INDOSUEZ
WEALTH MANAGEMENT

GLOBAL OUTLOOK 2025

A TRANSFORMING WORLD

Architects of Wealth

A Transforming World

Global Outlook 2025

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01 | Editorial

Alexandre DRABOWICZ
Chief Investment Officer

A TRANSFORMING WORLD

Dear Reader,

In our previous Global Outlook edition, titled "Searching for a new inflation regime," we emphasised "the need to move away from high inflation, avoid stagflation, and reach a reflation regime". Have we achieved this? Headline inflation in the United States has decreased from 3.4% to 2.4%, and in the Euro Area, it has dropped from 2.9% to the European Central Bank's (ECB) target of 2.0%. This progress has allowed seven of the ten major developed-market central banks to begin cutting interest rates, with the ECB initiating cuts three months before the Federal Reserve (Fed) in June. Both governing councils are now embarking on monetary policy normalisation. Is it mission accomplished for 2025?

CRUISING ALTITUDE

Throughout 2024, we maintained a soft landing scenario for the US economy, despite facing an inflation scare in Q1 2024 followed by a recession scare during summer. We held firm to our view, and we believe this situation will likely persist into 2025. We expect the US economy to grow by 2%, slightly above potential, while inflation should average around 2.2%. In fact, the soft landing narrative is somewhat obsolete: the US economy never really landed and continues to operate at cruising altitude. The key question for 2025 will be whether the new Trump administration will be reflationary or stagflationary.

FROM POLITICAL TO POLICY UNCERTAINTIES

In 2024, 40% of the world's population was expected to vote. Elections in India and the European Union (EU) brought surprises, while the US election outcome was clear and uncontested but opened the door to many questions. We are transitioning from an era of political uncertainties in 2024 to an era of policy uncertainties in 2025.

The new Trump administration is widely seen as pro-growth, pro-business, and pro-deregulation, likely to extend tax cuts and reduce corporate taxes. With the US economy already on a positive trajectory, these reflationary policies could push the economy into overheating. In this no landing scenario, the Fed might be forced to halt its rate cut cycle prematurely, posing a risk to stocks and their rich valuations. It will be a delicate balance to maintain.

BATTLE OF THE GIANTS

Another policy uncertainty lies in US tariff policy. It is unclear whether the Trump administration will pursue the proposed 10%-20% blanket tariff and 60% tariff on China. More modest tariffs, similar to those seen in 2018/2019, are likely as Donald Trump seeks to bring "trophy deals" back home. While the market may worry about announcements and executive orders, our guess is that Donald Trump will avoid creating a new inflation spike, focusing instead on making trade deals. Donald Trump was elected because the rise in prices under the Biden administration proved fatal, and he will aim to avoid repeating that mistake.

The other battle could be with the Fed. We anticipate the Fed will cut rates to reach 3.5% in 2025, though there is a risk they may do less if they perceive inflation threats from tariffs. However, if tariffs remains a one-off effect and inflation expectations stay anchored, the Fed might look through short-term effects and continue its policy adjustments. Jerome Powell has clearly stated, "we do not guess, we do not speculate, and we do not assume" in reference to Donald Trump's future economic policies.

Ultimately, we believe the bond market will be the arbitrator of which policies are acceptable. While the S&P 500 will be the barometer of Donald Trump's economic achievement, the 10-year Treasury borrowing rate will gauge his financial viability.

With US debt potentially reaching 160% of gross domestic product (GDP) by 2035 under a worst-case scenario, the Senate will be keen to avoid an out-of-control interest bill, requiring more careful public finance.

WHATEVER IT TAKES

What about Europe, caught between these two giants, the US and China? We expect the Euro Area economy to record sub-potential growth at 0.8% in 2025, with downside risks. The ECB, well aware of the economy's weaknesses, is ready to act. We forecast additional cuts to reach 2% in 2025 but note this is skewed to the downside to counteract any further weakness from tariffs and its economic impact.

A second Trump administration could be a decisive and transformative moment for Europe, particularly concerning its own defence. As the French President stated after Donald Trump's victory, "Do we want to read the history written by others?" In other words, Europe needs to write its own history in protecting its own interests. The sudden break-up of the German coalition reopens the debate around the constitutional debt brake[1]. With the German deficit at 63% of GDP, there is considerable room for Germany to stimulate investments, both for its own sake and in embracing joint debt efforts for European defence. This could become the "Whatever it takes" moment for protecting Europe, though it will likely take time and may not be a short-term catalyst for changing investor perception of Europe.

This new edition, "A Transforming World", explores the evolving macroeconomic landscape, including AI's impact on growth, setting equilibrium interest rates, shifts away from the US dollar in currency markets, China's economic rebalancing, and the energy transition towards electrification. We examine these captivating themes to provide valuable insights.

On a final note, it is also a transforming world for Indosuez Wealth Management, following the acquisition of Degroof Petercam. We welcome two new contributors in this edition: Jérôme van der Bruggen, who shares our key messages, and Hans Bevers, who provides a fascinating article about setting the neutral central bank policy rate, "A long-term macroeconomic story: written in R-star[2]."

I hope you enjoy reading this new Global Outlook edition.

1 - In Germany, the federal government and the 16 states are obliged to balance their books and are practically prohibited from taking out extra loans.
2 - R-star: the natural interest rate at which the economy is at full employment and inflation is stable, without stimulating or slowing down economic growth.

02 | Key Messages

FIVE KEY INVESTMENT STRATEGY MESSAGES

Jérôme VAN DER BRUGGEN
Chief Investment Officer Private Banking,
Degroof Petercam

The difficulties facing global decision makers in formulating a unified economic policy for the world are commensurate with what is at stake. Sharply slowing (and in some places even declining) population growth and climate change need bold and coordinated policy responses.

The world certainly looks divided on many issues, but, if you zoom out, the three large currency blocks represented by the United States, China and the Euro Area are aiming at – broadly – the same response although with different intensities. Large public and private investments to drive productivity growth, with the support of accommodative monetary policy. The world is a risky place but the rewards for the long-term investor are attractive.

We summarise our investment strategy in five key messages and refer to the dedicated articles within this edition of the Global Outlook.

RATE CUTS COULD BE DELAYED BUT ARE UNLIKELY TO BE STOPPED

The backdrop for equity markets continues to be positive

To loosen or not to loosen... Speaking on Odd Lots (the podcast) from Jackson Hole at the end of August 2024, Adam Posen, current President of the Peterson Institute, and former voting member of the Monetary Policy Committee of the Bank of England, expressed the view that the Federal Reserve's (Fed) stance should be more nuanced. He labelled Jerome Powell's much awaited intervention at the Central Bankers convention a "rifle shot" speech. What he meant is that the Fed chair, who had aimed his rifle at inflation back in 2022, was now redirecting his rifle too narrowly at the job market, to shoot down recession risks.

Donald Trump's tax cuts and tariffs agenda could indeed slow down the pace of rate cuts. However, as **Bénédicte Kukla** explains, if rate cuts are delayed, they will probably not be stopped. The loosening cycle still has legs. If so, where – at what terminal rate – will the Fed cuts stop for this cycle? **Hans Bevers,** argues for a Neutral Rate of Interest of around 1.5%. Given that the Fed continues to aim for a 2% inflation rate, it means that a terminal rate of 3.5% would neither be accommodative nor restrictive. Meanwhile, the US is projected to achieve a soft landing, with growth normalising around 2%. With growth that is still robust and further loosening in sight, the backdrop for equities remains positive. The bond market, which was again affected by inflation and global growth upward repricing in 2024, may regain interest in 2025 but benefiting more shorter to intermediate bonds as opposed to long-dated bonds, which remain vulnerable to concerns about term premia and public debt sustainability. Finally, on Private Markets, **Nicolas Renauld, Remy Pomathios** and **Matthieu Roumagnac** see improving financial market conditions as first signs of optimism for investors in what could be a turnaround year.

US EXCEPTIONALISM PREVAILS

The weight of US equities in global portfolios keeps rising

Most observers attribute the US stock market's resilience over the last decade to a set of exceptional conditions that underpin the exceptional economic growth experienced in the US. First among them are the sheer size of its economy and its vast natural resources, both providing solid foundations. Then there is its corporate culture of innovation and ability to execute, supported by financial markets that can be trusted to offer deep pools of financing.

The robustness of US financial markets is partly driven by the status of its currency. The dollar is the currency of global trade and accounts for over 58% of global foreign exchange reserves.

As **Lucas Meric** asserts, while the dollar's dominance is being challenged by the emerging countries' desire to reduce their reliance on the currency, fears of "de-dollarisation" appear overstated. A final element helping to explain US exceptionalism is the strategic policymaking of US institutions that have implemented bold measures such as the 2017 Tax Cuts and Jobs Act (TCJA) or the 2022 CHIPS and Science Act. All this has helped US companies to show superior earnings growth compared to their global counterparts and underpinned the performance of the US stock market and the rising weight of US equites in global portfolios.

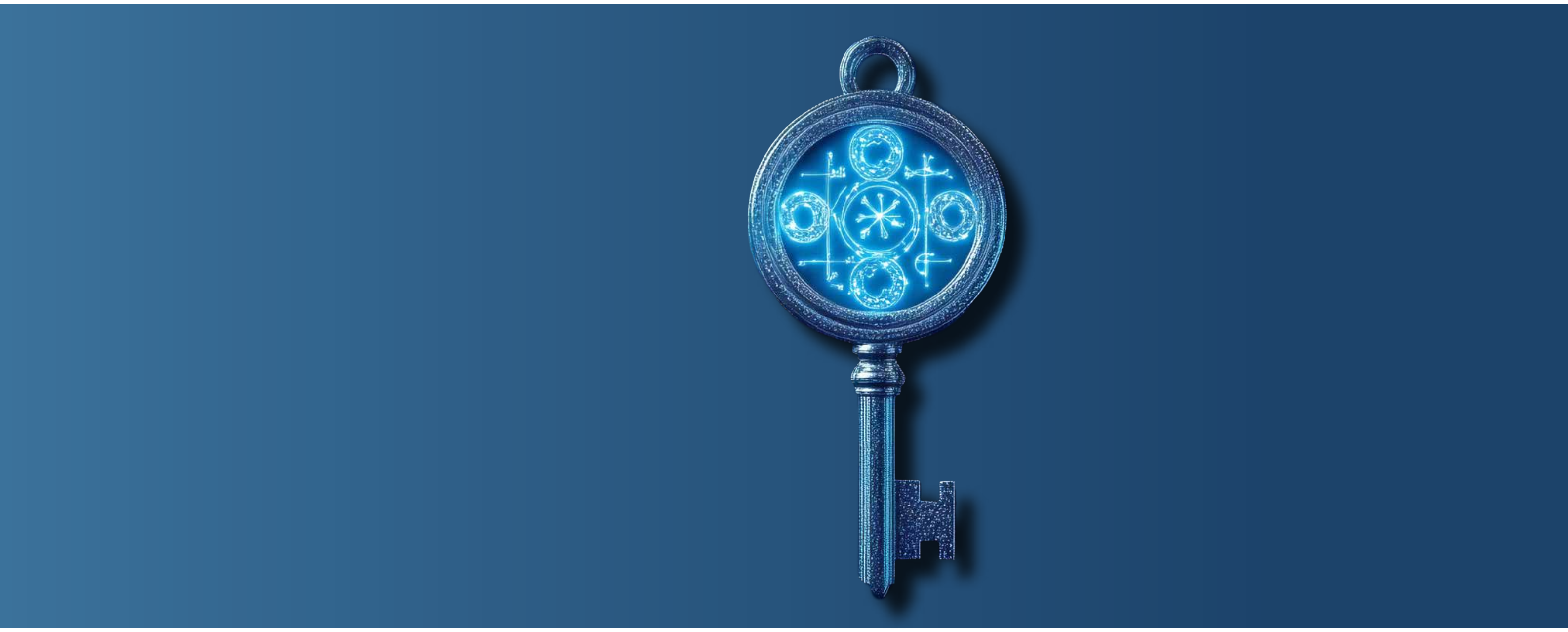
AI AND ELECTRIFICATION: TWO LONG LASTING THEMES

Both are likely to continue to attract massive investments

Two areas are likely to participate in the much-needed boost in productivity growth in the coming years. One – Artificial Intelligence (AI) – is currently driving a bull market in US Tech stocks. **Nicolas Mougeot** explains why AI, despite high developing costs and increasing demand for energy, is set to drive productivity growth like past technological revolutions did in the past.

Areas like generative AI, which creates new content from existing data, hold vast economic potential. He identifies several other areas such as automation, task complementarity, new task creation and advancements in robotics where (mostly) US Tech companies are leading in AI adoption.

The second theme – Electrification – impacts more than one sector. **Fabrice de Sousa** and **Laura Corrieras** label it a New Eldorado and write how it shapes the energy transition that itself relies on renewable electricity production. By 2050, electricity output is expected to more than double and become greener, with 70% from non-fossil sources, up from 11% today. The sectors that will likely benefit from investments include renewable energy, energy storage, grid transformation, and electric vehicles.



AS CHINA REFORMS, ASEAN EMERGES

We remain positive on a selection of emerging market equities, especially in Asia

China's real GDP growth stood around 5% in 2024, despite ongoing real estate issues affecting investment and consumption. Political uncertainties led to global tariffs against China, reducing Chinese exports by 4.7% globally and 13% to the US in 2023. In response, China initiated strong policy measures in late 2024, focusing on industrial restructuring and fiscal support.

Optimists, like **Francis Tan**, view these efforts as stabilising, with positive implications for emerging markets (EM) and the Association of Southeast Asian Nations (ASEAN). The shift in supply chains, spurred by US-China trade tensions, benefits ASEAN, which is also experiencing robust demographic growth, increased foreign direct investment (FDI), and market-friendly reforms. ASEAN's dynamic economies are poised to continue driving global growth. We remain positive on a selection of EM equities, especially in Asia where growth potential is supported by an ongoing monetary easing cycle and the prospect of a Chinese stimulus that could act as a regional catalyst.

MULTI-ASSET PORTFOLIOS: THE BEST OF BOTH WORLDS

These portfolios are balanced, diversified, and managed with conviction

Investors are often perplexed as to how to express their convictions in equity or bond portfolios. **Grégory Steiner** and **Adrien Roure** explain why they think a multi-asset approach provides the best of both worlds. The goal of this approach is to provide capital appreciation by investing in a broad range of financial instruments, relying on the risk premium inherent to all asset classes. So, these portfolios are constructed to provide several attractive features that enable investors to see through the volatility of financial markets. They are balanced and designed to optimise returns relative to the risk taken. They are highly diversified both geographically and by sector, and include foreign currencies and commodities, like gold. Finally, they are actively managed and, at Indosuez Wealth Management, reflect the core convictions expressed in the investment strategy summarised above.

03 | Macroeconomics

THE BUTTERFLY EFFECT

Bénédicte KUKLA
Senior Investment Officer

2024 was pivotal for democracy, with key elections having significant and far-reaching consequences. In 2025, political uncertainty will give way to policy uncertainty under Trump 2.0, potentially creating ripples across the globe. Domestic demand will be the primary source of growth in both Europe and China as globalisation rewiring continues and highlights the risk of foreign trade dependency. While tariffs pose a risk to inflation expectations, central banks are expected to continue to cut rates in 2025.

On course for a
SOFT LANDING
US scenario

A UNITED SWING

In the 2024 elections, it was ultimately not a state or sector swing for Donald Trump, but a national swing to the right giving Donald Trump a clear mandate for the US economy and "Americanisation". The impact on growth will depend on the degree to which Donald Trump will deliver on his intense election promises. The US is on course for a soft landing scenario, whereupon growth should normalise to around 2% by 2025, slightly above potential long-term growth (estimated at 1.8%), as consumption cools in line with wages in a less tight job market (back to 2019 unemployment rate of 4%).

The probable extension of Trump's previous tax cuts (TCJA) end 2025 are factored into our scenario and should help to maintain the pace of growth. The implementation of a 60% tariff on Chinese goods also seems probable, justifiable by acclaimed unfair production subsidies. Both popular measures could hinder the current fall in goods inflation. A short-term spike in inflation would prompt the Federal Reserve (Fed) to err on the side of caution. This should not, however, hinder the Fed maintaining a less restrictive policy, even if the natural rate of interest is arguably higher (see "A long-term macroeconomic story: written in R-star" article on page 22).

The Fed made it clear in a 2018 Federal Open Market Committee (FOMC) paper (following Trump's initial trade restrictions) that a "see-through" policy - whereby the monetary response is to overlook a short-lived inflation rise and lower the policy rate - would be appropriate in response to tariff hikes, provided inflation expectations remain firmly anchored and do not affect wages. The latter will therefore be the elements to watch. Elements that have not been factored into our scenario due to the uncertainty around implementation, include the decrease in corporate tax rate to 15% which represents an upside risk to our scenario. Inversely, the effects of the proposed global 10% tariff and measures to drastically cut immigration are stagflationary.

A FISCAL BRAKE OR BREAK?

GDP growth should improve as purchasing power improves and investment benefits from lower rates, but divergent in growth within the Euro Area will persist in 2025. Germany is the main uncertainty in our scenario. It sits on excessive household savings (at 20% of revenues in Q2), which could be unlocked with the fall in rates, but political uncertainties continue to undermine business confidence. The sudden break-up in the ruling coalition will reopen the debate around the constitutional debt brake and the increasing need to stimulate investment in Germany. Forming a new government takes time, but maybe a glimmer of hope for a downbeat Europe. Unfortunately, the good news ends here. Germany continues to find itself on the defensive in the tax competition with the US (Germany has the sixth highest corporate income tax rate in the OECD, at 29.9%) and price competition with China.

In France, where the public debt-to-GDP ratio will reach 115% in 2025, the structural efforts (stripping out the impact of the economic cycle and interest payments) to rein in spending are consequential, with an adjustment of over 1% of GDP planned in the draft budget. Over the past 20 years there has only been one case of budget tightening over one percentage point of GDP recorded in France (and it was during the stress of the European sovereign debt crisis). For Spain and Italy, domestic fiscal tightening will likely be at least partially offset by the EU Recovery and Resilience Fund spending, which is expected to pick up next year before the 2026 deadline (just 40% of the 650 billion euros allocated to countries has been disbursed).

Euro Area
GROWTH BELOW 1%
in 2025

With both main economic engines running low in 2025, the Euro Area is expected to grow less than 1% in 2025 (Table 1). The European Central Bank (ECB) may need to cut rates more aggressively if European GDP growth weakens significantly. Nevertheless, a significant depreciation of the euro alongside European tariff retaliation could spur inflation fears.

EMERGING MARKETS

For emerging markets, election outcomes were mixed in terms of stability. India saw the fall of its majority governments, which could make its ambitious reform agendas harder to push forward. In Mexico, continuity in leadership with President Claudia Sheinbaum may allow for some policy consistency. However, her administration faces challenges, including managing a high deficit and the impending renegotiation of the United States-Mexico-Canada Agreement (USMCA) on trade in 2026, which will limit her policy flexibility, notably with China.

Emerging Asia will continue to be the main driver of GDP growth in 2025, even though China should moderate, and Indian growth should normalise to pre-pandemic levels. China should foster more of its resources to developing internal and regional demand. The ongoing transformation of globalisation will deepen (Chart 1, page 13), and emerging markets are vulnerable to tariffs on China, which could hamper China's growth and affect the economies dependent on it. However, countries like Vietnam, India, and South Korea could benefit from potential tariffs on China, as is already evident. Asia is thus expected to outweigh Latin America, with Brazil's GDP growth strength standing out against Mexico.

EXPONENTIAL TRADE WAR RISKS

With US elections behind us political uncertainty has dropped, but with Donald Trump returning to office policy uncertainty has increased. The major risk highlighted by the International Monetary Fund's (IMF) recent report is that a universal tariff increase results in more inflation, with only small effects on the trade balance. Although higher US tariffs redirect American demand away from goods produced in the Euro Area or China, subsequently reducing inflation in these regions, they also lead to an appreciation of the US dollar, making imports more costly for global consumers.

TABLE 1: MACROECONOMIC FORECASTS 2024 - 2026, %

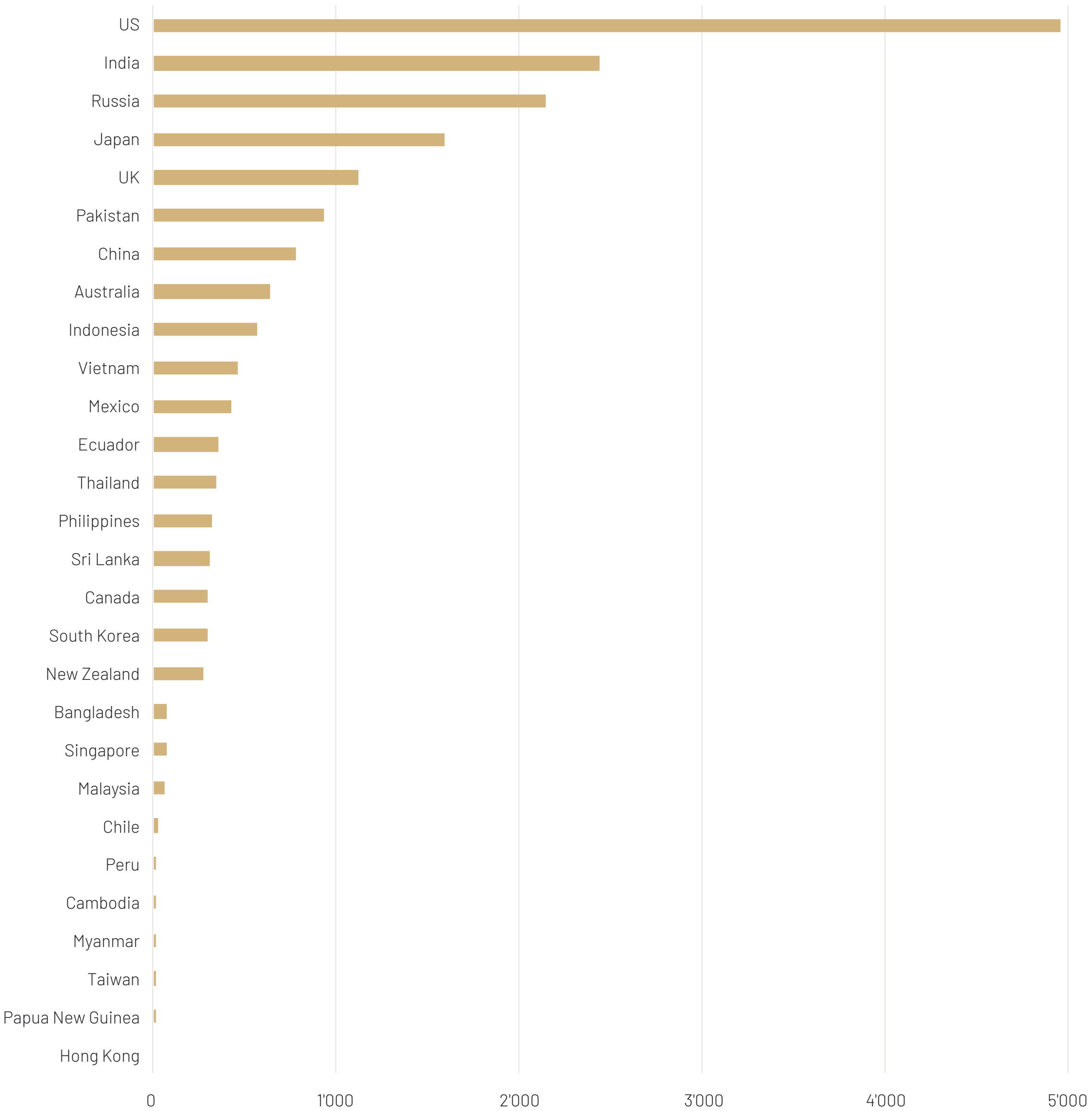
	GDP			INFLATION		
	2024	2025	2026	2024	2025	2026
United States	2.7	2.1	2.0	2.9	2.2	2.2
Euro Area	0.7	0.8	1.2	2.3	1.7	2.0
China	4.8	4.7	4.5	0.7	1.8	1.5
Japan	0.3	1.1	0.8	2.2	2.0	2.0
World	**3.1**	**2.9**	**2.7**	-	-	-

Source: Indosuez Wealth Management.

Additionally, retaliatory tariffs are anticipated to come into effect by 2026, which will further drive-up consumer prices. Under Donald Trump, higher inflation, higher interest rates, and a stronger dollar could also negatively impact emerging market currencies. If these trends are prolonged or outsized, EM central banks may be pressured to stabilise their currencies through interest rate hikes (or less cuts).

Finally, the conflict in Ukraine and operations in the Middle East are anticipated to extend into the coming year. However, the impact on global oil prices (often the scapegoat of geopolitics) may be mitigated by a structural shift in energy demand, as electric vehicle adoption curtails oil consumption and production encouraged by the US, the world's number one oil producer.

CHART 1: NUMBER OF HARMFUL TARIFFS[3]



Source: Sustainable Trade Index (2022), Indosuez Wealth Management.

3 - According to Global Trade Alert, a harmful tariff is any tax on imported goods that discriminates against foreign commercial interests.

04 | Asset Allocation

MULTI ASSET IN 2025: THE BEST OF BOTH WORLDS

Grégory STEINER, CFA
Global Head of Multi Asset

Adrien ROURE
Portfolio Manager

2025 looks set to be a challenging year, with adaptability key to capturing sector rotations, managing increased volatility and navigating fragmented policy and monetary environments. Success will be based on conviction based management, while maintaining a selective approach to US and emerging market equities, high quality yielding assets and, in addition, diversification assets.

2025:
Investors will need to be
AGILE AND FLEXIBLE

2024: A YEAR OF TRANSITION AND ECONOMIC RESILIENCE

2024 proved to be a key milestone in the global economic cycle, with economic and monetary dynamics gradually normalising. While economists predicted global growth to be uniformly fragile, developed economies took divergent trajectories. In the US, economic strength has defied expectations, driven by the strength of the US consumer. This dynamic contributed to slower than expected disinflation, leading to later and more moderate rate cuts compared to other advanced economies.

The contrast is striking in Europe. After a slight rebound at the beginning of the year, the Euro Area finally posted modest and heterogeneous growth. Southern economies benefited from European stimulus packages and a pick-up in tourism, while northern economies, particularly Germany, were hampered by their reliance on manufacturing and trade links with China.

In emerging countries, the situations were varied, but overall industrial relocation and the beginning of a monetary easing cycle fuelled growth, especially in Asia. China remains a notable exception as it continued to face the fallout from the property crisis and structural challenges. However, the introduction of major new stimulus plans at the end of 2024 could give the Chinese economy a boost for the coming quarters.

2025: A VOLATILE YEAR INFLUENCED BY ECONOMIC DATA?

The key message for 2025 seems clear to us: investors will need to be agile and flexible in the face of episodes of volatility that are likely to multiply and intensify. We see a number of factors contributing to this view:

- **Uncertainty over the trajectory of the US economy:** While consensus quickly adjusted to forecast a strong US economy in 2024, the outlook for 2025 remains divided. If we envisage for a soft landing of US economic activity, frequent policy shifts between sustained growth and a slowdown could increase investor nervousness and lead to significant sector rotations.
- **Asynchronous monetary policy:** The strength of the US economy relative to the Euro Area leads us to expect more moderate interest rate cuts in the US. This divergence is likely to lead to significant differences in performance between geographic areas. However, we believe that the current global monetary easing cycle is creating favourable conditions for certain segments such as European listed real estate and US small and mid-caps to catch up.

- **Political and protective implications:** We expect the first concrete implications of the 2024 elections to emerge, particularly in the US, where a reappraisal of economic priorities could benefit domestic stocks. In Europe, fiscal consolidation may curtail growth and make the environment more challenging for European assets. Meanwhile, emerging markets, will need to continue to adapt their strategies, particularly through new trade alliances, while China and its fiscal stimulus efforts will be a key focus.
- **Geopolitical factors:** The ubiquity of geopolitical tensions makes the investment landscape more uncertain with potentially more bouts of volatility. However, the geopolitical backdrop and the increase in protectionism could present tactical opportunities for the markets but could also benefit specific segments such as defence and semiconductor stocks in the longer term.

2025: Picking the RIGHT SECTORS AND COMPANIES will be paramount

EQUITY MARKETS: TOWARDS A MARKET OF CONVICTIONS?

In 2024, the macroeconomic framework allowed equity markets to rise sharply and directionally, with performances concentrated on certain segments, first and foremost the US technology sector. For 2025, we expect a shift towards an environment where the ability to pick the right sectors and companies will be paramount.

Although we remain constructive on risky assets, the challenges of the year ahead call for a flexible and opportunistic stance.

US equities remain our focus, not only because of the stronger economic outlook but also because companies are better able to meet earnings growth expectations. While strong demand for Artificial Intelligence (AI) initially boosted technology stocks, we believe its diffusion throughout the economy should enable a broadening of performance in equity markets, especially as some forgotten segments of the stock market catch up. However, current valuations limit the potential for near term multiple expansion.

Conversely, despite attractive valuations in the Euro Area, we remain wary of less favourable economic *momentum*, the prospect of fiscal consolidation and growing global protectionism that could affect the region. The United Kingdom could nonetheless be an area of outperformance, benefiting from renewed political *momentum*, a more conciliatory US stance and a possible rapprochement with the European Union.

Lastly, we remain positive on a selection of emerging market equities, especially in Asia where growth potential is supported by an ongoing monetary easing cycle and the prospect of a Chinese stimulus that could act as a regional catalyst.

The
BOND MARKET
may regain interest in 2025

BOND DIVERSIFICATION ALONGSIDE EQUITIES

While we expect positive returns from equity markets, the bond market, affected by an inflation and global growth upward repricing in 2024, may regain interest in 2025.

On the one hand, the correlation between equities and bonds is likely to normalise, giving back bonds their role as hedges in portfolios. On the other hand, the monetary easing cycle is under way, particularly benefiting short to intermediate bonds. In contrast, long-term bonds remain vulnerable to concerns about term premia and public debt sustainability.

Geographically, European government bonds, while offering lower yields, could benefit from more pronounced interest rate cuts, offering the potential for additional capital appreciation relative to US government bonds. In credit, we reiterate our focus on high quality corporate debt and the best high yield segments, which allow us to take advantage of an attractive level of yield that is properly compensated for embedded risk.

TO GO FURTHER: SOME DIVERSIFICATION OPPORTUNITIES

Certain asset classes should also play a key role in portfolio diversification:

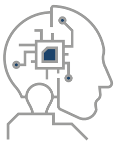
- **US linkers:** In a no landing scenario, real rates embedded in US linkers provide true carry.
- **Emerging market debt in local currency:** In addition to benefiting from an attractive yield, this asset class remains relevant to benefit from a more favourable monetary environment.
- **Gold and the US dollar:** Gold remains a diversifying asset, the price of which continues to be supported by growing demand from emerging market central banks. Meanwhile, the dollar continues to act as a hedge against alternative scenarios and potential volatility.

05 | Focus

AI AS THE NEW ENGINE OF PRODUCTIVITY GROWTH?

Nicolas MOUGEOT
Head of Investment Strategy
& Sustainability

Technological revolutions have reshaped the global economy one after the other. Today, Artificial Intelligence (AI) is driving the latest transformation. This article explores AI's potential economic impact, its effects on various sectors, and the challenges of measuring its true influence.



CHIPS'
power
DOUBLES
every 2 years

Over the past 200 years, the global economy has undergone numerous technological revolutions. These include the advent of electricity and the development of railways in the 19th century, the expansion of the telephone in the early 20th century, the rise of personal computers in the 1970s, and the emergence of the internet in the late 1990s.

The current decade is no different, as it is marked by a new technological revolution: Artificial Intelligence and in particular generative AI. Generative AI is a branch of Artificial Intelligence that can create new content—such as text, images, music, or entire virtual environments—by learning patterns and structures from existing data. Using techniques like neural networks and deep learning, generative AI models can produce highly realistic and innovative outputs that mimic human creativity. We therefore discuss the potential impact that AI could have on the global economy and how it could affect equities across different sectors.

WHY IS IT DIFFICULT TO MEASURE THE IMPACT OF AI?

Let us begin with a word of caution, drawing from Solow's Paradox and Moore's Law. First, Robert Solow, a US economist and Nobel laureate, once remarked, "You can see the computer age everywhere but in the productivity statistics." This highlighted the fact that the rapid expansion of personal computers in the 1970s and 1980s failed to significantly boost productivity during that period. This observation likely applies to the advent of other technologies, such as the internet or 5G. Often, the initial excitement surrounding new technologies fades as their practical applications prove to be more limited than initially anticipated.

Could AI be any different? Yes. Gordon Moore, an engineer, famously predicted in 1965 that the number of transistors on a microprocessor would double approximately every two years. Nearly 60 years on, this prediction holds true, as demonstrated by Chart 2 (page 20). While semiconductors have exponentially increased in power, our brains are wired to think linearly. This makes it challenging for us to comprehend the future potential rise in computing power and its implications for AI. In essence, the actual advancements in AI could far surpass our current expectations.

THE IMPACT OF AI ON ECONOMIC GROWTH

Numerous studies have assessed the impact of AI on global economic growth. Artificial Intelligence is poised to have a transformative impact on both economic growth and the job market. On the one hand, AI technologies promise to boost productivity, streamline operations, and foster innovation across various industries. This increased efficiency can lead to substantial economic growth, as companies can produce more with less, reduce costs, and create new products and services. Goldman Sachs mentioned that the adoption of generative AI could increase global GDP by almost 7 trillion dollars, or 7% over a decade. Meanwhile, a report by the McKinsey Global Institute points to a potential GDP rise between 17 to 25 trillion dollars, representing a 1.5-2.4% annual increase over the next 10 years.

However, Daron Acemoglu, recipient of the 2024 Nobel Prize in Economics and Massachusetts Institute of Technology (MIT) professor, argues in a recent paper that while AI will lead to cost savings and productivity improvements, there is no evidence of AI's revolutionary effect on the economy that could validate such significant impacts on GDP growth[4]. Instead, he focuses on AI's capacity to improve productivity and reduce costs across various tasks, as well as its impact on wages and inequality.

4 - See Daron Acemoglu, "The Simple Macroeconomics of AI", 2024, Economic Policy.

AI-driven productivity gains can come from:

- **Automation:** AI models could take over some tasks or reduce their costs.
- **Task Complementarity:** Workers could use AI to access better information or complementary inputs, thereby increasing their productivity.
- **Deepening of Automation:** Already automated tasks could be further improved by generative AI.
- **New Tasks Creation:** AI could create new tasks that enhance overall productivity.

Daron Acemoglu estimates that AI could boost total-factor productivity - measured as the ratio of GDP to total inputs - by 0.7% over a decade, which translates to a modest 0.07% annual increase. Depending on the scale of investment in AI, he believes the overall impact on GDP growth could range from 0.9% to 1.8% over 10 years. Although Acemoglu's estimates are more conservative compared to other studies, they are far from insignificant. An additional 15 to 20 basis points in GDP growth is still notable, especially when economists project global GDP growth to hover around 2.7% to 2.8% per year.

AI could increase
GLOBAL GDP BY 2%
or more

WHICH COMPANIES ARE MOST LIKELY TO BENEFIT FROM AI?

No place to hide. In the US

Generative AI has made significant strides over the past decades, but it truly captured global attention in 2022 with the public launch of ChatGPT.

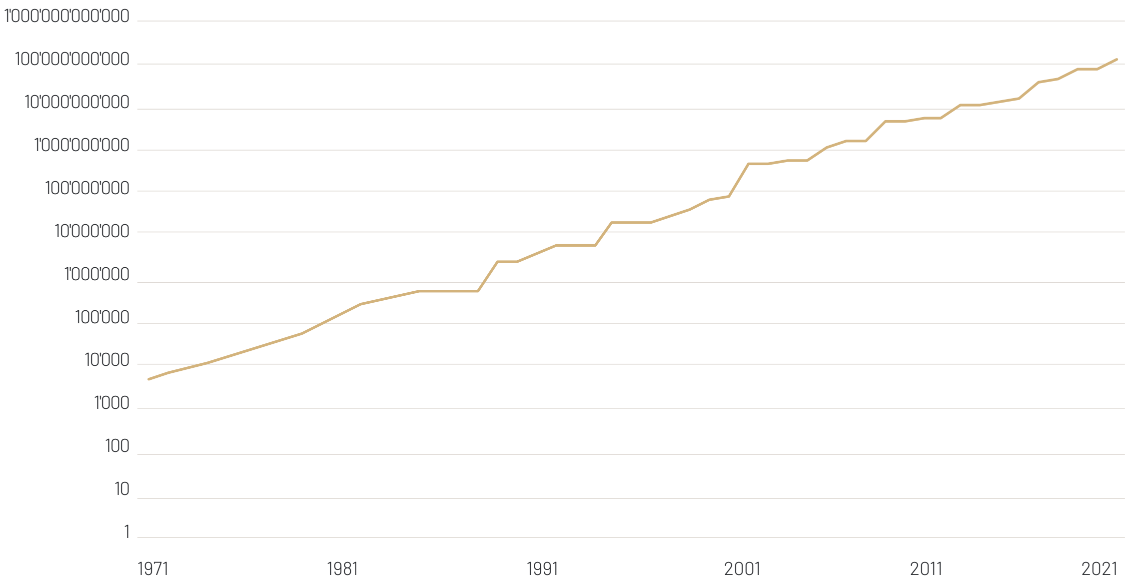
As illustrated in Chart 3 (page 21), numerous companies are riding this wave; mentions of AI during earnings calls by US companies have skyrocketed from fewer than 500 before ChatGPT's debut to over 3'000 today. In contrast, European and Asian companies appear to be lagging in AI adoption, with references to AI fluctuating between 500 and 900 each quarter.

The disparity between the US and Europe may be attributed to sectoral differences, as the US hosts numerous tech companies that are at the forefront of AI development. This suggests however that the impact of AI is likely to be more pronounced for American companies compared to their European counterparts. The dominance of the US in AI is further evidenced by the significantly lower number of AI references made by Asian companies during their earnings calls, despite the presence of many AI specialists in China, South Korea, and Taiwan.

Production versus Automation and task complementarity

Companies can benefit from AI either through production and its entire ecosystem or through task automation. Indeed, technology companies ranging from semiconductor manufacturers to hardware and software firms are poised to take advantage of increased AI adoption. However, utilities could emerge as the next major beneficiaries. AI models require vast amounts of data for training, increasingly efficient and powerful chips, and therefore, a growing demand for electricity.

CHART 2: TRANSISTOR PER MICROPROCESSOR, LOG SCALE



Source: Our World in Data, Indosuez Wealth Management.

It is no surprise that energy companies like Vistra, a power company in Texas, saw its share price surge in 2024. Similarly, Sam Altman, founder of OpenAI, became the chairman of Oklo, a California-based company specialising in small nuclear reactors, highlighting the critical intersection of AI and energy sectors.

Automation and task complementarity will impact several sectors, with service industries likely to experience the most disruption. These sectors employ highly educated workers in cognitive-intensive occupations, making them more susceptible to AI integration. For instance, in the media sector, AI can enhance content creation, while in the financial sector, AI can be used to improve risk management, detect fraud, and offer personalised financial advice.

Boosting productivity should not come at any cost. Training a generative AI model currently costs around 10 billion dollars, and according to Dario Amodei, CEO of AI company Anthropic and former vice president of research at OpenAI, this cost could increase tenfold or even thousandfold. This escalating expense poses a risk: the development of future AI models could become prohibitively expensive and create a significant barrier to entry for new startups.

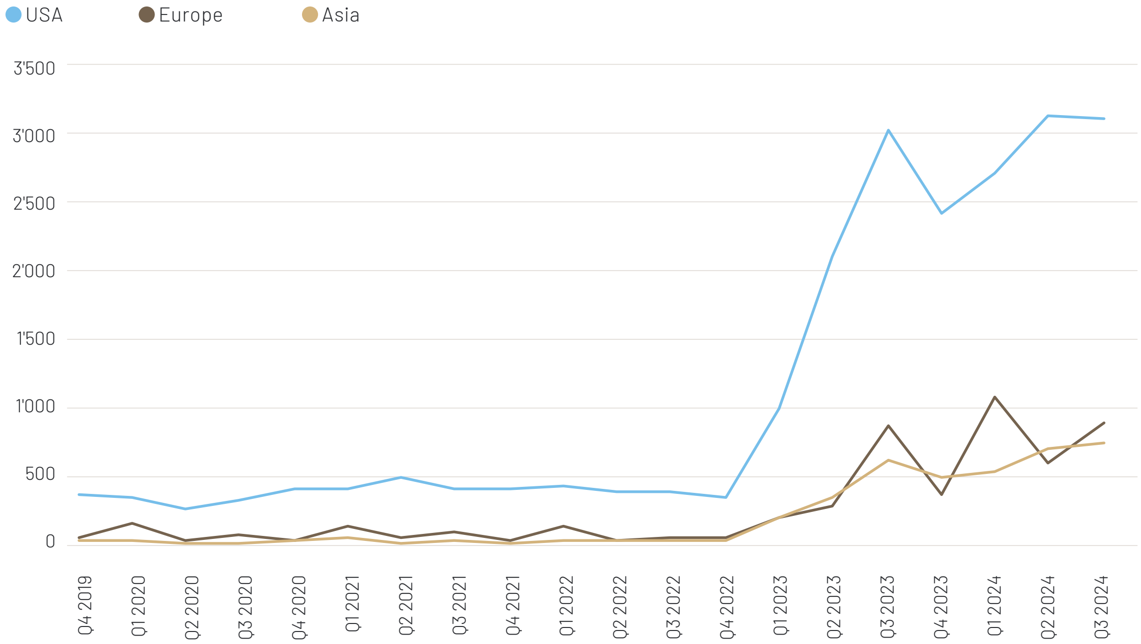
USD
10 BILLION:
Could AI's cost become too prohibitive?

The rise of robots, the next frontier?

Finally, beyond generative AI, which can enhance the productivity (and possibly replace) highly skilled jobs, the next major trend may be the development of robots capable of performing low-skilled tasks, from waste collection to mining for example. It is likely too early to predict the economic impact of highly skilled robots, as their commercialisation is still a few years away.

AI has been at the forefront of investors' attention over the past two years, driving structural changes in the way we work and interact, and impacting the global economy and investment landscape. However, there may be a gap between the speed at which AI can develop and the pace at which it is adopted. While this article's syntax has been enhanced using generative AI, let us reconvene in a year to see if our 2026 Global Outlook is fully written by AI and robots!

CHART 3: NUMBER OF MENTIONS OF AI DURING EARNINGS CALL BY US AND EUROPEAN COMPANIES



Source: Bloomberg, Indosuez Wealth Management.

A LONG-TERM MACROECONOMIC STORY: WRITTEN IN R-STAR

Hans BEVERS
Chief Economist
Degroof Petercam

Just as astronomers study starlight to understand the history of the universe, economists examine the concept of R-star to uncover the forces that have shaped its past evolution. Moreover, it provides a framework to discuss interest levels from a structural perspective. Amid a rapidly transforming world, can we say anything meaningful about R-star's future trajectory? Or is this idle hope and is (R-) stardust all that's left?

R-STAR
fell below
1%
IN THE 2010s

R-STAR: CONCEPT AND RELEVANCE

R-star, or the natural rate of interest, is a key macroeconomic concept. Independent of central bank actions, it represents the real interest rate when the economy is operating at full potential, with stable inflation (around 2%) and full employment. Essentially, R-star is the *equilibrium* interest rate that neither stimulates nor restrains economic activity.

Central banks use R-star to set interest rates. Comparing the current real policy rate to R-star helps determine if monetary policy is expansionary or contractionary. More specifically, if the current rate is below R-star, it suggests an expansionary policy; if above, as was the case in most countries throughout 2023 and 2024, a contractionary one. As such, it guides timely policy adjustment to maintain economic stability.

For investors, R-star can help to make informed decisions to maximise returns. For example, in a low interest rate environment, investors could decide to diversify funds into financial instruments that might offer higher risk-adjusted returns. R-star can also help investors to evaluate the potential risks within their investment portfolios. Portfolios with lower duration bonds for example are less sensitive to an environment of structurally rising interest rates.

The concept of R-star was first introduced by the Swedish economist Knut Wicksell in the late 19th century, influencing the work of John Maynard Keynes in the 1930s. Both economists understood that the natural rate of interest is fundamentally determined by the balance between savings and investments. When the desire for savings exceeds investment demand, the natural rate tends to fall. Conversely, when investment demand is high relative to desired savings, the natural rate rises.

LOOKING UPON R-STAR: FORCES OF THE PAST

Even though R-star is notoriously difficult to measure accurately, economists widely agree that R-star declined significantly in the four decades before the pandemic. According to estimates by the New York Federal Reserve (Fed), *equilibrium* real interest rates in advanced economies averaged around 3% from the late 1970s throughout the early 1990s, before falling to below 1% in the 2010s. It should be noted, however, that this figure hides significant differences between regions. R-star fell in all advanced economies, but the evolution was more pronounced in Europe. While R-star in the US fell from 2.5% in the mid-1990s to about 1% on the eve of the pandemic, in the Euro Area it dropped from around 2.5% to merely 0%.

In a very long run perspective, R-star is arguably best explained by potential growth. Slower economic growth implies a lower expected return on investment and therefore leads to lower investment demand. At the same time, because a softer growth outlook weakens expected earnings, it leads (forward-looking) households to consume less and save more. Over medium-term horizons, however, potential growth is not the sole driver. Chart 4 on page 23, illustrates that the decline in R-star in the 2010s has been steeper than the decline in potential GDP growth. Indeed, as households and companies strived to repair their balance sheets after the Global Financial Crisis, reflecting a stronger desire for savings over investment, additional downward pressure was put on R-star.

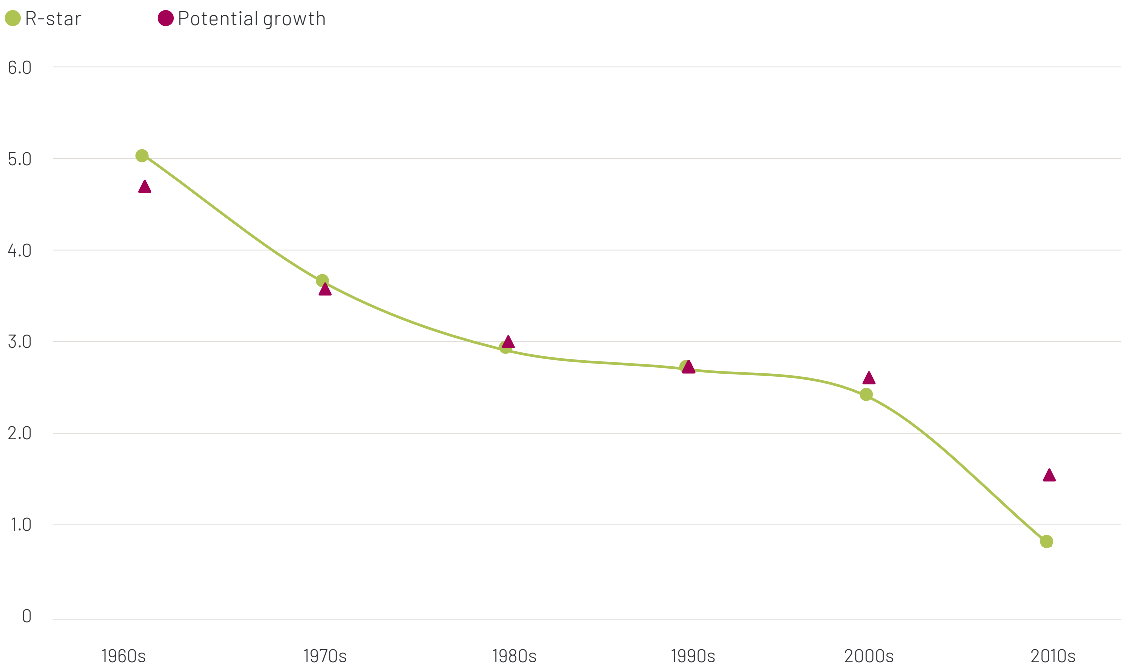
Considering the long-term perspective in more detail, economic studies acknowledge the primary importance of demographic changes (despite uncertainty about the precise contribution). Aging populations in advanced economies have led to increased savings as workers prepared for retirement. And with fewer new workers entering the labour market and a slowdown in population growth, the need for additional investment in infrastructure diminished. Besides demographic ageing, the slowdown in productivity growth (alongside lower public investment) is often identified as another main contributor to the secular decline in R-star. Indeed, productivity growth in recent decades was rather disappointing – averaging only 1% per year across the OECD since the start of the millennium, down from 2% in the 25 years before – reducing the expected return on investments and weakening the attractiveness of investing for the future, thereby dragging the natural rate lower.

SHOOTING FOR R-STAR: WHAT LIES AHEAD?

Naturally, the caution expressed above should only increase when discussing what is ahead. Some believe that talking about R-star is pointless altogether because the level cannot be directly observed. But this view crucially overlooks a critical element: as a policymaker or economist, having a framework or theory is indispensable, no matter how big the uncertainty. As Fed chair Jerome Powell famously quipped: 'we are navigating by the stars under cloudy skies.' Financial investors cannot afford to sit still either. All in all, intuitively, there are several reasons to think that R-star has already risen from its recent lows (and may go higher still).

First, as the process of private balance sheet repair in the form of deleveraging has run its course, an important R-star suppressing factor has faded. Moreover, there seems to be a pressing need and demand for more private and public investment in the face of important structural developments, including the energy transition, mounting geopolitical tensions, as well as the rapid diffusion of AI. This last factor may, over time, also become a key source of innovation on its own, thereby boosting productivity growth and potential returns. And, while it is true that slower population and employment growth contribute negatively to future potential growth, ageing populations are expected to drive a long-term decline in household savings. Indeed, whereas the high-savings group of people in their forties and fifties has grown steadily over the past four decades, it is projected to shrink in the next twenty years.

CHART 4: R-STAR AND POTENTIAL GROWTH IN NORTH AMERICA AND THE EURO AREA, %



Note: GDP weighted average of United States, Canada, and Euro Area (using proxy for Euro Area potential growth before 1990s).

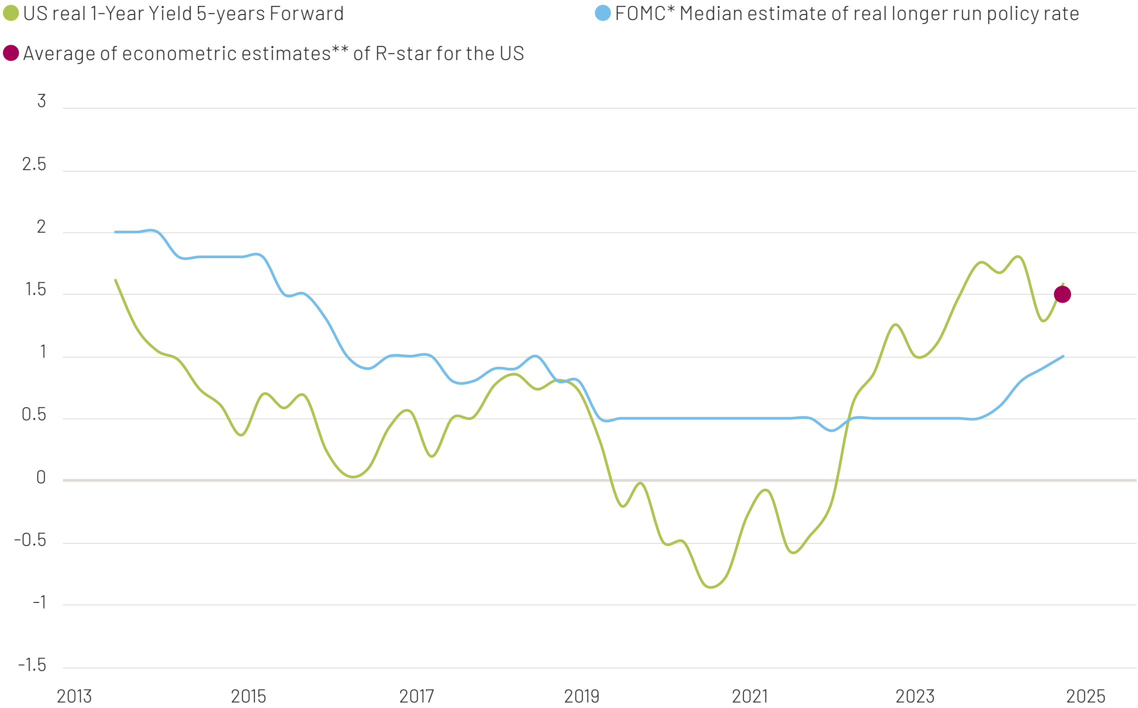
Source: New York Fed, OECD, European Commission, Indosuez Wealth Management.

CURRENT ESTIMATES of R-star in the US hover AROUND 1.5%

Another reason to consider, is the fact that global economic activity has remained resilient (even markedly strong in the US) during and following the aggressive monetary tightening process seen over the past two years. Meanwhile, both Janet Yellen and Jerome Powell have nodded to the idea that productivity and potential growth may have increased and that, under conditions of permanently higher fiscal deficits, R-star could be experiencing upward pressure. Gradually but surely, this view also seems to be seeping into the Fed's longer-term projection of the real policy rate. Financial market pricing and recent econometric estimates, for their part, hint more decisively toward a higher *equilibrium* interest rate (Chart 5). Recent econometric estimates of R-star in the US hover around 1.5%. In the Euro Area, by contrast, the figure is more likely to be around 0.5% if we respect the pre-pandemic gap with the US.

Caution and humility remain essential when estimating R-star, but it appears unlike that the extremely low interest rate environment of the 2010s will return anytime soon, at least not structurally. This scenario is not written in the stars, but policymakers will be quite pleased if it holds true. It would mean that monetary policy would be less prone to reach the (zero) lower bound during economic recessions, reducing the need for extensive quantitative easing (QE). Complaints about "artificially" low interest rates would also diminish. And if, contrary to current expectations, the ultra-low-rate environment does return, it will be explained that the "natural" interest rate reflects structural forces, largely beyond the control of central banks.

CHART 5: INDICATIONS OF HIGHER FUTURE REAL EQUILIBRIUM RATE IN THE US



* FOMC: Federal Open Market Committee.

** Models include: Del Negro et al, Lubik and Matthes, Holston-Laubach-Williams, Johanssen and Mertens, Lewis and Vazquez-Grande.

Source: Federal Reserve, Bloomberg, Goldman Sachs, Indosuez Wealth Management.

05 • Forex

A CURRENCY TALE: THE DOLLAR MYTHS AND THE GOLD SEEKERS

Lucas MERIC
Investment Strategist

In recent years, the global economic landscape has been characterised by increasing government debt, rising inflation, and economic fragmentation, rekindling the conversation around "de-dollarisation." A trend reflecting the strong desire among emerging countries to reduce their reliance on the US dollar. While the prospect of a significant decline in the dollar may seem ambitious, these structural shifts and diversification strategies have propelled gold prices to new heights in 2024, underscoring the importance of real assets in investment portfolios.

54%
of global GDP is anchored to the
US DOLLAR

GAME OF THRONES: AN UNRIVALLED DOLLAR

The theme of de-dollarisation has been a recurring topic since the dollar emerged as the international reserve currency. French Finance Minister (Valéry Giscard d'Estaing) first spoke of the "exorbitant privilege" of the dollar in 1971, highlighting its central role in the global financial system. A privilege allowing the US to sustain perpetual deficits without deteriorating the dollar's value or its borrowing capacity, supported by foreign appetite for dollar-denominated assets.

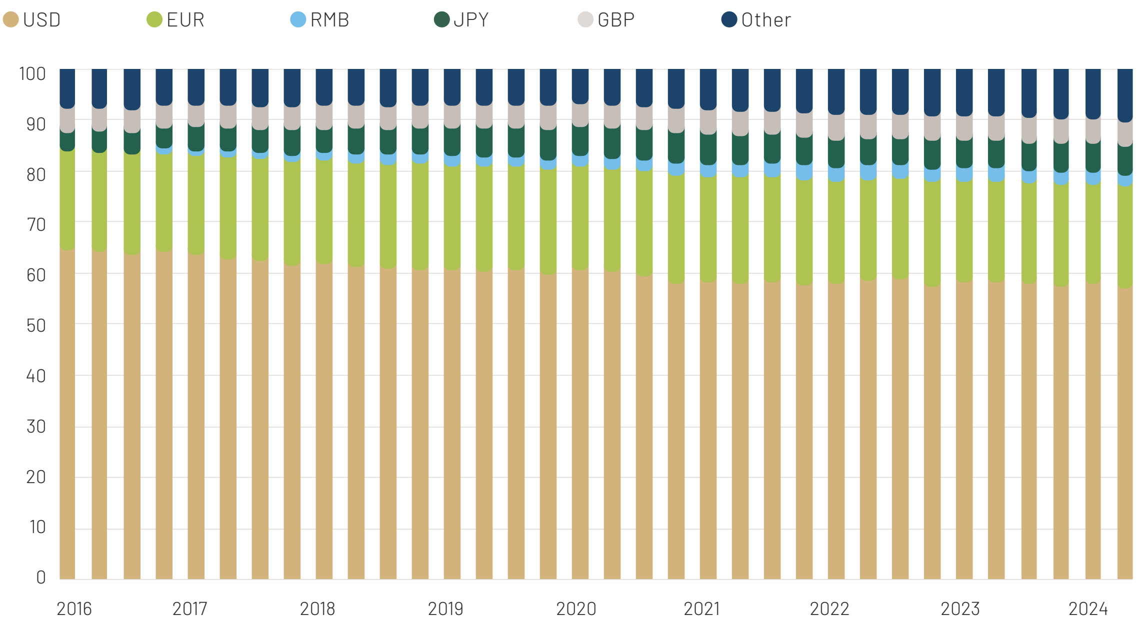
However, in recent years, this dollar dominance has faced growing defiance from international actors, driven by persistent inflationary policies, escalating debt, and the emerging countries' desire to diversify their exposure to the dollar - especially following the financial sanctions imposed on Russia in 2022. Some evidence of de-dollarisation is already visible; for instance, the share of dollars in foreign central bank reserves has been gradually trending down in recent years, while some emerging countries have intensified non-dollar purchases of energy, notably Russian oil.

That being said, if we take a step back, the dominance of the US dollar remains unmatched at the moment. The greenback still represents 58% of official foreign exchange reserves (Chart 6, page 26), nearly half of international debt securities, and is involved in approximately 90% of international transactions, while 47% of cross-border banking claims are denominated in dollars. Furthermore, 54% of global GDP is anchored to the dollar. This dominance is underpinned by strong fundamentals: the US is the largest economy in the world, representing 25.4% of global GDP, and continues to be a leader in technological innovation. The US offers deep and liquid financial markets, with its bond market accounting for 40% of the global bond market, alongside an absence of capital controls and a strong rule of law, making the dollar the gateway to the most competitive economy in the world and unrivalled investment vehicles for foreign investors.

While these advantages are undisputed compared to other potential reserve currencies, one might argue that the US share of the global economy has decreased since it first became the international reserve currency - falling from 50% in 1945 to 25% in 2024 - while China, currently at 17% of global GDP, is projected to become the largest economy in the world by 2038 (according to the Centre for Economics and Business Research). This could potentially pave the way for the renminbi to challenge the dollar's status as the leading international currency.

However, it is important to note that renminbi internationalisation is currently far from the dollar's standing - representing only 3% of global central banks foreign exchange reserves, 7% of international trade, and 5% of international debt securities - notably due to capital controls. Moreover, the mere projection of the Chinese economy surpassing the US does not guarantee immediate dominance of the renminbi, as historical shifts in currency status typically take time. For instance, the dollar overtook the pound sterling as the main international currency in 1945, at a time when the US economy was already five times larger than the UK's. Such transitions are mainly catalysed by dramatic crises rather than gradual changes in fundamentals.

CHART 6: SHARE OF GLOBAL RESERVE CURRENCIES, %



Source: IMF (COFER), Indosuez Wealth Management.

EM
central banks
HOLD ONLY
7%
of their reserves in
GOLD

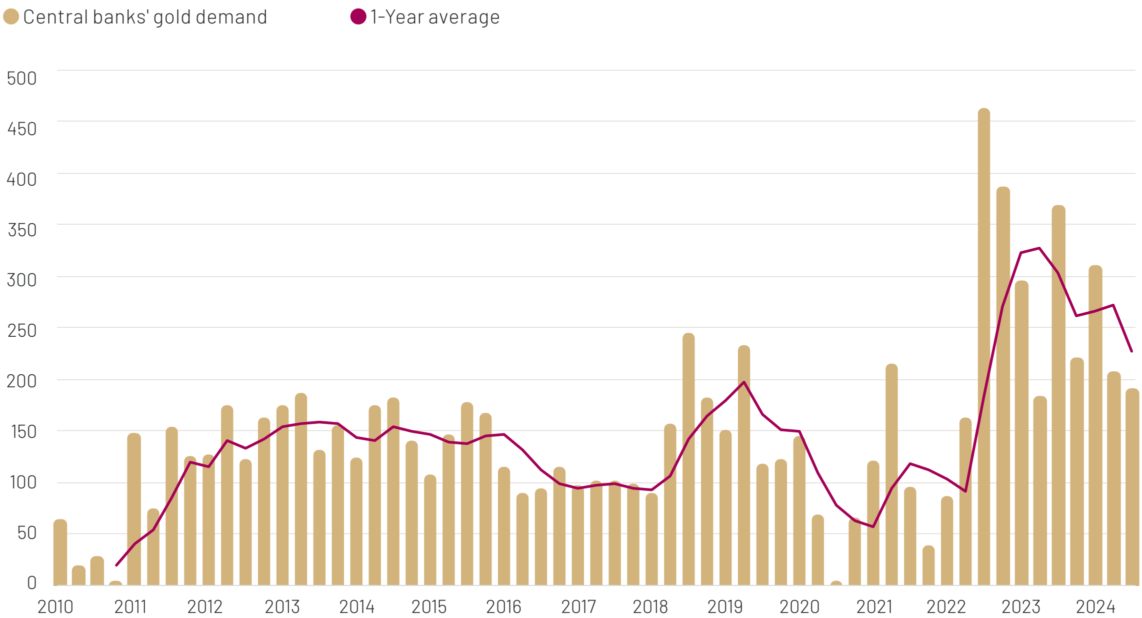
WALKING IN THE FIELDS OF GOLD

The major beneficiary of this diversification from the dollar has been gold, which has experienced strong performance, surging by 35% in 2024 (as at October 2024) despite a sharp increase in real interest rates since 2022. This surge has been partly driven by strong demand from central banks for gold to diversify their official reserves (Chart 7). Emerging central banks, particularly in China, Poland, India, and Turkey, have been significant buyers, seeking greater independence from the dollar, which has sometimes been viewed as a tool of political and economic warfare, as evidenced by the freezing of Russian dollar assets in 2022. While central bank demand has begun to taper from its peak in 2023, the June 2024 World Gold Council Central Bank survey revealed that 81% of central banks expected global gold reserves to increase in the coming year. This growth in gold reserves among emerging central banks also reflects an effort to catch up with advanced economies, which held 17% of their official reserves in gold at the end of 2021 compared to just 7% for emerging countries.

Beyond geopolitical concerns, the push for gold mirrors broader anxieties about a structural shift toward higher government debt and increased monetary supply. Since 2019, the US debt-to-GDP ratio has climbed from 79% to 97% in Q2 2024, with the Committee for a Responsible Federal Budget projecting it to rise to 142% by 2035 (central scenario). This trajectory raises concerns among investors about the sustainability of US debt. Although the dollar's status as a reserve currency facilitates financing for US deficits compared to other countries, there are fears that the response to the growing debt burden may involve more inflationary policies, potentially leading to a so-called "monetary debasement".

Historically, debasement was made by mixing precious metals with lower-value metals to increase currency circulation; for example, Roman emperors consistently reduced the silver content of coins from 90% under Nero in 64 *Anno Domini* (AD) to just 2% in the third century AD to finance wars. In modern economies, debasement has manifested in the form of extensive monetary creation by central banks, particularly since 1971, when currencies were no longer pegged to gold. This has led to a mechanical loss of currency purchasing power.

CHART 7: GLOBAL CENTRAL BANKS' GOLD DEMAND, TONNES OF GOLD



Source: World Gold Council, Indosuez Wealth Management.

An
UNCERTAIN WORLD
supportive for
"ALL-WEATHER" STRATEGIES?

The contrast is stark when considering real assets (Chart 8): in 1924, the average house price in the US was around 10'000 dollars, equivalent to 500 gold ounces at the time. Today, 10'000 dollars barely buys a car in the US, while 500 gold ounces are worth over a million dollars.This divergence highlights the attractiveness of gold as an inflation hedge, emphasising the difference between an asset with a theoretically infinite supply (the US dollar) and one with a semi-finite supply (gold). In this context, some modern assets, like certain cryptocurrencies (e.g., Bitcoin), benefit from a finite supply, leading some investors to consider them a "safe haven" against monetary expansion.

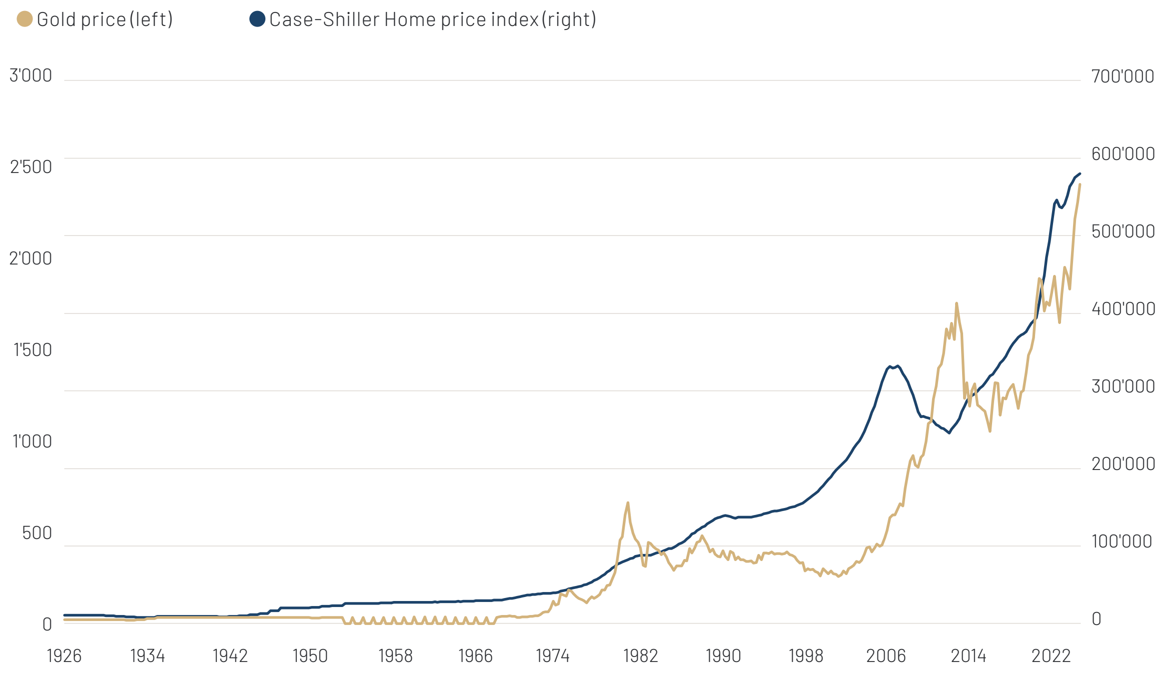
A TRANSFORMING WORLD. KEEP IT REAL?

While fears of "de-dollarisation" may appear overstated, the global economy is undergoing significant structural shifts characterised by heightened geopolitical risk and surging government debt. This combination has propelled the rise of gold since 2022, and these factors will likely remain a focal point for investors in the years to come. In 2021, the Federal Reserve (Fed) changed its inflation target from 2% to an average inflation target, allowing for periods of overshooting.

In this context, more inflationary policies could become a widely accepted solution to address the debt burden, reinforcing the structural case for real assets, particularly gold, as a hedge against "monetary debasement."

From a portfolio construction perspective, a more fragmented world with elevated geopolitical risk and uncertain economic policies could possibly lead to more frequent supply shocks, resulting in volatile inflation - similar to the stagflation shock experienced in 2022, which caused corrections in both equity and bond markets. This unwelcome positive correlation left investors without their traditional bond hedge. A more uncertain world could prove supportive in the long term for "all-weather" strategies, with portfolios including not only equity and bonds, but a broader base of assets, and notably real assets such as gold or commodities.

CHART 8: GOLD VERSUS HOUSE PRICES SINCE 1925



Source: Longtermtrends.net, Indosuez Wealth Management.

ASEAN EMERGES AMID CHINA'S REFORMS

Francis TAN
Chief Strategist Asia

Amid China's GDP growth challenges and real estate woes, rising trade tensions and global political uncertainties are prompting strategic economic shifts. While pessimists see policy efforts as too little, optimists view them as critical to stabilising the economy. ASEAN stands to benefit from these changes, leveraging demographic strengths and market-friendly reforms to become a key alternative in global supply chains.

Chinese manufacturing is **38%** of GDP while services is **55%**

CHINESE POLICY SUPPORT MARKS A STRONG U-TURN

While China's real GDP growth maintained the "around 5%" in 2024, many were concerned with the seemingly perennial real estate problem dragging on both investment and consumption growth.

Domestically, China's consumer sentiment hovers at an all-time low, while the 70-city residential price index continues to contract.

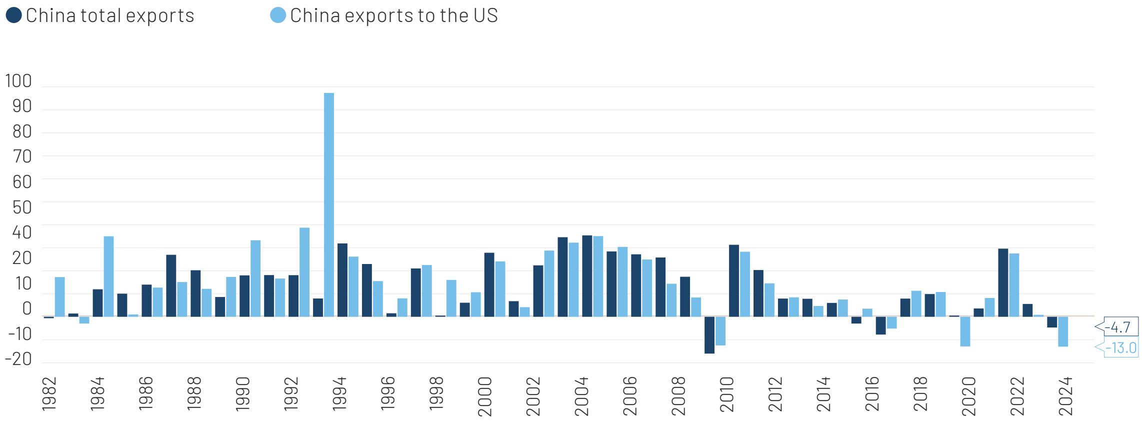
Externally, the political uncertainties in 2024 (a year of elections) saw global leaders aiming for higher vote counts by attacking the beneficiaries of the past decades of globalisation (read: China), drawing up strong trade breakwaters such as tariffs against exporting economies. Due to that, Chinese exports to the world fell by 4.7% in 2023, while their exports to the US fell by 13% - a rare occurrence in a non-recessionary year (Chart 9).

Such a negative impact on the dual engines of Chinese growth (domestic and external) prompted the Chinese government to embark on a strong policy push towards the end of 2024. Industrial restructuring, even before the recent years of US-led trade tensions, has seen the manufacturing sector ("secondary sector") decline from 47% of GDP to the current 38% (Chart 10, page 30). Meanwhile, the services sector ("tertiary sector") rose from 44% to 55% currently. As China anticipates one engine (manufacturing/export) of its "dual circulation" to slow or even stall amid potential rhetoric from the new US administration, it had to strongly support the other engine (services/domestic consumption).

AS MANUFACTURING GETS HIT, SHIFT TO SERVICES

Details of Chinese monetary support were transparent and public and that surrounding the potential fiscal push to the tune of 10 trillion renminbi will likely be unveiled into 2025.

CHART 9: EXPORT CONTRACTION WAS A WAKEUP CALL, USD



Source: Macrobond, China Customs Statistics Information Center (CCS), S&P Global; China General Administration of Customs (GAC), Indosuez Wealth Management.

ANY NEWS
of support from policymakers
IS BETTER THAN NO NEWS

For that matter, any news of support from policymakers is better than no news. We believe this marks a U-turn and signals the urgency to stem further slowdown in the Chinese economy, while preparing its industries (particularly manufacturing) for further trade tensions, especially in a transforming world.

Pessimists look at the concerted policy efforts as "too little and too late", but optimists like us see this bold move as a clear willingness to put a floor on equity valuations, stop the deflation process and restore consumer confidence. We upgrade our 2025 China GDP forecast to 4.7% (previously 4.2%) to reflect the policy support. Meanwhile, we forecast 2026 GDP growth at 4.5%.

Overall, we remain positive on emerging markets (EM), where China will provide an additional and much needed engine to the asset class, with positive repercussions on the rest of Asia, particularly ASEAN.

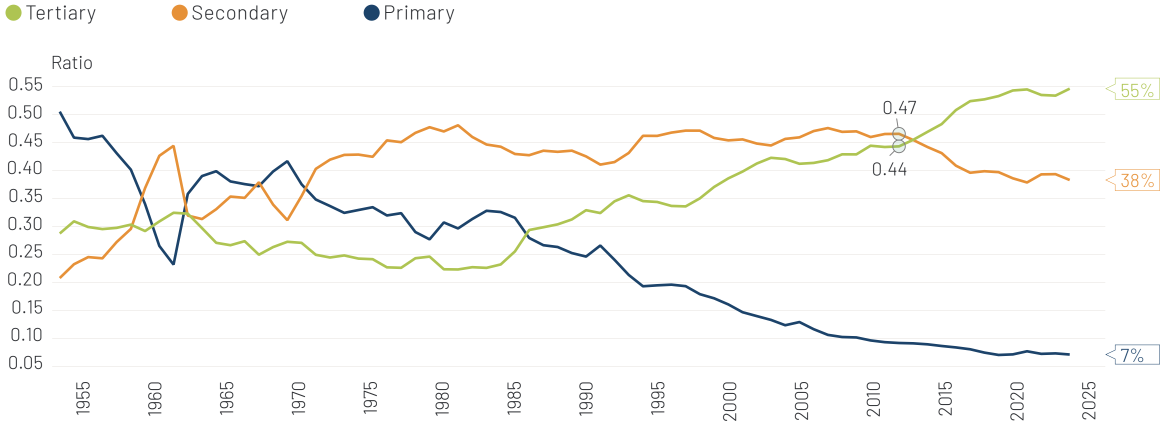
CHINESE MANUFACTURING SHIFTS OFFSHORE, BENEFITTING ASEAN

The escalating trade conflict between the US and China, along with the COVID-19 supply-chain disruptions, has prompted companies to reassess their supply chains. This has led to a surge in "near-shoring," where companies restructure their supply chains to move manufacturing closer to home.

We anticipate this will be a long-term trend that could benefit ASEAN countries, which can leverage their favourable demographic trends, abundant labour forces, and policy reforms aimed at boosting trade cooperation. As such, a main beneficiary of the "China Plus One" strategy will be the ASEAN economies.

From 2018 to 2021, ASEAN countries have already increased their exports to the US by over 65%. Investors are beginning to view ASEAN markets as viable alternatives to China. As a case in point, ASEAN experienced three consecutive years of record inflows of foreign direct investment (FDI) and total trade, retaining its position as the world's top destination of FDI inflows in 2023 (226.3 billion dollars) after the US.

CHART 10: CHINA'S REAL GDP BY SECTOR CONTRIBUTION



Source: Macrobond, China National Bureau of Statistics (NBS), Indosuez Wealth Management.

The ASEAN region stands out with one of the best demographic dividend stories globally. The bloc includes about 224 million individuals aged 15-34, a number expected to grow up to 2038. This cohort of digital natives is set to continue driving consumption for years to come. Education levels have risen notably, with adult literacy rates surpassing 90% across all ASEAN members, except Myanmar (89.1%) and Cambodia (84.7%). Labour force participation is also robust, exceeding 65%. Moreover, the region has experienced declining poverty rates and improved income equality, as indicated by Gini coefficients. This trend signifies a broadening economic growth, likely to sustain long-term domestic consumption trends.

Several major companies have made strategic decisions to shift their production out of China and into ASEAN countries, reflecting a broader trend of nearshoring in response to various economic and geopolitical factors.

For instance,

- Samsung has significantly expanded its manufacturing facilities in Vietnam, making the country a key global production hub for its electronics.
- Nike has moved a substantial portion of its footwear production to Indonesia and Vietnam, leveraging the competitive advantages of these markets.
- Apple has been diversifying its supply chain by increasing its investments in countries like India and Vietnam, planning to establish more manufacturing sites.
- Intel had announced plans to invest in new manufacturing facilities in Malaysia, leveraging on its skilled workforce and favourable business environment.

The above showcases the growing importance of ASEAN nations in the global supply chain landscape, as companies seek to optimise their operations and reduce potential vulnerabilities.

Moreover, market-friendly reforms in the region are expected to significantly boost stock performance over the medium-term. Some examples:

- Thailand's new State Investment Fund, with the unique feature of government guaranteed return, began investing in the Thai Stock Exchange on 1 October 2024.
- Malaysia is encouraging investment and economic activity by offering corporate tax rates of 0-5% for family offices in its Special Financial Zone, similar to those in Shenzhen and Dubai. The country has also passed comprehensive tax reforms, rationalised subsidies, controlled civil service costs, and established a 3% fiscal deficit target to attract FDI and improve business conditions, particularly in high-value sectors like semiconductor manufacturing and digital technology.
- Indonesia's ambitious "Golden Vision 2045" programme aims to transform the country into a more skilled workforce with higher wages, positioning it to become a high-income nation.

In the face of rising trade tensions, the global economic landscape is undergoing significant shifts. Countries are now accepting that these tensions are the new normal, prompting them to adapt and evolve their economic strategies. This adjustment is evident in the restructuring of supply chains, the implementation of market-friendly reforms, and the pursuit of new trade partnerships. As nations adapt to this changing environment, they are finding innovative ways to sustain growth and foster resilience. Ultimately, the ability to navigate these tensions will define the future trajectory of global economies. We are positive on the future of ASEAN in the "China Plus One" strategy.

ELECTRIFICATION: THE NEW ELDORADO?

Fabrice DE SOUSA
Portfolio Manager

Laura CORRIERAS
Equity Portfolio Manager

The fight against climate change requires a profound rethinking of how we produce and consume energy. Among the crucial drivers of the energy transition, the electrification of the economy stands out as an essential path. By replacing the use of fossil fuels with electricity in key sectors such as transport, industry, and buildings, this transformation aims to reduce greenhouse gas emissions while promoting the growth of renewable energy.

ALIGNING WITH SUSTAINABILITY GOALS

Electrifying the economy involves replacing fossil fuels (oil, natural gas, coal) with decarbonised electricity, ideally produced from renewable sources.

This implies changes in the production, distribution and consumption of energy. The electrification of transport is perhaps the most emblematic example of this phenomenon, with the rise of electric vehicles. But this transition also impacts other sectors. Heavy industry, traditionally a large consumer of fossil energy, as well as building heating systems are also shifting towards electric solutions through technologies such as heat pumps and electrolysis.

The global goal of electrification is straightforward: to reduce dependence on fossil fuels, whose extraction and combustion are significant sources of greenhouse gas (GHG) emissions, and to use electricity produced from decarbonised sources like wind, solar or hydropower. This transformation is essential to achieve the climate targets set in the Paris Agreement and to limit the increase in global temperatures to less than 2 °C by 2100. It not only reduces carbon emissions but also limits dependence on fossil fuels, thus enhancing energy security.

Electrification also promotes the integration of advanced solutions such as energy storage, smart grids, and large-scale green production (Chart 11, page 33). All these advancements are direct responses to the commitments of governments and companies towards a more sustainable future. By stabilising energy costs and limiting the volatility associated with oil and gas prices, electrification also contributes to greater economic resilience.

CHALLENGES OF ELECTRIFYING THE ECONOMY

The electrification of the economy involves several crucial challenges, affecting energy infrastructure, public policies, and economic dynamics.

From an environmental perspective, the main challenge is reducing GHG emissions. Currently, the energy sector is responsible for more than 70% of global CO_2 emissions. Electrifying sectors such as transport and industry, which still heavily rely on fossil fuels, is crucial for significant decarbonisation. By using "clean" electricity, it is possible to substantially reduce the overall carbon footprint.

However, this transition presents challenges in terms of energy security. Renewable energy such as solar or wind is intermittent by nature, requiring a rethink of infrastructure to ensure stability and resilience of the electrical grid. Energy storage solutions, such as large-capacity batteries, are essential to ensure continuous supply.

Moreover, the electrification of the economy requires massive investments. This includes modernising electrical grids, installing additional and decentralised renewable electricity production capacities, and deploying equipment such as electric vehicles and heat pumps.

A DRIVER OF SUSTAINABLE ECONOMIC GROWTH

Electricity demand has tripled since 1980, a trend that has accelerated in recent years, driven by technological advances such as Artificial Intelligence (AI), the growing need for data centres, and the relocation of certain industries or the rise of electric vehicles, all shaping a rapidly transforming world.

USD 300 BILLION
global investment in grid modernisation in 2022

According to a report by the International Energy Agency (IEA), the electricity consumed by data centres worldwide is expected to double by 2026, mainly due to complex calculations related to AI and the development of cryptocurrencies (for comparison, this increase corresponds to Germany's current consumption).

According to McKinsey, the electricity demand of data centres in the United States is expected to grow by 15% per year until 2030 (Chart 12, page 34). At the same time, the reindustrialisation policies of Western countries, after decades of offshoring, are increasing the pressure on existing infrastructure.

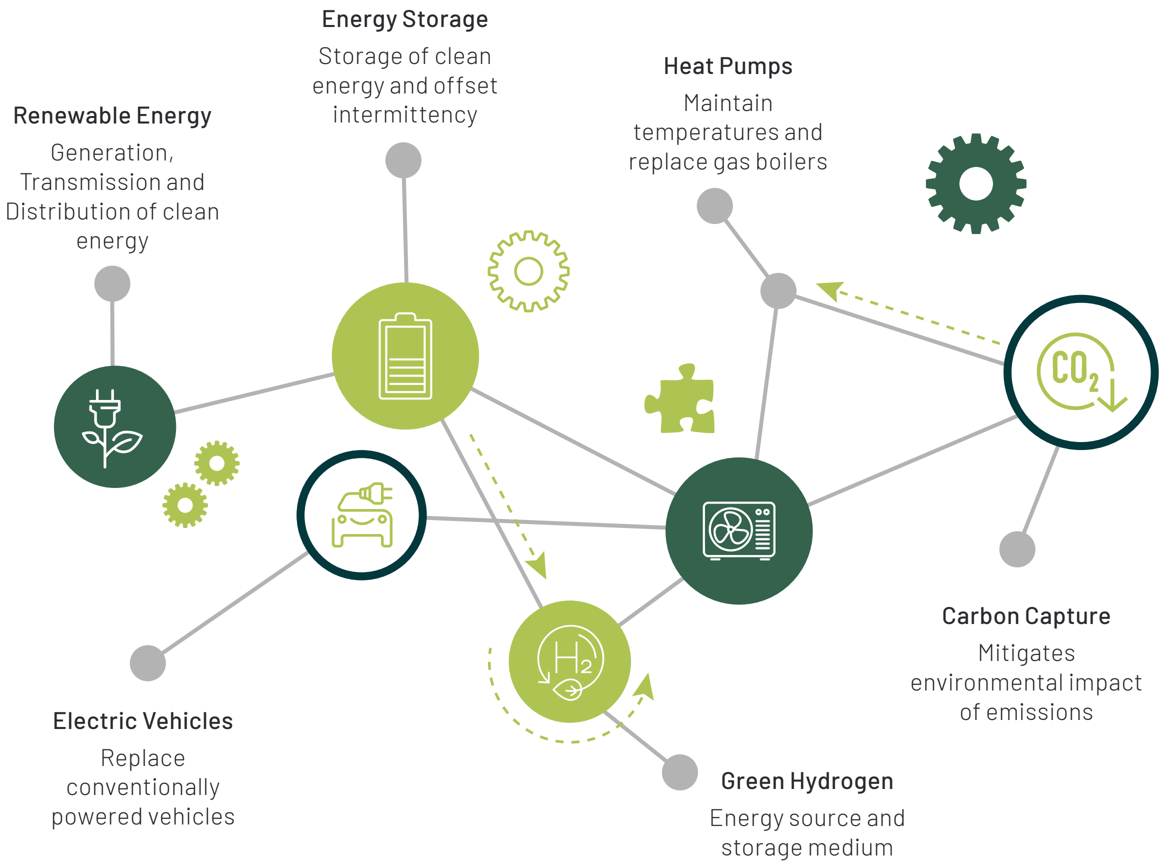
This rapid growth in energy demand represents a major challenge for nations and companies to secure a reliable and constant supply.

ELECTRIFICATION: CONCRETE EXAMPLES OF OPPORTUNITIES

While the challenges are significant, electrification opens promising growth prospects in several sectors that will directly benefit from this transformation. Electrification is not just a concept; it is already underway. Concrete examples are multiplying in various sectors, illustrating how this transformation is already in progress.

Energy storage technologies (such as batteries) and the production of renewable and low-carbon energy (solar, wind, nuclear) are essential to meeting the growing demand. The transformation of grids is also a fundamental aspect to support the growth in demand. Investments in transmission infrastructure and smart grids allow for more efficient energy management and strengthened reliability.

CHART 11: SIX EXAMPLES OF ELECTRIFICATION APPLICATIONS



Source: Indosuez Wealth Management.

96.4%:
Penetration rate of
ELECTRIC VEHICLES
in Norway[5]

The transport sector, for example, is undergoing a profound transformation with the shift to electric vehicles. In parallel, many governments, like Norway, have set ambitious targets, such as banning the sale of combustion engine cars by 2025.

The acceleration of the development of energy efficiency solutions also offers new industrial opportunities, particularly in steel and cement production. Pilot projects such as the HYBRIT initiative in Sweden aim to produce carbon-free steel using hydrogen from renewable electricity. Another example in Europe, where several large companies are investing in hydrogen to decarbonise energy-intensive processes, such as ammonia production, refining, and chemicals. Thyssenkrupp and ArcelorMittal are experimenting with green hydrogen to reduce iron ore in steelmaking, a process that could eventually replace coal.

Faced with increasing energy needs, particularly related to AI, American tech giants are now turning to nuclear as a sustainable solution. Microsoft, for instance, has partnered with nuclear electricity leader Constellation Energy to ensure a constant and low-carbon supply.

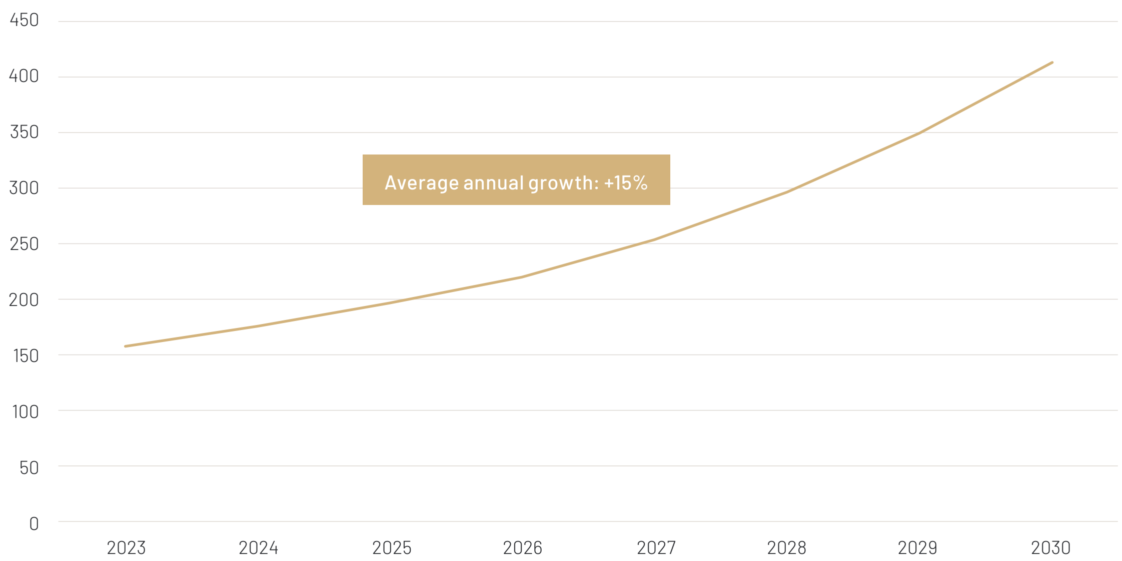
CONCLUSION

The electrification of the economy stands as a major lever to address the challenges of the energy transition and meet the needs of a transforming world. By decarbonising key sectors and accelerating the adoption of renewable energy, it not only reduces CO_2 emissions but also fosters the development of new economic sectors and strengthens the energy resilience of countries. Beyond the challenges, the opportunities offered by this electrification are immense, especially for investors and companies that can seize this technological and environmental turning point. The future of the global economy will undoubtedly be largely electrified.

Based on the average electricity consumption of a French person (source: ADEME), writing this article would have required approximately 3800W of electricity, equivalent to the energy consumed by one electric radiator for 2 hours.

CHART 12: ELECTRICITY DEMAND FROM DATA CENTRES IN THE US

(in TWh)



Source: McKinsey Energy Solutions Global Energy Perspective 2023, Indosuez Wealth Management.

5 - In September 2024.

PRIVATE MARKETS IN 2025: GAINING MOMENTUM!

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Over the past two years, higher interest rates have significantly disrupted activity in Private Markets creating a challenging environment for deal making and exits. As we approach the end of the year, we can clearly see that mergers and acquisitions (M&A) activity started to regain some momentum in 2024. Improving financial market conditions and decreasing inflation are fuelling first signs of optimism for investors in what could be a turnaround year for Private Markets in a transforming world. Below, we will highlight our predictions for 2025 for each segment of this industry.

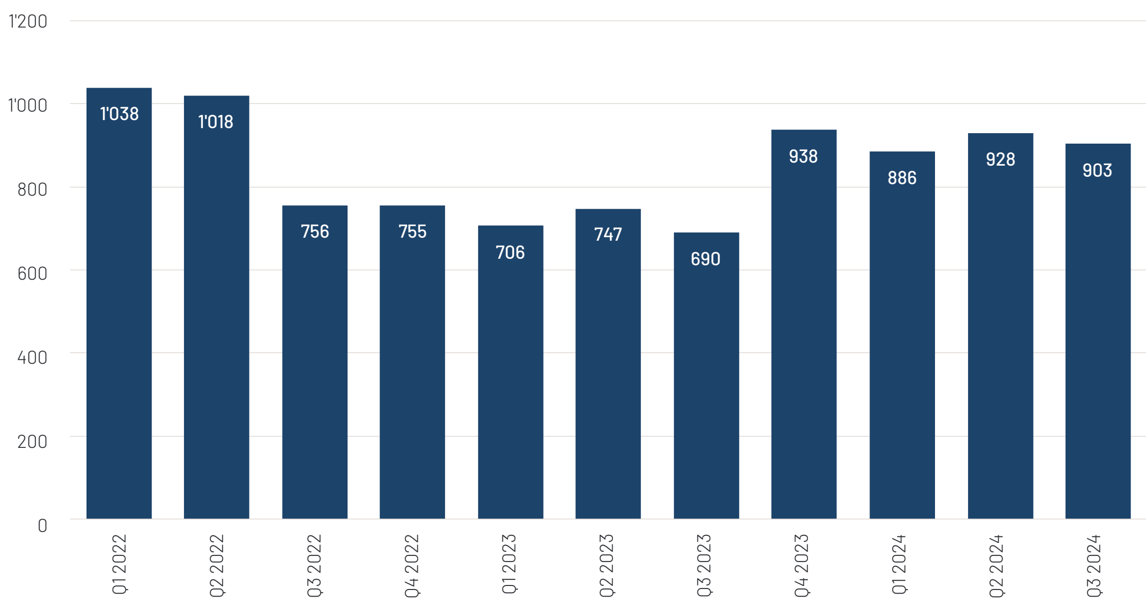
M&A
volumes up by
+27%
as at YTD
September 2024

THE M&A MARKET REBOUND

With monetary policies going from tightening to easing combined with the rebound of financing supply, the M&A recovery that initially started in the last quarter of 2023 has continued to gain some *momentum* in 2024. Both strategic buyers and financial sponsors have reaped the benefits of the narrowing bid-ask spreads to resume deal activity, which eventually led to M&A transactions being up by +27% in terms of deal value on a year-to-date (YTD) basis (as at September 2024 – Chart 13).

Recalling our last year's Private Markets outlook, we expected 2024 to be a turnaround year for the M&A market but we are convinced that there is further acceleration to come in 2025 driven by additional interest rate cuts expected in Europe and to a lesser extent in the US. This is of course assuming that there will be no major macro-economic disruptions or geopolitical tensions escalating too far.

CHART 13: GLOBAL M&A ACTIVITY BY QUARTER, USD BILLION



Source: Pitchbook Global M&A Report Q3-2024, Indosuez Wealth Management.

BUYOUT FUNDS ARE PAVING THE WAY

Buyout funds have been the most active in terms of deal making in 2024 with increasing transaction volumes across all regions of the globe. This growth has notably been enhanced by the larger end of the market with several multibillion acquisitions occurring (particularly in the software sector), a segment that was totally muted in 2023. This was especially supported by the return of large banks on the lending market evidenced by the strong uptick in leveraged loan volumes (Chart 14) associated with lower financing costs.

In terms of exits, the buyout market remains slightly below the long-term average but has demonstrated some resilience during the year with quarterly exits volumes steadily increasing, driven notably by a strong rebound in the US. It must be noted that once again, there has been a clear focus from buyers on the highest quality assets where competition and pricing remained relatively elevated. We believe the exit pace is going to accelerate materially in 2025 on the back of several market trends: (1) the significant dry powder held by buyout sponsors (more than 1 trillion dollars) waiting to be deployed after 2 years of subdued activity; (2) the pressure from limited partners asking for liquidity before re-investing in newer vintages; and (3) the continued rebound of the M&A market following anticipated lower base interest rates from central banks, in particular in Europe.

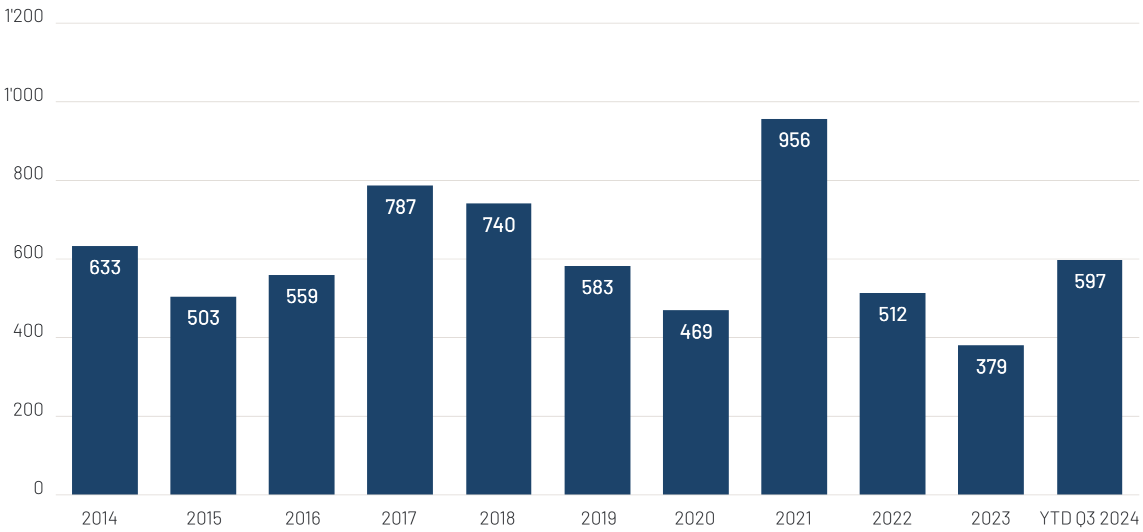
When it comes to Venture Capital, the story is relatively different as deal activity has remained largely consistent with the levels seen in 2023 after two years of steady decline from the industry's peak in 2021. The market pricing adjustment that started in 2022 is still ongoing while the biggest challenge faced by Venture Capital funds is the lack of exits. We believe investors must remain cautious and extremely selective on this segment, but we think that the market is now healthier in terms of valuation entry points, which should offer interesting opportunities on the buyside.

PRIVATE CREDIT, A NORMALISING MARKET

From a performance and fundraising standpoint, private credit funds have been clear beneficiaries of interest rate increase since 2022.

With the combined effect of (i) banks having come back on the leverage loans markets and (ii) first central banks' interest rates cuts, we have seen yields starting to decrease in 2024 which notably pushed up the refinancing activity. With additional rate cuts in sight, we expect this trend to continue in 2025, thus reducing the expected returns of private credit funds. With inflation normalising, real yields will however remain attractive on an absolute basis.

CHART 14: LEVERAGED LOAN NEW ISSUANCE (US AND EUROPE), USD BILLION



Source: LCD Global Leveraged Finance report (Q3 2024), Indosuez Wealth Management.

Towards a
RECORD YEAR
for secondaries
IN 2024

While we have been more prudent in 2022 and 2023 on senior lending strategies given the abundant inflow of capital raised and the scarcity of opportunities, the market is now normalising along with the interest rates and rebound in M&A activity supporting the leveraged loan market.

Finally, we believe that senior private credit strategies under semi-liquid format are particularly attractive offering a balanced and appealing combination of protection, liquidity and performance.

INFRASTRUCTURE, A RESILIENT SEGMENT

As for other Private Equity strategies, deal-making activity has been on the downside by approximately -20% in 2023 for infrastructure assets both in value and number of deals. When looking at the first three quarters of 2024, we are seeing the first signs of a rebound in the activity level particularly in terms of number of deals suggesting (i) investor preference for smaller transactions which are less dependent on financing and/or (ii) a drop in assets valuations. Fundraising has remained relatively resilient for infrastructure funds in 2024, with however some cautiousness to be taken as a large chunk of the capital inflow has been captured by mega funds.

The reset of valuations has been evident in the renewables space since the peak of 2021, which we believe makes today a more attractive entry point for these assets. On the digital infrastructure front, the phenomenal breakthrough in Artificial Intelligence (AI) is expected to accelerate further in 2025, fuelling the need for more data centre capacity.

All things considered, we remain positive on the outlook of infrastructure for the years to come as the asset class is expected to continue capitalising on the megatrends of energy transition, digital transformation and mobility needs. The scarcity of taxpayer money means private capital is filling the gap in what we trust is a generational investment opportunity. Overall, we maintain a strong conviction that all electrifying technologies should rise front-and-centre in the mind of infrastructure investors in 2025.

SECONDARIES, A CLEAR WINNER IN THIS ENVIRONMENT

The secondary market has been very strong in 2024, with total secondary transactions volume expected to reach approximately 140 billion dollars in 2024, which would represent an increase of around 25% over 2023 and a record high for the industry. This strong activity resulted from both (i) Limited Partners (LP) seeking liquidity to compensate the lack of distributions and thus selling stakes in the more mature funds of their portfolio and (ii) General Partners (GP) being more active on the GP-Led space where they generated liquidity on their best performing assets through continuation funds.

The secondary market has evolved significantly in the last two decades, transforming from what was previously a niche segment into a broader, and increasingly sophisticated market. We expect the secondary market to continue evolving and expanding in the coming years on the back of (i) the very strong growth we have seen in the last 10 years in assets under management in the Private Market asset class which should naturally increase the set of opportunities for secondary players, and (ii) investors' growing need for liquidity in a traditionally illiquid investment universe. We envisage this market reaching a volume over 150 billion dollars in the coming years, around five time the size of the market 10 years ago.

06 | Global Presence

OUR STORY

Indosuez Wealth Management is the global wealth management brand of the Crédit Agricole group, the 9th largest bank in the world by balance sheet (The Banker 2023). For over 150 years, Indosuez Wealth Management has been supporting high-net-worth individuals, families, entrepreneurs, and professional investors in managing their private and professional wealth. The bank offers a bespoke approach, allowing each client to preserve and grow their wealth in line with their aspirations. Its teams provide a continuum of services and offerings, including Advisory, Financing, Investment Solutions, Fund Servicing, and Technological and Banking Solutions.

In 2024, Indosuez Wealth Management finalised the acquisition of the Belgian bank Degroof Petercam.

This merger allows Indosuez to enrich its value proposition with one of the most comprehensive offerings on the market. Indosuez Wealth Management brings together nearly 4'500 employees across 16 territories worldwide: in Europe (Germany, Belgium, Spain, France, Italy, Luxembourg, the Netherlands, Portugal, Monaco, and Switzerland), in the Asia-Pacific region (Hong Kong SAR, New Caledonia, and Singapore), in the Middle East (Abu Dhabi, Dubai), and in Canada (representative office).

With over 200 billion euros in client assets, the Indosuez group is among the European leaders in wealth management.

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07 | Glossary

Artificial Intelligence: Technology that enables machines to perform tasks that typically require human intelligence, such as learning, problem-solving, and decision-making.

ASEAN: Association of Southeast Asian Nations.

Basis points (bps): 1 basis points = 0.01%.

CBO (Congressional Budget Office): Congressional Budget Office of the United States.

China Plus One Strategy: The "China Plus One" strategy is a business approach where companies diversify their supply chains by adding manufacturing or sourcing operations in countries other than China. This strategy aims to reduce dependence on China and mitigate risks associated with geopolitical tensions, trade wars, labor costs, and supply chain disruptions. By having additional production bases in other countries, companies can enhance their resilience, increase flexibility, and better manage potential uncertainties in the global market. Common alternative countries include Vietnam, India, Thailand, and Mexico.

Chips Power: Refers to the power and performance characteristics of semiconductor chips, often used in computing and electronic devices.

Deflation: Deflation is the opposite of inflation. Contrary to inflation, it is characterised by a sustained decrease in general price levels over an extended period.

Duration: Reflects the sensitivity of a bond or bond fund to changes in interest rates. This value is expressed in years. The longer the duration of a bond, the more sensitive its price is to interest rate changes.

ECB: The European Central Bank, which governs the euro and Euro Area member countries' monetary policy.

ESG: Environmental, Social, and Governance: A framework used to assess a company's practices and performance in three key areas: environmental impact, social responsibility, and corporate governance. Environmental criteria evaluate how a company manages its impact on the planet, social criteria consider how it treats people, including employees, customers, and communities, and governance criteria assess the quality and transparency of its leadership and internal controls.

FDI: Foreign direct investment (FDI) is a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy.

Fed: The US Federal Reserve, i.e. the central bank of the United States.

FOMC (Federal Open Market Committee): The US Federal Reserve's monetary policy body.

GDP (Gross Domestic Product): GDP measures a country's yearly production of goods and services by operators residing within the national territory.

General Partners: Are professional investment managers responsible for managing private equity, venture capital, or other types of private investment funds.

Generative AI: A type of artificial intelligence that focuses on creating new content, such as text, images, music, or other media, by learning patterns and structures from existing data. It uses models like generative adversarial networks (GANs) and transformers to produce original outputs that mimic human creativity and innovation.

GHG: Greenhouse gas.

Greenflation: Refers to a rise in prices of raw materials and energy as a result of the green transition.

High yield: A category of bonds, also called "junk" with ratings lower than "investment grade" rated bonds (hence all ratings below BBB- in Standard & Poor's parlance). The lower the rating, the higher the yield, normally, as repayment risk is higher.

IMF: The International Monetary Fund.

IEA: International Energy Agency.

Inflation breakeven: Level of inflation where nominal bonds have the same return as inflation-linked bonds (of the same maturity and grade). In other words, it is the level of inflation at which it makes no difference if an investor owns a nominal bond or an inflation-linked bond. It therefore represents inflation expectations in a geographic region for a specific maturity.

Limited Partners: Investors in a partnership, typically in private equity or venture capital funds, who contribute capital but have limited liability and involvement in the management of the fund. Their financial risk is restricted to the amount of their investment, and they typically receive returns based on the fund's performance.

Moore's Law: The observation that the number of transistors on a microchip doubles approximately every two years, resulting in a consistent increase in computing power and a decrease in the relative cost of electronic devices. This principle has driven the rapid advancement and miniaturization of technology over the past several decades.

Nearshoring (regionalisation): Described by the OECD as the decision to relocate previously offshored activities, not necessarily back to the company's home country, but rather to a neighbouring country.

No landing scenario: An economic situation where growth continues steadily without slowing down or entering a recession.

OECD: Organisation for Economic Co-operation and Development.

Policy rate: An interest rate that a country's monetary authority (i.e. the central bank) sets in order to influence the evolution of the main monetary variables in the economy (e.g. consumer prices, exchange rates or credit expansion, among others).

Quantitative easing (QE): A monetary policy tool by which the central bank acquires assets such as bonds, in order to inject liquidity into the economy.

Quantitative tightening (QT): A contractionary monetary policy tool applied by central banks to decrease the amount of liquidity or money supply in the economy.

R-star: The natural rate of interest where the economy is at full employment and stable inflation, neither stimulating nor slowing down economic growth.

Secondary markets: Secondary markets, also known as secondary financial markets, are platforms where investors buy and sell securities they already own. Unlike primary markets, where securities are issued and sold for the first time (such as during an initial public offering, or IPO), secondary markets facilitate the trading of existing securities. Examples of secondary markets include stock exchanges like the New York Stock Exchange (NYSE) and NASDAQ, where stocks, bonds, and other financial instruments are traded among investors. The liquidity provided by secondary markets is crucial because it allows investors to easily buy and sell their securities, thus promoting investment and contributing to the overall stability and efficiency of the financial system.

Soft landing: A controlled economic slowdown that avoids a recession and keeps inflation in check.

Spread (or credit spread): A spread is the difference between two assets, typically between interest rates, such as those of corporate bonds over a government bond.

SRI: Sustainable and Responsible Investments.

Stagflation: Refers to an economy that is experiencing simultaneously an increase in inflation and stagnation of economic output.

TCJA: Tax Cuts and Job Acts.

USMCA: The United States-Mexico-Canada Agreement, signed by the political leaders of the three countries on 30 September, 2018, replacing NAFTA (created in 1994).

Venture capital funds: Venture capital (VC) funds are pools of capital provided by investors to startups and small to medium-sized enterprises (SMEs) that have strong growth potential but may be too risky for traditional financing methods. These funds are managed by venture capital firms or professionals who invest in high-potential businesses in exchange for equity, or partial ownership, of the company. The primary goal of venture capital funds is to generate substantial returns for their investors through the successful growth and eventual exit (like an initial public offering or acquisition) of the invested companies.

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