

Investment Strategy Insights:

Credit markets are funding more AI capex

- US reporting season has once again shown that US economic resilience is delivering for investors. Around 85% of companies that reported have beaten consensus EPS expectations. The percentage of beats was once again led by Information Technology (IT). Around 95% of stocks in the sector beat expectations, supercharged by the AI boom.
- Hyperscaler capex plans for FY26-FY28 were once again revised up. Analysts bumped up consensus capex estimates from \$US2.5 trillion to \$US2.8 trillion during this period. In a sign that the boom is maturing, capex is also becoming increasingly debt funded. Gross issuance over the next few years is rising and expected to peak at around \$US460 billion in FY28 or 33% of capex.
- The capex of the hyperscalers appears likely to deliver a return on capital over the next two years that will meet the historical average. However, it may fall well short of consensus expectations. A \$US610 billion lift in revenue over the next two years would deliver a 17.7% return on capital, which is around the long-run average. But at this stage, analysts expect revenue to rise by \$US908 billion.
- Public and private credit markets are increasingly funding more AI-related capex but also provide more scrutiny on the financial fundamentals of the borrower. Credit markets have a history of identifying turning points in markets well before equities, so it's worth noting that the CDS spreads of the hyperscalers have already widened even though gross margins and balance sheets appear solid. But as AI-related issuance continues to rise, credit spreads more broadly seem likely to widen as well. Over time this will likely impact equity performance.
- Debt issuance is broadening. AI-related debt issuance looks set to tap non-US dollar markets. Investor demand for datacentre project finance debt also has room to grow, given it is currently less than one third of all AI-related supply.

Messages from US earnings season

US reporting season has once again been strong. Around 95% of S&P 500 stocks have reported Q2 earnings, with 85% of those stocks beating analysts' EPS expectations. The IT sector has once again been the star performer, with 95% of these stocks beating expectations.

The AI boom is clearly driving IT earnings outperformance, but more broadly investors also need to monitor stock concentration, given the Magnificent Seven account for 35% of the market cap of the S&P 500. The results of the Magnificent Seven were mixed in Q2, with only three out of six companies, who have reported so far, beating expectations. Alphabet's miss was tempered by a small increase in Q3 earnings expectations, while Microsoft and Amazon's beats were enough to lift expectations for Q3 earnings. Tesla and Meta saw not only large Q2 misses but also downgrades to Q3 earnings.

Mixed earnings results for the Magnificent Seven

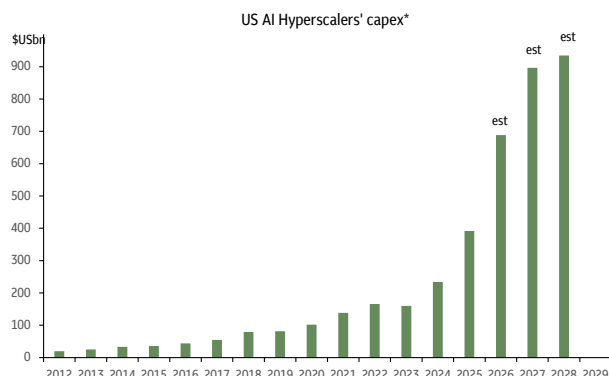
Stock	Sector	EPS \$US		
		Forecast	Actual	Q3 revision (%)
Microsoft	Information Technology	4.24	4.74	1.10
Alphabet	Communications services	2.91	2.85	0.20
Apple	Information Technology	1.89	1.91	-1.40
Meta	Communications services	7.22	6.18	-3.90
Amazon	Consumer discretionary	1.82	1.97	1
Nvidia*	Information Technology	2.09		
Tesla	Consumer discretionary	0.51	0.33	-15.00

Source: LSEG, MWM Research, August 2026. *Indicates yet to report.

During the past few months markets have become concerned about the size of the capex program of the hyperscalers. Capex becomes a step increase in depreciation expenses in the profit and loss statement that are spread over the economic life of the assets making it difficult to grow longer term earnings.

During the Q2 reporting season analysts raised capex expectations for the hyperscalers from \$US2.5 trillion in FY26-FY28 to \$US2.8 trillion. Over the two years from Q2 2026 capex is expected to be \$US 2.2 trillion.

Capex plans are rising



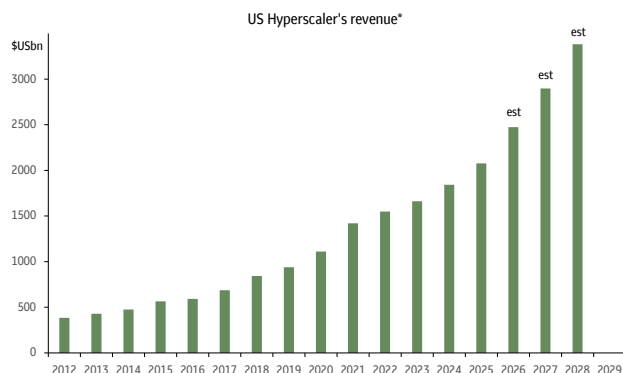
Source: LSEG, MWM Research, July 2026. * Hyperscalers include Microsoft, Apple, Google, Amazon, Oracle and Meta.

The Capex must deliver

Companies need to be confident that capex will deliver stronger revenue growth, and a strong return for shareholders.

During reporting season, analysts revised up their revenue outlook for the hyperscalers, with revenue now expected to increase from \$US2.1 trillion in FY25 to \$US3.4 trillion by FY28. The size of the revenue is put into some context, by the output of the Australian economy, which is around \$US2.1 trillion per annum.

Revenue payback expectations are rising as well



Source: LSEG, MWM Research, July 2026. * Hyperscalers include Microsoft, Apple, Google, Amazon, Oracle and Meta.

The lift in revenue, expected by consensus estimates, assumes an exceptionally strong return on capex. An acceptable return on capital could be delivered by just a \$US610 billion increase in revenue over the next 2 years (average of \$US551bn and \$US668bn at 62.1% gross margin), but this would fall short of consensus expectations of \$US908 billion.

Hyperscaler capex may deliver a good return but it may fall short of consensus

	Rate of depreciation (%)				
	5	10	15	20	25
Consensus capex over 2 years (\$USbn)					
Year 1	964				
Year 2	1196				
Δ assets from capex					
End year 1	916	867	819	771	723
End year 2	2006	1857	1713	1573	1439
Depreciation year 1	48	96	145	193	241
Depreciation year 2	106	206	302	393	480
Δ NPAT to deliver 17.7% ROIC					
191	268	342	415	484	551
Δ revenue to deliver Δ NPAT \$USbn)					
50% gross margin	536	685	829	968	1103
62.1% gross margin	432	551	668	780	888
70% margin	383	489	592	692	788
Consensus Δ revenue (\$USbn)					
	908				

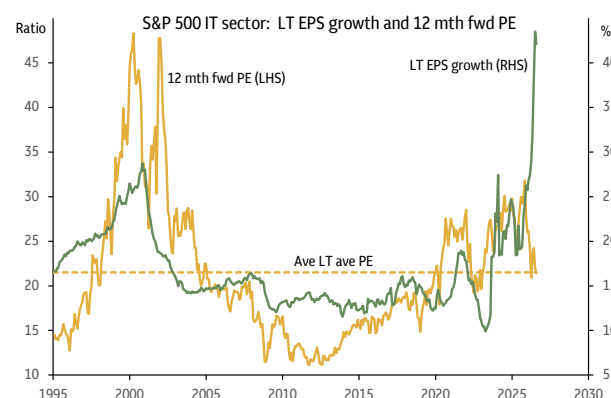
Source: LSEG, MWM Research, August 2026. A 17.7% ROIC is the capex weighted average ROIC for each stock over the past 12 years. A 62.1% gross margin is the capex weighted average gross margin of each stock over the past 5 years. A \$US610 billion revenue increase is the average assuming a 10% and 15% rate of depreciation highlighted in bold.

Robust revenue expectations also seem consistent with excessive longer-term earnings growth expectations.

The AI boom began with strong PE expansion after ChatGPT was released. But speculation is now less represented in the price relative to earnings and more in the exceptionally strong consensus earnings outlook.

This is very different from the dot-com boom when there were much lower earnings expectations on the sector. Longer-term EPS growth forecasts that analysts are using beyond the next 12 months for the sector are now 43% p.a., while the P/E ratio calculated from 12-month forward earnings expectations is 21x, which is the long run average.

Earnings expectations are stretched



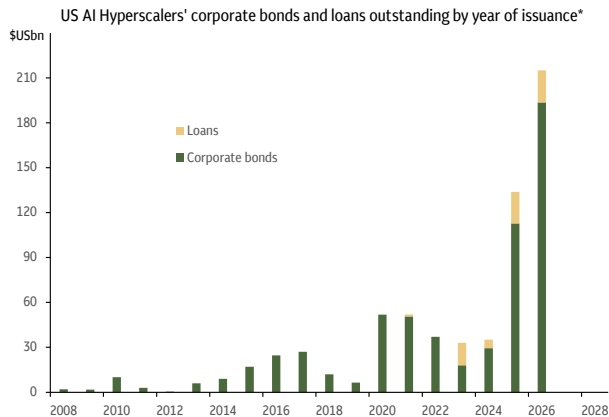
Source: LSEG, MWM Research, August 2026.

Speculation in earnings is a key vulnerability for the equity outlook, but so too is the balance sheet.

Hyperscaler debt outstanding is at a record high mainly because of the large amount of issuance over the past two years. Most of the debt has been issued in deep and liquid corporate bond

markets, with a relatively small amount borrowed compared to the assets of the companies.

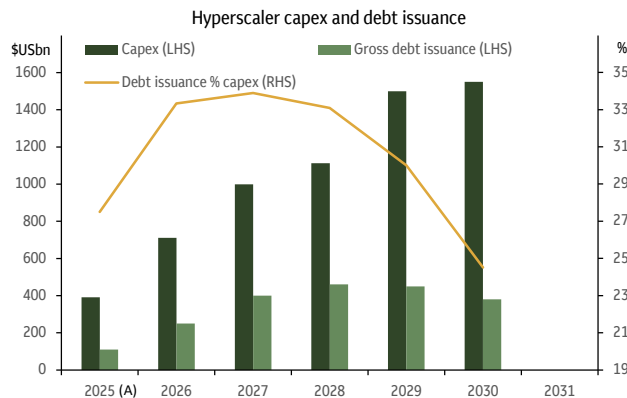
Hyperscaler debt is rising



Source: LSEG, MWM Research, August 2026.

Goldman Sachs expects the pipeline of debt issuance to peak in 2028 at around \$US460 billion even though it expects the capex pipeline to continue to rise at least out to 2030. At its peak around 33% of capex is expected to be debt funded.

Debt is expected to peak in 2028



Source: LSEG, MWM Research, August 2026. Consensus estimates to FY28. Goldman Sachs Investment Research estimates in FY29 and FY30.

Debt markets are best at pricing risk

The large increase of issuance into US corporate bond markets provides a useful gauge when assessing the risks to the AI super cycle.

Equity markets tend to be more focused on the earnings outlook, while bond markets tend to be more focused on the risk of default or problems meeting coupon payment liabilities. This can sometimes provide a different perspective on the financial health of the companies.

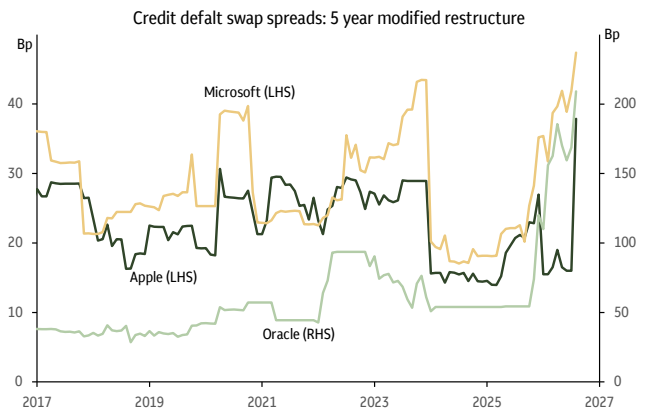
Tech companies generally create assets that have relatively short economic lives when compared to businesses that create

physical assets such as plant and equipment, or buildings and structures. Rapid technological advances have the potential to quickly make Tech assets obsolete and consequently firms find it more difficult to issue asset-backed debt.

However, debt issued by Tech companies is large and liquid enough to become actively traded, so a market for default protection usually emerges quickly. Credit default swaps (CDS) provide liquid pricing for the risk of default, and we think both equity and debt investors should not ignore the signals sent by price movements in these markets.

CDS spreads, or the cost of protection of default, on hyperscaler debt has widened in the past year. Oracle has a much wider spread because its cash-to-debt ratio is only 0.23, which is much lower than the average of the other hyperscalers (1.1). Oracle's net debt-to-equity ratio sends a similar message. It is 2.06 and much larger than the average of the other hyperscalers (-0.13).

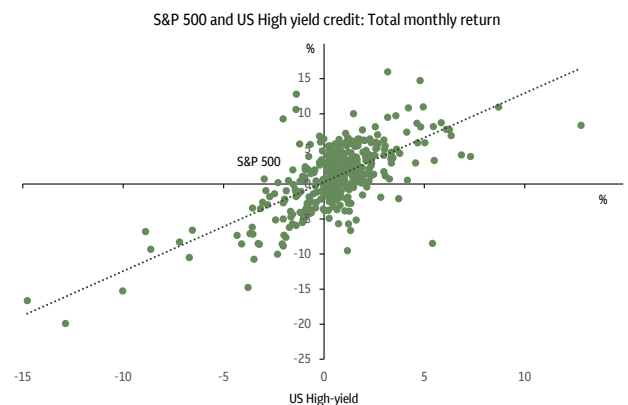
Hyperscaler CDS spreads are widening



Source: LSEG, MWM Research, August 2026.

Credit spreads usually widen on signs of balance sheet deterioration or pressure on earnings that may affect the ability of a firm to make coupon payments. It's unsurprising then that there's a strong positive correlation between equity and credit returns, but investors should carefully note when equity and credit markets are sending different signals.

Return of US stocks and high-yield credit is positively correlated



Source: LSEG, MWM Research, August 2026.

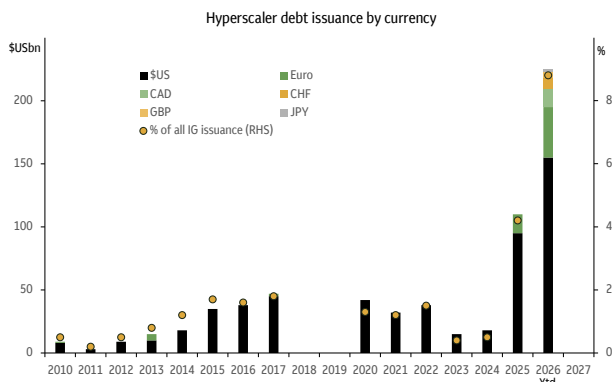
Furthermore, credit markets will be more sensitive to off balance sheet leverage and other opaque funding that equities may not see. The GFC is probably the best example of this where banks and non-banks provided leverage to households via mortgage-backed securities (sub-prime), which were mistakenly purchased by investors convinced they were buying a low-risk asset.

But the AI boom does not look anything like housing markets prior to the GFC. Nonetheless, credit market blockages or illiquidity could cause spreads to widen and over time this will likely impact equity performance.

The risk of crowding out

Google announced a \$US25 billion investment grade debt offering on 6 August, which attracted total bids of \$US115 billion according to news sources. The company's new issuance since the start of 2025 is now \$US114 billion, and Goldman Sachs expects this to climb to around \$US250 billion by year end. This would likely take hyperscaler debt issuance to around 10% of total global public investment grade debt issuance. In 2026, broader AI-related issuance is expected to be around 40% of longer duration investment grade corporate bond supply.

Hyperscaler public market debt issuance is near \$US250 billion



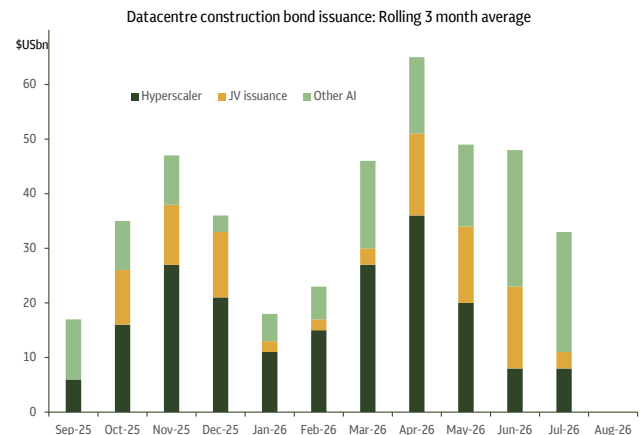
Source: LSEG, Goldman Sachs Investment Research, MWM Research, August 2026.

In 2026 Goldman Sachs estimate that around 70% of hyperscaler debt issuance has been in USD investment grade bond markets, with the remaining 30% distributed across Euro investment grade, USD high yield, USD leveraged loans and investment grade markets in CAD, GB, CHF, JPY and AUD. The non-USD investment grade markets are expected to absorb a larger portion of issuance over the next few years. A good example of this is Google's recent A\$5 billion kangaroo issue, which according to press reports was more than three times oversubscribed.

The strong rise in capex has also seen demand for issuance related specifically to the assets being created. For example, project finance issuance for datacentre construction increased significantly this year, but it will most likely continue to rise strongly, given it accounts for less than one third of all AI-related issuance and a very small percentage of computer capacity.

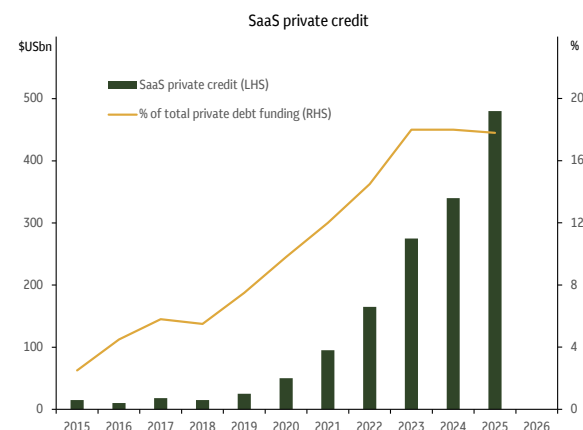
The spread for datacentre financing bonds to duration-matched corporate bonds from the lease guarantor (hyperscaler) has generally tightened. The tightening has been driven mostly because hyperscaler corporate yields have widened.

Data centre construction deals



Source: LSEG, Goldman Sachs Investment Research, MWM Research, August 2026.

AI's direct reach into public markets has also extended to private markets. Software as a Service (SaaS) companies are scrambling to invest in AI technology to protect their business models from competitors with AI algorithms. In 2025 these companies raised around \$US480 billion in private credit, which accounted for 18% of all new private borrowing.



Source: Bank of International Settlements, MWM Research, August 2026.

Overall, equity market expectations on the revenue growth from AI capex seems optimistic but the return on invested capital may meet historical averages. Hyperscaler CDS spreads have widened even though equity analysts are bullish on longer-term earnings. Investors should look at these markets for signs of stress, given they often lead equities. Credit markets have plenty of capacity to fund more capex, and issuance into non-US dollar markets looks set to rise and more data centre construction debt finance will add to private market issuance.

Macquarie WM Investment Strategy Team

This Report was finalised on 21 August 2026.

Recommendation definitions (Macquarie Australia/New Zealand): Outperform – return >10% in excess of benchmark return Neutral – return within 10% of benchmark return Underperform – return >10% below benchmark return.

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