CJ's Weekly Market Memo

August 1, 2026

Leverage, Always Leverage

Start in Seoul. Korean retail investors spent the spring piling into leveraged ETFs tied to the AI trade, and by late May gross exposure in the largest funds had topped $500 billion. Samsung and SK Hynix alone had grown to more than half the market cap of the entire KOSPI. When the AI trade turned into a pain trade in late June, the unwind was brutal. The KOSPI fell 38% from its June 22 high, and even after a record 17.9% single day rally to close out this week, the index is on pace for its third worst month ever recorded. The leveraged exposure that took months to build has now almost entirely unwound. The selling was not about Samsung's business prospects. It was about borrowed money coming out of the market faster than it went in.

Source: Bespoke Investment Research

Now come home. Situational Awareness, an AI focused hedge fund that grew from $3 billion to roughly $45 billion in a matter of months, imploded this week in a classic prime brokerage unwind. The mechanics are worth understanding because they never change. Prime brokers lend against portfolio collateral. When the collateral falls, they demand more equity or force sales. When the positions are large and concentrated, the forced selling weakens the remaining collateral, and a feedback loop takes hold. That loop ran for five savage weeks, taking a basket of SA's holdings down 37%, until Citadel agreed to take over substantially all of the fund's public book, over $40 billion at its peak, in a deal blessed by the prime brokers. Remove the forced seller and the pressure lifts.

Those same stocks rallied 14% on Thursday, and the S&P 500 climbed more than 2% in the final two sessions to finish July essentially flat.

Two markets, one lesson. Leverage, always leverage. It is almost never the fundamentals that produce a 38% drawdown in five weeks. Margin debt has soared relative to total market cap over the past 18 months after years of decline, options volumes keep setting records, and leveraged ETF exposure rose by more than a third this year at its peak. None of that changes what the underlying businesses earn. It changes how violently their share prices move when someone has to sell. Sharp selloffs inside a bull market are usually a story about financing, not about value, and this episode fit the pattern perfectly.

Scott Nations made this point the organizing principle of his book A History of the United States in Five Crashes, and it is worth revisiting this week. Studying the panic of 1907, the crash of 1929, October 1987, the 2008 meltdown, and the 2010 flash crash, Nations found the same two ingredients at every scene: a new investment vehicle that investors did not yet fully understand, and leverage applied to it. Trust companies in 1907, margin fueled investment pools in 1929, portfolio insurance in 1987, securitized mortgages in 2008, ETF driven trading in 2010. Today's candidates fit the mold, leveraged ETFs, record options volumes, and multi billion dollar funds financed by prime brokers. Nations also identified the accelerant that turns a break into a panic: investors' abiding fear that the Federal Reserve will misstep at exactly the wrong moment. That fear was on full display Wednesday, when Chair Warsh delivered precisely the decision the market expected and was pilloried anyway. The ingredients for the sixth crash are always assembling somewhere. That is not a prediction. It is a reminder of what to watch.

The Economy

The expansion continues at a slower pace. Second quarter GDP grew at a 1.5% annual rate, down from 2.1% in the first quarter, with consumer spending, equipment and intellectual property investment, and exports doing the work while government spending contracted. June durable goods orders rose 0.3%, with core capital goods orders up 0.9%, and first half orders ran 6.7% ahead of last year. The advance goods trade deficit narrowed to $101.5 billion. On inflation, the news was mixed: core PCE slowed to 3.4% from 4.4%, but the broader price index for gross domestic purchases accelerated to 5.7%. Core CPI at 2.57% remains the only major inflation reading with a 2-handle.

The monthly momentum picture deserves attention. Bespoke's Matrix of Economic Indicators swung from +19 in May to negative 12 in June, the steepest one month reversal since March 2020, with softer readings across manufacturing, housing, and the consumer. But the July data that has arrived since looks better. The five Fed manufacturing composite hit a cycle high of 55.9, initial jobless claims sit at levels seen only a few times since the 1960s, and continuing claims are the lowest since 2023. June looks like a speed bump from higher oil prices and geopolitical noise rather than the start of something worse, though we will treat that as a hypothesis to be tested, not a conclusion.

Earnings are the strongest argument the bulls have. Through Thursday, more than 700 companies had reported, with 78% beating on earnings, 74% beating on sales, and 14% raising guidance against just 3% lowering, all multi-year highs. The market's reaction has been a shrug, an average one day gain of 0.10%, with misses punished far more than beats are rewarded. When great results stop moving stocks higher, expectations are already rich. That is not a reason to sell, but it is a reason not to expect multiple expansion to do the heavy lifting from here.

Market Technicals

The cumulative advance/decline line, our preferred leading indicator of breadth, made another new high on Tuesday. That matters more than the flat headline index. Under the surface, leadership is broadening exactly the way a healthy aging bull should broaden. The S&P 500 Equal Weight index broke out to new all time highs this week, gaining 1.3% in July against a 0.82% decline for the cap weighted index, its second straight month of outperformance. Seven of eleven equal weighted sectors beat their cap weighted counterparts. Energy led the market with a 13% gain on rising crude, followed by Financials, while Technology fell 3%.

The rotation was dramatic. The twenty best performing S&P 500 stocks of the first half fell an average of 25.3% in July, every one of them finishing lower, while the twenty worst first half performers gained an average of 12.2%. Momentum strategies were whipsawed: down 38% from the June peak to a 52-week low, then the second best single day in the history of the series on Thursday. The index itself sits near its 50-day moving average, and the long term trend measure we care most about, a smoothly rising 200-day moving average, remains intact. History offers some comfort on broadening leadership. In the 2000 to 2001 bear market, the Equal Weight index gained 1% while the cap weighted S&P fell more than 28%. Breadth is a port in the storm.

The bond market is the sore spot. The 10-year Treasury yield closed the week at 4.72%, a 52-week high, and the long bond ETF traded at its lowest level since 2004. Long term Treasuries now rank among the worst 5, 10, and 20 year returns ever recorded for the asset class. The criticism raining down on Chair Warsh says less about the Fed than about the misstep fear Nations described; meanwhile the long end is delivering its own verdict on inflation and supply. Rising yields are the primary challenge to equity valuations, and they are the number we will watch most closely in August.

Prognostication

Our view has not changed. This remains a secular bull market dating to 2009, aging but continuing. Aging bulls do not die of old age. They die when the economic engine quits or when credit is choked off, and neither is happening. As I argue in my forthcoming book, artificial intelligence is the engine that is driving this economic expansion and will continue to drive it, much as electrification powered the economy and the market through the decades after 1915. Engines of that scale do not run smoothly. They attract speculation, speculation attracts leverage, and leverage guarantees that the ride will include episodes exactly like the past five weeks. Korea and Situational Awareness were not verdicts on AI. They were verdicts on borrowed money.

Near term, the calendar is not our friend. August has averaged a small decline over the past 25 years and September is historically worse, with midterm politics adding noise. But the setup matters more than the calendar. In years when the market's high for the year came in the second quarter and July paused, August has produced a median gain of about 2% and the stretch from here to year end a median gain of about 7%. With the advance/decline line at new highs and the 200-day rising, we would treat seasonal weakness as opportunity rather than omen.

The contest that decides the next leg is earnings against rising rates. Record beat rates and raised guidance are pulling the market up. A 4.72% ten year is pulling valuations down. As long as the earnings engine keeps outrunning the discount rate, the bull gets older and stays alive. If the ten year presses toward 5% while reactions to good earnings stay muted, expect more turbulence, and remember where turbulence usually comes from. Leverage. Always leverage. Keep some dry powder, respect the trend, and watch the feet, not the mouth.

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