Royston Capital

Economic and Markets Update

August 2026 edition by Krasni Shrivastava

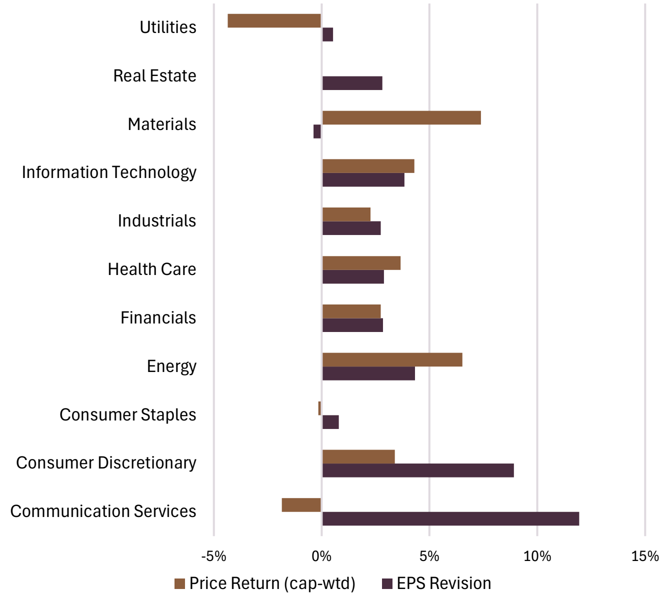
August 2026 Reporting Season & Portfolio Update

August gave us a lot to read: an exceptionally strong US Q2 reporting season, the July run of US economic data, the first weeks of the Australian FY26 reporting season, and an RBA that held in August with a slightly more dovish-sounding Statement on Monetary Policy (SoMP). We have done some digging to bring you the story behind the wall of numbers, and this month the digging yielded returns, because nearly every headline needed one adjustment before it was usable. **US earnings** needed the Alphabet and Amazon mark-to-market gains stripped out, **US payrolls** needed the summer education swing removed, **Australian property market** charts needed seasonal adjustment, and the **RBA's inflation forecasts** needed their oil assumption re-dated. Those adjustments confirmed the breadth of the US season and left much less standing in Australia, and we close with how the data has set our positioning.

US Q2 earnings season

US Q2 is about 90% reported, and 86% of reported companies beat estimates, the highest share since Q2 2021 and above the five-year average of 78%. Headline earnings advanced 50.4%, with aggregate earnings coming in 29.2% above estimates against a 7.0% 5-year norm. One item does a lot of the work here: excluding the mark-to-market gains booked by Alphabet and Amazon, growth moves from 50.4% to 32.0% and the surprise from 29.2% to 10.9%. The beat was still uniquely broad-based, with 10 of the 11 GICS sectors in the Royston US universe seeing upgrades in aggregate. We would also note that Q2 2026 cycles a particularly weak Q2 2025, the tariff shock quarter, and that consensus already expected 23.1% growth before the season began.

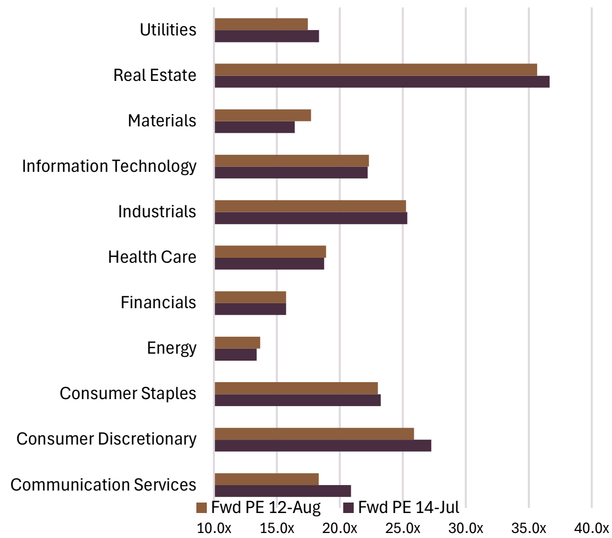
Fwd EPS revision vs price by GICS sector (14 Jul - 12 Aug)



The market has largely kept pace with the upgrades. Analysts raised forward earnings approximately 5% from mid-July to mid-August while the index rose 2.5%, taking the forward multiple from 20.8x to 20.4x against a 5-year average of 19.9x and a 10-year average of 19.0x. In plain terms, earnings expectations grew faster than prices, so the market ended the season slightly cheaper on that measure.

Margins were the standout. Blended net profit margin reached a record 16.9% in Q2, from 14.8% in Q1 and 12.9% a year ago. Approximately 2.1pp of the Q2 figure is the Alphabet and Amazon investment gains, which carry earnings and no revenue. Excluding them, the margin is approximately 14.8%, still an expansion of approximately 1.9pp year on year, with the 32.0% ex-gains EPS supported by 15% revenue growth. We attribute that underlying expansion to revenue outrunning costs, with revenue up approximately 15% against implied cost growth of approximately 12.5%. Both cost lines contributed. Goods inputs fell in July (producer goods prices -0.7%, petrol -5.7%) while retailers held shelf prices, and wage growth ran below CPI throughout 2026 (see the inflation and wages section below).

Fwd PE by GICS sector, pre vs post earnings



This wedge is naturally cyclical rather than structural, and we think the party stops sooner rather than later. Producer Price Index (PPI) deceleration should now pass onto consumer prices, which caps the selling-price side, and the revenue strength is concentrated in AI capex and upper-decile consumption rather than broad demand (see the consumer section below). Within that, earnings were particularly strong for the hyperscalers, although GOOG and AMZN have now entered negative free cash flow territory due to growing capex bills, with META teetering on the brink of it. Headlines speculating how much cloud demand growth is originating from frontier labs (and therefore funded by investors rather than end-user demand) have dubious mathematical basis, and we remain engaged in the unfolding of that conversation.

Portfolio Positioning: We took profits in Consumer Discretionary and performed in-sector re-allocations between healthcare and hyperscaler names in the Royston Capital International Direct portfolio. We have kept our weighting in semiconductors and hardware untouched through the trough, with only minimal exposure to memory.

Note on coverage: 426 of ~503 S&P 500 members are in our investible universe (ACWI), approximately 96.1% of index weight. The missing ~4% are the smallest index names, so aggregate results are representative. Growth is measured against year-ago actuals and surprise against estimates at the time of reporting, so the two figures do not compound. S&P500 aggregates sourced from FactSet August Earnings Insight.

US macro data – inflation and wages

We start with producer prices to understand margin outlook, and because both CPI and PPI form the basis of the Fed's PCE target measure. Core PPI is running 4.7% over twelve months, which is a trough deceleration stemming from a July 2025 base effect but directionally cooling underneath also. The July headline figure was flat (+0.0%), after printing -0.1% in June and +0.5% in May, with much of that swing reflecting fuel input costs. Looking under the hood, the continued deceleration tells us the price tailwind under revenue growth is fading, and that PPI as an inflation input is progressing in the right direction.

The composition supports that read. Consumer goods inputs fell, with goods producer prices down 0.7%, petrol down 5.7% and food down 0.9%, while retailers held shelf prices and the margin widened. Capital goods inputs rose, with lumber up 5.0%, aluminium scrap up 5.8% and construction up 2.2%, and wholesalers of machinery and building materials could not raise selling prices at the same speed, so their margin compressed. Core goods, meaning final demand goods less foods and energy, is decelerating: +0.4% in March, +0.7% in April, +0.8% in May, +0.2% in June and +0.1% in July.

Consumer prices carry the same message. Headline CPI rose 0.1% in July and 3.4% over the year, from 3.5%, while core rose 0.2% in the month and eased to 2.5% over the year, from 2.6% in June. Core momentum is below target: the +0.2%, 0.0% and +0.2% prints across May to July annualise to about 1.6%, six-month annualised is 2.4%, core ex-shelter is near 1.95% and core goods are +0.8% over the year. Ex-energy, the US headline has run 0.2% to 0.35% every month this year. Looking forward, headline CPI should hold near 3.4% into the December quarter unless petrol falls, mathematically as we cycle through the year. The soft spot is wages, which missed CPI again in July, so real wages have gone slightly backwards in 2026.

US macro data – jobs, the Fed and bond yields

July payrolls printed -23,000 against consensus of +83,000, and the unemployment rate was 4.1%. The headline overstates the weakness somewhat, because local government education fell 50,000 and is seasonal over summer, and excluding it payrolls rose 27,000. We await the revisions to these numbers, which have been running in one direction: May was cut 66,000 to +63,000 and June was cut 37,000 to +20,000, for 103,000 combined, leaving the last three prints at +63,000, +20,000 and -23,000.

The unemployment rate fell from 4.3% in May to 4.2% in June to 4.1% in July. Participation is 61.4% and the employment-population ratio 58.9%, down 0.7 and 0.5 points respectively since January. The labour force is shrinking roughly as fast as labour demand, which is why the rate itself has moved so little. This is the "frozen market" we have been hearing about, with little hiring and little firing.

On the policy rate, the July PPI, CPI and jobs numbers left the markets breathing a sigh of relief, as they seemed to cool the market's read on rate hike probability, but the release of the July FOMC meeting minutes reversed the sentiment slightly with hawkish commentary by several participants. The table below sets out current pricing.

Market	Probability priced Aug-26
Any hike by the December meeting (Polymarket, $7.6m volume)	48%
Any hike by the October meeting	40%
Upper bound reaching 4.25% before 2027, meaning two hikes	16%

The main concern is the scrapping of forward guidance from new Chair Warsh's Fed, which analysts have complained will cause volatility and raise the cost of capital. We think there is some inflation uncertainty pushing up bond yields, but not to be missed is the significant demand for capital (AI capex) motivated by strategic priority rather than needing immediate ROI which is more likely to be persistent.

Further out the curve, the US 10-year is 4.7%, with TIPS decomposition pricing approximately 2.25% long-run inflation + 2.45% real yield. ACM model expected policy path is 3.90% + term premium 0.80%. US Treasury Secretary Bessent recently made headlines for doubling buybacks of deeply discounted 10y and 30y bonds funded by T-bill issuance. Gold and bitcoin reacted with a jump, reflecting the risk that this leads to more expensive debt, and a government incentivized to tolerate inflation by managing rates down. Goldman's base case is that rates are held through 2026, with inflation normalization mid-2027 bringing the short end down to a low-to-mid-3s landing, and we agree. On this timeline, we expect 10y yields remain relatively stable with the curve normalizing at the short end. We are not of the belief that high yields are reflective of alarmingly high government debt or a risk of currency debasement, yield level reads to us as a fair price of an economy borrowing heavily to build.

US macro data – consumer

Visa (NYSE: V) and Mastercard (NYSE: MA) are currently core holdings in our International Direct portfolio, and their data gives us a close read on the US consumer. The chart below is the Visa Spending Momentum Index, Discretionary, US. It measures the share of Visa-branded credit and debit cards that spent more in a given month than in the same month a year earlier, scored 0 to 200 as a diffusion index, with magnitude excluded. The series historically ran 99 to 104, indicating stable to growing economic activity, spiked to about 120 during the 2021 stimulus, and has run about 94 to 100 since mid-2022. That is 4 consecutive years of cards cutting discretionary spend outnumbering cards increasing it. The threshold is nominal, so with CPI at 3.4% (July 2026), the sub-100 readings imply most cards cutting nominal discretionary spend and even more cutting real spend, year over year.

In this climate, Visa US payments volume from consumers specifically rose 9.5% in the June 2026 quarter (estimated, 10% including commercial), the fastest pace since fiscal 2019 outside the pandemic recovery. The World Cup helped, as did some cash-to-card conversion, although the latter is minimal with the US being a mature, saturated market. The gap between those two measures drove our interest in the concentration of consumer spending. Moody's Analytics famously (and controversially) estimated the top 10% of earners accounted for 49.2% of US consumer spending in Q2 2025, a record in data back to 1989, and Mark Zandi reiterated his method in June 2026 (while partially conceding that it may be somewhat overstated), saying the top 20% now account for 60% of consumer spending. We see mounting evidence of a deepening K-shaped US consumer, where the answer to "how is the US consumer doing" is two answers- both good and bad.

Portfolio positioning: Our International Direct portfolio reduced exposure to consumer discretionary spend in the US in the quarter, with the exit of our position in Masco (NYSE: MAS). With significant earnings upgrades in the sector but a relatively muted price movement, we note that the market is wary of the quality of earnings in these names due to macro-overhangs.

Australian FY26 earnings season

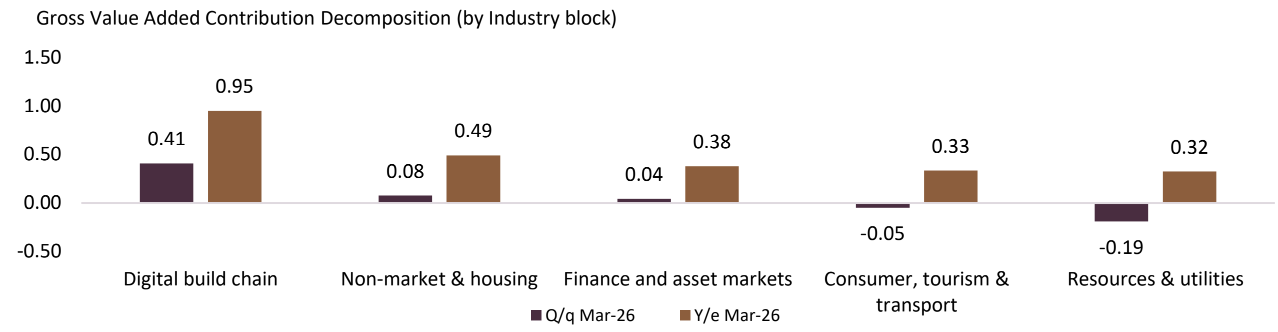
Turning home, the ASX200 hit a record 9296.7 early in the season, but momentum faded as week two produced more misses than beats, with the index closing near 9120, about 1.5% lower for the week. Weakness in financials, consumer discretionary, industrials, healthcare and telecommunications outweighed gains in utilities and energy.

AU Gross Value Added: "Australia Inc."

The Australian economy grew 0.3% in the March quarter, a deceleration from the 0.9% in December. Domestic final demand contributed 1.0pp, among the strongest quarters in two years, and net trade subtracted 0.8 points, with exports down 1.1% on conflict shipping disruption and imports up 2.1%. Population growth of approximately 1.7% leaves output per person up approximately 0.8% over the year and approximately flat in the quarter.

The composition is the interesting part. Machinery and equipment investment rose 16.3% in the quarter and 23.9% over the year, contributing 0.7 points to quarterly growth (ABS 5206.0 Table 2), while non-dwelling construction was flat in the quarter and rose 1.5% over the year, below population growth. The current cycle is installing hardware: servers, batteries and grid equipment. Westpac IQ claims that data centre investment is the significant driving force of the Australian economy, with all other sectors showing weakness, and estimates that the net effect of this investment, including spillover effects, drove all the growth this quarter and around 0.8ppts of GDP growth in year-ended terms.

Portfolio positioning: About half the spending leaks offshore. Of the 0.7 points equipment contribution in the March quarter, roughly 0.3 points is imported hardware, and the domestic value added of approximately 0.41 points lands in the supplying industries shown below. Domestic exposure to the data centre build is crowded, and we therefore look internationally for a better risk-weighted return.



Source: ABS 5206.0 Table 6 seasonally adjusted chain volume levels ($m) supplied 14 Aug 2026.

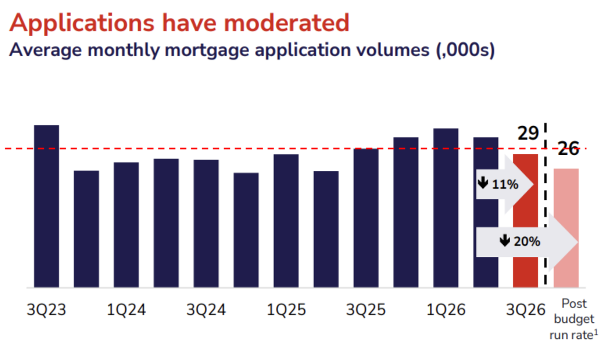
Australia housing

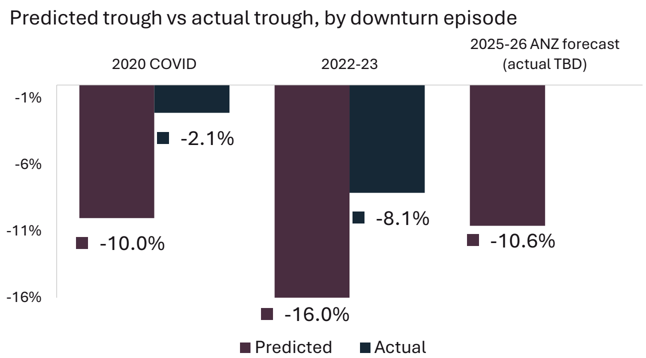
The changes to negative gearing and CGT have introduced a dampener to the housing market. Negative gearing is grandfathered for existing owners, new builds are exempt, and carry-forward losses remain available for new entrant investors to offset against the sale of the investment property. For gains accruing after July 2027, the 50% CGT discount is being replaced with inflation indexation, charged at the marginal tax rate of the owner with a 30% minimum.

When assessing the impact of these changes, we note that the cashflow for a new investor has almost certainly been impaired, with holding costs inflating by potentially several thousand a year. Brokers will be quick to point out that tax losses are deferred till sale, not extinguished, but the cash flow impacts have been enough to impair sentiment. However, sentiment recovers – but there is one input into the Australian property market that does not. We believe the strongest impact on property occurs when borrowing is constrained – sentiment can be negotiated with while borrowing capacity cannot. APRA guidelines recommend excluding negative gearing against salaried income as an inflow when assessing serviceability, however we've spoken to a network of Australian brokers who confirm that calculators used to include tax benefits as cashflows, and now they do not. That creates a debt capacity event. The number of loans that now hit these constraints will determine whether the negative gearing changes impact prices in the same way that cash rate hikes do, albeit restricted this time to the investor pool.

Bank commentary is strongly bearish, and the two exhibits below show why we discount some of it. Adjusting for seasonal effects and the obvious 3 rate hikes we have seen, and based on an approximation of the Westpac chart, we estimate mortgage application volumes are running roughly -8% on a quarter-average yoy basis, while the number on the slide they chose to give, unadjusted for the winter downturn, was -20%. The banks' predicted housing market troughs for 2020 and 2022 were also multiples more severe than the downturns that ultimately transpired.

Portfolio positioning: Valuations for the Big 4 banks remain stretched relative to earnings and growth, even despite the sell-off triggered through earnings season. We await an opportunity where the market prices what we believe is an overstatement of the impact of these changes.





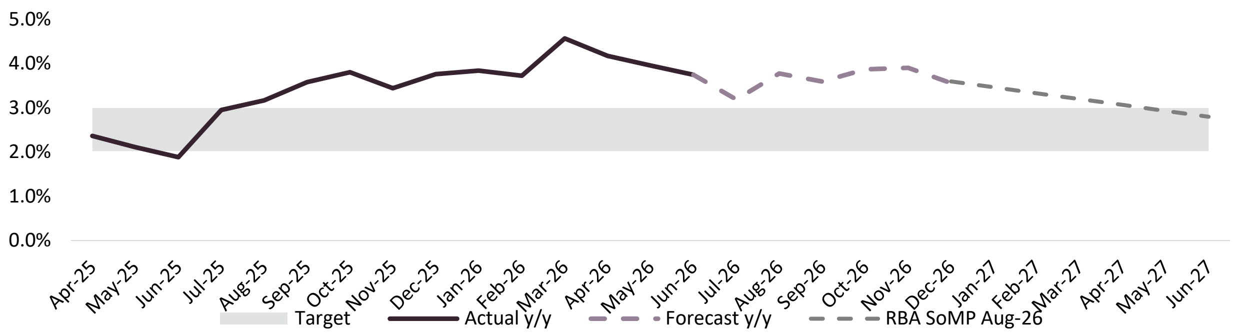
Source: Westpac 3Q26 result presentation, ANZ Research August 2026, Cotality

RBA rate decision

The Reserve Bank of Australia held the official cash rate steady at 4.35% at its board meeting on August 11, 2026. The stated milestones for inflation are a headline forecast of 3.6% in December 2026 and 2.6% in December 2027, with the trimmed mean above 3% until mid-2027 and easing to 2.5% by early 2028. The fall between those headline points is not linear, because the fuel spikes of March to May 2026 roll out of the twelve-month window across March to May 2027, so we think the recovery to target is June 2027.

Unsurprisingly, we see upside risk to those forecasts, with the key areas of interest being housing and oil (see the oil section below). The SoMP says business investment strength is expected to be driven by data centre investment, and that headline inflation will stay above target into 2027 across many advanced economies because of elevated energy prices and AI-related demand.

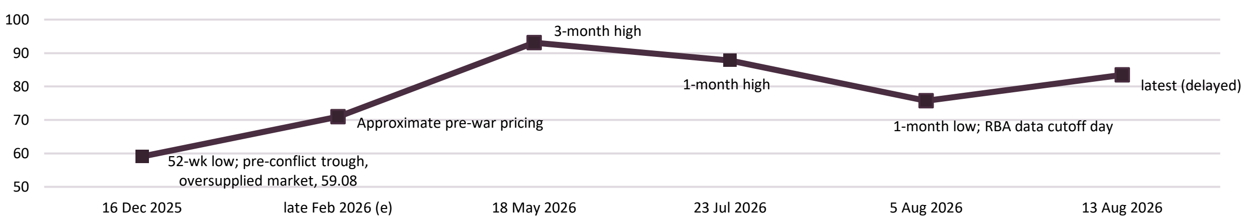
Headline CPI y/y: actual, Royston model forecast, and RBA SoMP points



Source: Royston model, RBA August 2026 SoMP

Much ado about oil?

December-26 forward Brent crude (CBZ26) vs RBA assumption



The August 2026 observation for all series in the SoMP is as at 5 August, with the cash rate path derived from financial market pricing as at that date and the exchange rate assumed unchanged from its 5 August level. The chart above shows that date was the one-month low of the December 2026 crude contract, and the same contract trades about US$8 higher a week later, with significant volatility over the year. Further, as refining margins (for diesel in particular) make headlines, the spread between refined fuel prices and Brent is assumed to return to historical average levels by early 2027. Naturally, we therefore watch for the falsification of any of these premises.

The oil crisis itself has not been as bad as feared. Between leakage of some non-transponding vessels through the Strait (CENTCOM), utilisation of strategic reserves, some Saudi and OPEC+ ramp, and “prices being their own cure” demand destruction, we are yet to see some of the highs that analysts would have expected to have arrived despite continued disruption for near-6 months.

Portfolio positioning: For energy, if there is a crunch time to come, we think December and the Q1 Northern hemisphere peak heating demand. The EIA path has OECD commercial stocks just under 2.3b barrels, which is record low territory, and China reaches month ten of drawing against strategic storage buffers.

Where this leaves us

The month rewarded the adjustments, and they pointed in different directions in the US and Australia. In the US the strength held up: earnings grew 32.0% even excluding the investment gains, upgrades reached 10 of 11 sectors, and underlying margins expanded 1.9pp, so we stayed with our semiconductor, hardware and hyperscaler positions and trimmed only where upgrades were already in the price. The open questions in the US sit on the demand side, with the top 10% of earners near half of consumer spending and a frozen labour market, which is why our trims started in consumer discretionary. In Australia the adjustments took most of the story away: on Westpac IQ's estimate, data centre investment drove all the March quarter's 0.3% growth, about half of that spend is imported, and week two of the FY26 season produced more misses than beats. We therefore look offshore for the data centre theme rather than pay crowded domestic multiples, and we wait on the Big 4 until the market prices the housing changes on the evidence. The near-term tests arrive quickly, with the September 16 Fed meeting, oil into the December quarter, and the spring housing data at home. We will report back as they land.

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