Summer 2025

The Financial Letter

Review, opinions and markets' perspectives

Summary

Global landscape

The arrival of the Trump administration is not just a change of guard - it is the onset of a seismic regime shift, a true tidal wave whose first ripples are only beginning to disturb the global order. This is not a gentle transition; the old frameworks are being swept aside, and the consequences - economic, political, and financial - are poised to multiply, often in unpredictable ways.

The prospect of a soft landing for the previous era is, frankly, a mirage.

Investment framework

We stand at the threshold of heightened volatility, a turbulence that will likely persist through the coming quarters. The abrupt and persistent surge in global uncertainty is set to leave its mark on growth, inflation, and interest rates. Public debt and deficits, those perennial specters, will remain front and center. While the fiscal largesse and still-accommodative central banks may stave off an immediate recession, the slow but steady normalization of risk premia threatens to erode the lofty valuations that have buoyed certain asset classes. Leverage and speculative positioning remain stubbornly high, with active hedging fueling the resilience of hard assets. Expect the uneasy dance between equities and bonds to continue, with correlations hovering near zero - a regime of instability, not equilibrium.

Regime in transition

Three tectonic forces are reshaping the landscape.

- First, climate change: the acceleration of climate disruptions is now a structural source of inflation.
- Second, geopolitics: we are witnessing a realignment of power, with new axes and old certainties dissolving.
- Third, technology: the relentless march of digitalization and artificial intelligence is not only transforming industries but unsettling white-collar workers, ushering in a disinflationary wave that promises eventual productivity gains but breeds insecurity in the interim.

Deglobalization is gathering pace. The BRICS and the Global South are forging new trade settlements—yuan, gold, and alternative reserves. De-dollarization is no longer theoretical; it is underway, with gold's renaissance as a reserve asset unmistakable. Whispers of disruptive American initiatives—the so-called Mar-a-Lago agreements—deserve attention. The US faces an urgent imperative: to safeguard the dollar's reserve status, cap long-term rates, and channel global capital flows. The toolkit is evolving, and the stakes are existential.

(Geo)-Politics. Europe, for its part, is fighting to avoid marginalization as three great spheres - Americas, Asia, and a pan-European Russia - take shape. Traditional anchors like Canada, Japan, Korea, and Australia are adrift, searching for new bearings.

Economic Policies. Despite the virtuous rhetoric of early 2025, US fiscal dominance is far from over. It is, in fact, becoming the new normal, spreading across Europe, China, and beyond. High macro volatility is here to stay.

Look sharp

An even more unpredictable Donald than anticipated

Like it or not, the President remains the ultimate arbiter. He rejects consistency, transparency, and process, preferring to impose his narrative through disruption and surprise. His breathtaking reversals - on deficits, in Iran - render policy inscrutable and credibility fragile. Even as he chalks up short-term wins, he galvanizes opposition and risks alienating his own base. The economic slowdown, the likely resurgence of inflation, fiscal slippage (the DOGE/Musk fiasco), and the Iran bombing will leave deep scars - potentially costly ones as the 2026 midterms approach.

Serious macro-financial storms are gathering as summer nears and economic momentum wanes. The US is locked in hard-nosed trade negotiations with both Europe and China. Talks with Brussels are fraught, with Washington demanding a 10% tariff and sweeping concessions, while the EU digs in its heels. With China, the US presses for delivery on trade promises, but progress is glacial.
The clock is ticking for Trump - his erratic moves are inflating risk premiums and sending markets into contortions-

Enjoy / ride evaporating fear - while it lasts

Recent months have brought a striking improvement in global macro indicators, reversing the gloom that once fuelled stagflation fears. Massive fiscal stimulus in Europe and China has been the catalyst. In the eurozone, government spending is reviving domestic demand, with real GDP set for a gradual upturn. China, too, is embracing fiscal activism, widening deficits and issuing fresh bonds to support consumption and stabilize growth. Meanwhile, US inflation has cooled, settling near 2.4%—the lowest since 2021. For now, this has banished stagflation anxieties, as the labour market remains robust. But this calm is fleeting. Front-loaded inventory building in early 2025 has delayed the tariff impact, but consumer prices will feel the pressure by autumn.

Chart. The narrative of imminent stagflation has faded

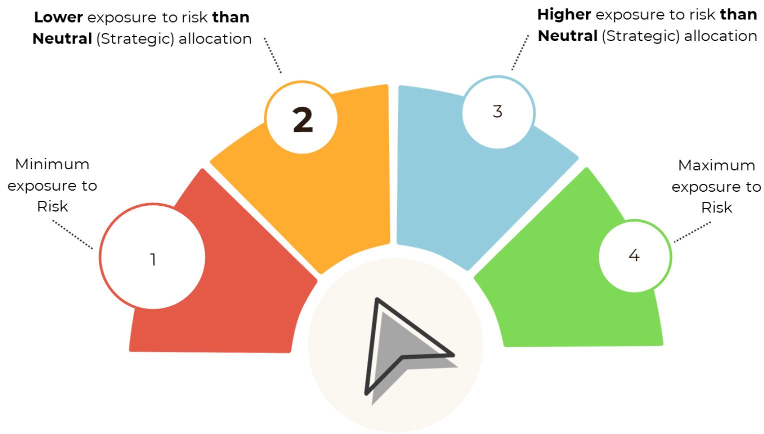
The US Treasury faces a formidable task: refinancing $11 trillion in debt over twelve months, just as the debt ceiling deadline looms. This collision of timelines will force policymakers' hands, raising the spectre of market volatility, surging borrowing costs, and possible credit downgrades. The Fed, meanwhile, is shrinking its balance sheet, removing a crucial backstop. As ever, US policymakers will ultimately fail to rein in deficits, opting instead for higher average inflation and a blend of creative monetary, regulatory, and foreign policy manoeuvres to curtail rates.

Europe's defence and infrastructure plans will lend support to growth, and early signs of renewed cohesion are encouraging. Yet the productivity gains from military spending are meagre, and the continent's structural energy disadvantage-relative to the US and China - remains unresolved.

Japan, too, is at a crossroads. Inflation has broken free, consistently overshooting the Bank of Japan's 2% target and intensifying calls for rate hikes. The central bank is inching toward normalization, but the recovery at home is patchy, and external risks - especially from US policy - loom large.. *All told, the medium-term outlook is for a global economy beset by turbulence and fragmentation*

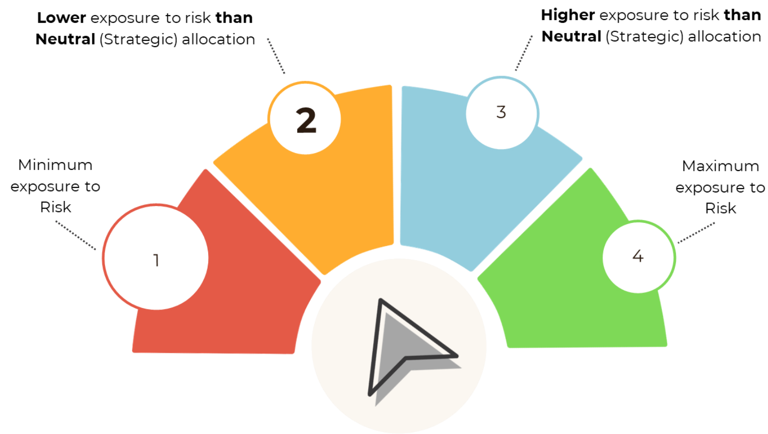
Investment takeaways

The global investors' sentiment has markedly improved in the last months. But big fat tailsrisks remain present.



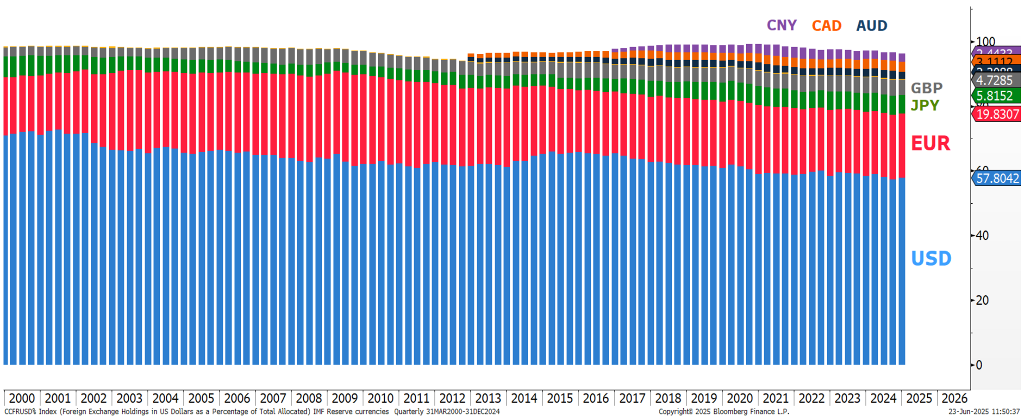
Currencies

The USD has been the world's reserve currency for 80 years. The question is now how long this will continue. The USD is unlikely to lose its reserve-currency status soon. Systemic global change is typically precipitated by conflict or its subsequent aftermath.



Following the WWI, the GBP lost its status. In the aftermath of WWII, the USD emerged as the preeminent global reserve currency. The USD has consistently maintained its position as the preeminent currency in global central bank reserves. However, it has experienced a 2-decade decline in its share of global FX reserves. USD holdings have fallen from 71% in 1999 to 58% now, a sharp drop of 13 percentage points. Conversely, the share of other currencies, ex -EUR, has exhibited a substantial upward trend, increasing from 11% to 22% over the past 25 years.

Chart. Share of FX reserves



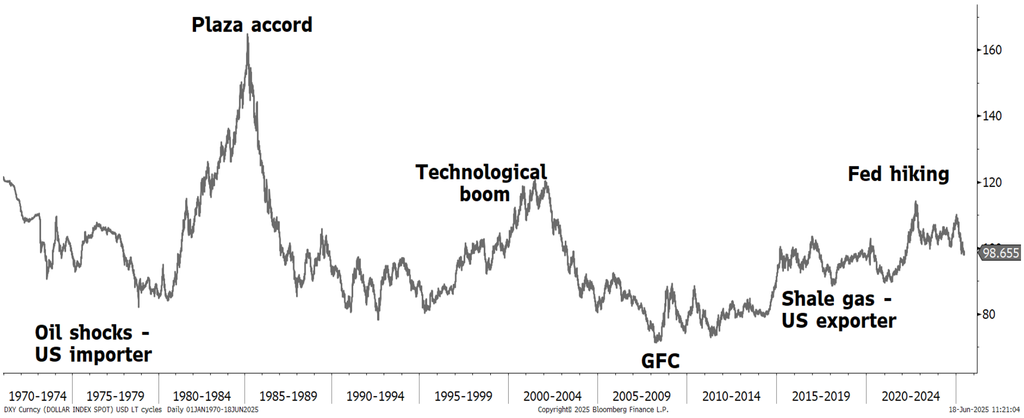
Non-traditional currencies from smaller economies, such as Australia and Canada, are proving increasingly attractive to reserve managers. The diversification of central bank reserve portfolios through the use if non-traditional currencies is a growing trend. The decline in the USD share of global central bank reserves has been redistributed, with 25% shifting towards the yuan, and 75% to other currencies. This trend is partly due to the yuan status, which limits its broader adoption. There are several factors that explain the increasing allocation to other reserve currencies: 1) higher returns combined with relatively lower volatility, 2) advances in financial technologies that facilitate their trading, 3) the existence of bilateral swap lines with the Fed, 4) open capital accounts and sound stable price policies, and 5) the economic stability.

The USD cycles

The USD is entering a period of heightened valuation vulnerability. It is at its highest point since 1986, in real trade-weighted terms. The USD has experienced multiple cycles of appreciation and depreciation since the 1970s. Each rally or decline in the USD was unique:

- In the 1970s, the US was a net importer of oil. Following the significant oil prices spikes in 1973–74 and 1978–79, there was a decline in growth, a surge in inflation, and the USD fall by c. -20%.
- During the 1980s, the US economy demonstrated robust and sustained growth, in contrast the rest of the world was sluggish. US yields were higher than those of their peers, as Japan & German policymakers were easing. The President Reagan stance of a strong USD is a sign of a strong America was a key factor in the USD strengthening. In 1985, the G5 expressed its willingness to take coordinated interventions, leading to the signing of the Plaza Accord in September 1985. It results in the decline of the USD by c. 50%.
- In the 2000s, the Asian Financial Crisis coupled with the tech stocks boom boosted the US growth. US assets attracted inflows. The Fed hiked rates while the ECB and BoJ were keeping rates low. The USD declined into the Global Financial Crisis.
- From 2011 until mid-2023, the USD surged by 56%. This spike was only interrupted by three corrections (of less than 10%). During this period, the US economy demonstrated notable growth. In 2016–17, the US became a net energy exporter, which explains the positive correlation between the USD and commodities. Rising commodity prices have a positive effect on the US terms of trade and the USD. Since 2022, the Fed has been adopting a more aggressive approach to rate hikes, attributable to the robust resilience of the US economy.

Chart. USD different regimes and drivers

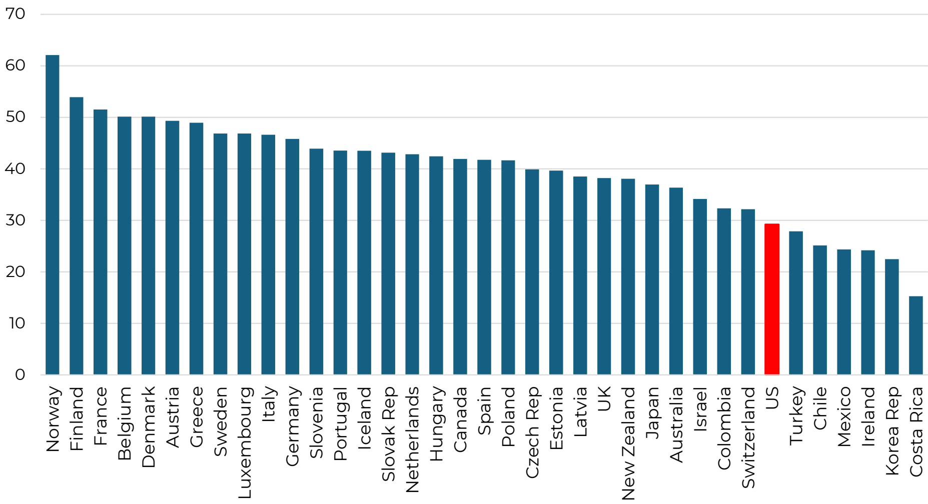


A turning point?

With a 71% share of developed equity markets, the US market appears disproportionately large in relation to its 25% share of global GDP. The US is not twice as productive as the rest of the world, but its companies are globally successful. If tariffs are to be maintained in perpetuity, it is highly likely that the US commercial sector will experience a gradual erosion in its competitive edge.

The USD is also less cyclically safe. As the reserve currency, it continues to serve as the primary source of funding for the global financial system. Consequently, when deleveraging occurs, as it does in periods of stress, the USD tends to appreciate. However, this funding premium is becoming less prevalent, as the global financial system has become significantly more stable in recent years. This is due to the tightening of financial sector regulations that has taken place over the last 15 years. Investors are now also demanding a premium to purchase US government bonds, as evidenced by the UK's experience over the past three years. It is evident that tariff revenue will not be sufficient to address the US's financial shortfalls, as has now been confirmed. The US's budget and current account deficits are both larger than the UKs.

Chart. OECD countries, Revenues to GDP (%)



While the US fiscal trajectory is unsustainable, the risk of a US default remains low. However, it should be noted that the US expenditure stands at 36% of GDP, with revenue at 29%. In the OECD, only five of 38 economies have a lower revenue share than the US. While it is not immediately evident that the US is experiencing a spending problem, it is facing a significant issue with excessively low revenue. There is a lack of political will to raise revenue, but financial reality may change this in time. Until such a time as these conditions are met, US bond yields are likely to be more sensitive to unfavourable fiscal news and less sensitive to a weaker economy. This will put pressure on corporate funding costs at inopportune times of the cycle, particularly if credit spreads are widening as well.

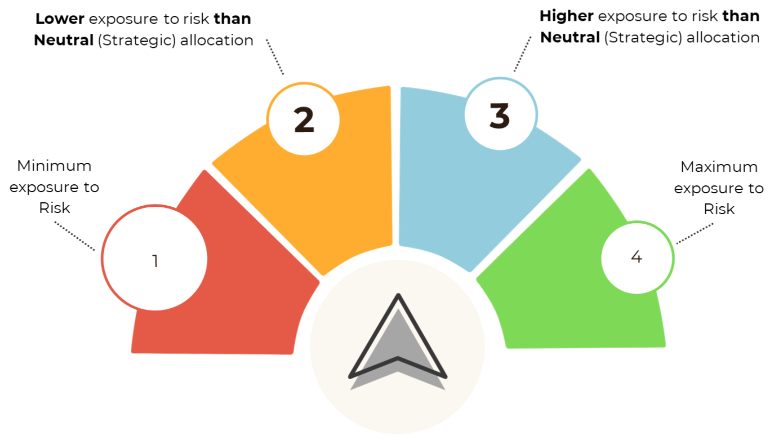
In sum, the USD depreciation during this year's tariff stress is likely to become the new norm. The USD remains the reserve currency, However, as the old saying goes, "Discretion is the better part of valour."

The EUR/USD moved out of its long-term downtrend

Expectations of shifts in relative economics have driven and will continue to drive the EUR. Germany's recent announcement of stimulus and investment plans for defence, transport and infrastructure, a significant shift from its usual fiscal conservatism, has ed to a positive outlook for the European economy. Furthermore, political uncertainty in the area, which has been a drag on the EUR/USD, has declined. *A monthly close above 1,1660 will clear the way to 1,22 within this year.*

Bonds

Central bank independence is defined as the ability to set monetary policy free from the influence of political considerations. Conventional wisdom, derived from extensive academic research and historical experience, suggests that an independent central bank will be more credible in fighting inflation, anchoring inflation expectations with less of a loss in output or employment.



The Fed's independence

In recent months, the Fed's independence has been a topic of discussion. This is partly due to criticism of Fed Chair Powell from President Trump and the fact that the Chair's term ends shortly. A relevant but highly technical starting point is that the President names the Chair of the Board of Governors of the Federal Reserve System, but it is subject to confirmation by the Senate. The FOMC is the entity that sets the policy rate. It is distinct from the Board. The FOMC comprises each member of the Board, the NY Fed President, plus 4 of 11 remaining Reserve Bank Presidents. By convention, the Chair of the Board also assumes the role of the Chair of the FOMC. However, the FOMC selects its own Chair. The FOMC and the Board are conceptually distinct.

Powell is simultaneously Chair of the Board, a Governor on the Board, and Chair of the FOMC. If Powell were no longer to be Chair of the Board but still a Governor, the FOMC would still have the capacity to choose him as its Chair. However, this change would be an anomaly and could result in a market reaction. FOMC decisions are made through a voting process. The President possesses the capacity to exert influence on the composition of the Board and the composition of the FOMC. The first clear vacancy for the President to fill is Governor Kugler's seat in January 2026. Powell's term as Chair is scheduled to expire in May 2026.

Chart. Little concern about the Fed independence

Board of Governors of the Federal Reserve System		
	Current Term Expires	
Jerome Powell (as Chair of the FOMC)	**May 15, 2026**	
Jerome Powell (as Governor)	**January 31, 2028**	
Philip Jefferson (as Vice Chair of the Board)	September 7, 2027	
Philip Jefferson (as Governor)	January 31, 2036	
Adriana Kugler	January 31, 2026	
Christopher Waller	January 31, 2030	
Michael Barr	January 31, 2032	
Michelle Bowman	January 31, 2034	
Lisa Cook	January 31, 2038	
Other Federal Open Market Committee Members		
	Current Term Expires	**Must Leave By**
John Williams (New York, Vice Chair of FOMC)	February 28, 2026	June 2028
Susan Collins (Boston)	February 28, 2026	July 2032
Austan Goolsbee (Chicago)	February 28, 2026	August 2034
Alberto Musalem (St.Louis)	February 28, 2026	April 2034
Jefferey Schmid (Kansas City)	February 28, 2026	August 2033

No other Board positions are scheduled to be vacant before January 2030. It is common for members to leave before the end of their terms. If only 2 members of the Board turn over next year, Fed independence would still be largely intact. The Chair exerts significant influence over the Committee, which could result in policy variations. However, the Committee would remain largely unchanged.

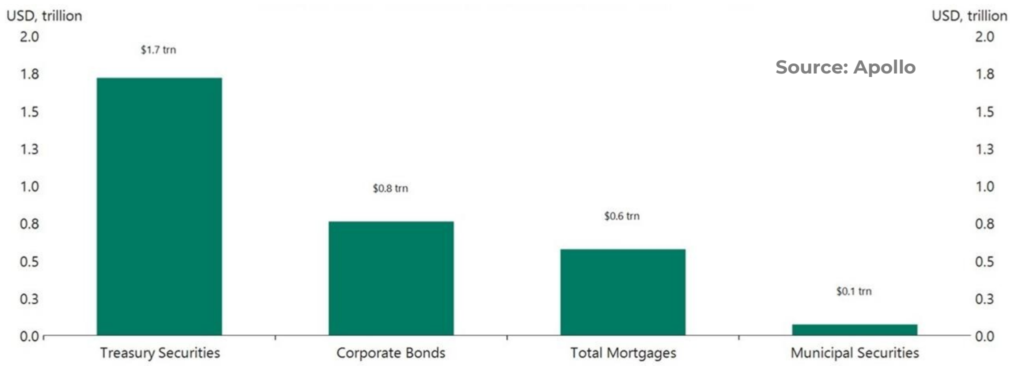
The FOMC could undergo substantial changes over the next couple of years, but it will take time.

Supply/demand: a key driver of long-dated yields

The Swiss curve continues to be in high demand, with negative 2-year yields, while the US is attempting to maintain bond yields below 5%. This is a challenging situation, and it is unlikely to become any easier soon. Last year, half of all bonds issued were Treasuries. Mortgages and municipal bonds have experienced significant pressure due to higher financing costs for homebuyers and states. Companies are still benefiting from the low rates locked 3-5 years ago. Therefore, they have no need to refinance their debts, even at the low spreads. This is the reason why the credit market is currently so quiet, with limited supply and solid demand.

In the same way that it was unthinkable in the past to consider negative government bond yields, will we see negative spreads for corporate bonds?

Chart. Half of all fixed income products supply is Treasuries



The main long-term driver is a simple story of supply and demand. Foreign governments buying treasuries to stabilize their currencies represent one of the most inelastic demand sources for US debt. When the issuance roughly matches this demand, it has a downward effect on yields. Rates drop and everyone takes less yield as a result. That dynamic also pushes some investors into riskier assets.

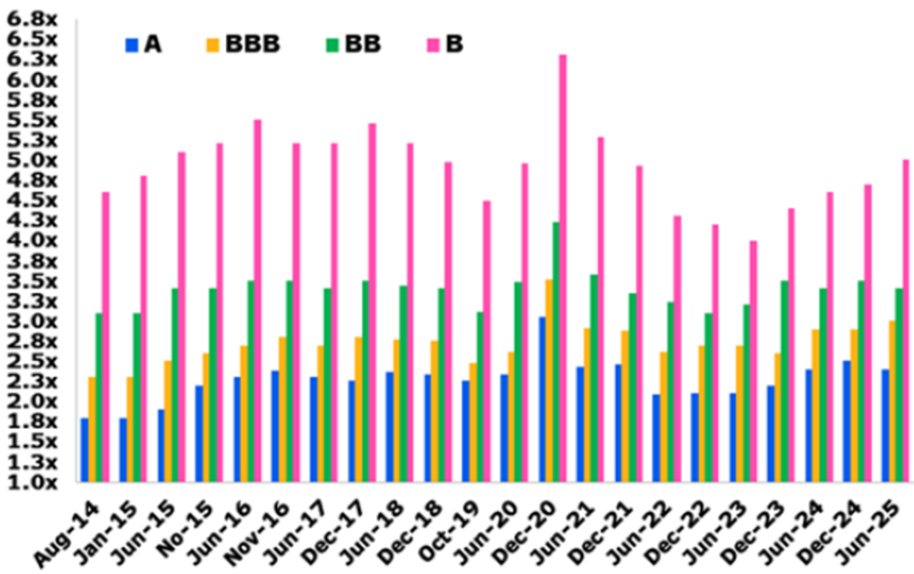
The more the Treasuries available and the foreign holdings diverge, the more yield investors will demand to hold US Treasuries will increase.

Credit decoupling is confirmed

S&P, Fitch and Moody's bearish risk ratings trends in high yield continues for a 4th straight year as their upgrade to downgrade ratios remain below 1x in the US, with Fitch having the weakest ratio. That contrasts with investment-grade issuers, where the ratio is over 1x for all 3 rating agencies, and growing for a 7th straight year despite the looming threat of tariffs. The credit median leverage metric remains relatively stable but at elevated levels.

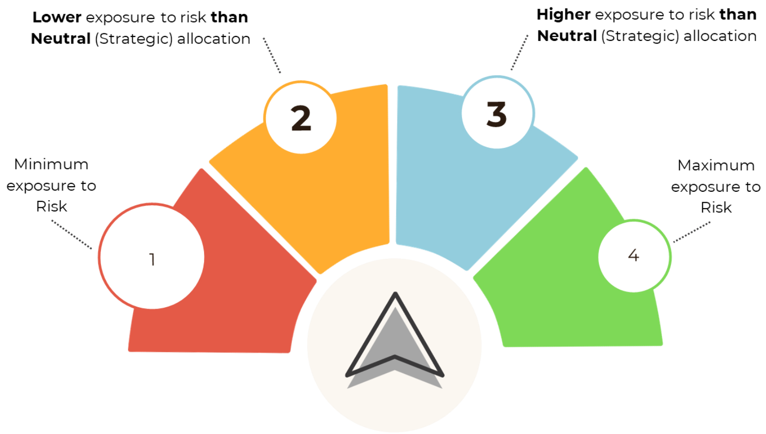
This dynamic remains supportive for the IG credit.

Chart. Different leverage trends



Equities

A rather favorable environment for stocks: rising corporate profits, stabilizing inflation and accommodating central banks.

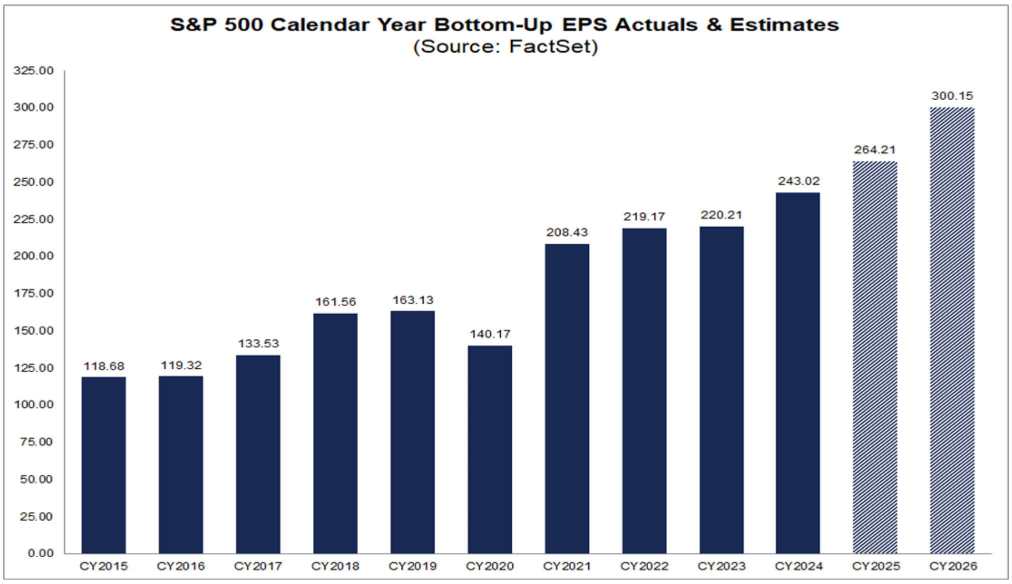


The impact of geopolitical shocks on equities is hard to predict, as they can also represent buying opportunities in certain sectors; just like deglobalization.

Five difficult years, with the pandemic and the shutdown of the global economy, the Russian invasion of Ukraine with its energy and food crisis, and the chaos generated by Donald Trump with his trade war, have not caused the much-feared depression or high structural inflation.

The Israeli decision to attack Iran to halt Iran's military nuclear program and bring down the mullahs' regime poses a new challenge for companies, with an energy risk, and therefore for the stock markets. The markets are not panicking, for the moment, about this new war, expecting a limited conflict and stability in the region with the potential elimination of the Iranian mullahs' regime.

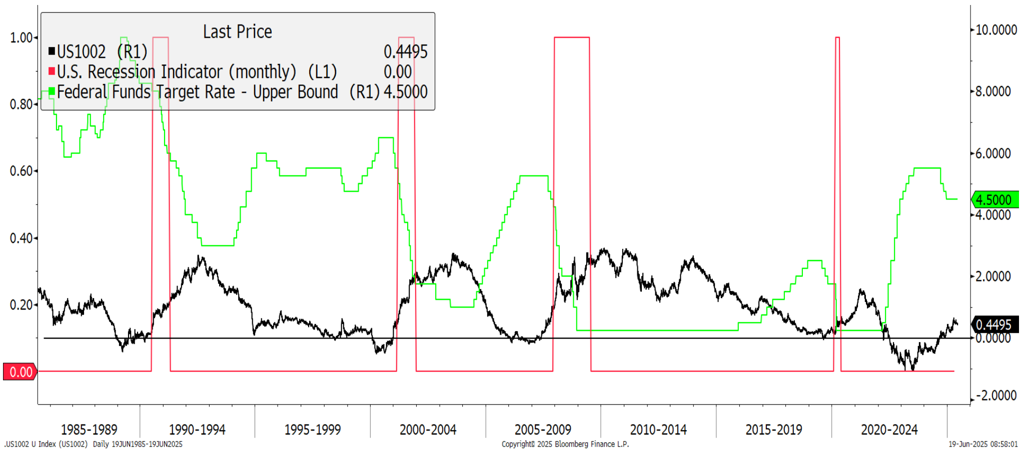
Companies have certainly suffered from all these events, but they have demonstrated strong flexibility in changing their business models and supply chains. A much more balanced world in terms of trade flows, high-quality balance sheets, and cost control have made it possible to navigate each period with very little damage on margins. This great resilience largely explains the strong performance of stock indices. Bottom-up analysts estimate a 10% increase in S&P 500 profits in 2025 and 13% in 2026.



The stabilization of inflation relative to the targets of the major central banks and accommodative central banks justifies current stock market valuations.

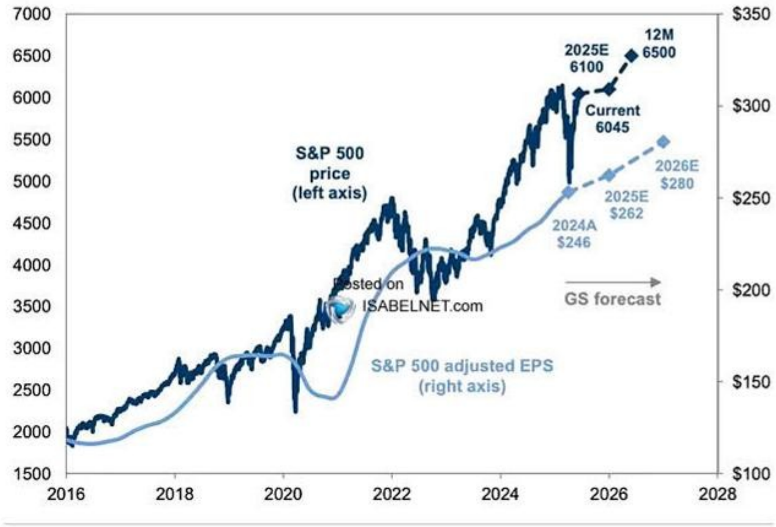
The main arguments for worried investors stem from the steepening of the US yield curve (10Y-2Y) and the downward trend in the Fed Funds rate, which historically precede a recession. An economic recession, and therefore a decline in profits, results in an average 30% correction in the stock markets. The main risk comes from the trade war over customs duties launched by Donald Trump, which seems to be easing due to ongoing negotiations and the US president's intellectual fatigue.

Chart. US Recessions, Fed Funds and the Slope of the 10-2Y Curve



If estimates are correct and inflation is under control, stock markets will continue to rise. A range of 6,600-7,200 is realistic over the next six months.

Chart. Goldman Sachs top-down S&P500 forecasts



Source: FactSet, Goldman Sachs Global Investment Research

Over the past 50 years, bull markets have lasted an average of 8 years with gains of nearly 300%. The current bull market is 32 months old with gains of 67%. The correction from mid-February to April 8th did not turn into a bear market, as the decline was 18% (–23% intraday).

Chart. Year three of bull markets can be Choppy. Bull markets the past fifty years that made it to their second birthday

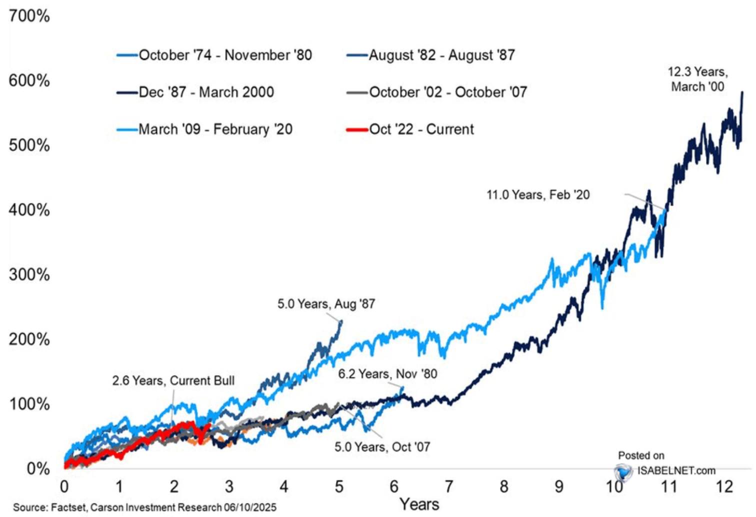
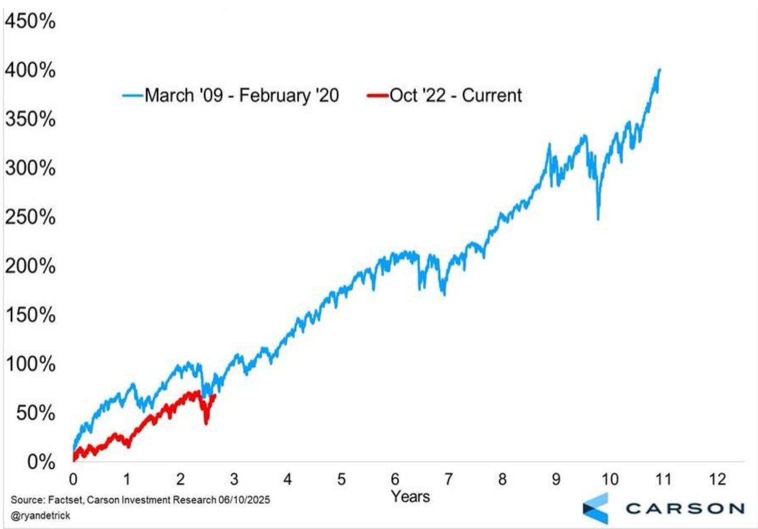
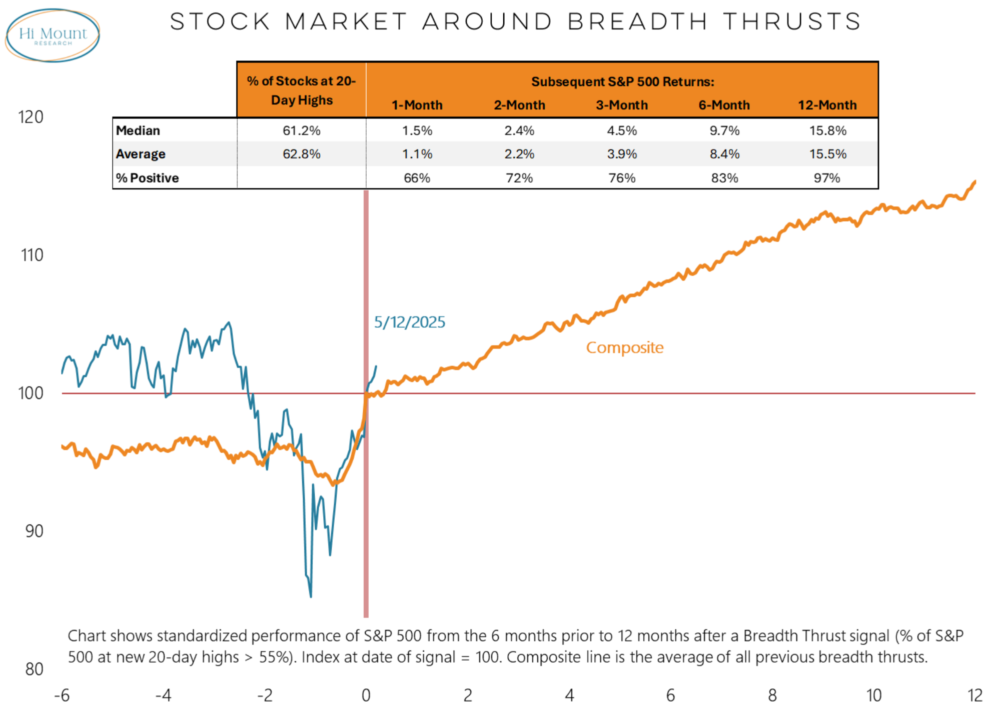


Chart. Two bulls that look similar so far. The 2009 bull market compared with this one



A favorable comparison between the 2009-2020 bull market and the current one.

The Breadth Thrusts momentum indicator is a technical indicator that determines market momentum and signals the start of a potential new bull market. The calculation is based on 20-day moving averages and the percentage of rising stocks. Its principle is that a sudden change in liquidity in equity markets causes stocks to rise and signals increased liquidity. We are now one month away from the 20-day peak of mid-May, which produced a bullish signal. On the chart below, the behavior of the S&P 500 is consistent with that observed after previous Breadth Thrusts over the past 40 years.



	% of Stocks at 20-Day Highs	Subsequent S&P 500 Returns: 1-Month	2-Month	3-Month	6-Month	12-Month
Median	61.2%	1.5%	2.4%	4.5%	9.7%	15.8%
Average	62.8%	1.1%	2.2%	3.9%	8.4%	15.5%
% Positive		66%	72%	76%	83%	97%

Chart shows standardized performance of S&P 500 from the 6 months prior to 12 months after a Breadth Thrust signal (% of S&P 500 at new 20-day highs > 55%). Index at date of signal = 100. Composite line is the average of all previous breadth thrusts.

2015 marked the beginning of the US stock market's outperformance relative to the rest of the world thanks to the technology sector and Big Techs in particular, formed within a group called The Magnificent Seven, with an acceleration from April 2023 to the end of January 2025 with the emergence of AI. We believe that the end of January 2025 may have been the end of American exceptionalism with the Chinese shock of DeepSeek and its R1, an AI model as efficient as those of American leaders, but requiring fewer resources and open source. The shock for US tech was massive and called into question the gigantic investments announced by Big Techs. Big Techs are under pressure with the arrival of Chinese and, to a lesser extent, European competition, and strict European regulation, the Digital Markets Act, and the Digital Services Act, on Big Techs in terms of competition and content.

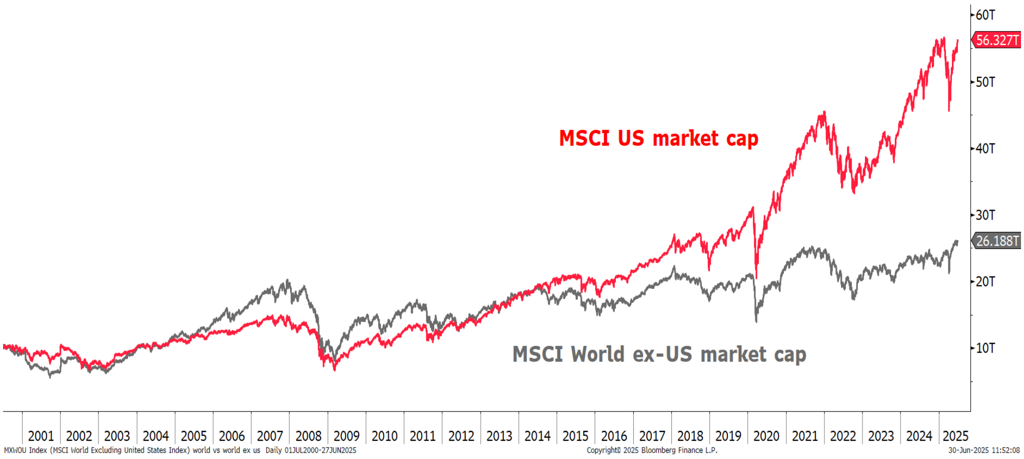


Chart. US stock market divergence from advanced economies since 2018

Our overweight in non-US equities is explained by the end of American exceptionalism and the PE ratios of the S&P 500 and the Nasdaq above historical averages. The weight of the US stock market in the overall index increased from 40% in 2008 to 50% in 2015 and 70% today. The market capitalization of the US stock market relative to US GDP is at an all-time high at nearly 190%, while this ratio has remained stable over the past twenty years, between 40% and 60%.

Chart. The share of equity market capitalisation relative to GDP has risen steadily in the US, although not so in the rest of the world

US technology explains the high PE ratios of the S&P 500 and the Nasdaq, well above historical averages. We are overweight non-US equities.

Chart. US equity index P/E valuations vs. history

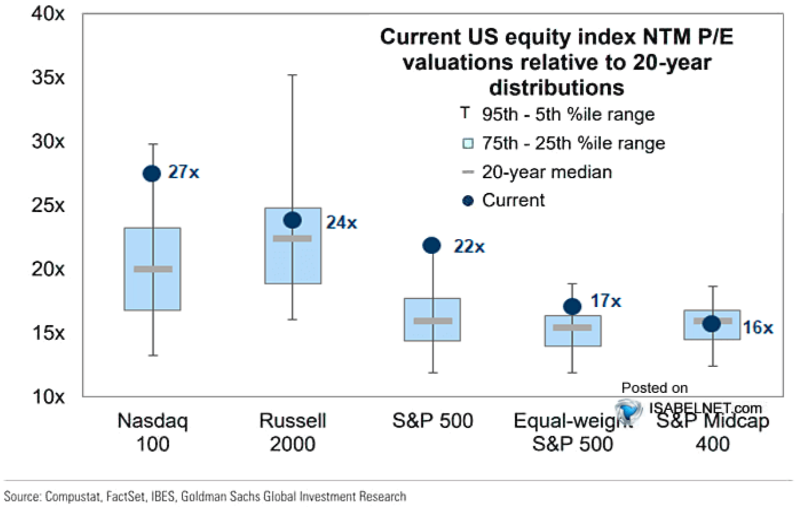
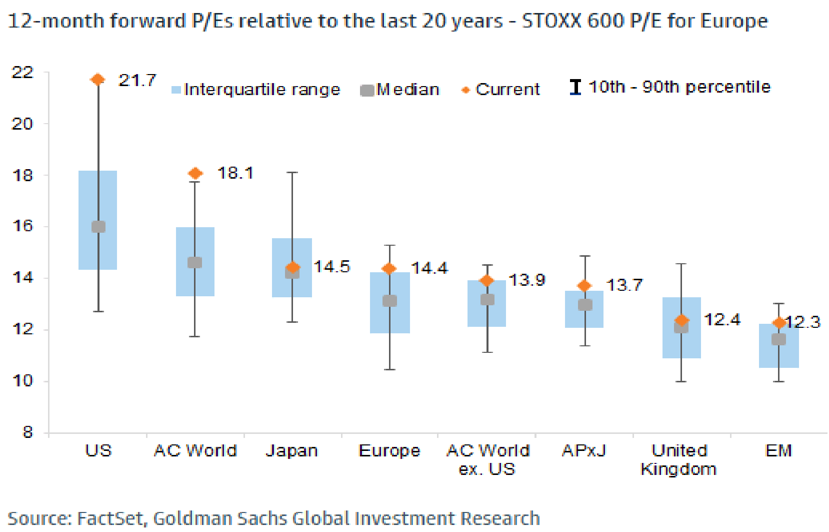
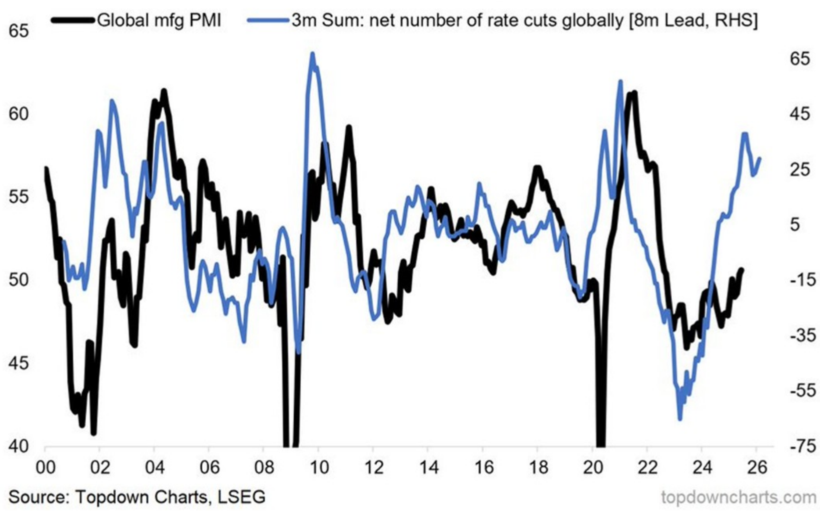


Chart. MSCI Regions valuations



Interest rate cuts from central banks give a positive signal on PMI Manufacturing and on companies' profits.

Chart. Global monetary policy stimulus



A weak dollar is historically favorable for risky assets, particularly emerging markets.

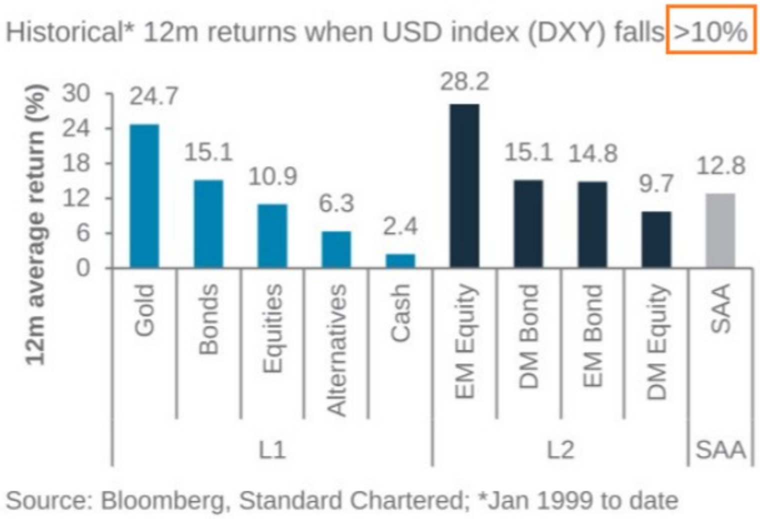


Chart. Weak USD environments generate positive returns for financial markets and risky assets

The bearish positioning of large speculators on the S&P 500 aligns with historical trends observed at market lows, supporting a contrarian approach according to which a rally is likely if shorts are forced to cover their positions.

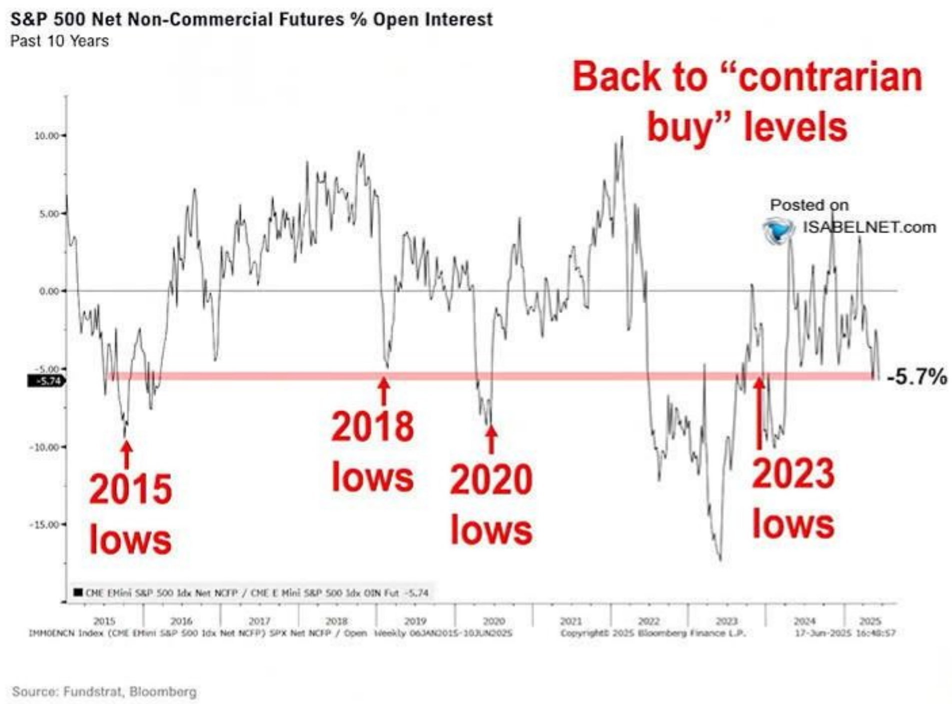
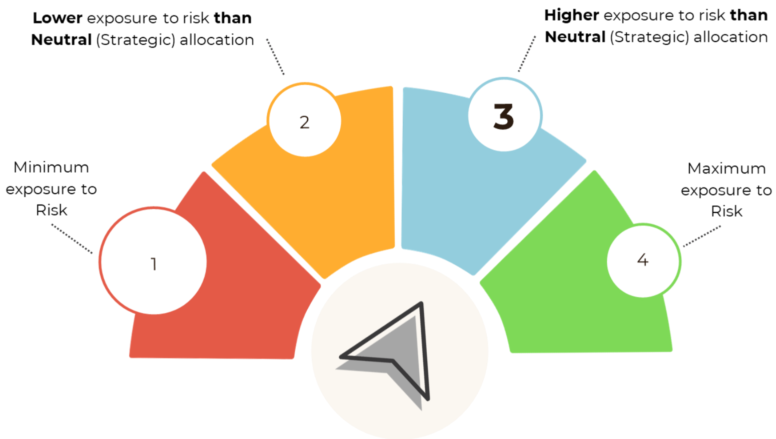


Chart. MSCI Regions valuations

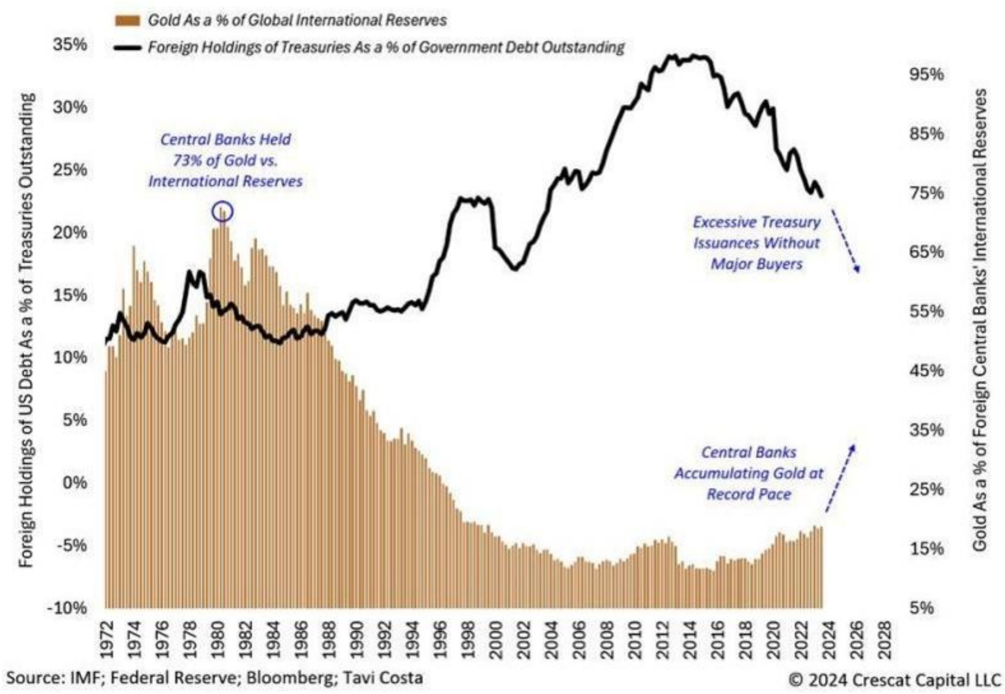
Alternative Investments

Gold and industrial metals: structural demand on the rise. Oil: structural overproduction.



Central banks are reducing their exposure to the dollar and US Treasury bonds in favor of gold. This process is certainly slow, but unstoppable. US deficits and debt, as well as geopolitics, favor gold. Gold is the second most important reserve asset, surpassing the euro in 2024.

Chart. Foreign central banks transitioning toward gold



95% of central banks have announced they will continue their gold purchases in the coming years and reduce their exposure to the dollar.

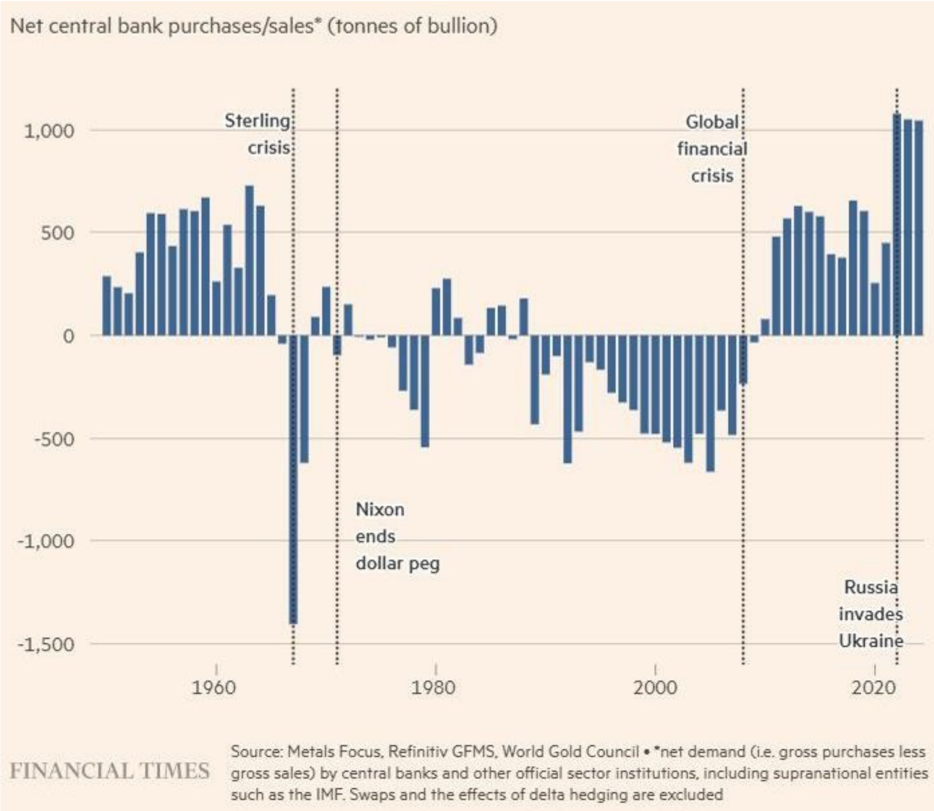


Chart. Central banks are ploughing record amounts into gold

Donald Trump's incessant attacks on US allies and the US Federal Reserve, as well as geopolitical turmoil, are pushing Germany and Italy to repatriate their gold, located in New York. These two countries hold the two largest gold reserves after the US, and more than 40% of these reserves are in New York. Repatriating gold is a widely shared political consensus in the face of the risk of the Fed losing its independence. A survey shows that 70% of global central banks are considering keeping their gold at home.

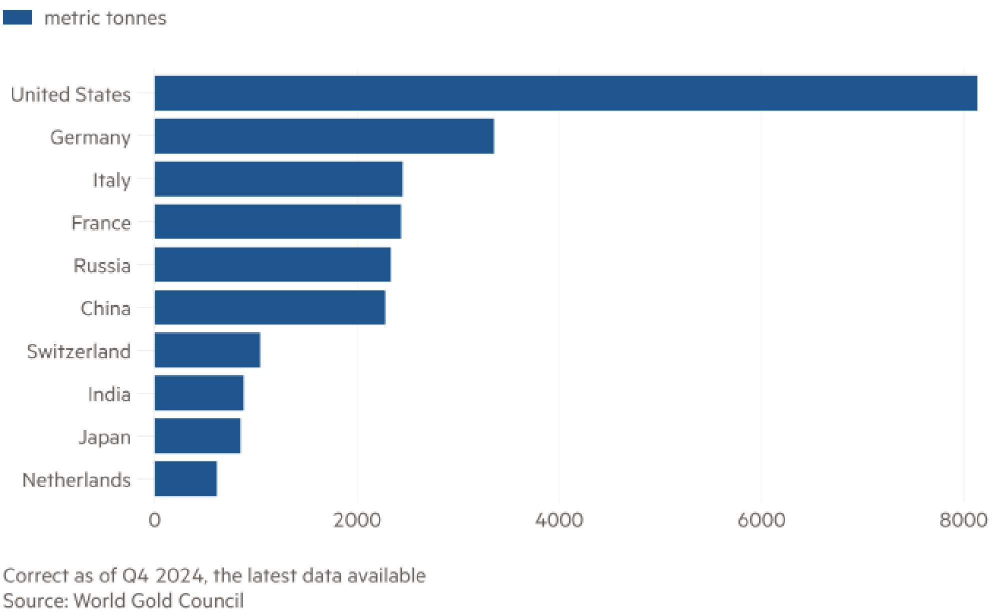


Chart. Central bank’s gold reserves

Reduced tensions on commodity prices following the Covid and Russia shocks.

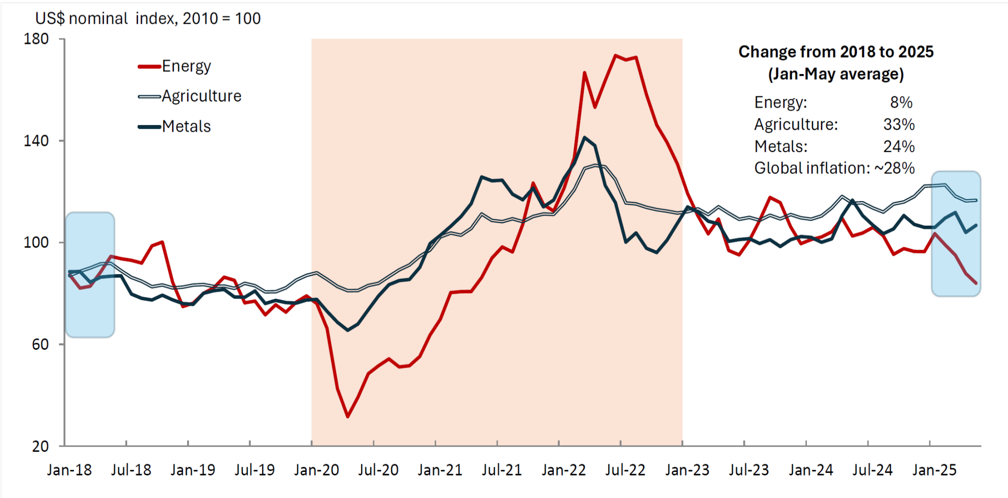


Chart. Prices coming down, approaching pre-2020 levels in real terms

Oil. Prices are under pressure with the Israel-Iran war, with the risk of regional expansion and closure of the Strait of Hormuz. Despite a historically unstable region, the Strait has never been closed, and we do not believe the conflict will escalate.

Oil prices remain below $80 per barrel: the market is in a structural situation of oversupply, Saudi Arabia can export its oil through a pipeline network leading to the Red Sea, and China, Iran's main customer, would likely not agree to a closure of the Strait of Hormuz. Iran accounted for 15% of China's oil imports, and 25% of China's LNG imports came from Qatar, all of which passed through the Strait of Hormuz.

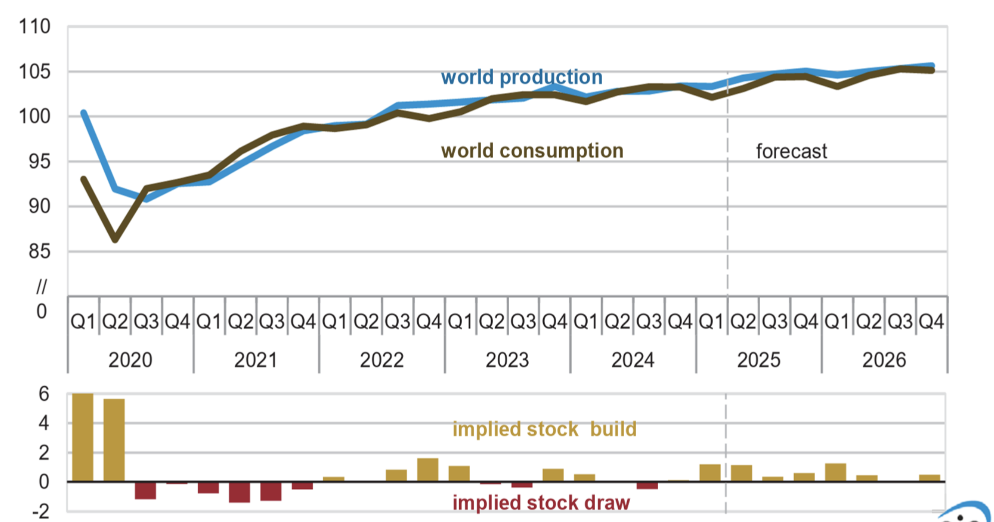


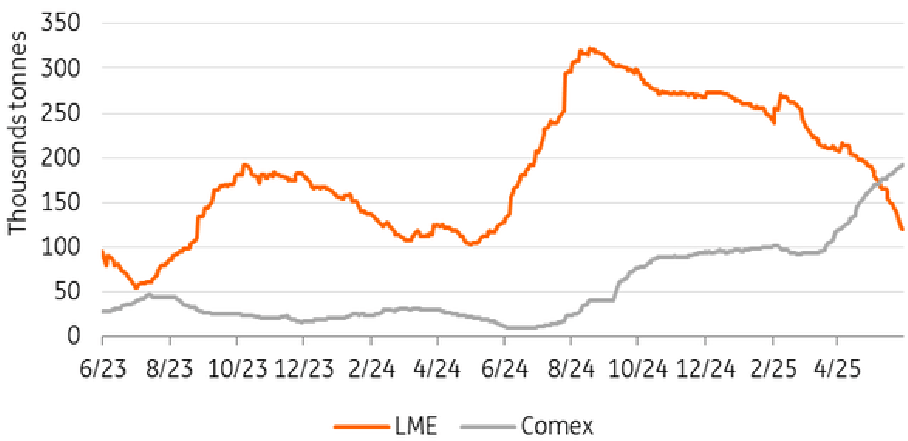
Chart. World liquid fuels production and consumption balance (million barrels per day)

Saudi Arabia and the United Arab Emirates have said they could quickly put 3.5 million barrels/day on the market if necessary, and non-OPEC producing countries are still producing more. High volatility in oil prices, with an average price of $64 per barrel over the past 25 years. Structural oversupply justifies a return to the mean.

Chart. Brent Crude Prices

Industrial Metals. Rising demand from defense, vehicle electrification and renewable energy is supporting prices. In the United States, copper prices have risen sharply due to massive restocking in anticipation of higher import tariffs.

Chart. Restocking in New York (Comex) and destocking in London (LME)



The outlook for China is improving, and we could see a rise in industrial metal prices if the Chinese economy were to accelerate.

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