

Caution Demands Investors' Attention

July 30, 2026

Both equity and fixed income markets have exhibited considerable volatility, domestically and internationally, over the past twelve months. On the equity side, the S&P 500 decline in the first quarter of this year was the worst quarterly loss in the past four years. That was followed by the best equity gain in the past six years in the second quarter. From the S&P's all-time high on June 2, most stocks and stock indexes have declined through June and July.

Many international equity indexes have likewise shown dramatic instability. The prime example is the South Korean Kospi index, which is most heavily influenced by AI-driven memory chipmakers, specifically Samsung Electronics & SK Hynix, which account for over 50% of the index weight. That index more than doubled in the first half of 2026. In the past month, however, the index gave up more than a third of its value. As I write in late July, that index suffered a 10.8% loss last night.

The fixed income market, while not as volatile as equities, has suffered poor performance far longer. In fact, the Bloomberg U.S. Aggregate Bond Index has endured a small negative total return over the span of the past six years, the longest declining market in U.S. history. Because I anticipated rising interest rates, which has led to the long-term negative total return, apart from legacy equities I have kept portfolios almost exclusively in short-term U.S. Treasury securities earning just under an annualized 4%, almost exactly equal to the historically average yield on such securities. There is good reason to expect those and longer yields to move even higher over the next several months.

Some leading figures in the field of finance are issuing serious warnings about interest rates and fixed income securities. Jamie Dimon, CEO of J.P. Morgan Chase, the world's largest bank by market capitalization, believes a bond market crisis is looming. He particularly worries about the risks to private credit. Howard Marks, co-founder and co-chairman of Oaktree Capital Management, points to a great many bond maturities coming in 2027 and worries that a significant number of companies will be unable to refinance in the prospective high interest rate environment. Mohamed El-Erian, chief economic advisor at Allianz SE and one of my favorite economic commentators, sees the economy facing a looming capital crunch as corporations and governments prepare to tap markets for massive amounts of funding in coming months. He is uncertain where capital will come from to meet the demand for tech companies, AI infrastructure investments and government debt refinancing. He anticipates that the bond market can't meet those massive funding demands without pushing interest rates higher. Should these forecasts for higher rates be realized, I would expect broad negative

implications for financial markets, mortgage rates, corporate borrowing costs, equity valuations and overall economic activity.

What positive factors could lead to a more favorable economic and securities market outcome? The domestic economy has remained resilient, avoiding recession, but the second quarter GDP has just been announced as 1.5%, down from the prior quarter and well below the 3.2% long-term U.S. average. The main hope is that AI will deliver on the promise that is anticipated. So far, most of the money has been made by the builders of AI systems. There has been little profit made to this point through the employment of AI services. Several analysts have also recently begun to question whether depreciation and operating expenses will soon begin to cut significantly into the projected profits of the hyperscalers that have been responsible for almost all corporate profit growth in recent quarters.

Compounding the problem of just modest economic growth, debt levels have expanded dramatically throughout the world. Former governor of the Bank of France, Jean-Claude Trichet, warned: "The debt outstanding, as a proportion of GDP, public and private, is higher at the moment than just before the collapse of Lehman Brothers. The market is way too calm given the risks that exist out there."

Last month, Pimco warned that: "The credit loss cycle is upon us." The firm expects "significantly higher losses in lower quality credit, such as leveraged and private direct lending." Pimco highlighted "increased instances of maturity extensions and payment-in-kind structures that allow borrowers to repay debt with more debt." The country "remains on an unsustainable trajectory under current policy, which continues to kick the can down the road."

Just this month, federal debt reached \$40 trillion. Annual deficits are now near \$2 trillion. Interest to service that debt is now the second-largest budget item. Even if the economy should deteriorate and fall into a recession and inflation decline, it is likely that most interest rates will head higher.

On top of interest rates, several other concerns cloud the picture for future investments.

The mid-east war and its effect on world oil supplies and inflation are in the news daily. Warren Buffett has called the stability of the banking system into question. We're seeing such late-cycle phenomena as a flood of insider selling and the registrations of initial public offerings (IPOs). And there are historically high levels of concentration in AI-related and high-tech companies. Buffett has also recently expressed his views on investor speculation, saying: "We have never had more people in a gambling mood than now....It's tough to find values when everybody is preferring gambling." Most of these conditions have been seen leading up to the major stock market declines of the past century.

Just last week, J.P. Morgan Chase's Jamie Dimon summed up his concerns, saying that investors are underestimating the risks facing the global economy, and that he would not buy either equities or long-dated U.S. Treasuries at current prices. He believes that markets are not fully accounting for the growing list of geopolitical and fiscal threats: wars in Ukraine and the Middle East, tensions between the U.S. and China, and rising military spending in a time of mounting government deficits.

In the last few weeks, the legendary Jeremy Grantham characterized the current equity market as "*the most expensive in history*." That consideration of valuation is to me the most important intermediate to long-term determinant of whether to be bullish or bearish toward equities. In a study I did last year, I profiled the major stock market peaks and troughs since the 1930s. Today's valuations are far, far above those at the major market troughs. In fact, current valuations are well above the average of the seven prior market peaks and are virtually at the level of the highest prior level, which preceded the nearly decade-long decline that left stock prices at about half the level of the 2000 peak in 2009. The average decline from each of the valuation peaks was 40%. On average, the decline took away nine years of prior market gains, and it took an average of 9.8 years to permanently exceed the prior high.

Does the collection of these many factors necessitate an imminent equity market decline? Of course, not! The powerful momentum generated from belief in the glorious potential of AI can continue indefinitely. Excessive valuations can become more excessive. No valuation peaks even close to today's, however, have ever gone unpunished. That does not mean that one can't. It can always be "different this time." I am a firm believer, however, in betting on theprecedented rather than the unprecedented. And, while AI is undoubtedly a revolutionary technological advance, is it more important than such prior advances as railroads, harnessing electricity, the inventions of radio, television, the computer, or the internet, several of which have been essential to the development of AI? Markets rose to extremes with the development of each of those epochal advances. In every prior instance, however, markets eventually declined in price to reach levels of historically normal valuation, often to levels below average valuations.

The enthusiasm for the advances in AI and its prospects is receiving far more publicity than the concerns I have outlined here. The prudent investor should weigh both positive and negative factors carefully.