

Situational Awareness

How Leverage Turned an AI Thesis into a Liquidity Crisis

Research Paper | August 7, 2026

Abstract

Situational Awareness, the investment firm founded by former OpenAI researcher Leopold Aschenbrenner, was built around a coherent premise: artificial intelligence would drive an extraordinary buildout of compute, data centers, power, memory, and related infrastructure. The strategy produced extraordinary early returns, but in July 2026 a sharp reversal in AI-linked securities exposed a more fragile part of the design - leverage. Reuters reported that the fund was up 439% for the year through June, then suffered a 67% decline in portfolio value during July and was forced to unwind most of a roughly \$16 billion public-equities book. Citadel ultimately purchased a large portion of the positions, with subsequent reporting putting the discount at more than 10%. [5][6][8] This paper argues that the episode is best understood not as a simple disproof of the AI thesis, but as a case study in the interaction of conviction, leverage, liquidity, market impact, and time. Leverage changes the question from “Is the thesis ultimately correct?” to “Can the portfolio survive the path to being correct?” That distinction created the crisis for Situational Awareness and the opportunity for Citadel.

1. The thesis was coherent

The starting point matters because it is easy to reduce the episode to “AI fund blows up.” That framing misses the interesting part. Aschenbrenner’s 2024 essay, *Situational Awareness: The Decade Ahead*, argued that rapid improvements in AI capability would lead to an enormous industrial buildout: progressively larger compute clusters, a scramble for power, and trillions of dollars of investment in GPUs, data centers, and supporting infrastructure. [1] On his official biography page, he described the investment firm he subsequently founded as focused on AGI and named Patrick Collison, John Collison, Nat Friedman, and Daniel Gross as anchor investors. [2]

As an investment framework, that thesis has internal logic. If AI systems become more capable and demand for inference and training rises, then the bottlenecks around compute, memory, energy, data-center capacity, networking, and specialized infrastructure can become economically valuable. A manager who genuinely believes that outcome is rational to seek concentrated exposure to it.

The error, therefore, does not need to be “believing in AI.” A strategy can be directionally insightful and still be structurally fragile. The relevant question is whether the portfolio was financed in a way that could survive the volatility inherent in that thesis.

2. The public book was more complex than a simple long-AI bet

The fund’s March 31, 2026 Form 13F reported 42 positions with an aggregate reported value of approximately \$13.68 billion. [3] The filing does not reveal the complete economic portfolio: Form 13F has important limitations, does not provide a full picture of short positions or private investments, and option values in the filing should not be read as simple dollar-for-dollar directional exposure. Still, the filing is useful because it shows the breadth and complexity of the public book.

Selected disclosed positions included large long exposures in AI-adjacent infrastructure companies as well as large put positions on major semiconductor and technology securities. [4] This matters analytically. Situational Awareness was not simply buying every AI stock it could find. It was expressing relative-value and directional views across different layers of the AI capital stack.

Table 1. Selected Q1 2026 Form 13F positions

Issuer / instrument	Disclosed form	Reported value
VanEck Semiconductor ETF	Put	\$2.043B
NVIDIA	Put	\$1.568B
Oracle	Put	\$1.073B
Broadcom	Put	\$1.006B
AMD	Put	\$0.969B
Bloom Energy	Long common	\$0.879B
SanDisk	Long common	\$0.724B
CoreWeave	Long common	\$0.556B
IREN	Long common	\$0.401B

Source: SEC Form 13F information table for quarter ended March 31, 2026. Reported option values are filing values, not a complete measure of economic notional exposure. [4]

That complexity actually strengthens the central lesson. A sophisticated portfolio can still encounter a primitive constraint: cash must be produced when financing providers require it. No amount of thematic insight eliminates that obligation.

3. July 2026: volatility became a financing problem

The strategy entered July after an extraordinary run. Reuters reported that the fund had gained 439% from the start of 2026 through the end of June. [5] Then the underlying market moved violently in the opposite direction. A broad selloff in AI-linked and semiconductor securities hit crowded positions across the hedge-fund industry. By July 31, Reuters reported that Situational Awareness's portfolio value had fallen 67% during the month. [6]

This is where leverage changes the nature of the problem. In an unleveraged portfolio, a severe mark-to-market decline is painful, but the owner generally retains the choice to hold if the thesis remains intact. In a leveraged portfolio, falling asset values also reduce the collateral supporting borrowed money. The manager may then need to post cash, contribute additional eligible collateral, reduce positions, or otherwise satisfy the financing provider. FINRA's investor guidance describes the basic mechanism plainly: when equity falls below required margin levels, a broker can force sales to address the deficiency. [9]

Public reporting on the exact sequence deserves care. Reuters' initial July 30 report said Situational Awareness was under pressure either to raise fresh capital or offload the book, and said it was not yet clear whether formal margin calls had occurred before the Citadel deal. That report also identified Goldman Sachs, JPMorgan Chase, Bank of America, and Citigroup among the prime brokers that helped facilitate the transaction. [5] By August 5, Reuters described the fund as having faced margin calls as AI stocks fell. [8] The investor letter reviewed by Reuters said the firm had ultimately removed all leverage from the portfolio. [6]

Table 2. Simplified illustration of leverage amplification

The following example is deliberately simplified. It ignores options, shorts, financing costs, changing margin requirements, and portfolio hedges. Its purpose is only to show how a 20% decline in assets can produce a much larger decline in the investor's equity.

Structure	Starting balance sheet	Assets after -20%	Equity after decline	Equity return
Unleveraged	\$100 assets / \$0 debt	\$80	\$80	-20%
2.0x gross assets	\$200 assets / \$100 debt	\$160	\$60	-40%
3.0x gross assets	\$300 assets / \$200 debt	\$240	\$40	-60%

The essential point is not that Situational Awareness used exactly 2x or 3x leverage - the public sources reviewed for this paper do not establish a single comprehensive leverage ratio. The point is that leverage mechanically narrows the distance between an adverse market move and a financing event. Once that distance disappears, time stops being free.

4. Why "just sell it in the market" is not a free option

The natural response to a margin or collateral problem is: if the securities are publicly traded, why not simply sell them? In principle, that is always an available route. In practice, the quoted price of a security is not a promise that an institution can sell billions of dollars at that price. The displayed market price applies to limited quantities. A very large seller must consume available bids, wait for new liquidity, or accept progressively worse prices.

Market-microstructure research treats large institutional orders as "metaorders" precisely because they are commonly broken into smaller pieces and executed over time. Research summarized by Farmer, Gerig, Lillo, and Waelbroeck finds that large orders create measurable market impact and are typically executed incrementally rather than all at once. [10] The practical implication is straightforward: size has a cost, and urgency makes that cost worse.

Consider the intuition behind a hypothetical \$10 billion liquidation in a security that normally trades \$1 billion per day. This is not a claim about a particular Situational Awareness position; it is an illustration. Attempting to sell ten days of normal volume immediately would reveal an enormous supply imbalance. Even if the position were divided across many orders, the seller would be competing against the market's finite capacity to absorb inventory.

Information leakage compounds the problem. If market participants infer that a large fund is a forced seller, they have little reason to provide generous liquidity. They may reduce bids, wait for a lower price, hedge against anticipated supply, or demand additional compensation for taking inventory. Aschenbrenner's investor letter, as described by Reuters, said liquidity dried up as positions moved against the fund and compared the dynamic to vulnerability feeding on itself. [6]

Mechanism: forced-deleveraging feedback loop

- 1 Asset prices fall
- 2 Collateral value and portfolio equity decline
- 3 Financing pressure rises; cash or exposure reduction is required
- 4 Positions are sold into a weak market
- 5 Selling can worsen price impact and reduce remaining collateral
- 6 The next round of deleveraging becomes more urgent

5. Citadel bought urgency

Situational Awareness ultimately found a buyer capable of absorbing a large block directly. Reuters reported on July 30 that Citadel acquired the portion of the public portfolio financed with leverage from brokers, while Situational Awareness retained a roughly \$10 billion book of other stocks and private investments, including its Anthropic stake. [5] The following day, Reuters described Citadel executives working through the night to analyze the trading book and the liquidity of the positions; one investor familiar with the transaction said only a small number of firms could absorb that much risk. [7]

The economics became clearer in subsequent reporting. On August 5, Reuters reported that Citadel had purchased Situational Awareness positions at a discount of more than 10%. [8] For the seller, that discount was the price of certainty and immediate liquidity. For Citadel, it was compensation for providing balance sheet when the seller's negotiating leverage was weak.

This is why the transaction should not be described simply as a bailout. Citadel was solving a real problem, but it was also buying an advantageous option set. A forced seller had to optimize for speed. Citadel could optimize for economics.

After acquiring the positions, Citadel had multiple possible risk-management paths. It could hold securities it considered attractive, sell pieces gradually into deeper liquidity, offset some exposures with derivatives or correlated instruments, or wait for market conditions to improve. These are analytical possibilities rather than a claim that Citadel used any one specific liquidation program. Importantly, hedging does not make the trade "risk-free": basis risk, execution risk, liquidity risk, and adverse price moves remain. The discount simply gives the buyer a cushion and more room to manage those risks.

Reuters later reported that Citadel's Wellington fund gained 6% in July, its tactical trading fund gained 11%, and its equities fund gained 14.2%. The same report said the Situational Awareness purchase helped stabilize the market during the final two trading days of July. [8] Those returns should not be attributed entirely to the transaction, but they underscore the asymmetry: the market event that created acute stress for one leveraged participant created opportunity for a participant with liquidity and risk capacity.

6. The real transformation caused by leverage

The most important lesson from the episode is conceptual. Leverage does more than multiply returns. It changes the variables that determine whether an investment succeeds.

Without leverage, the core question is primarily fundamental: is the asset eventually worth more than today's price? The investor must still manage concentration risk, valuation risk, permanent impairment, and personal liquidity needs, but an arbitrary 20% or 30% market decline does not automatically impose a sale.

With leverage, the thesis becomes conditional on additional variables: timing, volatility, collateral values, financing terms, market liquidity, counterparty behavior, and the correlation of positions during stress. A position can eventually recover and still be a failed investment for the leveraged owner if the owner is forced out before the recovery occurs.

That is why the fund's own language is revealing. Aschenbrenner told investors the firm had come closer to "permanent capital impairment" than it considered acceptable and said the portfolio had removed all leverage. [6] The distinction between temporary market losses and permanent impairment is exactly the issue. Leverage can convert one into the other.

7. A timeline of the rise and the unwind

Date	Event
June 2024	Aschenbrenner publishes Situational Awareness: The Decade Ahead, arguing for rapid AI capability growth and a massive compute/power buildout. [1]
June 2024	He launches an AGI-focused investment firm with anchor investments from Patrick and John Collison, Nat Friedman, and Daniel Gross. [2]
Mar. 31, 2026	The fund's Form 13F reports \$13.68B across 42 reportable entries. [3]
June 30, 2026	Reuters later reports the fund had gained 439% year-to-date through June. [5]
July 2026	AI-linked securities sell off sharply; portfolio value falls 67% for the month. [6]
July 30, 2026	Reuters reports that the fund is forced to unwind most of a roughly \$16B public-equities book and sells the leveraged portion to Citadel. [5]
July 31, 2026	Investor letter reviewed by Reuters says the firm has removed all leverage and remains up 80% for 2026 despite the July loss. [6]
Aug. 5, 2026	Reuters reports Citadel bought positions at a discount greater than 10%; Citadel posts strong July fund performance. [8]

8. Broader lessons for portfolio construction

First, liquidity is not idle capital when it protects the ability to make decisions. Cash, unencumbered assets, and unused financing capacity may look inefficient during a bull market, but they become strategic assets when markets gap lower. The ability to wait has option value.

Second, correlated risk often appears only when it matters. A portfolio can look diversified across companies, instruments, and long/short expressions yet still be exposed to a common underlying factor - in this case, the repricing of the AI capital-spending complex and the market's willingness to finance it. Stress periods are when correlations, volatility, and financing demands can all rise together.

Third, forced selling transfers bargaining power. The party with the deadline must accept terms; the party with liquidity can demand compensation. Citadel's reported discount was not an accident separate from the crisis. It was the economic price of Situational Awareness's urgency.

Finally, leverage should be evaluated relative to the expected return of the underlying thesis. If an investor already believes an unleveraged position has the potential to generate life-changing wealth, the incremental benefit of "more" must be weighed against the possibility that leverage removes the investor from the trade before the thesis has time to work. The upside is amplified, but so is path dependence.

Conclusion

Situational Awareness's July 2026 crisis is compelling because it separates two ideas that are often confused: being right about the future and structuring a portfolio that can survive the journey to that future. The fund's AI thesis may ultimately prove correct, partially correct, or wrong; July alone cannot answer that question. What July did demonstrate is that leverage can make the path itself decisive.

The fund entered the month after extraordinary returns, suffered a severe drawdown, encountered financing pressure, and ultimately sold a large public-equity portfolio to a buyer with superior liquidity. Citadel's reported greater-than-10% discount was, in effect, the price paid by the forced seller for immediacy and the compensation earned by the patient buyer for absorbing risk. [8]

An unleveraged investor can be wrong and lose money. Leverage does not create that risk; it creates an additional one: the possibility of being forced to act while still believing the thesis is right. That is the heart of the case. If a thesis is strong enough to make an investor rich over time, adding leverage to become richer faster may introduce exactly the complexity capable of preventing the thesis from paying off at all.

References

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