

DHGI Fund

Monthly Investment Letter

August 2026

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US equities registered modest gains in August, with the S&P 500 advancing 2.7%—nearly all of which accrued during the first two trading sessions, when markets anticipated the imminent reopening of the Strait of Hormuz, prompting a sharp decline in oil prices and a pullback in interest rates. Thereafter, the index drifted lower, accompanied by a narrowing of advancing stocks. At the sector level, AI-related capital rotated from semiconductors into software, while energy continued to lead. Momentum strategies, heavily unwound in July, saw no recovery in August. In our view, the key development in August was the shift in sector leadership, rather than the magnitude of index returns.

We do not interpret this as a broad rotation from growth to value. The outperformance of value in July was predominantly driven by energy and financials. In August, only energy, healthcare and materials advanced; industrials, small caps and real estate failed to gain ground in either month. Three phenomena have unfolded over the past quarter: crowded momentum positions were liquidated, rising oil prices propelled an energy-sector rebound, and AI capital rotated from hardware towards application software. These occurred concurrently, yet they have not coalesced into a definitive growth-to-value rotation.

The semiconductor index declined nearly 30% from its June peak through the end of July, even as major companies reported record earnings. We view this as a positioning and valuation adjustment, not a demand-led downturn. The August rebound faltered mid-month for two reasons: long-end yields rose to their highest levels since 2007, and hedge funds did not re-establish positions following July's deleveraging. Nvidia's earnings beat expectations, yet the stock rallied for only one session. We regard this as a consolidation phase following a substantial advance, rather than a cyclical peak. The software sector's gains were attributable to two factors: a handful of companies reported growth in AI-related order books; and software had been the most heavily shorted sector among hedge funds in the first half of the year, prompting a significant short-covering rally in August. Whether application software companies can sustain incremental revenue generation will require scrutiny of third-quarter results.

Oil prices remain the most consequential macro variable. Following the collapse of the ceasefire in July, Brent crude briefly exceeded US\$100 per barrel. In early August, market chatter regarding the reopening of the Strait sent oil down to US\$79, only for it to return above US\$90 by month-end. Rising oil prices

initially feed into headline inflation before filtering through to core measures; core PCE has now held at 3.3% for three consecutive months. Fed Chair Warsh remarked at Jackson Hole that "there is still work to do," and market pricing for a September rate hike rose to nearly 60%, while the 10-year Treasury yield reverted to 4.75%. Equities have not sold off, underpinned by robust second-quarter earnings growth. However, consumption has begun to moderate, as reflected in Walmart's results and forward guidance. Slowing employment alongside accelerating manufacturing activity does not constitute a data mix sufficient to alter Fed policy. The determining factor is the breadth of inflation, which in turn hinges on oil prices. Consequently, over the next two quarters, the trajectory of geopolitical developments and Strait transit volumes will exert greater influence on markets than any single economic data release.

The AI capital expenditure debate has shifted from profitability to financing. The four major cloud providers collectively project capital expenditure in excess of US\$700 billion this year, with Alphabet recording negative free cash flow for the first time since its public listing. In August, Nvidia signed a memorandum of understanding with six large asset managers to establish a computing-power financing platform, aiming to gradually raise more than US\$500 billion in third-party capital and treat compute capacity as an investable asset class. The agreement has not yet been finalised, and media reports regarding Nvidia guarantees have not been reflected in company filings. GPU-backed loans could expand the scale of infrastructure build-out while simultaneously transferring three categories of risk to the credit market: chip depreciation outpacing loan tenors; supplier financing of customers creating circularity; and end-demand concentration among a narrow set of counterparties. Credit markets have already begun to price these risks, with spreads on data-centre bonds widening and subscription ratios for newly issued cloud-provider debt declining.

Over the coming months, we are monitoring three variables. First, oil. If Brent sustains above US\$90 for a full quarter, core inflation is likely to re-accelerate, the Fed would be compelled to raise rates, and higher long-end yields would weigh on valuations. Conversely, a decline below US\$80 would simultaneously alleviate inflationary, interest-rate and consumption pressures. Second, the cost of AI financing. The final terms of the financing platform, data-centre bond spreads and cloud-provider free cash flow are more informative indicators of cycle positioning than GPU order books. Third, application software revenues, which will determine whether the software sector's rally proves durable. The 3 September release of GPT-6 Astra falls after month-end, and we do not base judgments on it at this stage. It does, however, along with the release of multiple open-weight models, pose the same question: do more powerful models increase compute demand, or reduce per-unit compute consumption? Two scenarios would prompt us to revise our assessment: first, if earnings expectations for small caps, industrials and banks are revised upward in tandem with a decline in long-end yields, signalling that rotation has broadened; second, if oil prices retreat while core inflation remains above 3%, suggesting that inflation is being driven by AI-investment-related demand, implying that higher rates will persist for longer.

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