For professional investors only

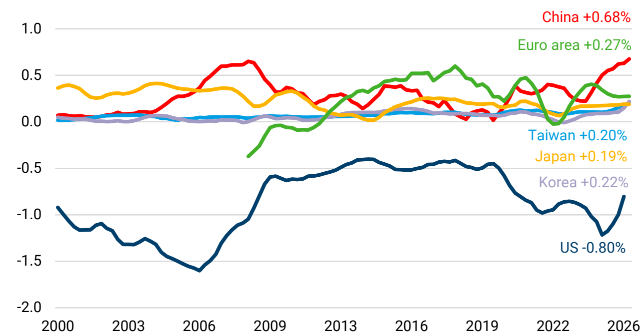
Monthly Commentary

August 2026

Rising Imbalances

With the release of the IMF's latest annual External Sector Report on July 30th, we receive confirmation from the 'experts' in the room that imbalances are indeed growing. The report titled 'Amid Rising Imbalances, the Case for Rebalancing' follows the 2025 release where global current account balances were 'projected to narrow over the medium term.' We add the latest Q2 data, except for the US (still at Q1) which shows balances widening after the release of the report.

Current Account Balances, trailing 4 quarters as % of World GDP



Source: Refinitiv Datastream

China's surplus has been a source of the error and at 0.68% of World GDP is higher than its pre-GFC peak. Korea's June surplus hit a record $49.7bn, roughly 4 times its level last year. At 0.22% of World GDP, Korea has leapt past Japan and Taiwan to become Asia's second largest surplus. Taiwan, at 23.6% of its own GDP, is running an extreme domestic imbalance tied to the AI investment boom.

The US deficit has narrowed from 4.7% of GDP in Q1 2025 to 3.1% on a trailing four quarter basis. The initial decline was largely due to a rush of gold imports and tariff front-running which unwound in the subsequent quarters. The latest goods balance data released this month however shows the goods deficit plunging again to its lowest level since March 2025 as computers, semiconductors and other data center related hardware imports surged.

This comes after the Supreme Courts February ruling that IEEPA does not grant the President power to impose tariffs. Most of the tariff revenue pool generated last year has been approved for refunds. The striking down of duties not only removes the import suppression that contributed to the improvement in the current account, but refunds deteriorate the fiscal picture further.

President Trump remains determined to conduct trade policy through the implementation of tariffs. Talks with its second largest trading partner, Canada, broke down again this month with the President declaring 50% tariffs on $20bn of Canadian goods. Prime Minister Carney declared that 'we got attacked' and has promised to match them dollar for dollar from the 8th of September.

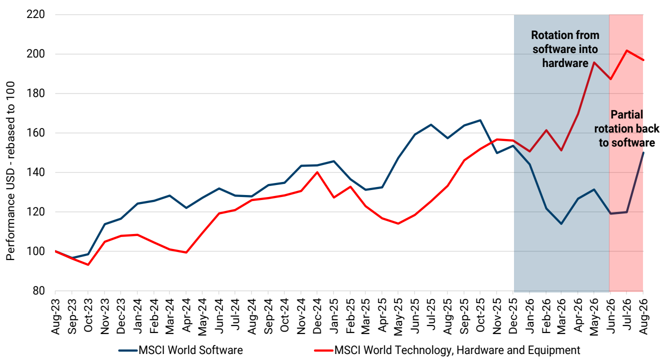
Amidst the debates (see Druckenmiller vs Miran this month) on the causes of rising long term bond yields across the board, the IMF does bring up an important point. This is not a 2008 story. In the 2000s growing current account balances 'coincided with falling real interest rates, reflecting a faster increase in saving…In the current episode…global balances have widened alongside rising real interest rates, as saving has declined more than investment.' Real interest rates did end up squeezing the cycle in 2008 with 5-year real yields peaking at 2.764% in June 2007.

The efforts by Scott Bessent this month to tame the long end were unrewarding as expected. The US faces a growing savings-investment imbalance. Reckless deficit policies over the last 5 years are now crowding out the financing of the AI investment boom.

Tech Rotation

Since the turn of the year, the technology sector split in two. Capital rotated aggressively out of software and into AI hardware — semiconductors, memory and data-centre systems — as investors favored the order-backed cash flows of the AI build-out and grew fearful that agentic AI would erode the value of traditional software.

That trade peaked around mid-2026. Since late June there has been a partial rotation back into software, driven by extreme relative valuations, resilient software fundamentals, and recognition that the market had painted the whole sector with too broad a brush.



Source: Refinitiv Datastream

What drove the rotation back?

Valuation extremes reversed. With software having derated and some names at trough valuations, the risk / reward has flipped.

The threat of AI-disruption overshot. Disruption risk is highly differentiated: incumbents with proprietary data, deep workflow integration, regulatory/compliance entrenchment and “system-of-record” status can adopt the very AI tools that were seen as threats.

Fundamentals reasserted. Software names reported solid fundamentals. At the sector level, return on equity has remained within the 22-23% range for the last 12 months. Recurring revenue remains strong and has underpinned durable margins.

M&A set a valuation floor. Reports that Silver Lake was in talks to acquire Workday acted as a floor signal for the sector; software names rallied on the read-across.

Semis looked over-extended and cyclical. After enormous runs, chip valuations discounted continued growth with little allowance for the sector’s inherent cyclicality, while software’s scalable, subscription economics screened as higher quality.

The bottom line is that AI is reshaping software, not extinguishing it. The sell-off reflected fear of the sustainability of business models more than confirmed fundamental deterioration. As the hardware premium unwinds and software quality reasserts, the leadership baton is passing back — but selectivity, moat quality and monetization of the AI investment cycle will determine how far the reversal runs.

Pyrford International
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