Cantor Fitzgerald Asset Management

STRATEGY & OUTLOOK

Market Update

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The Biggest Bet in History

AI is now the biggest bet in history. Entering the second half of the year the funds are positioned for a very volatile period as rate hikes meet euphoric, exuberant, and artificially Intelligent expectations. Despite the strong performance in global markets to start 2026 we believe our low risk, low beta portfolio is the prudent approach. The funds lagged their benchmarks in H1 2026 after Semiconductors led a near record breaking rally in risk assets in Q2. We used this strength in AI related names to reduce our exposure fully to AI technology and anything in the AI supply chain. Global indices were dragged higher by this euphoria which we feel is unsustainable and now entering alarming levels.

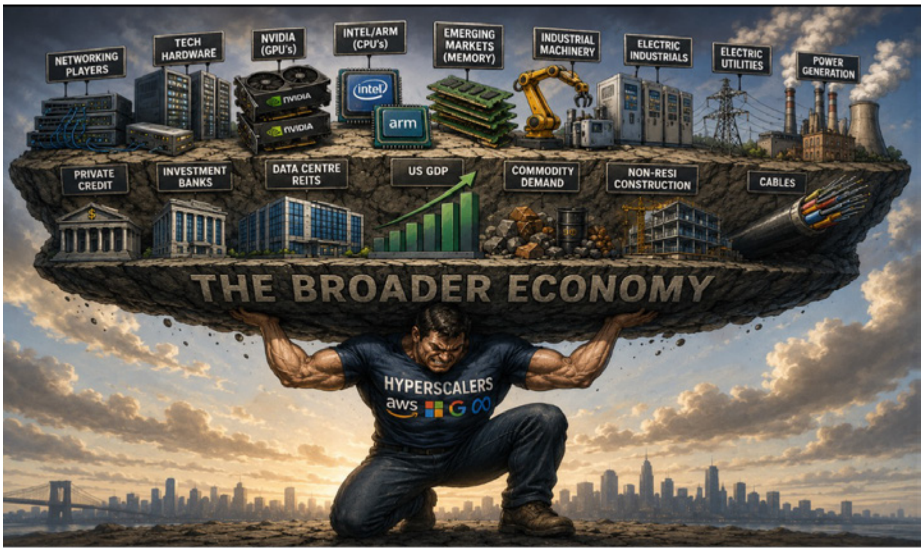
The earnings upgrades seen year to date in the US are undoubtedly impressive but also increasingly concentrated in one part of one subsector of the market (AI Semi conductors). The quality of the earnings overall is worrying. The circular nature of the financing of AI capex is now leading to circular earnings upgrades as the hyperscaler's are marking to market higher their holdings in private AI companies that they are funding. The creative and competitive nature as well as the actual cost of financing this unprecedented buildout goes ever higher, increasing the need to see evidence of material, sustainable, and immediate ROI across the entire value chain. Capital requirements go ever higher. Alphabet just announced an 80bn equity raise ahead of some of the largest IPO'S in history which are all AI related. Debt issuance across the AI value chain continues to accelerate at an unprecedented level. Newly issued AI related Debt is expected to be 500bn this year, a colossal figure for a nascent technology in one year, and yet to fuel the markets expectation of investment out to 2030 it would need to grow year on year. For context, the US governments net issuance for this is circa $1.5trillion.

The sustainability of this multi year bull run relies on a trajectory of AI spending, borrowing, building and power consumption that by any historic standards is unsustainable. This spending is falling on a small number of companies whose share prices are not rewarding them for doing this. Microsoft has underperformed the market by close to 50%. Even if this level of investment ultimately generates sufficient long term returns incumbent management may not live to see them with this level of share price underperformance. Initially spending was increasing as they expanded their plans, recent spending is all cost led as the supply chain has seized up, with memory costs being the high profile event of the quarter. This puts further pressure on ROIC.

The technology supply chain is under so much pressure that we are seeing real world inflationary impacts play out in real time. Apple hiked prices on their entire product range by $200, fuelling the inflationary pressures in the US. This economy is not overheating as much as parts of it are burning now from the unsustainable trajectory of AI spend. Inflation is beginning to rise noticeably, marking a clear break higher in what had been a downward trend in inflation since the summer of 2022. The number of rate hikes priced in is slowly rising, with 2 now expected in the UK and Europe. All cuts have been priced out of the US and the language out of Fed governors has recently turned noticeably hawkish. Governor Warsh's opening press conference marked a significant change in how the Fed will interact with markets. Removing forward guidance when inflation is above trend and rising will see overall volatility increase. Markets for a generation have relied on a Fed Put. Under Warsh it would appear the strike is a lot lower , if there even is one. The welcome cessation of violence in the middle east has not been enough to see the inflationary impacts of the crisis disappear, with all the risks pointing towards a higher oil price over the medium term. We note that gasoline is still up 50% versus its pre-crisis levels. Regardless of what central banks do the long end of the bond market has continued to trend higher, a development that can hit risk appetite quite materially in the short term as various issues such as relative value of equities to debt sustainability come back to the fore. Warsh's desire to shrink the Fed's balance sheet seems to have gone under the radar. Liquidity is such a large part of modern market returns and traditionally any threat to that has been met with market volatility.

Current US economic growth and stock market returns rely wholly on AI spend being maintained. June threw up some interesting data points in this regard. The place of open sourced, more efficient models seemed to gain more validity as Microsoft indicated a willingness to offer them to their customers. Any unexpected pricing pressure on the frontier models (OpenAI and Anthropic) could jeopardise the pace of the buildout as 50% of the hyperscaler's backlog is with these two private companies where rapid exponential growth is expected. At the same time OpenAI implied they would delay their IPO untill next year. This delay seems inconsistent with these lofty expectations.

We continue to have a low level of risk and beta but we did make some changes to the portfolios over the quarter. We reduced all our exposure to AI infrastructure build out, replacing it with some undervalued higher quality names that have lagged and offer good value in US healthcare, Financials and even Software. Our main sector over weights are Energy, Utilities and Banks. These sectors should benefit from this elevated and rising commodity and rate environment. Technology remains our largest underweight. The record-breaking rally in semi-conductors is matched only once in history (March 2000) and has been met by the most amount of leveraged retail exposure on record. Whatever ones positive long term views on the foundational technology that is AI, now does not appear to be the time to be expressing them. It is imperative to not to confuse a belief in AI as a transformational technology of the future with AI stocks being a transformational investment of the present moment. We also reduced the duration of the bond portfolio. Ever rising inflation and rate hike expectations has resulted in a worrying level of correlation between bonds and equities.



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