UPSIDE DOWN?

The Strait of Hormuz is open again, at least for now. Oil prices have plummeted. Hopes abound for a continued ceasefire between Iran and the US, even if obstacles remain to a lasting peace in the region. Yet equities are not celebrating the good geopolitical news. Instead, the week opened with a sharp drop in most things AI-related, which left US equities down as June draws to a close. Other markets experienced significant volatility – notably, Korea and Taiwan, which had been buoyed by enthusiasm for inputs into AI.

Investors may have been buying on the rumor of peace and selling on the fact: it had become clear during June that President Trump did not want to pursue further conflict and was keen to get oil and gas flowing again. Or perhaps it was just time for a breather after an extraordinary run-up.

Two other factors affected market sentiment: new leadership at the Federal Reserve, with Governor Kevin Warsh interpreted as being unexpectedly hawkish at his first press conference this week, and growing evidence of the enormity of the coming cash flow needs of tech companies. A reminder of these needs came with SpaceX's decision to raise a significant amount of debt less than two weeks after tapping equity markets for $75 billion in the largest ever IPO, which valued the company at nearly $2 trillion – a milestone.

Looking ahead, RockCreek sees the following themes for investors to watch:

1. Thematic trading and volatility. Investors have moved into and then out of specific sectors – AI-related and other, crypto, gold – giving the impression of heightened volatility, although the overall VIX is not unusually high, at 19.

2. Inflation and interest rates. Governor Warsh largely avoided giving clues to his views after his first meeting as chair in June. But the statement was starkly clear on one point: the Fed "will deliver" price stability. It is possible that the new Governor is hoping a stronger tone on inflation will push market rates higher without the need for an actual policy action. The US is still far from the 2% inflation goal, and getting there may require monetary tightening. This week's PCE, which has been the Fed's preferred measure, continued to be significantly above the Fed's 2% target. It was, however, in line with market expectations, so not a make-or-break number.

3. Power needs and heatwaves. Record high temperatures have swept across Europe, causing France to close the Eiffel Tower to visitors and London to threaten closure of the London Eye attraction. Climate change is forcing its way on to the agenda for governments and power companies – at a time when power-hungry data centers are upsetting some US consumers.

The disconnect between geopolitics and equities is not new. Until recently, it went in the other direction: US and global stocks continued to march higher even as the world became more troubled. The reason: hopes for transformative AI and an associated boom in investment outweighed concerns about a pull back from the globalization that has buoyed company earnings and profits for

decades. The rapid run-up in stock prices has now pushed US equity market capitalization to an astonishing total of nearly $100 trillion: close to three times US GDP. As noted by RockCreek Senior Advisor and author, Liaquat Ahamed, in discussion with CEO Afsaneh Beschloss of his latest book *1873: The Rothschilds, the First Great Depression, and the Making of the Modern World*, this is far above earlier levels, including the dotcom boom and pre-GFC.

Enthusiasm for AI remains rightly high. Over time, the innovative technology will deliver broad productivity gains. Indeed, as Harvard economist Jason Furman pointed out earlier this month, productivity for this cycle is already running well above the post-1973 average (with the exception of the dotcom period). Expected outperformance in productivity and profits is underpinning today's equity valuations. But user companies are becoming more concerned about costs of employees trying out large language models (LLMs). And investors wonder if competition among AI innovators and among those providing inputs will whittle away profits. There is no clear winner in the race to improve AI; much is riding on the brainpower of individuals in the major firms. Alphabet shares were hit hard this week following news that key research engineers were leaving for competitor startups Anthropic and OpenAI.

Political battles over tech use of electricity and power are becoming more widespread. The Virginia legislature this month passed a special tax on data centers, based on their electricity use. The proceeds will be paid into the state's general fund to help offset costs of upgrading the grid. This is a notable reversal from the days when states, including Virginia, competed to offer tech – and other – companies incentives to locate within their borders. The political pressure is not all one-way, however. In a concession to tech firms, revenues in the Virginia scheme were capped at $600 million.

Expect the pressure to resist data centers to mount as household electricity bills in many jurisdictions rise and communities complain about the sight of massive buildings appearing in farmland. Is conventional wisdom about the likely rise in electricity prices wrong? Research publicized by the American Enterprise Institute suggests that it may be. The electricity grid in the US – and many other advanced economies – is in need of upgrading to improve efficiency and resilience as well as to provide for new demand related to compute. The latter may be a way to provide the revenues needed to offset the huge fixed costs inherent in electricity systems, allowing for needed upgrades and economies of scale that will benefit all customers.

MONETARY POLICY: REGIME SHIFT

Kevin Warsh held his first meeting as chair of the Federal Reserve, the nearest thing to a global central bank, just a week before the passing at the age of 100, of Alan Greenspan, one of the most influential Chairs of the Federal Reserve, nicknamed the Maestro, and a valued and much loved Senior Advisor to RockCreek for 20 years and a member of its Advisory Board. Warsh, who has often highlighted Alan Greenspan's policies, made clear that he planned to change the way the Fed works, announcing five task forces to examine key areas of the Fed's operations and recommend changes if needed, and making an immediate change in communications. The latter brought reminders of the Greenspan Fed, when transparency was not the goal. Indeed, Greenspan, once, famously remarked "If I turn out to be particularly clear, you've probably misunderstood what I said."

The new chair chose not to add his mark to the "dot plot" that senior Fed officials use to indicate where they see interest rates going in coming months. He also kept the FOMC policy committee statement short and simple. Some parts of the new direction are clear: the commitment to price stability and to less talk. Less talk can also leave markets and analysts with more uncertainty. It will take a while before Warsh makes his direction clear.

Other advanced central banks shifted more decisively in June. The European Central Bank raised rates for the first time in nearly three years. The Bank of Japan also moved upwards, although this still leaves rates well below inflation. Both issued hawkish forward guidance given lingering inflation pressures.

BREXIT AT 10: DANGERS OF GOING IT ALONE

The voters who chose to leave the EU in 2016 ushered in a decade of political instability. There have been six prime ministers in the past ten years. Compare that to the longevity of Margaret Thatcher (11 years) and Tony Blair (10 years). There will now be a seventh. British Prime Minister Sir Keir Starmer stepped down on June 22. It had become clear that he had lost the confidence of his Labour party just two years after winning an outsized parliamentary victory. His likely successor, Andy Burnham, may wonder how to avoid the fate of his previous six predecessors. A majority of Britons now regret the move to sever ties with their closest trading partner. Is that a lesson for other countries contemplating lessening trade ties, including the US, as negotiations begin on the USMCA with Canada and Mexico?

EQUITIES

Equity markets have turned choppier this month after an unusually smooth run. The S&P 500 had been positive in 11 of the prior 12 weeks, leaving investors looking for a reason to take profits. Traders appeared to be preparing for more volatility as well, with open interest in VIX call options relative to puts reaching its highest level of the year. The pressure was most evident in semiconductors, where lofty expectations, strong retail participation, and heavy inflows into levered ETFs left little room for disappointment. A familiar buy-the-dip mentality, supported by reassuring results from Micron, ultimately helped steady the market, but the episode highlighted how sensitive market leadership has become to any challenge to the AI narrative.

The key question is no longer whether artificial intelligence will be transformative. Investors have largely settled that debate. The more important question is how long today's extraordinary growth rates can persist. Strong earnings growth has so far prevented valuations from becoming as stretched as headline price moves might suggest, which may help explain why a more meaningful correction has yet to emerge. The risk is that expectations continue to move further into the future. Markets rarely struggle because transformative technologies fail to deliver; they struggle when investors overestimate how quickly those benefits can be realized.

There are also signs that enthusiasm is becoming increasingly speculative. Taiwan has become a useful barometer. According to Bloomberg, Taiwanese brokers have issued nearly $1.2 billion of bonds this year — roughly seven times the amount raised during all of 2025 — to fund investor demand for margin loans tied to AI-related stocks. Borrowing became so intense that it reportedly disrupted a central bank debt auction, a reminder that powerful investment themes can spill over into broader financial conditions.

Meanwhile, the industry's response to extraordinary profitability has been predictable: build more capacity. Reports that SK Hynix is pursuing a large U.S. listing highlight the scale of capital now flowing into AI infrastructure. Demand remains exceptional today, but history suggests that periods of supernormal returns eventually attract enough investment to ease shortages and pressure margins. The timing is impossible to predict, but it is difficult to imagine today's pricing environment persisting indefinitely.

Looking ahead, lower oil prices — assuming the Strait remains open — could become an underappreciated market catalyst. Beyond supporting consumers, lower energy costs would provide a disinflationary tailwind and potentially broaden market leadership. Rather than replacing

AI as the dominant theme, lower oil prices could create conditions for capital to flow into a wider set of cyclical and consumer-oriented sectors, resulting in a healthier and more balanced market backdrop.

FIXED INCOME

Fixed income markets were driven by the Federal Reserve so far in June. As mentioned above, the tone out of last week's FOMC meeting was particularly hawkish – and that spurred meaningful action in rates markets. Short term interest rate (STIR) markets saw some of the most drama. Expectations for a hike at the September FOMC meeting spiked from 39% to over 80% immediately following the statement release and closed around those levels for the day. As of writing, expectations for a hike are still above 70% in September, having been as high as 100% at the beginning of the week. Similarly, markets now fully expect a hike at some point by the end of the year, with a 20% probability we get a second 25bp hike between now and then.

This shift in policy expectations caused a flattening of the yield curve with rates rising through the five-year point, and the seven-to-30-year points falling month to date. The real curve flattened as well, with rises outpacing the moves in the nominal curve driving breakeven inflation lower. While some of the moves in nominal rates have retraced post-FOMC meeting, real rates remain elevated. This combination of real rates higher and breakeven lower generally reflects a belief that future rates will be sufficient to bring inflation down. This tends to have a dampening effect on risk asset performance. Current cross-asset performance is consistent with that pattern. Keeping an eye on this relationship between real and breakeven interest rates may prove a useful guide to the market's expectations regarding the appropriateness of monetary policy guidance and actions as the new Fed Chair works to rein in inflation.

Despite gyrations in the interest rate markets, bond markets remain open for business. The most recent demonstration of that is SpaceX's $25 billion debt issuance mentioned earlier. Despite being nearly three times oversubscribed, the issues are trading generally wider than the standard BBB rated borrower.

There are other signs of potential mild indigestion from investors, at least for specific issuers, as Oracle debt continues to trade much wider than its rating cohort. Moreover, Meta issues, particularly their longer dated maturities, are trading wider not only than its AA cohort, but beyond the BBB cohort as well. Despite this, others such as Amazon and Alphabet are trading closer to their rating averages. Overall, hyperscalers' spread level relative to similar issuers is certainly worth watching over time as it gives a clear indication of investors' forward looking expectations of the viability of their capital spending.