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PRIVATE BANKING

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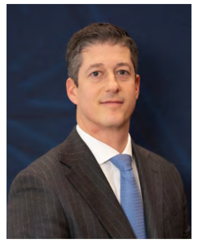


Nicolas Bickel, CFA
Group Head of Investment Private Banking & CIO

The financial markets began the year with high hopes, partly due to Donald Trump's promises to cut taxes and introduce ultra-liberal measures. It is clear that in the face of the new US administration's erratic communication and new tariffs announced at the start of April, investors' patience and confidence have both been hit.

Market trends have reversed several times since the start of the year, mainly on foot of decisions taken by the US government, culminating in the announcements of import tariffs being imposed on almost every country. Most significant of all is perhaps the tumble taken by the highest-valued shares, which were particularly badly hit by the recent market movements. This is the case in particular for the tech sector and artificial intelligence (AI), key market catalysts over the last two years. Modestly priced equities and defensive stocks have fared better since the start of the year, while growth stocks and the stocks of multinationals, the top performers over the last few years, have suffered heavily, particularly since mid-February.

As the backdrop to all of this, the Pax Americana, the period of relative global stability led by the United States and defended by its military strength, has come to an end.

The repeated attacks by President Trump against the historical allies and main trade partners of the US have prompted a very strong political response, particularly in Europe, with exceptional budgetary proposals to facilitate increased defence spending by European countries and infrastructure developments in Germany, countries which strongly supported the equities of those very sectors before the "liberation day" shock. These announcements have sparked a rise in long-term inflation expectations and have weakened perceptions of solvency, particularly in relation to Germany, which has seen its ten-year bond rates rise temporarily to 2.9%, their highest level since 2011, while real rates are above 0.9%. Given the new environment of higher deficits, European sovereign bond yields should now trade within higher ranges. European equities, which have lower valuations than their US counterparts, are being sought out by investors who are now focused on cyclical stocks, in particular stocks set to benefit from higher domestic exposure because of the risk of export tariffs. Higher valuations are the main factors that have supported European equities since the start of the year, rather than growth in earnings per share. The latter have only slightly beat market expectations, underpinned mainly by exporting companies and a weak euro.

Are these changing trends in the financial markets, reflected mainly in the outperformance of the European markets in the first quarter and the extreme volatility of the equity markets, the start of an underlying shift or are they a direct by-product of the current climate of uncertainty?

We note that many indicators, such as GDP growth forecasts and investor sentiment in the US, have deteriorated. US consumer confidence indicators have also fallen to their lowest level in three years, with patent anticipation of a deterioration in employment and a fall in expenditure. In January, the US trade deficit reached an all time record of $153 billion on foot of massive imports by US companies prior to the tariffs announced in early April, causing growth forecasts to decline in the first quarter. Amid this heightened uncertainty, gold climbed to record highs, surpassing $3,000 an ounce, compared with less than half that amount five years ago. In parallel, the dollar has weakened significantly against most currencies, including the euro, despite claims that the tariffs would strengthen it.

Investors who maintained a good balance between equities and bonds in their portfolios had some reassurance. In fact, we observed an increased correlation

between interest rates and equities during the first quarter, particularly in the United States. This strengthened the appeal of good quality bonds and gold in a diversified portfolio, helping to partly offset the negative contribution from equities since the start of the year while limiting portfolio losses.

Various studies show that investors, in particular private investors, have taken advantage of the market declines to strengthen their equity positions. This is supported by the observation of significant buy flows during recent corrections and record equity trading volumes, particularly during the 9 April rebound.

At any rate, we should be wary of making premature announcements that the US equities golden era, of more than fifteen years, has ended.

Since the start of the year, growth in US indices has well and truly lagged behind that of European equities. But periods of outperformance of European equities seldom last more than a few quarters and price differences on the scale of what we saw at the end of 2024 have only been seen on rare occasions. After the European awakening at the start of 2025, we could see a return to American exceptionalism within a few months.

Besides, we have learned some lessons from the market jolts of April 2025. Donald Trump's decision to introduce a blanket reduction in tariffs to 10% for a three-month period (excluding China) following pressure from major banking and industrial groups, and the surge in US treasury yields seem to have, temporarily at least, reassured the markets as to his capacity to listen to the economy and the markets. It seemed to be called into question by his ideologically protectionist approach, raising manifest risks for the economy (and his popularity). The "Trump put" now seems to be back, which is somewhat positive for US equities. The much anticipated tax cuts should also support consumption, a vital engine for growth in the United States.

Emerging markets are likely to be slower to recover on the back of the tariff announcements, because unlike developed countries many of them (excluding China) have few possibilities for putting major stimulus plans in place. The coming months will see many countries engage in bilateral negotiations with the US administration. Retaliatory measures as well as voluntary offers of tariff reductions might be used in the hope of a positive response from the United States; the prospect of a broad trade war is not yet clearly in focus.

In this edition, we present our convictions for the equity and bond markets for the second quarter of 2025. We look at Europe's awakening in relation to defence, industry and the banking sector in light of US protectionism and the future that may be in store for the Magnificent Seven in this context. We also delve into the recent commodity, currency and emerging market trends and, last but not least, we address the issue of liquidity in private markets. In this highly uncertain environment, I hope that this edition brings you some stimulating insights on the markets.

Watch
the video

Doubts about supply and demand caused prices to plummet in the first quarter

As we wrote in our last Outlook & Convictions, politics, in particular US politics, has had a very significant impact on commodity prices.

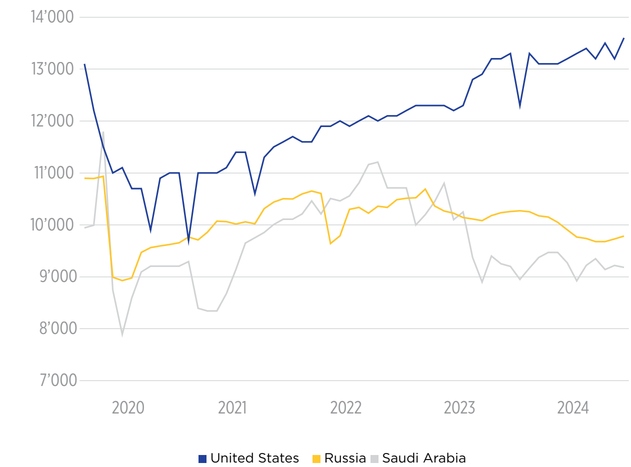
Oil: uncertainty weighing on oil prices

The oil market continues to show strong volatility, with prices falling significantly. Between January and March 2025, the price of Brent fell by around $10 a barrel, from over $80 to $70. **This was due to fundamental factors but also geopolitical factors.** In international relations, the prospect of negotiations between the United States, Ukraine and Russia, the world's second largest oil producer at nearly 10 million barrels a day (see chart 1), offered the glimpse of a possibility of less strict sanctions against Russian oil, which would allow it easier access to the global market. At the same time, investors saw contradictory signals on US-Iranian relations, marked by growing tension since Donald Trump's inauguration at the end of January 2025. These tensions could give rise to a reduction in oil exports by Iran, a country that produces nearly 4 million barrels a day, or 4% of global production.

The start of this year also saw an announcement by OPEC+ countries (an alliance of OPEC member countries plus a dozen other oil producing countries, including Russia) that they would increase production. Investors focused especially on the announcement of a rise in production from April, which helped prices to fall. It is important to note, however, that OPEC+ clearly signalled it would take account of market conditions and could change its mind very rapidly if necessary. Representing more than 40% of global production, OPEC+ is a key component in the market. Like the central banks, it also claims it has long defined itself as data dependent.

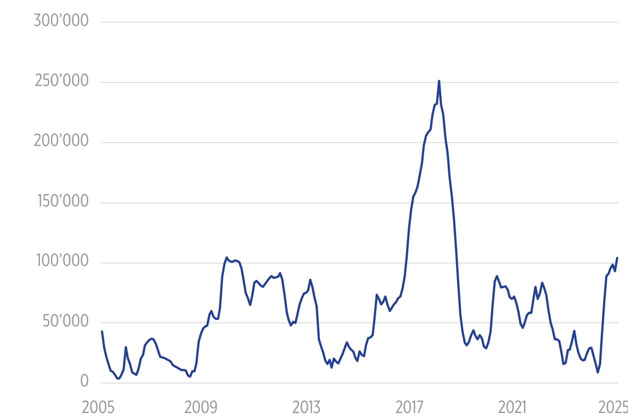
So, on 3 April 2025, OPEC+ decided to increase its production to sanction rogue countries like Kazakhstan that did not comply with the quotas and instead produced more. The combination of this change in paradigm by OPEC+ and the import tariff announcements sparked a sharp fall in the oil price from $70 dollars a barrel to just over $60 dollars on 4 April 2025.

Chart 1:
Oil production by the top three producers
in thousands of barrels per day



Sources: LSEG Datastream, Edmond de Rothschild Economic Research

Chart 2:
U.S. copper inventories (in tons)



Sources: LSEG Datastream, Edmond de Rothschild Economic Research

In early April 2025, the barrel oil price fell by as much in one week as it did between January and March.

These geopolitical movements are taking place in an ever more uncertain economic environment fuelled by Donald Trump's announcements and reverse announcements. His words and actions about a trade war have had the effect of causing prices to fall because they increasingly worry investors who believe this policy will potentially have a negative impact on global economic

activity as well as American activity. This expected slowdown in demand has therefore a negative impact on prices. **Note that the current price of Brent (at the time of writing) of around $60 a barrel is a price below which few market players would wish to go.** Indeed, because of high production costs, certain US producers will see their production costs exceed their sale prices. Parallel to this, Saudi Arabia is investing in major infrastructure projects, racking up significant expenditure. All of these factors could bring prices to an equilibrium range of between $65 and $85 a barrel.

In conclusion, Donald Trump's policy has jolted the commodities market and this volatility is likely to persist in line with the flow of the US president's announcements. The tariff announcement at the start of April caused energy and industrial metal prices to fall in a context of very high copper storage levels in the United States (see chart 2) and amid fears of a sharp economic slowdown. Added to this is the paradigm shift by OPEC+ in deciding to increase its production.

Manuel Maleki, Ph. D.
Senior Economist US & Commodities

Against all expectations, Europe outperforms the US

The scene we have witnessed since the start of the year brought a rare occurrence: the US markets underperforming European markets. This is linked to several factors: high valuations, the announcement of new customs tariffs and chaotic communications by the Trump administration.

America's new protectionist approach has triggered an awakening in Europe

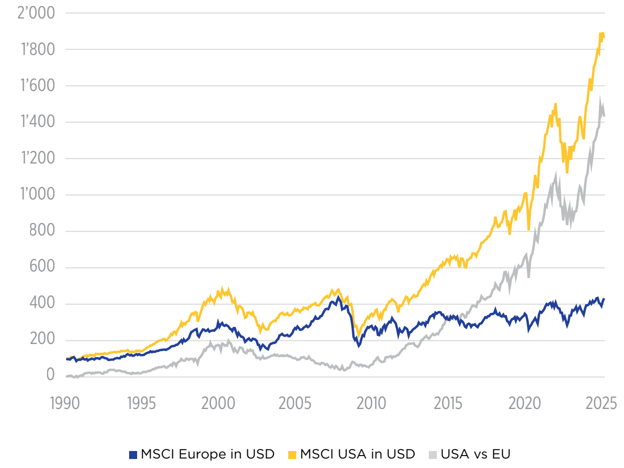
The situation in the United States is generating a potentially negative impact on economic growth, with some commentators even mentioning the risk of a recession. The tax cuts promised during the presidential campaign seem all but forgotten. Conversely, the protectionist policies being touted in the United States have triggered an awakening in Europe in relation to defence, with a new "whatever it takes" rule and a potential budget of €800 billion. What's more, Germany's new government announced a supplementary plan of €500 billion to stimulate infrastructure development.

The market view of Europe and the United States today is the complete opposite to what it was less than two months ago. In December 2024, investors believed that Trump was going to prioritise tax cuts to further strengthen US dominance while EU countries were faced with stagnation because their priority was to reduce their deficits.

US protectionism has triggered an awakening in Europe concerning its defence and infrastructure.

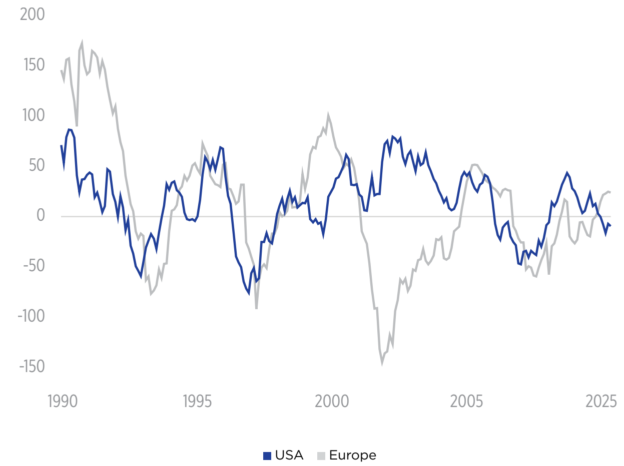
The February 2025 awakening was a rude one. Tariffs turned out to be Trump's priority. No announcement has yet been made on tax cuts, whereas Treasury Secretary, Scott Bessent, has declared he wants to bring down the US budget deficit. On the other side of the Atlantic, Europe, and Germany especially, are in favour of deficits for the purpose of implementing a new stimulus plan, supported by Chancellor Friedrich Merz, that is focused on growth and favourable to free trade. In this context, highly valued US equities seem unable to withstand the climate of uncertainty, exacerbated by frequent and often contradictory press briefings, while European equities with lower valuations are attracting investors. Since the start of 2025, investors have been keen on Europe, taking positions in European cyclical stocks, while defensive stocks have outperformed in the United States. This comes after two years of the opposite scenario!

Chart 1:
US equity markets outperforming Europe has been the long-term trend since 2010



Sources: Bloomberg, Edmond de Rothschild

Chart 2:
Since the start of 2025 the macroeconomic trend has reversed to Europe's advantage
Ratio of economic surprises, USA vs Europe



Sources: Bloomberg, Edmond de Rothschild

The multiple assets of the US economy that could drive a possible rebound

We anticipate that the current underperformance of US equities could, however, be short lived and we remain positive on this zone in the medium term: the US economy benefits from a still strong domestic market, a structural advantage in terms of innovation (linked to its capital market) and cheaper energy thanks to its various sources.

Since the start of 2025, investors have been keen on Europe, taking positions in European cyclical stocks, while defensive stocks have outperformed in the United States.

The sharp fall in US equities is primarily due to the sell off of its largest tech stocks. At this stage, we do not see a slowdown in growth in the sector, and a rebound remains possible, particularly after the corrections of high valuation levels. Lastly, the flexibility of the Federal Reserve, which has scope to lower its interest rates, remains an key asset. An announcement of tax cuts later in the year could also help to stimulate the US market (what traders refer to as the "Trump put").

In the short term, we think the momentum in Europe will continue given the trends in place. That said, extreme reactions have been observed recently. **As such, it is wise to remain prudent and seek exposure to themes related to European defence and Germany's "whatever it takes" stance by only selecting stocks that continue to show decent valuations, or buy on weakness stocks that are penalized by market volatility, such as European banks.**

Hervé Prettre
Head of Global Investment Research

Emilie Magnien
Research Analyst, Global Investment Research

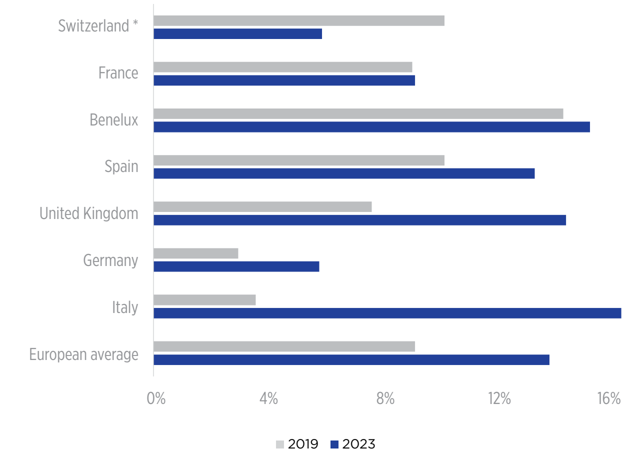
European banks continue to outperform despite the volatility

European banks have enjoyed a strong performance but remain supported by solid fundamentals: still decent valuations, strong earnings growth and fresh potential from European defence projects and infrastructure plans in Germany. Volatility has nevertheless arrived in the short term.

European banks have, at the time of writing, turned in the best performance of the main sectors of the Stoxx Europe 600 index over the past few months. This is due to a combination of factors:

- **Bond interest rates** with the prospect of higher ECB rates at the end of 2025 and, further still, a straighter yield curve. The steepening of the yield curve, or the spread between long- and short-term rates, is a factor supporting financial players, as these traditionally borrow in the short term to lend over the long term. In Germany, the spread between 10-year and 2-year government bond rates has jumped from under 30 to more than 80 basis points since the end of 2024;
- **Higher profitability:** banks have succeeded in reducing their costs and increasing their productivity, particularly through digitalisation, so much so that their margins have improved over the past five years. With this, European banks can currently offer ROTE of 12% versus just above 10% in 2022 (see chart 1) thanks to higher rates;
- **Strong resilience to the economic climate** thanks in part to high forecasts since the Covid period which have not been significantly reduced since;
- **Low risk of new regulations** after a decade of implementing strict standards, which means good visibility on future profits and that banks can offer good returns to shareholders. In this regard, the combination of a high dividend yield (6.6%) (see chart 2) and share buybacks (1.7%) makes this the most attractive of Europe's main sectors;
- **Valuations are still low:** the price to book value of European banks sits at under 0.8 versus 1 for their US counterparts;
- **A more favourable macroeconomic environment in Europe** after the proposal of the EU's €800 billion defence plan and Germany's €500 billion infrastructure plan, which boost the growth and lending prospects of European banks while strengthening market activities;
- **A switch by investors from US banks** which are facing risks of lower growth in the United States.

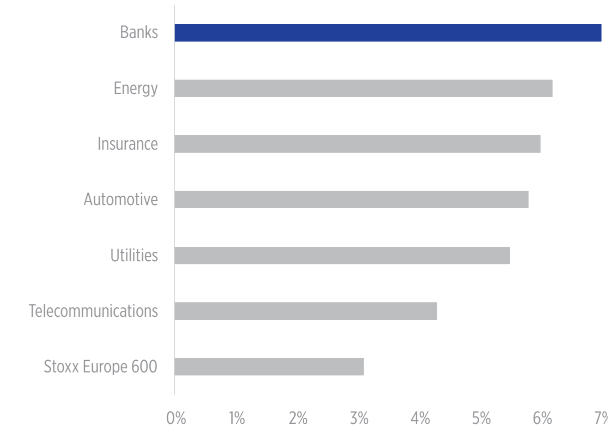
Chart 1:
Profitability of European banks by selected country



Sources: Bloomberg, Edmond de Rothschild

*impact of Credit Suisse in 2023

Chart 2:
Dividend yield, Stoxx Europe 600 by selected sector



Sources: Bloomberg, Edmond de Rothschild

Can this outperformance last?

Even if this outperformance were to decrease in the long term (and beyond the short-term volatility linked to prospects of lower growth in the event that customs tariffs are applied), many tailwinds remain:

- Trading activity bolstered by the current financial market volatility;
- Economic activity that is expected to be stronger in Europe going forward;
- A focus by bank executives on shareholder returns;
- Investor interest in sectors that are not impacted by customs tariffs (90% of the activity of European banks is domestic);
- Lastly, European bond yields should be higher than in the past given the new long-term spending plans, which in turn should support a continued steepening of the yield curve, if not a slight inflationary impact, which leads to higher rates in the longer term. This is good news for banks' lending activities.

We therefore continue to have a constructive opinion on the sector, which is underpinned by an improved outlook in Europe, while being more selective. We favour selected banks exposed to German stimulus plans, to Eastern Europe in the event of peace in Ukraine, to zones of higher growth, such as Spain or certain emerging markets, and to investment banks, or buying on weakness given the current volatility.

Hervé Prettre
Head of Global Investment Research

The Magnificent Seven or the Maleficent Seven: has their dominance come to an end?

The US equity market tumble following questions around the notion of US exceptionalism and the erratic tariff policies of the Trump administration has been amplified by profit taking on the Magnificent Seven* since December 2024.

*Apple, Amazon, Alphabet, Nvidia, Meta, Microsoft and Tesla

These major tech groups, star performers since the end of 2022, accounted to a large degree for the performance of the S&P 500 in recent years: nearly half of the 25% gains by the index in 2024 came from these seven stocks alone! However, since the start of 2025, they have seen a sharp correction, exacerbated by the release of competing artificial intelligence models produced at lower costs, such as that unveiled by Chinese startup DeepSeek in January. Tesla remains a case apart from the others, having suffered from the political activities of its CEO Elon Musk. Between December 2024 and March 2025, Tesla lost half of its market capitalisation.

Furthermore, the Magnificent Seven account for a significant portion of capital expenditure for the development of technological infrastructure to train and maintain next generation AI models: amounts totalling more than $250 billion were committed in 2024 and are expected to increase by 40% this year to $350 billion. In this environment of high capital expenditure, the release of a lower cost rival model from China (officially just $6 million for its development versus more than $500 million for the latest US models) created tremors in the US tech sector, raising questions as to the real need to spend so much to develop AI models and questioning in particular their return on investment. With this, and given the pressure put by the Mag Seven on the S&P 500 in 2025 due to their weight in the index (25-30%), some are already calling them the Maleficent Seven.

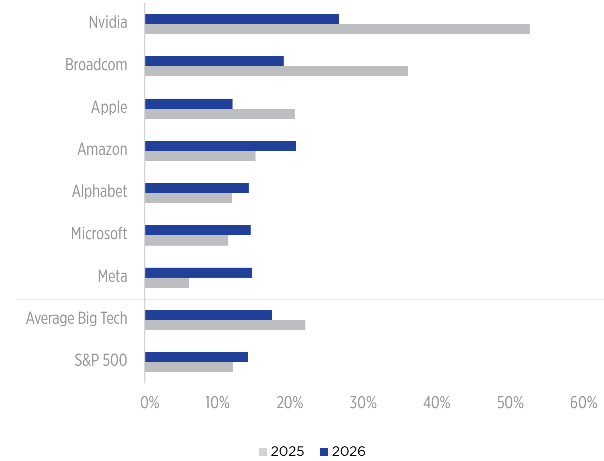
Is their domination really challenged?

Certainly, in the short term, questions about the notion of American exceptionalism and remaining doubts about the US tech monopoly could continue to be factors of volatility. Nevertheless, we are sticking with our positive opinion over the long term on the US equity market and in particular concerning the growth capacity of the US tech giants.

Volatility could continue to dominate in the medium term, but we remain positive on the tech sector in the long term.

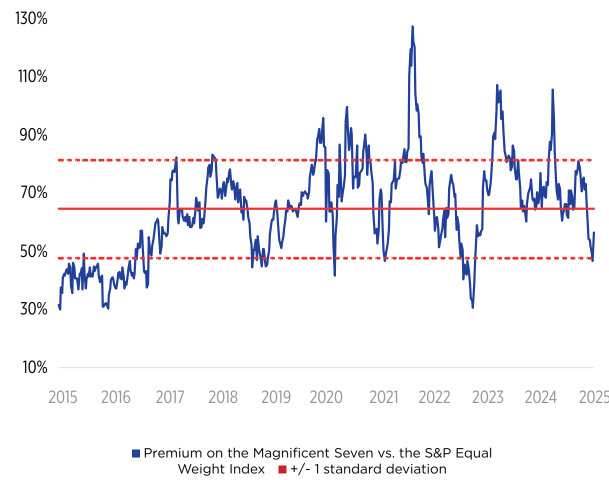
In fact, US companies still have the highest earnings profiles in the world, driven by the tech sector which represents more than 35% of the S&P 500 index, and have the highest margins (average net margin of 16% compared with 11% for the rest of the S&P 500 in the fourth quarter of 2024). The earnings growth expectations of major tech companies remain above those of the S&P 500 this year and in 2026 (see chart 1).

Chart 1:
Expectations of earnings growth per share among the 7 largest U.S. technology stocks (excluding Tesla) and the S&P 500, 2025e and 2026e



Sources: Edmond de Rothschild, Bloomberg

Chart 2:
Differential (premium) in the 12-month price/earnings ratio of the Magnificent Seven versus the S&P 500 Equal Weight Index



Sources: Edmond de Rothschild, Bloomberg

Moreover, the average valuation of the Magnificent Seven has fallen to its lowest level since early 2023 (see chart 2) and its lowest level since 2017 relative to the 493 other S&P stocks (i.e. excluding the Magnificent Seven).

We do not believe that the domination of major US tech groups in the field of AI is really under threat in the short term: although the release by DeepSeek may have raised questions about the benefits of the capital spent by the Magnificent Seven, we would stress that DeepSeek's model itself could only have been developed thanks to the technological infrastructures financed by the US tech groups (it was based on the open-source models of Meta Platforms and OpenAI, among others). We believe on the contrary that there is still a need to invest massively in AI infrastructure (datacentres, high tech processors and related semiconductors) and it is even becoming a strategic necessity in the current global AI race. The Stargate project, spearheaded by the Trump administration to boost the AI capacity of the United States, for an investment of $100-500 billion over four years, and the European InvestAI project which aims to invest $200 billion, are perfect examples.

True, the tariff announcements by the US president since 2 April have complicated visibility on tech stocks, which are overall highly exposed to imports of electronic components from Asia. We believe nevertheless that the Trump administration could in the end allow exemptions for certain technological imports (advanced chips, for instance) to maintain the global competitiveness of US tech companies. If it does not, these companies could lose market share in this highly strategic AI era.

As such, volatility could continue to dominate in the medium term, but we remain positive on the tech sector in the long term. Hovewer investors must remain selective, even among the Magnificent Seven, and maintain exposure to the US market. Beyond higher growth in the tech sector, we expect a higher degree of uniformity in earnings growth across all sectors of the S&P 500, with sector performances becoming more consistent. This should help mitigate the risk of less pronounced growth in US tech stocks moving forward.

Anthony Toupin
Senior Research Analyst, Global Investment Research

Trump’s protectionism has triggered an awakening in Europe concerning its defence and industry

The weeks that followed Donald Trump’s return to power were a spectacle that quickened the pace of history: the Pax Americana, the global peace led and defended by the US since the end of the Second World War, came to an end. The current transactional approach by the United States bargains guarantees of security in exchange for territories (Greenland, Canada) and resources (rare metals agreement with Ukraine and Congo).

A new era in European defence is unfolding

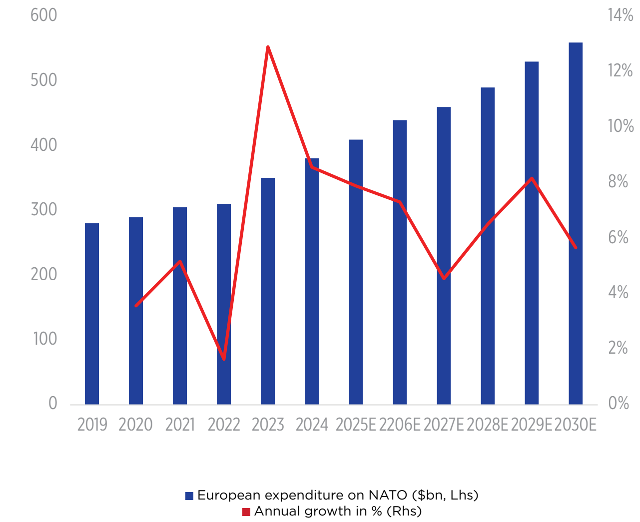
America’s new pragmatic ideology prioritises US short-term economic and geopolitical interests and disregards historical alliances. European governments have reacted swiftly, with summits in Paris and London at which they agreed to continue providing aid to Ukraine to guarantee its territorial independence and also to invest massively in strengthening their own strategic autonomy. This new era of strengthening Europe’s defence capabilities will require considerable investment by Europeans, the budget for which could almost double from 1.8% of GDP to at least 3.5%, returning to its highest level since the 1960s (see chart 1).

This collective awareness is expected to accelerate a rearming process that had already begun after Russia’s prior invasion of Ukraine more than a decade ago. While in 2014, only two European countries, members of NATO, allocated more than 2% of their GDP to defence (the UK and Greece), 22 countries are doing so ten years later (see chart 2). The urgency of the situation is further highlighted by the fact that military workforces have practically halved since 1990. At that time, the French and German armies each had around 550,000 in their ranks. In 2024, France had a military workforce of 201,000 while Germany had 182,000. The structural investment deficit in the sector led moreover to an alarming decrease in production capacities within Europe.

When it comes to weapons, Europe has quality but not quantity, with production volumes remaining relatively limited.

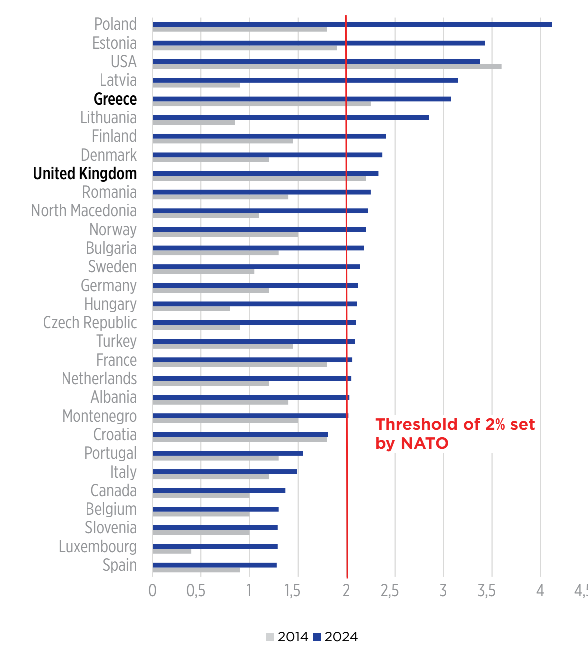
Into the bargain, Europe’s defence industry remains fragmented and highly competitive. European dependency on the United States has continued to grow, to the extent that nearly two thirds of arms imported by Europe over the last five years were from the United States. While the scaling of production capacities could favour sector consolidation, it will need in all cases significant investment by EU states. In this context, the European Commission has called for

Chart 1:
Total spending by Europe on NATO and expected growth to 2030



Sources: Edmond de Rothschild, Sipri

Chart 2:
Military expenditure as a% of GDP, 2024 vs. 2014 and level set by NATO of 2%



Sources: Edmond de Rothschild, NATO

the mobilisation of at least €800 billion in public and private funds to finance this new defence plan. Germany's new Chancellor, Friedrich Merz, has for his part unveiled a budget proposal to invest "whatever it takes" in the country's defence, with a warning about the imminent risk of a demise of NATO.

The narrow financial leeway of European countries

At this pivotal time for Europeans, a major obstacle is complicating the picture. The financial leeway of most European states is restricted by structural deficits caused by very high expenditure and debt. Public debt surpasses 100% of GDP in most of the continent's main economies, France, the United Kingdom and Italy to name a few, with the latter's debt to GDP reaching 137% in 2024 compared with just 30% in the 1960s. The overindebtedness of European states means prohibitive costs for their public finances, while servicing this debt costs nearly 2% of the EU's GDP, and 4% in Italy.

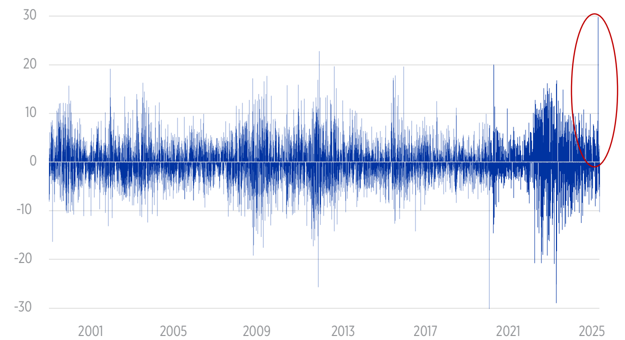
In this context, the funding of defence expenditure directly by the European Union is one of the most realistic options.

Germany enjoys greater leeway with a debt to GDP ratio of just 62% and balanced public accounts thanks to the debt brake mechanism in place. The new Merz-led government is expected to herald in an easing of fiscal constraints unlike anything seen in the country's recent history. This "Zeitenwende" or new era could also signal a historical turning point for one of the strictest upholders of budget austerity within the zone, and could lead to higher interest rates (see chart 3).

European defence stocks remain attractive over the long term

The EU has deployed a new €150 billion stimulus plan financed through joint bonds backed by the EU budget, and the exclusion of up to €650 billion

Chart 3:
Daily change in the German 10-year Bund (in bp) since the creation of the euro in 1999



Sources: Edmond de Rothschild, Bloomberg

of defence spending from the Maastricht budget criteria. Like vaccine orders during the Covid pandemic, the European Commission has suggested to member states that they pool their arms purchases to obtain more favourable commercial terms from industrial groups. In this regard, Ursula von der Leyen recently called on member states to limit these investments to European arms manufacturers and not offer new contracts to US manufacturers, thus giving European players long term visibility on their orders.

This new multi-annual investment cycle is key for the European defence sector: due to their limited capacity, they need visibility on new contracts over a period of 5, 10 or 20 years depending on the arms being ordered (e.g. short-term for ammunition, long term for submarines) in order to be able to invest in new factories. This puts into perspective the recent sharp growth in European defence stocks (+60% since the start of the year, at the time of writing). In fact, this rise comes on foot of earnings growth forecasts between now and 2028 of +20% to +40% a year depending on the area of defence (three-year visibility on earnings growth), but it excludes a good portion of the growth potential beyond that, given that the cycle should last at least ten years. These stocks therefore remain attractive in the long term but hold more limited potential in the short term.

Chair detail, client lounge in Geneva, design by Philippe Druillet

Also, European defence stocks are likely to see greater volatility in the short term, dictated by the pace of decisions on exact defence budgets, whether there is a peace agreement between Russia and Ukraine and Trump's stance towards NATO. Neither should we forget that this budget will be made available gradually, hence its impact over the medium and long term, given that the danger is not immediate (if a lasting ceasefire is agreed, Russia, weakened by the war in Ukraine, could need at least four years according to military experts to rearm and launch a new major attack).

"The security model that has underpinned peace and prosperity in Europe for decades no longer exists—and it is not coming back", Anders Fogh Rasmussen, former Secretary General of NATO

US defence stocks, for their part, could benefit from Europe's remilitarisation in fields in which it has less expertise (such as communications, reconnaissance, mapping and semiconductors), but their potential should be limited given the EU's aims to source most supplies from local providers. There is also the threat of budget cuts in the US Department of Defence by the Elon Musk-run DOGE. European defence seems to show increased potential in the long term due to the level of under investment in past decades, which must be reversed at all costs.

The heightened protectionism of the Trump administration has sounded the alarm for remilitarisation in Europe, which must now ensure its own security. The dividends gained from several decades of peacetime must now give way to massive investment in defence, the financing of which must necessarily come from Europe and continue over the long term. Given the significant dependencies tied to past alliances that have now been broken, it will take at least a decade before Europe will be able to defend itself without help from the United States. A window of opportunity is opening therefore for all European players in the armament value chain.

Hervé Prettre
Head of Global Investment Research

Darius Bakhtari
Research analyst, Global Investment Research

Where is growth hiding?

While the world's markets become more prudent in view of Trump's tariff plans and concerns about a slowdown in the United States continue to grow, America's dominance of stock market performance is starting to crack.
As Trump's "MAGA trade" reveals signs of weakness, global equity funds are looking for alternatives.

Unlike MAGA (Make America Great Again) trade, MEGA (Make Europe Great Again) trade is gaining ground, as evidenced by the DAX index which has gained more than 20% since the start of the year, as at the time of writing. The emerging market gains have been fairly timid, with the MSCI EM at 4% YTD versus the US S&P 500, which has shed 4.5%. However, emerging market specialists say it has been a long time since they have seen such a strong start to the year:

- Eastern Europe saw a gain of more than 30%[1] in USD amid the prospect of a ceasefire between Russia and Ukraine;
- The MSCI China Index surpassed its previous one-year peak in September 2024, gaining more than 20% YTD;
- The Hang Seng Tech index, which represents the 30 largest tech companies listed in Hong Kong, rallied by more than 30% YTD thanks to DeepSeek;
- In the LATAM region, Colombia, which is currently experiencing an "Andean spring", gained 33% in USD;
- Even the big stock market losers of 2024, Mexico and Brazil, turned in higher performances than average for emerging markets.

It's true to say there is frequent arbitrage, particularly from overbought assets with high valuations to underbought assets with lower valuations. Emerging market (EM) equities are effectively trading at a discount of nearly 30% based on P/E ratio compared with the average for developed market equities over the last ten years, which boosts their appeal. Statistically, the MSCI EM index has frequently outperformed the S&P 500 in the past, during US equity market falls. We believe that in the current US market correction emerging markets have a greater chance of further outperformance due to the bigger valuation differential than in the past with the S&P 500.

Emerging market specialists say it has been a long time since they have seen such a strong start to the year.

Like us, most emerging market investors are risk takers, adopting a style focused on growth and momentum. US tech companies have sharply surpassed us in terms of momentum these past years thanks to higher growth. US growth is now starting to be revised down for 2025 and the AI capex story is starting to be less dominated by the United States due to the emergence of competing models such as that by DeepSeek in China and LeChat in France. In this situation, growth scenarios, whether related to the European defence sector or the emerging markets, are looking more attractive. A weaker dollar versus other currencies is also generally viewed as an additional positive factor for emerging market equities.

China

The Chinese growth scenario looks to be the most attractive. The competitiveness of Chinese generative AI tech companies came to the fore in January and their potential for monetisation seems higher than that of their US counterparts given their lower costs, if the results and development costs presented bear out. The Chinese equity market has entered a new upward cycle with several private sectors receiving stimulus from a central government intent on boosting growth. We believe the Chinese market has more opportunities to offer this year despite concerns about a possible slowdown of growth in the second quarter of 2025 due to a potential halt in exports because of the rise in US customs tariffs. The rally being led until now by the tech sector could instead be driven by consumption and financial companies given the expected acceleration of growth in the second half of the year.

India

Indian equities benefited from a structural revaluation in 2023 and 2024 thanks to the catalyst provided by long term growth in the country. Presently, the sharp fall to 19 × 12-month P/E from a record level of 24x is starting to offer opportunities to buy major companies at a good price. For now, it would be wise not to try and catch a falling knife as downward revisions to earnings growth could continue in the short term. We are patiently awaiting for investments to pick up in India's private sector and, overall, a broader resumption of growth in consumption, particularly in rural areas.

LATAM

US trade policy is likely to have limited macroeconomic impacts for Latin American economies. The growth prospects of Mexico are being eclipsed by its trade policy in relation to Chinese imports, which has already had a significant impact on the relocation of industries in Mexico. The specific sectors impacted by the forthcoming US tariffs in the Mercosur economies and Andean countries could give rise to tensions. Certain countermeasures could also give rise to earnings growth revisions. A positive factor is that the valuations of Latam equities are very low at 8.6 × 12-month P/E, well below their 10-year average of 11.5x P/E. The risk of disappointing growth is therefore already factored into these low valuations, hence their favourable risk/return profile.

We believe that emerging markets on the whole could continue to outperform amid the current US equity correction given their low valuations and a more resilient growth framework in Eastern Europe and China. The expansion of valuation multiples has in fact been behind the bulk of performances of the MSCI EM since January. At this point, the right answer to the question "where can growth be found?" could also be the answer to outperformance opportunities. But the question "where can quality growth be found?" will swiftly arise once the growth opportunities from low valuations have disappeared.

"The greatest danger in times of turbulence is not the turbulence; it is to act with yesterday's logic." The former market favourites risk losing their advantage if they are unable to adapt to a constantly changing world. In a scenario of widespread trade war, a deep and robust domestic market like those of China and India could better adapt, absorb external shocks and potentially offer structural growth opportunities in the long term.

Xiadong Bao
Fund Manager, Edmond de Rothschild Asset Management

(1) MXME – MSCI EM Eastern Europe Index, annual performance to 14 March 2025. All performances are expressed in USD.
(2) MXEF BEst P/E Ratio vs MXWO since 2015, according to Bloomberg
(3) China is everyone's problem. – Outlook & Convictions #12

The brake has been lifted on German debt: what impact for the European bond market?

In Germany, a coalition led by Chancellor Merz has set out a new budget framework for the country. It heralds a paradigm change in terms of growth in Germany and Europe.

The German coalition agreement comprises several dimensions:

- Exemption from the brake on debt mechanism for defence expenditure in the main budget surpassing 1% of GDP; An infrastructure fund outside of the budget of €400 billion and €100 billion for the energy transition (in total 11.6% of GDP in 2024) to be paid out over the next ten years;
- Authorisation of an increase in the structural deficit for federal states (Länder) from the current level of 0.0% of GDP to 0.35%.

It also allows leeway for additional public spending of up to 3.85% a year over the coming years if defence expenditure were to be increased up to 3.5% of GDP, as suggested in some proposals. In practice, we believe the implementation of these measures will be gradual given the capacity constraints and the challenges generally associated with increasing public investment in Europe.

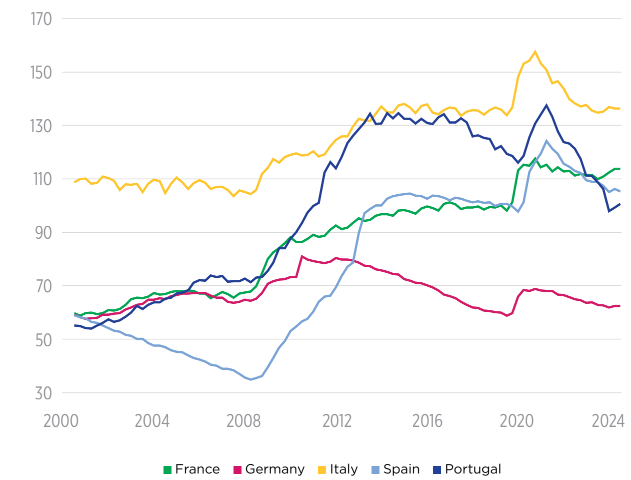
How have European bond markets reacted?

Euro bond markets saw an unprecedented rise in sovereign yields in March 2025. This followed Germany's announcements of its debt-financed investment plans in infrastructure and defence, and a European agreement to activate a mechanism that would allow member states to borrow up to €650 billion over four years specifically for defence, outside of their usual budgetary constraints. This would be supplemented by residual funds of €150 billion that had initially been allocated to combat the Covid pandemic, which could be reallocated to defence.

Germany's potential fiscal pivot tells us that its low debt to GDP ratio of 62% could now be a thing of the past, and it is clearly focused on growth at the expense of a balanced budget.

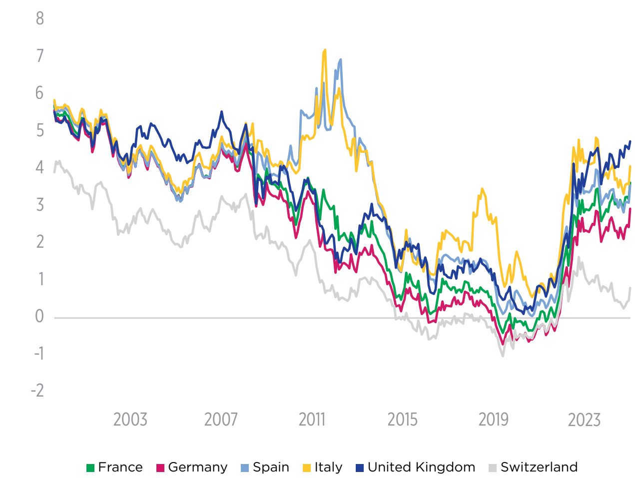
One investment bank has estimated the impact on Germany's deficit at 1.0% to 2.5% of GDP per year, which would consequently cause an increase in public debt in the future. On 5 March, the yield on German 10-year sovereign bonds rose by 30 basis points, in line with other European sovereign yields. Such a phenomenon has not been seen since the introduction of the euro. The rise in long-term yields reflects an adjustment of the markets to Germany's new fundamentals, which now incorporate higher growth and inflation premiums, and a slight increase in credit risk in order to align with the expected rise in the ratio of debt to GDP. Even though increased slightly, German debt should remain at a moderate level relative to other European countries. The sudden rise in European bond yields can also be attributed to long positions in German bonds held by European and Japanese bond funds. These funds had to rapidly adjust their allocations due to the rise in risk in their portfolios, thereby adding a temporary liquidity problem to a fundamental market movement. This new European paradigm comes amid a normalisation of inflation and low growth that has led the European Central Bank to lower its deposit rate from 4% in June 2024

Chart 1:
Debt to GDP ratio of European countries



Sources: Edmond de Rothschild, Bloomberg

Chart 2:
European 10-year rates in % at end-March 2025



Sources: Edmond de Rothschild, Bloomberg

to 2.25% as of today. The market expects further interest rate cuts that will bring it to less than 2% by the end of 2025.

While the Eurozone sovereign yield curves had already gradually steepened, i.e., long-term rates are higher than short- and medium-term rates, this movement was further amplified with a widening of the spread between 10-year and 2-year rates from 30 basis points at the start of 2025 to over 60 basis points as at the time of writing. In this context, we can expect to see greater interest rate volatility because of increased borrowing volumes in European countries and the maintenance of budget deficits.

What are the outlooks?

Unless expenditure significantly exceeds current expectations (which seems unlikely given the high amounts already indicated) we think it is unrealistic at this point to expect the Bund to durably surpass 3% while the ECB continues to cut interest rates and with inflation remaining at around 2%. Furthermore, uncertainty around customs tariffs will weigh more heavily on activity than on inflationary pressures. Admittedly, credit risk has increased slightly, but Germany still has a triple A rating and its debt to GDP ratio of 62% is the lowest among Europe's largest countries (see chart 1). It is only likely to rise by a few percentage points a year (remember that the infrastructure plan will only represent 1.2% of GDP a year and the defence plan a maximum of 1%, i.e. an extension of debt that seems limited in theory to 2% a year). Besides, the 10-year break-even inflation rates for Germany have changed little given the gradual implementation of these programmes.

Concerning the yields of other European countries, they have evolved in line with the Bund (see chart 2): in fact, the increase in German expenditure is associated with stronger growth for all of Europe and the budget conventions imposed by the European Union have been relaxed by Ursula von der Leyen. Given the fact that expenditure is now coming from the EU and no longer national budgets, unlike the significant reversal in Germany, credit spreads have remained relatively tight. We would nevertheless advise caution in relation to the yields of countries that show budgetary risks, such as France. An Italian BTP above 4% would seem more attractive in this regard, particularly as Italy is set to benefit from disbursements under EU expenditure plans: in 2025, funds from the EU Recovery and Resilience Facility (RRF) should serve as an essential driver of growth by reinvigorating private sector activity in Italy.

German industrial groups should benefit overall if the implementation of the new government's pro-growth programme is successful, as this will have a positive impact on most sectors.

With regard to corporate credit, the rise in sovereign yields will weigh on weaker balance sheets and could put an end to the positive trend in credit indicators in certain sectors such as real estate. However, German industrial groups should benefit overall if the implementation of the new government's pro-growth programme is successful. The new coalition aims to restore competitiveness by reducing corporate income tax and personal income tax, by investing massively in the modernisation of infrastructures and by reducing electricity prices through lower taxes and the strengthening of production capacities. However, execution risk is high because the performance of bonds seems to be closely linked to the capacity of the Merz government to implement its programme and to offset the negative effects linked to the imposition of customs tariffs. Finally, if the euro continues to rise against the dollar, this could reduce the positive effects of stronger growth by impacting the profitability of companies highly exposed to global trade.

Guilhem Savry
Head of Strategy Research, Global Investment Research

Liquidity in private markets, a key indicator

In recent years, private markets have evolved in a macroeconomic environment that is not very conducive to generating liquidity for investors. In this context, the private equity sector has innovated by developing the secondary market, which has appeared to be effective in generating investor returns.

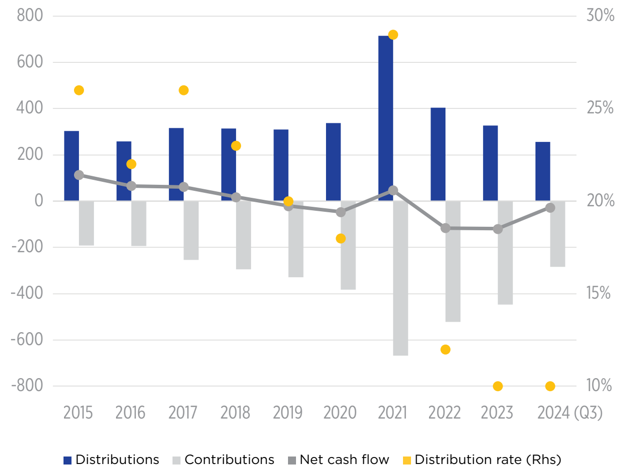
Private market funds are characterised by the fact that they invest in unlisted assets and also, in the majority of cases, they are closed-end funds. This structure is particularly suited to the creation of value in the medium and long term by fund managers. As such, these vehicles offer low liquidity insofar as the possibility of realising the investment, i.e. converting the securities into liquidity, is at the discretion of the fund manager. The latter must sell or refinance the companies in their portfolio. Investors cannot, generally speaking, sell their fund units on a secondary market, or at least not easily. They remain therefore dependent on economic events within their portfolio, such as the sale of a company to an industrial player with a strategic interest in it, rather than a transaction that is purely for financial purposes, like those usually seen on listed markets.

Liquidity generation is therefore a key factor in the performance of private market funds because they are directly dependent on the fund manager.

In short, beyond the fund's performance, the fund manager's capacity to convert often theoretical results – based on accounting valuation methods – into ready cash for distribution to investors is essential. This is particularly true in a macroeconomic environment that is less favourable to the generation of liquidity, such as the one we have recently seen.

In an environment of high inflation, restricted access to debt and high related costs, as well as geopolitical and economic tensions, the returns distributed on private equity funds have in fact fallen significantly since 2022, impacting most asset classes. With the exception, perhaps, of private credit, the distribution rates recorded are the lowest seen since the last global financial crisis (2008-09). Moreover, the gap between fund contributions and fund distributions (i.e., net cash flow) is significant. The share of the unrealised value of funds effectively liquidated and paid out to investors, i.e., broadly speaking the number of portfolio companies sold each year, has also decreased. Where this metric was historically

Chart 1:
Historical cash flow from private equity worldwide ($ bn)



Sources: MSCI Private Capital, Q3 2024

(1) The distribution rate is the level of distribution during the period divided by the last known portfolio valuation, and annualised.

between 20% and 30%, i.e., one company out of every three or five sold, it has only reached one out of ten companies over the last three years (cf. distribution rate shown in the chart[1]). After several consecutive quarters of net contributions, private equity funds finally paid out to investors more capital than they asked for in the second quarter of last year, and to the same degree in the third quarter.

These distributions are crucial because they enable investors to honour a golden rule, namely the need for regular capital commitments in private markets, vintage year after vintage year.

The secondary market, a source of liquidity

This improvement was made possible by increased use of asset refinancing. In fact, fund managers recapitalised certain investments by issuing new debt under more relaxed conditions, enabling the payment of dividends to investors.

Also worth stressing is the growth of the secondary market as a source of liquidity. This market has become a real strategy in the realm of private markets. Traditionally, it allowed an institutional investor to transfer their commitment in a closed-end fund to another investor, who purchased the asset at a discounted price and also took on the remaining commitment, thus releasing the seller from their obligation to honour future capital calls: This is referred to as "LP-led".

However, the secondary market has evolved in recent years with a growing number of fund managers initiating "GP-led" secondary transactions. In GP-led transactions, a manager who holds a company in a portfolio for several years but believes that it still offers potential for value creation can continue to manage this asset while offering liquidity to investors that wish to withdraw. For this, the fund uses a secondary fund that values the asset and buys the units of investors seeking to withdraw, while allowing the investors that wish to continue investing to do so. These transactions require particular expertise in analysis, structuring and management of potential conflicts of interest. **There has been strong growth in these types of transactions in recent years, providing a liquidity solution to investors who need it without forcing managers to sell their assets under unfavourable conditions**.

Matthieu George, CFA
Head of Private Equity Allocation

PRIVATE MARKETS

From political versatility to market volatility

Lighting in the Tasting Room at Château Clarke, Listrac-Médoc

There will probably be no clear trend for the dollar in 2025

The scenario of an appreciation of the dollar based on the implementation of customs tariffs in the United States was clearly challenged in the first quarter of 2025. Naturally, new customs tariffs create a risk of a return of inflation in the United States that could reduce any inclination by the US Federal Reserve (Fed) to lower its key rates. However, Donald Trump's aggressive rhetoric as well as the erratic and short-lived nature of some of his announcements have revived the spectre of economic recession in the United States, in the context of a global trade war. In this scenario, the stock market is stumbling between fits of profit taking by spooked investors and the risk of rate cuts by the central bank to support growth has become a real possibility. Internationally, sales of US securities are naturally being accompanied by sales of the dollar to the benefit of national currencies. In parallel, the rate differential in favour of the dollar, also referred to as carry, has fallen sharply in recent months. Indeed, the assumption of a more accommodative Fed supporting the economy comes on top of the new risk of a rise in the cost of debt in Europe following announcements on the financing of the military effort through debt and Germany's easing of fiscal restraint. As indicated in the chart showing the evolution of the EUR/USD and the differential in the 1-year interest rate, the correlation is strong and recent carry trends have substantially supported the rebound of the euro.

With the watchword for 2025 being volatility as the market eyes Trump's next move, to conclude that the dollar will continue to fall on the back of the new interest rate and growth dynamic would be premature. It is in fact probable that the dollar will rebound from its current levels, supported by technical factors and a respite on the stock markets amid potential tax cut for US companies later this year, orchestrated by the White House.

What maximum price for an ounce of gold?

Gold for its part has continued to reach new summits in 2025, registering an increase of more than 20% at the start of April. This stems from its role as a safe haven amid a tense geopolitical situation and the global uncertainty that has been amplified since Donald Trump's inauguration. It is also benefiting from the gradual increase in gold reserves by central banks amid growing distrust with regard to public debt levels. The recent stock market panic triggered by the announcement of customs tariffs nevertheless led to profit taking on gold enabling a return below the psychological level of $3,000 dollars an ounce. Furthermore, the price of XAU (the stock market symbol for gold) is closely linked to its opportunity cost, as highlighted in the chart showing the price of gold and the evolution of the 1-year interest rate in USD. In other words, as gold assets are not remunerated, when US dollar interest rates fall, gold becomes more attractive. The growing risk of monetary easing by the Fed in response to a downturn in the economy has recently been a major factor enabling gold to surpass $3,000 an ounce. Donald Trump's inflexibility on customs tariffs is strengthening the possibility that the central bank will step in with a liquidity injection to aid the economy.

In conclusion, 2025 is undoubtedly set to be a year without any clear trend, and will require monitoring of currency risk and precious metals.

Jean-Marc Guillot
Group Treasurer

Chart 1: Evolution of the EUR/USD and the 1-year interest rate differential

Sources: Edmond de Rothschild, Bloomberg

Chart 2: Gold price and evolution of the US dollar 1-year interest rate

Sources: Edmond de Rothschild, Bloomberg

Disclaimer