BLUE GRANITE CAPITAL, LLC

INVESTMENT COMMENTARY, JULY 2026

Beyond the Headlines

We are all a bit exhausted by the relentless focus on the "Magnificent Seven" and Artificial Intelligence (AI). Yet, given their ubiquitous role in shaping both the stock market and the broader economy, they warrant a deeper look.

Over the past three years, equity markets have staged one of their strongest runs in recent history. Strong corporate earnings, sustainable economic growth, persistent capital inflows, and the transformative potential of AI have propelled market gains—outweighing headwinds from elevated interest rates, persistent inflation, geopolitical instability, and an unpredictable international trade environment.

The AI Landscape: Evolution and Obsolescence

While AI was initially seen as a rising tide that would lift all corporate boats (earnings), the market has become far more discerning over the past 12 months. Investors are actively separating the true beneficiaries from companies at risk of disruption. A significant portion of the software sector, along with select companies in travel, consulting, and finance, has faced notable pressure under what markets are calling the "AI Obsolescence" trade.

Meanwhile, investment in data centers and related infrastructure remains immense. AI-related capital expenditures are approaching $1 trillion, acting as both an economic engine and a primary market catalyst. For instance, tech giants like Alphabet, Amazon, Microsoft, and Meta are projected to spend roughly $725 billion on capex in 2026 alone—a 77% year-over-year increase. While this spending supported strong Q1 blended earnings growth of 27.1%, Wall Street is growing cautious. Investors are increasingly evaluating whether these massive capital investments will deliver a compelling return on investment, particularly if spending outpaces operating cash flows.

Market Leadership and the Value of Diversification

The Magnificent Seven dominated headlines and portfolio returns for several years, but as we have said many times, owning a concentrated basket of seven mega-cap stocks is not a sustainable long-term strategy. Year-to-date, we have witnessed a significant market rotation. While mega-cap technology has cooled and top holdings have experienced pulled-back valuations, market leadership has broadened into semiconductors, industrials, healthcare, financials, and consumer sectors. Crucially, recent mega-cap weakness has not dragged down the overall index, as leading stocks in other sectors have rotated into favor and picked up the slack with a nice rally of their own.

The companies within the Magnificent Seven remain exceptional, dominant industry leaders that belong in a well-curated portfolio, and we continue to own them. However, pairing them with high-quality, non-correlated businesses across defense, banking, healthcare, manufacturing, and retail reinforces our commitment to true diversification. This approach mitigates market risk and smooths volatility without sacrificing portfolio growth.

Economic Headwinds and Macro Risks

Despite market resilience, several macro risks require disciplined monitoring. Recent spikes in oil prices—driven by geopolitical tensions and supply channel friction—have pushed CPI (inflation) higher, presenting a renewed challenge to economic growth. At the same time, the personal savings rate has compressed significantly, signaling potential tightening in consumer spending down the line and which has historically represented 70% of the total economy. Furthermore, while AI-driven capital expenditure was a major contributor to recent GDP performance, broader economic measures show signs of moderation, highlighting a growing divergence between technology investment and general economic activity.

Looking Ahead

Navigating volatile markets requires balancing enthusiasm for transformational trends like AI with a grounded risk-management framework. While mega-cap leadership may fluctuate, market dynamics are expanding opportunities across multiple sectors. By staying disciplined, focusing on strong balance sheets, and maintaining broad diversification, our portfolios remain well-positioned to navigate near-term economic friction while capturing long-term capital appreciation. We are pleased to report that your portfolio is benefiting from this strategy.

Thank you for your continued trust and partnership. We hope that you and your family are enjoying summer.

Warmest regards,

Scott & John