

# Higher-for-Longer Discipline: U.S. Macro Stability Meets AI Capex Reality and Geopolitical Repricing

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## Macro & Rates

U.S. growth remains resilient but sticky services inflation and balance-sheet dynamics are keeping real yields elevated and limiting expectations for near-term Fed easing.

## Technology & Valuations

Investor focus has shifted from AI-driven growth narratives to cash-flow durability, with capex-heavy platforms and long-duration software under pressure while hardware and supply-chain beneficiaries hold up better.

## Policy, Geopolitics & Positioning

U.S. industrial policy and sanctions enforcement are embedding a resilience premium into equity valuations, favoring firms that can absorb higher strategic costs without compromising free cash flow.

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## Section 1: U.S. Macro & Treasury Market Dynamics

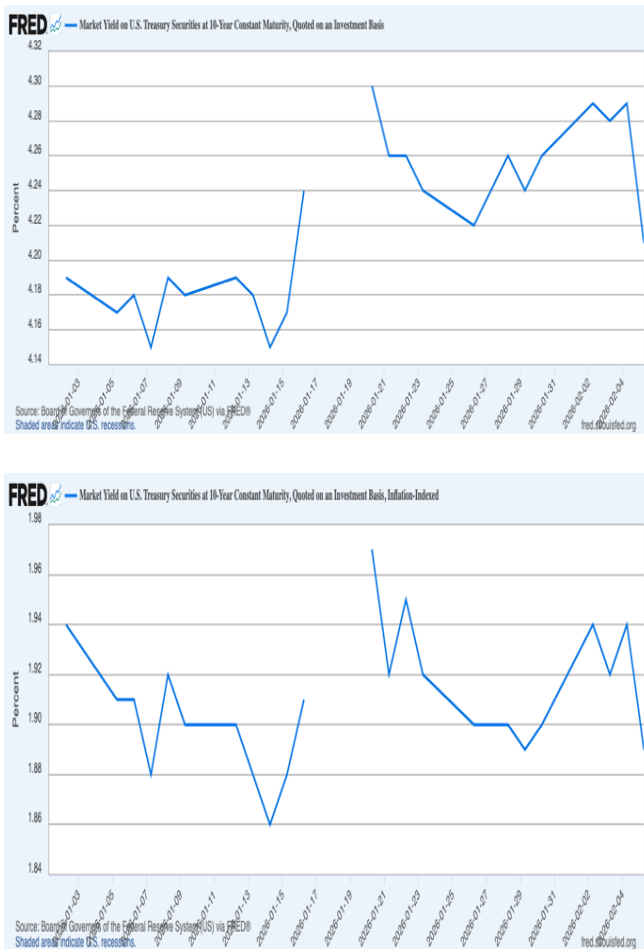
The economic data released in the US during the past week showed mixed but increasingly stable signals, with the economy's growth appearing strong but with risks of inflation persisting. The US factory activity showed a surprise gain, with the ISM Manufacturing PMI registering at 52.6, the first reading above 50 in almost a year. The rebound was driven primarily by new orders and post-holiday restocking, though business sentiment remained cautious due to tariff uncertainty and planning challenges. At the same time, the services sector which represents the majority of U.S. economic output held steady, with the ISM Services PMI at 53.8. More importantly, the prices-paid component rose further, indicating that input cost pressures in services remain sticky. This reinforces the idea that inflation, particularly in services, is unlikely to decline quickly enough to support aggressive near-term monetary easing.

Labor data softened this week. Job openings dropped to their lowest level in more than five years, January layoffs moved higher, and initial claims came in above expectations. Markets reacted quickly, with investors moving into Treasuries and pushing yields lower mid-week.

At the same time, consumer sentiment unexpectedly improved, reaching a six-month high. The strength appears concentrated among higher-income households, likely supported by asset-price gains and slightly better inflation expectations. Lower-income consumers remain more cautious.

Overall, the picture is mixed: the economy is clearly losing some momentum, but it is not rolling over. That gives the Federal Reserve room to stay patient and keep policy restrictive for now. From a policy and structural perspective, the rate environment continues to be shaped not only by growth and inflation data but also by expectations around the Federal Reserve's balance sheet path. Markets increasingly anticipate a steeper yield curve over time, particularly if balance-sheet reduction continues alongside eventual rate cuts. A smaller Fed balance sheet implies greater Treasury supply to the market and higher term premium at the long end, which could keep long dated yields structurally elevated even if short term rates eventually decline.

**Figure 1&2: U.S. Rates Overview: Nominal and Real Yield Movements**



Treasury market movements during the week reflected these crosscurrents. Nominal 10-year yields initially approached the upper end of their recent range before declining sharply toward the end of the week as softer labor data drove a flight to duration. Real yields followed a similar path, easing modestly but remaining near cycle highs, indicating that financial conditions are still restrictive despite the pullback. Breakeven inflation rates remained relatively stable in the mid 2% range, suggesting that inflation expectations are anchored even as growth and employment data soften at the margin. Meanwhile, the front end of the curve remained comparatively steady, with the 2-year yield moving only marginally, indicating that markets are not yet aggressively repricing the timing of Fed rate cuts. The overall picture is one of gradual easing in yields rather than a structural shift in the rate regime.

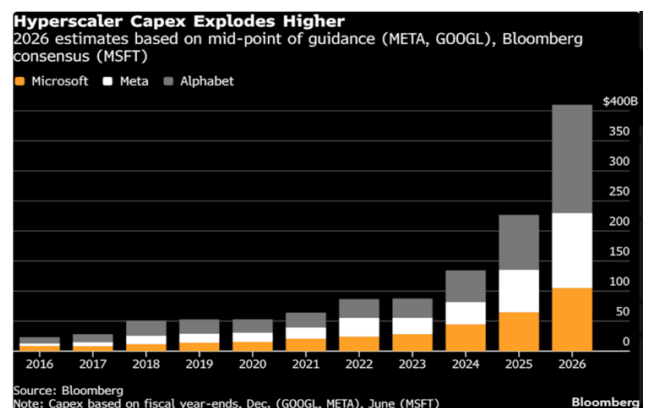
Looking ahead, the January CPI release on

February 13 will be the key macro catalyst, as it will determine whether the recent pullback in yields can sustain or if markets revert to repricing a more restrictive rate path.

**Section 2: U.S. Tech – Valuation & Positioning**

U.S. technology equities saw increasing dispersion as market sentiment shifted from celebrating “AI growth” to funding the costs of that growth. The primary driver of the market movement appears to be the reassessment of the capital intensity of hyperscalers and the near-term return on investment for AI infrastructure spending. Alphabet’s strong cloud growth rate of 48% year over year prompted a conservative equity response after management guided to sharply higher 2026 capex, reinforcing investor sensitivity to free cash flow compression and duration risk. That same dynamic carried into Amazon, where attention was tightly focused on AWS as the sector’s “jewel” amid broader cloud deceleration concerns following Microsoft’s post earnings drawdown and slower Azure trajectory. What the market now wants to see is not simply growth, but growth combined with operating leverage, and the capital expenditures related to AI spending are now viewed as a negative to operating margins and valuation multiples until the monetization of that spending becomes clearer.

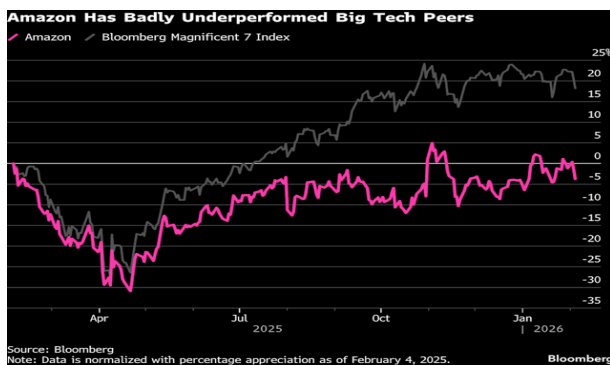
**Figure 3: AI Capex Cycle Intensifies Across Mega-Cap Platforms**



The result has been a widening split within tech between infrastructure beneficiaries and software names facing disruptive narrative pressure. On the software side, selloffs accelerated after Anthropic’s latest agent tools heightened fears that AI native workflows could cannibalize SaaS pricing power and reduce seat growth, triggering broad de-

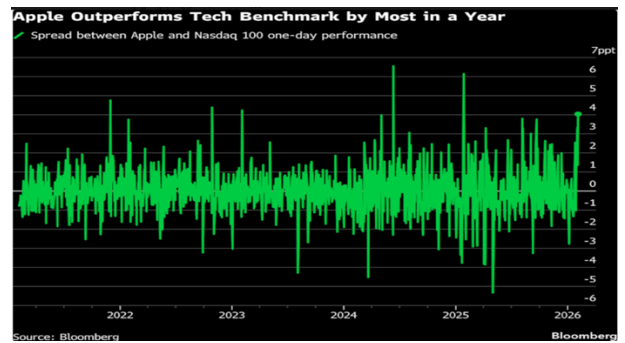
risking across software, data, and IT services. Even as large-cap CEOs argued the “AI eats software” thesis is overstated emphasizing that enterprises will still rely on orchestration layers, the market reaction suggests positioning remains fragile and multiples are still compressing. The implication of the market's reaction to the latest developments within the AI sector is that the “burden of proof” has shifted back to the ability to retain and grow user counts and the demonstration of mission-critical workflows and data advantages.

**Figure 4: Amazon Lags Mega-Cap Peers Amid Cloud & Capex Scrutiny**



At the index level, the week also reinforced that “tech” is not one trade. Semiconductors and AI hardware remained more insulated supported by continued visibility into datacentre buildouts even as the platform layer takes valuation pain. Meanwhile, Apple emerged as a relative defensive winner. The stock outperformed broader tech as investors leaned into hardware cash flow stability and perceived it as a beneficiary of AI usage without needing to fund the same scale of infrastructure arms race. When considered collectively, the data indicates a rotation from narrative driven multiple expansion to cash flow credibility. Capex heavy platforms and long duration software are being penalized, while AI supply-chain beneficiaries and more stable cash generators are being treated as safer expressions of the theme.

**Figure 5: Apple Emerges as Defensive Leader in AI-Driven Rotation**

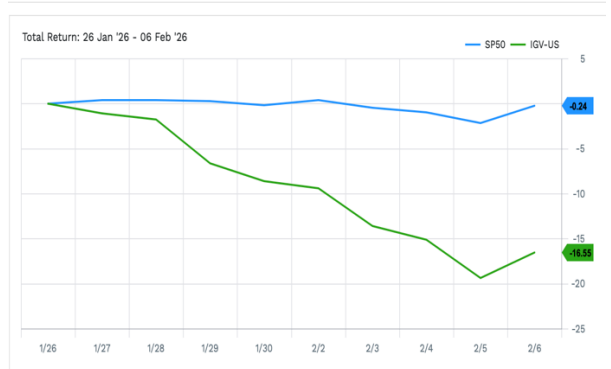


*Market Performance & Sector Dispersion*

The technology sector has seen a significant valuation correction over the past two weeks, driven by a combination of factors related to AI capital expenditures, software disruption, and varying earnings trends among hyperscalers. Market performance data highlights a clear divergence both across subsectors and within mega-cap leadership, reinforcing the view that the current environment is less a broad tech selloff and more a repricing of specific risk exposures.

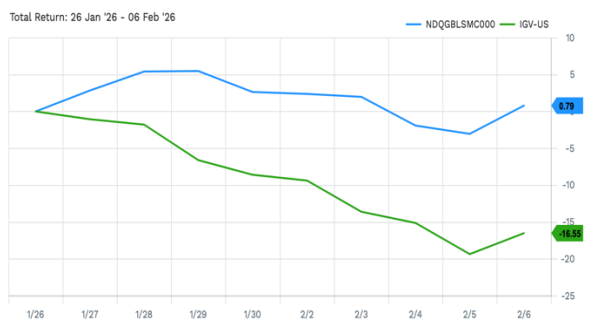
From a broad market perspective, technology underperformed the wider equity market during the period. The Nasdaq declined roughly 2–3% while the S&P 500 remained relatively stable, suggesting sector-specific pressure rather than macro-driven equity weakness. Amazon was the clear laggard, dropping sharply and significantly underperforming both indices. This reinforces the narrative that investor concerns are centered on the sustainability of AI-driven spending and the timing of returns, particularly for companies aggressively scaling infrastructure.

When looking at subsector-level market performance, it is evident that the divergence between semiconductors and software was more pronounced. During this two-week period, the Nasdaq Global Semiconductor Index remained relatively stable or up moderately, whereas software stocks, as represented by the IGV index saw a severe drawdown approaching mid-teens declines. This reflects a rotation within the AI theme itself where markets appear increasingly confident in infrastructure beneficiaries (chips, compute, data centers), while questioning the near-term durability of software margins as AI tools potentially compress pricing power and reduce switching costs. The scale of this dispersion signals a meaningful shift in valuation assumptions rather than short term volatility.



**Figure 6: Semiconductors Hold Steady While Software Faces Sharp De-Risking**

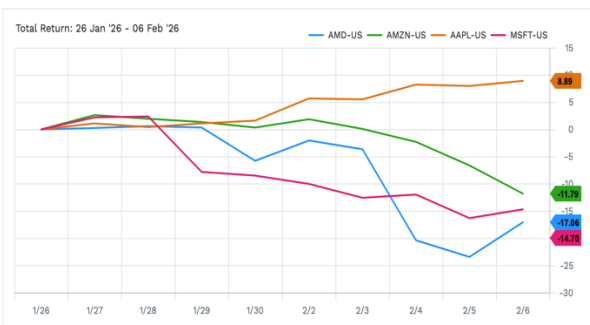
Nasdaq Global Semiconductor Index (NDQGBLSMCD00) \$2,622.98



Apple emerged as a relative outperformer, posting strong gains and acting as a defensive anchor within tech. Investors appear to be favoring companies with stable cash flows, hardware ecosystems, and indirect AI exposure over firms committing massive upfront capital to infrastructure expansion. In contrast, AMD and Microsoft both saw notable declines, reflecting sensitivity to expectations around profitability, cloud momentum, and AI monetization timelines. Amazon experienced the steepest drop, consistent with market unease over escalating capital expenditure and competitive positioning within cloud.

**Figure 7: Mega-Cap Dispersion: Hardware Resilience vs Platform Weakness**

Advanced Micro Devices, Inc. (AMD) \$208.44 Next Report Date: 03 Feb '26 Key Statistics FactSet Fundamentals /



**Figure 8: Software Sector Under-performance vs Broader Market Stability**

Overall, price action across indices, subsectors, and single names suggests the market is transitioning from a narrative driven AI rally to a valuation-driven selection phase. Capital is rotating away from high-multiple software and capex-intensive platforms toward perceived structural winners and defensive mega caps. The widening performance dispersion within tech indicates investors are becoming more selective, rewarding visibility and execution while penalizing uncertainty around returns on AI investment.

### **Section 3 — U.S. Geopolitics as a Domestic Market Variable (Industrial Policy, China Risk, and Sanctions Transmission)**

The rotation described earlier away from long-duration stories and toward cash-flow credibility has not been driven by fundamentals alone. Over the past week, U.S. geopolitical policy has acted like an additional “discount-rate” on certain earnings streams, because it changes (i) input costs, (ii) supply reliability, and (iii) the probability of sudden regulation/tariff/sanctions shocks. In a high real-yield regime, markets punish uncertainty faster: if policy can change a cost curve overnight, investors demand either a higher risk premium (lower valuation multiple) or clearer near-term free cash flow.

1) Critical minerals: industrial policy moves from theme to implementation risk (and opportunity). The most market-relevant U.S. geopolitical development this week has been the administration’s push to formalize a critical minerals preferential trade bloc aimed at reducing dependency on China for strategic inputs used in electric vehicles, advanced electronics, and defense manufacturing. Reuters reported Vice President JD Vance unveiling plans for a coordinated approach with allies, including discussion of price floors and preferential access mechanisms.

Why this matters for U.S. equities is not the headline politics it is the mechanism:

- Price floors and “tariff-free club” structures are designed to stabilize returns for non-China supply chains, reducing the boom-bust dynamic that has historically killed Western mining investment. If executed, this can shift capex from “optional” to “financeable,” which supports U.S.-linked mining, processing, specialty chemicals, and industrial equipment providers.
- The U.S. is also backing this with stockpiling and financing concepts (reported as “Project Vault” in Reuters’ account), which signals that Washington is willing to use balance-sheet tools not just rhetoric to underwrite supply security.
- Importantly, Reuters also reported the U.S. intensifying efforts to secure African mineral flows through offtake agreements and state-backed financing rather than directly operating mines this is a “U.S. model” that relies on capital markets, contracts, and governance standards.

So what for U.S. markets? This policy path supports a barbell outcome:

- Potential winners: U.S.-exposed supply-chain enablers (mining services, processing, engineering, rail/logistics tied to materials), defense-industrial base suppliers, and domestic infrastructure plays that benefit from reshoring/nearshoring.
- Potential losers / multiple compression risk: manufacturers and tech hardware supply chains with high sensitivity to single-region inputs and thin gross margins because “redundancy” raises the cost base before it raises revenue.

2) China risk shifts from “macro narrative” to “inputs and compliance line items.” Markets used to treat U.S.–China tension as episodic headline volatility. The critical minerals agenda makes it more concrete: if supply is re-architected, firms face real cost and timing consequences (qualification cycles, supplier switching, inventory strategy, and working-capital drag). The key valuation linkage is that resilience spending often looks like insurance capex: operationally necessary, but not always

productivity-enhancing so it can reduce free cash flow and lower return on invested capital unless pricing power is strong.

That directly reinforces the selection regime you already outlined in tech: *execution + cash conversion* beats *story + capex*. When geopolitics raises the probability of forced supply-chain change, investors prefer firms that can self-fund transition without threatening margins or buybacks.

3) Sanctions and energy-security policy: a U.S. inflation and risk-premium channel, not just foreign policy. On the sanctions side, the U.S. Treasury’s Office of Foreign Assets Control (OFAC) posted a February 6 action focused on illicit traders of Iranian oil and the “shadow fleet.” Even without assuming an immediate oil-price spike, these actions matter because they affect shipping behavior, insurance availability, and routing all of which feed into delivered energy costs and freight costs with lags.

Additionally, compliance commentary noted OFAC actions from late January targeting Iranian regime officials tied to repression different objective, but it underscores that sanctions policy remains active and adaptive.

So what? For U.S. markets, this mainly expresses through:

- Energy and transport risk premia: sanctions enforcement can tighten “effective supply” by raising frictions, even if headline barrels don’t immediately change.
- Inflation expectations at the margin: if freight/insurance rises, it can slow goods disinflation (small on its own, but relevant when services inflation is sticky and the Fed is data-sensitive).
- Sector dispersion: energy and defense can attract incremental flows as “geopolitical hedges,” while margin-sensitive consumer/industrial names face higher uncertainty on input costs.

*Optional limitation:* policy headlines can move faster than fundamentals. Markets can oscillate between complacency and overreaction, and the investable effect often shows up through second-order channels (supplier qualification, insurance,

working capital), which are harder to observe in real time.

Transition: If U.S. geopolitical strategy is increasing the premium on resilience, the next question is financial: which U.S. sectors and firms can fund resilience and growth while keeping free cash flow intact in a high real-rate world?

#### **Section 4 — U.S. Fiscal, Defense-Industrial Policy, and Capital Allocation Under High Real Yields**

The “high real-rate” environment has turned balance-sheet quality into a competitive advantage. This week, that theme intersected with policy in a very direct way: Congress advanced/approved major FY2026 defense funding, reinforcing that U.S. security priorities are translating into fiscal reality, not just strategic messaging. The Senate Appropriations Committee’s release described passage of the FY2026 Defense Appropriations Act, including explicit framing around deterring China and Russia and strengthening the defense industrial base.

Separately, the House Appropriations Committee described a broader five-bill FY2026 spending package being repassed/sent toward the President, reflecting efforts to restore funding stability. (An AI-focused policy note tied to this package suggests “industrial policy” is increasingly embedded in must-pass budgeting rather than standalone initiatives.)

1) Defense spending: why it matters for equity isn’t the headline number it’s cash-flow visibility. In a high discount-rate environment, the market values durability. Defense-linked revenues often have:

- longer-duration contracts,
- program continuity,
- and demand that is less tied to the business cycle.

That can make defense and select defense-adjacent industrial suppliers behave like “quality growth” with more stable cash flows particularly attractive when investors are punishing delayed or uncertain monetization elsewhere (including parts of mega-cap tech with heavy capex).

But the market will still discriminate inside the theme. Higher funding can also amplify:

- working-capital strain (inventory, progress payments timing),
- capacity bottlenecks (labor, specialized components),
- and execution risk (margin variance when supply chains are stressed).

So the investable takeaway is not “buy defense broadly,” it’s “buy the names that convert backlog into free cash flow without balance-sheet stress.”

2) Industrial base strengthening links back to your tech section: capex is no longer automatically “good.”

The same lens applied to hyperscaler AI capex applies here: capex must be judged by returns and funding structure.

In today’s regime, higher real yields raise three hurdles:

- Refinancing risk: leveraged firms face higher interest expense and more punitive equity multiples.
- Higher hurdle rates: projects must clear a higher return threshold to be value-accretive.
- Duration compression: cash flows pushed further out get discounted harder.

That’s why markets have become skeptical of “strategic” investment if it is not paired with pricing power or clear productivity gains. U.S. policy is pushing resilience (defense industrial base, critical minerals security), but resilience spending can still be a free-cash-flow headwind in the near term.

3) Connecting the dots: a U.S. “resilience cycle” favors cash-rich balance sheets and domestic optionality.

Putting Sections 3 and 4 together, the last week’s policy flow strengthens a coherent domestic market narrative:

- Policy is incentivizing domestic and allied supply chains (critical minerals bloc + financing/stockpiling concepts).
- Fiscal priorities are reinforcing defense demand visibility (FY2026 Defense Appropriations).

- Sanctions enforcement remains active (Iran oil / shadow fleet action), sustaining a background risk premium in energy and logistics.

So what for U.S. positioning?

- The market is likely to keep rewarding self-funded resilience: firms that can absorb higher strategic capex without sacrificing buybacks/dividends or leveraging up.
- Within industrials and defense-adjacent names, dispersion should remain high: balance-sheet strength + execution will matter more than thematic exposure.
- For broader equities, these policy moves reinforce why the rally can stay narrow: macro may be “okay,” but the valuation regime is selective, and policy-driven costs raise the bar for marginal firms.

Optional limitation: budget headlines and appropriation mechanics can create timing noise; sector-level conclusions can miss meaningful single-name dispersion driven by contract structure, working capital, and margin mix.

Transition: With U.S. geopolitics and fiscal priorities reinforcing a resilience-led capex cycle, the next lens is how this interacts with rates, the dollar, and cross-asset risk appetite especially around the next macro catalyst window.

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