Winter 2025-2026

The Financial Letter

Review, opinions and markets' perspectives

Summary

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Global vision

Regime analysis

A seismic shift is underway in economic, political, and financial spheres. The US administration will expedite its actions prior to the mid-term elections. Unpredictability is compounded by upcoming SCOTUS decisions. Numerous and highly unpredictable repercussions will reshape incentives, institutions, and behaviours in ways that are only partly visible in the present.

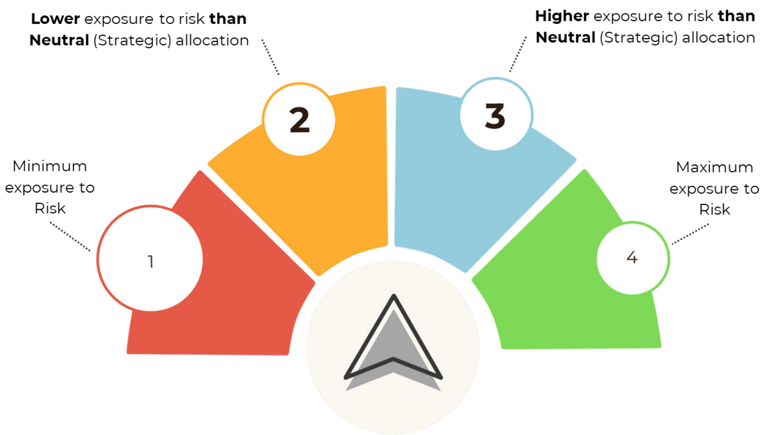
Regime change and disruptions have become the defining mantras of the age.

Investment framework

In a first phase (H126), solid and synchronised nominal growth is likely in the global economy. Absent a major financial accident, this will to push the US towards overheating. Together, large divergences should open up between inflation cycles, reflecting different policy mixes. Throughout this period, global debt will continue to climb, while the overall level of global liquidity remains elevated, increasing longer-term vulnerabilities.

In a second phase (from H226), global liquidity will start receding. The odds of a sovereign debt scare or a hard landing will therefore rise. A key question in both phases is whether the dollar can retain its status as the dominant reserve currency.

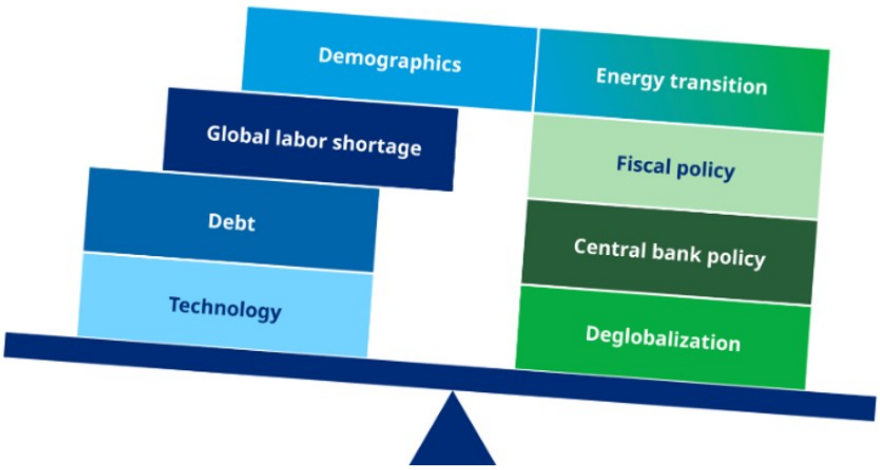
- Stay fully invested (neutral vs strategic allocation) short term
- In H126, overweight (vs. strategic) allocation to alternative / real assets (Commodities, real estate, precious metals)



Long-term drivers

Review of key Long-term drivers

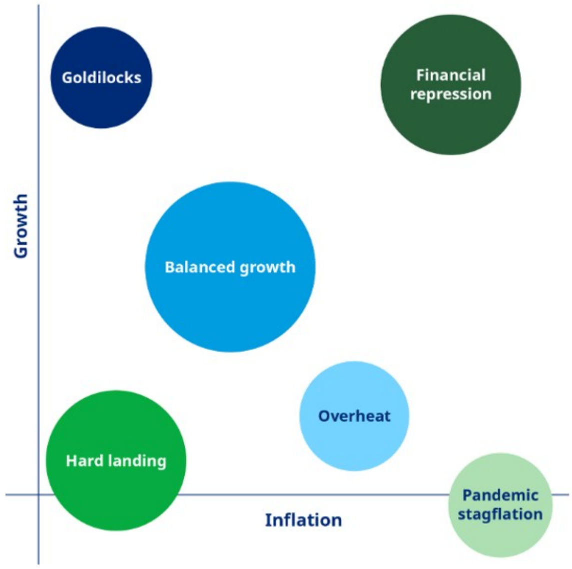
Chart. Macro trends Secular forces taming inflation have evaporated



The world is more fragmented, with rival blocs shifting power and trust, weakening the global system. Fiscal dominance is evident as governments press for deficits and debt, while central banks are pressured to accommodate, eroding monetary independence and testing inflation-control frameworks. Technological progress might offset some strains, but it is uncertain whether the benefits will be significant enough to ease inflation.

- Inflation volatility and regional divergences are likely, as countries face different fiscal stresses, demographics, energy constraints, and geopolitical risk.

Chart. Macro Regimes Unstable, still



The past fifteen years have seen relatively benign conditions: low inflation, subdued volatility and subpar growth in many developed countries. Financial repression by central banks played a key role in this, alongside large-scale asset purchases and the suppressing of risk premia. The result is a significant rise in government debt. The next years look set to be very different, with reflation policies / fiscal dominance in the US, eurozone, Japan if not China. The shift will involve a new round of financial repression, to keep funding costs down. The private sector leverage will rise due to tighter real restrictions and more volatile income streams.

- Financial repression will persist, as policymakers seek to avoid a debt crisis. This will increase the risk of overheating, and a hard landing.

US Debt super-cycle

Unprecedented perspectives

Chart. US govt. debt % of GDP & real gold price Source Bloomberg, IIF

Prior to the GFC in 2008, the five-year average U.S. budget balance was a surplus of around 1% of GDP. By 2024, however, this had deteriorated to a deficit of -8.8% of GDP, with net public debt climbing above annual GDP levels.

From 2008 onwards, gold effectively 'pre-announced' the impending deterioration in fiscal metrics, foreshadowing the widening deficit gap and rising debt-to-GDP ratio.

- Gold is again signalling concern over a renewed upward spiral in US debt.

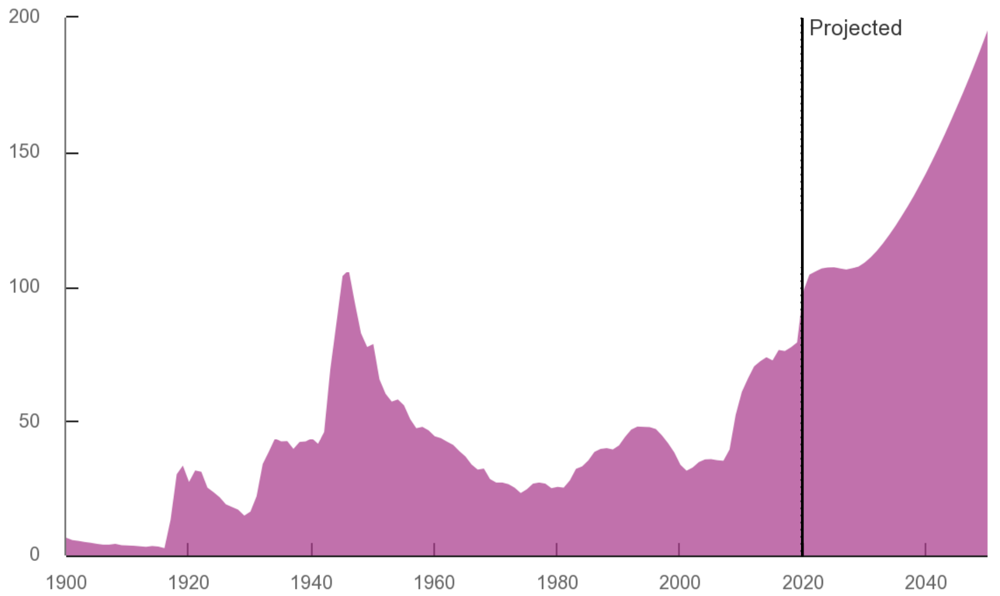


Chart. CBO projections

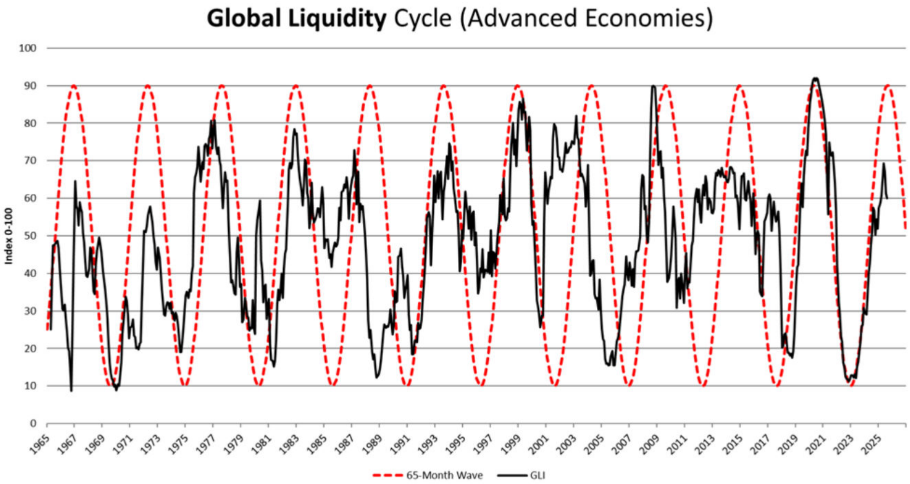
The CBO forecasts that federal debt will reach no less than 200% of GDP by 2053.

Chart. Normalization of global yield curves allow for more solid bank lending

Next years will experience a restoration of risk premia and a return to positive real rates. Expect a consequential resurgence in the private sector credit, driven by traditional bank in the US, Japan and the EU, although China will be a notable exception. Nevertheless, the incremental impact of this new bank lending on real growth is expected to be low to marginal.

Liquidity super-cycle (Crossborder)

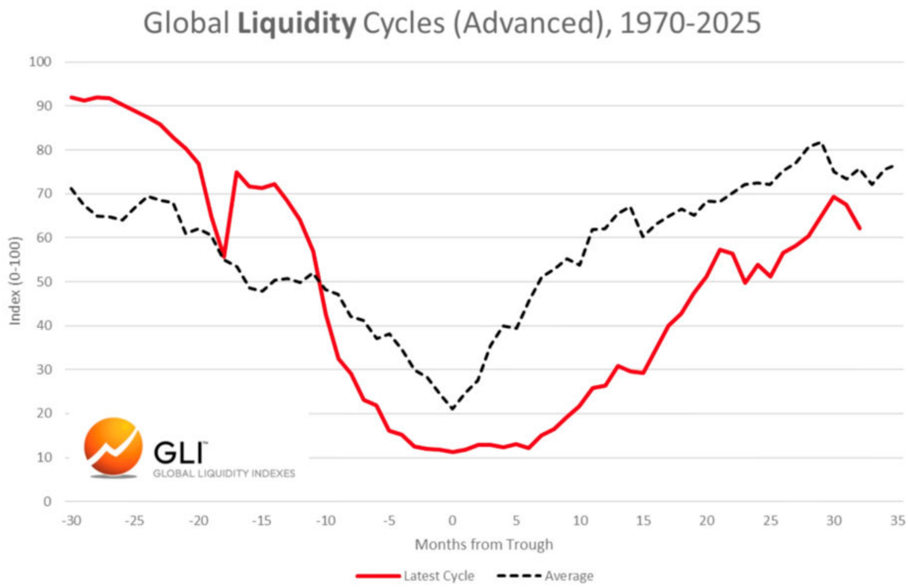
Chart. Very late cycle
Source: Crossborder capital



Global cycles show comparable patterns over time. They usually show five- to six-year waves, before reversing course. These cycles rarely reach extreme readings – such as sustained levels above 80 or below 20 – before fading and a turning point emerges. Exhaustion sets in before the system reaches its theoretical limits.

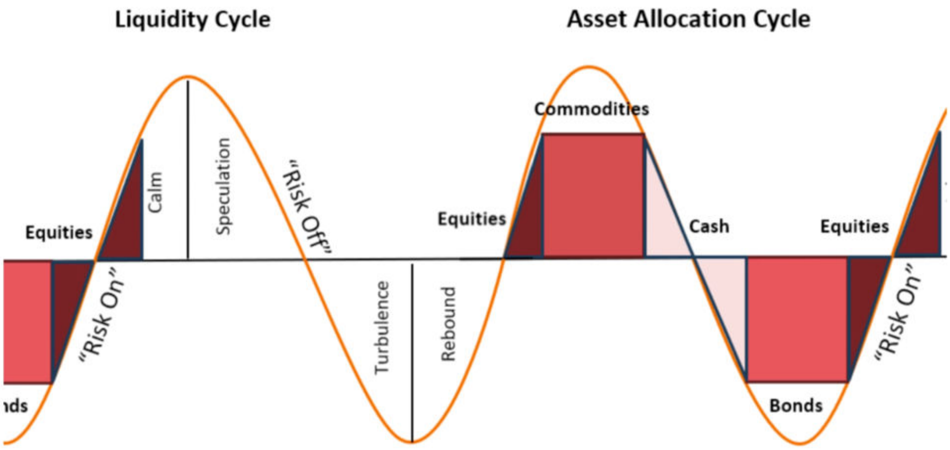
The previous cyclical peak was reached around 2020, after several years of strengthening conditions and abundant liquidity. The ensuing downturn continued until a trough in 2023, marking the transition into a new, early-stage upswing.

Chart. Is this Time... different?



The current global liquidity cycle is similar in length and magnitude to previous ones. Its upswing is now about thirty-five months' old, as previous cycles have been. From the trough, the index has recovered by 60 points, rising from around 10 to a peak near 70. This typical rebound suggests that the current episode is a mature, fully developed liquidity expansion. We are in a late phase of the global liquidity cycle. Gains become harder to achieve, and risks shift towards plateauing or reversal.

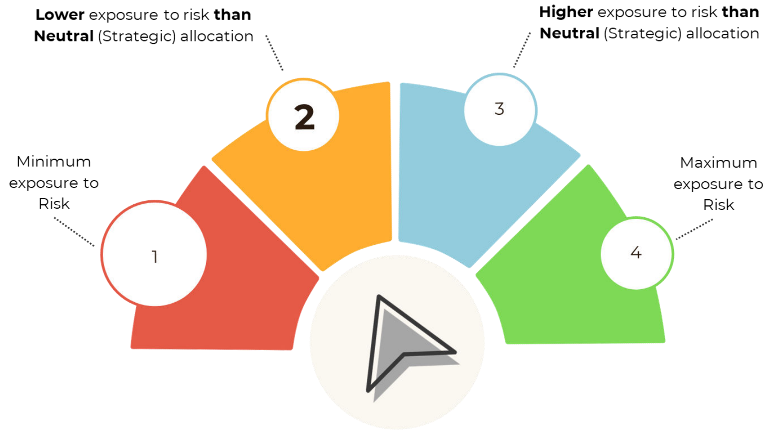
Chart. More volatile markets' perspective in 2026



In stylised patterns that hark back to the past, the slowdown in global liquidity relative to its cyclical peak usually coincides with speculative phases in the markets, when risky assets tend to outperform massively.

Following this, its contraction is accompanied by turbulence, during which real assets (and cash) become the primary drivers.

Currencies



Is the USD dominance at risk?

Since WWII, the USD has played a central role in global finance. It currently accounts for 88% of global FX transactions, 58% of global FX reserves, and 54% of global trade. As the default global reserve currency, central banks worldwide hold USD reserves, to manage exchange rates, settle trade transactions, repay foreign debt, and guard against financial shocks. The USD status, however, is not guaranteed and has been eroding in recent years.

The USD role as the default currency was formalized with the establishment of the Bretton Woods system in 1944, when other countries pegged the USD, and the USD itself to gold. Even now, long after the US abandoned the gold standard in 1971, many countries continue to peg to the USD due to its stability. Its strength is reinforced by several factors, like the size of the US economy, the stability and transparency of US government and economic institutions, and an independent central bank that credibly balances maximum employment and price stability. The USD is also the dominant currency for international trade, and assets held in USD are seen as a superior store of value. Countries also borrow in USD to reduce investor concerns about local currency risks and secure financing at favourable terms.

For decades, countries had few alternatives to USD reserves. That may be changing now. Non-traditional currencies, like AUD, are much more liquid and tradeable than before. They account for a rising share of global reserves. Gold has also made a comeback and is a rising share of central bank reserve portfolios. Central bank digital currencies (CBDCs) could also provide an alternative for international financial transactions in the long run.

The USD reserve currency status grants the US an exorbitant privilege...

- Because of widespread demand for and confidence in the USD decreases the costs that the government would otherwise pay on its debt and increases its overall borrowing capacity.

- As global investors hold USD, they are more likely to invest in the US market and stability. The US is the largest recipient of foreign direct investment.
- A strong USD lowers the cost of imported goods, increasing US households living standards. It gives the US a powerful leverage to enforce far-reaching sanctions against other countries.

...but is not without downsides.

- High foreign demand for USD-denominated assets strengthens the USD and makes US exports more expensive and imports cheaper, contributing to larger trade deficits. Moreover, other countries' desire for USD assets are financed by heavy imports to the US. The trade deficits are linked to the USD reserve currency status.
- Easy access to cheap borrowing has contributed to current staggering debt levels by emboldening the US government to borrow at elevated levels, ignoring warnings calling for reforms.
- Foreign investors hold $9trn in US Treasuries, playing an important role in funding the federal deficits and keeping yields low. Some worry that interest payments on this foreign debt direct US tax dollars overseas rather than being spent at home.

Overall, the USD remain dominant in the global economy. There are few if any immediate alternatives that match its longstanding stability and liquidity, which are supported in large part by the depth and reliability of the U.S. Treasury market. Even so, there has been a gradual decline in the USD share of global reserves, from 71% in 1999 to 58%, its lowest level in years. The foreign-held share of US Treasuries has also decreased from nearly 50% in the 2010s to 30% now. More recently, the USD has weakened because of increasing trade barriers and economic uncertainty. The normal correlation between US yields and the USD has also frayed, raising concerns about the USD traditional safe haven status.

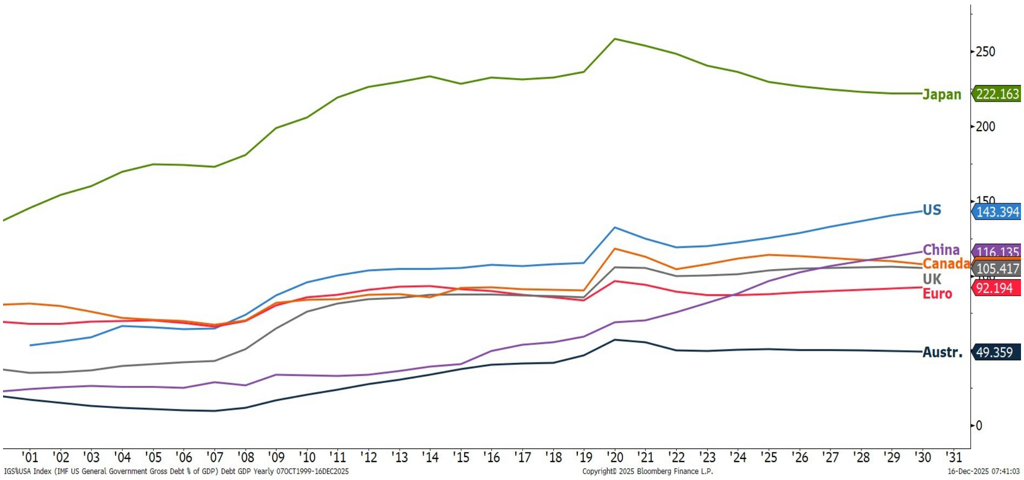


Chart. The US indebtedness will climb quicker than peers

Chart. The share of FX reserves held in USD is declining

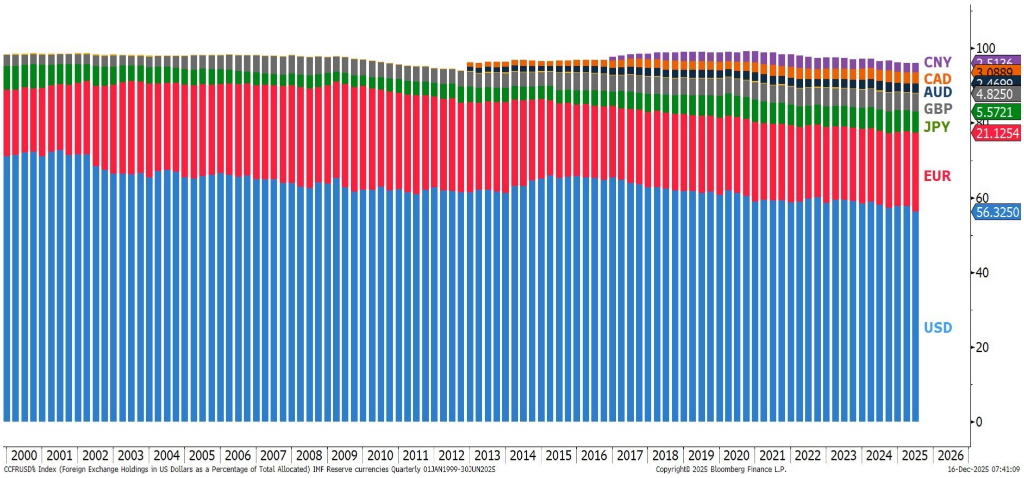


Chart. The Swift payments are still mainly done in USD

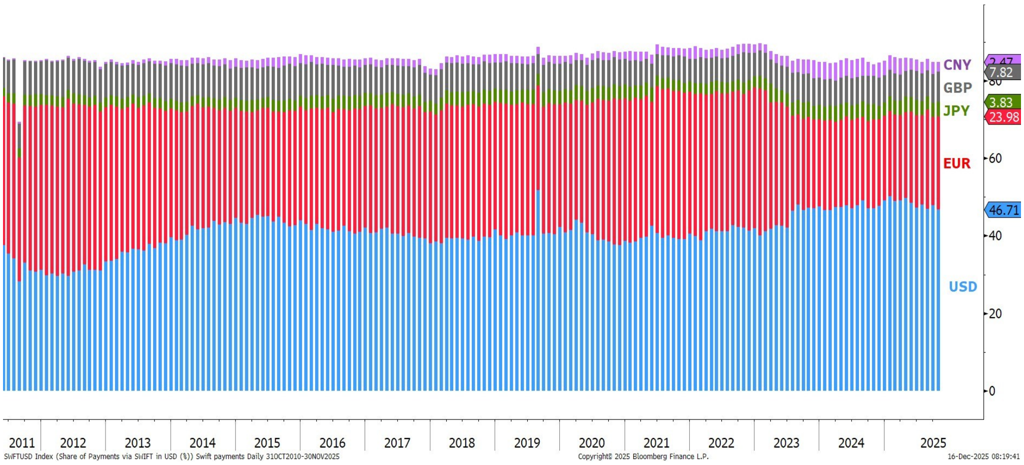
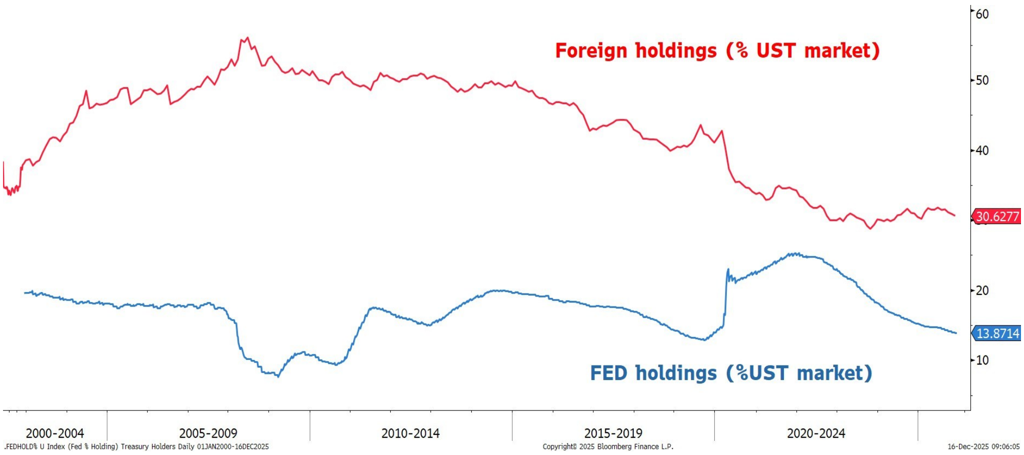
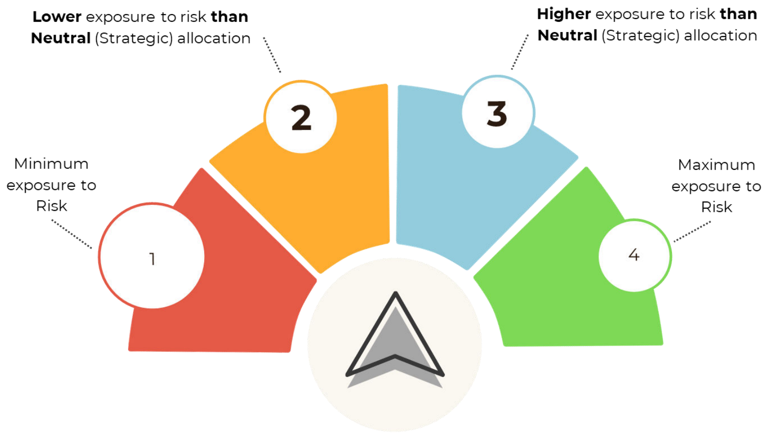


Chart. The US refunding still relies on foreign investors



Bonds



Extreme scenarios

Here we examine 2 scenarios, both based on the notion that the Fed does not stop cutting at 3.0%, but rather gets the Fed Funds down to 2.0%. There are 2 ways to get there. The 1st one is with justification. It will be positive for the US Treasury market, as the Fed remains credible. While the 2nd is without clear reasons. It would be negative for 10yr Treasuries, as the Fed lost credibility.

The 1st scenario is one where the economy decelerates and creates severe corrections in the tech and housing markets, squeezing confidence and spending and pressuring the economy into a recessionary tendency, necessitating Fed cuts to 2%. In this non-inflationary scenario, the US 10yr yield would quickly pull towards 3.0%.

The 2nd scenario is where a Trump-administration-impacted Fed swings super dovish and executes rate cuts far more than what is required to juice the economy in good time for the mid-term elections. While a positive comes from higher tax receipts, the bigger negative is a rise in inflation risks.

The Fed will be doing things it really should not be doing, tarnishing credibility. While Treasuries love rate cuts, they won't like them much given this cocktail. Here, there is a material risk that things finally begin to unravel for longer tenors, with the 10yr yield hitting 5%, and the 30yr risks hitting 6%. In fact, this is a cocktail that could necessitate yield curve control, taking policy onto a very troubling trajectory.

Sustained high fiscal deficits are the cornerstone

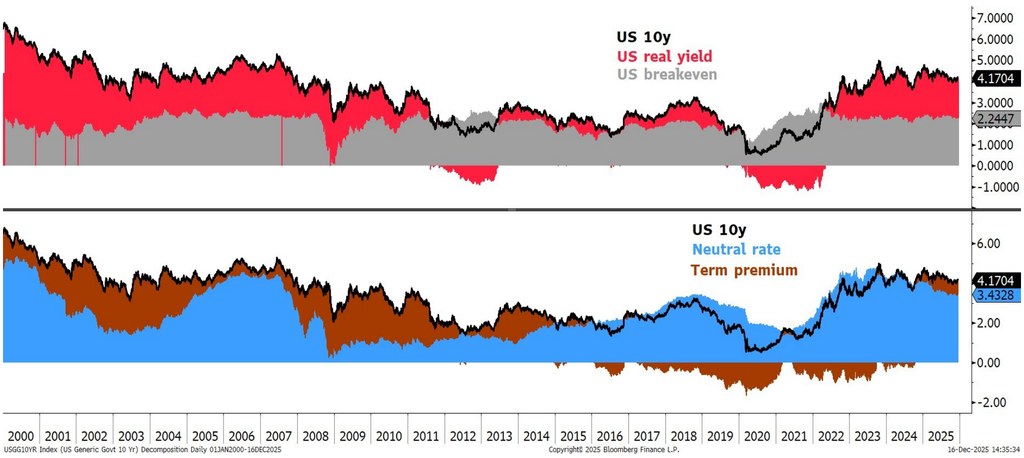
For government bonds investors, the fiscal backdrop is a critical concern that could trigger significant market volatility. Government bonds can still mitigate downside growth risks, especially when real yields are positive, as recently.

However, investors must be reactive. The correlation between bonds and risk assets can shift from negative to positive, potentially diminishing bonds' hedging effectiveness.

Front-end yields are more sensitive to central bank policy and have tended to offer strong counter-cyclical properties, acting as a hedge during economic weakening. So, central bankers can keep policy rates compressed to support growth. The Treasury is aiming to concentrate issuance in the short end. Yet, we have not seen effective impact on interest rates paid on Treasuries after 150bps of Fed cumulative easing.

Conversely, long-end yields are more susceptible to fiscal concerns and inflation expectations, driving term-premium higher. There is no magic number like deficit or debt level. What matters more are the surrounding conditions. Despite the Fed easing cycle, upward pressure on bond yields could stem from the term premium. The US 10-year yield can be decomposed into risk neutrality and term premium or into breakeven inflation and real yield. Given the periods of relatively high inflation, risk neutrality and inflation expectations appear close to their historical norms. Only long-term real yields have levelled up.

On the long end, political dysfunction, economic discontent, heavier fiscal spending, elevated issuance, and associated inflation risks put a floor under long rates. This upward pressure should persist in 2026. Two additional risks factor into the affordability of federal debt: global investor demand, which held up well in 2025 but could turn on a dime; and Fed independence. This threats could pressure long rates higher by eroding confidence in the Fed's long-term inflation-fighting abilities.
Rising global long yields reflect long-term policy and debt risks, i.e. higher term premium.
Credible Fed cuts could push down the US 10-year yield towards 3%, while non -justified cuts could lead the 5.0%.

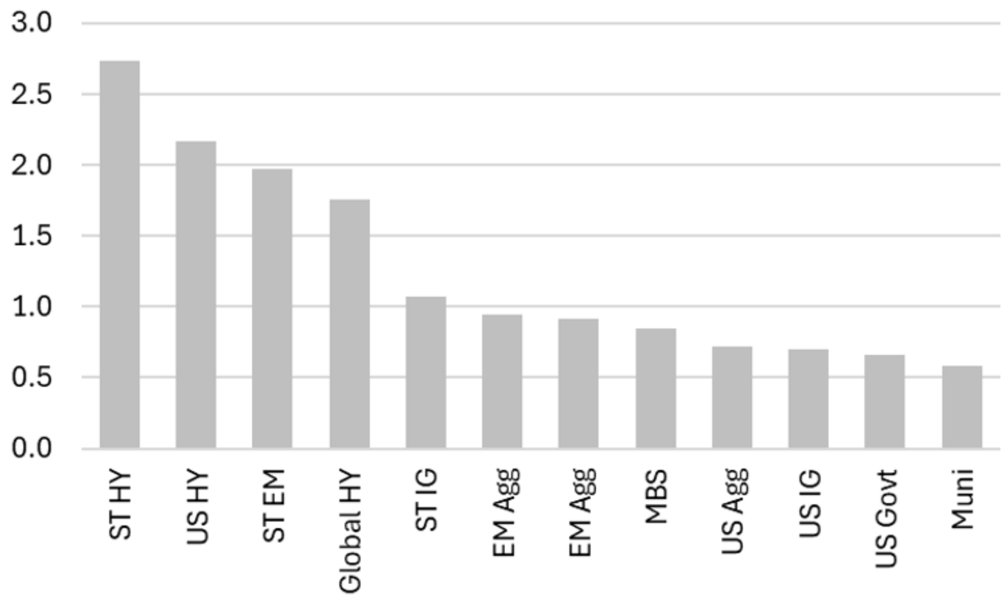


Maturing credit cycle

As the credit cycle matures, investors are watching for signs of strain. Recent bankruptcies (First Brands Group, Tricolor Holdings) alongside unexpected bank loan losses have heightened the scrutiny of credit risk. In the absence of publicly available data, private credit is – and we believe it will remain – prone to headline risk. Still, we view these events as isolated, not systemic, in part because of the role of fraud in recent bankruptcies.

The credit cycle is healthy today, but leverage is likely to build in the coming years.

Chart. As the credit cycle matures, maximizing the yield per duration is key

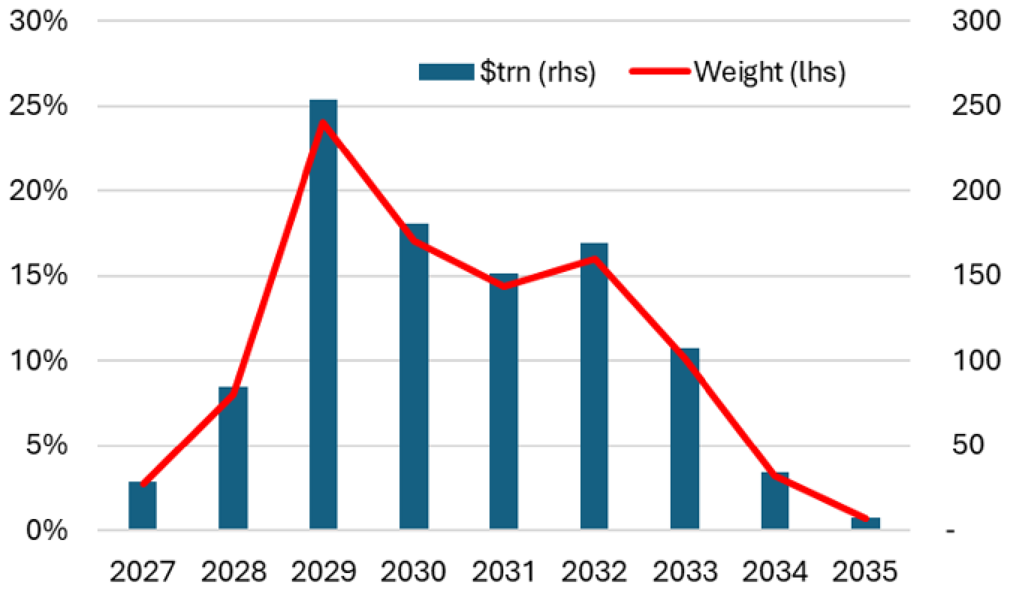


Spreads are tight, creating significant price risk for bonds. However, resumed Fed easing and the improved credit quality make that we are not concerned about systemic credit quality.

With the Fed in easing mode, upside risks to long rates remain. We are staying on the short side of neutral in duration. The better risk adjusted return is in favour of the short-term High Yield segment.

The US HY class has improved in quality thanks to changes in corporate financing structure. Cyclically, leverage and coverage ratios are healthy, supporting tight spreads. Furthermore, over 50% of the HY market is now rated BB or higher. We see this quality at work in the maturity wall. HY issuers have been incredibly successful at pushing out their obligations.

Chart. The HY market maturity wall is far from now



Keeping short-term HY exposure can cushion against rates volatility.

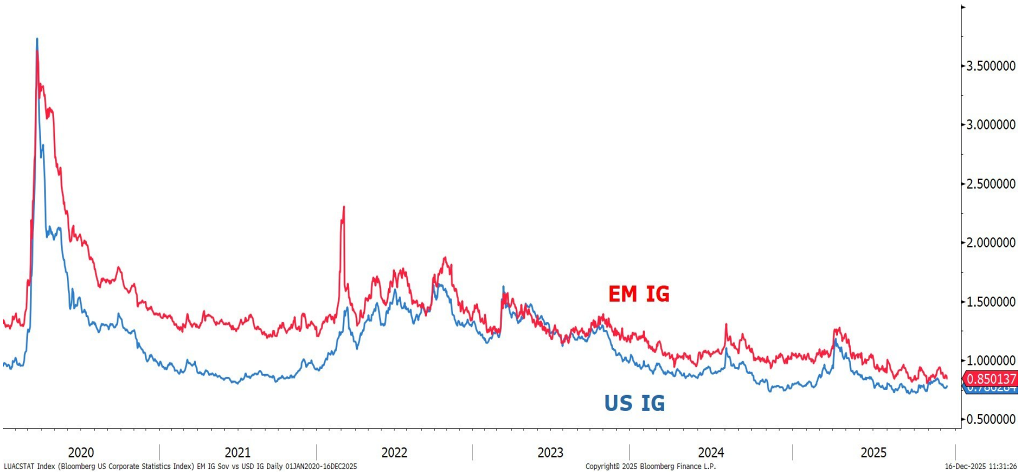
EMD a solution to mitigate portfolio risk

Unlike developed countries, EM countries have not experienced the full force of volatility following US President Trump's tariff policy in last April. They have exhibited lower debt levels than developed countries, and contrasting monetary and fiscal orthodoxy.

Moreover, their average Investment Grade ratings contrast with the unprecedented levels of debt and public deficits in some G7 countries. Confident in their solvency and praising their debt reduction efforts, the rating agencies have upgraded more EM issuers than downgraded over the past 2 years.

EM debt remains an attractive area of focus. Firstly, growth prospects in EMs are higher than in developed countries. Over the past few decades, globalisation has changed the economic balance of power between developed and emerging countries. Secondly, short-term EM debt offers an attractive and sustainable risk/return profile. Over the past 18 years, the short-term EM debt has posted an annualised performance comparable to that of a US high yield index (5.4% vs 5.0%), with lower annualised risk (8.6% vs 9.5%) and a maximum drawdown almost 3 times lower (-12.2% vs -34.8%). Finally, the EM IG spread, although declining, has remained higher than their US peers.

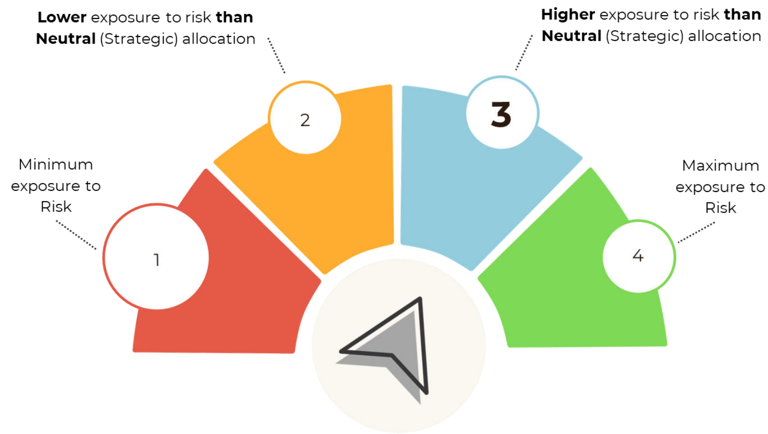
Chart. Persistent Premium in EM IG Credit



Exposure to short-term EM debt reduces the risk. The data refutes the commonly held belief that EM investors are exposed to increased volatility and political and geopolitical risk.

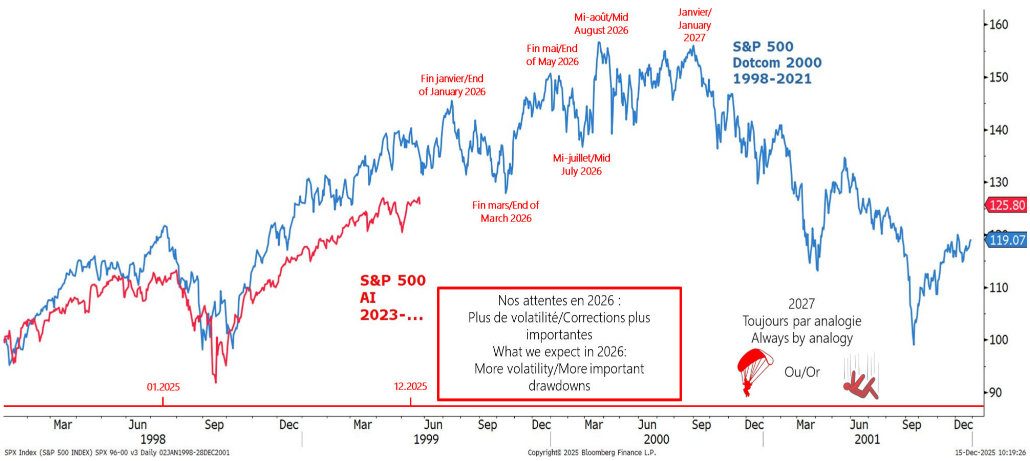
Equities

Will 2026 follow the three previous successful years?

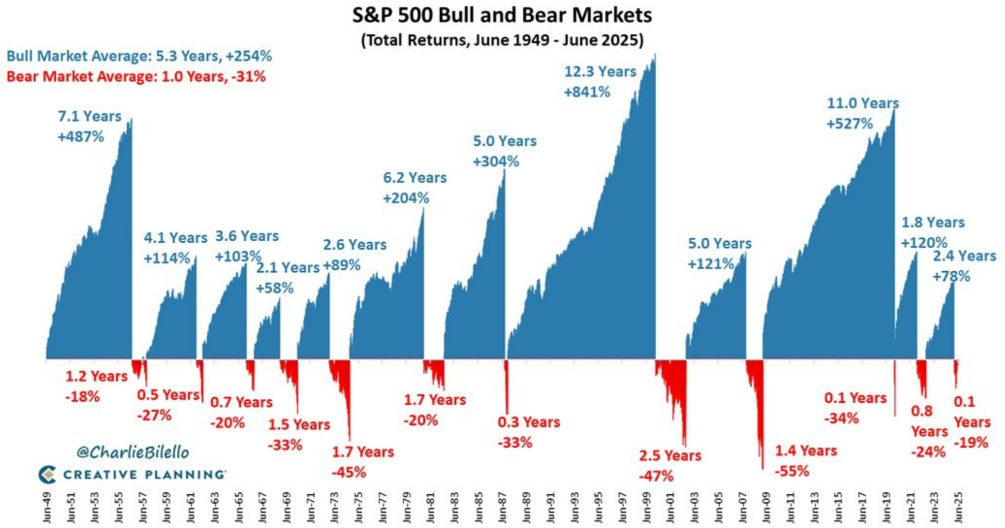


After gains of 22% in 2023, 17% in 2024, and currently 19% in 2025, will 2026 perform as well? If we compare the current AI boom to the dot-com bubble of the 2000s, the S&P 500 still has upside potential of 18% (to 8,000) until the end of 2026/beginning of 2027. After that, things could get complicated.

Chart. S&P 500 comparison AI boom and 2000-Dotcom bubble



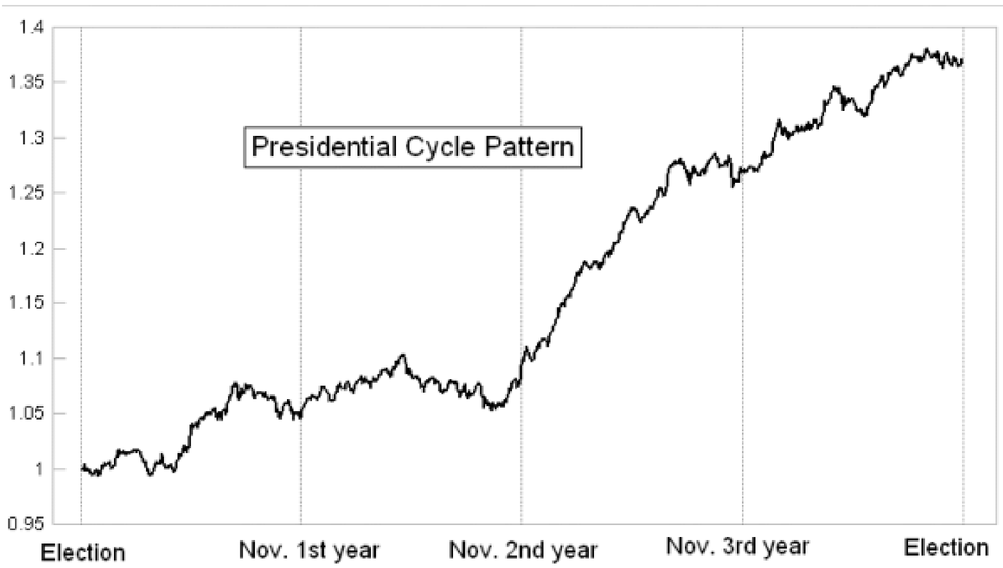
The current bull market is young, with a duration of 3.2 years and an 85% gain for the S&P 500, while the average is 5.3 years and 250%. The average P/E ratio of a bull market (S&P 500) is 19x, while the current one is 23x, but without the "Magnificent Seven," it stands at 19.3x. In conclusion, no exuberance, even for the Magnificent 7.



Other favorable factors for stocks in 2026 will be:

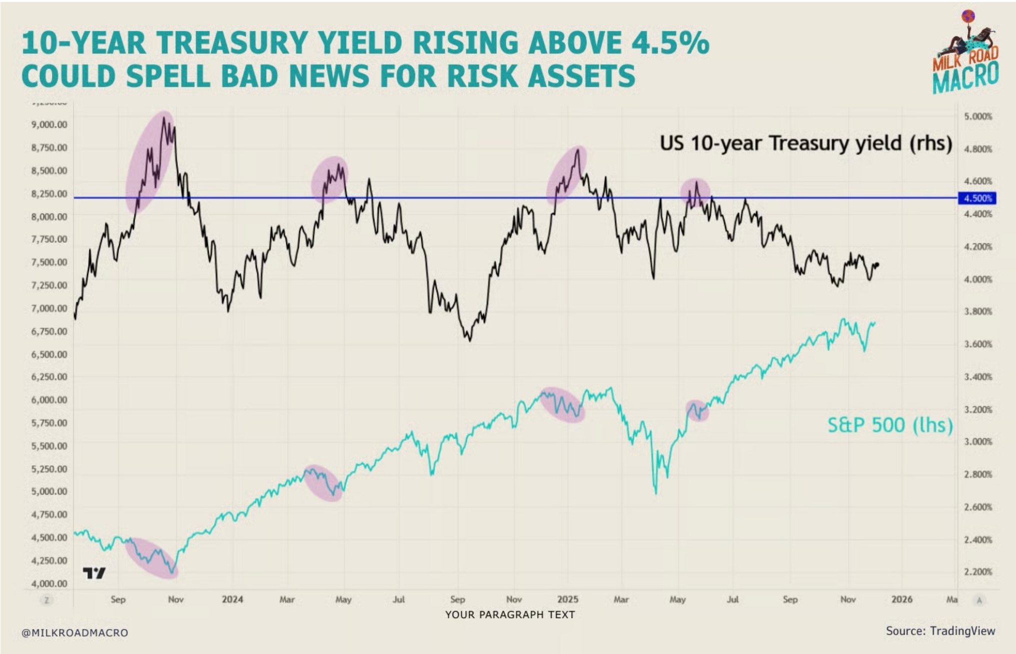
- Significant fiscal stimulus packages in the United States, Japan, and Germany.
- An accommodative monetary policy from the Fed thanks to its new chairman serving the US administration.
- A decrease in the Fed Funds rate in an environment of economic growth, which generally favors the rise of equities.
- After a record-breaking 2025, 2026 will be marked by mega-IPOs: SpaceX with an expected valuation of $1.5 trillion, OpenAI $500 billion (probably more), ByteDance $500 billion, and Anthropic $350 billion. The negative point : we need liquidity to absorb such amounts.

But risks exist. First, the second year of a US presidential cycle, which is a congressional election year - the midterms -, underperforms the other years: in average +7% in year 1, +3% in year 2, +15% in year 3, and +8% in year 4.



If Trump continues on the same trajectory as in the recent elections lost in New York, Miami (after 30 years of Republican dominance), New Jersey, Virginia, and California, and nearly suffers a humiliating defeat in Tennessee, the Republicans risk losing both houses of Congress. With a 40% approval rating, Trump is the most unpopular of all US presidents, just as he was during his 2017-2021 term. His significant absence from domestic issues is causing his MAGA base to abandon him, as seen with Marjorie Green. Therefore, political cacophony is likely in the United States in 2026, along with a worsening of Trump's authoritarianism.

Another risk is the overall rise in long-term interest rates currently being observed. A drastic cut in the Fed Funds rate could trigger a sharp rise in the US 10-year Treasury yield due to inflationary risk, and the premium demanded by bond investors could be higher given the OBBBA fiscal plan and its potential to exacerbate budget deficits.



A US 10-year above 4.5% has often resulted in stock market corrections.
The end of the yen carry trade is also a risk. These swap transactions have encouraged the purchase of US stocks, particularly in the technology sector. A rise in Japanese interest rates and a strengthening yen could trigger a correction in global equities, as seen in the summer of 2024 when stock indices corrected by 10% while the yen appreciated by 10%.

The Equity Risk Premium (ERP) indicates less attractive stocks, but this long-term ratio may no longer be as relevant given the deterioration of public finances (debt, budget deficits) and the financial strength of companies. The ERP compares the return of profits/dividends with sovereign interest rates.

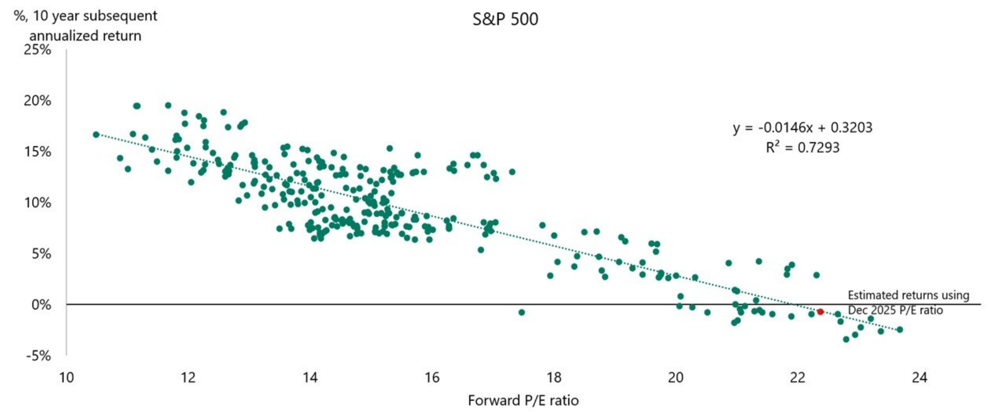
Financial confidence is currently more prevalent among listed companies than among indebted countries. Based on this same observation, some analysts believe that the financial strength of companies, particularly large US tech stocks, warrants higher valuation ratios than in the past.

Wall Street fears an AI bubble, while we believe in an AI boom with high, but appropriate, valuations, far lower than those seen in 2000. The market is concerned that massive investments in AI infrastructure would lead to overcapacity and that the return on investment would not materialize. Concerns also extend to OpenAI, a highly indebted company that plans to spend $1.4 trillion on AI infrastructure and semiconductors, but which, according to its business plan, does not expect to generate cash before 2030. The AI environment of cross-shareholdings and cross-orders worries investors, given that the bankruptcy or problems of one tech company can bring down the entire mosaic. According to its financial plan, OpenAI anticipates a cumulative loss of $115 billion by 2029 before generating profits. Currently, OpenAI has no problem raising funds, with Microsoft and Softbank, Thrive Capital (Peter Thiel), and the Abu Dhabi sovereign wealth fund as shareholders. The massive cash flow generated by the four hyperscalers (Microsoft, Alphabet, MetaTrader, and Amazon) allows us to remain calm, and we believe in a reasonable exuberance.

However, relatively high P/E ratios reduce long-term annualized returns over the next 10 years.

APOLLO

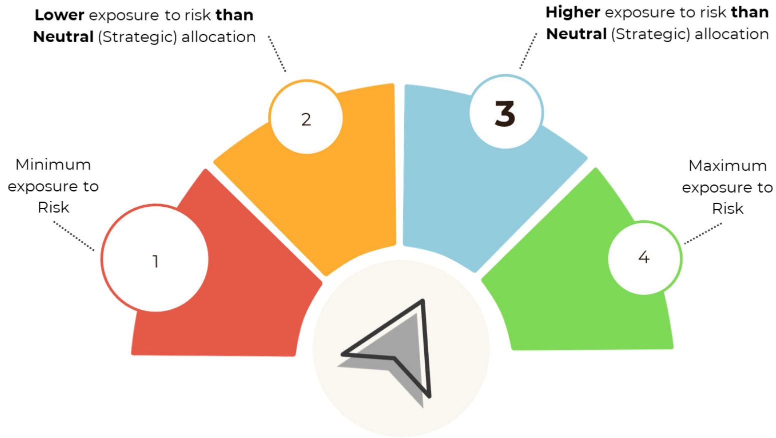
S&P 500 forward P/E ratio vs subsequent 10-year annualized returns



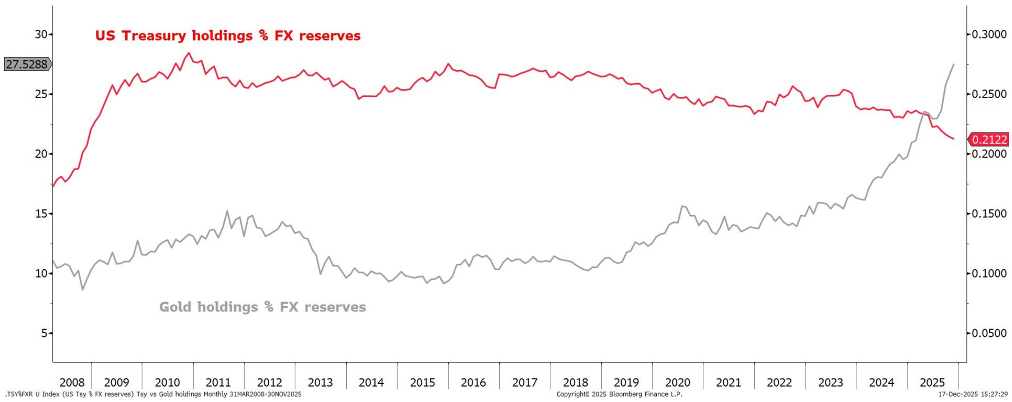
In conclusion, 2026 should be positive. We expect performance likely to be lower than that of the last three years, with increased volatility. Diversification and more tactical management of portfolios will be necessary to handle the anticipated larger drawdowns.

Alternative Investments

Favorable environment for precious and industrial metals. Oil prices under pressure. Crypto bug.



A highway is opening up for precious metals: de-dollarization, debt, and geopolitics. Central banks, particularly emerging market central banks, continue to buy gold at the expense of US Treasury bonds. This reflects the de-globalization and the strengthening of the Global South.



Rising debt interest payments are boosting the price of gold.

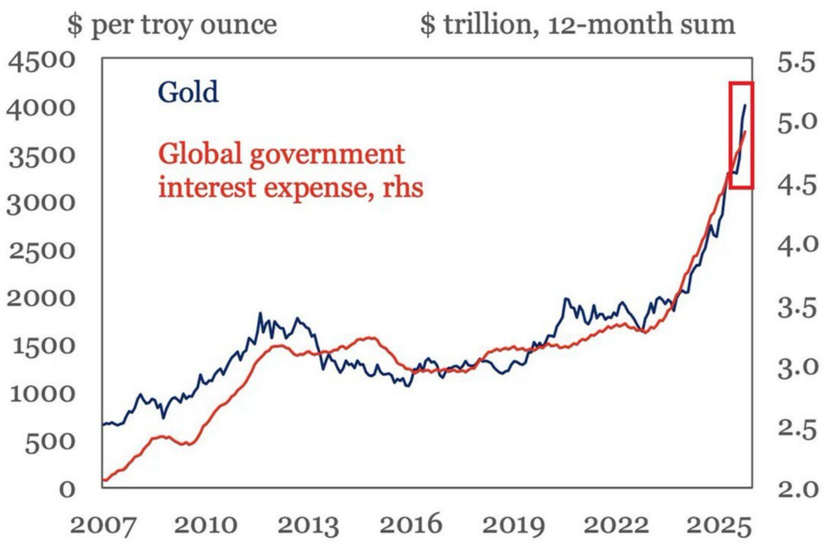
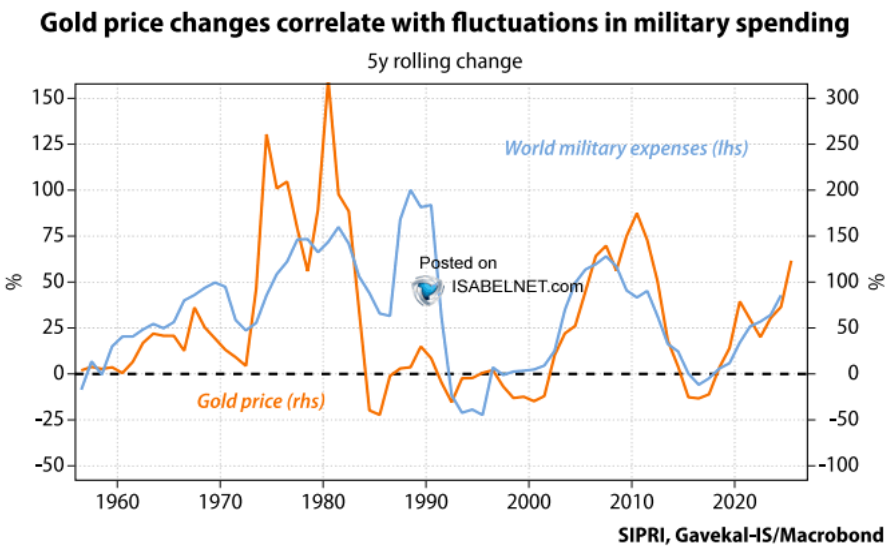


Chart.
Source Bloomberg, IIF

Growing geopolitical risks are driving global military spending, and the price of gold is following suit.



Over the past 10 years, the price of copper has nearly tripled, with three

Graph. Copper price

corrective phases. But since 2022, the increase has been more consistent. This trend will accelerate with rising demand from the energy transition, AI, the expansion of electrical grids, particularly in the United States, and defense. Part of the pressure on copper prices is linked to tariffs on refined copper imports. Since prices are higher in the United States, traders have an incentive to favor the US over the rest of the world. Outside the US, stocks are dwindling. Supply is suffering from problems in mines in Chile (accident), the Democratic Republic of Congo (flooding), and in Indonesia at Glasberg, the world's second-largest mine. Production shortfalls will increase in 2026.

Aluminum, a substitute for copper. Aluminum is also performing well, reaching three-year highs of nearly $2,900 per ton. Aluminum is considered a less expensive alternative to copper, whose prices have skyrocketed this year. This metal remains the main alternative to copper for electrical conductivity. Donald Trump's tariff policy also contributed to the rise in aluminum prices.

President Trump imposed tariffs of 25% on aluminum in February, then doubled them in June. China has reached its limits in terms of aluminum production capacity, while supply disruptions will increase pressure on supply.
Oil prices are falling due to increased OPEC production aimed at regaining market share. US production is at a record high of 13.85 million barrels per day.
Energy prices are little reacting to Donald Trump's military pressure on Venezuela. In 2025, Venezuela exported 750,000 barrels per day, half of which went to China.

Cryptocurrencies. Investors are asking themselves the right question: will cryptocurrencies make a comeback in 2026 after a difficult 2025? Since the beginning of summer, Bitcoin has not followed the Nasdaq, gold, or overall liquidity. This is unusual.

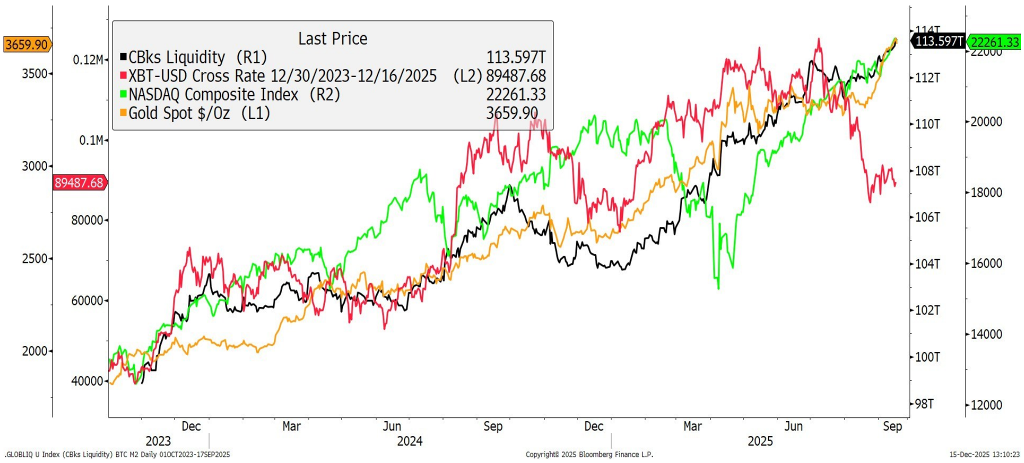


Chart. BTC (red line) with gold, Nasdaq and global M2.

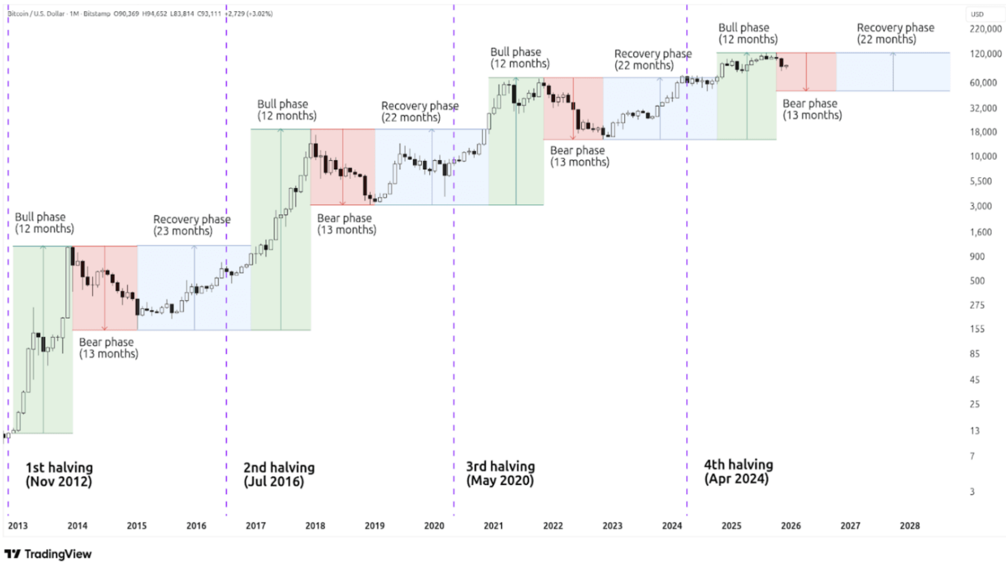
The arrival of crypto ETFs has created a disconnect between ETF investors and on-chain holders. The implications are significant. ETF flows reflect asset allocation decisions made by wealth managers in response to macroeconomic conditions, client redemptions, and portfolio adjustments. On-chain accumulation, on the other hand, reflects conviction-based positions taken by long-term investors.

When these dynamics diverge as sharply as they did in November, it often precedes an inflection point: either a continued decline if on-chain conviction weakens, or a rebound if ETF flows stabilize while supply remains constrained.
The "digital gold" narrative for Bitcoin deserves re-examination, given that gold appreciated by 65% in 2025 while BTC fell by 7%. Was the November 2025 crash an accident? It left its mark. Buy recommendations no longer hold true. A rally is quickly followed by a correction. The “Finfluencers” keep repeating that Bitcoin is a hedge against a falling dollar and that central banks will buy it. The reality is quite different: the BIS, the IMF, and major central banks constantly state that cryptocurrencies are speculative, volatile instruments and have no place in their reserves.

Traders are talking about a “crypto winter” and are seeing investor fatigue.

The explanation for using cryptocurrencies as a hedge - inflation, deficits, dollar depreciation - seemed reasonable until investors realize that the correlations aren't stable enough when they need them most. The November crash occurred against a backdrop of general risk aversion and funding strains - precisely when "protection" should be helpful. Instead, Bitcoin behaved like a high-risk asset. Even pro-cryptocurrency commentators acknowledged that this decline reflected investors' aversion to risk and a short-term capitulation.
Bitcoin is the most leveraged asset, so when volatility increases and liquidity decreases, BTC corrects more sharply. There's also the fear that the four-year cycle is over. In 2025, we were supposed to see a strong rise in BTC, followed by a bear market in 2026. Some investors are therefore worried about the continuation of the BTC bear market in 2026.

Chart. The 4-year BTC cycle



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