance using the same calculation above. Too tight and the top cracks. Too loose and the joint rattles and the ends stand proud in every season. The slot is not a compromise between rigid and loose. It is a computed tolerance, set before assembly, from a number he looked up rather than a number he felt.

I do not know a better physical description of a rebalancing band. Anchor the center — the strategic allocation, glued and pinned, not up for renegotiation because oil moved. Let the edges travel, but only inside a slot you cut on purpose, sized to the movement you already know is coming. The discipline is not in holding still, and it is not in reacting. It is in having done the arithmetic before the humidity changed.

One more thing worth stealing from the shop. A finish does not stop wood from moving. It slows the rate at which the board exchanges moisture with the room, which is a different and much smaller claim than the one most people think they are making when they varnish something. And you have to finish both faces. Coat the top and leave the underside bare; the two faces exchange moisture at different rates, and the panel cups — pulled into a curve by its own asymmetry. A hedge is a finish. It slows the transmission; it does not remove the exposure, and applied to one side of the book and not the other, it is not protection. It is a warp you paid for.

The last thing is a caution about the evidence. Furniture that survives two centuries is not the furniture that was built tightest, and every antique worth studying wears its accommodation in plain sight: a back panel shrunk away from its rabbet, a pin slot worn shiny from ten thousand slow trips, a top standing slightly proud of its breadboards in January and flush again by July. We admire old work partly because the rigid pieces are unavailable for inspection. They were firewood by 1840. Survivorship applies to tables too, and the tables that made it are the ones somebody built loose on purpose.

The standard was never stillness. It was adjustment, sized in advance, and then left alone to breathe through its seasons.

Disclosure Statement

Index performance does not reflect the deduction of any fees and expenses, and if deducted, performance would be reduced. Indexes are unmanaged and investors cannot invest directly in an index. Past performance does not guarantee future results. Investing involves risk, including loss of principal.

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