

Outlook & Convictions

Asset Management | 1st semester of 2026



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SUMMARY



Asset Allocation	6
<hr/>	
by Benjamin Melman Investing amid a bubble	
Fixed Income	12
<hr/>	
by Alain Krief 2026 is set to be a strong year for credit markets!	
European Equities	16
<hr/>	
by Caroline Gauthier European equities, a three-step Waltz	
International Equities et thématiques	20
<hr/>	
by Jacques-Aurélien Marcireau 2026, a structural year for equities and the end of the prologue	
European sovereignty	22
<hr/>	
by Anthony Penel Decorrelate your portfolio by investing in European defence	

Investing amid a bubble



Benjamin Melman
Global Chief Investment Officer

Markets have lost their bearings in the United States

One has to admit that visibility is wanting on the US economy. Never had such a slump in job creation been observed without a slowdown in growth - a situation that poses many questions today, with no truly satisfactory answers on the nature of the cycle. Furthermore, the longest government shutdown in history left market observers flying mostly blind, with no access to important economic data. This will also have technical upshots - negative, then positive - which call for greater caution when considering the next set of statistics.

Finally, while the tariffs seem to have had much less recessionary impact than initially feared, they are trickling down into the economy slower than planned, and it would be wise to wait a little before drawing any conclusions. In any case, the Constitutional Court may soon decide to cancel these tariffs... A looser fiscal policy remains in the cards for next year, though one aspect remains uncertain. In addition to the Big & Beautiful Bill, D. Trump has mentioned returning the cash generated by the tariffs to the population. American households are due to receive a cheque for \$2,000 which could ultimately weigh between 1% and 2% of GDP (depending on whether the cheques are only sent out to households with incomes under \$100,000).



But while the economic environment in the US is somewhat murky, it is not necessarily more worrying than usual. Neither private company balance sheets, nor corporate margin growth are pointing to a risk of recession. The latter seems to come down to a turnaround in the massive investments made in artificial intelligence (the effects on growth are estimated at roughly 1 point of GDP), which would undoubtedly trigger an equity bear market, negative wealth effects, and weaker consumer spending.

AI and the bubble

There are many similarities between the AI boom and the internet bubble: excessive valuations, high presence of retail investors in stock market flows, the emergence of circular mega-deals signed between OpenAI, Nvidia and Oracle - whereby the supplier lends to the client to pay for the order (which is reminiscent of the end of the 1990s when Cisco, Lucent and Nortel lent capital to their telecoms clients, which had then led to oversized infrastructure). The main question is how these US players will monetize their investments, knowing that competition is tough between US and Chinese hyper-scalers¹ and that many surveys conducted with AI users frequently point to the absence of truly tangible results from their investments.

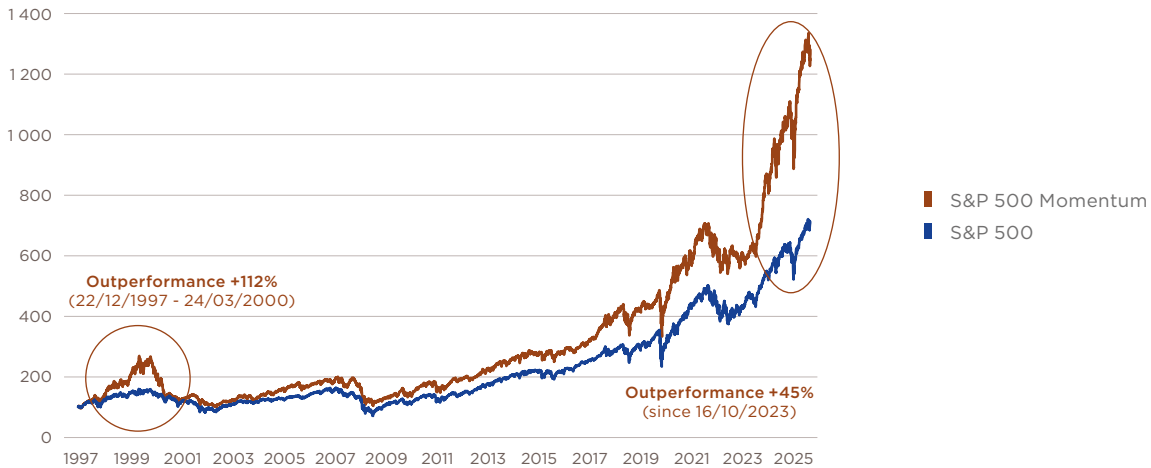
Furthermore, two hurdles are emerging that could hinder the development of AI: weak energy supply relative to demand, which is causing electricity prices to soar, and **incidents within the US private credit space**, which are starting to create bad press for this new market after its very rapid growth in recent years. As a reminder, according to some projections, private credit is supposed to finance around half the creation of data centers by 2030.

Nothing today can help us predict when this bubble will burst. And according to several criteria, the situation is not as extreme as it was in 2000. The bubble has expanded owing to excess cash and the Fed announcing the end of quantitative tightening is not a threat. Nevertheless, several of the large players (Softbank, Peter Thiel's Macro LLC) that fed this AI bubble have recently sold their NVIDIA shares. Long-term investors, on the other hand, are now warned of the highly speculative nature of this large market segment. As a firm, we also largely underweight the MAG7. In the US, Q3 corporate earnings have finally pointed to an interesting inflection point: earnings growth is no longer principally driven by the MAG7, a fact that also argues in favour of diversifying investment themes outside of AI.

¹ A hyperscaler is an IT service provider that operates very large-scale data centres to offer cloud computing and data management services. These are cloud giants such as Amazon, Google, Microsoft, Alibaba, etc.

ASSET ALLOCATION

Performance of the S&P 500 and S&P 500[®] Momentum² indices since 1997



Source: Factset. Data as at 27/11/2025.

Past performance is not indicative of future performance, is not constant over time and may be independently affected by changes in exchange rates.

The performance figures shown do not take into account the costs and commissions incurred when issuing and redeeming units, but include ongoing charges, intermediation fees and any performance fees charged.

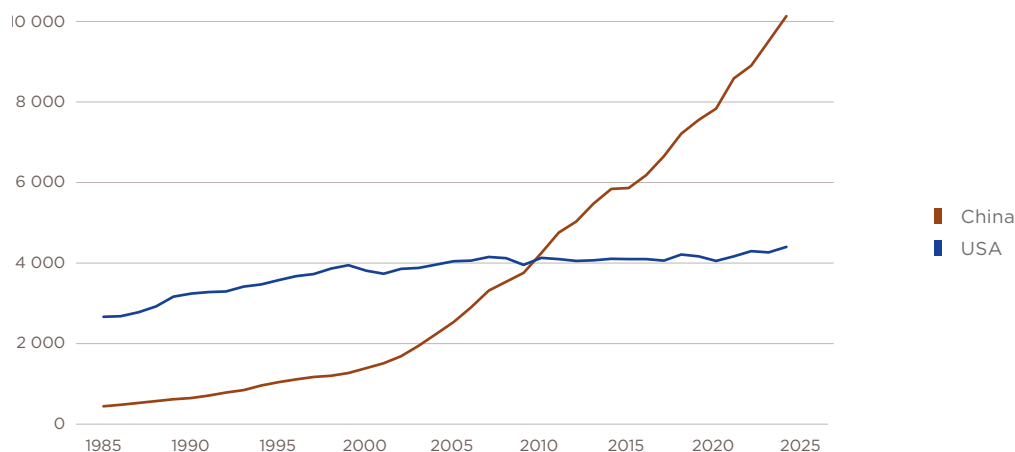
China: a different AI model, more pragmatic and less risky

China has developed its own AI based on a very different model, which in some respects, carries less risk and is more pragmatic than its US equivalent. First, LLMs are based on open architecture rather than on proprietary models, facilitating their dissemination. Furthermore, **investments in hyperscalers were more modest (roughly one tenth of the amounts recorded in the US), which de facto limits the risk of over-investment.** The adoption of the technology is facilitated by the authorities, notably within industry through a broader vision of the country's industrial policy, thereby reducing uncertainty over its use. Finally, with energy production becoming a constraint, China has developed extraordinary power production capabilities at a much lower cost. AI-related stocks are trading at much lower prices than their US counterparts. In other words, even considering the structural weaknesses of the Chinese market (economy bordering on deflation, weak governance...) which had caused a number of investors to flee, it would be unwise for allocation strategists to overlook this market.

² The S&P 500[®] Momentum Index is designed to measure the performance of stocks in the S&P 500 universe that exhibit a certain degree of consistency in their relative performance.



Evolution of electricity production over 40 years (terawatt hours)



Source: Ember (2025); Energy Institute - Statistical Review of World Energy (2025). Data as of 27/11/2025. The figures relate to past years and do not prejudice future results.

Europe still has the ability to surprise

Of course, France remains in a highly fragile situation both fiscally and politically, but none the less, the risk of a crisis at this stage has been contained. Southern Europe is still relatively dynamic, supported by Next Gen EU and by new-found competitiveness in these countries. **But Germany has changed its doctrine and could pull all of Europe in its wake. The stimulus plan - the effects of which will be manifest in 2026, Mr. Merz's call for a single capital market (Germany had put the brakes on until now), or Germany supporting the protectionist measures put forward by the European commission for the steel industry, in response to the dumping from China,** all mark a radical break aimed at stepping up European supply and demand.

According to the EPIC think tank, only 11.2% of the measures recommended by the Draghi report have been implemented so far, one year after the report was released, with 20.1% only developed partially. While there is still a lot of work to be done, the political drive is present. And while Mr Merz is in office and pending other political levers, there are reasons for optimism.

ASSET ALLOCATION

Changes at the Fed in 2026

Mr. Powell's term as Fed Chair ends in May 2026. While his successor has not yet been named, the attempt to evict Mrs Cook and Trump's repeated attacks aimed at Mr. Powell indicate very clearly that the White House intends to have a say in the country's monetary policy. Nobody can tell if and to what extent the Fed can lose its independence, but it seems reasonable to imagine a more accommodative central bank, if only based on the natural turnover within the Board that has already been planned and will take place when M. Powell steps down.

“The only thing Scott is blowing it on is the Fed because the Fed, the rates are too high, Scott. If you don't get it fixed fast, I'm going to fire your ass”

President Donald Trump, CNN (20/11)

As Europe becomes less competitive on account of Chinese dumping and American tariffs, the ECB may have no other choice than to ease its monetary policy if the Fed resumes its rate-cutting cycle. With fiscal policies expected to be expansionist next year within the 3 largest G7 countries and with growing public deficits (United States, Japan, Germany), we have chosen not to favour long-dated bonds, as the rise of the term premium seems incomplete in light of its past history, particularly if under pressure, the Fed ends up adopting an overly loose monetary policy.

Investment policy

Overall, markets are generally expensive and the specific and growing risk of the AI bubble bursting is still running. As AI investments continue to soar, so are market jitters on the monetization of these investments. **But otherwise, the economic environment does not point to any fundamental reasons that would trigger a market turnaround.** In this respect, we are entering the new year with a relatively balanced allocation between stocks and bonds, with a possible cautious bias, nonetheless, in the first weeks of 2026 pending more visibility on the changes at the Fed. Within equities, we have no marked regional preference.

In equity markets, we remain cautious on AI-related large caps (basically the MAG7) and prefer to focus on the theme of Big Data (and notably on companies that use data and will gain most from AI) and **on stocks poised to benefit from the play on resilience and the return of sovereignty**, at global and European level, as the implementation of the Draghi report is the European commission's main objective.



Considering the strength of the momentum factor these past two years, **we feel that the best way to prepare for a change of market regime while investing for the long-term is to raise the weight of under-held, undervalued stocks and preferably, that have recently begun to recover. These would include European small caps** which are due to benefit fully from the new focus on domestic growth, the single capital market that is looming, and possible rate cuts by the ECB. **The healthcare sector also meets these criteria.** After suffering from political hurdles, the future is looking brighter, and healthcare players are now in better shape. Such a positioning would be particularly effective in the event of a sharper economic slowdown. However, since the return of a highly expansionist policy in the US seems feasible (if Congress agrees to the household cheques and/or if the Fed switches to a policy better aligned with White House aspirations), US Value stocks could also feature among these diversification plays. Gold stocks, which have already enjoyed a strong market run, also stand to benefit if the reshuffling within the Federal Reserve leads to a firmer political hand.

Within the fixed income space, spreads are so narrow today that it is difficult to imagine any further contraction. However, sovereign bonds are deteriorating so badly that the scenario cannot be excluded. **We prefer to focus on hybrid financial debt and on bonds issued by companies mostly within the Investment Grade space, as well emerging debt (due to benefit from Fed easing) and carry strategies.**

Key points

- The US economy remains uncertain, characterised mainly by a softening in employment without a slowdown in growth, as well as an AI bubble that is at risk of bursting.
 - China and Europe offer differentiated opportunities: Chinese AI is more pragmatic and less expensive, while Europe is benefiting from a recovery driven by Germany and the NextGen EU plan.
 - Our investment strategy remains cautious and balanced, favouring diversification between equities and bonds, avoiding large-cap AI names and focusing instead on European small caps, the themes of resilience and European sovereignty, as well as healthcare and Big Data.
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2026 is set to be a strong year for credit markets!



Alain Krief
Head of Fixed Income

Whether bullish or bearish, markets rarely move in a straight line up or down. They may seem to over short periods, but this is often misleading.

At the start of 2025, the dollar declined sharply, with many market observers expecting the green back to fall to 1.20, and then to 1.40 euro. The EUR/USD exchange rate ultimately hit 1.19 during one trading session but has been hovering around 1.16 since July. Meanwhile, oil prices - which appeared to be trending downwards - have stabilised at roughly 60 dollars per barrel over the past few months. After an exceptional rally, the price of gold fell in mid-October. These examples offer perfect illustrations of how volatility and complex capital markets can be.

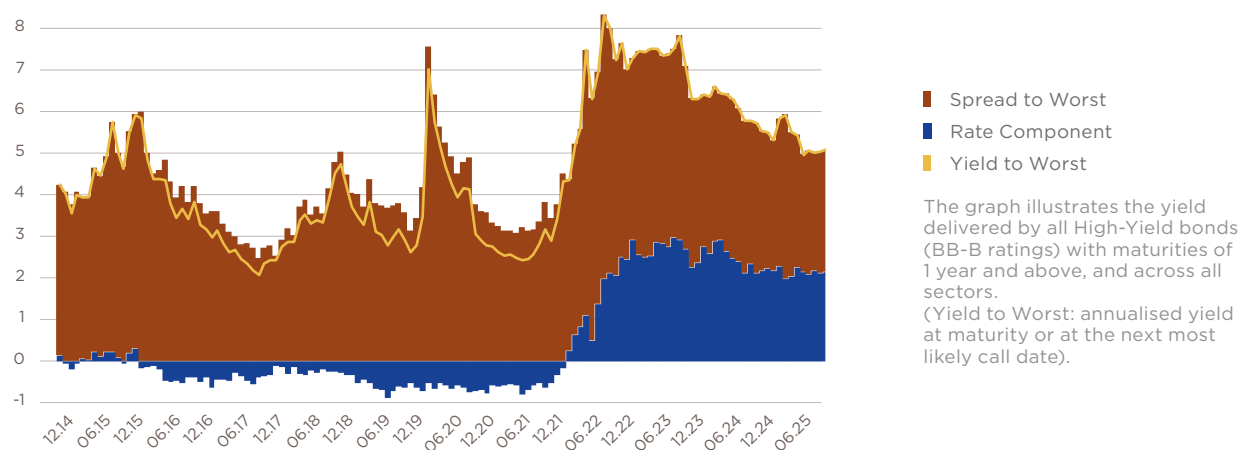
But in 2026, credit markets could be the exception. The carry yield on bonds, which is the provisioning and payment of the coupon, is set to remain on a rather linear trajectory. This trend has already been observed over the past three years in this market segment, despite a few volatility spikes - such as in April, when Donald Trump made his tariff announcements.

In practical terms, the momentum enjoyed by the credit market is driven by its underlying components and by the factors that affect these components.



Let's take the European High Yield market as an example: this segment delivers an annualised yield that is the sum of the average sovereign yield and the average credit risk premium (spreads) of issuers.

Yield to Worst over 10 years



Source: Factset, data as at 31/10/2025.

Looking ahead to 2026, it is essential to analyse both sovereign rates (the grey area of the curve) and credit risk premiums (blue area), without omitting the correlation between the two.

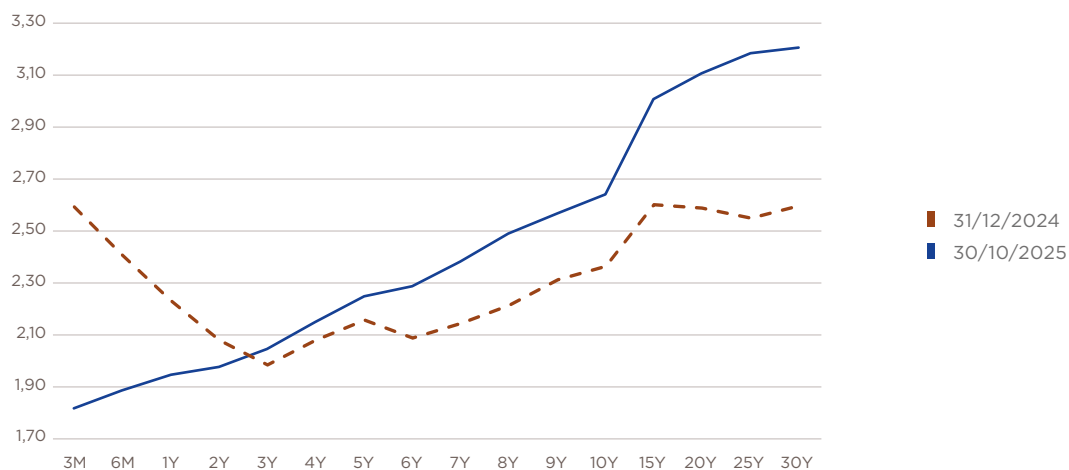
In the Eurozone, after sovereign yields rose sharply in 2022 during the fight against inflation, the ECB gradually eased its monetary policy as inflation moved closer to the 2% target. The terminal rate is now probably just one or two rate-cuts away. This situation led to the normalisation of the yield curve, also supported by the recent fiscal policies (fall in short-term rates and rise in long-term rates). Only the 3 to 5-year segment has remained stable (see graph below).

Credit spreads follow a similar logic for the same issuers.

This steepening yield curve has enabled investors to unlock more income (with more risk) on longer-dated bonds, but also to change the performance characteristics of these securities owing to the “rolldown” factor - the natural fall in a bond's yield as it approaches maturity.

FIXED INCOME

EUR yield curve



Source: Factset, data as at 31/10/2025

The performance pattern of the High-Yield BB-B index remains rather straightforward: since the end of 2020, it is essentially driven by the carry yield and narrowing credit risk premiums, while sovereign yields have been stable. This logic also applies to other high-yield bond segments such as subordinated financial debt (AT1, Tier 2), hybrid corporate debt, and emerging market sovereign and credit markets. All of these segments have high spreads relative to risk-free rates. In contrast, the investment grade segment, which has a lower spread, remains highly sensitive to movements in sovereign rates, which can quickly wipe out carry gains.

In practice, even in a favourable technical environment, it is essential to consider the financial health of companies and how this could evolve in 2026 because spread movements on a name-by-name basis can be very significant. And there are currently many disparities within the high-yield segment, depending on the sector and credit ratings. Single-B issuers saw their spreads widen over the past few months; however, this trend is expected to normalise gradually as global economic growth continues to hold up.

In our view, the economy is K-shaped – marking a transition phase between the middle and the end of the cycle: growth is lacklustre and uncertain in the US, while Europe, which is more upstream in the cycle, should benefit from the German fiscal spending in 2026. This divergence is reflected in sector performances: some are still at the early stages of the cycle, whereas others are close to the end.



Companies within AI-related sectors, such as hyperscalers and utilities, seem to be at the latter stage of the cycle. Over the past quarter, hyperscalers (Meta, Oracle, Alphabet, etc.) alone issued close to \$118 billion. If this pace continues, these players could raise substantial new debt that would weigh on sector spreads in the Investment Grade category, as these issuers, who are still in the early stages of their debt issuance, are highly rated, which limits the immediate risk of default and contagion to other segments of the credit market.

Furthermore, other sectors - that are more sensitive to interest rates - such as basic materials, construction materials, automotive financing, commercial real estate, residential construction and low-income consumer spending are operating in a tighter environment. Demand largely depends on credit, investments and construction. These players were also affected by US tariffs, which have led to the weakest labour market of the past five years. Despite these difficulties, their mid-cycle positioning allows them to deliver positive returns.

In this environment, High Yield credit is proving particularly attractive. This segment comprises many cyclical sectors and is less exposed to capital-intensive industries and to hyperscalers. **We have identified many opportunities within the High Yield market, with a preference for rating risk over duration risk.** Furthermore, the high carry delivered by High Yield bonds and their shorter duration create an appealing safety margin, even in the event of a wave of corporate defaults - which we do not anticipate for 2026.

Therefore, upon closer examination of these disparities within credit markets, it appears that segments with high spreads, particularly high yield, have the potential to deliver “straight-line performance” close to what theory suggests, thereby offering an interesting playing field for investors seeking returns.

Key points

- Since the end of 2022, credit markets have been on an upward trend. Their momentum is mainly due to high carry and positive factors affecting their composition: rates and spreads.
 - The performance of a BB-B high-yield index is based primarily on total yield, and for 2026, we favour credit risk over duration risk.
 - The high-yield segment is attractive because it includes many cyclical sectors correlated with growth, while being less exposed to capital-intensive sectors and hyperscalers.
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European equities, a three-step Waltz



Caroline Gauthier
Co-Head of Equities

2025 has perfectly illustrated the market's ability to undergo a regime change while outpacing the economic reality. This is known as the 'Hope' phase of the business cycle, which precedes 'Expansion' and tends to support equity market rallies. **This is when the best opportunities are up for grabs: markets are still affordable; valuations are starting to rise; and the margin for growth remains high as earnings are yet to recover.** While hopes of a recovery persist, we believe that European equities continue to offer substantial upside potential. However, patience is needed as a recovery rarely follows a linear pathway. In the present case, the recovery is unfolding in three steps.

Stock markets and politics have different time signatures

The quasi-simultaneous announcements of the 'Re-Arm Europe' and the German 'Bazooka' plans stirred up a powerful wind of optimism across Europe in early 2025. **The stock market responded instantly: in just a few weeks, Eurozone equities soared by almost 20%, supported by the strongest inflows of the past 10 years.** But stock markets and the political world have different tempos.

The former ran out of steam after the announcements. The contrast between investor enthusiasm and the real pace of the economy became noticeable. Having understood that corporate earnings would not grow in 2025, due to a weak dollar and the disruptions



caused by US tariffs, markets continued to rise but showed signs of frustration owing to the limited effects of the pluri-annual plans that had been announced.

We have now entered the longer time signature of politics. While the agenda cannot be controlled, every stage of implementation will be welcomed positively.

The first steps forward in Europe's efforts to regain control are already visible. The 50% cut in steel import quotas, combined with additional tariffs, should support the European steel industry from as early as 2026. Current talks aimed at delaying the ban on combustion engines would ease pressure on the automotive industry. Headway on the SIU* could also become a powerful catalyst for Europe's financial ecosystem.

In Germany, the defence and infrastructure spending plan weighing almost €1,000 billion marks the start of a new paradigm. But after decades of under-investment, government administration is under-sized: the first effects will begin in 2026 on the defence side, but probably not before 2027 for infrastructure.

Meanwhile, the government's supply-side policy can also rely on the private sector: as part of the "Made for Germany" initiative, 105 companies have collectively pledged €735 billion of investments over 3 years, leveraging the fiscal "boost" announced by the government (accelerated depreciation options already in place and tax cuts from 2028).

In this sense, it was logical that 2025 failed to reflect the revival. The performances posted by Eurozone equity markets, up roughly 20% in 2025 (after a cumulated +30% in 2023 and 2024) were mostly driven by rerating. In 2026, performances will depend on the recovery of corporate earnings.

2026: time for the entrepreneur to step in

Earnings growth, combined with a shareholder return (dividends and stock buybacks) of around 4 to 5%, should continue to propel equity markets in 2026. Several drivers will fuel the recovery in earnings.

The fiscal engine (mostly in Germany) will not be the main contributor in our view but could become a catalyst in the event of new reforms. Some sectors, such as defence, IT services (public sector spending to boost digitalisation) or steel, should be the first to benefit from the support measures in 2026; however, the lion's share of the impact is expected from 2027 onwards.

The macroeconomic engine will be more significant in the Eurozone. Economic surprises are positive; PMIs are moving closer to the

¹ Savings and Investments Union

EUROPEAN EQUITIES

expansion zone; and lending conditions are easing thanks to the gradual dissemination of the ECB's rate cuts. In this respect, several European construction markets are already showing signs of an early inflection point.

After three years of stagnating profits, earnings are expected to grow by 11% in Europe and 14% in the Eurozone, according to a consensus of economists. While the magnitude of the rise is in fact likely to be more modest, this growth scenario seems realistic considering the multiple levers at play. All sectors should see their profits grow, which is rather exceptional.

Electrification-related sectors (industrials, utilities, services and engineering) shall continue to enjoy a strong momentum, driven by the need to upgrade power grids. Higher defence spending will benefit specialist players as well as their more diversified sub-contractors (steel, engines, infrastructure).

Several sectors are heading for a rebound in volumes thanks to a favourable basis for comparison and/or the end of inventory reductions stemming from the post-pandemic recovery (healthcare, semiconductors). The operating leverage will be substantial, notably within industry, construction and materials. Moreover, the negative implications caused by the decline of the dollar and tariffs should begin to fade and support exporting companies.

Finally, profits within the financial industry should remain on a positive track amid a stabilised interest rate environment and rising credit volumes.

Capitalising on the different tempos

Today, the Eurozone is benefiting from a two-pronged monetary and fiscal support; however, the gradual implementation of the plans mentioned above is creating a time lag that investors can leverage by applying thorough stock selection. Under the surface of index performances, stock dispersion is high and it will be important to: i) identify stocks that are reasonably priced and offer a strong outlook (the aeronautical industry, for example, benefits from very long order books, improving supply chains and has not pledged new, heavy investments), ii) leverage waves of accelerating volumes when they occur in cyclical sectors, and iii) identify any current mispricing.

We have identified blatant under-valuations on quality stocks that are being overlooked in favour of high-beta value stocks. The valuation relative to the market has now hit a 15-year low, exceeding the threshold of both standard-deviations, below their historical average (which often signals a means reversion). These stocks include health-care and software companies, IT services or advertising agencies which tend to be showcased as AI losers. When their earnings gradually confirm their strength, a re-rating is likely to follow.



Eurozone Small Caps also offer a pool of attractive opportunities: earnings growth across smaller caps is outpacing the large cap segment; they are trading at a relative discount of 15% (compared to a historical premium of 22%) and will be the first to benefit from a domestic recovery. Historically, Small Caps have outperformed in periods of economic recovery in Europe. Furthermore, the sector diversity within this universe of niche players allows investors to gain exposure to domestic and sovereign plays benefiting from tailwinds, and to innovative players with an international reach.

Conclusion

After announcements and weariness, the time has come for execution - which plays out over the longer term. Regardless of its pace, Europe is on the path to a recovery that should start to become noticeable in corporate earnings in 2026, before it gathers speed in 2027.

An even brighter scenario would emerge if a peace deal were agreed over Ukraine (lower energy prices and risk premium, reconstruction plans). Nevertheless, uncertainties remain over the political agenda (United States, France...), the momentum in China, the US dollar, tariffs and of course the on-going AI cycle in the US. For the latter, a potential turnaround would lead to the depolarisation and rebalancing of global asset allocations, which would be positive for Europe, where fundamentals are strengthening and relative valuations remain attractive.

To sum up, Europe is in motion, and it would be a shame to quit the dance floor before the tempo accelerates.

Key points

- After big announcements and a period of doubt, the time has come for implementation.
 - In 2026, markets will be driven by earnings growth.
 - Investors should capitalise on pockets of under-valuation in quality stocks or small caps.
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2026, a structural year for equities and the end of the prologue



Jacques-Aurélien Marcireau
Co-Head of Equities

2025 will go down in the annals of history as an incredible year, in the literal sense. The Trump administration's anti-immigration drive, the enforcement of unprecedented customs barriers and the breakthroughs made by Deepseek - the Chinese algorithm - did not yield the expected results: no inflation, no recession, no slowdown in AI investment spending. Markets overcame the obstacles thrown at them and delivered strong gains (mostly) in all regions of the world.

Region-wise, new secular trends are likely to emerge in 2026 that will allow investors to position their portfolios with some conviction as they navigate the end of the decade.

Indeed, **in the United States, the political power balance will be clarified after the mid-terms**; the impact of tariffs will be annualised once and for all; and AI - the engine of the world's leading economic power- will have supplied enough data on monetization to allow for a finer assessment of capex sustainability.

In Europe, the effects of the German stimulus plan will be more tangible, as will be the bloc's ability to either unite or dislocate as it faces the blows coming from China and the United States. Expectations remain low, but if Europe gathers speed and improves its



ability to defend its economic space and its interests, it will emerge as a major winner - politically as well as on the stock market. Rewards to be reaped include the steady return of investment flows into the area, which could in many respects herald a “new Florence” for researchers, entrepreneurs and investors alike.

As for China, the country’s intentions regarding Taiwan will have become clearer by the end of 2026, as will its attitude towards the rest of the world: will China initiate a strategy based on isolation for the United States and conciliation with the rest of the world, or will it opt for confrontation in a case of ‘one against (almost) all’? Once again, the future of capital markets is in the hands of the country’s leader Xi Jinping, a situation that perpetuates China’s unique status among the world’s leading financial centres. The country risk is idiosyncratic and political. Indeed, the quality of Chinese entrepreneurship and its technological champions has not been called into question for a long while on the world stage.

Other emerging countries, except possibly for India which benefits from a unique and attractive momentum, are responding to the afore-mentioned blocs with a reaction function.

For these three main areas, the outcome will be binary: a setback at any of these crossroads will cause the concerned region to under-perform severely and durably. Rather than taking a risk that is difficult to control, investors may be tempted to equal weight their exposures.

Another solution may simply be to adopt a suitable wait-and-see position for 2026 and beyond, which could offer asymmetrical risk/reward. In this environment, thematic or speciality approaches truly come into their own. We continue to believe in the asymmetrical profile of healthcare and in the theme of resilience at global level. We can be certain of one thing: change and preparation for the future will always remain a rewarding theme for investors.

Key points

- Despite numerous obstacles, equity markets posted strong gains in 2025 (mostly) in all regions of the world.
 - The United States, Europe and China are at strategic inflection points, each facing challenges that could shape their economic outlook and create opportunities (or risks) for investors.
 - Rather than taking risks that are difficult to control, investors may choose to equal weight their investments and focus on powerful themes such as healthcare and resilience, which offer asymmetric risk reward opportunities.
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Decorrelate your portfolio by investing in european defence



Anthony Penel
Portfolio Manager - European
Equities

With cycle-sensitive sectors dominating the European market, the key to portfolio construction is diversification, as well as performances. **Asset correlation has become a fundamental parameter enabling investors to better spread their risk and safeguard the stability of their portfolio in changing macroeconomic conditions.**

According to the Modern Portfolio Theory developed by Harry Markowitz (Nobel Memorial Prize for Economics in 1990), performance is driven by individual returns, but mostly by asset correlation. Adding stocks with low correlations to a portfolio can lower overall volatility as it diversifies the sources of risk. A single asset may be more volatile taken in isolation, but its differentiated behaviour smooths out variations in portfolio returns and improves risk/return for investors.

Since the invasion of Ukraine, the European defence sector has gradually de-coupled from broad equity markets. Unlike traditional MSCI Europe sectors, which depend on growth, interest rate and consumer forecasts, defence stocks have their own specific engines: rising national military budgets, strategic re-arming, renewed industrial capacity and pluri-annual government procurement. These dynamics are more closely related to geopolitics, international alliances and changes in national security doctrines than to traditional business cycles. Moreover, with the Peace Dividend now called into question, the sector is undergoing a structural re-rating after several



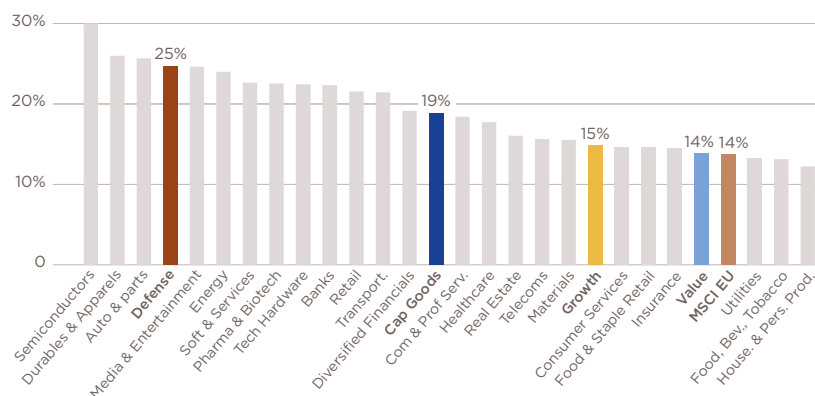
slow decades. The outcome: fluctuations within the sector tend to reflect geopolitical tensions and government announcements rather than market movements caused by macroeconomic developments and stock valuations (debates on the AI bubble, monetary policy decisions...). Even concerns over the sustainability of sovereign debt in some countries have not had an impact on the trajectories posted by defence stocks.

Unsurprisingly, since the summer of 2025, many European sovereignty funds have emerged in the investment market. These funds tend to focus on the recommendations made in Mario Draghi's report published in September 2024 ("The Future of European Competitiveness"), which include strengthening the EU's defence capabilities.

We can now draw the first data-based lessons from this theme, which has become a 'must-have' in any active equity strategy. We shall use the Bloomberg Europe Defence Select Net Return (BSHIELDN Index), comparing the data with the broad MSCI Europe Net Return (M7EU Index) market index and its sector components (GICS Level 2), and notably the Capital Goods sector, which comprises most defence stocks.

Over 52 weeks, since November 2024, volatility readings show that European defence ranks among the most volatile sectors within the index, a level similar to the most cyclical industries (automotive for instance) and much higher than Capital Goods.

Volatility - Weekly Nov 24/Nov 25

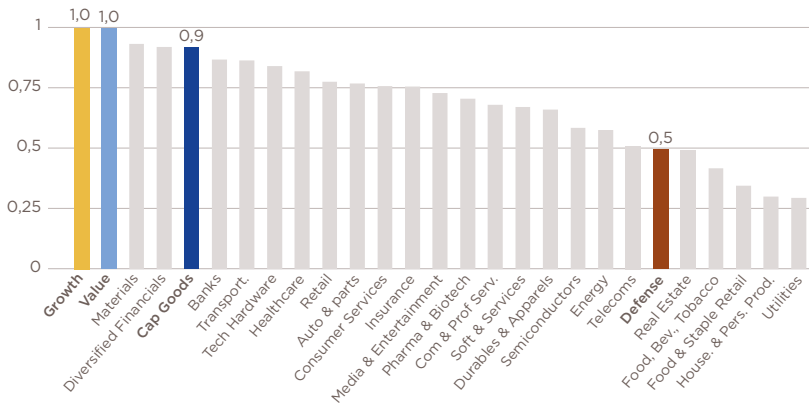


Source: Edmond de Rothschild AM (France) calculations, based on Bloomberg data as the end of November. Past performance and volatility are not indicators of future performance and volatility. They are not constant over time and may be affected independently by exchange rate fluctuations.

EUROPEAN SOVEREIGNTY

While volatility tends to be a turn-off for investors, the latter should nevertheless consider the decorrelating effect of a given sector within their allocations: indeed, a volatile sector - but weakly correlated - can lower the overall volatility of a portfolio.

Correlation (ρ)* with MSCI Europe - Weekly Nov 24/Nov 25



*Correlation (ρ) is a nonparametric measure that assesses the extent to which the relationship between two variables can be described by a monotonic function.

Source: Edmond de Rothschild AM (France) calculations, based on Bloomberg data as the end of November. Past performance and volatility are not indicators of future performance and volatility. They are not constant over time and may be affected independently by exchange rate fluctuations.

Defence stands out as one of the most decorrelated sectors, similar to real estate or telecoms, and displays the highest decorrelation among industrial/volatile sectors.

However, current market conditions are very different and Russia's invasion of Ukraine on February 22nd, 2022, opened a new period, distinct from the pre-war years.

Based on several observation periods, it is apparent that the statistical behaviour of the defence sector has changed considerably:



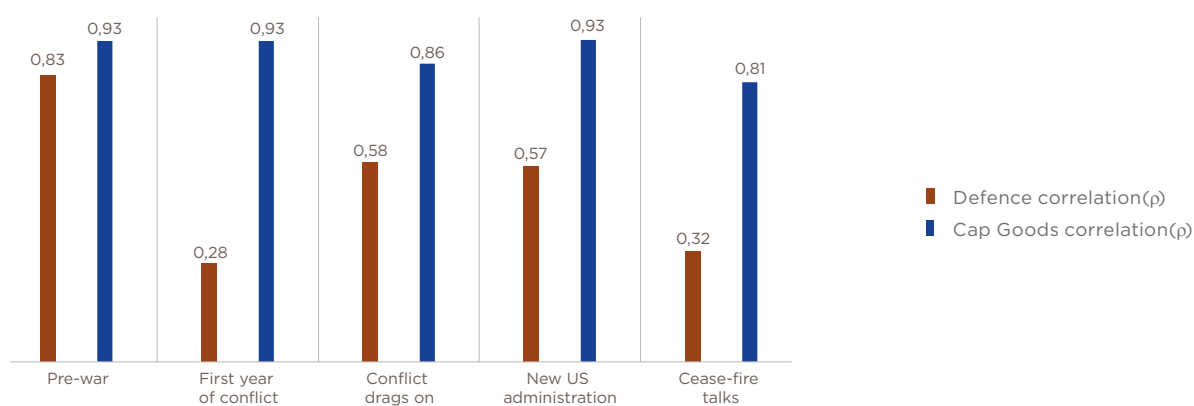


The sector's volatility has been compared to the broad market index for each period. And for comparison purposes, we shall also examine the volatility ratio between Capital Goods and the broad index.

While the volatility of Capital Goods relative to the broad index has remained rather stable, the relative volatility of Defence did increase, though without soaring.

Analysing the correlation coefficient on these same periods is much more interesting:

Correlation (ρ) with MSCI Europe - Weekly Nov 24/Nov 25



Source: Edmond de Rothschild AM (France) calculations, based on Bloomberg data as the end of November. Past performance and volatility are not indicators of future performance and volatility. They are not constant over time and may be affected independently by exchange rate fluctuations.

In the years preceding the war in Ukraine, defence company stocks displayed a reasonable correlation with the MSCI Europe, similar to their index sector category, Capital Goods.

The breakout of the conflict had a drastic impact on the sector's behaviour, which now posts extreme decorrelation levels (0.28, a R^2 at 8% ...). After the coefficient rose for 2 years, the recent period - dominated by cease-fire talks - has seen Defence moving back to very high levels of decorrelation relative to the broad market index. The price to pay has been higher relative volatility (cf.supra).

R^2 : In statistics, Pearson's linear coefficient of determination is a measure of the quality of prediction of a linear regression.

EUROPEAN SOVEREIGNTY

By observing a list of 7 Sovereignty funds invested in the Eurozone, the European Union, and Europe, starting from the launch of the most recent of these strategies on August 1st, 2025, we have analysed the correlation coefficients based on daily net asset values.

The lower the correlation with the MSCI Europe broad index, the higher the correlation to the Defence theme (approximate weight of Defence in the fund).

Naturally, the funds' volatility will vary according to their Defence weightings; however, the resulting readings remain highly acceptable, with annualised volatility ranging between 10% and 15%.

Incorporating a Defence envelope - driven by geopolitical rather than economic factors - helps to lower the correlation of a portfolio with the broad market. Despite its higher volatility, this thematic sub-sector reinforces overall stability, cushions periods of market stress, and improves the risk/return ratio of a given portfolio, thereby providing investors with an additional performance and resilience driver over the long term.

Key points

- Since the invasion of Ukraine, the defence sector in Europe has decoupled from traditional equity market movements, influenced by geopolitical factors rather than conventional economic cycles. This decorrelation makes it a strategic option for diversifying portfolio risk and cushioning market fluctuations.
 - Although the defence sector is among the most volatile, its low correlation with other sectors helps reduce the overall volatility of a portfolio.
 - Adding defence assets to a portfolio can help strengthen overall stability, cushion periods of market stress and improve the risk return ratio.
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