Monthly Market Insights

Data and opinions as of July 31, 2026

Markets widen their field of vision

July forced investors to look beyond the most obvious signals. The Federal Reserve held its policy rate steady, but the reaction in longer-term bond yields showed that financial conditions can change even when the overnight rate does not. Strong technology earnings confirmed that AI demand remains powerful, but rising capital requirements shifted attention toward cash-flow generation and the eventual return on that spending. At the same time, improving performance from the equal-weighted S&P 500 suggested that the opportunity set is expanding beyond the largest technology companies. The market is increasingly organizing around two broad themes, AI and not AI, while also finding underappreciated businesses that support the buildout from outside the mega-cap technology complex.

NEI perspectives

Fed holds as the yield curve steepens: Three policymakers voted for a rate increase, while higher long-term yields pressured growth stocks and longer-duration bonds. Bottom line: If the equity market was not already watching the bond market, it is now.

AI earnings meet the cash-flow test: Alphabet's strong results were overshadowed by heavy capital spending, while disruption concerns continued to weigh on software companies. Bottom line: Investors increasingly want proof that AI investment can generate durable returns.

The market broadens beyond mega-cap tech: The equal-weighted S&P 500 is making up ground as investors find underappreciated AI picks-and-shovels and opportunities outside the dominant theme. Bottom line: The diversification trade remains in play.

– NEI Asset Allocation team

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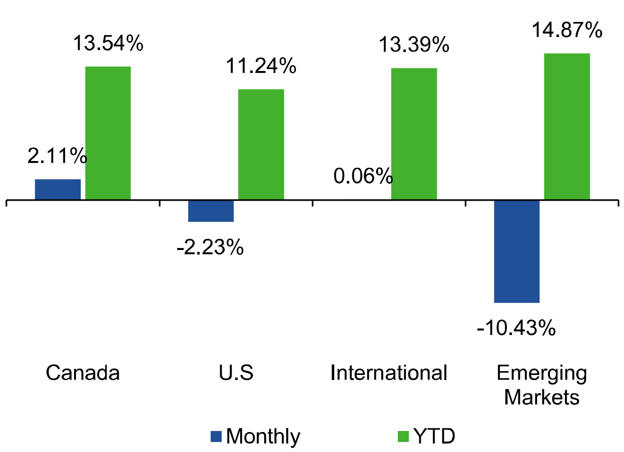
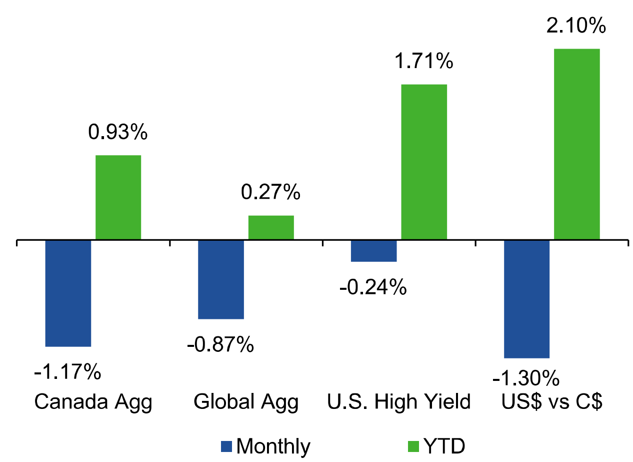
Equity returns (in C$)



Canada: MSCI Canada Index TR; **U.S.:** MSCI USA Index TR **International:** MSCI EAFE Index TR; **Emerging markets**: MSCI Emerging Markets Index TR.

Source: Bloomberg

Fixed income and currency returns (in C$)



Canada Aggregate: Bloomberg Barclays Canada Aggregate Bond Index; **Global Aggregate:** Bloomberg Barclays Global Aggregate Bond Index; **U.S. High Yield:** Bloomberg Barclays U.S. High Yield Index.

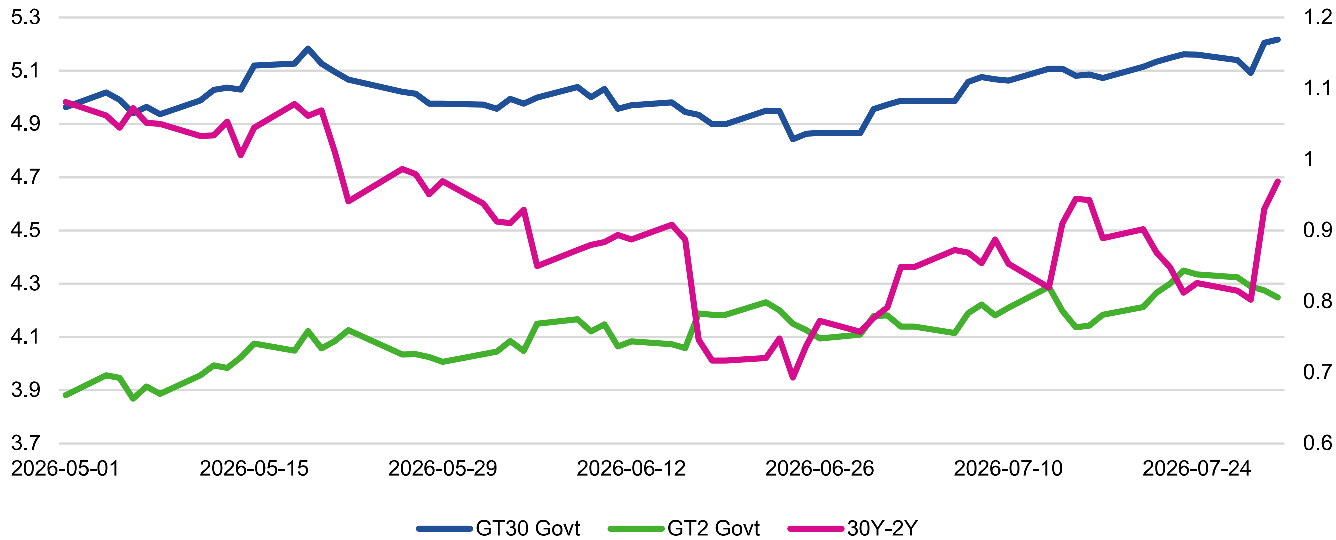
Source: Bloomberg

Fed stays on hold as the inflation debate moves into the bond market

The Federal Reserve held its policy rate at 3.50% to 3.75% in July, but the 9–3 decision revealed a meaningful divide within the committee. Three policymakers preferred a 25-basis-point increase, while the majority opted to remain on hold. Chair Warsh reinforced the Fed's commitment to its 2% inflation target but offered limited forward guidance, leaving incoming economic data and market prices to play a larger role in shaping rate expectations.

The bond market delivered a clear response. The yield curve steepened, with upward pressure further out the maturity spectrum signalling continued concern around inflation, economic resilience and the risk that rates stay elevated. If the equity market was not already watching the bond market, it is now. Higher long-term yields increase discount rates and create a shared headwind for long-duration assets, including growth equities and longer-maturity bonds. The Fed may have stayed put, but financial conditions did not.

Chart 1: The yield curve steepened following the Fed decision



Source: Bloomberg.

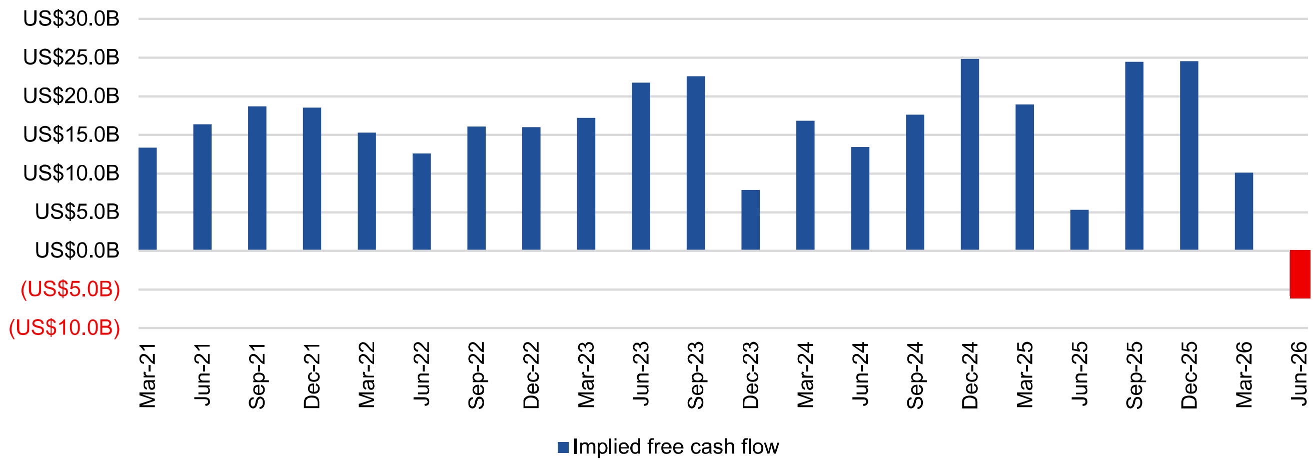
Bottom line: An unchanged policy rate does not mean unchanged financial conditions. With longer-term yields under pressure, the bond market may now matter more for portfolios than the Fed's latest rate decision alone.

AI earnings meet the cash-flow test

Alphabet delivered a resounding quarter, with revenue up 24%, Google Cloud revenue up 82%, and operating margins expanding to 34%. But investors focused on the cost of that growth. Quarterly capital expenditures reached US$44.9 billion, exceeding US$39.1 billion in operating cash flow and pushing free cash flow into negative territory. While the results reinforced that AI demand is real, the bar for proving that today's infrastructure spending can generate attractive returns has also raised.

The pressure is creating a sharp divide within technology. Semiconductor and memory stocks remain major beneficiaries of the AI infrastructure buildout, despite taking a breather in July after strong year-to-date gains. Software companies face the opposite question: whether AI will enhance their products or replace parts of their traditional subscription models. As AI platforms move further into the application layer, investors are becoming increasingly selective about who captures the economics of the buildout and who risks being disrupted.

Chart 2: Alphabet's AI spending outpaced operating cash flow



Source: Bloomberg.

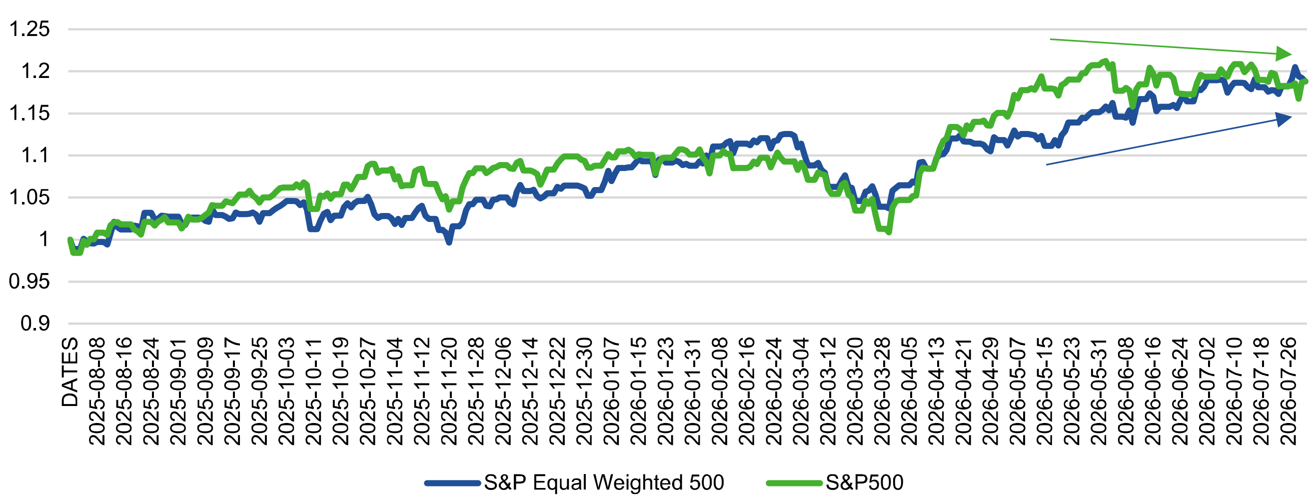
Bottom line: The AI theme remains powerful, but the standard for success is rising. Investors increasingly want proof that AI spending can translate into durable free cash flow, not just faster revenue growth.

The market broadens into AI, and everything else

The equity market is increasingly loading up on two broad themes: AI and not AI. Mega-cap technology remains at the centre of the AI trade, but the diversification trade is still in play. Over the past three months, the equal-weighted S&P 500 has begun making up ground against the capitalization-weighted index, suggesting the rally is reaching beyond its largest constituents. Because the equal-weighted index assigns the same weight to every S&P 500 company, it increases exposure to the smaller companies within the large-cap universe and provides a clearer view of how the average stock is performing.

Importantly, broadening does not necessarily mean rotating away from AI. Many less prominent industrial, electrical-equipment, power-management and infrastructure companies provide the picks and shovels supporting the AI buildout. Others are genuine diversifiers, with earnings driven by consumer demand, domestic activity or company-specific fundamentals rather than AI investment. The opportunity set is widening both around the buildout and beyond it.

Chart 3: The average stock is beginning to catch up



Bottom line: Market concentration remains elevated, but participation is broadening. Equal weighting can capture underappreciated beneficiaries of the AI buildout while reducing reliance on the handful of mega-cap companies dominating the index.