

28 August 2026

July Monthly Report

Dear Investors

We're pleased to provide you with the July 2026 Monthly Report for the Fawkes Capital Fund ("Fund"). In this monthly report, we:

- (1) Update our performance for July 2026;
- (2) Describe our views on artificial intelligence; and
- (3) Describe our views on bonds, currencies and the macro outlook.
- (4) Outline our views on Japan

Performance Update

It's been a while, but the Fund suffered a setback in July. Over the course of the month, artificial intelligence (AI) stocks fell precipitously, with many high-profile beneficiaries of the theme, including memory stocks, declining by 60% or more.

The reasons behind the sell-off became clearer as the month progressed. Chief among them was forced selling from highly leveraged positions. The highly publicised Situational Awareness Fund ended up lacking a little of its namesake, but it wasn't just Leopold: leveraged positions had built up across Asian markets as well. This was compounded by news that NVIDIA would reduce the HBM memory specifications required for its next-generation chip configuration. Together, these developments triggered a sharp reassessment across the broader AI complex.

There has also been growing concern over the financial viability of AI model providers. The first issue is the diminishing return from training ever-larger models. The cost of training frontier models continues to rise rapidly, while the incremental improvement in capability appears to be narrowing. Put differently, it is becoming increasingly expensive to produce increasingly modest gains. For instance, how much did corporate adoption really change between GPT-5 and GPT-5.5?

Against this backdrop, momentum stocks experienced their largest one-month sell-off since the Great Depression.

It was within this environment that the Fund suffered a setback, returning -5.3% in July. Following a significant run-up in returns over the previous 12 months, some reversal was perhaps inevitable, although that does little to make the month any less disappointing.

Jul-26	1 Mth	3 Mth	1 yr	3 Yrs	5 Yrs	SI (ann)	SI (cum)
Fund (Net)	-5.3%	5.9%	66.7%	27.5%	19.1%	17.7%	135.3%
Blended Index	0.0%	1.2%	3.4%	6.8%	5.3%	5.7%	33.4%
All Ords	1.7%	3.3%	4.8%	10.0%	7.6%	8.3%	52.1%
RBA Cash	0.4%	1.1%	4.0%	4.2%	3.2%	3.1%	17.1%

Returns are calculated net of fees and represent the combined income and capital returns over the specified period.

All returns provided are in AUD. Blended Index returns are composed of 50% All Ords / 50% RBA Cash.

Despite the setback, we continue to put in the work. We have made substantial progress in our idea generation through the rollout of a new AI machine and are building agents that can operate across our entire data stack. At the same time, we continue to search for the most attractive risk-reward opportunities in which to deploy your capital.



Views on Artificial Intelligence

We have become less certain that AI will prove to be the defining technology of our future, although we still think that outcome is more likely than not. For AI to create value on the scale currently anticipated, however, it will need to be adopted broadly across the corporate sector and, to some extent, substitute for the value currently generated by labour. We are not seeing that yet.

Most leading corporations have now experimented with AI. The feedback we commonly hear is twofold: first, that AI has the potential to deliver a major productivity boost, but has not yet done so at scale; and second, that capturing those gains requires active management from the executive suite. Without that discipline, AI risks becoming an additional employee expense rather than a source of genuine productivity.

That caution is beginning to show up publicly. Microsoft and Uber, for example, have indicated that they intend to be more disciplined in their AI spending. We have also yet to see a true “Barnes & Noble moment” for AI: no major incumbent has been displaced in a way that forces competitors to adopt the technology simply to survive. Corporate adoption remains meaningful, but it has yet to reach an inflection point.

Where AI is already extremely effective is in the application of deductive logic: defined environments in which a large amount of structured reasoning is required, supplemented by a smaller degree of inductive judgement. One field where we believe large language models (LLMs) are particularly well suited to this type of work is cybersecurity.

While cybersecurity and, to some extent, robotics could become major use cases for AI, these opportunities are not without risk. Increasingly powerful models are attracting greater regulatory scrutiny. Regulators have already delayed the release of Anthropic’s Mythos LLM and could impose restrictions on even more capable models in the future. If regulation begins to constrain the capabilities that make these models economically valuable, it could become another significant obstacle to widespread corporate adoption.

The second concern is the potential impact of proliferating open-weight models on the economics of frontier AI. Unless frontier models become sufficiently capable to replace entire teams of workers, open-weight alternatives may simply be good enough for many corporate applications. Both Chinese and American open-weight models can be considerably cheaper to run. If model capabilities become increasingly commoditised, the ability of frontier providers to earn attractive long-term returns could be severely constrained. In that scenario, it becomes difficult to justify the trillions of dollars of capital currently being deployed across the AI ecosystem.

The evidence so far does little to dispel that concern. When Claude released its latest Fable model, there was no significant acceleration in corporate adoption. This matters because the cost of developing increasingly capable frontier models continues to rise rapidly, while the incremental commercial response appears limited. For AI to generate returns commensurate with the trillions of dollars being invested, it will ultimately need to produce substantial and measurable productivity gains. In many cases, that is likely to mean corporations accomplishing the same amount of work with fewer people.

We are not seeing that yet. There has been one meaningful wave of retrenchment across software companies, but little evidence of a broader or sustained shift in employment. This is particularly notable in software engineering, which should be among the occupations most directly exposed to current AI capabilities. If material labour substitution is going to emerge anywhere early in the adoption cycle, we would expect it to be visible there. So far, it is not.

As such, we remain cautious in our outlook for AI. We believe the more attractive opportunities lie in enabling technologies that replace existing approaches to chip manufacturing. The appeal is that these investments do not necessarily require AI demand to continue growing at its recent pace. Even in a more mature demand environment, the installed base of AI infrastructure will age and require replacement, typically over a five- to six-year cycle. Where a new manufacturing technology is adopted across an entire generation of chips, that transition can create a structural and durable change in the economics of the companies supplying it.



One example is the likely adoption of PTFE as an insulating material in next-generation circuit boards. As successive generations of AI chips consume more power and operate at higher speeds, maintaining signal integrity across the copper traces becomes increasingly difficult. The surrounding insulating materials contribute to signal loss, and the industry has repeatedly upgraded these materials over the past two decades to keep that loss under control. PTFE represents a potential next step because of its exceptionally low dielectric loss.

The trade-off is that PTFE is soft and difficult to process, which has so far contributed to warping and low manufacturing yields. One emerging solution is therefore a hybrid board: PTFE is used in the core layers, where its electrical properties are most valuable, while existing M9 glass-cloth prepreg is used elsewhere to provide structural stability.

This is the type of structural change we are looking for. Even if the overall AI market stops growing rapidly, a technology moving from effectively zero adoption to potentially millions of chips represents a significant shift in industry economics. We believe PTFE adoption will continue to increase and could become an important material in future generations of AI hardware. That would benefit Dongyue, which is one of the world's largest producers of PTFE.

Views on bonds, currencies and the macro-outlook

The macroeconomic outlook has become considerably more complex. Currency, bond and commodity markets are increasingly being pulled by a range of powerful, and at times conflicting, forces.

Let's begin with the bond market. We see a significant funding challenge emerging in the United States. Over the coming years, the amount of capital seeking funding is likely to rise substantially at the same time that some traditional sources of demand for bonds are diminishing. The result, in our view, is an increasingly difficult imbalance between the supply of bonds and the capital available to absorb them.

There are several reasons why the demand for capital is likely to grow substantially:

- **Large and persistent fiscal deficits** – The US federal government continues to run a budget deficit of around 6% of GDP, requiring substantial Treasury issuance each year.
- **A political environment increasingly conducive to fiscal expansion** – Populism is gaining ground across many developed economies, including in countries where incumbent governments won decisive mandates only relatively recently. Whether from the left or the right, these movements frequently favour some combination of fiscal stimulus, tax cuts and greater infrastructure or defence spending. In the US, even the fiscally conservative wing of the Republican Party ultimately supported legislation that added trillions of dollars to projected federal borrowing. A continued shift towards more expansionary fiscal policy would place further pressure on already-large government deficits.
- **The enormous capital requirements of AI infrastructure** – Based on the approximately 50 gigawatts of data-centre capacity currently planned for 2028, we estimate that roughly \$2.5 trillion of capital could be required to build it. Big Tech may be able to fund around \$1 trillion through internally generated cash flow, but that would still leave approximately \$1.5 trillion requiring external financing. That alone is equivalent to roughly 6% of US GDP.

Alongside these funding requirements, traditional sources of bond demand are becoming less supportive. Quantitative tightening continues to remove central-bank liquidity from the system, while foreign official-sector demand for US Treasuries is no longer the structural source of marginal buying that it once was. Putting these forces together, the total call on capital could approach 15% of US GDP by 2028. That is an enormous amount of financing for the market to absorb.

The problem is that we do not see sufficient incremental demand to absorb this supply without a meaningful adjustment in yields.



- **Foreign capital is unlikely to close the gap** – The major recyclers of dollars are no longer investing heavily into the US. With the dollar broadly stable, foreign capital inflows might amount to only around 1% of GDP, broadly consistent with the financing required to offset the current account deficit. That leaves relatively little incremental foreign capital available to absorb the additional financing needs outlined above.
- **The domestic savings pool also appears constrained** – Consumers are no longer accumulating deposits at anything like the pace seen in recent years. We track household bank balances through banking data, and deposit growth has effectively stalled. Money-market funds continue to attract inflows equivalent to roughly 2–3% of GDP, although some of this reflects corporate and foreign capital rather than household savings. Pension assets might contribute another 1–2% of GDP, but only a portion of those flows will ultimately find their way into fixed-income markets. Taken together, these sources might provide several percentage points of GDP in additional bond demand, but nowhere near enough to absorb the potential increase in financing requirements.
- **There remains a stock of excess household savings left over from Covid** – We estimate this at around 3% of GDP. In principle, some of this capital could be mobilised, but the extent to which households are willing to deploy it into financial assets remains uncertain. That uncertainty is particularly relevant in the early stages of a funding squeeze, when higher yields may be required before additional savings are drawn into the market.

In total, then, perhaps 5% of GDP of incremental demand can be identified against as much as 15% of GDP of prospective debt supply. That leaves a very large funding imbalance. Put differently, capital equivalent to roughly 10% of US GDP would need to be drawn away from other assets, generated through additional saving, or induced by materially higher yields.

We have not seen a funding challenge of this scale since World War II. The important difference is that, during the war, the Federal Reserve was able to monetise a substantial portion of the funding requirement. With inflation still above target today, policymakers have far less room to pursue the same approach.

It is against this backdrop that the US Treasury has increased the scale of its potential purchases of longer-dated bonds, funded through greater issuance at the short end of the curve. This may provide some support to the long end, but the amounts remain small relative to the overall financing requirement. Even purchases equivalent to around 0.5% of GDP would represent little more than a drop in the ocean against the scale of prospective issuance.

The longer-term fiscal arithmetic is also becoming increasingly uncomfortable. The weighted-average maturity of US federal debt is approximately six years, meaning that higher prevailing interest rates will progressively feed through into the government's funding costs as existing debt matures and is refinanced. If the average interest rate on federal debt eventually rises towards 4.5%, the government's interest burden could approach 7–8% of GDP. These pressures will emerge gradually, but they raise increasingly important questions about fiscal sustainability and the appropriate risk premium investors should demand for holding very long-dated Treasuries.

The imbalance between the supply and demand for bonds is also likely to affect other asset classes. As bond yields rise, fixed-income securities become increasingly attractive relative to equities and other assets. At the margin, capital must therefore be drawn away from those markets to absorb new bond issuance. That repricing mechanism could weigh on asset valuations more broadly.

Against that backdrop, we expect aggregate equity-market returns to be relatively subdued over the next 18 months. Dispersion between individual companies should become increasingly important, creating an environment in which stock selection matters considerably more than broad market exposure.

We believe we may already be seeing the early stages of this adjustment. New data-centre financing is beginning to test the depth of corporate bond markets, with spreads tending to widen as additional issuance comes to market. Google's decision to issue in the Australian bond market may also be indicative of issuers increasingly looking beyond the US for additional pools of capital. With financing requirements set to accelerate globally, we are watching these developments closely.



Views on Japan

There has also been an important shift in the macroeconomic debate in Japan. Prime Minister Takaichi's support has weakened as the cost of living has become an increasingly important political issue. Her version of Abenomics – expansionary fiscal policy, low interest rates and a weak currency – is no longer delivering the same political dividend. A persistently weak yen has raised the cost of imported goods and contributed to inflation, leaving households sensitive to whether nominal wage gains translate into sustained improvements in real purchasing power.

This matters politically. Since Abe's departure, the Liberal Democratic Party has repeatedly changed leaders when public support has deteriorated. Takaichi is acutely aware of that dynamic. If fiscal stimulus is increasingly associated with a weaker yen and higher household costs, simply delivering stronger nominal growth will not be enough. The government also needs that growth to translate into higher real incomes.

As a result, we believe Japan may be moving towards a different policy mix. Fiscal policy is likely to remain stimulatory, but there is now greater pressure to stabilise or strengthen the yen and greater tolerance for higher interest rates as the Bank of Japan normalises monetary policy. The objective is to preserve the benefits of stronger investment and corporate profitability while reducing imported inflation and allowing wage growth to translate into rising real incomes.

Recent comments from both the government and the Bank of Japan reinforce this view. BoJ Governor Ueda has warned of the risks of waiting too long to raise interest rates, signalling a greater willingness to act against inflation. Prime Minister Takaichi has similarly acknowledged that Japan has entered a world of positive interest rates and argued that policy should encourage households and pension funds to invest more of their capital in Japanese financial assets. The government has also begun encouraging Japan's major state pension funds to increase their domestic allocations after years in which substantial amounts of capital were invested overseas.

It was against this backdrop that the US Treasury coordinated with Japan's Ministry of Finance to intervene in support of the yen. The significance of the intervention goes beyond the currencies purchased on the day. US Treasury Secretary Bessent has subsequently made clear that Washington views intervention as part of a broader policy adjustment in Japan. He has described the yen as substantially undervalued and said that, following discussions with Japanese officials, the US expects Japan to continue putting in place policies that move the currency towards a more normal equilibrium.

That is important. Currency intervention on its own is unlikely to reverse a deeply entrenched trend. But intervention accompanied by higher interest rates and policies that encourage Japanese households and institutions to hold more domestic assets could fundamentally change the supply and demand for yen.

We believe the yen remains substantially undervalued. It will take time to change market perceptions after years in which low domestic interest rates and a weak currency encouraged Japanese capital to flow overseas. But those incentives are beginning to change. If Japanese investors start retaining more capital at home, or ultimately repatriating some of the enormous stock already invested abroad, the implications for the yen could be significant.

We believe we may be at the beginning of that process and the start of a new trend. We continue to monitor the macroeconomic environment closely and adjust the portfolio accordingly.

Kind Regards,
Fawkes Capital Management

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