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Capital Markets Commentary – August 2026

If there is a month designed for stepping back, many would argue it is July. Long days, warm evenings, and a general cultural permission slip to slow down. We hope you took advantage of it. We stayed locked in this summer, and the markets certainly didn't take a vacation. This month we will cover the bond market's most persistent warning signal in nearly two decades, a rotation beneath the surface of the equity market, a welcome but fragile improvement to inflation, and a development in the yen carry trade that most investors are not watching closely. We have a lot to mention this month, so let's take a look at the numbers.

The S&P 500 was essentially flat for the month, slipping just 0.1%. On the surface, this may appear to suggest a calm month, but it masks a considerable amount of movement beneath it. The Nasdaq fell 3.2% as technology stocks faced renewed pressure, while the Dow added a modest 0.4% as capital rotated toward more defensive and cyclically grounded areas of the market. The equal weighted S&P 500, which treats every company the same regardless of size, has outperformed its cap-weighted counterpart so far this year, a sign that the rally is broadening in the way healthy bull markets tend to do. Overseas, the results were sharply mixed. The Eurozone STOXX 50 added 1.5%, while the Nikkei fell a notable 6.2%, reflecting yen strength and renewed concerns about the pace of global growth. The Hang Seng was the standout of the month, surging 13.5% as improving trade sentiment helped fuel a sharp reversal from prior weakness. On the fixed income side, the 10-year treasury yield closed the month at 4.73%, continuing its climb and keeping pressure on bond prices.[i]

The fixed income numbers tell only part of the story. To understand what the bond market is actually saying this month, we'll need to look beyond the 10-year yield and specifically at what has been happening at the long end of the curve. As of July 27th, according to data compiled by

Bloomberg, the yield on the 30-year United States Treasury bond traded above 5% for most of July, which included 12 consecutive days.[ii] That is the longest consecutive stretch since 2007, the year before the global financial crisis. The yield closed the month of July at 5.27%, its highest month-end reading since the pre-crisis era.[iii] We want to be precise about what this means and what it does not mean, as the 2007 comparison needs to be made carefully. In 2007, long yields were high because the economy was running hot and the Fed was tight. Today, long yields are high despite a Fed that has been on hold, which tells us the pressure is coming from somewhere else entirely. We see three forces driving this currently: a deteriorating fiscal picture with federal debt having crossed 100% of GDP[iv] for the first time since World War II, a downpour of corporate bond issuance flooding the market to fund artificial intelligence infrastructure which can compete directly with treasuries for the same pool of buyers, and a softening foreign demand for U.S. government debt.

With the 30-year closing July at 5.27%, it is offering a return that is genuinely difficult to ignore on a risk-adjusted basis. To put this into context, the S&P 500's earnings yield, the inverse of the price-to-earnings ratio or better understood as the percentage return a company generates on each dollar invested in its stock, is now in the same conversation as the 30-year Treasury. That means that a government bond is offering a similar, sometimes even higher, yield than the return implied by owning the equity market. This is not a reason to abandon equities, but it does frame how much incremental risk investors are being compensated to take. In this type of environment, we believe duration risk may be more attractive than credit risk, depending on a clients long term objectives. When reaching for an extra percentage point of yield in high-yield or leveraged credit markets, you take on default risk, liquidity risk, and in some cases the kind of AI-linked leverage we have flagged in prior letters as potentially mispriced. The reward for taking that additional risk has rarely been thinner relative to what investment-grade duration is currently offering.

The pressure on long-term U.S. yields is not coming from domestic forces alone. The Bank of Japan has been quietly raising interest rates, moving from near-zero rates that persisted for decades to a current policy rate of 1.0%, with many pundits suggesting there could be further increases before year-end.[v] To understand why this matters, one must first understand the yen carry trade. For decades, investors borrowed cheaply in Japanese yen (where rates were effectively zero) and then deployed that capital into higher-yielding assets elsewhere. The trade worked beautifully as long as Japanese rates stayed low. As the Bank of Japan allows yields to rise, the economics of the carry trade begin to break down as borrowing costs increase, the risk of yen appreciation grows, and investors who have built leveraged positions funded in yen may be forced to unwind those trades, essentially selling global assets to repay yen-denominated liabilities. We have seen this before in recent years where in 2024, a surprise Bank of Japan rate hike triggered a sharp but short-lived selloff across equities, bonds, and even digital assets simultaneously. In the US, this type of day can be confusing for investors as there was no obvious U.S. specific catalyst to point to. The catalyst was Tokyo.

Japan is also one of the largest foreign holders of U.S. Treasuries. If rising domestic yields in Japan make Japanese government bonds more attractive relative to hedged treasury holdings, then Japanese institutions have less incentive to invest abroad. That potential repatriation of capital could put upward pressure on U.S. Treasury yields.

The fiscal pressure driving long yields higher and the carry trade dynamics emanating from Japan ultimately connect back to the same question every central banker is wrestling with right now. Where is inflation going, and how long does it take to get there? July gave us the most encouraging answer in recent months. July 14th brought a welcome surprise to start the morning. The Bureau of Labor Statistics released June's CPI Data, and for the first time in five months, the number moved decisively in the right direction. Headline inflation fell 0.4% for the month, bringing the annual rate down to 3.5%. Core inflation, which strips out food and energy, is the number the Fed watches more closely and it eased to 2.6% annually, its lowest reading since September 2025. The driver was energy. The data at least for one month, agreed with us. On that same day, Kevin Warsh walked into a House Financial Services committee hearing room and offered his assessment. He acknowledged the encouraging print, noted that services inflation remains elevated, and reminded the committee that one month of favorable data does not constitute a trend. The inflation trajectory has genuinely improved and the four-month acceleration appears to have peaked. That view is supported by the behavior of energy prices, which eased in early July as the Iran ceasefire (however fragile) has allowed some normalization of oil flows through the Strait of Hormuz. The risk, as it has been all year, is that the geopolitical situation reasserts itself. It seems we are constantly being reminded that a ceasefire is a condition, not a settlement. We remain of the view that inflation will be meaningfully lower by year-end than it was at its May peak. As we noted last month, we hold that view with appropriate humility.[vi]

As we mentioned in the market recap, July's headline numbers tell only part of the story. Beneath the S&P 500's essentially flat return this past month lies a rotation that is, in our view, one of the more constructive developments of the year, and one that has received considerably less attention than it deserves. The Magnificent Seven, the handful of mega-cap technology stocks that drove the majority of last year's returns, have stumbled this year.[vii] The Nasdaq slid more than 3% and yet, the broader market held its ground.[viii] When looking at YTD numbers, the equally weighted S&P 500 has outperformed the cap-weighted version. We can break this down by looking at some of the components for reference. Mid-cap stocks are up ~14.6% for the year with small-caps up ~19.0%.[ix] The index is holding up not because seven stocks are carrying it, but because hundreds of companies are contributing to it. That is a fundamentally different and healthier kind of bull market. Why does this matter? Well, a rally built on a handful of names is fragile by definition.

When those names stumble, the whole market tends to stumble with them. A rally built on broad participation is typically more durable, more reflective of genuine economic health, and more likely to sustain itself through the kind of volatility that 2026 has already delivered in abundance. Most companies in the S&P 500 reported actual EPS that exceeded estimates in Q1, which suggests the broadening is being driven by genuine fundamental improvement rather than simple rotation out of expensive names.[x]

As we close this month's letter, we are reminded that August has a way of arriving before anyone is ready for it. Before you know it, kids are heading back to school, the calendar will fill up, and the "slower" pace of summer will soon be a memory. We hope you managed to steal some of it before it disappears. The markets, however, did not slow down on your behalf and the second half of 2026 is shaping up to be as consequential as the first. We remain where we have been all year: focused on quality, attentive to risk, and committed to keeping you informed.

As always, should you have questions or concerns, please never hesitate to reach out. We look forward to hearing from you.

Graystone Consulting | Charleston, WV

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[i] Source: Morgan Stanley Wealth Management GIO, Bloomberg, FactSet.
[ii] Source: Bloomberg, "US 30-Year Yield Raises Alarm in the Longest Run Above 5% Since 2007", July 22, 2026.
[iii] Source: Morgan Stanley Wealth Management GIO, Bloomberg, FactSet.
[iv] Source: Congressional Budget Office, "The Budget and Economic Outlook: 2026 to 2036", February 2026.
[v] Source: Bank of Japan, "Change in the Guideline for Money Market Operations", Statement on Monetary Policy, June 16, 2026.
[vi] Source: U.S. Bureau of Labor Statistics, "Consumer Price Index – June 2026", News Release USDL-26-1191, July 14th, 2026.
[vii] Source: J.P. Morgan Asset Management, "Guide to the Markets – U.S.", Q3 2026, data as of June 30, 2026.
[viii] Morgan Stanley Wealth Management GIO, Bloomberg, FactSet.
[ix] Source: Morgan Stanley Wealth Management GIO, Bloomberg, FactSet. (Russell Midcap & Russell 2000)
[x] Source: FactSet Research, Earnings Insight Report as of May 1, 2026

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Dow Jones Industrial Average (DJIA). A price-weighted average of 30 blue-chip stocks that are generally the leaders in their industry.

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