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MONTHLY SPOTLIGHT:
The Next Phase of the AI Trade
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MONTHLY MARKET PULSE – SEPTEMBER 2026

HIGHLIGHTS

- **A Close Call:** Market expectations remain divided over whether the Federal Reserve (Fed) will raise rates by 25 basis points this month. The odds of a rate hike increased following Fed Chair Kevin Warsh's speech at Jackson Hole.
- **Fundamentals Lead:** Earnings growth has been the primary driver of equity returns this year, helping offset pressure on valuations from higher interest rates and elevated uncertainty.
- **The Next Layer of AI:** The AI investment opportunity shows signs of broadening beyond semiconductors as investment shifts from infrastructure buildout toward deployment and monetization. We examine where AI value may accrue next in this month's *Spotlight*.

MACRO INSIGHTS

Fundamentals in Focus as AI Leadership Shifts

WHAT HAPPENED

Equities rebounded and participation remained healthy. The S&P 500 gained 2.7% and the Nasdaq rose 4.0% in August, snapping two consecutive monthly declines, while the equal-weight S&P 500 advanced 2.0%. Strength extended across several areas of the market, with Technology, Energy, Materials, and Healthcare among the leaders. Software was particularly strong, rising more than 16%, while semiconductor shares stabilized following July's sharp decline.

Corporate fundamentals remained supportive. Earnings continued to demonstrate healthy demand and strong investment activity, particularly around artificial intelligence. NVIDIA highlighted exceptional growth that remains constrained more by supply than demand, while cloud and technology companies continued to report robust AI-related demand and adoption. More broadly, corporate results continued to support expectations for very solid earnings growth.

The economy moderated but remained resilient. Payroll growth softened, retail sales were mixed, and consumer sentiment remained subdued, but household spending remained resilient and unemployment remained low. Importantly, inflation data were relatively benign, with few signs that higher energy prices were producing a meaningful broader acceleration, though the level of inflation remains above the Fed's 2% target.

Fed policy remained a source of uncertainty. Fed Chair Warsh emphasized at Jackson Hole the need for greater confidence that inflation is returning toward 2% at a sufficient pace, increasing market-implied odds of a potential September rate hike. However, unexpected weakness in the upcoming payroll report could take a September hike off the table. Short-term Treasury yields rose modestly in August, while longer-term yields were relatively stable following the sharp move higher earlier this summer.

WHAT IT MEANS

August largely reinforced our constructive view. **Earnings are growing, consumers remain engaged, and business investment continues to support economic activity**. At the same time, market participation has broadened, reducing dependence on the narrow group of semiconductor and mega-cap technology companies that drove much of the market's earlier gains.

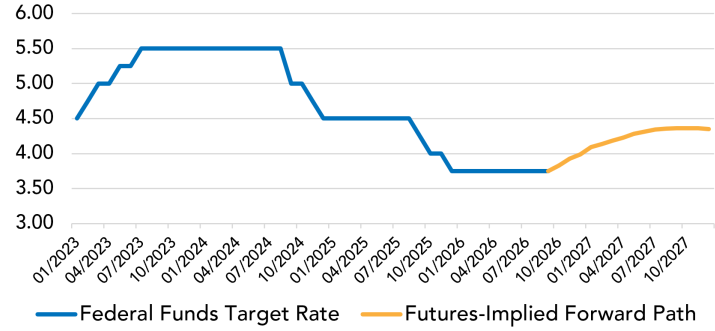
The evolution within the AI complex is particularly notable. For much of the year, investors rewarded the companies supplying the infrastructure required to build AI capacity. More recently, attention has begun to broaden toward companies positioned to deploy and monetize that capacity. We view that as a natural progression rather than evidence that the AI investment cycle is weakening. **This month's *Spotlight* examines where the next phase of AI value creation may emerge**.

Monetary policy remains an important risk, particularly with the Fed maintaining a restrictive posture as inflation remains above target despite some moderation in economic data. However, weakness in rate-sensitive areas has been evident for some time and has not translated into broader economic deterioration. We question the need for tightening policy in response to a supply disruption in oil and demand strength in a rate-insensitive area such as AI infrastructure.

We therefore remain favorable toward equities. Valuations and elevated interest rates argue for selectivity, **but healthy earnings growth, continued capital investment, and broader market leadership provide a solid foundation for returns**. As the AI cycle matures, we expect differentiation to increase, with investors placing greater emphasis on companies that can turn technological adoption into durable fundamental growth.

Markets Reprice the Fed Path Higher

Chair Warsh emphasized at Jackson Hole the need for greater confidence that inflation is returning toward 2% at a sufficient pace. Markets responded by increasing the probability of additional tightening.



Sources: U.S. Department of the Treasury and Macrobond.

Christopher D. Shipley
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WHAT TO WATCH

The Fed continues to articulate a reaction function that is biased toward inflation. As a result, incoming data will be the focus for investors. Consumer spending appears resilient, but higher energy prices may be starting to pressure spending, warranting continued monitoring. Headlines surrounding the conflict in the Middle East will continue to create volatility in energy markets.

- The next Federal Open Market Committee (FOMC) decision will be announced on September 16. The market is currently pricing in a roughly 65% chance of a rate hike.
- Inflation releases are likely to drive elevated market volatility. The Producer Price Index (PPI) will be released on September 10, followed by the Consumer Price Index (CPI) on September 11, with both reports arriving ahead of the September FOMC meeting. The Personal Consumption Expenditures (PCE) Price Index will not be released until September 30.
- September 16 will provide further insight into the consumer with the release of retail sales data.

MONTHLY SPOTLIGHT

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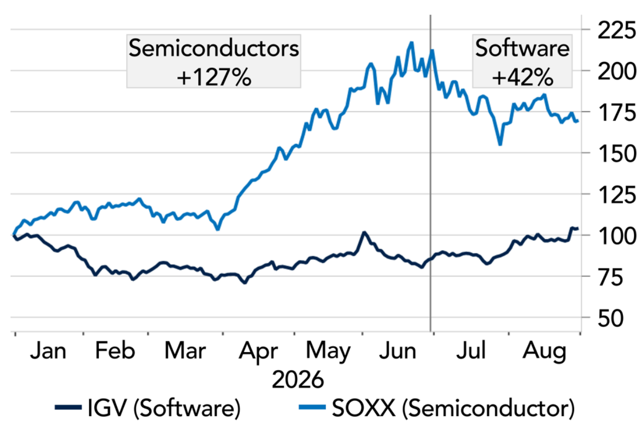
The Next Phase of the AI Trade

For much of this year, the market has treated artificial intelligence as a hardware-winner, software-loser trade. Although software has outperformed since the end of June, semiconductors remain well ahead year to date, with the Semiconductor ETF (SOXX) up 70%, compared with just 4% for the Tech-Software ETF (IGV). The divergence reflects a reasonable dynamic: the massive investment in AI infrastructure translates directly into demand for semiconductors, memory, networking equipment, and other components needed to build computing capacity. But as AI moves beyond the initial infrastructure buildout, an important question for investors is where the economic value ultimately accrues—and which companies are positioned to capture it.

In our view, it is unlikely that semiconductor firms will capture a disproportionate share of the economics indefinitely. Instead, the AI opportunity should broaden as the technology moves from building the infrastructure to deploying it at scale and monetizing it through applications. Semiconductors have been the clearest beneficiaries of the build phase. Hyperscalers increasingly represent the deployment phase, owning the cloud infrastructure, distribution, data, and customer relationships through which AI is delivered. Importantly, there are early signs that the enormous capital commitment is producing attractive economics.

Software vs. Semiconductors Relative Performance



Amazon recently noted that its server and networking investments typically break even in less than three years, while the equipment has useful lives of at least five to six years and much of its AI capacity is contracted for five years or longer. While significant investment is still required up front, these economics illustrate why hyperscalers continue to aggressively build capacity.

Further down the value chain, we expect more of the focus to shift toward monetization, including the software applications that sit on top of that infrastructure. However, the implications for software are nuanced. AI will undoubtedly disrupt portions of the industry, particularly where it lowers barriers to entry or commoditizes existing capabilities. But software is not a homogeneous category. Deeply embedded, mission-critical applications with high switching costs, proprietary data, and important positions within customer workflows should be considerably more resilient. For these businesses, AI can become an enhancement rather than a disruption—making the product more valuable to customers and more difficult to replace.

Recent performance may offer an early glimpse of this broadening. Since June, IGV gained 21%, compared with a 20% decline in SOXX. Two months does not establish a lasting shift in leadership, and we do not believe the semiconductor opportunity is over. Rather, investors may be beginning to look beyond the infrastructure buildout toward the businesses positioned to capture the next phase of AI value creation.

AI is not one trade, and its long-term value will not be distributed evenly. As the technology matures, the investment question will likely shift from who builds the infrastructure to who controls the customer relationship, captures the productivity gains, and can use AI adoption to drive durable returns above the cost of capital. Ultimately, valuations will determine how much of that opportunity investors capture.

Chart sources: Bloomberg and Macrobond.

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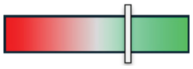
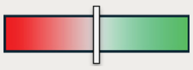
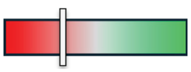
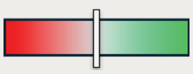
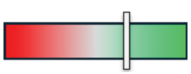
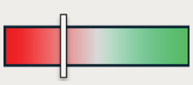
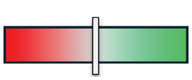
CURRENT OUTLOOK

Topic	View	MoM Change	Commentary
			Macroeconomic Views
Economic Growth		–	▶ Growth expectations for 2026 are largely centered on trend growth (~2%), as **capital expenditures rise, consumer spending remains stable, and accommodative fiscal conditions** contribute to economic expansion. The market is assigning a low probability to sustained disruptions from the conflict in the Middle East, though higher gasoline prices appear to be weighing on consumers. ▶ Job growth and jobless claims remain steady, keeping the unemployment rate range bound. ▶ Risks remain elevated amid geopolitical tensions, sticky inflation, and uncertainty surrounding both monetary and trade policy.
Inflation		–	▶ Market expectations suggest that **inflation will remain above 3% for the remainder of the year**. Elevated energy prices and AI-driven spending are contributing to concerns about future inflationary pressures. ▶ **Core PCE inflation** is running at **3.3%** year over year. Goods inflation should moderate if oil prices ease, but services inflation has remained relatively firm, supported by shelter and transportation. ▶ The Administration recently announced new tariffs under Section 301 to re-establish some of the tariffs struck down by the Supreme Court. This is likely to result in a lower average tariff rate on imports compared with expectations that included tariffs imposed under the International Emergency Economic Powers Act (IEEPA).
Monetary Policy		–	▶ Kevin Warsh held his second press conference following the FOMC's July decision to keep **interest rates unchanged**. While the Committee remains **focused on price stability**, investors appear conflicted by the disconnect between its rhetoric and actions. ▶ Economists are divided on the likelihood of a rate hike this year given the economic data relative to remarks from Warsh. Current market pricing implies one rate hike this year and a second in the first half of 2027.
Fiscal Policy		–	▶ Accommodative tax policy is providing **support to households, as tax refunds** delivered a one-time income boost during the first half of the year, while **lower withholding taxes** should help sustain spending. Additionally, capital expenditure plans continue to underpin growth, aided by accelerated depreciation. ▶ Flexibility within fiscal policy remains low, as federal debt levels continue to increase and **higher interest costs** consume a larger portion of government outlays. The Congressional Budget Office (CBO) projects the federal deficit to remain above 5% of GDP over the next several years.
			Market Valuations
Rates		–	▶ Rates were volatile given concerns over fiscal deficits, hyperscaler issuance, and uncertainty surrounding monetary policy but ended the month largely unchanged. The yield curve flattened modestly as short-term rates rose while longer-term rates declined. The 10-year Treasury yield ended the month at 4.75%. ▶ We anticipate that the expected **path of policy rates will continue to shift** with new information related to the Iran conflict, FOMC communication, and inflation data. ▶ Intermediate- and long-term **rates are toward the higher end of our fair-value range**, resulting in a modest duration bias at current levels.
Credit		–	▶ Credit spreads tightened modestly during the month and remain at levels that are **expensive relative to historical averages**. ▶ We believe the **risk–reward is skewed to the downside**, although strong corporate fundamentals should help support spreads. ▶ Investment Grade (IG) spreads (10-year BBB industrials) tightened marginally and ended the month at their 13th percentile. High Yield spreads (single-B corporates) tightened more significantly, ending at their 1st percentile since the 1990s.
Equity		–	▶ The **S&P 500 reached another all-time high in August**, gaining 2.7% for the month and 13.1% YTD. Market leadership has broadened this year beyond mega-cap technology, with better relative performance from the equal-weight S&P 500, value, and small-cap stocks. ▶ Second-quarter **earnings season broadly exceeded expectations**. The 493 companies outside the Magnificent Seven generated roughly 32% earnings growth in the second quarter, their strongest growth since late 2021. Consensus earnings estimates also continued to rise. ▶ **Equity valuations for the S&P 500 remain moderately above historical averages at 19.5x forward earnings**. Market fundamentals remain healthy, and we expect returns in 2026 to be driven primarily by earnings growth.

MARKET DATA & PERFORMANCE | AS OF 08/31/2026

U.S. Snapshot	Current	6 Months Prior	1 Year Prior
Core Inflation (YoY)	3.3	3.0	2.9
Unemployment Rate	4.1	4.4	4.3
Real GDP (YoY)	2.1	2.0	2.1
Retail Sales (YoY)	5.0	4.2	5.0
30-Year Mortgage Rate	6.7	6.0	6.6
10-Year Treasury Yield	4.8	3.9	4.2
US Corporate IG Yield	5.5	4.7	4.9
US Corporate HY Yield	7.3	6.7	6.8

TOTAL RETURNS

Asset Class	MTD	QTD	YTD	1 Year	3 Years*	5 Years*
Equity						
Russell 3000 Index	2.7%	2.3%	13.4%	20.1%	20.6%	11.8%
S&P 500 Index	2.7%	2.7%	13.1%	20.4%	21.0%	12.8%
S&P MidCap 400 Index	0.2%	-2.2%	14.7%	17.1%	14.1%	8.1%
Russell 2000 Index	1.0%	-2.1%	20.0%	26.5%	17.5%	6.8%
MSCI World Index	2.6%	3.1%	13.4%	20.8%	20.6%	11.7%
MSCI World ex USA Index	2.2%	4.3%	14.3%	22.9%	19.5%	10.3%
Fixed Income						
Bloomberg US Aggregate Index	0.4%	-0.9%	-0.3%	1.9%	4.1%	-0.3%
US Corporate Investment Grade	0.4%	-1.2%	-0.3%	2.0%	4.9%	-0.1%
US Corporate High Yield	1.0%	0.7%	2.7%	4.9%	8.5%	4.1%
Emerging Market Debt	0.8%	-0.9%	1.4%	6.3%	9.3%	1.9%
US Treasury (7–10 Year)	0.3%	-1.5%	-1.6%	0.2%	2.9%	-1.5%
Cash	0.3%	0.6%	2.4%	3.8%	4.6%	3.7%

Source: Fort Washington and Bloomberg. *Returns for periods greater than one year are annualized. Past performance is not indicative of future results.

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