

LETTER FROM THE CIO AM

**MARKET ANALYSIS
AND PRINCIPAL INVESTMENT THEMES
OCTOBER 2025**



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Behind the apparent resilience, weak points are forming

The global economy has entered the final quarter of 2025 in a state of serenity that few observers would have predicted last Spring, in the thick of the trade conflict.

Six months after Liberation Day, despite a few regional disparities, global growth data has held up: according to IMF estimates, GDP is projected to grow +2.9% in 2025 and 2026 - a very similar pace to 2024. Yet the environment is weighed down by higher tariffs, record debt levels - in the US, France and even Japan - with plans to introduce fiscal stimulus, and sticky inflation, which has remained above the Fed's targets for over four years. With GDP growth projected at +2.2%, the economy is more vigorous in the United States than in other developed countries. Investment spending is largely driven by AI, while housing investment has remained very sluggish. Consumer spending has stayed robust, but the more modest households are showing signs of weakness. The 10% most wealthy consumers account for 50% of spending, boosted by the 'wealth effect' when the S&P index is at its highest. All these factors suggest that private demand is less homogeneous than it seems. Europe, on the other hand, remains stuck in a hesitant recovery under new leadership from

Germany - which is striving to accelerate its fiscal response. However, implementation is taking a long time, and recovery plans have not begun to support capital expenditure at this stage. Nonetheless, Europe has clearly set a new course.

So far, capital markets have continued to rise unperturbed, supported by the Fed - which has resumed its easing cycle - and by the hype around artificial intelligence, amid exceptionally low volatility and rising flows into equity funds. Emblems of today's hyper-concentrated indices, AI-related stocks have accounted for almost three quarters of S&P500 gains since the launch of ChatGPT in 2022.

The first cracks

Yet behind this peaceful facade, little cracks are forming. First, the labour market has slowed sharply in the US - as revealed by the drastic





downward revision to job creation data, with job growth now below 1%, a historically low figure in non-recession periods. The situation is even more alarming if one examines public and private sector employment, as the latter has fallen sharply both in absolute and relative terms. Second, adding to labour-related risks, tensions between China and America were revived after D. Trump announced new tariffs of +100% on all Chinese imports starting on November 1st, as well as a series of massive restrictions on the import of Chinese products and 'critical' software. Beijing, on the other hand, had just unveiled its own protectionist arsenal which includes new rules to curb the export of rare earths. Foreign companies now need the Chinese government's approval to export products with even small amounts of rare earth components. If the extra tax is enforced, the world's two largest economies could be heading towards a form of embargo, weakening global supply chains. Third, in its recent Financial Stability Report, the Bank of England warned of the proliferation of private credit managed outside of the traditional banking space, with the risk that leverage may be poorly identified. Indeed, the recent twin defaults by US automotive players Tricolor and First Brand pointed the finger at high levels of debt and the opaque and complex nature of the financing structures. These failures also raised doubts over 'due diligence' standards and risk assessment within the private credit space - a market that weighs over \$1,500 billion in the US. The lack of transparency has upped risk perception in private credit markets and may intensify the risk of contagion to other private borrowers with high leverage ratios.

Does the immense capital intensity within technology bring threats or opportunities?

Private financing has grown massively, particularly among AI players competing in the frenetic race to build new infrastructure. But if the high valuations within the sector are to be reckoned by, the issue of 'return on investment' was never addressed in earnest. According to a study by Goldman Sachs, **the Big Five (Microsoft, Amazon, Google, Meta, Oracle) will have spent \$380 billion this year on capex, principally to support generative AI. This is a 60% increase**

year-over-year. The study also highlights that for most 'hyperscalers', the return on investment is higher than the cost of capital. In other words, operating margins are large enough to handle the expansion. But this does raise the question of future earnings forecasts. Among areas that need watching, the Cloud/AI segments currently display an investment/sales ratio of almost 35%, compared with a historical average around 15%. The concentration of investments has reinforced barriers to entry but has increased the systemic risk for all market suppliers if one single player suddenly chooses to cut its budgets. Interestingly, after Oracle issued a substantial bond, Moodys' flagged several potential risks: high reliance on large AI contracts, debt that would increase faster than its EBITDA, negative cash-flows for an extended period, and high leverage of 4x before Oracle's EBITDA begins to surpass its debt. Furthermore, physical and power capabilities are proving to be limited, notably owing to saturated power grids around large hubs (North Virginia, Dublin, Frankfurt) and to the extended timeframe needed to develop a new datacenter. To sum up, AI requires massive, energy-hungry, and costly infrastructure that takes a long time to become profitable.

Towards increasingly selective asset allocation

After over a decade of dominance, the dollar has recorded its sharpest 9-month depreciation in forty years. This fall stems from three factors: the Federal Reserve's accommodative stance, despite sticky inflation; growing concerns over the Fed's loss of independence which could intensify with the departure of J. Powell; and the growing tendency among investors to hedge their dollar risk, in association with the de-dollarization strategy adopted by many central banks in emerging countries, notably via the purchase of precious metals. To illustrate this point, according to the World Gold Council, China's official gold holdings have been growing at their fastest rate since 2015. Beyond the profit taking that could cause the euro-dollar parity to consolidate, the green back is on a downward structural trend which is prompting us to remain underweight, while seeking opportunities in other currencies.



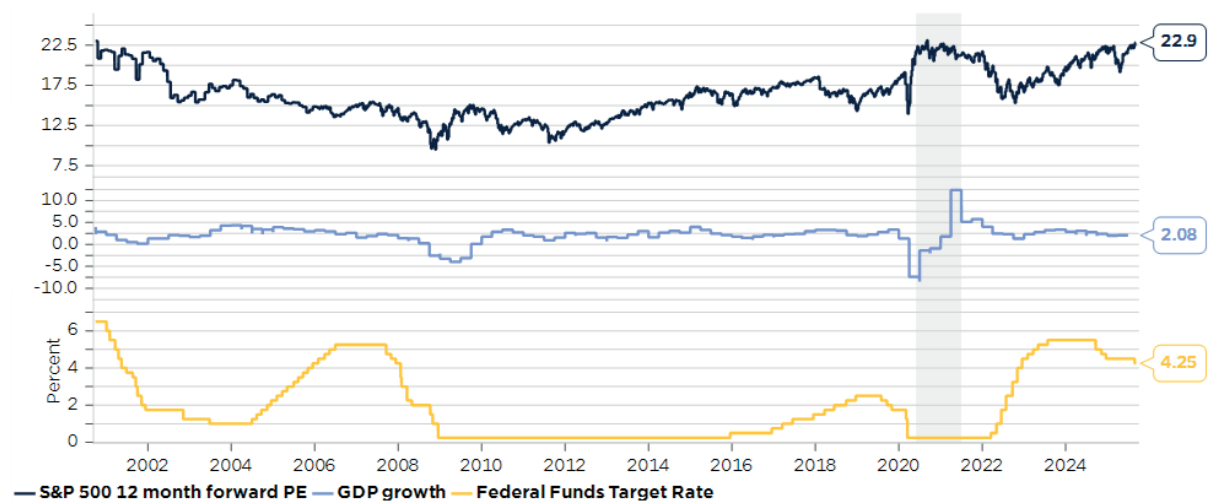
As for the debt market, the labour market slow-down suggests that short and mid-term rates will be capped on account of the Fed's resolutely accommodative posture - which has become even firmer since S. Miran was sworn in at the Board of Governors. The latter believes that the appropriate Fed fund rate should be significantly lower than the FOMC's official projections. Based on these considerations, we have chosen to raise duration tactically and selectively, focusing on the lower end of the yield curve with a preference for US and German sovereign debt, while continuing to underweight French government debt. We continue to deploy our carry yield strategy, notably in the emerging space and generally across corporate debt which still offers attractive volatility-adjusted returns.

As far as equities are concerned, we have kept a

rather cautious approach and pay particular attention to index valuations in the US, which are heading for the post-pandemic heights of 2021 - yet without offering the same monetary easing potential from the Fed, or indeed, the same growth outlook. It is undeniable that artificial intelligence has been a powerful driver for equity markets; nevertheless, while future profitability does argue in favour of these high valuations, the growing gap between the cost of capital and expected profits is becoming increasingly difficult to sustain considering the earnings forecasts issued by large companies. We have therefore chosen to diversify our investments into themes related to economic sovereignty in Europe, to the use of Big Data - with a careful approach to valuations, and to small and mid-sized companies for their local exposure and lower sensitivity to currency fluctuations.

Valuations rise to 2021 levels against a radically different macro-financial backdrop

12 months forward PE



Source : Edmond de Rothschild Asset Management, Macrobond



	Our convictions	Changes compared to the previous month
ASSET CLASSES		
Equities	-	→
Fixed Income	= / ★+	↑
Dollar	-	→
Cash	=	→
EQUITIES		
US	-	→
Europe (ex-UK)	=	→
UK	=	↓
Japan	=	→
China	=	→
Global Emerging	=	→
SOVEREIGN BONDS		
US	=	→
Euro Zone	=	→
Emerging Markets	+	↑
CORPORATE BONDS		
US Investment Grade	+	→
Euro Investment Grade	+	→
US High Yield	=	→
Euro High Yield	=	→

Range of investment committee ratings on the asset class/geographical zone (from -/ to +/+). Source: Edmond de Rothschild Asset Management (France). Ratings at 14/10/2025. ★ Tactical score



KEY POINTS

- The deterioration of the US labour market comes on top of renewed tensions between China and the US following Donald Trump's announcement of new tariffs of +100% on all Chinese imports from November 1.
- The depreciation of the dollar is encouraging a more selective asset allocation, with a tactical increase in duration, favoring US and German sovereign debt and remaining underweight in French government debt.
- Caution remains the watchword for US equities, whose valuations are approaching the highs reached in 2021. The focus is therefore on diversification through themes related to economic sovereignty in Europe, big data, and small and mid-sized companies for their local exposure and lower sensitivity to currency fluctuations.

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Société anonyme governed by an executive board and a supervisory board with capital of €11,033,769 - AMF registration No. GP 04000015 - 332.652.536 R.C.S Paris

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