QUARTERLY INSIGHTS – Q2 2026

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IN SUMMARY

- Q2 demonstrated how quickly markets can move between regimes. AI productivity supported the Deflationary Boom, infrastructure and defence spending strengthened the Inflationary Boom, the energy shock briefly created an Inflationary Bust, and rising financial leverage remains the most likely path into a Deflationary Bust.

- The old ESG has been replaced by a new ESG: Energy, Security and Geopolitics. Energy is now the physical foundation of AI, industrial competitiveness and sovereignty; security now includes grids, cyber networks, semiconductors and supply chains; and geopolitics increasingly determines where and at what cost capital can flow.

- AI is both the great productivity hope and the great financing risk. The promise of digital abundance is real, but delivering it requires an enormous physical build-out in energy, data centres, chips and grids — increasingly funded through debt, equity issuance and financial leverage.

- The Fiscal Age is making inflation more volatile, not necessarily permanently higher. One supply shock changes the price level; repeated shocks, combined with fiscal accommodation and rising deficits, risk changing the inflation regime itself.

- Portfolio construction must respect regime uncertainty. The Permanent Portfolio is not a forecast that all assets rise together; it is a recognition that leverage can finance extraordinary progress while making regime transitions violent, nonlinear and impossible to time.

THE BIG PICTURE

THE WORLD HAS NOT MERELY ACCUMULATED MORE DEBT. IT HAS ACCUMULATED MORE POINTS OF DEPENDENCY – AND EVERY DEPENDENCY GIVES SOMEONE LEVERAGE.

The second quarter offered a remarkable demonstration of how quickly markets can move between economic regimes. War in the Middle East threatened one of the world's most important energy arteries; oil surged before collapsing as the Strait of Hormuz reopened and diplomacy seemingly returned. Global equities recorded their strongest quarter in six years as investors rushed back into semiconductors as the AI-hardware trade reaccelerated. Brent crude ultimately fell 38% during the quarter, while Nasdaq gained more than 20%.

This was not the triumph of one economic regime. It was evidence of how violently markets can migrate between them.

What is increasingly clear, is that:

Energy is no longer merely a commodity input. It is becoming the physical foundation of sovereignty, industrial competitiveness and artificial intelligence.

Security is no longer merely a discretionary defence budget as it encompasses grids, cyber networks, semiconductors, critical minerals and supply chains; and

Geopolitics is no longer background noise as it increasingly determines where capital is invested, what it costs and whether it can cross borders at all.

This is the central argument in a recent thematic whitepaper we wrote, Security: The New Sustainability.

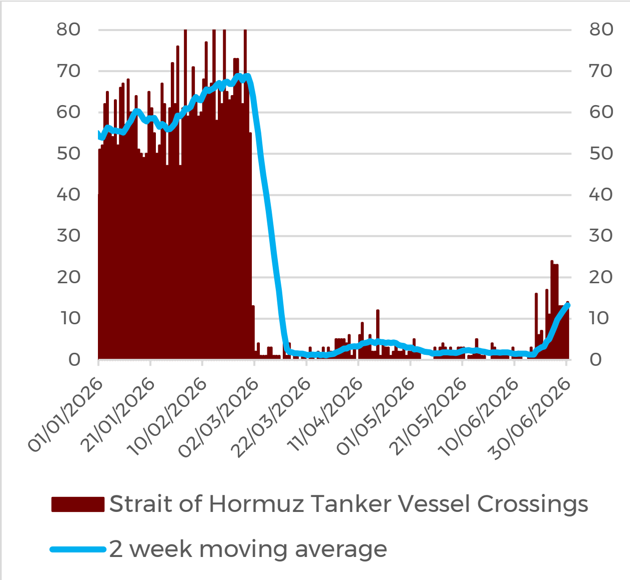
The world is moving away from systems optimised for efficiency and towards systems designed for resilience. Energy security, cybersecurity and national defence are converging into a structural, multi-decade capital cycle supported by necessity rather than optimism.

This also led us to conclude that in a world where we 'de-globalise', power inherently comes from controlling what others cannot easily replace.

"THE STRONG DO WHAT THEY CAN, AND THE WEAK SUFFER WHAT THEY MUST." ~ THUCYDIDES

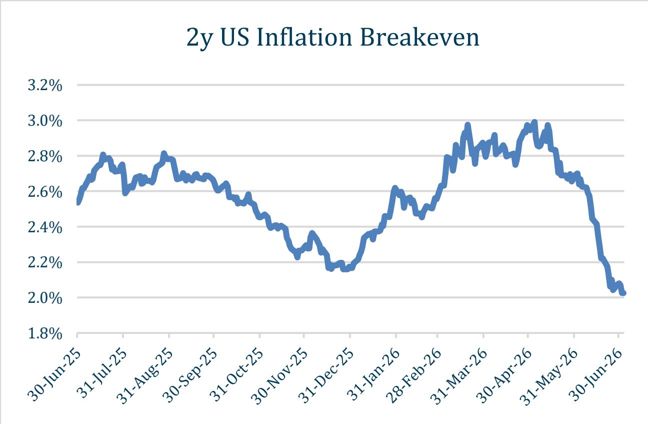
Iran demonstrated the leverage embedded in an energy chokepoint. China derives leverage from manufacturing scale, critical minerals and its position in Asian trade. The United States retains extraordinary power through the dollar, capital markets, technology and security guarantees. Europe is attempting to buy back its strategic autonomy through defence, infrastructure and energy investment.

Exhibit: *Vessel crossings through the Strait of Hormuz have started to normalise.*



Source: *Bloomberg L.P., Shard Capital, 24/06/2026*

Exhibit: *Declining oil prices have resulted in a sharp fall in inflation expectations.*



Source: US *Federal* Reserve, Shard Capital, June 2026

The sharp decline in inflation swap and breakeven rates has been a key driver behind the rally in equity markets, which continue to broaden out as sentiment and FOMO take hold.

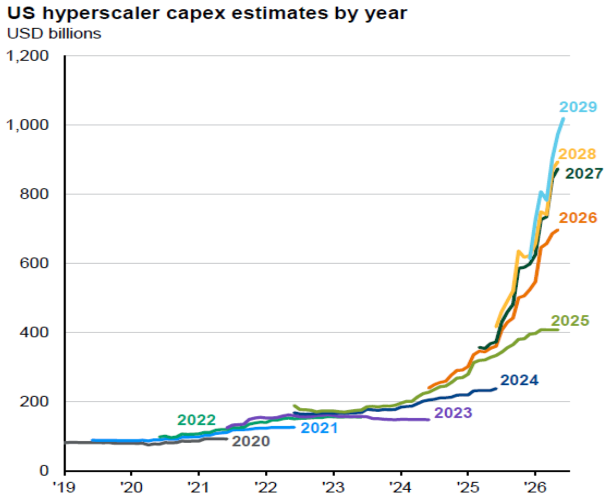
AND THEN THERE WAS AGI, THE SINGULARITY, AND THE PROMISE OF ABUNDANCE.

Artificial Intelligence sits at the intersection of these themes. It is a form of productive leverage, allowing the combination of knowledge and capital to generate greater output and a future of abundance.

Yet the infrastructure required to deliver that productivity — data centres, electricity generation, cooling, grids and semiconductors — is intensely physical and capital-hungry.

A key question market participants are asking is whether the high-margin, capital-light business model is becoming a thing of the past. Indeed, network effects and subscription-based software business models are increasingly being priced as if they are.

Exhibit: *The below chart shows US hyperscaler capex estimates by year. In the absence of significant revenue growth, the return on these capital expenditure plans looks increasingly uncertain.*



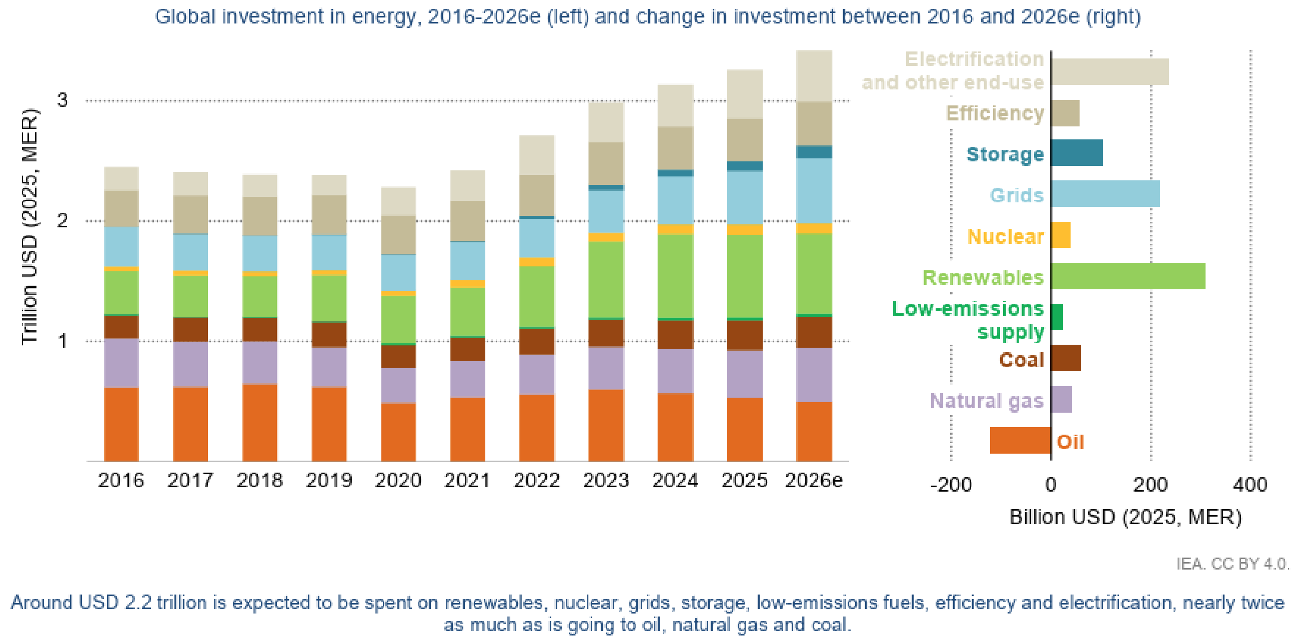
Source: *FactSet, J.P. Morgan Guide to the Markets – UK, June 2026.*

Hyperscaler capex includes Alphabet, Amazon, Meta, Microsoft and Oracle.

Increasingly, it is also debt-funded. The BIS notes that the scale of anticipated AI investment is forcing companies to migrate from internal cash-flow financing towards debt and private credit. History shows that genuine innovations, from railways to the internet, can attract considerably more capital than the eventual commercial returns justify.

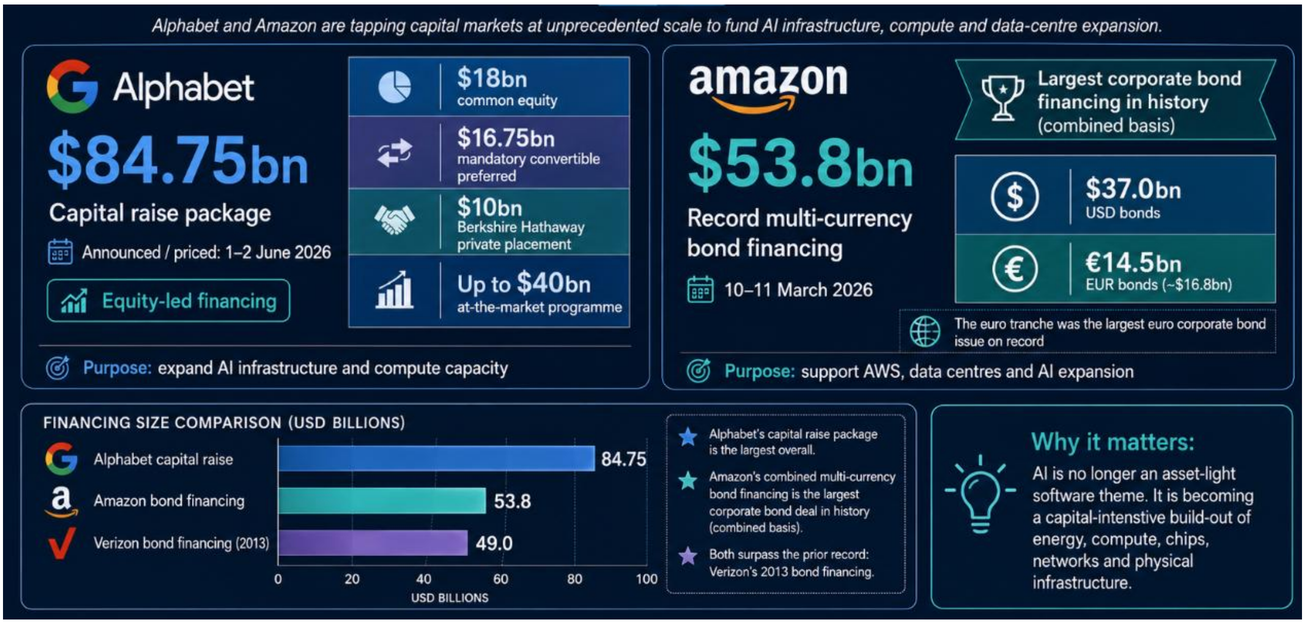
WHILST GOVERNMENTS CANNOT PRINT ENERGY, THEY CAN PRINT MONEY.

Exhibit: *Energy Investment continues to grow since the arrival of ChatGPT and the breakout of regional wars in 2022, growing to USD 3.5 trillion in 2026 amid economic and geopolitical uncertainty.*



Source: IEA.org, *https://www.iea.org/reports/world-energy-investment-2026, June 2026*

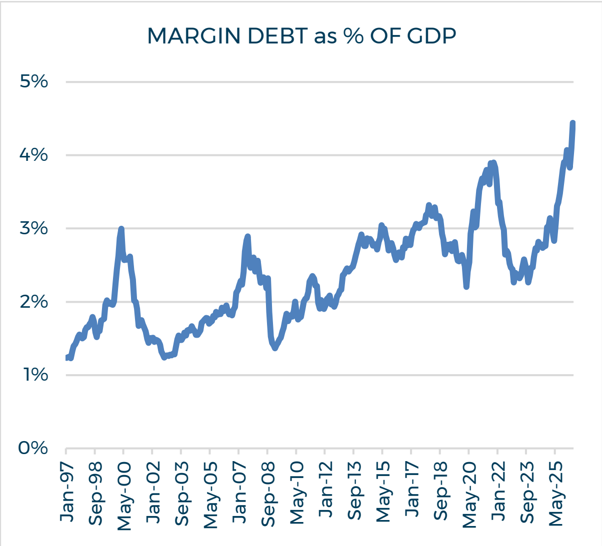
Exhibit: *The AI Financing Arms Race: Alphabet and Amazon have tapped capital markets in unprecedented scale to fund their AI ambitions.*



Source: *company filings, Bloomberg, Reuters, BIS, FINRA, Shard Capital, June 2026*

Financial markets are leveraging the same narrative. US margin debt reached $1.416 trillion in May, 54% higher than a year earlier. Assets in leveraged US exchange-traded products have approximately doubled to $200 billion, primary dealers' equity-repo exposure has exceeded $220 billion, and hedge-fund gross equity exposure is estimated at around $10 trillion. Much of this leverage is concentrated in technology and semiconductors.

Exhibit: *Margin Debt as a percentage of GDP has reached all-time highs as investors and speculators back the AI trade through derivates and leveraged products:*

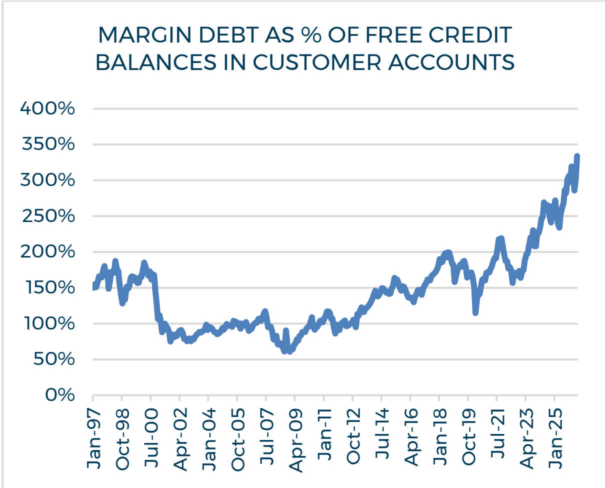


Source: *FINRA.org, Shard Capital, June 2026*

Rising prices increase collateral values, attract passive flows and create additional financing capacity. But the mechanism reverses when prices fall. Leveraged ETFs reduce exposure, margin calls force liquidation and more expensive financing causes investors to retreat. A fundamental AI story can therefore become a financial reflexivity story.

More importantly however, this investment cycle is arriving in the early stages of what we call The Fiscal Age: an era in which ageing populations, welfare-state obligations and political incentives produce structurally large deficits, leaving monetary policy increasingly subordinate to fiscal needs.

Exhibit: *Margin Debt as a percentage of free credit balances in customer accounts – cash and securities – continue to push upwards:*



Source: *FINRA.org, Shard Capital, June 2026*

WE WOULD ADMIT, LEVERAGE IS NOT A CATALYST FOR A DECLINE. HOWEVER, IT IS THE ACCELERANT.

Governments have effectively leveraged future tax revenues to preserve present stability. The most likely path forward is not an outright default, but recurring financial repression, inflation volatility and currency devaluation.

To highlight this, we need to look no further than our local economy here in the UK.

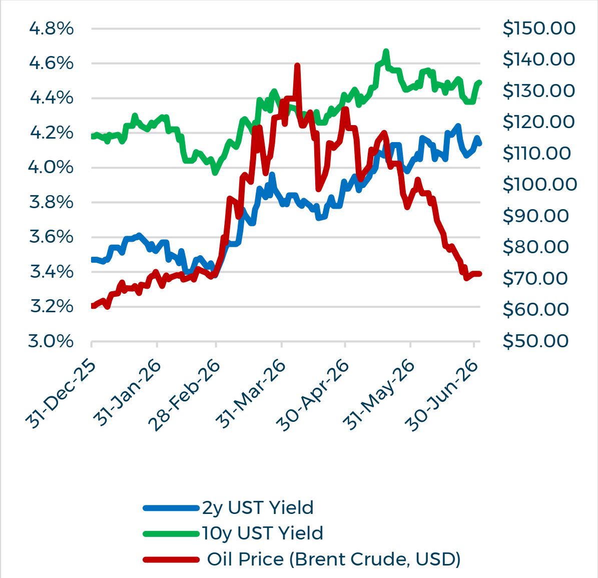
The UK faces a particularly difficult credibility problem. Weak productivity limited fiscal flexibility and repeated policy reversals have made gilt investors increasingly sensitive to both political instability and long-term debt sustainability.

The UK is in dire need of growth, better and more open immigration policy, and a society backing and supporting a long-term vision that will work for everyone

Across the Atlantic, the US is running one of the largest peacetime fiscal deficits on record. The CBO projects a $1.9 trillion deficit, equal to 5.8% of GDP, in 2026, with rising interest costs pushing debt higher throughout the coming decade.

It is difficult to see why term premia should not rise.

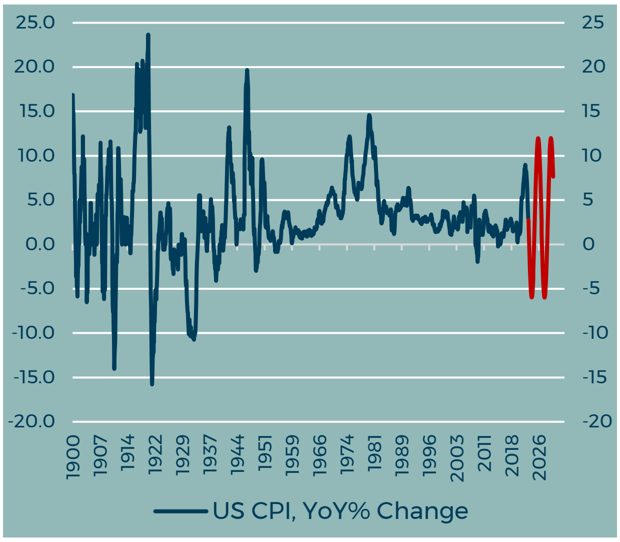
Exhibit: *Whilst oil prices are down significantly, treasury rates remain elevated. This is either because the market is expecting oil prices to go back up – which is unlikely given the fall in inflation breakeven rates – or term premia are rising.*



***Source**: Federal Reserve of St Louis, Shard Capital, June 2026*

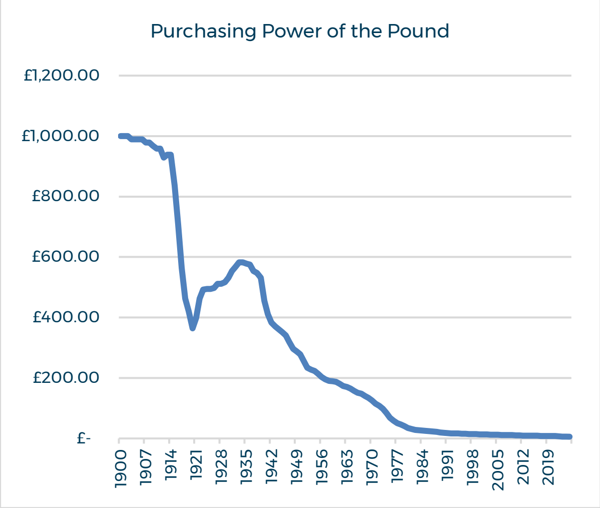
THIS IS WHAT MOST MARKET PARTICIPANTS REFER TO AS THE 'DEBASEMENT TRADE'.

Exhibit: *A direct consequence of our thesis behind The Fiscal Age is the inevitability of financial repression: more money supporting ever growing spending needs. Alongside aging demographics and new technologies, the outlook for inflation is uncertain and volatile.*



Source: *US Bureau of Labour Statistics, http://www.bls.gov/cpi/, Shard Capital, 29/01/2023*

Exhibit: *The UK pound has suffered a 99.4% decline in purchasing power as a result of UK inflation. Between the start of World War 1 and 1920 alone, it fell 35% against the US dollar as it lost its status as the global anchor. This is the reality of fiat currencies, and the future of the US Dollar.*



Source: *UK ONS, Shard Capital, 30/06/2026*

Government policy response over the next twelve to eighteen months will likely differ considerably by region.

Crucially however for inflation, is that market expectations have not yet become unanchored. US five-year and ten-year breakeven rates ended June close to 2%, as did five-year inflation expectations five years forward. Markets are pricing a shock, not yet a regime change.

The danger comes if governments repeatedly socialise energy costs while maintaining large structural deficits.

ONE SUPPLY SHOCK CHANGES THE PRICE LEVEL. REPEATED SHOCKS COMBINED WITH FISCAL ACCOMMODATION CHANGE THE INFLATION REGIME.

We are not yet in full fiscal dominance. But the direction is clear: central banks are increasingly forced to accommodate political commitments they did not make.

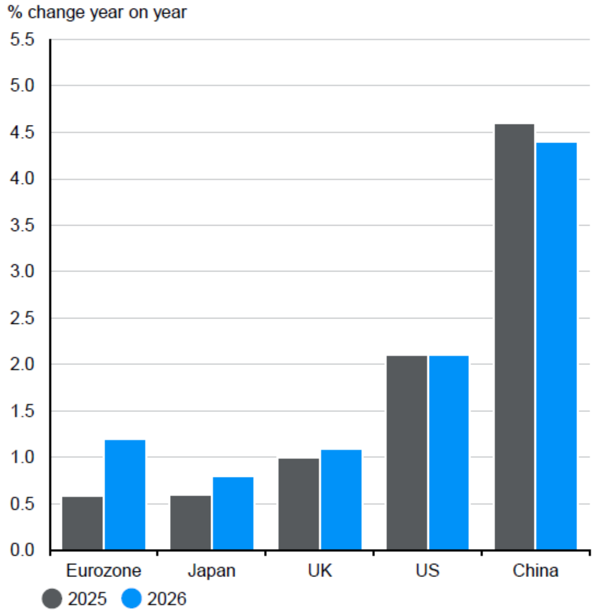
Nominal GDP can be increased through leverage and debt creation. But sustainable real growth ultimately requires only two things: more workers or greater productivity.

The labour force in most western economies is in decline. This leaves AI and automation as the principal hope for improving living standards while labour forces shrink. The opportunity is enormous, but as discussed, so is the risk of financing tomorrow's productivity with today's leverage.

"STABILITY IS DESTABILISING." ~ HYMAN MINSKY

So, our base case is that the energy shock fades sufficiently to prevent a global recession, but not quick enough to restore the benign disinflationary environment markets enjoyed before the Iran conflict. The OECD expects global growth to slow to 2.8% in 2026, including approximately 2.0% in the United States, 0.9% in the UK, 0.8% in the euro area, 0.6% in Japan and 4.5% in China.

Exhibit: *Consensus forecasts for Real GDP growth:*

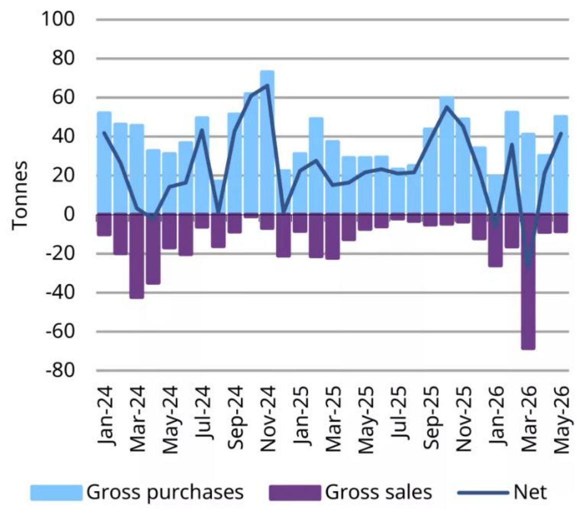


Source: *Bloomberg L.P., J.P. Morgan Guide to the Markets – UK, June 2026.*

For portfolios, industrial commodities should benefit from AI infrastructure, grids, defence and reshoring, although they remain vulnerable to a cyclical slowdown. Managed futures are particularly valuable because they can participate in commodity trends without requiring a permanent bullish forecast.

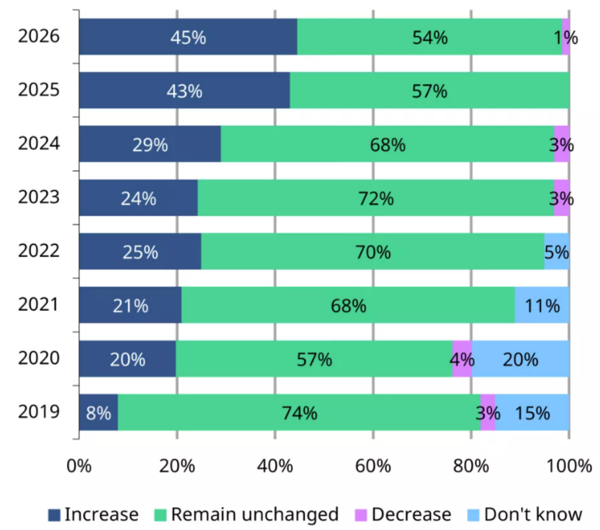
Gold's sharp correction during Q2 does not invalidate its strategic role. Gold is not merely an inflation hedge; it is protection against fiscal dominance, negative real rates and declining trust in sovereign promises. Inflation-linked government bonds offer more direct protection against realised inflation, while gold protects against the failure of the monetary architecture itself.

Exhibit: *Central Bank gold purchases remain positive:*



Source: *IMF, respective central banks, World Gold Council, June 2026*

Exhibit: *And expected purchases are at record highs:*



Source: *IMF, respective central banks, World Gold Council, June 2026*

CONCLUSION

Through our Permanent Portfolio and economic-regime lens, Q2 was not one market environment — it was all four regimes compressed into a single quarter. AI productivity and the promise of digital abundance powered the Deflationary Boom. Defence, infrastructure, electrification and the rebuilding of sovereign resilience strengthened the Inflationary Boom. The energy shock reminded investors how quickly physical scarcity can drag markets into an Inflationary Bust. And beneath the surface, record margin debt, leveraged products and reflexive flows left one uncomfortable truth: the most likely path into a Deflationary Bust is not necessarily a recession first, but a reversal in financial leverage that turns optimism into forced liquidation.

The greatest risk is not that inflation, growth, recession or productivity dominates forever; it is that investors build portfolios as though only one outcome is possible. The Permanent Portfolio is not a forecast that all assets will rise together. It is an admission that the same leverage capable of financing extraordinary technological progress can also make regime transitions violent, nonlinear and impossible to time. In a world where abundance depends on energy, security depends on supply chains, and markets depend on borrowed conviction, diversification is not caution — it is survival.

CONTACT US

For further information on any of our services, or if you would like to arrange a meeting with an investment manager to see how we can work with you, please get in touch.

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