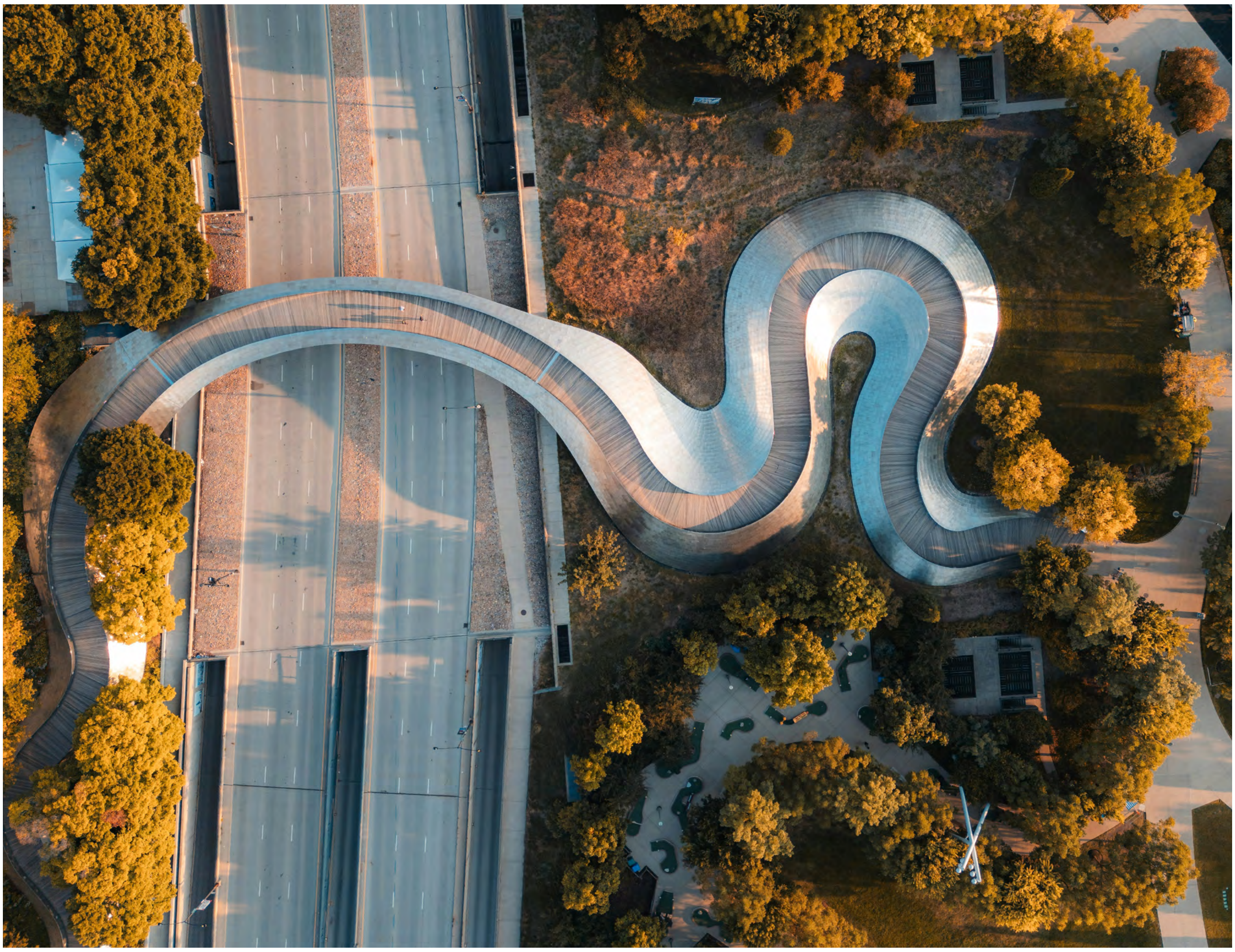
PICTET 1805

Horizon

2025

Turning inward



AUTHORS

Pictet Wealth Management
CIO Office and Macro Research
César Pérez Ruiz, Alexandre Tavazzi

Djâafar Aballeche, Dong Chen,
Xiao Cui, Frederik Ducrozet,
Milène Dumont, Jean-Pierre Durante,
Nadia Gharbi, Sebastien Gorgoni,
Michael Hart, Zhennan Li, Andrew
Macpherson, Alessandro Nilo,
Lauréline Renaud-Chatelain,
Graham Secker and Carlos Ungil

EDITORS

PWM Investment Marketing
& Communication
Paul Carrel and Laura Kolly

DESIGN

Forth Studio

PHOTOGRAPHY

Unsplash/Willian Justen de Vasconcellos,
Brendan Beale, Janke Laskowski,
Job Savelsberg, Adrien Dascal and
Ankhurr Chawaak

Cover page image
Designed by Frank Gehry, this serpentine footbridge links Millennium Park with Maggie Daley Park in Chicago. Clad in stainless steel and completed in 2004, it doubles as both a pedestrian walkway and a noise barrier over Columbus Drive. Its flowing curves mirror Gehry's sculptural architectural style.

Contents

Pictet Wealth Management's return expectations for the next 10 years

10 year annualised nominal returns

Expected return by currency using modified purchasing power parity (%)

	Local	CHF	CHF HEDGED	EUR	EUR HEDGED	USD	USD HEDGED	GBP	GBP HEDGED	CNY	CNY HEDGED
CASH											
Cash USD	3.2	1.7		1.5		3.2		2.8		3.2	
Cash EUR	1.9	2.1		1.9		3.6		3.2		3.6	
Cash CHF	0.4	0.4		0.2		1.9		1.5		1.9	
Cash GBP	3.3	2.1		2.0		3.7		3.3		3.7	
Cash JPY	1.0	1.6		1.4		3.1		2.7		3.1	
Cash CNY	1.7	0.2		0.0		1.7		1.3		1.7	
GOVERNMENT BONDS											
Global sovereign 1-10	3.3	2.5	1.3	2.3	2.8	4.0	4.1	3.6	4.2	4.0	2.6
US bonds 1-10	4.4	2.9	1.6	2.7	3.1	4.4		4.0	4.5	4.4	2.9
Euro bonds 1-10	3.1	3.2	1.5	3.1		4.8	4.4	4.4	4.4	4.7	2.8
UK bonds 1-10	4.4	3.2	1.4	3.1	3.0	4.8	4.3	4.4		4.8	2.8
Global sovereign all maturities	3.7	2.9	1.8	2.8	3.3	4.5	4.6	4.1	4.7	4.5	3.1
10-year US treasuries	4.8	3.2	1.9	3.1	3.5	4.8		4.4	4.9	4.8	3.3
10-year Euro bonds	3.7	3.9	2.2	3.7		5.5	5.1	5.1	5.1	5.4	3.5
10-year German bunds	3.4	3.5	1.8	3.4		5.1	4.7	4.7	4.7	5.1	3.1
10-year Swiss bonds	0.9	0.9		0.7	2.4	2.4	3.7	2.0	3.8	2.4	2.2
10-year UK bonds	5.2	4.0	2.2	3.8	3.8	5.6	5.1	5.2		5.6	3.5
10-year Japan bonds	1.9	2.5	1.3	2.4	2.9	4.1	4.2	3.7	4.2	4.1	2.6
10-year China bonds	2.2	0.6	0.8	0.5	2.4	2.2	3.7	1.8	3.7	2.2	
EM debt (hard currency)	6.6	5.0	3.7	4.9	5.3	6.6		6.2	6.7	6.6	5.1
EM debt (local currency)	6.4	5.8		5.6		7.4		7.0		7.4	
AGGREGATE BONDS											
Global aggregate	4.2	3.3	2.0	3.2	3.6	4.9	4.9	4.5	5.0	4.8	3.4
US aggregate	5.3	3.7	2.4	3.6	4.0	5.3		4.9	5.4	5.3	3.7
Euro aggregate	3.7	3.9	2.2	3.7		5.5	5.1	5.1	5.1	5.5	3.5
Swiss bonds	1.2	1.2		1.1	2.8	2.8	4.1	2.4	4.2	2.7	2.6
CORPORATE BONDS											
Global investment grade	5.3	4.1	2.7	4.0	4.3	5.7	5.6	5.3	5.7	5.7	4.1
US investment grade	5.8	4.2	2.9	4.0	4.4	5.8		5.4	5.9	5.8	4.2
Euro investment grade	3.8	3.9	2.2	3.8		5.5	5.1	5.1	5.2	5.5	3.6
Asia investment grade	5.6	4.1	2.7	3.9	4.3	5.6		5.2	5.7	5.6	4.1
Corporate EM debt	6.5	5.0	3.6	4.8	5.2	6.5		6.1	6.6	6.5	5.0
Global high yield	6.1	4.9	3.5	4.7	5.0	6.4	6.4	6.0	6.4	6.4	4.8
US high yield	6.5	4.9	3.5	4.7	5.1	6.5		6.0	6.5	6.4	4.9
Euro high yield	4.7	4.8	3.1	4.7		6.4	6.0	6.0	6.1	6.4	4.5
Asia high yield	7.6	6.0	4.6	5.8	6.2	7.6		7.2	7.6	7.5	6.0
EQUITIES											
Equity all countries	7.2	5.9		5.8		7.5		7.1		7.5	
Equity world	7.1	5.9		5.8		7.5		7.1		7.5	
Equity world ex-US	7.0	7.0		6.8		8.6		8.2		8.6	
Equity US	7.1	5.5		5.4		7.1		6.7		7.1	
Nasdaq	9.3	7.7		7.5		9.3		8.9		9.3	
Equity Europe	7.2	7.0		6.8		8.6		8.2		8.6	
Equity euro	7.5	7.7		7.5		9.3		8.9		9.3	
Equity Switzerland	6.8	6.8		6.6		8.4		8.0		8.4	
Equity UK	6.4	5.2		5.1		6.8		6.4		6.8	
Equity Japan	6.1	6.7		6.6		8.3		7.9		8.3	
Equity Asia ex-Japan	7.2	5.6		5.5		7.2		6.8		7.2	
Equity China	7.1	5.5		5.4		7.1		6.7		7.1	
Equity emerging markets	7.0	5.4		5.3		7.0		6.6		7.0	
Equity world small caps	7.4	6.2		6.0		7.8		7.4		7.8	
Equity US small caps	7.3	5.7		5.6		7.3		6.9		7.3	
Equity Europe small caps	7.5	7.7		7.5		9.3		8.9		9.3	
GOLD AND ALTERNATIVES											
Gold	3.8	2.3		2.1		3.8		3.4		3.8	
Hedge funds	5.5	3.9	2.6	3.8	4.2	5.5		5.1	5.6	5.5	4.0
Hedge funds conservative	5.2	3.6	2.3	3.5	3.9	5.2		4.8	5.3	5.2	3.7
Private debt	7.8	6.6	5.1	6.4	6.7	8.2	8.1	7.8	8.2	8.2	6.5
US private debt	8.1	6.5	5.1	6.3	6.7	8.1		7.7	8.2	8.1	6.5
Euro private debt	6.8	6.9	5.2	6.8		8.6	8.2	8.1	8.2	8.5	6.6
Private equity real estate	6.8	5.2		5.1		6.8		6.4		6.8	
Real estate	6.6	5.0		4.9		6.6		6.2		6.6	
Swiss real estate	4.8	4.8		4.6		6.4		6.0		6.4	
European value add real estate	7.8	8.0		7.8		9.6		9.2		9.6	
Infrastructure	6.9	5.3		5.2		6.9		6.5		6.9	
Private equity	9.8	8.6		8.5		10.2		9.8		10.2	
Venture capital	8.8	7.2		7.0		8.8		8.4		8.8	

Note: Inflation: 1.0% for CHF, 2.0% for EUR, 2.5% for USD, 2.7% for GBP, 1.6% CNY
Source: Pictet Wealth Management, as of 15.08.2025 Note: for illustrative purposes only. Expectations are indicative as of 15.08.2025 and may change depending on market conditions. Expected returns are an estimate of future performance based on evidence from the past on how the value of asset classes varies, and/or current market conditions and are not an exact indicator. They do not in any way constitute a promise of future returns and there can be no assurance that these targets will be achieved. Returns may increase or decrease as a result of currency fluctuations. Private assets are only suited for large or professional investors with: (i) a long-term investment horizon (>10 yrs); (ii) no liquidity requirements; and (iii) an understanding of the risks linked to this asset class.

10 year annualised real returns

Expected return by currency using modified purchasing power parity (%)

	Local	CHF	CHF HEDGED	EUR	EUR HEDGED	USD	USD HEDGED	GBP	GBP HEDGED	CNY	CNY HEDGED
CASH											
Cash USD	0.6	0.6		-0.5		0.6		0.0		1.5	
Cash EUR	-0.1	1.0		-0.1		1.0		0.4		1.9	
Cash CHF	-0.7	-0.7		-1.8		-0.7		-1.2		0.3	
Cash GBP	0.5	1.1		-0.1		1.1		0.5		2.0	
Cash JPY	-0.8	0.5		-0.6		0.5		0.0		1.5	
Cash CNY	0.1	-0.9		-2.0		-0.8		-1.4		0.1	
GOVERNMENT BONDS											
Global sovereign 1-10	1.1	1.4	0.2	0.3	0.8	1.4	1.5	0.8	1.4	2.4	1.0
US bonds 1-10	1.8	1.8	0.5	0.7	1.1	1.8		1.2	1.7	2.8	1.3
Euro bonds 1-10	1.0	2.1	0.4	1.0		2.1	1.8	1.6	1.6	3.1	1.2
UK bonds 1-10	1.6	2.1	0.4	1.0	0.9	2.2	1.7	1.6		3.1	1.1
Global sovereign all maturities	1.5	1.9	0.7	0.7	1.2	1.9	2.0	1.3	1.9	2.8	1.4
10-year US treasuries	2.2	2.2	0.9	1.0	1.4	2.2		1.6	2.0	3.1	1.6
10-year Euro bonds	1.7	2.8	1.1	1.7		2.8	2.4	2.2	2.3	3.8	1.9
10-year German bunds	1.3	2.4	0.7	1.3		2.4	2.1	1.8	1.9	3.4	1.5
10-year Swiss bonds	-0.2	-0.2		-1.3	0.3	-0.2	1.1	-0.8	1.0	0.7	0.5
10-year UK bonds	2.3	2.9	1.1	1.8	1.7	2.9	2.5	2.3		3.9	1.9
10-year Japan bonds	0.1	1.5	0.3	0.3	0.8	1.5	1.6	0.9	1.4	2.4	1.0
10-year China bonds	0.5	-0.4	-0.2	-1.5	0.3	-0.4	1.1	-1.0	1.0	0.5	
EM debt (hard currency)	4.0	3.9	2.6	2.8	3.2	4.0		3.4	3.8	4.9	3.4
EM debt (local currency)	6.4	4.7		3.5		4.7		4.1		5.7	
AGGREGATE BONDS											
Global aggregate	4.2	2.2	1.0	1.1	1.5	2.2	2.3	1.6	2.2	3.2	1.7
US aggregate	2.7	2.6	1.3	1.5	1.9	2.7		2.1	2.5	3.6	2.1
Euro aggregate	1.7	2.8	1.1	1.7		2.8	2.5	2.2	2.3	3.8	1.9
Swiss bonds	0.2	0.2		-0.9	0.7	0.2	1.5	-0.4	1.3	1.1	0.9
CORPORATE BONDS											
Global investment grade	2.8	3.0	1.6	1.9	2.2	3.1	3.0	2.5	2.8	4.0	2.4
US investment grade	3.1	3.1	1.8	2.0	2.4	3.1		2.5	3.0	4.1	2.6
Euro investment grade	1.7	2.8	1.1	1.7		2.9	2.5	2.3	2.3	3.8	1.9
Asia investment grade	3.0	3.0	1.7	1.8	2.2	3.0		2.4	2.8	3.9	2.4
Corporate EM debt	3.9	3.9	2.5	2.7	3.1	3.9		3.3	3.7	4.8	3.3
Global high yield	3.6	3.8	2.4	2.6	2.9	3.8	3.7	3.2	3.6	4.7	3.1
US high yield	3.8	3.8	2.5	2.6	3.0	3.8		3.2	3.7	4.7	3.2
Euro high yield	2.6	3.7	2.0	2.6		3.8	3.4	3.2	3.2	4.7	2.8
Asia high yield	4.9	4.8	3.5	3.7	4.1	4.9		4.3	4.7	5.8	4.3
EQUITIES											
Equity all countries	4.6	4.8		3.7		4.8		4.2		5.8	
Equity world	4.6	4.8		3.6		4.8		4.2		5.8	
Equity world ex-US	4.9	5.9		4.7		5.9		5.3		6.9	
Equity US	4.4	4.4		3.2		4.4		3.8		5.4	
Nasdaq	6.6	6.5		5.4		6.6		6.0		7.5	
Equity Europe	5.0	5.9		4.7		5.9		5.3		6.9	
Equity euro	5.4	6.5		5.4		6.6		5.9		7.5	
Equity Switzerland	5.7	5.7		4.5		5.7		5.1		6.7	
Equity UK	3.5	4.1		3.0		4.1		3.5		5.1	
Equity Japan	4.2	5.6		4.4		5.6		5.0		6.6	
Equity Asia ex-Japan	4.5	4.5		3.3		4.5		3.9		5.5	
Equity China	5.4	4.4		3.2		4.4		3.8		5.4	
Equity emerging markets	4.3	4.3		3.2		4.3		3.7		5.3	
Equity world small caps	4.8	5.1		3.9		5.1		4.5		6.0	
Equity US small caps	4.6	4.6		3.4		4.6		4.0		5.6	
Equity Europe small caps	5.4	6.5		5.4		6.6		5.9		7.5	
GOLD AND ALTERNATIVES											
Gold	1.2	1.2		0.1		1.2		0.6		2.1	
Hedge funds	2.9	2.8	1.5	1.7	2.1	2.9		2.3	2.7	3.8	2.3
Hedge funds conservative	2.6	2.6	1.2	1.4	1.8	2.6		2.0	2.4	3.5	2.0
Private debt	5.2	5.5	4.0	4.3	4.6	5.5	5.4	4.9	5.3	6.5	4.8
US private debt	5.4	5.4	4.0	4.2	4.6	5.4		4.8	5.3	6.4	4.8
Euro private debt	4.7	5.8	4.1	4.7		5.8	5.5	5.2	5.3	6.8	4.9
Private equity real estate	4.1	4.1		3.0		4.1		3.5		5.1	
Real estate	3.9	3.9		2.8		3.9		3.3		4.9	
Swiss real estate	3.7	3.7		2.6		3.7		3.1		4.7	
European value add real estate	5.6	6.8		5.6		6.9		6.2		7.8	
Infrastructure	4.2	4.2		3.1		4.2		3.6		5.2	
Private equity	7.1	7.5		6.3		7.5		6.9		8.5	
Venture capital	6.1	6.1		4.9		6.1		5.5		7.1	

Note: Inflation: 1.0% for CHF, 2.0% for EUR, 2.5% for USD, 2.7% for GBP, 1.6% CNY
Source: Pictet Wealth Management, as of 15.08.2025 Note: for illustrative purposes only. Expectations are indicative as of 15.08.2025 and may change depending on market conditions. Expected returns are an estimate of future performance based on evidence from the past on how the value of asset classes varies, and/or current market conditions and are not an exact indicator. They do not in any way constitute a promise of future returns and there can be no assurance that these targets will be achieved. Returns may increase or decrease as a result of currency fluctuations. Private assets are only suited for large or professional investors with: (i) a long-term investment horizon (>10 yrs); (ii) no liquidity requirements; and (iii) an understanding of the risks linked to this asset class.

The I-95 / I-695 interchange is a key junction within the Baltimore Beltway, which is a 51.46-mile ring road encircling the city. Completed in 2019, the renovation of the interchange included widening the outer loop and rehabilitating 12 bridges, improving safety and traffic fluidity.

“The guardrails of multilateralism are falling away.”

Turning inward

Dear reader,

The world as we knew it is over. The political shift brought by the change of US administration this year is accelerating a structural shift in the global framework that was already beginning to take shape. For much of the last 50 years, the US acted as global policeman, consumer and stability anchor. This was the period of "Pax Americana", or "American Peace". It began unravelling with President Obama's "Pivot to Asia" and the 2021 US withdrawal from Afghanistan, and is now well and truly over.
In its place is a new era in which countries are turning inward.

RETRENCHMENT

Retrenchment, rather than collaboration, is the theme of the emerging world order. In this new, deal-orientated era, in which the guardrails of multilateralism are falling away, countries must assess their capacity to look after their national interests and – where they identify deficiencies – redress them by forming alliances, often with their neighbours. This is driving a structural shift towards greater regionalism and away from globalism in geopolitical alliances and, by extension, in economic relationships.
In this context, our 2025 *Horizon* publication revisits long-term economic and asset class forecasts and delves into some of the key topics we expect to drive markets over the coming years.

> "Retrenchment, rather than collaboration, is the theme of the emerging world order."

Under the old framework, the US delivered economic stability, security guarantees and superior returns in exchange for foreign capital. The compelling, low-risk returns that the US offered under this set-up attracted capital from the rest of the world, allowing the US to accumulate its twin current account and fiscal deficits. As a result, the US net international investment position is negative and represents USD 27 trillion, or 90 percent of its GDP. Now, faltering international trust in that arrangement, exacerbated by the US tariffs policy, is increasing the risk of capital repatriation from the US. Indeed, raising US tariffs with a view to addressing perceived trade imbalances implies a reversal of trade flows, which may in turn bring a reversal in capital flows.

At the same time, US ambivalence about its commitment to acting as a guarantor of peace and stability has implications for security policy. This is a big driver of change for NATO in

Europe, where countries are increasing the share of national output they spend on defence. The latest spending commitment by NATO leaders includes 3.5 percent of GDP dedicated to core military capabilities and 1.5 percent going to security-related infrastructure projects. This increased government spending will act as fiscal stimulus, helping to support Europe's revival.

The increased defence spending goes hand in hand with a new fiscal stance in Germany, Europe's largest economy. Aiming to hit the 3.5 percent of GDP defence spending goal before many other European countries, Germany is showing a new readiness to engage in fiscal stimulus – a potential "game changer" moment that could spill over across Europe, where lending growth and easing monetary policy are supporting a broader structural revival.

TECTONIC SHIFT

Taken together, the shift in US posture vis-à-vis the rest of the world and the European revival represent a shifting of the tectonic plates in the global economy and financial markets. This has already seen some foreign funds flow out of the US. The clearest manifestation of financial markets' concerns about the new US posture – both the threats to international cooperation and to checks and balances at home – is the weaker dollar. Long the world's ultimate safe haven and global reserve currency, investors are starting to question its status.

> "The shift in US posture vis-à-vis the rest of the world and the European revival represent a shifting of the tectonic plates in the global economy and financial markets."

The shifting international framework has investment implications. Europe's revival means global investors have more alternatives when considering their long-term currency, fixed income and equity asset allocations. Asset allocation decisions made for the coming 10 years are likely to be different to those made for the past decade.

Navigating the new era will require a careful, strategic approach, with an awareness of the risks. Investors face a volatile macroeconomic environment in the coming years amid uncertainty about the potential for trade friction to fuel inflation, and upward pressure on long-term interest rates from investors concerned about fiscal sustainability, with both the US and Europe projected to experience increasing debt levels. In the US, the passing of the One Big Beautiful Bill Act (OBBBA), which the Congressional Budget Office (CBO) estimates will add more than USD 3.3 trillion to the national debt by 2034, has added to concerns about the long-term sustainability of the US fiscal position.

In this context, the term premium – the extra return that investors expect for holding longer-term bonds compared to holding a series of shorter-term bonds over the same period – is likely to continue rising over the long term. At the same time, the long-held notion that risk-free interest rates are represented by US short-term Treasury Bills is a concept that should now be challenged.

TECHNOLOGY RACE

The tectonic shifts in the global economy extend to Asia too, where the US emphasis on unilateralism and an "America First" approach means countries such as Taiwan, Japan and South Korea must reconsider their geopolitical risk situation. A reduced US presence in Asia would create space for regional powers to assume greater responsibility in shaping the region's security architecture.

China has already expanded its influence through initiatives like the Belt and Road Initiative (BRI) and could play a more assertive role in the region, particularly with regard to the Taiwan Strait and the South China Sea. Japan and South Korea, long-standing US allies, may seek to diversify their strategic partnerships while enhancing their own defence capabilities.

"The adjustments in US engagement in Asia coincide with technological advancements in China that exacerbate the Chinese-US rivalry."

The adjustments in US engagement in Asia coincide with technological advancements in China that exacerbate the Chinese-US rivalry. China's innovations in Artificial Intelligence (AI) present countries with a stark choice that will define their technological independence, political alliances and economic future. They find themselves with the choice to align with US or Chinese technology, or else attempting the delicate dance of using both. It is a complex calculation with profound consequences, particularly for those countries in the "non-aligned" camp between East and West. This divide will extend beyond hardware to digital governance, data security and cyber norms, forcing countries to make difficult choices that could shape their economic futures.

The race for ascendancy in technology extends to electrification, which is being spurred on by global warming. Countries are progressing at different speeds in this domain – particularly when it comes to electric vehicles (EVs). Thanks to a highly proactive policy, China has established uncontested leadership in almost every segment of the energy transition value chain, including EVs. The West risks further losing out if it fails to implement the right industrial policies, leaving an unbridgeable technology gap with the Chinese.

The world's economies face this volatile economic outlook, laced with geopolitical rivalry, at a time when they are grappling with growing demographic challenges at home. Population decline and shifting migration patterns are combining to alter growth prospects, labour markets and inflation dynamics across regions. These pressures will reshape economies in the coming decades. Those that thrive will find new ways to grow with fewer workers, more retirees, and a rapidly changing global landscape.

In conclusion, we are convinced that understanding the risks and opportunities of this changing world order will be crucial for those involved in asset allocation and portfolio construction in the coming years. We believe the starting point of any investment journey should be to grasp the interconnection of the rapid changes in the geopolitical, financial and technological landscape that we are experiencing in the world post-Pax Americana.

CÉSAR PÉREZ RUIZ
Head of Investments & CIO
Pictet Wealth Management

ALEXANDRE TAVAZZI
Head of CIO Office
and Macro Research
Pictet Wealth Management

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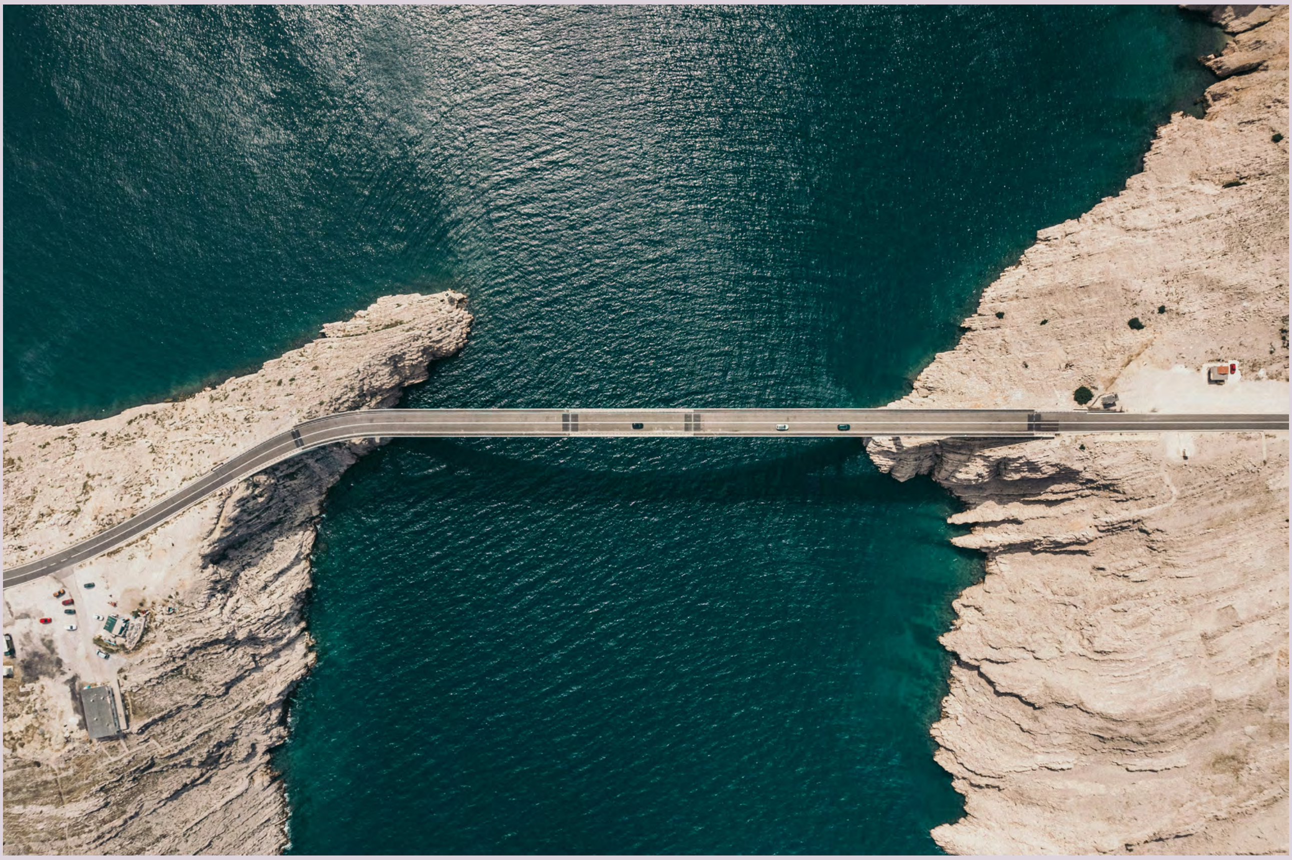
SECTION 1

Secular macro outlook



Opened in 1968, the Pag Bridge connects Croatia's mainland to the island of Pag and stretches 301 meters across the Adriatic. Its simplicity contrasts with the rugged limestone coastline and turquoise waters, making it both a vital transport link and a scenic landmark.

“The trade war raises the risk of new supply shocks, sluggish growth and elevated inflation, only a few years after the pandemic, while threatening global trade and multilateralism more broadly.”

Secular macro outlook

A new world order, from geopolitics to trade and finance
A mixed outlook across major economies

We forsee economic growth of

1.8%

in the US and

1.5%

in the euro area over the next decade.

For illustrative purposes only. There can be no assurance that these projections, forecasts or expected returns will be achieved.

The world is entering a new era in which the old rules governing diplomacy, security, trade, economics and finance are all being challenged. The trade war raises the risk of new supply shocks, sluggish growth and elevated inflation, only a few years after the pandemic, while threatening global trade and multilateralism more broadly. Large public deficits have continued to fuel record high debt overhangs globally. The US is planning to keep fiscal policy looser for longer, in the hope that the boost to growth from tax cuts and deregulation will be large enough to balance the books over the longer term. But the bond market has started to take notice.

The status of the dollar – the ultimate safe haven and global reserve currency – has started to be questioned by investors. The new US administration may be the catalyst for such changes, but some of the underlying forces arguably preceded this year's events. Macroeconomic volatility is expected to remain unusually high in the coming years.

Compared with last year, our secular outlook foresees slightly weaker economic growth in the US (1.8 percent on average over the next decade), stronger growth in the euro area (1.5 percent), and sticky but not out-of-control inflation (2.5 percent in the US and 2.0 in the euro area).

UNITED STATES

This year will mark a significant turning point in US real GDP growth as fractious geopolitics, trade policy disruptions, structurally higher inflation, a shrinking labour force and supply chain reconfigurations force a downward pivot to an average of 1.8 percent over the next decade. While this marks a sharp shift from last year's growth of 2.8 percent, it is in line with the Federal Reserve's (Fed) current estimate for long-term US growth potential.

We expect US inflation to re-accelerate in the second half (H2) of 2025 due to the pass-through effect of tariff increases, even though services and housing inflation should keep falling. We expect inflation to remain structurally higher at an annual average of around 2.5 percent in coming years, up from the pre-pandemic average (2010-2020) of 1.8 percent.

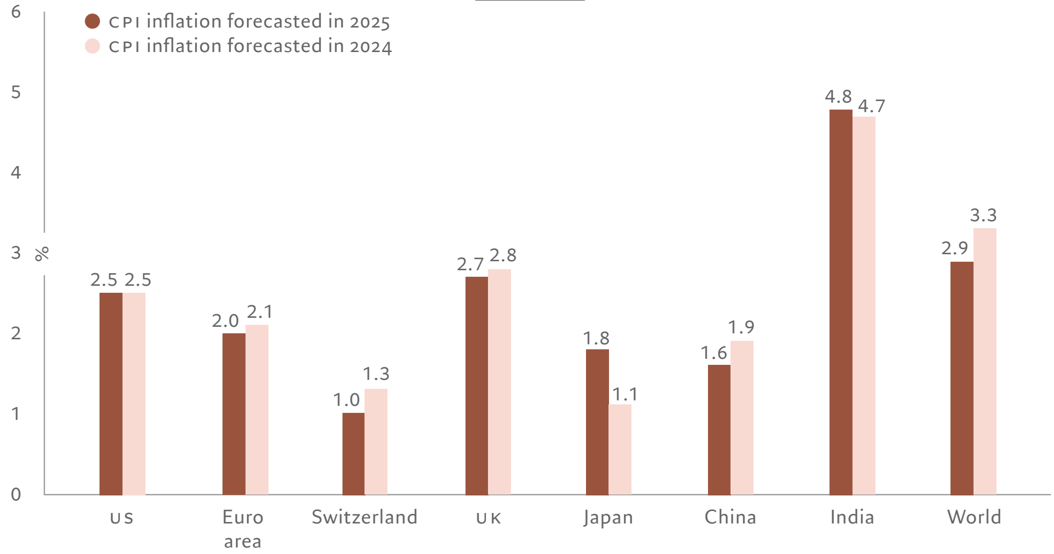
Supply shocks are likely, as a result of a reconfiguration of supply chains, geopolitics and labour shortages – as the effect of an already ageing population is exacerbated by a decline in immigration. Consumer inflation is unlikely to move below 2 percent on a sustained basis.

We expect the Fed funds rate to decline further over the coming quarters and converge toward 3 to 3.25 percent over the next decade, meaningfully above the 2 percent average in the past decade. Barring a deep recession, we are unlikely to return to the pre-pandemic environment of low interest rates and low interest-rate volatility. We also expect the Fed to continue to run down its balance sheet through quantitative tightening, but to eventually stop the process next year. There is great uncertainty regarding the appropriate level of "ample reserves", but we expect the Fed balance sheet to shrink to around 21 percent of GDP by the end of this year, down from a peak of 35 percent in 2021 but still much higher than the 2019 (pre-pandemic) level of 19 percent.

EUROPE

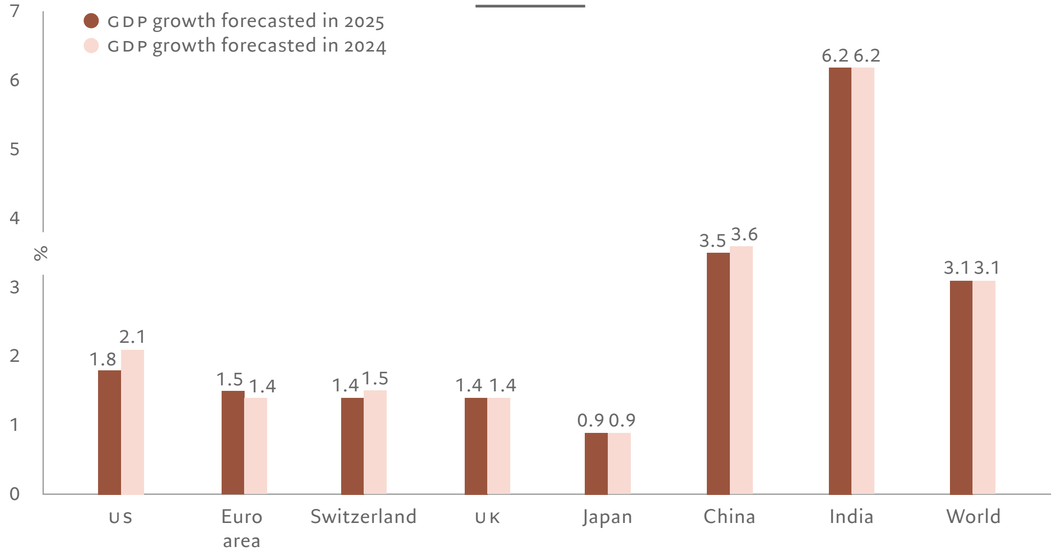
For Europe, a shift in US trade policy and rising geopolitical tensions have acted as positive catalysts, triggering a new fiscal consensus led by Germany. This points to an emerging era of European revival, driving our forecast of potential euro area growth averaging 1.5 percent over the next decade – higher than our previous estimate.

Our average annual inflation forecasts for the next 10 years



Source: Pictet Wealth Management, LSEG, as at 31.08.2025

Our average annual growth forecasts for the next 10 years



Source: Pictet Wealth Management, LSEG, as at 31.08.2025

For illustrative purposes only. There can be no assurance that these projections, forecasts or expected returns will be achieved.

In a significant departure from its traditionally conservative stance, Berlin has moved to address its economic challenges – after two years of contraction – by relaxing its self-imposed fiscal constraints inherent in the "debt brake". Its removal by Chancellor Friedrich Merz marks a turning point, opening up fiscal space through several key mechanisms: (i) Defence spending beyond 1 percent of GDP is now exempt from the constitutional debt brake; (ii) Germany will be allowed to borrow an additional EUR 500 billion over 12 years for infrastructure investment (which has already started with a plan for railways to receive about half of this year's funds); (iii) The 16 federal states can now run deficits of up to 0.35 percent of GDP rather than being required to balance their budgets – equivalent to around EUR 16 billion annually.

This package represents a paradigm shift for Germany and potentially for Europe. While not all EU countries are likely to pursue fiscal expansions of a similar scale, several have signalled their intentions to increase defence spending. Germany's stimulus could also support a modest improvement in productivity, with potential spillover benefits for the broader euro area. Moreover, higher research and design (R&D) spending and greater infrastructure investment could amplify the positive effects of defence spending across Europe.

We expect the narrative from 2026 onwards to shift from trade headwinds to tailwinds from fiscal spending and defence investment, in spite of short-term downside risks from potential US tariffs. This will help build the case for a European revival over the coming decade.

On inflation, the outlook has softened across several dimensions. A stronger euro, falling energy prices and likely trade diversion from Asia – particularly China – pose downside risks. We expect headline inflation to fall below the European Central Bank's (ECB) 2 percent target next year, before gradually returning to that level and averaging 2 percent over the next decade. As this unfolds, the European Central Bank (ECB)'s focus may shift from rate cuts back to potential hikes, with a terminal policy rate likely settling around 2 percent by 2035.

> "For Europe, a shift in US trade policy and rising geopolitical tensions have acted as positive catalysts, triggering a new fiscal consensus led by Germany."

UK

Since the Brexit decision, the United Kingdom (UK) has had to weather a series of structural shifts, from its trade relations to its parliamentary sovereignty, which have reshaped the economy. We forecast growth to average 1.4 percent over the next decade from an expanding public sector, which could, however, crowd-out the private sector. Fiscal risks are also likely to persist for some time, as financial repression may fade and productivity remains weak. But the country is expected to begin benefiting from industry deregulation, enhanced trade relations, and new capital investments following the change in government.

We expect inflation to average 2.7 percent by 2035, which would be structurally higher than the historical trend due to weaker productivity and post-Brexit demographic shifts, but represents an easing relative to current levels, driven by a loosening of the labour market. Ultimately, we expect the Bank of England to reduce its policy rate to 3.25 percent by 2026 and maintain it around this level until 2034, indicating further rate cuts relative to current levels but a terminal rate higher than pre-Covid levels.

CHINA

For China, maintaining decent growth in the coming years is very important for the government to achieve its long-term development goal (e.g. doubling income by 2035) and to avoid the "middle income trap". Still, we forecast gross domestic product (GDP) growth to trend down, ultimately driven by government policy.

Facing an increasingly challenging external and domestic environment, the Chinese government has already been shifting its policy priorities in recent years and a further worsening in the trade environment only strengthens the necessity and importance of this shift.

The Chinese government's "dual circulation" policy is the latest strategy capturing the long-term development landscape policymakers want to achieve in the coming years, which means demand and supply will be more domestically driven ("internal circulation"). From a supply perspective, this means boosting total factor productivity (TFP) growth.

One major effort is to promote technological innovation and upgrade manufacturing. The Chinese government has ramped up support in high-end manufacturing and is promoting development in the digital economy, such as in AI. We expect the share of technology to contribute up to 40 percent of Chinese GDP with further room to rise. We believe these efforts will continue in the coming years, which should help boost TFP growth.

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We expect the contribution from labour could moderate further due to a decline in the working age population. A sharp correction in the housing investment and a shift to a lower growth equilibrium in the coming years could drag on capital contribution. It is also worth monitoring potential downside risks around private firms' investment appetite if inflation stays subdued for an extended period.

JAPAN

We do not see a strong case for upgrading Japan's long-term real growth rate (0.9 percent). We expect labour to continue to be a drag on long-term growth, with the participation ratio of women and seniors peaking. We expect some structural demand to support private capital expenditure (capex), such as capex-related labour saving, and digitisation, which could be positive for capital contribution. But a rise in geopolitical tensions and shift in US foreign policy could pressure the Japanese government to increase military spending (aiming for 2 percent of GDP in 2027 from around 1.6 percent currently and possibly moving higher). This could be negative for long-term growth in Japan, given the government's strong commitment to fiscal consolidation with around 200 percent of public debt to GDP, as this could mean higher taxes, and/or cuts in other spending.

We anticipate a turning point, from a prices perspective, for the Japanese economy following decades of deflation and low inflation. This reflects a virtuous cycle between wages and inflation gradually taking shape, which is increasingly likely to sustain consumer price inflation (CPI) at around the 2 percent target. We expect this could lead the Bank of Japan (BOJ) to further normalise monetary policy.

INDIA

The Indian government aims for the country to achieve "developed economy" status by 2047, which requires average annual GDP growth of 8 percent in the coming decades. While 8 percent will be challenging, we believe India is likely to achieve around 6 percent growth, on average, in the coming years.

We expect India's investment-to-GDP ratio to trend up. This ratio, which had declined significantly since 2008, has picked up in recent years on the back of strong government spending. The share of government capital expenditure in GDP rose from 1.7 percent to 3.4 percent in the past five years, and we expect public investment growth to be maintained at higher levels in coming years. India could also benefit from more foreign direct investment (FDI) due to diversification of supply chains by foreign firms to mitigate risks – such as tariffs for China or geopolitics. To be sure, structural reforms aimed at improving the Indian business environment and easing sectoral access are needed to facilitate this. We expect a lasting reversal in India's long-standing decline in female participation in the labour force to help long-term growth.

US fiscal situation: hardly sustainable
Beware a return of the bond vigilantes

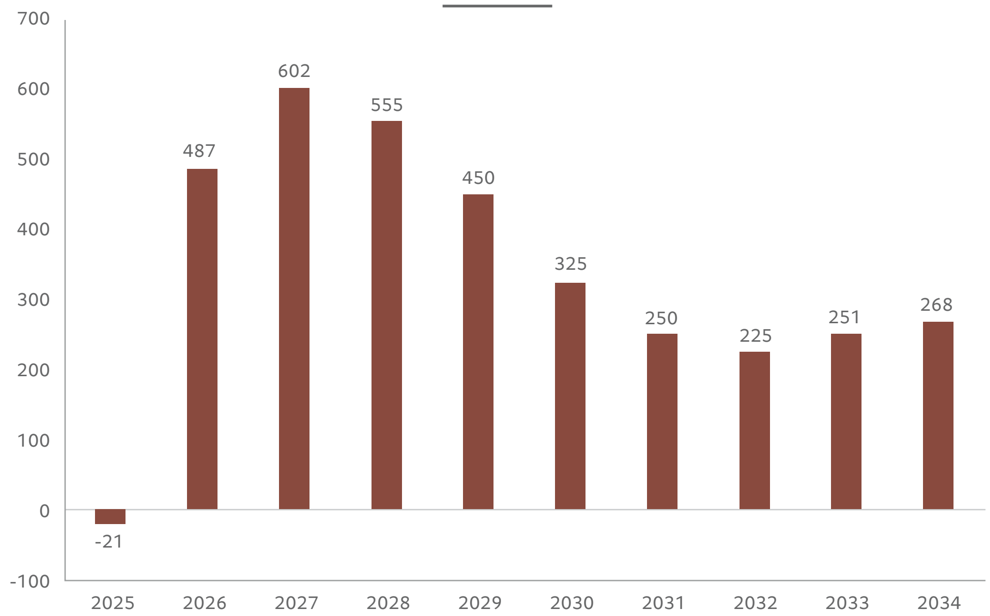
Last year, we identified a deteriorating fiscal backdrop in the US and argued that the unique status of the dollar as the world's reserve currency and the depth of the US capital markets provide exceptional fiscal leeway. We also said US debt and deficit reduction were likely to remain politically challenging.

Today, it is unlikely that meaningful US debt reduction will occur in the near future due to expansionary fiscal policy, a focus on industrial policy and deepening political polarisation. The Trump administration is on track to expand the budget deficit by more than USD 3 trillion in the coming decade as a result of the OBBBA, which extends expiring tax cuts, creates new ones and cuts spending on Medicaid, nutrition assistance, and some other discretionary spending. The cost could rise to close to USD 4 trillion, including interest expenses, and may approach close to USD 5.5 trillion if the temporary tax cuts were made permanent.

In a best-case scenario, tariff revenues could offset the expansion of the deficit from the bill. Under most reasonable estimates, the deficit would rise to around 7 percent of GDP, further adding to the country's debt burden. Elon Musk's

For illustrative purposes only. There can be no assurance that these projections, forecasts or expected returns will be achieved.

Deficit impact from One Big Beautiful Bill Act by year, USD billion
Congressional Budget Office's estimates



Source: Pictet Wealth Management, Congressional Budget Office, as at 29.06.2025

so-called Department of Government Efficiency (DOGE) fell spectacularly short of its cost reduction targets, highlighting the difficulty in cutting government spending.

Rising debt and deficits imply rising Treasury issuance. What's more, this is now happening against a backdrop of a tectonic shift underway in the global economy. The existing geoeconomic architecture – in which the US delivers financial stability, security guarantees and superior returns in exchange for foreign capital – is faltering as US policies undermine trust in the world's largest economy.

There are serious concerns about who will buy this massive issuance of Treasuries and at what price. Any shift in the global currency order away from the dollar, or de-dollarisation, is unlikely to become reality in the near future though it may persist as part of a longer-term trend. No single currency or currency basket currently present a viable alternative.

However, recent action from the Trump administration raises the risk of a return of the bond vigilantes. We may see a scenario similar to the so-called "Liz Truss moment" in the UK, where market forces demand a higher yield for holding government debt as a result of fiscal policy initiated – then abandoned – by the former British prime minister. The ongoing accumulation of debt threatens to exhaust the patience of price-insensitive buyers, which could trigger a rapid decline in market sentiment. The likelihood of this risk will only increase as long as the pace of debt accumulation continues.

An adverse scenario cannot be ruled out in which persistent worries from investors about the fiscal outlook push borrowing costs sharply higher and cause significant financial stress. The Fed could be forced to intervene with quantitative easing. Some have even suggested the possibility of yield curve control, which the US experimented during and after World War II when the Treasury needed help financing wartime expenditures. A major risk associated with this is the central bank's credibility, especially in an environment of higher inflation and inflation volatility.

> "There are serious concerns about who will buy this massive issuance of Treasuries, and at what price."

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Public debt in a high-rate era: financial repression, or a looming endgame?

Leading economies at risk of "debt spirals"

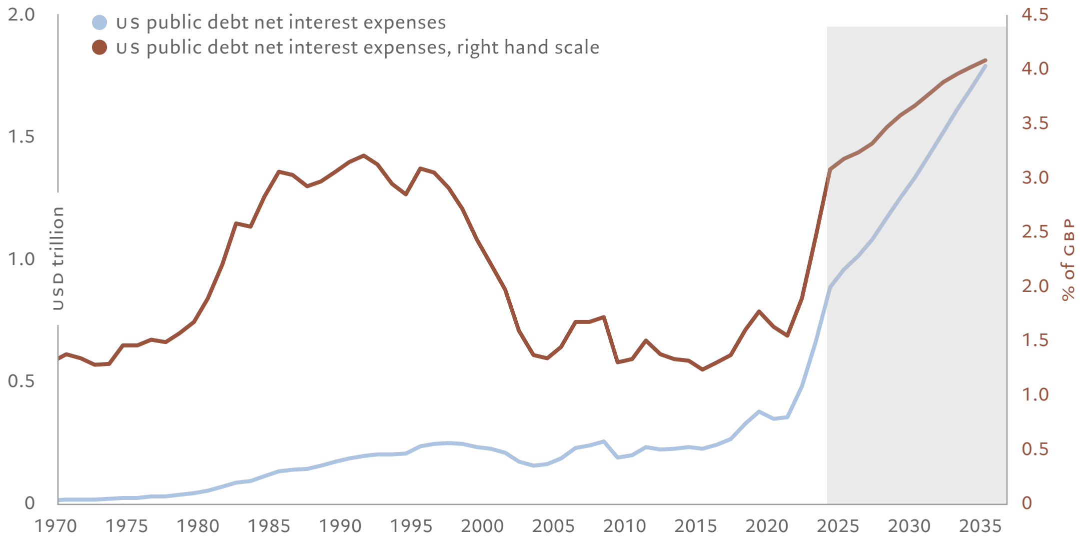
Today, central banks are wrestling with 1970s-style stagflation trade-offs between feeble growth and sticky inflation. This presents governments with a stark choice: implement fiscal austerity, revive financial repression, or risk a debt crisis. High debt-to-GDP nations like the US and UK are seeing ballooning debt-servicing costs and shrinking fiscal wiggle room, while deficits remain stubbornly large despite austerity pledges, threatening a self-reinforcing "debt spiral".

Policymakers could reintroduce financial repression by capping yields and directing banks into government bonds. They could also tweak their debt management strategies by issuing more short-term maturities or extending long bonds to lock in today's rates. The essential strategy which may have the potential to offset the pressure of higher borrowing costs – structural reforms boosting productivity through greater labour-market flexibility, R&D incentives and enhanced competition – are politically difficult, if not impossible in some cases.

It is likely that public finances will buckle under the twin pressures of rising rates and stagflation if policymakers fail to enact bold debt management strategies and growth enhancing reforms.

> "Public finances will buckle under the twin pressures of rising rates and stagflation if policymakers fail to enact bold debt management strategies and growth enhancing reforms."

US public debt interest expenses, including projections from the CBO



Source: Pictet Wealth Management, CBO, as at 30.07.2025

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Central bank independence: how big a risk?

The Fed under attack

The Fed established by Congress in 1913 has a dual mandate to promote maximum employment and stable prices. The Fed operates independently, setting interest rates without interference from Congress or the White House even if politicians publicly disagree with its actions.

Today, the Fed's independence is under constant attack. President Trump has repeatedly urged chair Jerome Powell to lower rates and simultaneously threatened to fire him due to policy differences. Trump wants the Fed to consult with the White House about interest rate decisions and to install a shadow Fed chair who could challenge and critique Fed decisions during the remainder of Powell's term.

A central bank lacking independence would rattle financial markets. Academic research indicates that central banks with more political independence tend to foster lower, more stable inflation. Trump's threats to fire Powell have led to higher long-term rates as markets worry that political interference could lead to a central bank that is more willing to tolerate higher inflation.

Attacks on the Fed will likely continue, and the risk of a Trump loyalist, whose policymaking could be directly influenced by the president, is rising. We see it as unlikely that the executive branch would de facto set monetary policy for a few reasons.

First, a recent Supreme Court ruling granting Trump's request to fire agency heads without cause does not implicate the Fed because the court said "the Federal Reserve is a uniquely structured, quasi-private entity that follows in the distinct historical tradition of the First and Second Banks of the United States." This essentially strips the president of the power to fire central bank governors simply for policy differences.

Second, monetary policy is set by the Federal Open Market Committee (FOMC), made up of 12 people: the seven members of the Fed's Board of Governors, the president of the New York Fed and an annually rotating group of four of the 11 remaining regional reserve bank presidents. Governors are appointed by the US president and approved by the Senate and have staggered 14-year terms. Bank presidents are appointed by their local boards of directors (with Board of Governors' approval). The chair has one vote out of 12 and can be overruled by the rest of the committee.

Third, although Congress could change the Fed's mandate or governance, such efforts have not progressed far because lawmakers generally understand that political influence over interest rates could lead to higher inflation. The Senate has the final say in nominating the chair, and there is a common understanding among senators that the Fed's independence shall be preserved. In 2019 and 2020, a Republican Senate refused to advance the nomination of a few controversial candidates supported by Trump in his first term.

Fourth, the Fed's policy independence from political influence has been the bedrock of the global financial system. If the Fed were seen as simply taking marching orders from the White House, markets could react forcefully, leading to significant volatility, which could persuade the administration to back off.

"A central bank lacking independence would rattle financial markets. Academic research indicates that central banks with more political independence tend to foster lower, more stable inflation."

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Global shifts in demographics and immigration policies

What are the challenges and opportunities?

Three major demographic trends are altering the trajectory of our global economy:

1. Population decline
2. An ageing workforce
3. New migration patterns

These changes are structural, meaning they will not simply reverse with the passage of time. The US, Europe, China and Japan are at the forefront of this trend and the world's emerging economies are not immune. The question to consider is how policymakers and businesses will adapt.

POPULATION DECLINE BECOMES A WIDER PHENOMENON

Population growth is set to be largely concentrated in countries that are less politically stable and economically integrated. Meanwhile, countries like Japan, China, Italy and South Korea are experiencing population decline at an accelerating rate. Japan has lost nearly 4 million people since 2010 and is on track to drop to just 100 million by 2050. China, long the world's most populous nation, hit its peak in 2022 and is now in decline. Even Europe, once seen as stable, is grappling with shrinking populations in nearly two-thirds of its countries.

> "Advanced economies will likely see slower growth unless productivity surges. Emerging markets have a limited window to capitalise on their demographic dividends before ageing catches up with them too."

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The economic consequences of these demographic changes are profound. Fewer workers means slower growth, strained pension systems and reduced demand for housing and infrastructure. AI, automation and immigration can help, but they're not a complete fix, and they may provoke other negative social consequences.

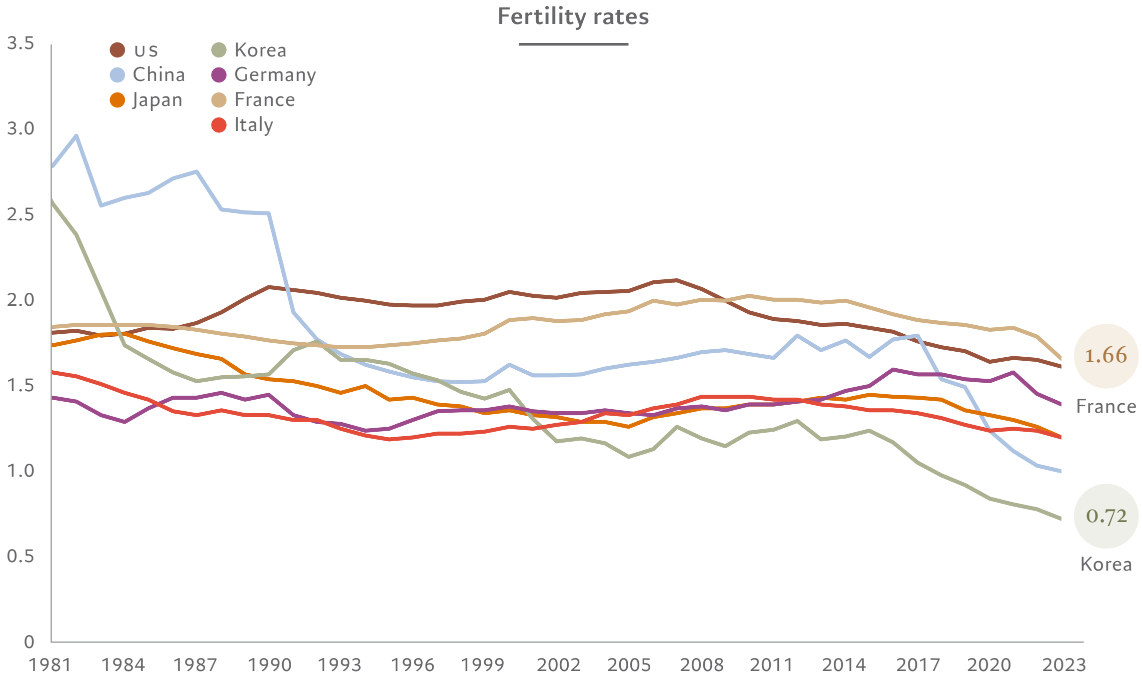
THE FERTILITY CRISIS DEEPENS IN SOME COUNTRIES

Birth rates are collapsing across the developed world. South Korea's fertility rate has fallen to an astonishing 0.72. Italy, Spain and Japan are not far behind, with rates hovering around 1.2 to 1.3. Even the US, once an outlier among developed nations, has seen fertility drop to 1.6, which is well below the replacement level of 2.1. China's decision to scrap its one-child policy in 2016 has done little to reverse its decline and fertility rates have flattened.

Governments have tried policies such as cash incentives, extended parental leave and subsidised childcare, but the results have been disappointing. France and Sweden, with their generous family policies, have managed slightly higher birth rates. However, the numbers remain below replacement levels. The deeper issue may be cultural. Young people are delaying marriage, prioritising careers and eschewing parenthood amid soaring living costs.

AGEING POPULATIONS ARE RESHAPING ECONOMIES

Medical advances are extending life expectancy rates in ways that will reshape the global economy. Japan is already there, with 30 percent of its population in that age group. China, once known for its youthful workforce, is ageing at an unprecedented pace. Its median age will soon match Japan's. Europe is not far behind, with its median age expected to hit 48 by 2050.



Source: Pictet Wealth Management, World Bank, as at 31.12.2023

This shift brings enormous economic pressures. Healthcare costs will likely continue to rise. Japan now spends 11 percent of its GDP on elder care. Pension systems are buckling under the weight of more retirees and fewer contributors. The US Social Security programme, for example, could be insolvent by 2034.

Yet an ageing demographic is not all bad news. The "silver economy", covering everything from healthcare to leisure, is booming. And in Japan, where one in four workers is over 65, older employees are helping to fill labour gaps. China recently started to extend retirement age for both men and woman in response to its shrinking workforce and ageing population.

By 2050,

1 in 6

people globally will be over 65, up from one in 11 today.

Source: World Health Organization, 2023

MIGRATION IN FLUX: TRUMP'S CRACKDOWN AND EUROPE'S DILEMMA

Immigration has long been a lifeline for ageing economies, but political winds are shifting. In the US, President Trump promises mass deportations, stricter work visas and a militarised border. If fully implemented, these policies could worsen labour shortages in key sectors like agriculture, construction and tech, where immigrants make up 17 percent of the workforce. The CBO estimates that immigration has contributed 2 percent annually to US GDP growth over the past decade. Without it, growth could slow further.

Europe faces a similar dilemma. Germany's population would have shrunk by 10 million since 1970 without immigration, yet anti-migrant sentiment is rising across the continent. At the same time, emerging economies are seeing their own migration challenges. India and the Philippines still benefit from young, growing workforces, but brain drain is a growing problem in Latin America, where millions have fled economic crises.

IMPLICATIONS FOR GLOBAL GROWTH AND INFLATION

The economic fallout from these demographic shifts will be complicated. Advanced economies will likely see slower growth unless productivity surges. Emerging markets, meanwhile, have a limited window to capitalise on their demographic dividends before ageing catches up with them too.

Inflation dynamics are also shifting. Labour shortages in the US and Europe could push wages higher, fuelling price pressures. At the same time, ageing populations tend to spend less, which could have a deflationary effect – something Japan has experienced for years. The wild card is technology: AI and automation might help offset labour shortages, but they could also widen inequality if not managed carefully.

There's no reversing these demographic trends, but there are ways to adapt. Pension systems need reform, labour markets must become more inclusive and immigration policies should balance economic needs with political realities. The economies that thrive in the coming decades will be those that find new ways to grow with fewer workers, more retirees and a rapidly changing global landscape.

Global rebalancing of international trade and capital flows, and the role of the US dollar

Will foreign investors keep buying US exceptionalism?

The US has long been a dominant force in the global economy, bolstered by its status as the world's largest economy and the dollar's role as the primary reserve currency. However, this foundation is coming under growing pressure, as the rapid expansion of its twin-deficits is causing concern among market participants.

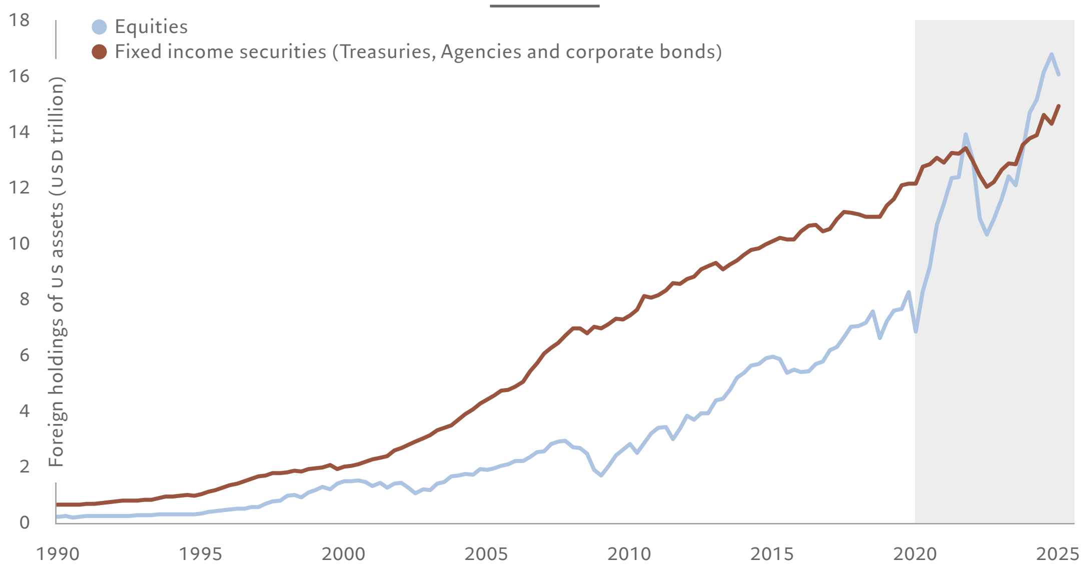
A key goal of the current Trump administration is to narrow the current account gap through a large rebalancing in global trade and a weakening of the dollar. However, a sustained narrowing of the US external deficits would ultimately require a reduction in the fiscal deficit – a scenario that seems unlikely at this stage, especially after the recent approval of substantial tax cuts under the OBBBA.

A cornerstone of US economic exceptionalism in recent decades has been its ability to attract foreign capital, evidenced by the significant expansion of its net international investment position (NIIP) alongside substantial purchases of US Treasuries by foreign investors to finance its deficit.

However, sustaining this level of financing depends on maintaining strong investor confidence in the country's economic outlook – a confidence that has recently shown signs of wavering, prompting some foreign investors to reassess their exposure to US securities.

This shift may drive downward pressure on the dollar while driving interest rates higher, potentially

Foreign holdings of US equities and fixed income securities



Source: Pictet Wealth Management, Federal reserve, as at 30.06.2025

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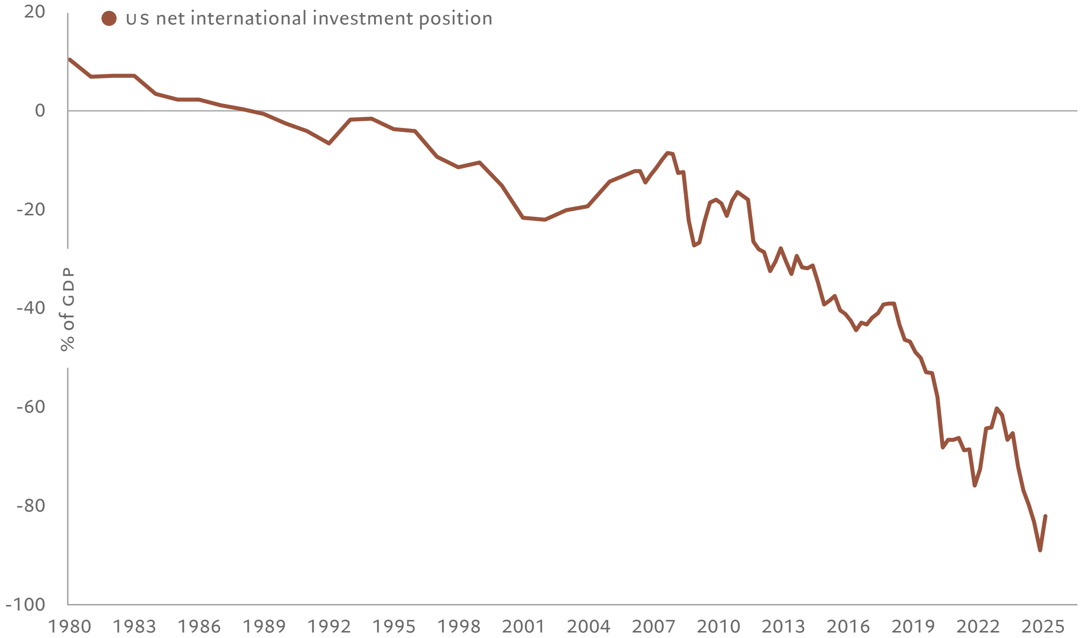
US net international investment position



Source: Pictet Wealth Management, Bureau of Economic Analysis, as at 30.06.2025

triggering a debt spiral and increasing hedging costs, which could narrow the gap in the NIIP.

Nevertheless, foreign investors face limited alternatives. The European capital market remains limited, and some investors remain dubious about the Chinese market. While we expect large outflows from US assets into the rest of the world, the process is unlikely to reach a breaking point, nor the dollar to be replaced as the dominant reserve currency.

Meanwhile, large current account surplus countries, including China, Europe or Japan, may find it hard to rebalance their economies swiftly. Even if they succeed in doing so, this protracted process will still leave them with large surpluses to be absorbed by the rest of the world, including the US consumer, which remains at the heart of global trade flows. Globalisation may be slowing among the major blocs, but it's also evolving, with supply chains reshuffling, rerouting across countries and decoupling from China for strategic goods. Diversifying exposure away from US markets will likely be a gradual process, allowing the country to retain its exceptional status for the time being – albeit with growing vulnerabilities.

"The status of the dollar has started to be challenged against the backdrop of record US deficits."

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The evolving order in Asia
Geopolitical and economic shifts amid US strategic adjustments

The potential recalibration of US security commitments in Asia under a second Trump administration could mark a significant transition in the region's geopolitical and economic landscape. Since the end of World War II, the US has played a stabilising role in the Indo-Pacific, supporting a rules-based framework that facilitated economic growth and regional cooperation. However, a shift in US priorities – marked by an emphasis on unilateralism and an "America First" approach – could accelerate the evolution of the post-war global order, prompting new strategic alignments, economic adaptations and opportunities for regional leadership.

A CHANGING GEOPOLITICAL LANDSCAPE

A reduced US presence in Asia would create space for regional powers to assume greater responsibility in shaping the security architecture. China has expanded its influence through initiatives like the BRI. Beijing could play a more prominent role in conflict resolution in the region, particularly in areas like the Korean peninsula, where diplomatic engagement remains crucial. A more assertive China will likely re-shape the geopolitical landscape in Asia with regard to the Taiwan Strait and the South China Sea.

"The adjustments in US engagement could accelerate a technological bifurcation between US and Chinese standards."

Japan and South Korea long-standing US allies, may seek to diversify their strategic partnerships while enhancing their own defence capabilities. Japan's military modernisation could contribute to regional security, fostering a more balanced power dynamic. South Korea, meanwhile, might deepen economic and diplomatic ties with neighbouring nations, which could reinforce stability in Northeast Asia.

Southeast Asia, home to dynamic economies and a hub of global trade, could see a strengthening in the role of the 10-member Association of Southeast Asian Nations (ASEAN) as a neutral platform for dialogue. Nations like Vietnam, Indonesia and the Philippines may increasingly pursue more flexible foreign policies, engaging with multiple partners to ensure continued prosperity.

BIFURCATION OF TECH ECOSYSTEMS

The adjustments in US engagement could accelerate a technological bifurcation between US and Chinese standards. In critical areas like 5G, semiconductors and AI, nations will increasingly face pressure to align with either the US-led or Chinese-led tech ecosystems. This divide will extend beyond hardware to digital governance, data security and cyber norms, forcing countries to make difficult choices that could shape their economic futures.

The US and its allies are likely to maintain leadership in advanced semiconductor and cutting-edge AI research. China is catching up quickly in these areas while continuing to excel in manufacturing scalability and telecommunications infrastructure. Smaller nations, particularly in Southeast Asia, may struggle to maintain neutrality, as both bigger powers push for alignment through trade incentives, investment conditions, and security partnerships.

For illustrative purposes only. There can be no assurance that these projections, forecasts or expected returns will be achieved.

Over time, this could lead to a fragmented digital landscape where interoperability declines and innovation becomes siloed.

WINNERS AND LOSERS IN THE NEW ORDER

Winners

1. China: a reduced US presence allows Beijing to expand its economic and technological influence, particularly through BRI projects and digital infrastructure exports.
2. Vietnam and India: both nations could attract manufacturing relocations as companies diversify supply chains away from China, benefiting from their neutral positioning and competitive labour markets.
3. Tech-savvy middle powers (South Korea, Taiwan, Singapore): these economies possess the advanced industries and strategic flexibility to navigate bifurcation, potentially serving as bridges between competing tech blocs.
4. Resource-rich nations (Australia, Indonesia): with critical minerals and energy reserves, these nations remain indispensable to both US and Chinese supply chains due to their abundance of critical mineral and energy resources.

Losers

1. Smaller ASEAN economies (Cambodia, Laos, Myanmar): these economies are less able to resist pressure to align with China, risking greater debt dependency and loss of economic sovereignty.
2. US tech giants: if decoupling accelerates, firms like Apple and Nvidia could lose access to China's vast consumer market and manufacturing base as the US and China reorient their economic relationship.
3. Global innovation: a divided tech ecosystem stifles cross-border collaboration, slowing progress in areas like climate technology and medical research.

CONCLUSION

The evolving geopolitical landscape presents both opportunities and risks. While Asia's economies are resilient enough to adapt, the bifurcation of technology standards and supply chains will create winners and losers, with middle powers best positioned to navigate the transition. The key challenge for the region will be maintaining open trade and innovation despite growing great power competition.

China's fiscal response: short-term fix and long-term strategy

Reform is required to redress local government fiscal gap

At the end of 2024, China's official government debt was about

60%

of GDP.

Source: International Monetary Fund, as at 04.04.2025

For illustrative purposes only. There can be no assurance that these projections, forecasts or expected returns will be achieved.

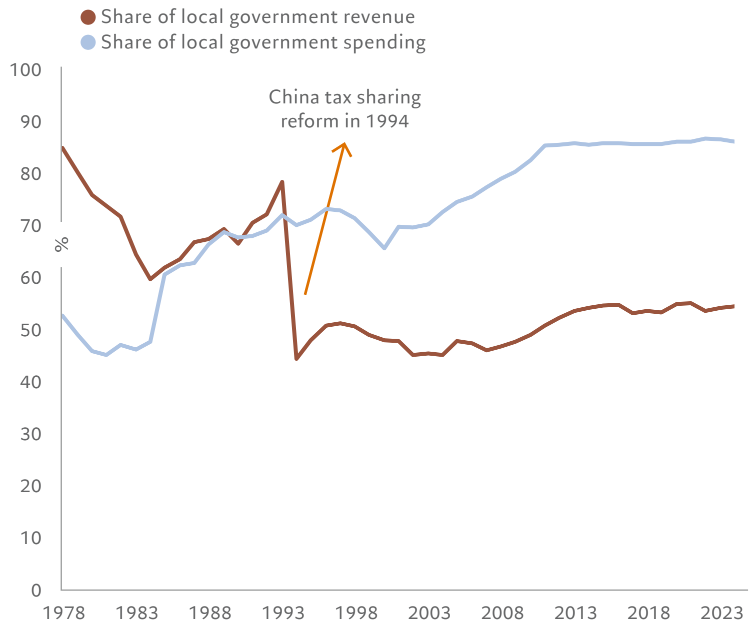
For decades, the Chinese government has prioritised high GDP growth. Fiscal policy, including both "on-budget" fiscal and quasi-fiscal levers, such as infrastructure investment, has been the major policy lever to boost growth. However, this has led to an accumulation of financial instability, not only resulting in high macro leverage and local government debt buildups, but also contributing to risks in the shadow banking sector and housing bubbles. All of these financial issues have a fiscal root related to China's fiscal regime.

China's fiscal regime is highly decentralised and local governments assume most spending responsibility, albeit with limited revenue sources at the local level. For example, local governments take around half of on-budget fiscal revenue but are responsible for about 90 percent of spending. This has led local governments to rely on land sale revenues ("land fiscal regime") and off-budget borrowing, like shadow banking through local government financing vehicles (LGFVs), in addition to on-budget revenue, to fulfil their spending obligations. This regime, combined with the structural/cyclical factors that have led to persistent demand for high infrastructure investment growth, has led to major financial instability issues.

Over the past decade, the importance of financial stability has increased significantly and there has been a broad policy paradigm shift from focusing only on growth to a balance between growth stability and financial stability. One important consequence of this shift is less overshooting in cyclical policy and less pressure on debt accumulation.

Significant policy efforts have been made as well. China's public debt issue is different from other major economies. For one thing, local government debt is much higher than central government debt, with significant variation across regions. For instance, at the end of 2024, official government debt was about 60 percent of GDP, consisting of 35 percent in local government debt and 25 percent in central government debt. China's official debt is not high in an international context, reflecting the government's conservative stance in on-budget fiscal policy.

China's local government tax and spend mismatch



Source: Pictet Wealth Management, Wind, as at 31.12.2024

> "China's fiscal regime is highly decentralised and local governments assume most spending responsibility, albeit with limited revenue sources at the local level."

The major risk has been primarily related to significant accumulation of local government implicit debt.

In order to deal with the implicit debt issue, one major effort the Chinese government has made is the so-called "close the back door" policy to prohibit local governments from off-budget borrowing, while at the same time deploying an "open the front door" policy to help increase local government borrowing through on-budget local government bonds. For instance, the local government special bond quota has increased 4,300 percent over the past decade, from RMB 100 billion in 2015 to RMB 4.4 trillion in 2025. Between 2015 and 2018, the government implemented the first round of a large-scale debt swap programme – issuing around RMB 14 trillion worth of local government bonds to swap outstanding implicit debt. The government has also implemented debt-to-debt swaps –swap short-term/high-costs debt into long-term/lower-cost debt to reduce maturity mismatch.

These measures have helped, but local government implicit debt has continued to rise in recent years to around RMB 14 trillion. Last year, the government started another debt swap programme, to issue around RMB 12 trillion worth of local government bonds.

Tackling China's implicit debt issue requires structural measures and reform of the fiscal regime. This may also help address other financial issues, such as reducing the speculative nature of the housing sector. To be sure, this strategy is challenging, complicated and takes time to implement. A new round of inter-government fiscal reform should focus on clearly dividing spending responsibility. Meanwhile, tax reform should be implemented in a way that promotes tax revenue for local governments through sources that are more stable and correlated with the local economy, such as a consumption tax and a property tax.

Chinese fiscal policy has historically placed more emphasis on capex-related spending, while social welfare and security expenditures have been insufficient. This has been one major driver of China's relatively low consumption-to-GDP ratio. So increasing spending in those areas would be important for economic rebalancing.

For illustrative purposes only. There can be no assurance that these projections, forecasts or expected returns will be achieved.

The road ahead for Europe
The coming decade will be decisive

Europe faces a convergence of economic, geopolitical and demographic challenges. Russia's invasion of Ukraine shattered the assumption of peace on the continent and exposed deep vulnerabilities in Europe's energy security and defence capabilities. Simultaneously, Europe is grappling with the consequences of stagnating productivity, declining competitiveness and strained public finances. Uncertainty in US policy and the threat of tariffs further exacerbate the challenges.

Over the past two decades, the EU has steadily ceded economic ground relative to the US. The transatlantic GDP gap has widened significantly since 2000. At the core of this divergence lies a persistent slowdown in productivity growth within the EU.

Last year, the Draghi report on EU competitiveness[1] laid out a comprehensive roadmap for structural reform in Europe. Among its central findings was the urgent need to address weak productivity in sectors where the EU lags furthest behind – particularly digital technology, energy and defence.

The report underscores that the primary driver of the EU–US productivity gap has been Europe's failure to capitalise on the first wave of the digital revolution, failing to scale tech-driven enterprises or create global champions. While productivity in US-listed technology firms has grown substantially – around 40 percent in the past 20 years – European firms have seen little improvement according to IMF estimates[2]. Compounding the issue is the relatively low R&D investment by European companies (2.2 percent of GDP in 2023), which remains well below that of their American counterparts (3.6 percent).

But this is only part of a broader problem. Across the continent, high-growth firms are rare and often small in size, making limited contributions to employment or innovation. Europe has too many small, mature companies that lack the scale to drive economic transformation. Fragmented consumer and labour markets, capital constraints and skill shortages further limit the ability of businesses to expand and compete internationally.

These structural weaknesses were brutally exposed by recent geopolitical shocks. Europe's decades-long dependence on inexpensive Russian gas was upended, leading to soaring energy prices that have weakened industrial competitiveness, particularly in countries like Germany. Meanwhile, the realisation of underinvestment in defence has triggered a rethinking of Europe's security posture. Although some member states have begun raising defence budgets, most still fall short of NATO's 2 percent of GDP old benchmark. Recently, NATO allies agreed on a more ambitious target of 5 percent defence spending of which at least 3.5 percent specifically to core defence capabilities and 1.5 percent of defence- and security-related spending.

Beyond defence, the broader question of strategic autonomy looms large. Shifting US policies and wavering security guarantees have further underscored the urgency of building Europe's internal resilience – economically, technologically and militarily.

Achieving this will require a historic surge in investment. Estimates in the Draghi report suggest the EU needs to mobilise an additional EUR 750 to EUR 800 billion annually through 2030 to meet its strategic objectives: digitalisation, energy transition and defence modernisation. This would mean increasing the EU's investment share of GDP from around 22 percent today to about 27 percent – a dramatic reversal after decades of decline according to the report.

An additional

EUR

750 to 800bn

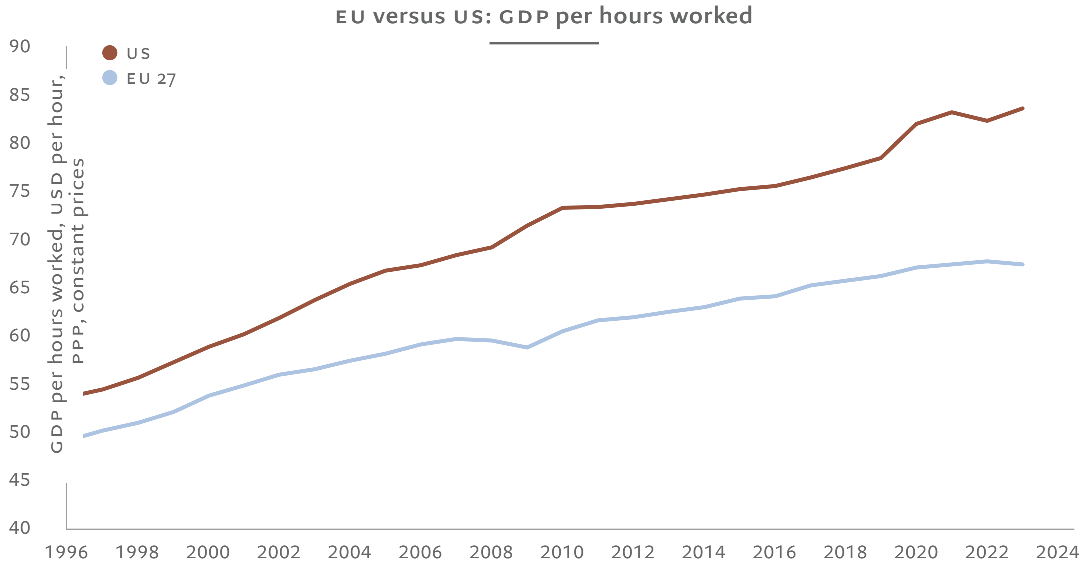
per year by 2030 is needed in the EU according to the Draghi report.

BUT WHO WILL PAY THE BILL?

The most contentious issue remains how to finance Europe's investment push. This remains a divisive question. Member states have vastly different fiscal capacities and many face hard choices between investing in future resilience or maintaining social spending commitments. The European Commission's "ReArm Europe" initiative has proposed loosening fiscal rules to allow countries more flexibility in financing defence, but some governments are wary of market backlash or rising debt.

At the EU level, the collective budget – just over 1 percent of GDP – is simply too small for the scale of transformation required. The region also suffers from a fragmented financial system heavily reliant on bank lending, which is ill-suited for funding high-risk, innovation-led projects.

1 Draghi, M. (2024) The future of European competitiveness. Part A: A competitiveness strategy for Europe and Part B: In-depth analysis and recommendations
2 Adilbish, O., D. Cerdeiro, R. Duval, G. Hong, L. Mazzone, L. Rotunno, H. Toprak, and M. Vaziri. 2025. "Europe's Productivity Weakness: Firm-Level Roots and Remedies." IMF Working Paper 25/40, International Monetary Fund, Washington, DC.



Source: Pictet Wealth Management, OCDE, as of 01.01.2023

Banks tend to favour companies with physical collateral, disadvantaging startups or tech firms with intangible assets like software or patents.

One promising solution is to better connect Europe's large pool of household savings of around EUR 10 trillion in bank deposits – with its unmet investment needs. The proposal for a European Savings and Investment Union (SIU) aims to achieve this by creating more integrated and efficient capital markets that channel private capital toward long-term projects. At present, many European investors avoid equity-based products, and the EU lacks the deep and liquid financial markets seen in the US. A more unified capital market could reduce financing costs, support innovative firms and attract global investment.

Similarly, deeper integration of the single market is key to unlocking growth. While Europe has made significant strides in removing trade barriers, especially for goods, major obstacles remain – particularly in services, energy, finance and communications.

Creating a truly unified market would incentivise firms to scale up, invest in R&D and compete on a continental level. Studies suggest that reducing internal trade barriers by just 10 percent could increase EU GDP by 7 percent according to IMF estimates[3].

Industrial policy can also play a role, but it must be forward-looking. Instead of protecting mature sectors from change, public support should help companies adopt green technologies, embrace digital transformation and compete globally. Poorly designed policies risk distorting trade and locking countries into outdated economic models.

Demographics add another layer of complexity. Europe's working-age population is set to shrink, creating additional pressure on productivity and public finances.

The coming decade will be decisive. The Draghi report offers a clear and timely blueprint. Importantly, there is growing alignment between diagnosis and political resolve. A new consensus is forming around the need for strategic autonomy, deeper capital markets and bold, coordinated investment. The direction of travel is encouraging – and the willingness to act appears stronger than it has been in decades. The recent fiscal package approved by the German government in March reflects this desire for change. In all, we believe the EU is on a positive trajectory. With sustained commitment to reform and cooperation, the gap with the US is expected to narrow.

> "Shifting US policies and wavering security guarantees have further underscored the urgency of building Europe's internal resilience – economically, technologically and militarily."

3 Kammer A. (June 2025), "Europe's integration imperative", Finance and Deveopment, IMF

For illustrative purposes only. There can be no assurance that these projections, forecasts or expected returns will be achieved.

Industrial policy: defence and technology

The evolution of industrial defence beyond the battlefield

The future of defence is poised to change dramatically over the next decade, driven by rapid technological advances and evolving geopolitical dynamics. These shifts will transform how states safeguard their security, with far-reaching economic implications for industries and global markets.

The war in Ukraine and President Trump's threats to withdraw from the North American Treaty Organisation (NATO) laid bare Europe's vulnerabilities, prompting a renewed focus on collective defence. In 2025, the European Commission's Re-Arm Plan and Germany's landmark fiscal stimulus marked a decisive turning point – both initiatives seek to strengthen Europe's military capabilities and enhance interoperability among member states.

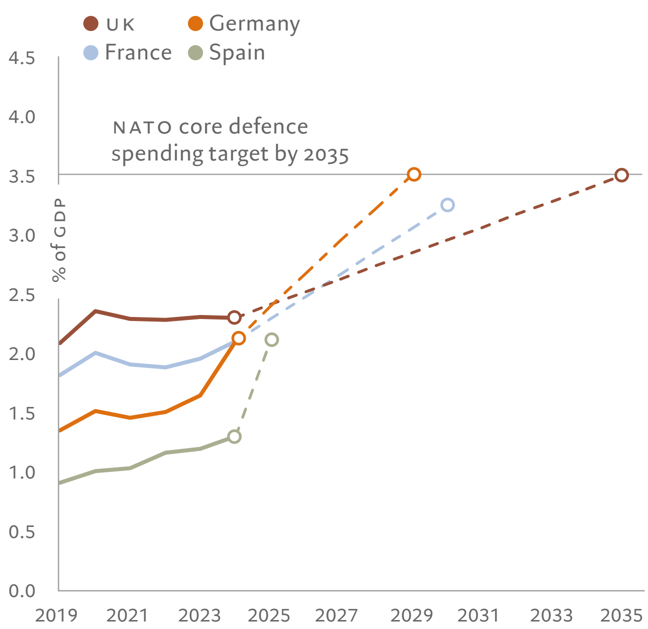
Investment in the global defence sector is set to rise due, in part, to the efforts of the NATO members to bolster their domestic military expenditures. That influx of capital will stimulate domestic industries and increase demand for skilled labour.

At the same time, many countries are pursuing technological superiority to bolster sovereign security, fuelling breakthroughs in AI, quantum technology and the space industry. These kinds of military innovations often find dual-use applications in civilian sectors that can drive productivity gains and economic prosperity.

It is worth noting the unequal capacity of nations to ramp up defence spending risks widening global disparities. For example, countries like the UK face fiscal constraints that could cap their defence budgets. Moreover, the rapid adoption of advanced military technologies raises ethical and regulatory questions that demand urgent attention.

Over the next decade, defence and related technologies will emerge as critical engines of economic growth and innovation. States that invest wisely in cutting-edge capabilities and deepen international cooperation can reinforce their security and unlock new economic opportunities.

NATO defence spending



Source: Pictet Wealth Management, Financial Times, as at 26.06.2025

> "Over the next decade, defence and related technologies will emerge as critical engines of economic growth and innovation."

For illustrative purposes only. There can be no assurance that these projections, forecasts or expected returns will be achieved.

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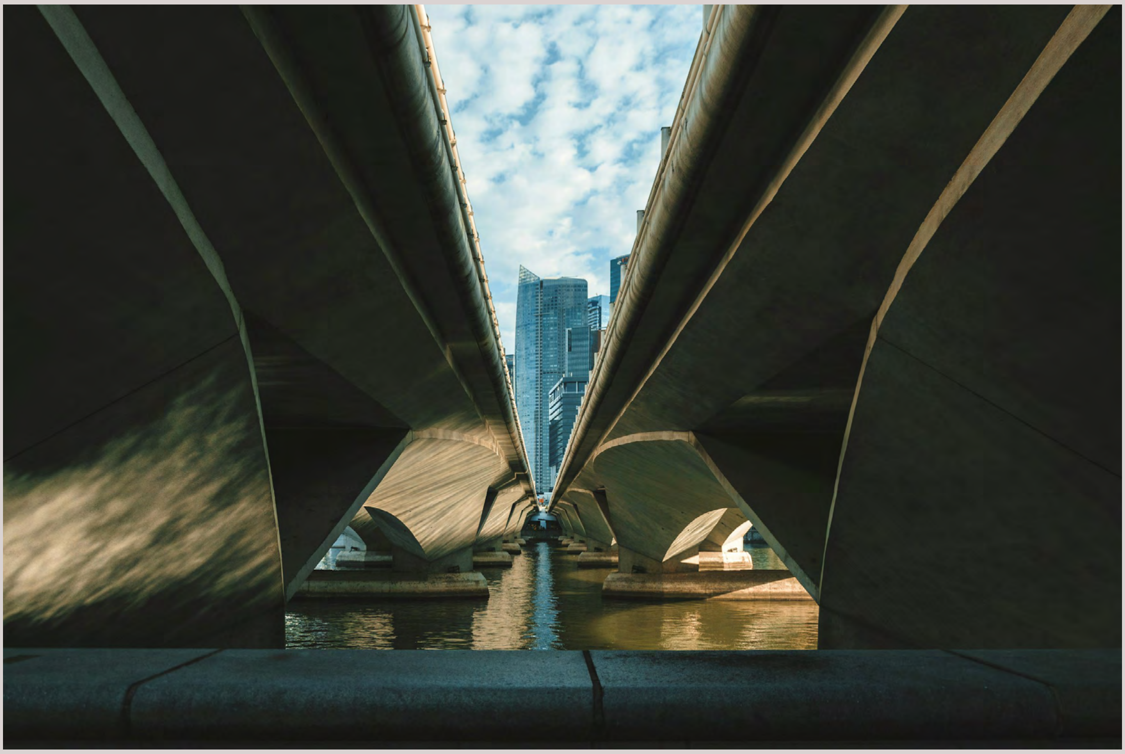
SECTION 2

In depth topics



Built over the Singapore River, the Esplanade Bridge serves as a vital link between Marina Centre and Merlion Park.

Completed in 1997, this 261-metre-long structure features two carriageways and pedestrian pathways, providing stunning views of Marina Bay.

"The choice for countries is no longer a simple technological preference but a profound geopolitical and economic calculation."

In depth topics

The great digital decoupling
China-US rivalry forces countries to choose between technological ecosystems

OpenAI's o3 and o4-mini models have dramatically improved AI's ability to solve coding challenges, boasting a

69%

success rate on industry tests this year.

Source: OpenAI, as at 15.04.2025

When Chinese artificial intelligence startup DeepSeek launched a large language model in January with a similar performance to that of US rival OpenAI at a fraction of the cost and computing power, it did not just set the stage for a battle between the US and China for AI supremacy.

The development ushered in a new world whereby governments now face a stark choice that will define their technological independence, political alliances and economic future. Policymakers are at a crossroads, compelled to choose between aligning with US or Chinese technology, or to attempt the delicate dance of using both. It is a complex calculation with profound consequences.

THE GREAT DISRUPTION

At the heart of this shifting landscape is a question of resources. The American approach has long been defined by massive capital expenditure. Training a frontier model like OpenAI's GPT-4 was estimated to cost over USD 63 million, with major US labs routinely spending upwards of USD 100 million by 2024.

DeepSeek turned this model on its head. The company reportedly trained its powerful V3 model for a mere USD 5.56 million. This staggering efficiency was achieved through sophisticated techniques like "distillation" – training smaller, nimbler AI "student" models on the outputs of larger "teacher" models – and innovative architectures.

DeepSeek made a pivotal decision to open-source its powerful R1 reasoning model. This move democratises access to state-of-the-art AI, allowing developers anywhere to build upon it for free. The company's API, the service used to access the model, is 90 percent cheaper than OpenAI's equivalent, effectively commoditising the foundational layer of AI. This trend threatens the competitive moat of proprietary, high-cost systems.

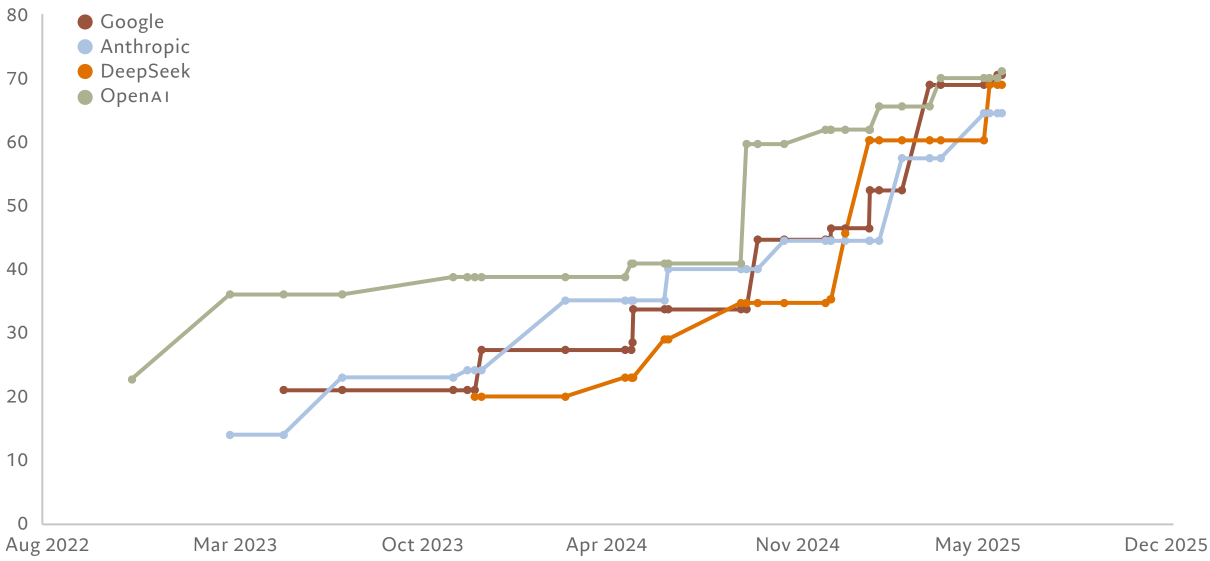
In response, US AI titans are not standing still. OpenAI's CEO, Sam Altman, vowed to "deliver much better models," and the company's latest models have shown remarkable advances in complex reasoning and programming. These models have dramatically improved AI's ability to solve coding challenges, boasting a 69 percent success rate on industry tests this year, a huge leap from just 4.4 percent in 2023. The message from Silicon Valley is clear: the frontier of intelligence is still theirs to push.

CHIP WARS AND THE QUEST FOR SELF-SUFFICIENCY

This battle of algorithms is built on a foundation of hardware. Recognising China's reliance on its technology, the US has imposed stringent export controls on advanced semiconductor chips, the lifeblood of AI development. This move was intended to hobble China's progress but instead ignited an intense drive for technological self-sufficiency. China's response has been swift and determined, with one of its tech giants emerging as a formidable domestic competitor to US chip designers. The US, meanwhile, is shoring up its own supply chain.

"Policymakers find themselves at a crossroads, compelled to choose between aligning with US or Chinese technologies."

Frontier language model intelligence, over time



Note: Artificial Analysis Intelligence Index: Combination metric covering multiple dimensions of intelligence - the simplest way to compare how smart models are. It incorporates 7 evaluations: MMLU-Pro, GPQA Diamond, Humanity's Last Exam, LiveCodeBench, SciCode, AIME, MATH-500.

Source: Pictet Wealth Management, Artificialanalysis, as at 10.06.2025

A 2023 study revealed that

43%

of China's AI venture capital was directed towards manufacturing, compared to just 3 percent in the US.

Source: Pitchbook, as at 03.04.2025

The CHIPS Act allocates over USD 52 billion to incentivise manufacturers to reshore chip production back to American soil. US tech behemoths are also pouring resources into developing their own custom AI chips to reduce their dependence on single suppliers. Despite these efforts, a technological gap remains. China still lags in the most advanced chip fabrication. However, Chinese firms have become adept at finding workarounds, from leasing offshore data centres to stockpiling, demonstrating their resolve to close the gap by any means necessary.

A CLASH OF VALUES: DEMOCRATIC VERSUS AUTOCRATIC AI

The competition extends beyond technology and into the realm of ideology. Choosing an AI system is increasingly seen as a political statement. US policymakers, such as Vice President JD Vance, are warning allies against signing AI deals with an "authoritarian master". The US vision is for AI that reflects ideals of free speech and liberty.

This stands in stark contrast to the Chinese model, where AI must embody "core socialist values". Chinese models are known to censor politically sensitive topics and filter criticism of state leaders. This has given rise to the concepts of "democratic AI" versus "autocratic AI", with significant implications for data security and privacy. The fear in Washington is that China could leverage its access to global user data to train its AI for espionage or malign influence operations. This concern has fuelled a digital decoupling, with services like Perplexity now offering to run DeepSeek's model on US-based servers, thereby stripping out Chinese censorship and ensuring user data never reaches China.

THE NEW GOLD RUSH: ECONOMIC OPPORTUNITY

As the cost of foundational AI models plummets, the real economic opportunity is shifting to the application layer: how this powerful technology is put to practical use. This has unleashed a torrent of innovation in sectors from healthcare and manufacturing to consumer tech and government services. China has demonstrated a particularly aggressive push for widespread adoption. A 2023 study revealed that 43 percent of China's AI venture capital was directed towards manufacturing, compared to just 3 percent in the US. Another report found that half of all Chinese companies were actively using AI, versus only a third of their American counterparts. This rapid integration, spurred by lower costs and a willing consumer base, could translate into a significant national productivity boom. Chinese startups are already pivoting their business models, leveraging powerful, low-cost open-source models to build tailored business solutions without incurring massive upfront training expenses.

A FORK IN THE ROAD

The choices made by nations in the coming years will shape the technological global landscape for decades to come, leading to several potential futures:

1. **A fragmented world**: The most likely near-term scenario is a greater "digital decoupling" of the world's major economies. Escalating geopolitical tensions could accelerate the emergence of at least two parallel AI ecosystems – one led by the US and its allies, the other by China – with diverging standards and limited interoperability. This could stifle global innovation by hindering collaboration.
2. **Continued US dominance**: The US could successfully leverage its lead in cutting-edge hardware and next-generation models to maintain its position at the top, keeping China a step behind. This depends on the effectiveness of its export controls and the pace of its own innovation.
3. **Rapid Chinese advances**: Through its focus on efficiency, clever workarounds, and a massive push in its domestic chip industry, China could achieve near-parity with the US for key AI capabilities. This would fundamentally challenge US leadership and create a truly bipolar AI world.

The rise of DeepSeek has done more than just introduce a new competitor. It has redefined the very nature of the AI race. The choice for countries is no longer a simple technological preference but a profound geopolitical and economic calculation. The path they choose will determine whether the future of AI is one of global collaboration and shared progress, or one of fractured ecosystems and escalating conflict over technological dominance.

China is leading the global energy transition

A multispeed transition

THE RACE TO ELECTRIFICATION – DIFFERENT STRATEGIES, DIFFERENT TRAJECTORIES

Global warming has spurred a global shift towards electrification, yet countries are progressing at different speeds, particularly when it comes to driving adoption of EVs. Thanks to a highly proactive policy, China enjoys uncontested leadership in almost every segment of the energy transition value. In contrast, Europe's EV adoption contracted in 2024 due to reduced subsidies. More recently, EV sales in emerging economies excluding China, notably in the Middle East, Africa, and Latin America, have jumped. The West risks further losing out in the race if it relaxes its efforts or fails to implement the right industrial policies.

SURGING SALES

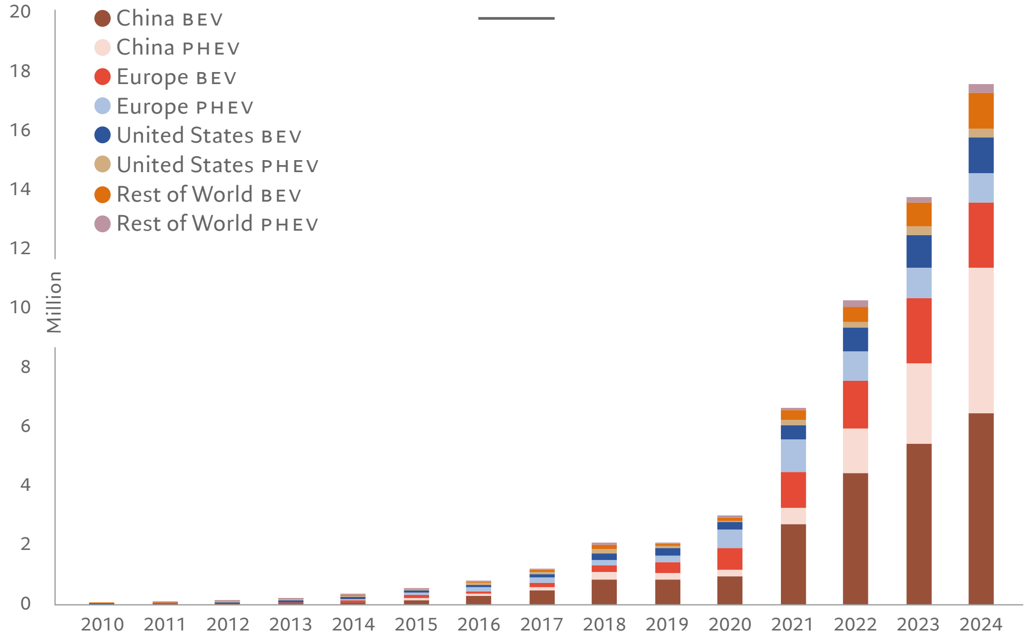
In 2024, electric cars[4] accounted for more than 20 percent of new car sales worldwide, with sales topping 17 million – a rise of over 25 percent compared to the previous year[5]. The additional 3.5 million cars sold in 2024 compared to 2023 exceeded total electric car sales in 2020. China maintained its lead, with sales exceeding 11 million, more than were sold globally just two years earlier (SEE CHART 1). However, global sales were tempered by stagnating growth in Europe, where subsidies were phased out or reduced in several major markets (SEE CHART 2). In the US, EV sales increased, although growth was roughly one-quarter of the previous year's rate. Outside these major

4 Electric cars refer to both battery electric vehicles (BEV) and plug-in hybrid electric vehicles (PHEV). PHEVs include extended-range electric vehicles (EREVs), which have both an internal combustion engine (ICE) and a plug-in rechargeable battery. However, in the EREVs case, the ICE only operates without direct mechanical connection to the wheels to recharge the battery through an electric generator.

5 Most of the data referred to in the text come from 'Global EV Outlook 2025 – Expanding sales in diverse markets', International Energy Agency, May 2025.

CHART 1

Electric vehicles sales



Source: Pictet Wealth Management, 'Global EV Outlook 2025 – Expanding sales in diverse markets', International Energy Agency, as at 31.05.2025

markets, sales surged by nearly 40 percent, reaching 1.3 million, closely approaching the US sales figure of 1.6 million EVs.

The rapid growth in EV sales over the past five years has significantly impacted the global car fleet. By the end of 2024, the global EV fleet reached almost 58 million units, constituting about 4 percent of the total passenger car fleet – more than triple the total EV fleet in 2021. Notably, the global stock of EVs displaced over 1 million barrels per day of oil consumption in 2024. The distribution is uneven: in China, one in 10 cars is electric, compared to one in 20 in Europe (SEE CHART 3).

MANUFACTURING POWERHOUSES: CHINA AND BEYOND

China is the world's leading electric car manufacturer, accounting for more than 70 percent of global production in 2024. The EU comes second, although production has stagnated at 2.4 million vehicles. Both are major EV exporters, while Mexico has ramped up exports to the US. Chinese manufacturers are increasingly looking abroad to capture a larger share of the global market. However, tariff policies complicate this effort. In 2024, multiple economies introduced new tariffs on Chinese imports, including the EU, which imposed specific countervailing duties aimed at offsetting alleged manufacturing subsidies received by Chinese original equipment manufacturers (OEMs). These additional tariffs are prompting Chinese OEMs to establish new overseas manufacturing capacities, primarily in the EU and Southeast Asia.

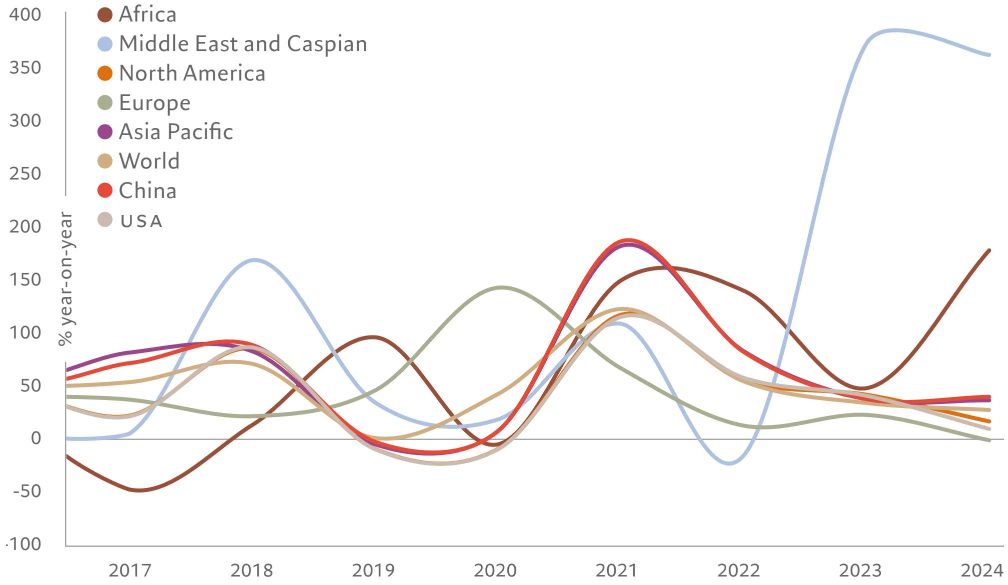
RANGE MATTERS: ADDRESSING CONSUMER CONCERNS

The average range of battery EVs remained stable in 2024, at about 340 kilometres under on-road conditions. Range was significantly lower for small cars, just above 150 kilometers. Medium and large cars, as well as SUVs, maintained ranges above 350 kilometres. As market competition

> "China enjoys uncontested leadership in almost every segment of the energy transition value chain, including EVs."

For illustrative purposes only. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations.

CHART 2
Electric vehicles sales



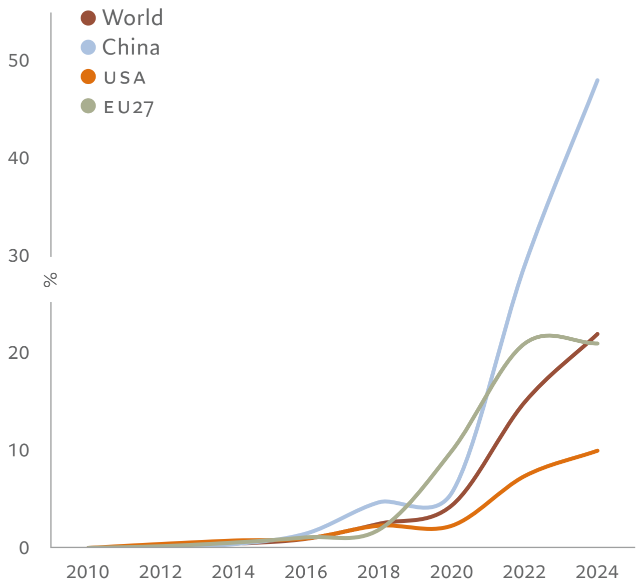
Source: Pictet Wealth Management, 'Global EV Outlook 2025 – Expanding sales in diverse markets', International Energy Agency, as at 31.05.2025

intensifies, this stabilisation in range generally suggests that carmakers have found an optimal balance between range performance and manufacturing costs. This offers energy and environmental benefits, since longer ranges require larger batteries, increasing vehicle energy consumption and demand for critical minerals.

Range anxiety remains a key factor influencing whether someone buys an EV. This could be mitigated through improvements in battery capacity and the expansion of charging facilities, or indirectly by offering alternative transportation options for long-distance travel.

Part of China's success in electrification is attributed to the rapid expansion of its high-speed rail system, which complements EV adoption by providing efficient solutions for medium- to long-distance travel, thus addressing range anxiety and accelerating EV adoption[6].

CHART 3
Electric vehicles sales share



Source: Pictet Wealth Management, 'Global EV Outlook 2025 – Expanding sales in diverse markets', International Energy Agency, as at 31.05.2025

6 Hanming Fang, Jing Li, Long Wang, Yang Yang, "High-speed rail and China's electric vehicle adoption miracle," Mimeo, February 2025

For illustrative purposes only. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations.

The electric car fleet has reached almost

58 million

units, constituting about

4%

of the total passenger car fleet.

Source: International Energy Agency, as at 31.12.2024

PRICE DYNAMICS: THE COST OF GOING ELECTRIC

Today, EVs often have lower total cost of ownership than internal combustion engine (ICE) cars over their lifetime, due to reduced fuel and maintenance expenses. However, in Europe, a 2023 survey by the European Commission identified the price of battery EVs as the main barrier to adoption. While prices generally fell in 2024, there is still a significant price gap between EVs and ICE vehicles in most regions.

CHARGING INFRASTRUCTURE: EXPANDING THE NETWORK

The number of public chargers has doubled since 2022 to over 5 million. Home charging remains the most popular method for EV owners. However, more public chargers are needed to support mass adoption for populations that do not have access to home chargers. The number of charging points added in 2024 was about the same as those available in 2020. About two-thirds of the growth in public chargers since 2020 has occurred in China, which now hosts about 65 percent of global charging infrastructure. EV owners report that charging speed is their most important consideration when using public chargers. Safety concerns related to EV battery technology have long limited faster charging, but recent innovations are reshaping the rapid-charging landscape.

Consumers buying large cars and SUVs in China are increasingly choosing plug-in hybrid electric vehicles (PHEVs) as a more flexible option, given their ability to handle long trips even when charging infrastructure is insufficient or congested.

Term premium on the rise: a global trend

Fiscal sustainability is in the spotlight

In the aftermath of significant government debt accumulation due to COVID-19 related fiscal easing, long-term government bonds have come under scrutiny from bond vigilantes. These investors have driven yields upward and bond prices downward following announcements of fiscal easing, notably in the UK in 2022, the US in 2023, and Germany in early 2025.

The primary factor behind the increase in long-term yields has been the rebuilding of term premiums – that is, the extra return investors demand for the risks associated with holding bonds over a longer period, such as interest rate volatility and inflation uncertainty.

Although term premiums are not directly observable, they can be estimated using models. The ACM model, developed by Adrian, Crump, and Moench, in 2013 breaks down nominal bond yields into two components: expectations of future short-term interest rates and the term premium. While the ACM model is widely used for US Treasury yields, it can be adapted for other countries as well (SEE CHART).

Term premiums have surged following fiscal easing, reversing a trend of compression that began after the GFC. This resurgence of bond vigilantes and the rebuilding of term premiums raise important questions about the factors driving these changes.

Several factors influence the term premium, but a few key drivers stand out. One major influence is bond market volatility. Historically, the ICE Bank of America MOVE index, which measures the implied volatility on US Treasuries, has been closely linked to fluctuations in the term premium. Heightened market uncertainty leads investors to demand higher yields, while calmer conditions typically reduce the term premium. However, since 2020, this relationship appears to have faded, suggesting that other factors are now playing a more prominent role.

One such factor is the sustainability of government finances. An increasing debt-to-GDP ratio can erode investors' confidence in a government's ability to service its debt, leading to a higher term premium. As the supply of government bonds surged significantly in the wake of the pandemic, term premiums rose globally.

While government borrowings also surged in the wake of the GFC, term premiums experienced a notable compression until 2020. This was largely due to extensive quantitative easing by central banks through the large-scale purchase of government bonds, reducing the supply of bonds to market participants, in turn, lowering the required premium. However, post-pandemic inflation shocks have prompted central banks to engage in quantitative tightening, adding to the already large supply of government bonds to market participants.

Finally, the reduced diversification benefits of traditional stock-bond portfolios may be influencing recent term premium increases. As the correlation between stocks and bonds has turned positive since the pandemic, the required returns on bonds have risen due to diminished diversification benefits.

Recent developments highlight this trend, such as Germany's decision to relax its "debt brake" to boost infrastructure and defence spending. The US may face similar challenges due to demographic shifts and rising deficits. President Trump's return to the White House has increased market concerns about fiscal policy, which is contributing to an upward trend in the US term premium.

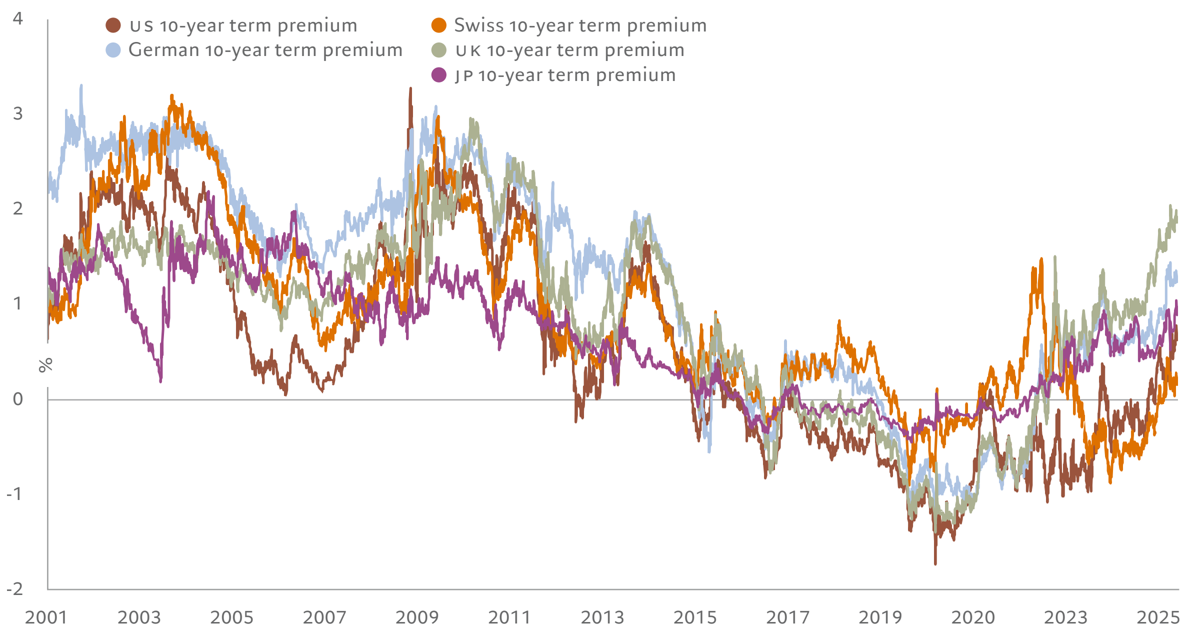
> "Looking ahead, the term premium is likely to continue rising over the long term."

Increased volatility in sovereign bonds, greater uncertainty regarding the medium-term inflation trajectory, the less stable correlation between stocks and bonds, and the probable rise in public debt-to-GDP ratios compared to the previous decade all point to structurally higher term premiums globally for the next decade.

Rising term premiums lead us to project that 10-year government bond yields will surpass nominal GDP growth over the next decade in the US, the UK, and Germany, with yields expected to reach 4.8 percent, 4.6 percent, and 3.3 percent, respectively. Conversely, we anticipate that 10-year yields will likely remain below nominal economic growth in Japan, China and Switzerland due to the preservation of relatively low policy rates for domestic reasons, either to stimulate the economy or prevent disinflation.

This divergence in the long-term yield trajectory implies that the projected total returns over the next decade for 10-year sovereign bonds are higher in the UK, US and Germany (at 5.2 percent, 4.8 percent and 3.4 percent, respectively) compared to China, Japan and Switzerland (at 2.2 percent, 1.9 percent and 0.9 percent, respectively).

Term premiums are on the rise globally



Source: Pictet Wealth Management, central banks, own calculations, as at 03.06.2025

For illustrative purposes only. There can be no assurance that these projections, forecasts or expected returns will be achieved. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations.

SECTION 3

Key market insights and analysis of expected returns

Winding through the Carpathian Mountains, Romania's Cheia road is among the world's most spectacular roads. Built in the 1970s, its switchbacks and hairpin turns rise above 2,000 meters, offering breathtaking views but also challenging driving conditions.

Key conclusions from our return expectations over the coming 10 years:

A depreciation of the dollar as investors start to question its status as the world's ultimate safe haven and global reserve currency.

US equity market dominance likely to fade in a less exceptional environment.

Private assets are producing stable returns, with private equity poised to outperform public equities.

Term premiums on the rise as fiscal sustainability is in the spotlight.

Diversification away from the US to continue.

Key market insights and analysis of expected returns

Europe: a brighter future for European equities

After a "lost decade", Europe starts to perform

After 15 years of persistently underperforming global equities, it would be understandable if some investors viewed euro area stocks as structural underperformers that warrant limited exposure in an equity portfolio. However, taking a longer-term perspective provides an alternative narrative, with CHART 1 showing that the region was a regular outperformer during the 1990s and early 2000s, especially during periods of economic expansion and equity bull markets. It is only since the global financial crisis (GFC) that Europe has become a consistent underperformer.

EUROPEAN STOCKS SUFFERED A "LOST DECADE" OF RELATIVE UNDERPERFORMANCE

This observation begs two obvious questions: what changed to turn euro area stocks from relative winners to relative losers; and will they return to being winners once more? We think there were two catalysts that drove a "lost decade" of relative underperformance for euro area stocks between the GFC and the onset of the pandemic in 2020.

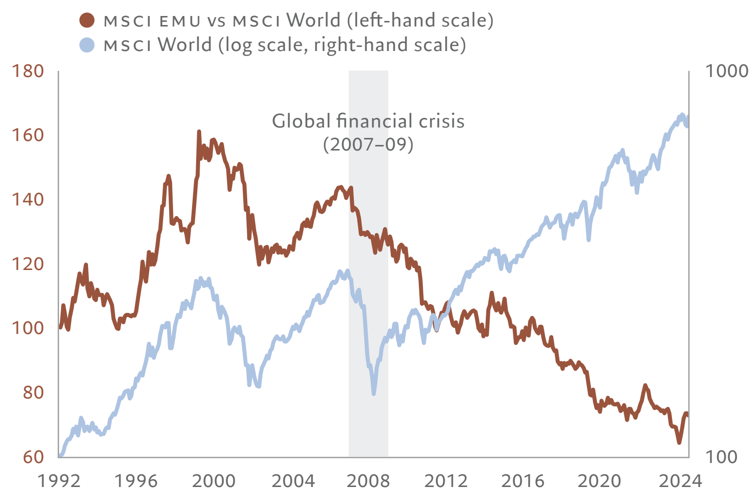
The first was the euro area sovereign debt crisis of 2011–12. This short-circuited the region's post-GFC recovery, ushering in a decade of tighter domestic fiscal policy and more elevated risk premia, limiting economic growth, corporate profits and asset valuations.

The second driver was a lack of inflation through the 2010s (including reaching 50-year lows in many countries), which, coupled with the debt overhang from the GFC, encouraged central banks to ease monetary policy to such an extent that nominal policy rates turned negative in the euro area. While this eased pressure on government finances (via lower bond yields), it weighed heavily on the region's banking sector, suppressing profitability and constricting loan growth. Reduced credit availability in the broader economy is particularly problematic for a region such as Europe where the majority of corporate financing needs are met by the banking sector rather than capital markets.

While the euro area's negative nominal interest rates were putting downward pressure on the region's value stocks (such as banks), negative real policy rates outside Europe were putting upward pressure on equity valuations of longer-duration growth stocks, most noticeably in the US technology sector. For comparison, US Federal Funds rate was lower than inflation over 80 percent of the time between 2010 and 2020.

These combined factors produced something of a perfect storm for the relative performance of euro area equities over the last 15 years. Weak economic growth led to disappointing corporate profit growth at the same time as investor outflows from the region (mostly to the US) put downward pressure on relative

CHART 1
The regular outperformance from European equities in the 1990s and 2000s has shifted to persistent underperformance in the post GFC era



Note: rebased to 100
Source: Pictet Wealth Management, MSCI, as at 30.05.2025

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valuations, which ultimately fell to a record low in the second half of 2024 (SEE CHART 2).

EUROPEAN POLICY TURNING MORE PROACTIVE AND DYNAMIC

Looking forward, the euro area is likely to remain on a relatively slower growth track than many of its global peers given long-term structural trends, such as demographics. That said, investing is predominantly about identifying changes and taking advantage at the margin. Here, we think things are clearly improving, both in terms of the outlook for economic growth and a shift towards a more proactive and dynamic approach from policymakers.

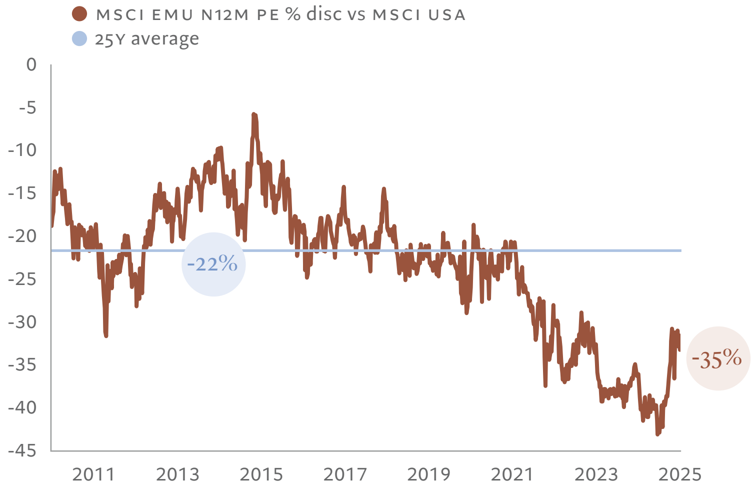
Ever since the euro's introduction in 1999, it has become something of a truism that the euro area requires a crisis to take the next necessary steps to strengthen its institutional architecture. This time around, the catalyst is not a domestic debt crisis (which created the conditions for more dynamic monetary policy at the ECB) or a global pandemic (which changed the parameters of fiscal policy with the introduction of joint liability debt issuance as part of the EU Recovery Fund). Rather, it is the shifting nature of geopolitics and, more specifically, changes in US government policy that challenge Europe's export-oriented business model (via tariffs) and require European countries to fund more of their own security through increased defence spending.

We believe the next steps in this European journey will help repair some of the impediments that have weighed heavily on the region's equity market since the GFC. Specifically:

- The removal of the German "debt brake" signals a more active fiscal policy dynamic that could push German GDP growth up to around 1.5 percent for the next decade (compared to less than 1 percent over the last 10 years). With Germany accounting for 28 percent of the euro area economy (and 24 percent of the wider pan-European economy), the policy shift here should also raise economic growth rates across the entire continent.
- While few other countries have the fiscal space to replicate this shift in German policy directly, broader regional fiscal policy will also get a boost from plans to rebuild the bloc's defence capabilities. These plans could include joint liability debt issuance (e.g., "defence bonds"), loans and a more flexible interpretation of euro area fiscal rules.
- The financial sector should be a natural beneficiary of stronger economic growth and broader fiscal burden sharing. However, equally as important is a changing regulatory dynamic with the pendulum shifting away from the punitive approach of the post-GFC years to a more pragmatic and market-friendly attitude today. Such a shift is likely to see progress made with regard to the Capital Markets Union (now renamed the Savings & Investment Union), which should deepen and improve the functioning of the region's financial system.

CHART 2

We expect euro area relative valuations to re-rate back to their long-run average on more dynamic domestic policy and a stronger EUR



Source: Pictet Wealth Management, MSCI, IBES, as at 02.06.2025

EUROPE IS SET TO REGAIN A GREATER MINDSHARE ACROSS GLOBAL EQUITIES

There are already some positive signs, with European equities enjoying their best start to the year relative to global peers since the advent of the European common currency in 1999 (the MSCI EMU index outperformed MSCI World by 15 percent in dollars through the first half of the year). So far, this recent bout of outperformance has done little to narrow the region's undervaluation gap. However, we expect to see significant progress in this regard over the coming years. In our *Horizon* forecasts we assume that the relative undervaluation of MSCI EMU versus MSCI USA reverts back to its long-run discount of 20 percent from its current level of -35 percent.

One positive factor in this regard should be our forecast for a stronger euro, which reflects a likely rebalancing of global fund flows away from the dollar as investors and institutions of all types take steps to diversify their currency holdings in the years ahead. Historically, European equity valuations were positively correlated to the euro and we see little reason why this should change. Therefore, our expectation for a stronger common currency also implies a relative valuation re-rating of the region's equity market versus global peers.

In summary, while it is difficult to see euro area company profits grow faster than their US peers due to regional economic growth differentials and a differing sector mix (the US will maintain a higher weighting in technology stocks for example), the potential for a substantial valuation re-rating and further currency appreciation should set the stage for much better European relative performance in the years ahead.

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A less exceptional environment for US equities

US equity market dominance set to slow

Recent shifts in US government policy that we have seen this year is creating unique challenges for investors. In the short term, it creates heightened uncertainty about the cyclical outlook for economies and corporate profits, in addition to the consequences for near-term asset returns. Longer-term, it fuels the debate as to whether we are past peak "US exceptionalism" after a crescendo of positivity last year that saw the dollar rise to its highest valuation since the 1980s and pushed US equities to record highs, whether measured by relative valuations, relative performance or their share of global market capitalisation.

It is too early to say whether the changing policy backdrop in the US will have a material impact on the US economy and undermine its traditionally superior growth record. But what is clear is that investors must heed a new reality defined by greater uncertainty and a wider range of potential outcomes when it comes to assessing economic performance, asset returns and capital flows.

Even a benign interpretation of events may not be enough to encourage fresh inflows into US assets given that current investor positioning is at a record high and the dollar is now depreciating. Given this backdrop, we suspect considerably more investors will be asking themselves "do we have the right amount of US exposure or do we have too much?" as opposed to "do we have the right amount of US exposure or too little?"

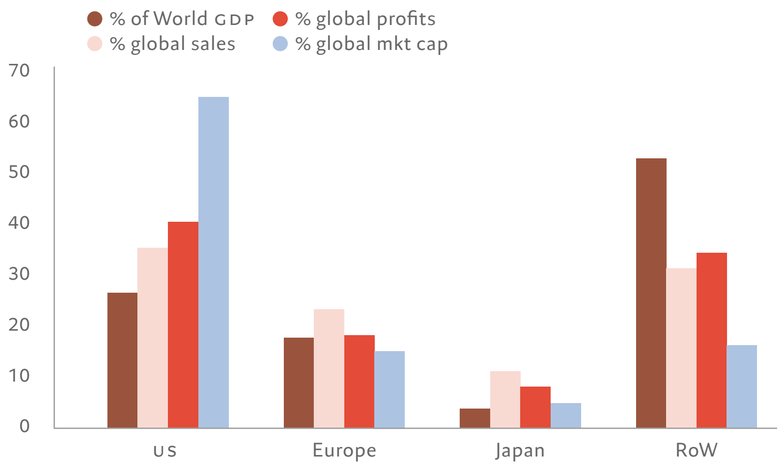
US WEIGHT IN GLOBAL EQUITY MARKETS IS LIKELY PEAKING

One way to think about this is to run a Goldilocks test on the current US weighting within global equity markets: is it too high, too low or about right? Currently US equities account for their highest weighting we have seen in the modern era of financial markets at around 70 percent of developed market equity indices by market capitalisation and 60 percent of all global equity markets, including emerging markets. It is also materially larger than the US share of world GDP or of global corporate revenues and profits.

This strong US equity performance has been underpinned by various building blocks (SEE CHART 1). For example, while the US accounts for around 26 percent of global GDP, it captures about 35 percent of global corporate revenues, reflecting a more capitalist dynamic and the global nature of many US companies. On top of this superior revenue trend, US companies also generate higher margins than their international peers, meaning that their share of global profits is then higher again at around 40 percent. Finally, US stocks enjoy higher valuations which are

CHART 1

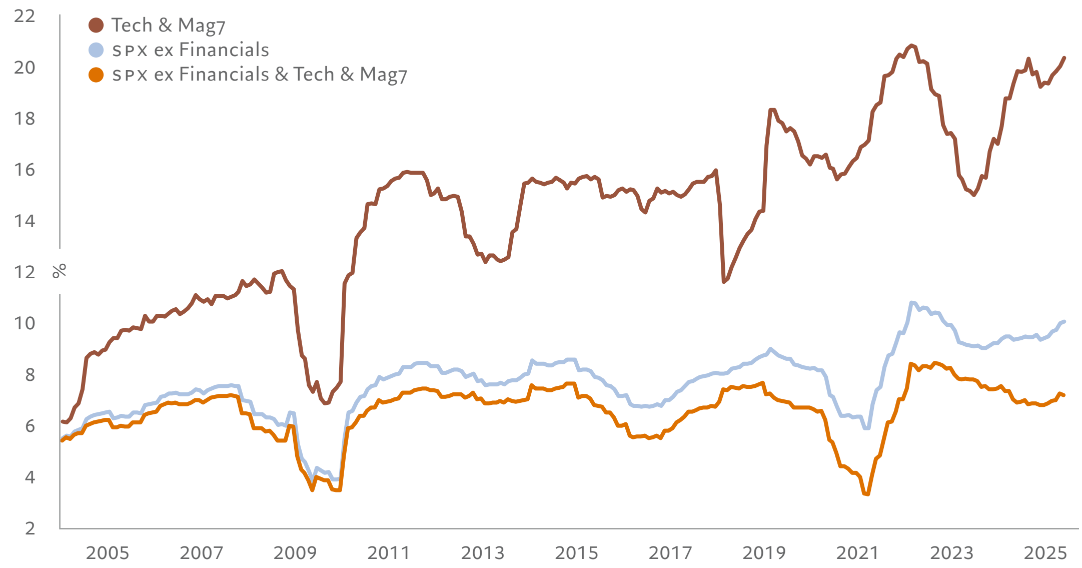
US equities share of global market capitalisation is much higher than its share of GDP, corporate revenues or profits



Source: Pictet Wealth Management, LSEG, IMF, MSCI, as at 20.06.2025

For illustrative purposes only. There can be no assurance that these projections, forecasts or expected returns will be achieved. Past performance should not be taken as a guide to or guarantee of future performance. Performances and returns may increase or decrease as a result of currency fluctuations.

CHART 2
US corporate margins do not look extended when technology-related company are excluded



Source: Pictet Wealth Management, Morgan Stanley, as at 31.05.2025

US accounts for around

26%

of global GDP and accounts for

35%

of global corporate revenues.

Source: Pictet Wealth Management, IMF, MSCI, Worldscope, as at 20.08.2025

then applied to these larger profits, leading to an even bigger share of global market capitalisation.

Looking forward, our economic forecasts do not project a material slowdown in the differential between US and rest-of-world GDP growth that would point to weaker relative corporate sales growth ahead. In addition, our expectation of dollar weakness over the coming years should be supportive for US corporate revenue share. Hence, any reduction in the US share of global market capitalisation would need to reflect either margin disappointment (such that earnings growth lags revenue growth) and/or a valuation de-rating.

> "Investors must heed a new reality defined by greater uncertainty and a wider range of potential outcomes."

AI CAN HELP US COMPANIES MAINTAIN MARGINS AT THIS HIGH LEVEL

With aggregate US margins currently close to a record high, simple economic theory suggests corporate margins should revert to the mean over time as periods of excess profitability attract new capital and push subsequent returns lower (and vice versa). However, this phenomenon has weakened over the last decade, mostly thanks to the growing dominance of technology stocks.

In the modelling that underpins our 10-year equity return forecasts, we assume a moderate decline in technology margins due to the increasing maturity of their business models coupled with the potential for increased competition over time. However, for the broader S&P index we assume companies will be able to maintain margins close to their current level. This reflects the fact that margins for non-technology companies have been relatively stable in the last few years and are currently close to their 20-year average as we show in CHART 2. Over the next decade, we think an increased adoption of AI by non-technology companies may boost their own efficiency and offset other factors that could have more negative implications for profitability (such as higher taxes or rising interest rates).

Historically, valuations and margins have usually been inversely correlated, whereby investors tended to

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apply a lower price-to-earnings (PE) ratio on peak profitability (in anticipation of its subsequent decline) and a higher PE ratio on trough profitability (ahead of an expected recovery). However, this relationship has also weakened over the last decade as margins have become less volatile and markets have become more momentum-oriented with a greater focus on near-term earnings trends driving tactical investment decisions.

Consequently, our relatively benign view on corporate margins suggests that US equity valuations are likely to remain above average and probably towards the upper end of their historic range. However, even under that assumption we see scope for valuations to move lower over time and our analysis assumes a 12-month forward PE for the S&P of 18 compared to its current level of over 20.

Our analysis assumes a 12-month forward price-to-earnings ratio for the S&P of

18

compared to its current level of over 20.

SHIFTING AWAY FROM US ASSETS?

A significant factor in our thinking here concerns the potential for global investors to repatriate capital from the US given the changing direction of government policy alongside a growing expectation that the dollar is likely to depreciate over the coming years. As illustrated in CHART 3, there has been a persistent net inflow into US assets from global investors over the last 15 years (shown here as a deterioration in the US's net international investment position) and this prompted US equity valuations to re-rate versus their global peers. Logically, therefore, any reversal in this flow of funds away from the US should also start to unwind some of the US' current valuation premium versus its global peers.

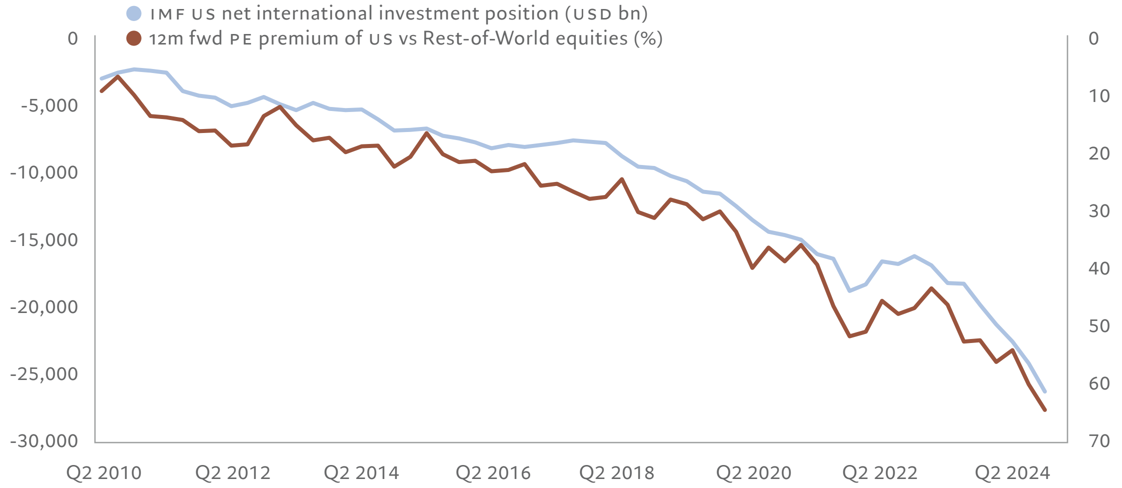
In our 10-year return framework, we assume this reduction in the US valuation premium occurs primarily through a fall in the US PE ratio, whereas valuations for rest-of-world equities are largely unchanged at their current level (which is close to observed long-run averages). Specifically, a fall in the S&P PE to 18 would see its valuation premium fall from around 35 percent today to 20 percent, which is close to the average premium seen over the last 25 years.

We have also "sense-checked" our assumptions by comparing the valuation of US equities to US bonds using a crude expression of the US equity risk premium (ERP) whereby we subtract the 10-year US Treasury yield from the 12-month forward earnings yield. Our assumption of 18 times the PE and a 10-year US Treasury yield of 4.8 percent (which is our bond strategist's *Horizon* forecast) gives an ERP of 75 bps. While this is low in the context of the last 20 years, it is similar to what we saw in the two decades prior to the GFC, which we think is a more relevant period to use as a comparison given a more similar inflation backdrop to today.

The combination of a smaller valuation premium and a weaker dollar should see the US share of global market capitalisation start to come down over the coming years. However, this retracement is likely to be a gradual one absent a bigger shock to the domestic economy or the earnings trend of the large-cap technology related stocks.

CHART 3

Global inflows into the US have been a key factor behind the persistent increase in the relative valuation of US stocks over the last 15 years



Source: Pictet Wealth Management, MSCI, IMF, as at 31.05.2025

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Private equity: resilience and growth amid challenges

Private equity is poised to outperform public equities over the next decade.

Nearly

60%

of total private capital raised in 2024 was allocated to private equity, followed by private debt at

18%

Source: Pitchbook, as at 30.04.2025

Over the last two decades, private equity has evolved from a specialised investment strategy into a widely recognised asset class. According to PitchBook, nearly 60 percent of the total private capital raised in 2024 was allocated to private equity (including venture capital), followed by private debt at 18 percent. Buyouts remain the cornerstone of the private equity sector.

The appeal of private equity lies in its potential to generate outsized returns. Several factors explain why private equity has consistently outperformed listed equities (SEE CHART 1). Firstly, private equity managers have targeted investments in burgeoning sectors such as healthcare, technology, and renewable energy, all of which continue to experience robust growth. For example, in Q1 2025, healthcare private equity deals in the US amounted to USD 25 billion across 278 transactions, with a particular focus on technology-enabled services and value-based care. Similarly, the technology sector remains a key area of investment, driven by AI and cloud computing trends.

Secondly, the inherent illiquidity of private equity enables fund managers to time their exits carefully to maximise value. Although exit activity has encountered challenges recently, the emergence of continuation vehicles offers an alternative to traditional exit strategies. This enables general partners to extend holding periods and optimise asset value in volatile markets.

Thirdly, private equity managers retain direct control over their investments, facilitating the implementation of operational improvements and increased efficiency. This alignment of interests between private equity firms, investors and company management is a distinctive feature of the asset class. Carve-outs and add-on acquisitions, for example, have become increasingly popular strategies, enabling private equity firms to acquire non-core assets and enhance operational synergies.

Finally, the use of financial leverage in private equity investments continues to amplify returns. Although the cost of debt has risen, favourable credit conditions in early 2025, characterised by tight credit spreads, have supported large-scale transactions such as Sycamore Partners' acquisition of Walgreens Boots Alliance for USD 23.7 billion.

Despite its historical success, private equity now faces significant challenges in the current financing environment. The cost of funding has increased since the COVID-19 crisis, while macroeconomic uncertainties, including rising tariffs and geopolitical tensions, have added further complexity. In Europe, for example, US-imposed tariffs on imports and political instability in key markets such as France and Germany have dampened investor sentiment, resulting in a 24.6 percent quarter-on-quarter decline in deal value in Q1 2025.

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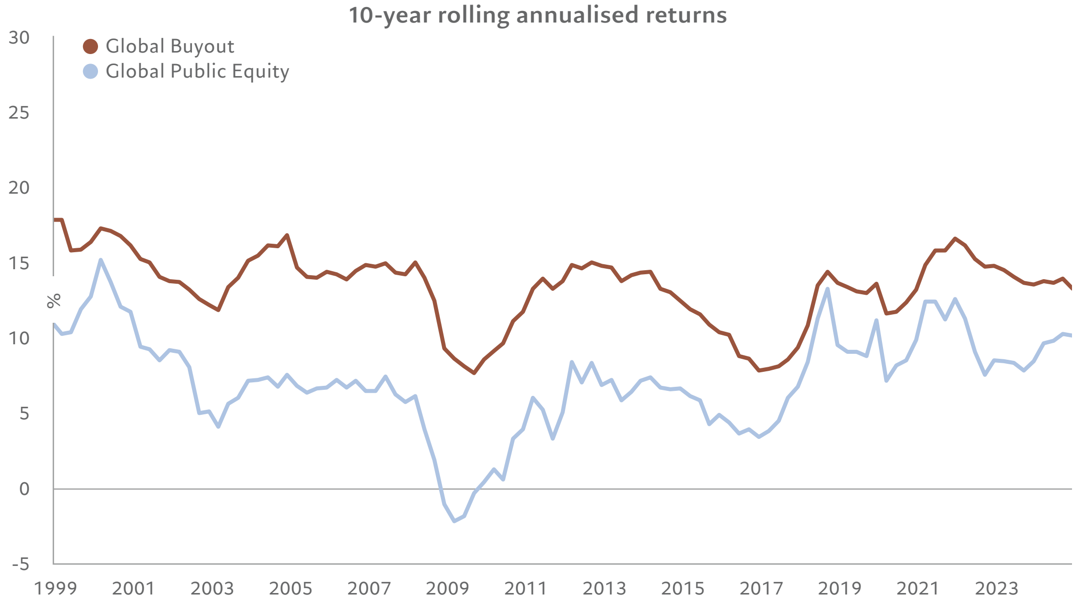
CHART 1
MSCI AC World index versus Global Buyout
10-year rolling annualised returns



Source: Pictet Wealth Management, Burgiss, FactSet, as at 31.03. 2025

In Q1 2025, healthcare private equity deals in the US amounted to

USD
25 billion
across 278 transactions

Source: Pitchbook, as at 30.04.2025

The performance of private-equity investments, which typically have finite holding periods, largely depends on managers' ability to secure exits at favourable valuations. However, exit activity has slowed in recent years (SEE CHART 2). In Europe, the median holding period for private equity-backed companies increased to 3.4 years in Q1 2025, up from 2.4 years in 2019. Meanwhile, a backlog of 3,800 private equity-backed companies held-for between five and 12 years in the US underscores the difficulties in achieving timely exits. Divergent valuation expectations between buyers and sellers, coupled with higher borrowing costs, have further complicated the exit landscape.

Higher interest rates and reduced demand have also affected financing conditions and investor sentiment. Nevertheless, monetary easing in Europe – including eight interest rate cuts by the ECB since June 2024 (at the time of writing) – has provided some relief, lowering borrowing costs and increasing sponsors' leverage capacity. In addition, the ample dry powder held by private equity firms – approximately USD 1 trillion in corporate private equity and USD 566.8 billion in private credit – positions the industry to capitalise on market dislocations and invest in undervalued assets.

Despite all of these challenges, the asset class remains resilient and adaptable. Initiatives such as the increasing prominence of growth equity funds, the adoption of continuation vehicles and a focus on high-growth sectors are expected to enhance its long-term performance. Ultimately, private equity's capacity to generate attractive returns will hinge on its ability to innovate and adapt to shifts in the market landscape.

Despite the current headwinds, our analysis suggests that global private equity is set to achieve an average annual return around 10 percent over the next decade, thereby continuing to outperform listed equities (with the MSCI AC World index forecast to

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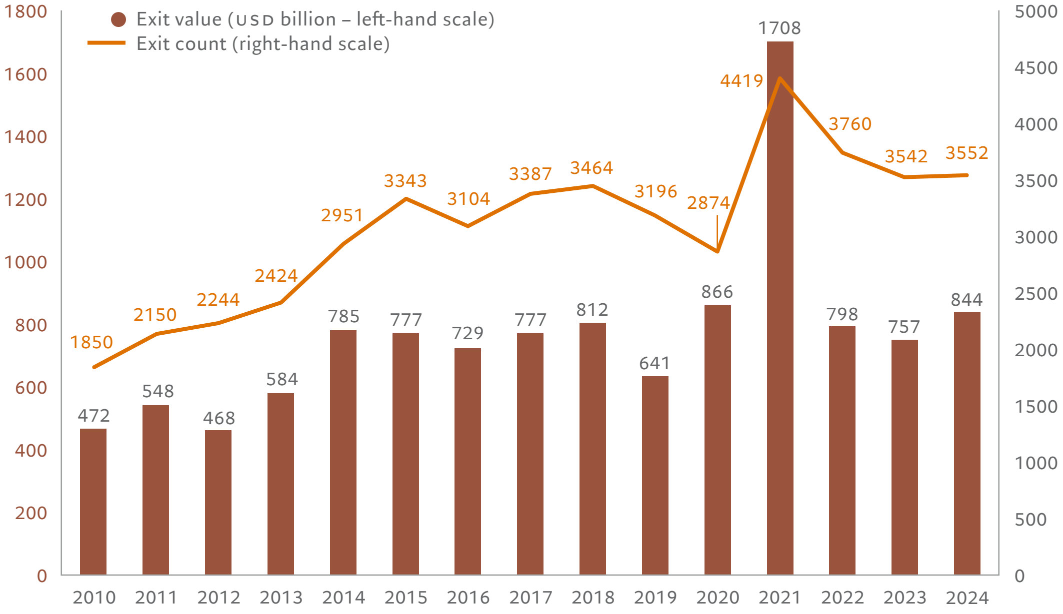
CHART 2

Global private equity exit activity has slowed significantly since 2021



Source: Pictet Wealth Management, PitchBook, as at 31.03. 2025

return 7.2 percent annually). This projection is derived from a regression model in which public equities and financing costs are the primary factors explaining private-equity returns. Statistically, public equities alone account for approximately 77 percent of private equity returns over a 10-year period. By incorporating the yield on a US non-investment-grade bond as a proxy for refinancing costs, the model explains about 90 percent of private-equity returns. While our 10-year return forecast of 10 percent for private equity is the highest among the asset classes covered in *Horizon*, it remains considerably below the past decade's average realised return of around 14 percent for global private equity and 15 percent for US private equity. However, the ability of individual private-equity managers to adapt their strategies and identify profitable buyout targets could potentially drive returns even higher.

In conclusion, the private equity industry has evolved significantly over the past decade and is expected to maintain its growth trajectory, despite the mounting challenges it currently faces. Evergreen funds are playing a pivotal role by enhancing exit opportunities and strengthening returns through continuous fundraising and improved liquidity options. Moreover, an easing of monetary policy and expanding fiscal measures in Europe, paired with the Trump administration's deregulatory agenda are likely to stimulate increased capital expenditure. This is expected to create a more favourable environment for growth and facilitate exit opportunities for private equity-backed companies. As interest rates decline, trade and policy uncertainties abate and macroeconomic conditions stabilise, new investment opportunities are likely to emerge.

> "The private equity industry has evolved significantly over the past decade and is expected to maintain its growth trajectory."

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The outlook for private debt markets versus public markets

Private debt expansion shakes up financing market for mid-sized firms

We forecast a global 10-year expected return of

7.8%

for global private debt.

Over the past decade, US companies have diversified their funding away from traditional bank lending and the corporate bond market into two alternative markets: broadly syndicated loans (BSL) and private debt.

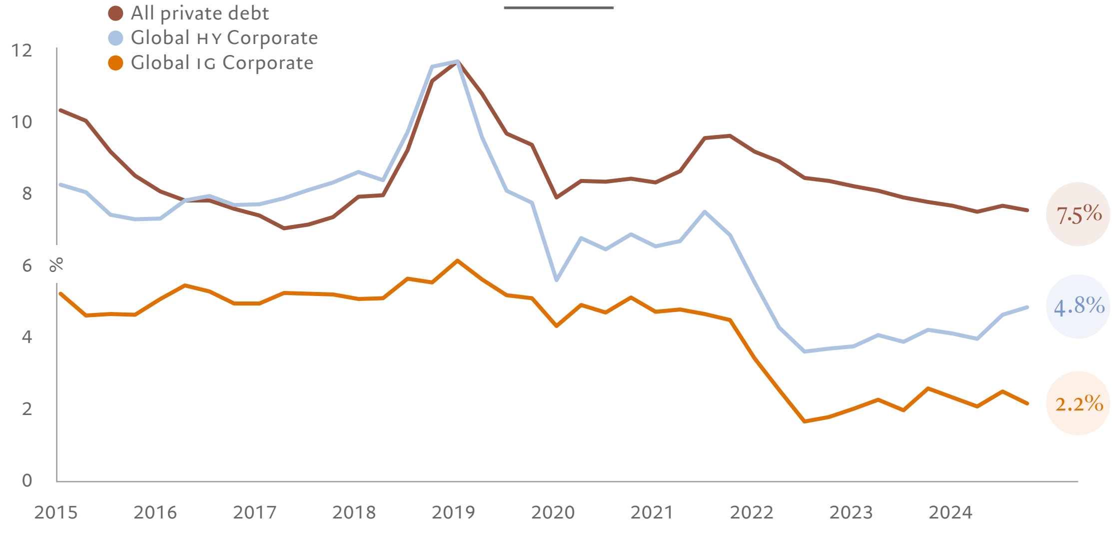
The private debt market, which is mostly US-based, is now bigger than the high-yield (HY) corporate bonds and BSL markets, serving as a primary financing tool for mid-market firms, private equity, and innovative lending strategies.

Both BSL and private debt are characterised by their floating rate features, with borrowers typically paying a spread over a base rate, often an overnight benchmark rate like the Secured Overnight Financing Rate (SOFR). This spread is typically determined by the lender and contingent on the borrower's debt risk profile. Meanwhile, the base rate is aligned with the policy rate and typically adjusted on a quarterly basis.

The floating rate feature minimises interest rate risk for investors, as rates on the loans adjust periodically, but it increases risk for borrowers who may face higher coupon payments if the base rate rises. This low duration risk makes BSL and private debt funds particularly appealing to investors during rate hiking cycles. It also explains the double-digit growth rates experienced by both markets during the previous two Federal Reserve rate hiking cycles between late 2016–2019 and 2022–2023.

CHART 1

10-year rolling total returns have come down except for HY corporate bonds



Source: Pictet Wealth Management, FactSet, Burgiss, as at 31.12.2024

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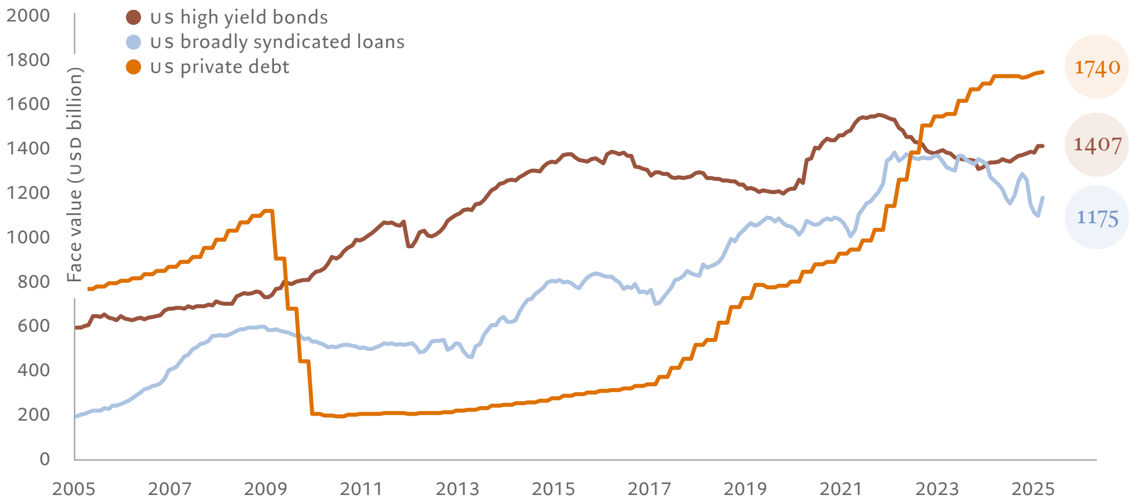
CHART 2

The public corporate bond and loan market has shrunk in favour of the private debt market



Source: Pictet Wealth Management, ICE Bank of America indices, as at 31.03.2025

Since 2017, a significant trend has emerged where private lenders have expanded into the territory traditionally dominated by banks and public markets, particularly in the US, leading to a five-fold increase in the size of the US private debt market over the last decade. Private debt has become more interconnected with traditional banks and non-bank financial intermediaries like hedge funds or private equity firms through partnerships and deal-making activities.

In contrast to BSL and HY bonds, private debt funds offer limited transparency and liquidity and are often structured as closed-end vehicles with multi-year lockups. While private debt delivered equity-like returns of over 10.2 percent annually between 2003 and 2015, the market's shift towards riskier borrowers and complex deal structures has raised concerns about diminishing returns and increased risks, evident in the downward trend of rolling 10-year total returns since 2021 (SEE CHART 1). In this year's *Horizon*, we have broken down the 10-year expected return on private debt into 8.1 percent for the dollar segment and 6.8 percent for the euro segment. Assuming a 75 percent weighting for the US market and 25 percent for the euro market, this yields a global expected return of 7.8 percent in local currency.

For global HY corporate bonds, the expected return of 6.1 percent over the next 10 years remains consistent with last year's forecast, with debt spreads forecasted at 300 bps, offering a favourable carry compared to sovereign bonds. The global investment-grade expected return has significantly increased from 4.2 percent to 5.3 percent, driven by anticipated higher total returns from sovereign bonds over the next 10 years, with credit spread forecasts remaining unchanged at 100 bps.

The rise in sovereign bonds' 10-year expected total returns from last year mostly stems from current yield levels, which are closely aligned with our long-term assumptions, providing a comfortable carry while causing minimal bond price depreciation. Overall, our 10-year expected returns continue to favour an overweight allocation to credit over sovereign bonds due to the higher expected returns in this segment. Additionally, the expansion of the private debt market and other developments in the credit market offer multiple opportunities for investors to secure a stable income over the next decade (SEE CHART 2).

"A significant trend has emerged where private lenders have expanded into the territory traditionally dominated by banks and public markets."

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De-dollarisation in the age of geoeconomics

Fragmentation, not substitution

A CHANGING LANDSCAPE

The death of the dollar has been foretold many times. Yet neither the end of the gold standard in 1971, nor an event as seismic as the GFC ended its dominance. True, central banks have shifted their reserves into other currencies and into gold over the past decade, in particular in the wake of Russia's invasion of Ukraine and the emergence of the "Global South". And China is promoting an acceleration of trade payments settled in renminbi, while the erratic policymaking of the Trump administration has dented confidence in the dollar. In addition, the development of digital currencies, whether officially or privately sponsored, offers yet further payment alternatives in the future.

But do these trends indeed herald the end of dollar dominance of the global financial system? To understand the forces driving de-dollarisation it is necessary to understand the forces that lead to the development of a reserve currency in the first place. Historically, the currency that served as the unit of account, means of payment and even store of value in a domain other than its own reflected a country's military and political strength. In other words, a conquering political entity (a tribe or a dynasty) imposed its political and economic order on the conquered entity, expanding trade and thus the use of its own means of exchange.

Historically, most leading international currencies were on a metallic standard (typically gold) and conquest often involved a transfer of gold stocks, solidifying the shift in power. Only a few international (Western) currencies were fiat currencies, such as those of the Italian city-states and the Dutch florin in the 14th and 17th centuries. The dollar is unique because it is the only modern instance of an international fiat currency whose status depends entirely on the credibility and the authority of the issuing state.

> "The dollar's preeminent role in the global financial system has been challenged repeatedly in the past."

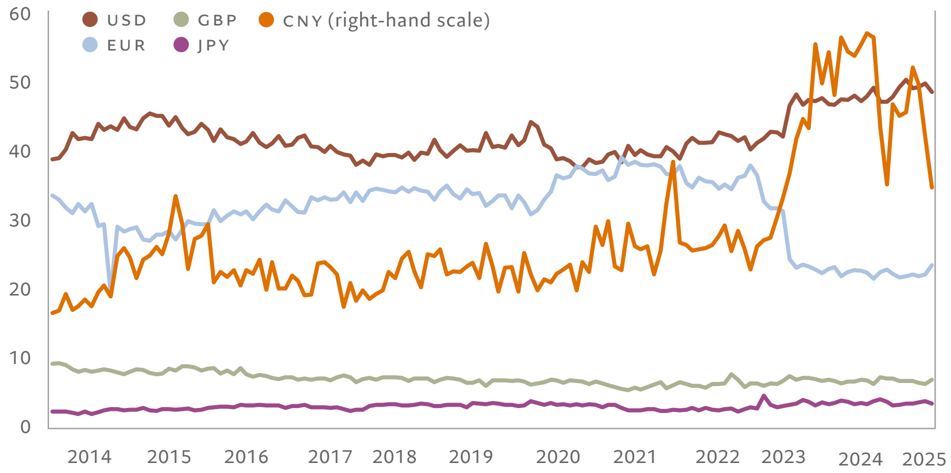
RECENT CHALLENGERS

The dollar's preeminent role in the global financial system has been challenged repeatedly, notably by the Japanese yen in the 1980s and the euro in the 2000s. Both offered potential substitutes for the dollar, providing access to deep, liquid open financial markets of advanced economies. Both competed on economic and financial grounds with the US. Yet, in the end, they failed to dethrone the dollar. Japan's economic bubble burst in the 1990s, engendering a painful and lengthy period of deleveraging that resulted in a low-growth, deflationary economy. The 2009–12 debt crisis revealed how the euro area lacked the requisite economic and fiscal integration to deal with large internal imbalances. Its bond market remains fragmented and is marked by divergent yields due to varying credit risk. In contrast, the US managed to restore its economic leadership following the GFC, having successfully recapitalised its banking system via the so-called troubled asset relief program (TARP) backstop. Its lead in terms of per-capita income and technological gains has only widened since then.

The main reasons for dollar dominance in global markets are the depth, breadth and liquidity of US capital markets and the protection US law and courts afford to foreign holders of reserve assets. In spite of this protection, the US has used sanctions repeatedly against foreign countries

CHART 1

Payments executed in SWIFT by currency, percent of total



Source: Pictet Wealth Management, Macrobond, as at 31.12.2024

in order to further its (geo)political goals. The trend towards increased diversification reflects not a lack of usefulness of the dollar as a means of exchange (those attributes remain fully in place), but rather a reluctance of certain countries to be subject to US political influence. In particular, the freezing of Russian reserves in 2022, following its invasion of Ukraine, represented a watershed moment as it called into question the fundamental principle of central bank immunity. Indeed, the imposition of US sanctions following Russia's 2014 invasion of Crimea prompted Russia to insulate itself against future sanctions by switching dollar reserves into euro, renminbi and gold and by creating an alternative card payments system called MIR. MIR cards are accepted in several "friendly" countries in Latin America, the Caucasus and Central Asia. In addition, Russia launched the System for Transfer of Financial Messages (SPFS), a domestic alternative to the Belgium-based Society for Worldwide Interbank Financial Telecommunication (SWIFT), to which 20 countries are connected according to the Central Bank of Russia. However, this is far from being a serious competitor to the well-entrenched SWIFT system, with its 11,000 correspondent banks in 200 countries (SEE CHART 1).

ASSESSING FUTURE CANDIDATES

In evaluating a currency's claim to global dominance, it is useful to analyse its qualities across the three functions of money mentioned previously (unit of account; means of exchange; and store of value). It is also interesting to observe whether any shifts are driven by the private or the public sector.

Invoicing and payments

There are strong network effects across the three monetary functions, which gives the incumbent currency a strong advantage. A single unit of account can reduce financial frictions such as price discovery, exchange rate volatility or hedging costs as it improves transparency and promotes competition. Indeed, the euro was created for this purpose amongst other, political, objectives). The dollar currently dominates as a unit of account as evidenced in global invoicing, with 96 percent of trade in Latin America invoiced in dollars, 74 percent in Asia-Pacific and 79 percent in the rest of the world. Only in Europe does the euro have a stronghold and the dollar is used in only 23 percent of all trade invoices.

China's renminbi lacks many of the dollar's advantages. For one, the exchange rate is not a market price and its holders thus face realignment risk. What is more, China maintains capital controls, impeding capital transactions between residents and non-residents. Nevertheless, the renminbi is gaining ground in invoicing and settling of China's own transactions, which are growing rapidly given the economy's size and growth.

Another area where a currency's role as a means of payment becomes evident is in global settlements. For example, China is building an alternative payments system as a way to reduce its vulnerability to Western sanctions. As a politically and economically powerful regional hegemon, China is mounting the most concerted effort to establish an infrastructure and financial arrangements to keep its economy functioning in case access to the global payment system is lost. Shortly after Russia launched its payment system. In 2015, China established the Cross-border Interbank Payment System (CIPS) in 2015, offering clearing and settlement services for participants in cross-border renminbi payments. To date, CIPS has grown rapidly and has participants located in 119 countries. Nevertheless, given inertia and the powerful network effects of the dollar, CIPS transactions represent only 3 percent of total global settlements today. The bulk of those remains denominated in dollar (51 percent) and continues to grow.

Other metrics suggest use of the dollar as the reference currency remains well ahead of other contenders. For example, the share of foreign currency debt denominated in US currency has remained around 70 percent since 2010. This puts the dollar well ahead of the euro, whose share is 21 percent. Dollar-denominated bank lending represents 51 percent of total foreign currency banking claims. The dollar was also the most traded currency in FX markets, making up 81 percent of turnover in the latest Bank for International Settlements (BIS) tri-annual survey, followed by the euro (43 percent) and the Swiss franc (34 percent). Finally, foreign investors also hold substantial amounts of US dollar banknotes, even increasing over the past two decades. Federal Reserve staff estimate that over USD 1 trillion in dollar banknotes were held by foreigners at the end of 2022, roughly half the total outstanding.

Store of value

While initiatives to establish alternative payments systems are driven by public entities, the choice to rely on them and which currency to use for underlying transactions or pricing remains private and thus, in a sense, market-determined. This is different when it comes to a currency's role as a store of value. Here, the public sector, as the repository of a country's foreign assets, plays a critical role.

Over the past 25 years, the share of US dollar reserves in total reserves held by central banks has declined from 75 percent in 1999 to 57 percent in 2024. This has benefited some other G10 currencies such as the pound and euro (both up 2 percentage points). The renminbi also benefited from Russia's decision to rotate from dollars into the Chinese currency, the renminbi's inclusion in the IMF's Special Drawing Rights (SDR) and the rise in cross-border payments settled in renminbi but it still represents only 2.2 percent of total reserve holdings. But the greatest beneficiaries of diversification were other small currencies (e.g., CHF, AUD) which have grown from a share of less than 2 percent to almost 10 percent.

To qualify as a reserve asset, an asset must be free of credit risk, offer deep and liquid debt and exchange markets and not carry any geopolitical risk. On the first count, only investment grade currencies need apply, thus reducing the attractiveness of the renminbi. The dollar leads with the size of its bond market, weighing in at USD 14 trillion in world government bond indices. The euro area sovereign bond market amounts to only half the size at USD 7.2 trillion, followed by Japan with USD 6.4 trillion. However, the seizure of Russia's reserves by western governments has introduced a geopolitical risk for dollar and even for euro reserve holdings. The weaponisation of a currency inevitably reduces its attractiveness and recent foreign exchange (FX) diversification trends are a direct result of it. But how far can this go? And are there any credible alternatives to the dollar's deep markets?

Changes in currency leadership have historically followed shifts in the economic and military balance of power ("Hegemonic Stability Theory"). In the post-war period, the US has underwritten peace and military protection for Europe and parts of Asia while delivering economic prosperity in return for political influence and a web of allies that help contain ideological adversaries. Of the world's USD 12 trillion reserves about 60 percent are held in dollars and about half of those are split between US allies and less US-friendly regimes. This latter set of countries is dominated by current account surplus countries, notably China, Russia and Saudi Arabia. Infamously, the US is the world's largest current account deficit country, with an annual dollar 1 trillion gap (4 percent of GDP) and is a key export destination for these surplus countries. Reducing their USD reserves would thus also require a reduction in bilateral trade flows. While it is conceivable that surplus countries form a trading bloc amongst each other, it would likely lead to a reduction in overall flows and a potentially painful adjustment in domestic demand.

A rising precautionary demand has led to an overall increase in reserve holdings to bolster financial stability in case of a sudden stop or outflow of capital. In addition, the Federal Reserve has established a permanent dollar swap facilities with five central banks (in the euro area, Switzerland, Japan, the UK and Canada) to ease (dollar) liquidity constraints in times of market stress. The Fed previously created temporary facilities for nine other countries, including Australia, Brazil and Denmark, that have expired but could be reactivated on demand. At the peak of the Covid-19 crisis, drawdown reached USD 500 billion. The People's Bank of China (PBOC) set up similar central bank swap lines in renminbi (RMB 4.2 trillion) to promote trade invoicing in China's currency.

OTHER ALTERNATIVES

Gold

Countries have pursued reserve diversification and de-dollarisation not only through accumulation of alternative FX reserves, but also through increased purchases of gold. Indeed, gold holdings have grown to 20 percent of total central bank foreign assets, a level last seen during the gold (exchange) standard, which

"The trend towards increased diversification reflects a growing reluctance of certain countries to be subject to political dominance by the US."

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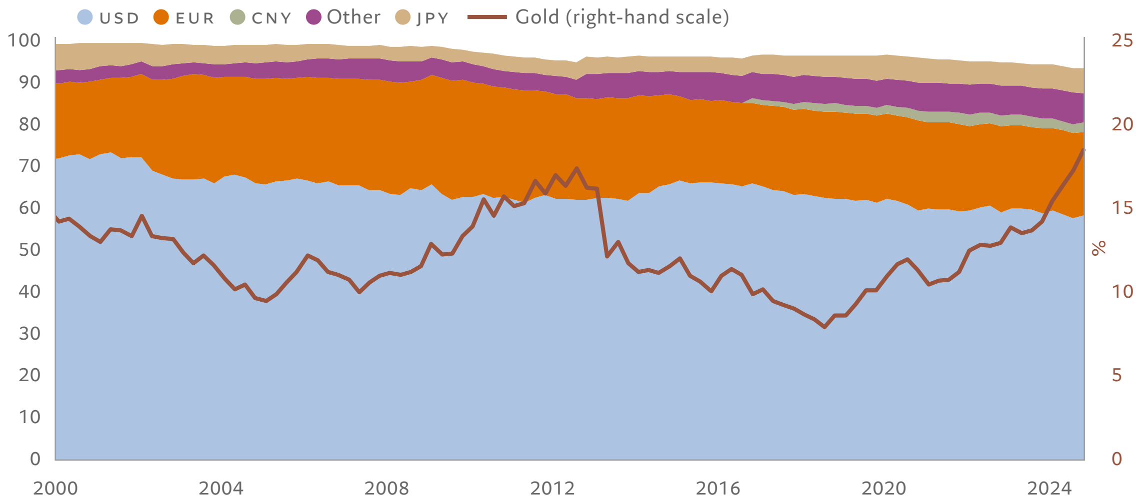
CHART 2

International reserves, percent of total allocated



Source: Pictet Wealth Management, Macrobond, as at 31.12.2024

ended in 1971. While gold has limited use as a means of exchange, it has served central banks well as a store of value, with an increase in value of 227 percent over the past decade. The metal has the additional advantage of being no one's liability (it thus carries no credit risk) and not being associated with any particular country (no geopolitical risk). For countries wishing to escape US political dominance, it thus presents a viable alternative. What is more, it is also often used by the public as a hedge against inflation and financial instability in countries such as India and Turkey.

But gold faces similar hurdles as other reserve currencies. If it is held in London or New York, it can easily be exchanged for other currencies in times of need. But it could also potentially be confiscated by the host country. On the other hand, if it is held domestically, buying and selling large stocks may be more difficult and could require difficult barter transactions. As a result, there is likely a limit to the place gold can hold amongst central bank reserves. However, this limit could potentially be overcome if gold were to be tokenised and thus freed from physical control, while holders would remain anonymous.

BRICS

The (re)emergence of the "Global South" has led to plans for the creation of a shared BRICS currency. It is telling that none of the BRICS countries are adopting the renminbi for its purposes even though they generally maintain positive relationships with China and share a suspicion of US foreign policy objectives. But such a currency faces challenges on several of the accounts outlined above, in addition to the traditional difficulty of pooling sovereignty among would-be great powers.

CBDCS

A third alternative reserve currency could be Central Bank Digital Currencies (CBDCs). These could provide an alternative to today's payment system and reduce the dominance of the dollar. If such currencies were directly connected to a centralised payments system, they could obviate the need for the dollar to be used as an intermediary currency. Similarly, central banks could choose to transact directly in their digital currencies. Russia and China are said to be studying a link-up of their e-currencies. According to the BIS, four central banks have already issued CBDCs and a further three plan to do so in 2025. However, developing full inter-operability of such currencies between central banks, establishing governance frameworks and adjudication mechanisms will likely take longer to develop. Nevertheless, CBDCs represent serious alternatives that could eventually undermine the dollar's preeminent role in settlements.

CONCLUSION

Reserve currencies have traditionally achieved their status thanks to military and political might. In more recent times, economic superiority has played an increasing role. Economic competitors have challenged the dollar in the past but have failed to succeed. Today, new possibilities have arisen, all the more so as geopolitical considerations have come to influence what used to be a mere technical matter.

As a result, alternative payment systems are being developed and promoted, while CBDCs could rival the dollar. This does not point to a world with a different dominant currency, but one which is de-globalised, more fragmented and where several currencies dominate their respective political spheres of influence.

Stocks and bonds: diversification in a world of tight correlations

Adapting portfolios to enhance resilience

Government bonds and stocks have long formed the core of a diversified portfolio, harnessing the hedging appeal of bonds' low volatility and their modest correlation with stocks.

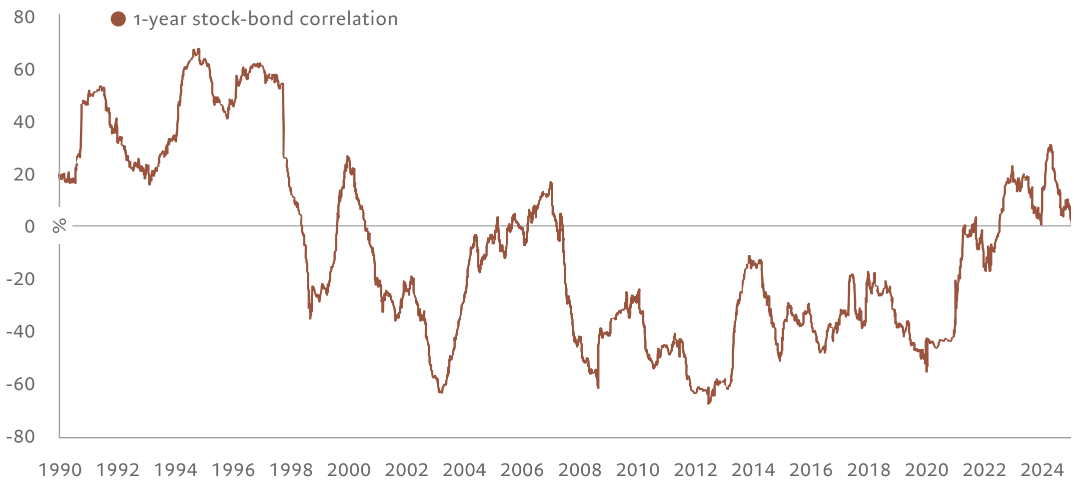
Yet, as recent events have shown, this equilibrium is vulnerable to certain economic conditions. The emergence of positive correlations between stocks and bonds since 2022 (SEE CHART 1) – reversing a decade of strong negative correlation – has raised market eyebrows.

We think this is a signal that investors should carefully re-assess their assumptions about the correlation between stocks and bonds. Indeed, looking ahead, there are warning signs that this correlation might gradually shift. This has implications for how investors should approach portfolio allocation.

As highlighted in our earlier *Horizon* publications, factors such as inflation play a significant role in shaping stock-bond correlations. Building on this insight, we extend our analysis here to examine how the relationship between stocks and government bonds has evolved across various combinations of inflation and economic-growth regimes.

In a period marked by low inflation and strong economic growth, stocks and bonds tend to move in a synchronised manner. Stocks often benefit from a robust economy in which companies post higher sales and profits, while bonds prosper when inflationary pressures are low because interest rates are generally stable or declining. This combination can create a positive correlation between the two asset classes – a relationship in which both stocks and bonds perform well. This

CHART 1
1-year US stock-bond correlation



Source: Pictet Wealth Management, DMS, FactSet, as at 31.03.2025

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CHART 2

Equity returns versus bond returns under macro-economic scenarios

Source: Pictet Wealth Management, DMS, FactSet, as at 31.03.2025

higher level of correlation should not necessarily be seen as a negative development, provided that both asset classes contribute positively to a portfolio (SEE CHARTS 2 & 3).

When the economy is growing strongly, accompanied by rising inflation, the behaviour of stocks and bonds diverges. Although stocks can continue to perform well owing to higher consumer spending and corporate profitability, bonds usually suffer as interest rates increase. In this inflationary scenario, the bond market can be adversely impacted by higher yields, sending their prices lower. Consequently, the correlation between stocks and bonds may weaken or even turn negative (SEE CHART 3). In this macroeconomic scenario, a balanced portfolio should still perform, driven by equity returns. However, investors must seek alternative ways to offset losses incurred from the bond portion.

During periods of recession – more specifically when inflation falls in tandem with sluggish economic growth – the relationship between stocks and bonds is often diametrically opposed. In such times, equity markets tend to fall steeply, while government bonds appreciate, benefiting from central banks' actions to lower interest rates in a bid to stimulate economic activity. This negative correlation emphasises the role of bonds as a cushion against equity losses during downturns. Historical events, such as the GFC, provide clear examples of this mechanism at work. During the crisis, the 10-year US Treasury appreciated by 21 percent, while the S&P 500 suffered a decline of 55 percent. Similarly, in March 2020, when stock markets experienced a significant downturn due to the COVID-19 outbreak, US Treasuries saw gains that helped offset the losses in equities.

That said, there are periods when even bonds cannot offer relief. For instance, periods of stagflation – high inflation coupled with stagnant growth – pose a particular challenge and both stocks and bonds tend to suffer. A striking example occurred in 2022, when central banks' aggressive moves to control inflation led to substantial losses in both markets (SEE CHART 2). The S&P 500 fell by 24 percent, while 10-year US Treasuries declined by 17 percent, signalling a rare instance when the normally diversifying role of bonds was compromised.

Today, rising inflation, higher real rates and evolving monetary policies suggest that the historically low correlation between stocks and bonds might evolve into a more positive relationship. Our current long-term forecast for the US anticipates inflation at around 2.5 percent over the next decade. Although this level is slightly above what we saw after the GFC and before the COVID-19 pandemic – when five-year average inflation rate remained below 2 percent (SEE CHART 4) – we think it is still

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moderate. Furthermore, our projections for US real GDP growth stand at around 2 percent per year over the next decade, which is somewhat lower than the average of 2.5 percent witnessed in the previous 10 years, suggesting a period of moderate economic expansion.

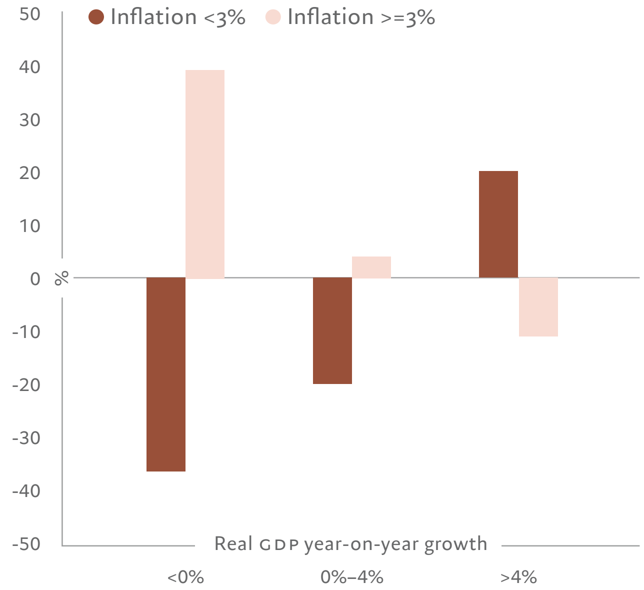
Our analysis suggests that, although the stock-bond correlation may be slightly higher in the next decade relative to the two decades prior to 2020, the correlation is likely to remain sufficiently low to preserve the diversification benefit. We also forecast that the yield on the US 10-year government bond will be around 4.8 percent in 10 years' time, allowing plenty of scope for bonds to help mitigate losses in the equity market during recessions.

Even with the prospect of tighter correlations between stocks and bonds, there is still potential for prudent asset allocation to deliver diversification benefits. Integrating other asset classes, utilising derivatives for risk management, and spreading investments across diverse regions and sectors can significantly enhance portfolio resilience.

CHART 3

Average correlation under inflation and real GDP growth regimes (yearly data since 1988)

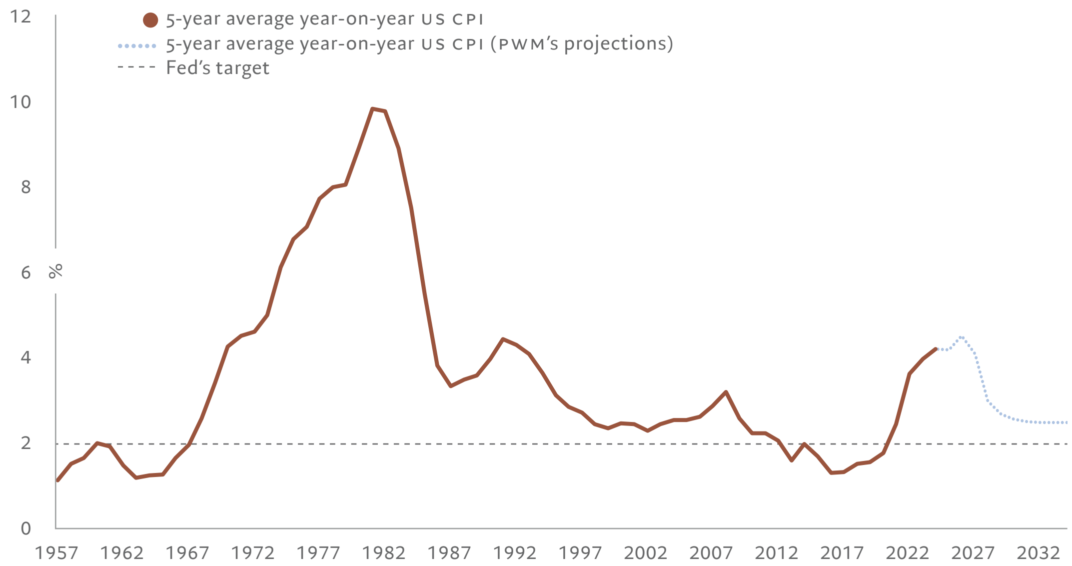
In a low-inflation environment, the stock-bond correlation tends to rise with economic growth. In a high-inflation context, it generally falls.



Source: Pictet Wealth Management, DMS, FactSet, as at 31.03.2025

CHART 4

5-year average inflation including Pictet Wealth Management's projection



Note: based on US year-on-year Consumer Price Index

Source: Pictet Wealth Management, DMS, FactSet, as at 31.03.2025

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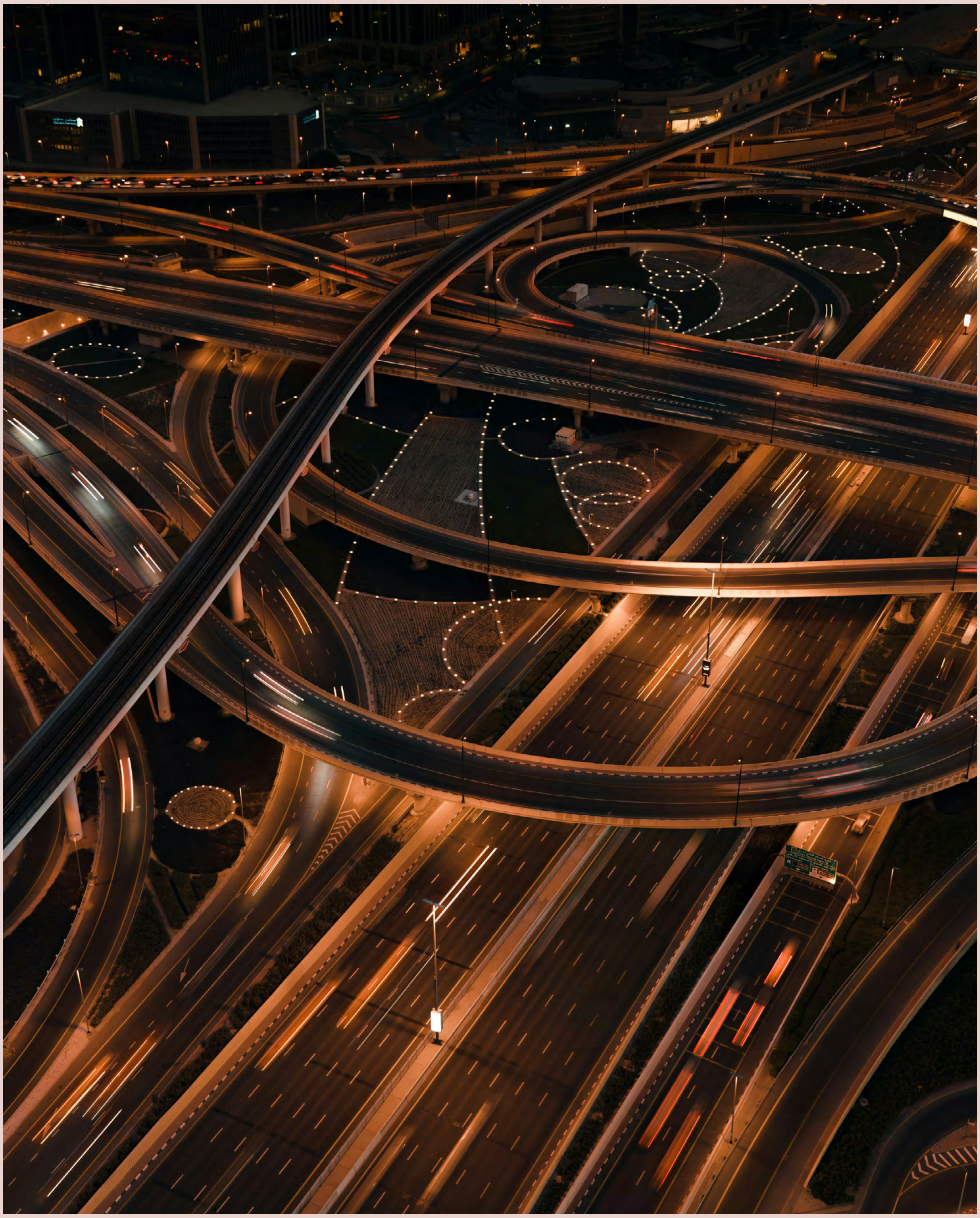

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“Investors must heed a new reality defined by greater uncertainty and a wider range of potential outcomes when it comes to assessing economic performance, asset returns and capital flows.”

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