

Outlook & Convictions

Private Banking #14



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Editorial



Nicolas Bickel
Group Head of Investment
Private Banking & CIO

Not since the end of the Cold War has the world experienced so many geopolitical conflicts and trade tensions at the same time. Though the global economy is holding up, this succession of geopolitical events creates new uncertainties and calls for greater vigilance in our investment choices. In this extremely uncertain and shifting environment, the key is not to predict each market movement but to adapt to it skillfully.

This state of affairs is perfectly encapsulated in the extreme swing on the equity markets, with equities falling by more than 15% in just one month and rebounding by the same percentage in just ten days between April and May. Our investment decisions in favour of equities, reinforced at the beginning of April through US and European equities, have proven highly beneficial for our portfolios.

But the question remains: was it the correction that was excessive, or is the rebound a reflection of excessive optimism, linked to the surge in market sentiment indicators, after the multiple turnarounds of the US administration?

On the macroeconomic front, US data confirmed a slowdown but did not point to a recession. While gross domestic product (GDP) contracted in the first quarter in the United States, the US labour market remains strong. Consumer and business confidence rebounded strongly on the back of the tariff truce. The corporate earnings season ended on a positive note, with solid profit growth and broadly maintained guidance. In addition, the long-awaited announcement of tax cuts in the United States was finally passed in the House of Representatives.

In Europe, the continued deceleration in inflation and growth, ultimately slightly higher than expected, though still weak, enabled the

European Central Bank to make its eighth rate cut on 5 June. In China, persistent deflation risks and negative effects of the trade war are likely to increase fiscal and monetary support measures. Chinese retail sales in May rebounded thanks to subsidies on the purchase of certain products.

Against this backdrop, US equities, after lagging in the first quarter, have once again outperformed other markets since the start of the second quarter. This performance has largely been driven by the tech sector, which continued to be bolstered by excellent earnings reports. US equities are once again trading at extremely high valuations, at 22 times expected earnings, which is 35% higher than the average of the last 20 years.

Looking beyond the rebound in equities, which does not appear to have been disturbed by recent increases in geopolitical tensions, a number of recent trends have shaken investors' convictions. Most notably, the dollar has lost more than 10% against the main currencies since the beginning of the year. The Dollar Index, which measures the dollar against a basket of currencies, is at its lowest level in nearly two years, following the start of the conflict between Iran and Israel.

The status of the dollar and US Treasuries has for decades been based on the major pillars of confidence in the US and the stability of its currency, the US military umbrella, and the applicability of the rule of law in the US. But since Trump moved into the White House, those four pillars have been, and continue to be, shaken regularly. This does not point to a recovery in demand for US dollars and US Treasuries, which will continue to weigh on long-term rates and the US currency.

That being said, at this stage, the dollar's safe-haven status and the long-standing quality of US Treasuries as a "risk-free" asset class in no way appear to be challenged in the long term, with over 70% of global transactions still in US dollars and the US debt market still the most liquid. The latter continues to benefit from the support and independence of the US Federal Reserve, despite the Trump administration's attempts to destabilize the institution, and remains extremely high-quality compared with many developed countries.

At this point, the diversification of investors away from US assets appears to be having a greater impact on the dollar than on US equities. Despite high valuations and direct exposure to series of short-term political uncertainties, US equities remain attractive. For investors seeking exposure to the tech sector, the US remains vital and we do not believe that the ability of US companies to deliver strong earnings growth and margins is compromised at this stage.

At the same time, although growth momentum is lower than in the US, European equities also remain highly attractive, particularly with more moderate valuations, low interest rates and a recovery in growth, notably via the rebound in consumer and corporate credit, as well as government programmes such as the German infrastructure plan and the ReArm EU plan.



Gold, which has benefited from significant flows for several years, continues to rise. Increasing geopolitical tensions and moves to diversify the currency reserves of various central banks around the world are fuelling the rise in prices.

Meanwhile, in a counter-intuitive development, oil has fallen sharply, temporarily below the \$65 mark, despite the US bombardment of Iran and threats to block the Strait of Hormuz, through which flows nearly 20% of the world's oil, mainly destined for Asian markets. The market considered this conflict as local and was reassured by OPEC's production reserves and by the new strategy of an all-conquering OPEC+ in favour of volumes and at the expense of prices. This served to alleviate some of the fears of a resurgence of inflation, which pushed the Fed into a standstill. The drop in oil prices could be one of the many sources of support for sectors such as travel and retail, consumer discretionary, food, and some industrial sectors.

Overall, lower short-term interest rates, tax cuts in the US, stronger growth in Europe thanks to the German infrastructure plan and the EU defence plan, as well as the stabilisation of retail sales in China, should support consumption and investment in the coming months and reinforce our positioning in favour of equities.

But the second half of the year promises to be full of surprises for investors, obliged to constantly adapt to geopolitical ups and downs and separate sentiment and fundamentals, in an environment where political decision-making cycles have become much shorter than those of investors, the market and the economy.

In this issue, we discuss our economic forecasts and our market convictions for the equity and bond markets for the second half of 2025. We look at the safe-haven status of the dollar, gold and US sovereign bonds and share our outlook on oil prices.

Our special report focuses on the evolution of technologies that will change the face of tomorrow's cities and explores how to gain financial exposure to this promising trend.

Lastly, we share our convictions on certain investment themes, such as European banks, the defence sector and Swiss equities.



▶ Our outlook in video



Macro-eco



The Trump effect: amplifying the slowdown in global growth.

- The strategy of the United States is not just a rise in tariffs but the pursuit of a new world order.
- Fall in trade, decrease in US consumption to reindustrialise the country, historical uncertainty, change in relative demand for US assets, Chinese deflation.
- Sharper-than-expected slowdown in December in the US, the eurozone and Asia.
- The German investment plan could prove insufficient to help the eurozone cope with a 50% tariff hike, a rise in energy prices stemming from the Iran-Israel conflict, and even more aggressive Chinese competition.

Heightened tensions on tariffs at the beginning of the year led to large-scale financial movements. The US stock index fell by 20%, the dollar depreciated by nearly 10% and US 10-year sovereign yields rose to a peak of 4.59% on 21 May 2025. The markets were disrupted not only by the announcements of record tariff increases but also by the United States' determination to make other countries pay for using the dollar as a reserve currency and to exit the Bretton Woods system.

The recessionary impact of the rise in tariffs and uncertainty

Similar to the protectionist measures implemented (export restrictions, subsidies, etc.), these increases push import prices and production costs upwards, reduce purchasing power, household consumption and investment, and constrain value chains. The most impacted countries are those with the greatest dependence on the United States, but the knock-on effects on their trading partners should not be underestimated. As the trade war is being waged by a major country with an influence on global demand, the United States may force its partners to lower their export prices if they want to continue exporting to the US. This will result in a decrease in additional margins of the targeted companies.

It is obviously complex to calculate the actual customs duties, as they are a bargaining tool. That is why we have developed two scenarios. In the first scenario, only a 10% increase in customs duties on the vast majority of US imports and a 30% increase on purchases from China would be applied, with sectoral surcharges. In this case, GDP

would fall by 2% in the US, 1.6% in China and 0.5% in the eurozone compared to 2024. Global GDP is expected to dip by 1.3%. By substituting foreign production, US industrial and service production is expected to increase by 1.5%. This effect is stronger for cross-border imports than for goods transiting through value chains. World trade is expected to fall by 6% compared with 2024. Trade flows are expected to contract the most in the transport equipment and electrical and electronic equipment sectors, estimated at 16%. The price shock would destabilise value chains, particularly in the electrical and electronic equipment and equipment sectors (the production of which is 30% dependent on value chains).

If the reciprocal "tariffs" announced by the Trump administration were to be fully implemented, with no sector exemptions and with retaliatory measures, GDP would decrease by as much as 3.8% in the United States, 1.5% in China, 0.8% in the eurozone and 2% globally. In this event, US production would grow by 2.7%. South-East Asian countries, and, more broadly, the "corridor" countries having benefited greatly from the US-China trade war since 2018, would be affected by the expected slowdown in global trade and the industrial recession. Moreover, Chinese companies will redirect their sales to compensate for their lower exports to the US and step up their deflation policy to gain market share.

European industry could be further weakened by the combined effect of higher energy prices resulting from the Iran-Israel conflict and an increase in imports from the United States following negotiations with the European Commission, the implementation of additional 50% tariffs on European exports to the United States, and increased competition from China. The effective US rate on imports of European goods could rise to a peak of 35%, compared with less than 2% in 2024! EU exports to the United States could fall by 60% compared with 2024 and EU GDP could decrease by as much as 2.1%, compared with an estimated 0.8% solely for an increase in tariffs on European exports across the Atlantic. This could lead the European Central Bank to decrease rates to close to zero, which would weigh on the value of the euro. Core inflation could be 0.5 percentage points lower than in the scenario with tariffs at 10%.

The increase in tariffs and the strengthening of protectionist measures are therefore not simply a short-term macro-economic shock. They would lead to a reorganisation of trade flows.

The increase in tariffs is not the sole channel of negative impact resulting from US policy. Further key factors are uncertainty and the rise in long-term borrowing rates. According to the Global Uncertainty Index (UPR), uncertainty tripled between the first and second quarter of 2025. The impact is extremely negative as it favors savings and undermines private investment. It also boosts the risk premium on the bond market, pushes up long-term rates, and thus increases government borrowing costs. Uncertainties over the trade war serve to postpone planned investments in both the value and expansion chains.



Uncertainty is also being fuelled by the tightening of financial conditions. The initial decline in stock markets negatively impacted the wealth effect and consumer confidence, while currency depreciations are inflationary. Meanwhile, increases in borrowing rates, particularly in the long term, are weighing heavily on real estate markets and driving up the refinancing costs of companies and States.

Supporting demand through increased public spending

The additional government spending announced since the beginning of the year should partially offset the fall in demand. In addition to the extension of the tax cuts under the 2017 Tax Cuts and Jobs Act, further expenditure will be proposed to Congress as part of the "One Big Beautiful Bill" to support investment in the US. In China, the government has continued to ease its monetary and fiscal policy. The increase in the deficit in 2025 relative to 2024 could be 1.2% of GDP, and as high as 4% of GDP including local and central government special bonds. According to our Chinese economist, Fang Liu, these measures, which are mainly focused on public investment, could impact Chinese growth by 1 percentage point. But the biggest surprise came from Germany, which once again announced a stimulus plan at a decisive moment. This development has led to a sudden rise in German 10-year sovereign bond yields and the appreciation of the euro. According to our estimates, these measures could increase German growth by 0.3pp in 2025, 0.6pp in 2026 and 0.8pp in 2027. In addition, Chancellor Merz has confirmed that Germany will meet the target of spending 3.5% of GDP on defence by 2032, an increase of 0.2 growth points per year. Germany has, as usual, chosen the path of investment, which in the medium term should also have a positive impact on capital accumulation and potential growth. In addition to the direct impact on German growth, the €500 billion plan and the adoption by the Bundestag of a constitutional amendment easing the debt brake on 18 March could support investment in the eurozone. The plan also provides some leeway in the short term to the ECB and to the European Commission (EC) for its trade negotiations with the United States. At the same time, the EC has announced a new global defence strategy, ReArm Europe Plan/Readiness 2030. The new plan earmarks more than €800 billion to targeted initiatives. For more details, see the analysis by Marie-Louise Deshaies, dated May 2025: "Eurozone: more defence, more growth".

A temporarily weaker dollar

It is not only the mistrust generated by the announcements of "reciprocal" tariffs (Liberation Day) on 2 April that has led to a rise in US sovereign yields and dollar depreciation. These trends have also resulted from the surprise announcement of substantial German fiscal support and an easing of the debt brake. This German response to US unpredictability proved an effective move, as it helped to support the euro and, as a result, lessen the impact of US attacks concerning the undervaluation of the single currency. The nominal effective exchange rate of the dollar decreased by 10% between January and June 2025, falling particularly sharply against the Brazilian real (-9.8%), the euro (-9.4%)

and the Swiss franc (-9.3%). Over the same period, the greenback declined 8.5% against the peso and 5% against the Canadian dollar.

As a result, the euro should continue to benefit from a proactive Germany and a robust performance by southern European economies. But dollar demand will continue to be bolstered by strong US nominal growth and the technological advance and military weight of the US.

Conclusion

US foreign policy since early 2025 is expected to amplify the slowdown in global growth initiated in 2025 and 2026. We have decreased our growth forecasts for the US to 1.7% in 2025 and 1.9% in 2026. However, we continue to expect the Chinese economy to grow by 4.8% this year and 4.9% in 2026 thanks to fiscal and monetary easing policies. The eurozone will benefit from the German stimulus plan and corporate tax cuts already passed. If the increase in tariffs on goods exported to the US is limited to 10%, we continue to expect growth of 0.6% this year and 0.8% in 2026.

Dr. Mathilde Lemoine

Group Chief Economist Edmond de Rothschild



Commodities



The oil market in 2025: geopolitical uncertainties, reshaped supply and persistent volatility.

The global oil market has been operating against a complex backdrop since the beginning of 2025, with political uncertainties, supply pressures, mixed signals on demand, and the resurgence of geopolitical risks. The major shock came in June, when military tensions between Iran and Israel suddenly pushed the price of Brent from \$60 to \$80 in just a few days. The Brent price then declined swiftly, to \$64, following the limited diplomatic and military intervention by the United States to contain the escalation. While oil prices are now stabilising at around \$60 to \$65 per barrel, this sequence of events highlights the fragility of the current equilibrium, torn between structurally bearish factors and peaks in geopolitical tensions.

The Iran-Israel conflict of June 2025 as a volatility trigger and catalyst of a lasting risk premium

The war between Israel and Iran marks a decisive step in the escalation between the two countries. This geopolitical shock immediately drove crude oil prices upwards, with the barrel increasing by nearly \$20 at the peak of tensions, revealing the extreme nervousness of the markets. But looking beyond this one-off reaction, the conflict could trigger a deeper paradigm shift, as it increases the likelihood of a cycle of recurring instability in the Middle East, with phases of acute tension followed by phases of partial easing. This generates structural volatility, in which prices rise in fits and starts, according to a sequence in which each crisis episode establishes a higher price level.

The geopolitical risk premium linked to Iran could therefore recalibrate upwards from time to time in step with current events. If this premium were to last, measures would be necessary that would directly impact the oil trade. Operators adjust their strategies in expectation of these jolts, reinforcing the speculative component of price movements.

Looking beyond the geopolitical dimension of oil, fundamental analysis is currently used to determine the market trend.

Further geopolitical factors in oil: US political uncertainty and the offensive strategy of OPEC+

The decline in oil prices between January and March 2025, with the WTI falling from over \$72 to around \$60, resulted primarily from renewed political uncertainty in the US. The election year, marked by Donald Trump's candidacy for a second non-consecutive term, revived doubts about the predictability of US policy on trade, energy and diplomacy. The markets feared the return of a more isolationist and transactional foreign policy liable to heighten trade tensions and increase regulatory instability. At the same time, OPEC+ surprised by adopting a less cooperative approach and seeking to regain market share, contrary to its strategy of restricting supply in 2023 and 2024. Saudi Arabia, Russia, the United Arab Emirates and Iraq have increased production since the spring, theoretically adding more than 400,000 barrels a day each month, capitalising on Asian needs and the erosion of US supply. This relative over-abundance increased downwards pressure, especially in the absence of a sharp rebound in demand.

An easing of the tariff war, calming the markets and stabilising prices at \$60 to \$65

Despite initial concerns about Donald Trump's return to the presidential race, the US-China tariff war feared by investors was less intense than expected. The statements made by Beijing and Washington since March show that both countries are seeking to de-escalate, especially regarding energy products, in which China remains dependent on strategic imports. Signs of temporary sector agreements have helped to stave off the scenario of a head-on trade war.

This relief has provided moderate support for crude oil prices. Reassured by the stability of global trade, investors have revised their demand expectations upwards. This has helped to stabilise prices at around \$60 to \$65, further supported by technical signals (rebounds for major vehicles) and more rigorous inventory management by Asian and European refiners.

Towards a new fundamental paradigm: the rise of OPEC+, the slowdown in US shale, and moderate growth in demand

The global oil sector is entering a phase of structural reorganisation. OPEC+ appears to have made a lasting strategic shift. Rather than defending high prices at the expense of volumes, several of its members are opting for a gradual increase in their production with a view to capturing the market share left vacant by the decline in US shale oil.



US production has indeed been in technical decline since the end of 2024 (but still remains at 11 million barrels per day). This trend can be attributed to several factors, including scarcer financing for independent producers, the gradual depletion of the best deposits (sweet spots), and less competitive extraction costs than for Middle Eastern crude. Rising interest rates in the US have also reduced the appetite for new drilling financing.

In response, OPEC+, particularly via Saudi Arabia, intends to capitalise on its ability to rapidly flood the market at a lower cost as part of a dominant rationale. Looking ahead, this strategy could boost volatility if the supply-demand balance remains fragile. On the demand side, the outlook remains stable, with moderate growth driven by emerging Asia. However, demand in the United States and Europe has hit a ceiling or declined slightly due to the energy transition and sluggish growth.

Conclusion: a market in transition, guided by contradictory forces

The oil market in 2025 is marked by chronic instability, fuelled by geopolitics, a supply reshuffle and uncertainties about the global macroeconomic cycle. Prices fell substantially at the start of the year but then stabilised on the easing of trade tensions and persistent geopolitical tensions. But the shift to a new paradigm, with an all-conquering OPEC+ and weakened US shale production, points to lasting volatility.

Against this backdrop, investors need to keep a close eye on major political signals (US elections, Iran, OPEC+ decisions) by following key micro-economic trends in the sector (storage, refining margins, extraction costs). Oil is still a geopolitical asset.

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



Global equities



Equity markets: sentiment prevails over fundamentals.

Since the beginning of the year, equity markets have experienced volatility rarely seen before, from the euphoria before President Trump's inauguration to panic after the announcement of tariffs, and from a phase of easing to renewed fears since mid-June.

The erratic communication of the new US administration and its announcement of exceptionally high tariffs in early April led to a massive sell-off of US assets. Stock market "exceptionalism" gave way to fears of inflation and recession related to the announcements and governance of the Republican administration. US equities rebounded considerably from mid-April on sound first-quarter corporate earnings, Trump's shift on tariffs, the announcement of tax cuts and bank deregulation, and the resilience of growth and deceleration in inflation. They almost returned to their record level of February, though the word "exceptionalism" is no longer being used. But concerns returned to the fore in mid-June owing to the geopolitical context in the Middle East and the Fed's fears of a potential rise in inflation.

Europe seems to be breaking away from the S&P 500, with a notable outperformance, the result of the "European awakening" following a loss of confidence by foreign investors due to the erratic nature of the US government's economic policies, the withdrawal of the United States from its role as guardian of world peace, and Germany's change of course. German Chancellor Friedrich Merz is abandoning Angela Merkel's policy of curbing public debt in order to boost the country's defence and infrastructure spending, which could amount to over €1 trillion over the next ten years.

In China, a rare divergence has been observed between the Hong Kong index, which has trended positively since early 2025, and the CSI 300 index of more domestic stocks. The Hang Seng index is made up of international companies, large-cap tech companies, and large-cap financials, which are benefiting from US equity outflows and international sales of Chinese products subject to cost deflation. The CSI 300 includes local companies exposed to weak Chinese demand and the deflation of selling prices in the Chinese market.

In the short term, the momentum of the rebound initiated on 8 April is likely to ebb and volatility will persist owing to several factors:

- More negative seasonality.
- The risk of a spike in oil prices.
- The expiry of the time limits for negotiating tariffs.
- More expensive valuations, especially in the US.

Our view for the longer term remains positive due to:

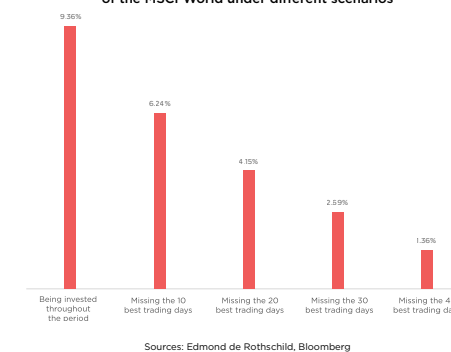
- The continued roll-out of artificial intelligence.
- Persistently resilient corporate earnings growth.
- The positive economic impact of tax cuts in the United States and infrastructure and defence plans in Europe.
- China's potential stabilisation.

Given the valuation level of the markets, and the US market in particular (see chart 1), the short-term potential in this market appears to be more limited than in recent weeks. We remain positive on European markets given their lower valuation, underestimated potential growth, and markets that we believe are already pricing in a large share of bad news (geopolitical, weak growth in China, strong euro, etc.). European financials (see page 30), which are showing strong momentum this year, still have potential, as do stocks linked to the European surge, particularly in defence (see page 32). With volatility on the rise, demand is strong for defensive stocks, such as basic goods and healthcare, which are well represented in the Swiss index, for example (see page 25). For investors with a long-term view, it is important to stay invested. Not being exposed to the equity market, even for a few days of good performance, can significantly reduce the long-term performance of portfolios (see chart 2).

Chart 1:
12-month price-to-earnings (P/E) ratios
of the S&P 500 and Stoxx 600



Chart 2:
Annualised performance (2003-2023)
of the MSCI World under different scenarios



Hervé Prettre
Head of Global Investment Research



Swiss equities



Swiss market: local stability, global power.

The Swiss equity market has long been perceived as a niche market dominated by a few defensive giants. That perception needs to be reviewed. In addition to its proven stability, the Swiss equity market combines international exposure, sector diversity, financial discipline and attractive returns. With investors today looking for visibility, quality and risk-adjusted returns, the Swiss market is an essential component of a global equity portfolio.

A global market showing resilience and growth

Buying a Swiss stock means gaining exposure to the global economy. Listed companies generate nearly 90% of their revenues outside Switzerland, with high exposure to North America, Europe and Asia, and their costs are mainly denominated in foreign currencies. This global dimension reflects the country's macroeconomic structure: Switzerland has a trade surplus of 10% of GDP and Swiss exports account for 48% of GDP, far more than its neighbours.

The domestic economy, driven by SMEs, is not strongly represented on the stock market. The Swiss market is often perceived as defensive owing to the weight of pharmaceuticals, consumer staples (with Nestlé, Roche and Novartis alone accounting for 40% of the SPI) and insurance, which make up around half of the index. Yet, the market is as exposed as the rest of the world to the global economic cycle, through its companies in the luxury goods, industry, asset management and med-tech sectors.

Underestimated depth and diversity

The Swiss market is a large market, almost as big as France and bigger than Germany, for obviously very different populations (see chart 1). The market stands out through the substantial size of its mid caps, which would be considered large caps in many other countries. The 20 largest Swiss capitalisations all rank in the top 100 in Europe.

The market impresses by its depth (nearly 50 companies with capitalisations between CHF 5 billion and CHF 50 billion) and by its diversity, including industry (Schindler, SGS, VAT), healthcare (Straumann, Alcon, Sonova), finance (Julius Baer, Partners Group), construction (Holcim, Sika) and luxury (Richemont).

A stable and attractive dividend... in CHF

With interest rates low, Swiss equities offer a source of alternative income with an average dividend of 3%, much higher than the 1.5% of the US market. In real terms, net of inflation, the Swiss yield is very attractive.

These dividends are growing steadily and attracting local institutional investors (pension funds, foundations). They are an alternative to a shallow bond market with limited yield (currently 0.8% for Investment Grade). Incidentally, the strong Swiss franc imposes investment discipline on companies, especially those pursuing external growth strategies.

Chart 1:
European markets: Capitalisation vs. Population

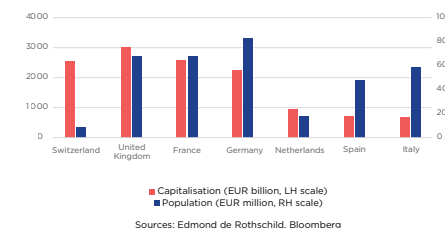
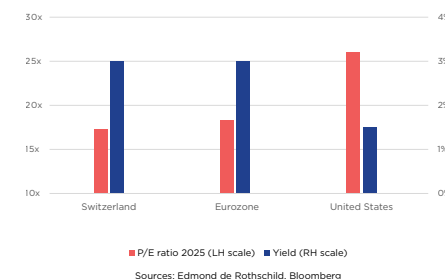


Chart 2:
Valuation multiples by region



A reasonable valuation

Long perceived as expensive, Swiss equities now look reasonably valued, following the revaluation of US equities in 2023-2024 and the rediscovery of European stocks in 2025 (see chart 2). This valuation seems justified by the quality of governance, the solidity of balance sheets and the regularity of distribution policies.

Investing in consistency and excellence

Buying a Swiss stock means investing in global groups built on rigour, innovation and prudence. It also means benefiting from high-quality governance, a strong currency and a stable political environment. The Swiss market combines scarcity, real returns and resilience. As such, it fully deserves its place in a diversified global portfolio, regardless of its reference currency.

Michel Leblanc

Head of Equity Expertise - Discretionary Portfolio Management Switzerland



Europe



European banks: still on a roll, particularly with the prospect of a banking union.

European banks, as pointed out in Outlook & Convictions #13, are the top-performing sector in Europe in 2025 and could still benefit from favourable tailwinds. They remain relatively cheap, despite their high profitability and robust outlook.

Many economic factors are positive

- The yield curve is steepening, and this should continue with significant fiscal spending by European governments. This steepening is beneficial as banks borrow short-term to lend long-term, which should allow for growth in net interest margins on loans.
- Trading activity is bolstered by today's financial market volatility;
- Consolidation is expected to intensify with several recent large-scale transactions.
- Inflows into European equities should primarily benefit the banking sector, with banks ranking as the leading sector in the Stoxx 600 index (13% of the index).
- Competitive pressures have decreased. Some retailers with financial activities have recently sold these businesses to banks owing to a lack of scale or expertise, while online banks have stagnated, their share of total deposits remaining low (3% to 5%) due to their difficulty in offering services with higher added value than simple payments or transfers.
- The impact of technology, and AI in particular, is fundamental for many retail and professional customers, and large banks have more capacity to invest in this area.
- Valuations continue to return to normal, with the 2026 P/E of European banks remaining moderate at 8.5x, compared with a historical average of 10-11x.
- Shareholder remuneration through dividends and share buybacks is strengthening, thanks to improved cash generation.

The acceleration of the establishment of the European banking union stands as an additional strength. The straightforward goals of a banking union are to channel into the economy the €1.4 trillion in European savings, which are often very little invested, and to allow surplus savings in certain regions to be lent and invested in other regions where savings are lower. The aim is also to create a true integrated capital market in Europe, as in the US.

A bill containing key measures

- The harmonisation of taxation on stock trading to make buying shares more attractive to retail customers.
- The lowering of solvency ratios in equity trading and securitisation, to reduce the dependency of European banks on traditional loans and help them expand into investment banking as financial intermediaries. This is in line with the model of the large American bank, which now finances only 30% of the domestic economy, the bulk of which is financed by asset managers, private equity funds and pension funds, for which the big banks act as intermediaries for a fee. European banks still finance more than 70% of the region's economy through traditional loans, increasing their risk and keeping a lid on their lending volumes, notably with high solvency ratios. The US model offers less credit risk and higher margins thanks to intermediation, which translates into higher profitability.
- The harmonisation of IPO rules to boost this market, which is beneficial for companies and banks, with margins of 4% to 8% on IPOs for banks.
- The adoption of the Digital Operational Resilience Act, to strengthen and harmonise IT risk management and network security at the European level.
- The simplification and standardisation of the calculation of capital requirements. The aim is to determine regulatory capital levels using a simple method based on a harmonised formula, facilitating comparability within the sector and between countries.

A banking union is expected to boost the business of investment banks, wealth managers and lending banks in Europe. It will benefit banks close to companies with a developed business line, as well as those with access to significant savings. It could also encourage a wave of mergers and acquisitions at the European level, serving Europe's goal to have larger banks, thus contributing to strengthening the revaluation of the sector.

Hervé Prettre
Head of Global Investment Research

Darius Bakhtari
Research Analyst, Global Investment Research

Chart 1:
Contribution to Stoxx 600 performance
since the beginning of the year

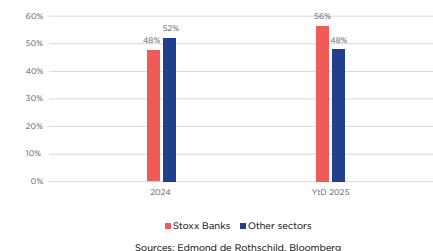
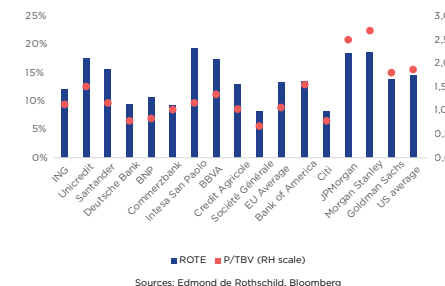


Chart 2:
12-month P/E for MSCI US and European
Banks indices (dotted averages)



Chart 3:
Return on tangible equity (ROTE) and price to tangible
book value (P/TBV) of European and US banks





“If you don’t deal with geopolitics, geopolitics will deal with you.”

This formula, attributed to President Carter’s former advisor, Zbigniew Brzezinski, has long seemed irrelevant in a Europe that would like to see itself as “post-historic”, peaceful, and economically integrated. But reality came crashing down over the last few months, with war returning to the Union’s doorstep, and the need for a strategic awakening. Europe is rediscovering a forgotten truth: if it is unable to defend itself, it shall have neither political sovereignty nor economic independence. Defence is the foundation that determines all the other fundamentals.

Defence, reality check and incipient sovereignty

The war in Ukraine has put an end to a long-standing strategic illusion. In just a few weeks, Europe discovered just how vulnerable it really is, with dispersed military capabilities, insufficient stocks of arms, and critical dependence on the American umbrella. These weaknesses illustrate a loss of autonomy that undermines our sovereignty.

The awakening is brutal, but salutary. The agenda on military budgets extends over the long term, but national intentions have already begun to rise dramatically. France is talking about 3.5% of its GDP going forward, while Poland will approach 5% by 2025. Germany has had the EU’s largest defence budget since 2024 and the country has announced €500 billion in additional military spending over ten years.

The issue of allocating budgets to equipment will be central. The European Defence Industrial and Technological Base (EDTIB), which is highly fragmented, will need to be structured and players with critical mass will need to be established in order to compete with the major US suppliers. As part of these efforts, we have discovered an unexpected ally: the new President of the United States of America. In an interview with *Le Figaro* in May, Ariane de Rothschild stressed that “Donald Trump is doing a great service to Europe by forcing it out of its lethargy”. By threatening to withdraw from NATO, the US president is spurring Europe into action, as shown by the stock market performances of European defence companies relative to their US counterparts. The political tone has changed. Strategic autonomy is a clearly stated objective. And public debate has acknowledged an obvious fact: without credible defence, Europe shall enjoy neither political sovereignty nor economic sovereignty.

With this in mind, it is entirely in the interests of investors to reintegrate defence into their strategic readings. Geopolitical stability is a prerequisite for lasting performance. No security means no long-term investment.

The Draghi report: investing for economic sovereignty

In his report submitted to the European Commission in September 2024, Mario Draghi, an economist and former ECB President, proposes nothing less than a paradigm shift. In response to the erosion of Europe’s competitiveness, he argues for a collective leap in the shape of a large-scale coordinated investment strategy focused on sovereignty. He advocates a Europe that entirely takes on its role as a full-fledged economic player, capable of competing with the United States and China.

This ambition rests on three pillars:

- **Energy:** Europe must ensure clean, competitive and independent energy. This involves renewables, the return of nuclear power (conventional and SMR, small modular reactor), denser electricity networks enabling industrial electrification, and the use of liquefied natural gas to offset the loss of Russian gas. Energy self-sufficiency is a prerequisite for a competitive and resilient industry.
- **Innovation:** the key challenge here is productivity. From 2040, the European Union will lose two million workers per year. It will need to produce more with fewer workers and to do so it will be required to master critical technologies (AI, biotech, space, semi-conductors) and restore its capacity for innovation.
- **Financing:** Europe has abundant but poorly allocated savings. Mario Draghi is calling for a “Savings and Investment Union” (SIU) to harness these savings to finance our sovereignty, in particular through the modernisation of the capital markets and a genuine banking union (see previous article), as today’s European banking sector is excessively fragmented.

But without security, these pillars remain fragile. Critical value chains, energy infrastructures, laboratories, factories: all these essentials rely on a stable geopolitical base. Defence is not a priority among others; it is the vital strategic factor underpinning the whole.



For investors, a transformation to be captured today

Long considered a taboo for investment, defence is now an accepted management theme, supported by governments, industry and European institutions. Budgets are growing rapidly, European tools and resources are increasing (notably the European Defence Fund), and a forthright determination is emerging to consolidate an integrated European defence industrial and technological base.

But this dynamic is just the beginning. Public capital will not be enough. The Draghi report calls for a joint effort in which private investors will play a strategic role in financing the continent's transformation. Defence is a major component of this transition, but it is not the horizon. European sovereignty will also play out on the economic front, through energy, innovation and financing.

Reasoned investment in sovereignty must not be a "one sector show", with its consequences in terms of volatility. By investing in the economic pillars of the Draghi report, private players can capture a fundamental transformation while diversifying their exposure to a cross-cutting and sustainable theme: sovereignty.

Investing in European sovereignty means capturing a deep-seated movement that generates financial performance with rearmament, energy rebuilding, reindustrialisation and critical innovations, not to mention the financing of these investments. These dynamics are no flash in the pan; they are long-term themes upheld by strategic European players. And in addition to financial returns, it is also a non-financial commitment. This theme embodies the responsibility of contributing to the rebuilding of our common home and the autonomy of our collective decisions. Quite simply, it is about our freedom. As Jean Monnet said, *"men accept change only in necessity, and see necessity only in crisis."* — The time has come to choose.

Anthony Penel

European Equities Portfolio Manager,
Edmond de Rothschild Asset Management

Caroline Gauthier

Co-head of Equities,
Edmond de Rothschild Asset Management



Special feature



The cities of tomorrow: urban revolution and investment opportunities.

The development of cities has historically been the cradle of major changes, be it technological progress or social, political, economic and cultural progress. And this will be increasingly the case in the future. The city of the future is already taking form. It is greener, more flexible and accessible, automated, focused on technology and innovation, better monitored, and home to the head offices of large companies and a broad array of services. Despite inequality issues, the continued growth of cities could provide numerous attractive investment opportunities.

The city in transformation

According to the United Nations, an additional 2.5 billion people will live in urban areas by 2050, bringing the world's urban population to about 68%. This percentage is expected to be as high as 80% in the wealthiest countries. This rapid urbanisation is creating considerable challenges in terms of infrastructure, mobility, sustainability and quality of life, and even in the balance between population categories. In this constantly changing world, the cities of tomorrow are emerging today through the prisms of sustainability, accessibility, technological innovation and the economic opportunities they generate. As urbanisation accelerates, environmental and social challenges are becoming ever more pressing, prompting municipalities and investors to rethink infrastructure and urban lifestyles. Sustainable, smart and connected cities are no longer a utopia; they are vital to responding to the demands of a growing urban population.

For savvy investors, these transformations represent endless opportunities. Green technologies, smart transport systems, neutral- or positive-energy buildings, connection platforms, monitoring systems and digital infrastructure are just some of the promising avenues for profitable and responsible investments in the cities of tomorrow, even if the future also involves challenges.

The sustainable city

Sustainability will be the central aspect of the cities of tomorrow, going beyond environmental considerations to embrace a holistic vision of urban planning. This is a new approach, after centuries of growth through a simple influx of population and the development of neighbourhoods with no real control over the whole. Faced with climate

emergency and resource scarcity, cities around the world are required to adopt ambitious strategies to reduce their carbon footprint and improve the quality of life of their inhabitants. The transition to more sustainable cities can be seen in a multitude of innovative initiatives, supported by increasing public policies and growing private investment. For example, the large-scale integration of renewable energy into urban networks not only reduces greenhouse gas emissions; it also creates local jobs in green technology sectors. Offshore wind farms, such as in Hornsea in the UK, and urban solar farms, such as those developed in Singapore, are becoming new components of modern urban landscapes.

The conversion of disused industrial buildings

Rehabilitating brownfield sites and converting existing buildings is vital to ensuring urban sustainability. Rather than expanding indefinitely, cities need to rebuild themselves, optimising the use of existing urbanised spaces. This approach preserves natural and agricultural land by limiting land take and also serves to revitalise neglected areas. Brownfield sites are unique opportunities for developing innovative projects such as eco-neighbourhoods or spaces dedicated to the circular economy, where old structures are transformed into living, working or cultural venues. This intelligent approach to increasing urban density also fosters the improved management of resources and infrastructure while encouraging social and functional diversity in city centres.

Towards zero-emission cities

The transition to more sustainable cities is also illustrated by positive-energy buildings, which produce more energy than they consume thanks to integrated solar panels and smart energy management systems. Cities such as Copenhagen and Stockholm have set ambitious targets to become carbon neutral, by 2025 and 2040 respectively, in part through the construction of such buildings. In Switzerland, the city of Geneva has undertaken an ambitious overhaul of its thermal networks, whereby, instead of having a boiler in every building in the city, the heat will be produced in a power plant and conveyed to buildings via underground pipes. The energy will come from the incineration of waste, natural gas and heat pumps that draw water from Lake Geneva to supply the network with heat. The deep water of Lake Geneva will also be used to cool the buildings. Through this initiative, Geneva intends to accelerate the energy transition and reduce its greenhouse gas emissions by 60% by 2030. These developments are backed by strict regulatory frameworks and tax incentives, creating a favourable environment for investments in sustainable real estate.



Green, waste-free cities

The creation of urban green spaces and the promotion of soft mobility are also key to improving air quality and public health. Green spaces have a significant impact on urban temperatures by acting as “islands of freshness”. They reduce the average temperature of cities by about 2°C and can even create differences of 10°C or more between a street and a green space during a heatwave. The coolness of these spaces is ensured by the shade of the trees, the absence of bitumen (which stores heat during the day) and “evapotranspiration”, which cools the ambient air.

Cities are also investing in bicycle infrastructure, extended pedestrian areas and more efficient and less polluting public transport. Sustainable cities are also innovating in smart waste and water management systems. Increasing use is also being made of advanced technologies, such as IoT (Internet of Things) sensors to monitor waste levels and optimise collection routes, and rainwater recovery systems to irrigate green spaces. These solutions reduce operational costs and also improve the efficiency and sustainability of urban services.

Sustainable cities thus become ecosystems conducive to innovation, attracting talent and capital into a virtuous circle of responsible growth.

Cities with significant economic disparities but sources of opportunities

The proximity of universities, research centres and large groups, which are becoming increasingly powerful owing to globalisation, makes capitals more attractive than other cities for highly-skilled populations. However, lower-skilled populations seeking service jobs are leaving medium-sized cities, rural areas and poor countries to settle precariously in capital cities or their outskirts. Soaring property prices are forcing some middle-class families out of large cities (for example, Paris has lost some 100,000 inhabitants since 2010). Because large cities create skilled jobs and service jobs, their populations are split between highly-skilled populations and precarious populations, and the number of middle-class inhabitants is decreasing.

What will cities look like ten years from now? Property prices will increase further in city centres, driving out families and the working classes and attracting wealthy populations and those willing to accept modest housing for employment. However, contemporary occupational models such as teleworking and co-working spaces could offer younger generations a chance to return to vibrant urban centres. Inequalities in cities are expected to further increase. This will strengthen the need for security but also forge an international culture. This skilled and globalised population will prove a windfall for service providers, traditionally from other countries. Cities will be home to technological leaps and bounds, driven by AI. But they could also be home to a greater intertwining of diverse cultures, which are both a source of richness and tensions, and which ultimately succeed in co-existing and creating more sustainable, high-tech and connected cities that are more pleasant to live in.

Technology central to tomorrow's cities

In an ever-changing world, the challenge for tomorrow's cities will be to merge technological innovations with urban development to create resilient, sustainable and smart environments where quality of life is enhanced by the seamless integration of smart and connected systems.

Singapore, a leader in this field, uses a dense network of IoT sensors to monitor various aspects of urban life, such as air quality and traffic volume. This network optimises the use of resources and improves urban mobility in real time. Dubai is investing heavily in 3D printing, with an ambitious plan for 2030 to build 25% of its new buildings using this technology to optimise the resources used in their construction.

Several US cities, including San Francisco and Phoenix, continue to make headway on integrating autonomous vehicles, serving to offset both the increasing density of car traffic and the lack of drivers. Meanwhile, London is experimenting with public lighting systems that adapt to the amount of people in the city's various districts at any given time, thus reducing night-time energy consumption. Autonomous air transport is on the rise, notably in Paris, where tests with drone taxis are under way with a view to offering rapid and environmentally sustainable journeys between the city's main hubs. Numerous cities plan to use drones to streamline goods transport, for home deliveries in particular, to reduce congestion.

In a further new trend, augmented and virtual reality technologies are being harnessed in urban planning to foster collaboration between designers, architects and developers so as to facilitate the planning of real estate projects. For example, digital “twins” or “clones” can be used both to improve urban projects ahead of construction and to manage the entire ecosystem virtually once the projects have been finalised. Lastly, the vertical “urban forests” that are thriving across Asia, as well as in the West, in cities such as Milan, demonstrate how sensors can be used to ensure the health of vegetation, while contributing to the reduction of carbon dioxide in urban environments.

How to gain exposure to the ramp-up of technology in cities?

The Internet of Things is central to this transformation, enabling efficient monitoring and intelligent management of urban infrastructures through a multitude of interconnected sensors. Artificial intelligence, the spearhead of smart technologies integrated into tomorrow's cities, plays a crucial role in optimising autonomous systems and providing predictive analytics capabilities that facilitate informed decision-making. Connectivity (5G, and soon 6G) improves communication between smart devices, accelerating the implementation of mobility and resource management solutions. 3D printing stands as a revolution in the construction industry, making it possible to build faster while reducing waste. Augmented and virtual reality technologies optimise the planning and visualisation of urban projects, thus facilitating collaboration between property development players. In



a further development, the rise of drone technology opens up new avenues for autonomous air transport, offering logistics solutions that could reduce road congestion. Semiconductors, ubiquitous in technological devices, will remain the backbone of all these innovations and the best way to gain financial exposure.

How to gain exposure to the infrastructure challenges of tomorrow's cities?

Sustainable cities are fostering the emergence of new forms of collaboration between the public and private sectors. Public-private partnerships (PPPs) are becoming an essential tool, serving to share the risks and benefits while stepping up the implementation of innovative solutions. For example, private companies can invest in cutting-edge technologies for energy or waste management, while municipalities provide the necessary infrastructure and regulatory frameworks and ensure long-term cash flow visibility for companies.

Urban sustainability is an unprecedented opportunity for investors to play a role in the construction of more resilient and prosperous cities. By supporting projects that incorporate sustainable practices, investors can not only contribute to the fight against climate change but also benefit from attractive returns in growing markets. The sustainable and innovative cities of tomorrow offer fertile ground for investments that are both profitable and responsible.

In conclusion, tomorrow's cities are shaping up to be dynamic and sustainable entities forged through technological innovation and a vision firmly focused on sustainability. This does not preclude cohabitation between the "extremely well-off" and the "extremely assisted". The challenges posed by increasing urbanisation and climate change, including the need for security, are paving the way for unprecedented investment opportunities in which financial performance and environmental responsibility go hand in hand. Investors have a crucial role to play in this transformation by supporting projects that generate attractive returns but also help to build a more sustainable future.

Eric de Tessières
Group Chief Sustainability Officer

Nadjat Hamrouni
Director Sustainable Investment Solutions

Anthony Toupin
Senior Analyst, Global Investment Research

Chart 1:
Energy transition investments by category (2010-2024)

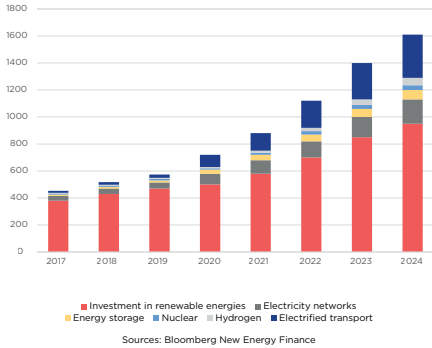
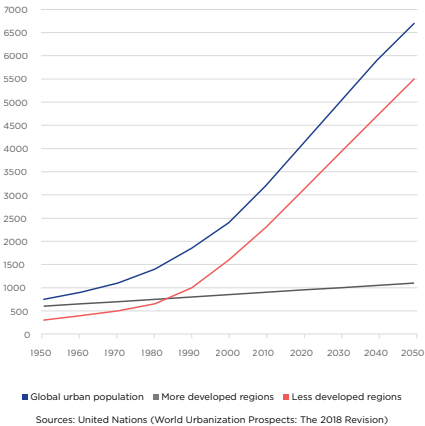


Chart 2:
Global urban population estimates and projections (1950-2050), in millions





Bonds



Heightened economic uncertainty doing no favours to bonds.

Historically, when the economy slows down and uncertainty increases, investors have found refuge in “defensive” assets such as sovereign bonds of the highest-rated countries, in certain currencies, such as the Swiss franc and the yen, and in gold. But this relationship is not as strong as it once was. Since the beginning of the year, all 10-year bond yields in the main countries have risen, even as growth prospects have been revised downwards owing to tariff-related uncertainty, widening public deficits, and the chaotic announcements of the Trump administration.

Bond yields in Europe have been boosted by the lifting of the debt brake rule in Germany to finance a vast infrastructure plan (20% of German GDP over 10 years). In the UK and Japan, fiscal uncertainties and higher-than-expected inflation have had a similar effect.

What are the causes behind this weakening relationship?

Two factors in particular are playing a key role:

- The level of government debt, which can no longer be financed at rates close to zero.
- Persistent inflationary risk in many countries, which reduces the possibility of across-the-board monetary easing.

The bond market is once again subject to investor vigilance regarding public finances, reflected in the reduced appetite for issues with long maturities. This rise in yields reflects an increase in the risk premium for sovereign bonds. This is especially true for US bonds, the long-term yields of which are highly sensitive to budget announcements and the possibility of a further increase in the already large deficit (with a budget deficit of around 7% expected in 2025). Another important factor is heightened uncertainty over the inflation outlook. The recent rise in inflation levels in the UK and Japan clearly shows that the battle against rising prices has not been won everywhere. In the US, while the latest inflation figures were encouraging, household inflation expectations have soared, keeping the US economy and the Fed uncertain about the trajectory of prices.

Most central banks have limited leeway to ease their monetary policy, despite the risks weighing on economic activity. Apart from the ECB, which cut its rates for the eighth time in a row in June, the US Federal Reserve, the Bank of England and the Bank of Canada have taken a more circumspect stance, waiting for greater visibility on inflation before focusing on risks to growth. The likelihood of Fed members easing monetary policy in the short term has declined significantly since the beginning of the year, and the same is true for the Bank of England. As a result, the markets now expect just two Fed rate cuts in 2025, compared with more than four at the end of March. Lastly, the relationship between sovereign rates and economic risk has become more stretched, owing to increased competition from issues by top-quality companies. As the volume of sovereign bond issuance continues to increase, high-quality corporate bonds are beginning to look much more attractive and are competing with the structural and institutional demand once associated with the highest rated government bonds.

What are the implications for asset allocation?

In our mind, the weakening relationship between sovereign bonds and economic risks has two major consequences:

- Long-term steep bond curves.
- The risk that investors having previously opted for sovereign bonds as part of their cautious allocations instead seek out other “defensive” assets.

While the short end of the curve is protected by central bank rate cuts and the accommodative nature of current monetary policies, the rise in yields with maturities of 10 years and more has led to a steepening of the curve on US, German and UK bonds alike. This trend will likely continue – and gather more steam. In this regard, it would be wise to expose bond or diversified portfolios to assets that are benefiting from this steepening. This curve trend has long been favourable to the financial sector, whose core business is the transformation of short-term liquidity into long-term credit (see page 51).

With regard to the protection capacity of sovereign bonds, the change in behaviour of the highest-rated sovereign bonds has been highlighted by the latest bouts of market stress and the limited reaction of long-term rates, which once benefited from the defensive flows of investors. As a result, their



sensitivity to economic and financial shocks has diminished, in particular due to persistent inflationary risk and a high level of debt. A quick and sudden drop in sovereign bond yields has become less probable and highlights the need to replace this asset class as a portfolio diversifier and defensive asset. Gold is one of the major beneficiaries of this shift, as is the Swiss franc.

Vigilance on sovereign rates

The situation in the US has been exceptional since 1987, as the 10-year yield has never increased this much following a rate cut by the Fed. Since the Fed lowered interest rates by 50bp in September 2024, the yield on the US 10-year government bond rose by more than 80bp, whereas in 1995 it remained stable five months after the first rate cut. The yield fell by 52 bps on average in the months following the first rate cuts. In Europe, despite eight ECB rate cuts, 10-year yields fell little or not at all over the period. This performance has been reinforced by the reform of Dutch pension funds (the most powerful in the eurozone), which should allow them to favour riskier bond investments and thus limit their purchases of safer sovereign bonds in the future.

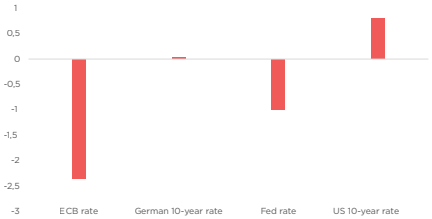
Sovereign bonds now appear less attractive, primarily because of the expected increase in issuance to finance larger deficits. The steepening of sovereign yield curves and higher rates can also lead to increased volatility in equity markets in the short term (see page 21). But this should not call into question the attractiveness of equities in the medium term, as a widening of deficits should translate into more economic growth. This environment is also favourable to the financial sector both in terms of equities and bonds.

Guilhem Savry
Head of Strategy Research, Global Investment Research

Chart 1:
Spread between 2-year and 10-year, US and German sovereign bond yields, in basis points



Chart 2:
Change in rates since the initial cut*



*The ECB cut its rates for the first time in June 2024 and the Fed in September 2024



US bonds



US bonds: structural pillar or source of vulnerability?

The re-election of Donald Trump has destabilised global financial markets. Trump's initial second-term economic announcements increased uncertainties about US assets. The announcements unnerved equity markets, but also spooked US government bonds, traditionally seen as a safe haven.

The markets have been driven more by sentiment than economic fundamentals for several months now. As illustrated by the tariff measures presented on "Liberation Day" in early April, which led to a spike in volatility. However, this reaction, although spectacular, was short-lived and does not call into question the sustainability of US debt. But the question arises: will there be a structural regime change for US Treasuries this year?

Public debt under watch

US debt exceeded 120% of GDP in 2025, a high level among major economies. This deterioration began in the 1980s, accelerated with COVID-19, and is showing no signs of slowing down. The main driver remains the budget deficit, which could exceed 7% of GDP by 2026 depending on the budget guidelines of the Trump administration.

This deficit is to be compared with nominal growth of around 5%, for a differential of 2%. This imbalance is certainly worrying, but remains less pronounced than in other major economies, such as France, where the gap between deficit and nominal growth stands at around 3%. Structurally, the US has higher nominal growth potential than Europe, both in terms of real growth and inflation, giving the country greater fiscal leeway.

The US government will have to address a growing need for financing and also refinance one-third of its debt in 2025. Today's high rates increase sensitivity to changes in rates, especially in an environment where sentiment appears to be dictating market movements. However, this stress should be put in perspective with persistently strong demand from institutional players, both US and international.

Limited market reaction

Despite the tensions, the performance of US bonds has remained positive year-to-date. According to the Merrill Lynch Option Volatility Estimate (MOVE) Index, the bond equivalent of the Volatility Index (VIX), volatility reached a two-year high on 2 April, but rates were little changed as of end of 2024. The 10-year rate stood at 4.5% at the beginning of June, compared with 4.6% in December (see chart 1). This has generated an overall performance of more than 2% since the beginning of the year, linked to high-rate carry.

The main change is in the yield curve. Investors have been favouring short maturities, leading to an over 20bp drop in the 2-year rate. In contrast, the 30-year rate exceeded 5% at the end of May, the highest since 2007. The spread between the 2-year and 30-year rates thus steepened by 40bp, a clear sign of an increased term premium.

This movement reflects a trade-off between a preference for the short term, perceived as safer in an uncertain environment, and a higher remuneration requirement over the long term, given the opacity of the US budget trajectory.

A key asset among political uncertainties with solid fundamentals

Volatility is likely to remain high in the coming months as Trump seeks to accelerate his reforms ahead of the mid-term elections in 2026. The question of rate cuts also remains open, with the Fed waiting for clear signs of inflation control before it takes any action and the President pushing for swifter easing. This stand-off is reinforced by rumours on the replacement of Jerome Powell by Scott Bessent as Fed chairman in May 2026. This replacement could affect the perception of the institution's independence and potentially destabilise the markets. It could also reinforce the scenario of monetary easing, further intensifying the steepening of the curve.

But despite these factors, US Treasuries still have major advantages. They constitute the deepest and most liquid bond market in the world. They remain at the heart of the global financial system through their role as collateral and their status as a benchmark for institutional investors.

Economically speaking, US fundamentals remain robust, with resilient growth, stabilising inflation and low unemployment. Despite losing its Moody's AAA credit rating in May, the country's fiscal capacity remains substantial. The rate of tax revenues relative to GDP, at just 27%, is lower than the OECD average (34%), offering potential room for manoeuvre.



To be handled with discernment

US government bonds retain their central status in the global financial system. Treasury yields, above 4% in nominal terms and close to 2% in real terms, are among the most attractive of the world's major economies (see chart 2). This yield offsets the uncertainties.

Today's environment calls for a selective approach. Short and intermediate maturities make it possible to benefit from carry while limiting exposure to an increase in term premiums.

Despite tensions, Treasuries remain an asset to consider when building a diversified portfolio. Their stabilising role and exceptional liquidity make them an interesting tool, though they now need to be handled with discernment.

Gary Girault, CFA
Head of Fixed Income Expertise - Discretionary Portfolio Management Switzerland

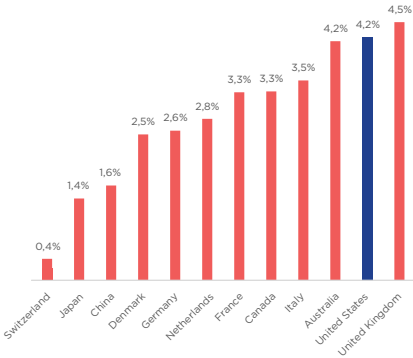
Guilhem Savry
Head of Strategy Research, Global Investment Research

Chart 1:
The US 10-year rate has remained firm at around 4.25% for the past two years despite increased volatility

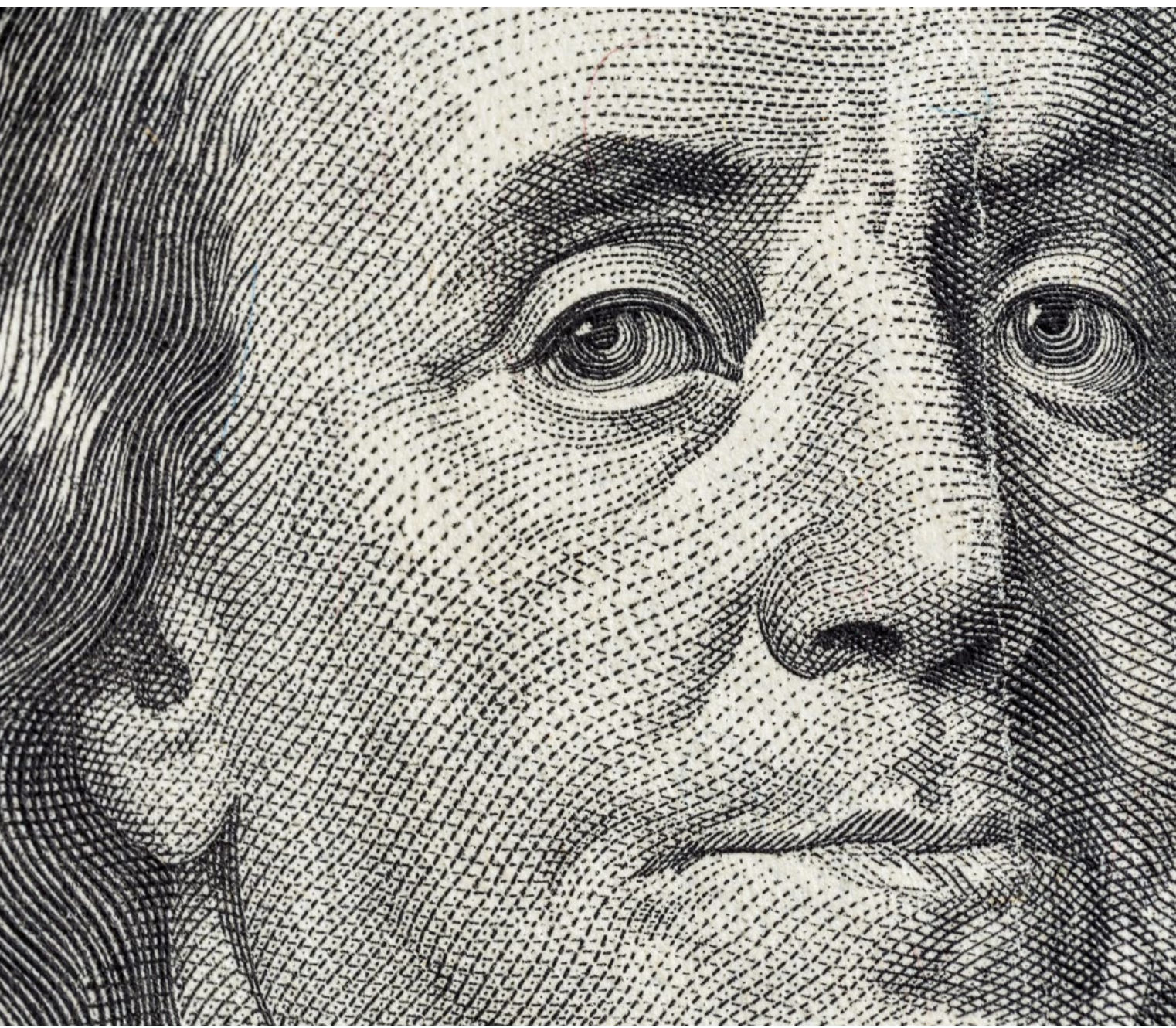


Sources: Edmond de Rothschild, Bloomberg at 30/06/2025.

Chart 2:
One of the most attractive 10-year rates among the world's major economies



Sources: Edmond de Rothschild, Bloomberg at 30/06/2025.



Forex



The end of the dollar as a safe haven?

The loss of international investor confidence in the US financial system is a reality, and the shift could spell the end of the US dollar's role as a safe haven during political or financial crises.

Soap opera

The soap opera of US tariffs is enjoying a new, jam-packed season. In the name of national security, Trump increased taxes on steel and aluminium from 25% to 50%. The White House is facing legal resistance as its tariffs have been found illegal by the New York-based United States Court of International Trade and a federal court in Washington.

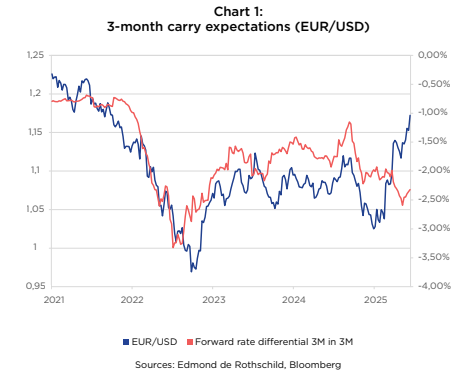
No suspension of taxes has been announced at this stage. But a sword of Damocles hangs over the flagship measures of the Trump programme. The reaction of the markets seems less visceral than in previous tariff episodes, with opinion increasingly appearing to consider that Donald Trump does not intend to actually apply these tariffs but instead use them to secure a strong position in his trade negotiations with the rest of the world.

More worryingly, the administration's renewed insults and criticism of Fed Chairman Jerome Powell clearly threaten the independence of the central bank. These attacks come at a time when Moody's finally decided to downgrade the US debt rating and US debt could rise to new highs in the wake of Trump's "One Big Beautiful Bill". At the same time, political tensions are rising amid discord between Trump and Musk, the deployment of the National Guard on US soil during the Los Angeles clashes in June, and the lack of significant progress by the Trump administration on peace in Ukraine or Gaza. All these developments argue against the use of the dollar as a safe haven and encourage investors to gradually "de-dollarise", diversifying through gold and reconsidering cryptocurrencies.

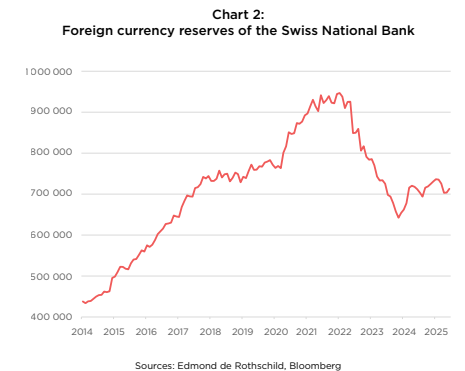
While inflation remains under control, the risk of a slowdown in the US economy is increasing, with job creations sliding. The Fed may finally decide to lower its key rate to bolster growth and thus reduce positive carry in favour of the dollar.

European growth holding up better than expected

In the European Union, growth is proving more resilient than initially expected. Inflation is under control and the European Central Bank has reached the 2% level it considers neutral for its key rate. With no particularly pressing reason for further cuts, the ECB may well choose to hold steady at its next monetary policy meetings. If so, while the Fed starts to lower its rates, carry would favour a rise in the euro against the dollar, as suggested by Chart 1 on three-month carry expectations. Moreover, in the event of more balanced-than-expected trade negotiations with the United States, the economic surprise would be on the European side, with a positive effect on the currency. Under our preferred scenario, the end of the year should see a move towards 1.20.



President Trump's suggested 31% tariff on imports from Switzerland creates a significant economic risk, especially since the dollar has lost 10% of its value against the Swiss currency since the start of the year, further reducing the competitive position of Swiss exporters. Flows into the CHF remain strong as investors seek to diversify risk in a safe haven. The Swiss National Bank has every reason to seek to stabilise the value of the franc. But it will not use foreign currency reserves (see chart 2), as the US would label the country as a currency manipulator, especially during a period of trade negotiations. The most obvious tactic would be to introduce negative interest rates to discourage speculators and reduce the attractiveness of the franc.



Gold still the champion

Gold has been stuck between 3,200 and 3,400 after reaching the 3,500 zone following the initial threats to the Fed's independence. But a fresh increase is on the cards for a number of reasons. Central banks continue to gradually de-dollarise, taking advantage of maturities on US debt to reinvest in gold. Investor appetite for gold as a safe haven and a portfolio diversification tool remains strong. Lastly, the drop in the interest rate paid on the dollar reduces the shortfall for gold holders and supports the price per ounce.

Jean-Marc Guillot
Group Treasurer



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