

# LETTER FROM THE CIO AM

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## MARKET ANALYSIS AND PRINCIPAL INVESTMENT THEMES - FEBRUARY 2026 by Benjamin Melman

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# Market rotation offers attractive opportunities

Since the beginning of the year, broadening has taken hold in US markets. The Magnificent Seven have under-performed the S&P500, which has lagged the Russell 2000 Small Cap index by a wide margin. This marks a major turnaround in market leadership compared with previous quarters.

Admittedly, the AI market cycle has become more mature and less univocal. Alphabet and Amazon's announcements of massive and higher-than-expected investment plans for 2026 were poorly received by investors - an all-time first - and failed to generate a pulling effect for the stocks meant to benefit from these plans. The free cash flows of many hyperscalers should be in negative territory this year, meaning that these players will have to raise debt or issue stocks to finance their investments - which is also unheard of. These "asset light" companies, a feature that supported their stock price, have gained weight. In addition, investors have started to raise questions about the profitability of these increasingly massive investments.

However, one theme has remained constant over the past few months: the identification of AI victims. Software companies suffered a sharp and indiscriminate correction, losing almost 20% in just a few weeks on fears that clients will use AI to build their own software. This thesis makes light of the high diversity with the software segment, and notably the difference between horizontal and



## MARKET ROTATION OFFERS ATTRACTIVE OPPORTUNITIES



vertical integration systems, which are not exposed to AI to the same degree. It also overlooks the Jevons paradox. This suggests that owing to the improved efficiency and lower cost of developing software (thanks to AI), demand will in fact rise rather than shrink. While we understand investors' strong reaction to uncertainties triggered by the AI-driven evolution of software business models, we consider the market response to be excessive.

The recent nomination of Kevin Warsh to serve as the next chair of the Federal Reserve (pending Congress approval) was not a revolution, but the news hit gold and metal markets. Indeed, Kevin Warsh is in favour of a very small Fed balance sheet. However, it seems that paring back the central bank's financial footprint any further would require a new regulatory framework for commercial banks. In other words, this goal is possible - but over the longer term. On the other hand, M. Warsh's belief that AI-related productivity gains will help lower inflation and allow for a looser monetary policy remains valid. To some extent, M. Warsh's appointment as Fed Chair is rather favourable to bond and equity markets, and probably for gold.

In this environment, we have raised our exposure to emerging equities. After lagging for several years, these stocks stand to benefit as investors reposition their portfolios away from the United States - now that the AI cycle has reached maturity - and seek out new AI-related stocks (in China). Emerging equities should also benefit from the prospect of rate cuts in the US and the upward trend on metal prices (Latin America).

In Japan, the LDP's landslide general-election victory has given Prime Minister Sanae Takaichi full powers to push on with her reflationary agenda. We remain overweight Japanese equities.

We continue to favour the broadening theme as we feel that AI is over-played by producers but rather downplayed on the user side.

In fixed income markets, we prefer financial and hybrid corporate bonds (a pool essentially comprising Investment Grade bonds), as well as emerging bonds. Spreads are narrow but private sector bonds seem less exposed to the risk of ballooning public deficits, and we have a preference for short and intermediary maturities, which are rather more sensitive to monetary policy and less to fiscal policy.

## MARKET ROTATION OFFERS ATTRACTIVE OPPORTUNITIES



	Our convictions	Changes compared to the previous month
<b>ASSET CLASSES</b>		
Equities	= / +	↑
Fixed Income	= / +	→
Dollar	- / =	→
Cash	=	→
<b>EQUITIES</b>		
US	=	→
Europe (ex-UK)	=	→
UK	=	→
Japan	= / +	→
China	=	→
Global Emerging	= / +	↑
<b>SOVEREIGN BONDS</b>		
US	= / +	↑
Euro Zone	=	→
Emerging Markets	+	→
<b>CORPORATE BONDS</b>		
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 12/02/2026.



### KEY POINTS

- The US market is rebalancing, notably in favor of small-cap stocks, as it begins to penalize the heavy AI investments by tech giants whose profitability is uncertain.
- The sharp drop in the software segment is deemed disproportionate. The market is underestimating the diversity of companies in the sector and ignoring the Jevons paradox, according to which lower costs related to AI will stimulate software demand.
- In this context, we are increasing our exposure to emerging market and Japanese equities. In fixed income, we favour financial bonds, emerging market debt, and corporate hybrids, focusing on short and intermediate maturities.

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