Investment Outlook

Q4 2025

ARE WE IN AN AI BUBBLE?

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Financial markets have once again demonstrated remarkable resilience. In the third quarter, both equities and credits posted solid gains, with leadership coming from large-cap technology stocks and the ongoing enthusiasm around artificial intelligence. The so-called "Magnificent Seven" continued to dominate market performance, driven by lofty expectations for the transformative potential of AI.

This strength is all the more notable given the increasingly fragile macro backdrop. Investors have largely shrugged off a range of risks — from rising US inflation and signs of economic slowdown to escalating trade tensions and renewed geopolitical conflicts. Even the recent US government "shutdown" failed to rattle market sentiment in any meaningful way.

At the same time, the sharp depreciation of the USD and the strong rally in safe-haven assets such as gold — up more than 50% year-to-date — send a more cautious signal. These developments suggest that we are far from a "Goldilocks" scenario. Instead, certain segments of the market appear to be pricing in growing uncertainty and concerns about long-term fundamentals.

While the AI boom continues to capture investors' imagination, we see increasing signs of complacency. Equity valuations, particularly in the US technology sector, have reached historically elevated levels. Credit spreads remain tight, and implied volatility is near multi-year lows. In our view, this combination reflects excessive optimism rather than a balanced assessment of risk.

We therefore continue to see an elevated risk of an equity-market correction. Contributing factors include high valuations, a slowing global economy, and heightened political and fiscal uncertainty in the US and Europe.

Against this backdrop, we are maintaining our cautious and defensive portfolio positioning.

We remain underweight equities, high-yield bonds, and commodities, while keeping an overweight in nominal government bonds, which should continue to benefit from declining policy rates. Within equities, we have further reduced exposure to the highly concentrated US tech sector by reallocating part of our holdings into an equal-weighted S&P 500 ETF.

While AI may well represent a genuine technological revolution, history reminds us that transformational themes often attract speculative excess before the fundamental value fully materializes. The challenge for investors today is to distinguish between structural opportunity and cyclical exuberance.

Financial markets

Equity markets saw strong gains in the third quarter. The S&P 500 Index advanced 11.6%, reaching new record highs. The MSCI China Index surged 19%, while Japan's Nikkei 225 gained 11%. In contrast, Germany's DAX Index ended the quarter largely unchanged.

Commodities presented a mixed picture. Growth-sensitive sectors such as energy and industrial metals declined slightly, whereas precious metals remained in high demand. Gold rose 16.8% in Q3 and is currently trading around USD 4,200 per ounce — more than 50% higher year-to-date. This exceptional performance was driven by geopolitical uncertainty and sustained demand from central banks diversifying their currency reserves. The USD, meanwhile, stabilized during the quarter and even appreciated modestly.

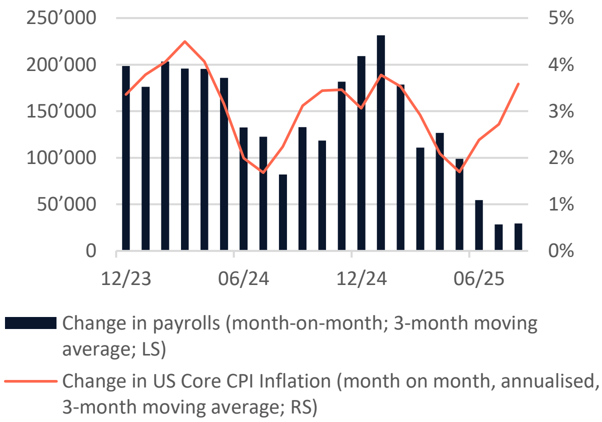
Global nominal government bond and inflation-linked bond indices were broadly flat in Q3. European 10-year government bond yields rose slightly by 10 basis points, while US 10-year Treasury yields declined by 8 basis points. Break-even inflation rates were stable in Europe but increased in the US by 9 basis points.

Some stress emerged in the US credit market due to company-specific disruptions. First Brand, an auto-parts supplier, filed for bankruptcy following severe liquidity shortages after accumulating excessive debt through private loans, factoring, and bonds. Similarly, Tricolore, a Texas-based used-car dealer and subprime lender, went bankrupt after its highly leveraged business model collapsed amid mounting losses in one of its key customer segments — undocumented workers. The company's management is also facing fraud allegations.

The key question is whether these two cases are merely isolated incidents or the canary in the coal mine, signaling a broader credit market deterioration. Either way, they cast a shadow over the outlook for the coming quarters.

Macroeconomics

The US labor market weakened noticeably in the third quarter. In August, only 22,000 new jobs were created — a very disappointing figure compared with previous months. At the same time, core inflation (excluding energy and food) rose from 2.6% in April to 2.9% in September. Due to the US government shutdown, the most recent economic data are currently unavailable. The chart below illustrates how, since President Trump's "Liberation Day" tariff announcement in April, labor-market momentum has deteriorated, while core inflation has continued its steady upward trend.



Central Banks

Central banks continue to navigate an increasingly complex economic landscape. Tariff measures are inherently stagflationary, as they tend to push inflation higher while dampening economic growth.

On 17 September, the US Federal Reserve cut its benchmark rate by 0.25 percentage points, to a target range of 4.00–4.25%. This was the first rate reduction since December 2023, marking a shift toward an easing cycle. The Fed signaled that further cuts may follow later this year, citing softening labor-market data and signs of slowing economic momentum.

The European Central Bank (ECB) kept interest rates unchanged in the third quarter. Inflationary pressures in the euro area have eased noticeably, although the September inflation rate of 2.2% remained slightly above the ECB's 2% target. Meanwhile, the growth outlook for Europe has deteriorated further. The ECB is therefore expected to maintain its current policy stance at least until the end of the year.

The Bank of Japan (BoJ) also left its short-term policy rate at 0.50% following its landmark hike earlier this year — the first in 17 years. Despite elevated inflation driven by wage increases and tariff effects, the BoJ refrained from additional tightening, pointing to weak GDP growth and falling real wages. However, internal debate continues within the BoJ regarding the need for further rate hikes to contain persistent inflationary pressures.

The Swiss National Bank (SNB) likewise opted for stability, keeping its policy rate at 0% during its September meeting. With inflation largely under control and global growth momentum fading, the SNB judged its current stance appropriate, emphasizing the importance of policy continuity amid ongoing geopolitical and trade uncertainties.

AI: Between Innovation and Exuberance

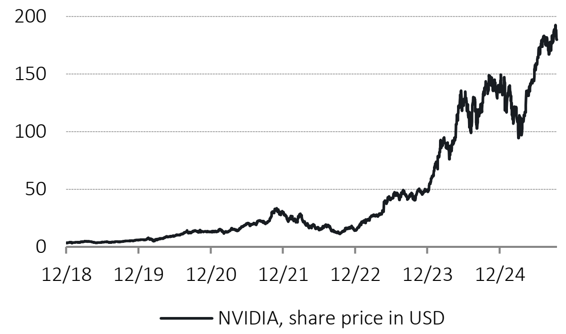
There are certainly bubble-like characteristics emerging in parts of the artificial intelligence (AI) ecosystem. Equity valuations for leading AI beneficiaries — notably in the semiconductor and hyperscaler segments — are stretched by historical standards. A small group of mega-cap stocks, including NVIDIA, Microsoft, Amazon, Alphabet, and Meta, have driven a disproportionate share of global equity-market gains. As illustrated in the chart below, NVIDIA's extraordinary share-price performance exemplifies the scale of investor enthusiasm surrounding AI. Valuations in the AI hardware and infrastructure space now imply sustained, exponential growth — an assumption that leaves little room for disappointment.

Unlike during the dot-com bubble of the late 1990s, today's AI leaders already generate substantial revenues, robust free cash flow, and enjoy defensible competitive advantages. The AI rollout is beginning to deliver measurable productivity gains and cost savings, particularly in cloud computing, software development, and digital content creation. However, monetization at scale especially for start-ups and smaller listed firms remains uncertain.

Venture capital inflows into AI have surged, while many non-AI sectors struggle to attract funding. Corporate spending on AI infrastructure — from chips to data centers — has reached unprecedented levels and could overshoot in the near term. Strong media attention and investor enthusiasm suggest that the AI market may have reached the peak-excitement phase.

History shows that every major technological revolution — from railways in the 19th century to electricity, the automobile, and the internet — began with an investment boom that produced a period of extraordinary returns, followed by sharp market corrections as exuberance met reality. AI may well follow a similar trajectory: its long-term structural potential is undeniable, but the path will not be linear.

While parts of the AI market clearly exhibit speculative dynamics, the underlying transformation is real and far-reaching. In our view, this represents an investment boom rather than a pure bubble. Nevertheless, with valuations already stretched and expectations extremely high, the risk of disappointment is significant. A period of correction or consolidation in the near to medium term would not be surprising — and might ultimately be healthy, paving the way for more sustainable long-term growth once speculation subsides.



Outlook

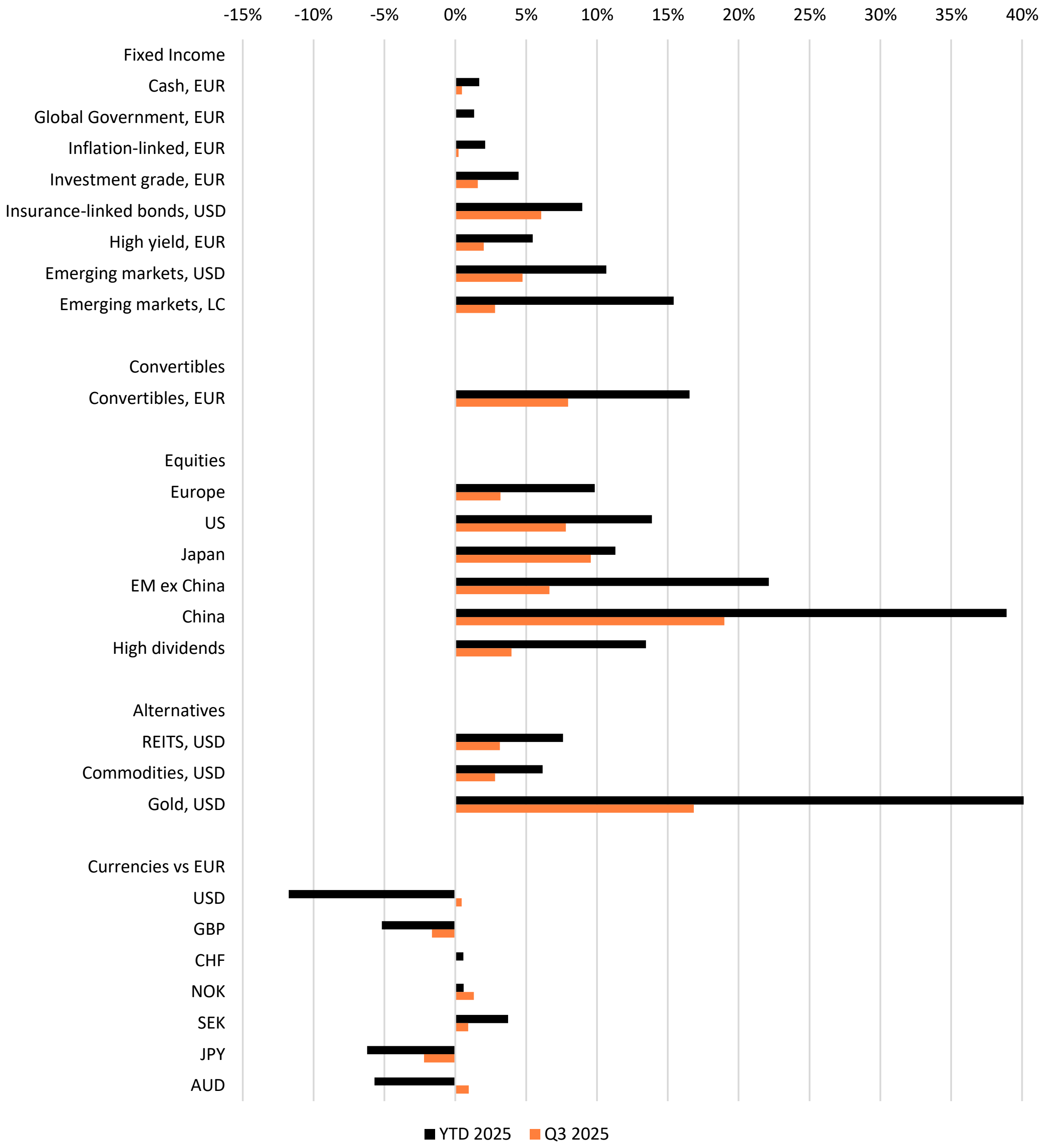
The effects of US tariff policy are only partially visible so far, as they typically unfold with a lag of several months. Additional inflationary pressures are therefore likely in the quarters ahead, while US growth is expected to slow further. Balancing inflation and growth risks, it seems probable that the Fed will continue with moderate rate cuts.

At the same time, US courts are reviewing whether the new tariffs were legally introduced. If deemed unlawful, the critical question will be whether the Trump administration complies with court rulings—or whether, in an extreme scenario, a constitutional crisis could emerge. While removing tariffs would support growth and ease inflation, it would also significantly reduce government revenues. This could further worsen already strained public finances, pushing both the budget deficit and debt levels higher.

Currently, the US economy is heavily driven by massive investments in artificial intelligence (“AI”) and related infrastructure such as data centers and energy supply. Recent developments, however, have raised concerns about a potential bubble. The ongoing AI boom shows striking similarities to the dot-com bubble: valuations of large AI companies such as NVIDIA, with P/E ratios above 40, are at levels comparable to tech stocks in 1999/2000. This surge is fueled by enormous profit expectations and heavy capital inflows, even though many business models have yet to generate sustainable earnings. Whether this represents speculative excess will depend on how quickly companies can translate their high investments into real profits.

ASSET ALLOCATION

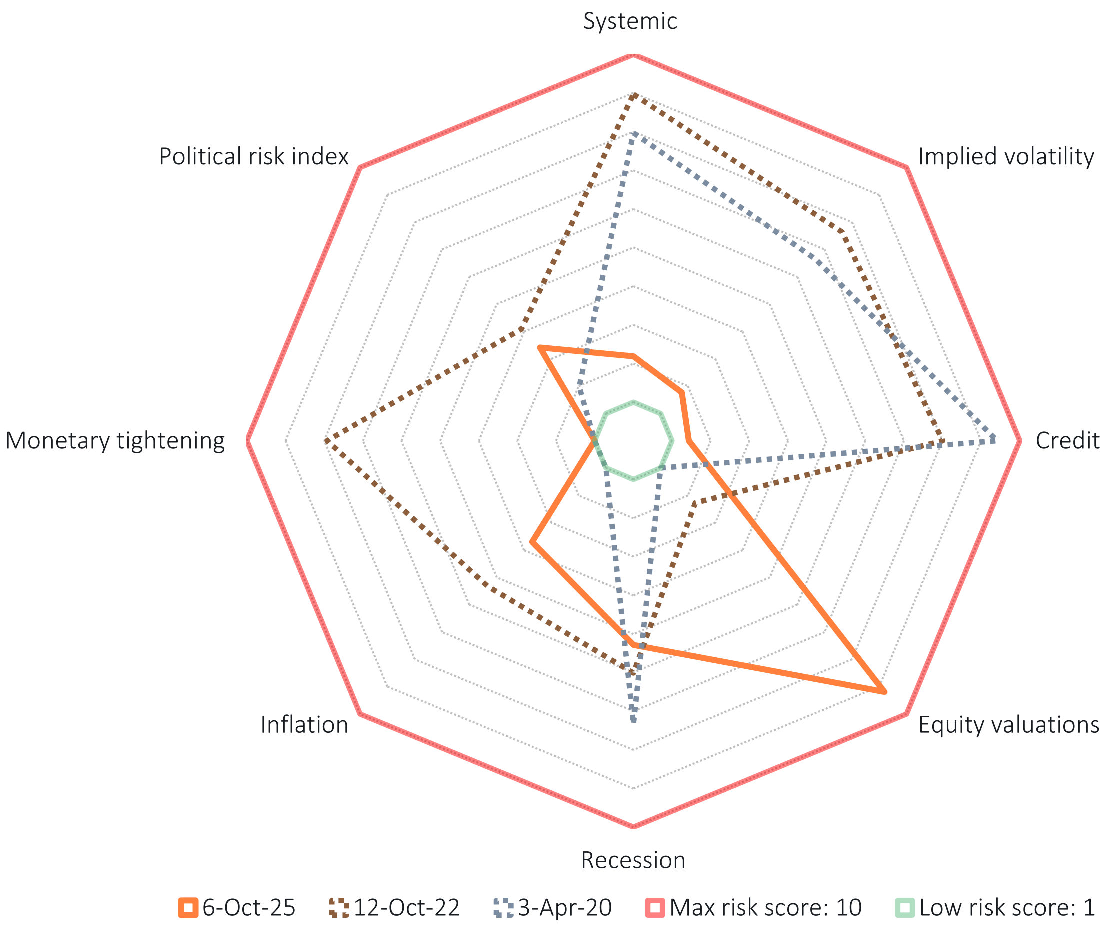
This year, we have witnessed a broad-based rally across nearly all asset classes, a trend that was particularly pronounced in the third quarter. Risky assets performed strongly despite persistent uncertainties and already elevated valuations. Interestingly, safe-haven assets also gained ground, with gold prices rising by around 40% year-to-date (as of end-September) and government bonds benefiting from central bank rate cuts. The most notable laggard has been the US dollar, which depreciated by roughly 12% this year — likely reflecting policy uncertainties and growing concerns about the credibility of the US administration. It is, however, worth noting that the USD has long been and remains overvalued based on purchasing power parity estimates.



RISK MONITOR

According to our risk monitor, risks are currently skewed toward elevated equity market vulnerabilities, primarily due to high valuations. Inflation and recession risks also remain somewhat elevated. Meanwhile, very tight credit spreads and low implied volatility — reflecting subdued demand for equity hedging — could, in our view, be interpreted as a sign of market complacency.

3-Apr-2020: Global pandemic
12-Oct-2022: Inflation shock



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