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After the blue wave – diversification becomes essential



> *"Three issues are taking centre stage: the next steps of the US-Iran conflict; growing risks surrounding the AI investment boom; and the scope for political action until the next presidential election."*

While surfers relish the moment when a wave first lifts them before carrying them back down, many investors were unable to enjoy the 'blue wave' of Democratic successes in the US mid-term elections. After markets initially reacted with relief to the clear election outcome, a sharp sell-off followed, particularly in technology stocks in the US and Asia. The trigger was concern that states now governed by Democrats could impose higher barriers to the construction of data centres. Whether markets have already reached their low point remains to be seen. Regardless, investors' focus is already shifting to the political and economic agenda leading up to the 2028 presidential election. While markets have so far been supported primarily by robust corporate earnings and persistently high levels of investment, uncertainty is increasing. Three issues are taking centre stage: the next steps of the US-Iran conflict and their impact on oil prices; growing risks surrounding the AI investment boom after Nvidia's crisis; and the scope for political action in the period between the mid-term elections and the next presidential election.

Macroeconomic trends – a robust US economy with early warning signs

On the macroeconomic front, warning signs are mounting, even though the economy remains resilient. US consumer spending is losing momentum, while the savings rate, at 3 per cent, is historically low. Inflation is also likely to remain a drag in the near term. In the wake of the AI boom, prices for memory chips, electronic components and batteries have risen in particular. At the same time, it remains unclear whether tensions in the Persian Gulf will ease and lead to lower oil prices. US government debt has doubled since 2017, with no end to this trend yet in sight. Following the Supreme Court ruling in February, tariff revenues have been replaced by refunds. Rising interest rates are also likely to place an even greater burden on the US federal budget.

Stock markets amid a wave of IPOs

Stock markets are rising primarily on the back of growing profits rather than expanding valuations. Technology stocks, in particular, continue to benefit from positive earnings revisions for 2027. Following the recent setbacks, valuations have also retreated from their all-time highs. This does not mean that equities are universally cheap, but entry valuations have become more attractive for many companies. Although the market does not fundamentally question the structural demand for artificial intelligence, warning signs are also beginning to emerge.

Investment in AI is growing faster than revenue, making it increasingly important for investors to focus on companies with disciplined capital allocation and positive cash flows. This is becoming even more relevant as the debt levels of many AI-related companies come under closer scrutiny. While hyperscalers are generally well positioned to absorb higher borrowing costs, the situation is becoming more challenging for neocloud providers such as CoreWeave. The company carries debt of 50 billion, exceeding its equity by a factor of 15.

Alternatives in Europe and Asia

Given the growing risks in the AI sector, investors are understandably looking for alternatives. Can they find what they are looking for in Europe or Asia? European equities appear attractive based on free cash flow generation and trade at lower valuations than their US counterparts. However, only a limited number of sectors are currently driving this favourable picture, and the outlook varies considerably. Lower oil prices, for example, could weigh on energy stocks, which have been among the strongest performers. At the same time, rising financing costs are likely to put pressure on highly indebted sectors. Higher government bond spreads could also spill over into parts of the European equity market, with banks particularly sensitive to such developments. By contrast, a recovery in the global economy is expected to support industrial stocks. In South-East Asia, the AI boom has led to a significant expansion in corporate profit margins, although these margins are now likely to have peaked. The reassessment of earnings prospects for AI and semiconductor companies has triggered a sharp correction in valuations across the region. With price-to-earnings ratios below 9, opportunities are emerging for long-term investors, albeit with the prospect of continued volatility. China's equity market has recently disappointed as domestic consumption remains subdued amid the ongoing property crisis. Nevertheless, the IPOs of CXMT and Unitree underline the country's continued strength as a centre of innovation and may offer opportunities for active, risk-tolerant investors.

The comeback of bonds

For a broadly diversified portfolio, it is encouraging that bonds benefited from falling yields immediately after the US midterm elections. This underlines that they have not lost their role as an effective diversifier within portfolios. Nevertheless, the medium- to long-term trend towards higher interest rates is likely to persist, as financing the AI boom is driving substantial corporate bond issuance that competes with government bonds for investor demand. Although market nervousness has eased somewhat in recent weeks, French assets remain under pressure due to ongoing political uncertainty. Opportunities may, however, emerge beyond the established markets. Lula's unexpected presidential election victory caught many investors off guard. For those who doubt that he will be able to implement his costly spending agenda against a conservative-dominated Congress, double-digit local-currency bond yields could present an attractive opportunity. The picture in corporate bonds has changed little. Credit spreads remain tight, but absolute yields are becoming more attractive again. Here, too, the growing issuance volumes linked to the AI boom are increasingly evident. A downgrade of a major issuer such as Oracle could trigger a reassessment of the speculative grade universe. In commodities, copper continues to look attractive, as long-term demand growth is meeting insufficient supply.

Conclusion

Following the correction in recent months, equities are once again offering more attractive entry opportunities. At the same time, broadening remains essential, as the high concentration in equity markets heightens the risk of setbacks. Short-dated corporate bonds, emerging-market bonds denominated in local currencies and industrial metals complement the asset allocation in a market environment characterised by geopolitical uncertainty and higher inflation. Over the long term, investors should focus on achieving real returns, with bonds likely to assume a more prominent role than in recent years.

A last word on Nvidia

Following the firing of Jensen Huang, we have decided to move Nvidia to Underweight. This is primarily a risk-management decision rather than a negative assessment of Nvidia's technology or long-term AI leadership. In the near term, we believe the shares are unlikely to trade solely on fundamentals. Questions concerning China-related sales, export-control compliance and accounting transparency could generate prolonged regulatory and political scrutiny. We would stress that several of the allegations reported publicly remain unproven.

The independent Board investigation into Jensen Huang also introduces a material governance and key-person risk. Nvidia's extraordinary success has been closely associated with its founder and CEO, making any uncertainty around his position particularly consequential. Therefore, there is a potential risk that at some point in the future, top-line growth numbers may be affected by the end or the slowdown of Nvidia-led vendor financing. Same principle can be applied to talent exodus following the departure of such a charismatic leader. Finally, Nvidia's substantial valuation (market-cap wise) and exceptionally high market expectations leave limited room for governance, regulatory or execution disappointments. Given this asymmetric risk/reward profile, we believe reducing exposure slightly is the prudent course until visibility improves.

Although results have once again exceeded expectations, the coming weeks are likely to be marked by a significant flow of information regarding the Department of Justice (DOJ) investigations and speculation surrounding the appointment of a new CEO. This backdrop should provide investors with greater visibility to reassess a company that we consider a key player in the technology sector.

READ THE PRESENTATION

Past performance is not a reliable indicator of future returns and is subject to fluctuation over time. Performance may rise or fall for investments with foreign currency exposure due to exchange rate fluctuations. Emerging markets may be subject to more political, economic or structural challenges than developed markets, which may result in a higher risk

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