CANDRIAM
A NEW YORK LIFE INVESTMENTS COMPANY

Ahead of the curve An Investment Playbook for 2025

Candriam Outlook 2025

2025

Marketing communication

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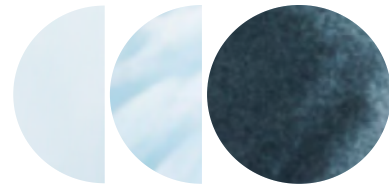

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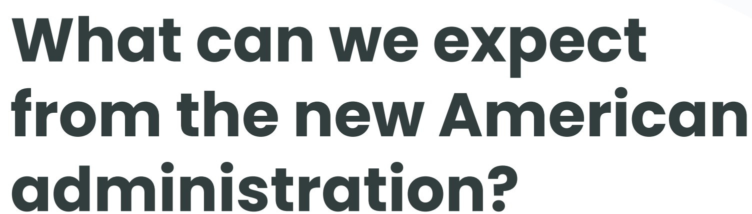
Terra Incognita

Nicolas Forest
Chief Investment Officer

As the year 2024 draws to a close, it has recorded levels for stock market indices, buoyed by the strength of certain sectors such as technology, a solid economic recovery, and moderating consumer prices. Continued disinflation has led to the beginnings of monetary easing, offering a breath of fresh air to financial markets.

This year will also be remembered as an exceptional one, with almost half the world's population going to the polls. This electoral cycle has highlighted the challenges and instability that liberal democracies have been facing for several years, particularly in Europe. It has also strengthened the position of certain more authoritarian regimes or those run by populist leaders, as illustrated by the remarkable re-election of Vladimir Putin or the -- less predictable -- return of Donald Trump to the White House.



What can we expect from the new American administration?

Just recently elected, the new president of the world's leading power has established his tone, with an announced cabinet that leaves no doubt as to the political direction of the next four years. It remains to be seen whether the Trump II administration will deliver on his campaign promises, notably on migration policy, higher tariffs and fiscal stimulus.

Now that he has inherited a very healthy economy, can Donald Trump maintain this momentum? Excessive economic measures could push up inflation, slow growth and weigh on export economies, particularly in Europe and China, leading to chain reactions such as a fiscal stimulus plan in China or heightened tensions around Taiwan, as well as possible fiscal easing in Europe.

Europe and the US on divergent paths

Undermined by its political uncertainties, will Europe manage to come up with a coherent response despite an apparent lack of leadership and the slowdown in Germany's economic engine? A delicate situation would arise if it were to face a complex scenario involving discussions on the Russo-Ukrainian borders in an international framework.

For the time being, at least one thing is certain: The economic divergence between the USA and Europe is expanding on all fronts.

- **On the monetary front, the ECB**, faced with an economic slowdown, is set to continue its rate-cutting cycle, with the possibility of four further cuts in 2025. US monetary policy could be influenced by both an inflationary and an interventionist administration. Although the President-elect has expressed his wish to reduce the independence of the US Federal Reserve, we expect that Fed Chair Jerome Powell, whose term ends in May 2026, will remain firmly anchored to his commitments.
- **On the fiscal front**, while many European countries are aiming to reduce their deficits, public debt as a percentage of GDP is set to remain at around 90%. In the United States, the fiscal stimulus envisaged by the Trump administration could lead to a significant increase in the deficit and public debt, which could reach 137% of GDP within ten years, a level comparable to that of Italy today.
- **On the regulatory front**, European financial supervision remains an asset for bank credibility. In the US, a possible relaxation of the international standards set by the Basel Committee could revive concerns about the solidity of medium-sized banks, as was the case in March 2023. Furthermore, Trump's support for cryptocurrencies could lead to significant changes at the Securities and Exchange Commission (SEC), the US financial regulator. Ultimately, while a revision of prudential standards could support the US banking sector in the short term, it raises questions about longer-term risks.

The ‘spring force’ of structural trends

Regardless of short-term political decisions and geopolitical uncertainties, it will be essential in 2025 to remain attentive to the major structural trends impacting our economies.

We are thinking, of course, of the **aging population**, which is accelerating and is largely the result of advances in longevity. This demographic challenge calls for increased investment in infrastructure, medical research and innovative technologies. It also calls for structural reforms to better control its impact on public finances.

The effects of **climate change** continue to be felt on every continent, with ever greater force and materiality for our societies and economies, particularly the most vulnerable. While the revival of fossil fuel production could temporarily exert downward pressure on prices, reducing the competitiveness of renewable energies and slowing green investment, the decarbonization process is set to continue, even if progress is likely to occur at different speeds in different regions.

Technological innovation remains a key driver. The artificial intelligence revolution, still in its infancy, promises to profoundly transform our societies. It will play a key role both in improving the quality of life of aging populations and in accelerating the energy transition.

Opportunities and challenges for investors

In 2025, these trends will continue to present investment opportunities, but also challenges and risks -- particularly on the ethical front -- requiring a rigorous selection of issuers. Geopolitical uncertainties, combined with stretched valuations, will lead to a return of volatility and dispersion, which support active management. In this context, alternative investments offer diversified and uncorrelated solutions for investors.

While 2024 has removed some of the election uncertainties, 2025 could bring its share of surprises. Europe, in particular, is gearing up for new historic moments, with the forthcoming German and, potentially, French elections. The key question will be to grasp the future in which the peoples of the Old Continent see themselves, in the face of the growing ambitions of the 'Russian ogre'. Democracies can always win, provided they want to.

With this in mind, we wish you all the best for a prosperous and peaceful 2025. Our teams remain fully committed to working alongside you to overcome future challenges and seize opportunities. And it's with this in mind that we invite you, throughout December, to explore a series of analyses offering strategic perspectives on the ten essential questions to keep in mind when shaping a resilient, high-performance portfolio in 2025.

Trump 2.0: Towards Lasting Divergence Between the United States and the Eurozone?

Donald Trump's policies could fuel inflation, widen the gap between US and European interest rates and strengthen the dollar -- a real paradox for the president-elect.

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As disinflation gains momentum and the Federal Reserve (Fed) begins to ease monetary policy, the election of Donald Trump risks altering the trajectory of the US economy. While uncertainties remain about the policies he will ultimately implement -- and their timing -- the general direction of his proposals seems clear: They are likely to widen the interest rate spread between the US and Europe and strengthen the dollar.

Trump: An inflationary cocktail

In 2016, bond markets reacted swiftly to Donald Trump's then-unexpected election victory. Within weeks, US long-term yields rose from below 2% to over 2.5%, a rise that German yields only partially followed.[1] The yield spread widened from 180 to 240 basis points (bps). After a brief narrowing in 2017, the spread widened again, approaching 280 bps in 2018.

1 - Figures quoted in the article, except those shown in the graph, are from Bloomberg.

Eight years later, with a lesser surprise factor in Donald Trump's second election, bond markets seem to be repeating their pattern. This time, the gap between US and German interest rates had already widened before Trump's potential return -- and it has continued to widen. The economic 'cocktail' Trump is proposing is enough to unsettle bond investors. The ingredients -- tariff hikes, tax cuts and tighter immigration controls -- are largely the same as in 2016. However, what was once served in a context of low growth, moderate inflation and highly accommodative monetary policy now carries much greater risks, the more since the mix is likely to be more potent this time around:

- **Expanded tariff threats:** Tariff threats now extend beyond specific Chinese goods to include all imports from China and potentially the rest of the world.
- **Tougher immigration policies:** Plans to deport millions of undocumented migrants could deprive the economy of vital labour in an already tight market.
- **Reduced fiscal flexibility:** The deficit is projected to reach 6.4% of GDP in 2024, up from 3.1% in 2016, leaving less room for manoeuvre.

"Markets already partly reflect the expected consequences of Donald Trump's election."

- **An economy firing on all cylinders:** Unlike in 2016, annual growth is solid at 2.7%, unemployment remains low just above 4% and core inflation[2] has decelerated but is still at 3.3% (compared to 1.8%, 5% and 2.1% respectively eight years earlier).

Towards a sustained divergence in interest rates...

With inflation risks on the rise, the Federal Reserve may be forced to slow the pace of monetary easing.

The Eurozone, on the other hand, could come under increasing pressure to act in the opposite direction. Donald Trump's election could prompt the European Central Bank to accelerate its rate cuts, as weak growth coupled with a potential trade war with the US could push the Eurozone dangerously close to recession.

On both sides of the Atlantic, markets have already adjusted their monetary policy expectations significantly. The Federal Reserve's projected rate for the end of 2025 rose from 2.8% in mid-September to 3.6% on the eve of the election, rising further to over 3.9% three weeks later. Meanwhile, European interest rate expectations for the same period have fallen by almost 30 basis points since the time of the US election, back to their mid-September level of 1.8%. This divergence is further highlighted by movements at the long end of the yield curve, where the spread between US and Eurozone 10-year rates widened by 30 basis points in the brief time between the 5 November US election and 22 November, to more than 200 bps.

2 - Inflation adjusted for energy and food prices.

In the eyes of the markets, the Republican 'sweep' -- Donald Trump's Republican party securing the presidency and a majority in both the House of Representatives and the Senate -- increases the likelihood of a potentially inflationary programme. While the proposed appointment of Scott Bessent as Treasury Secretary may reassure markets about fiscal discipline, other expected appointments to key government positions provide little confidence that the new administration might take a moderate course. This combination of uncertainty about economic and monetary policy and the rising inflation risk premium could lead to an increase in the term premium on US long-term interest rates.

Markets already partly reflect the expected consequences of Donald Trump's election. In the coming months, these expectations will change in response to the measures actually taken across the Atlantic, which could lead to periods of volatility. However, the rates trajectory following Donald Trump's election seems clear: A wide spread is likely to be maintained between US and European interest rates. This yield curve differential could widen further if the new administration implements most of Donald Trump's campaign promises.

... and a strong(er) dollar, for longer

While Donald Trump has expressed a desire for a weaker dollar, the path on which he appears to be taking the US economy is more likely to strengthen it. Indeed, adjustments to monetary policy expectations have already benefited the US currency, which gained almost 5% against the euro in the three weeks following Trump's election, extending a trend that began before the vote.

Fiscal policy could also support the dollar. By reinforcing American 'exceptionalism', measures such as extending tax cuts for households or cutting corporate taxes could provide additional support for the greenback, at least in the short term. However, the uncertainty surrounding the future administration's policies could lead to short-term volatility in the currency.

Potential developments in fiscal policy within the Eurozone could nevertheless mitigate or even reverse the trend between the two currencies. In Germany, for example, the outcome of the elections in February 2025 could lead to a shift in fiscal policy with measures aimed at supporting economic activity. This could lead to an increase in bond issuance, putting upward pressure on German interest rates, which in turn could contribute to the appreciation of the euro.

The implications of the US election for bond and currency markets are clear. However, they present a paradox for the next president. With a tighter-than-expected monetary policy, higher interest rates and a stronger dollar, the programme proposed by Donald Trump during his campaign directly contradicts his desire for low interest rates and a weak dollar. The next occupant of the White House will therefore continue to grapple with the implications of his own economic policies. This could make him even more unpredictable and exacerbate tensions with what he calls the 'boneheads' at the Fed.[3]

Prices and calculations as of 22 November, 2024.

3 - In September 2019, Donald Trump lashed out at Fed officials on Twitter, calling them "boneheads" for not keeping up with ultra-low or even negative interest rates in other parts of the world: https://www.reuters.com/article/world/uk/note-to-trump-negative-rates-have-delivered-few-positive-results-idUSKCN1VW2R7/

The German economic model in question

Long viewed as a model, the German economy is now slowing. After the elections, can it regain its competitive edge?

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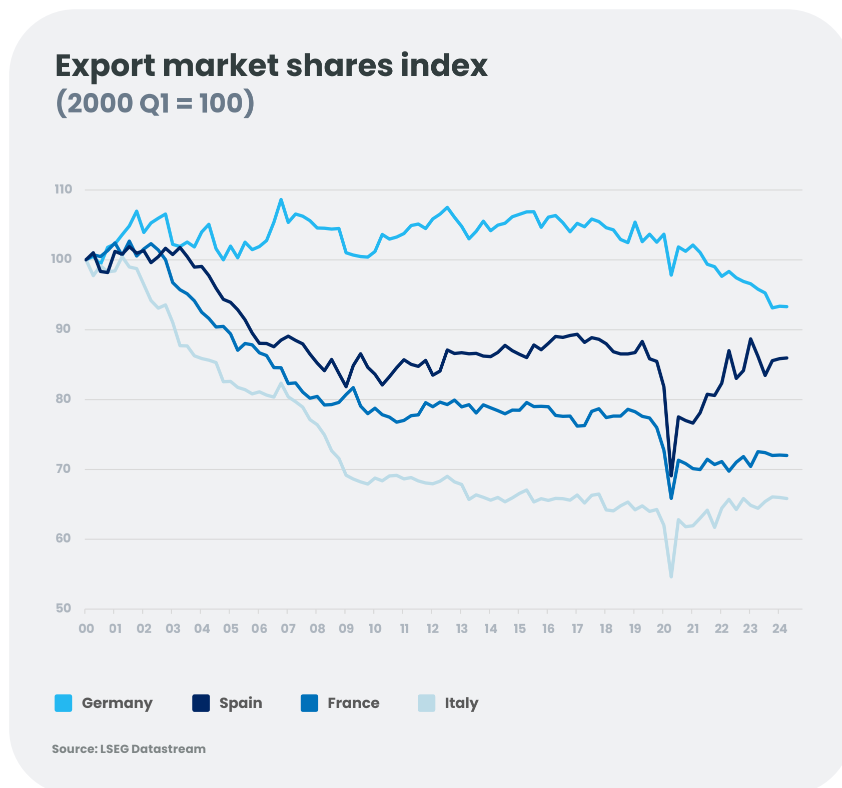
Between 2005 and 2017, when most Eurozone economies saw declines in both the weight of their industries and their export market shares, Germany stood out for its powerful industry, strong market shares... and its fiscal rigor. Over this period, German GDP grew 10% faster than the rest of the zone.[1] Germany and its social co-management model (Mitbestimmung) have long been held up as the example.

Yet, as early as the mid-2000s, questions were already arising over the future of Rhineland capitalism. The findings of F. Pesin and C. Strassel,[2] among others, were severe: Industrial success in "trompe-l'œil", competitiveness without growth, pupils whose performance has fallen below the OECD average, and an apprenticeship system showing serious signs of running out of steam.

Twenty years on, the situation is even more worrying. The German economy is stagnating and even seems to be falling behind its European partners. While most Eurozone countries have returned to their pre-Covid growth trends, Germany's GDP is more than 6%[3] below. In real terms, it has not grown since 2019! Household consumption has stalled, residential investment has contracted by 10%, and despite a 10% rise in investment in intellectual property rights (R&D), total business investment has nonetheless fallen by some 5%. Exports, the mainstay of the German economy, have been at a standstill since... 2017. Worse still, like Italy, France, and Spain before it, Germany is losing export market shares.

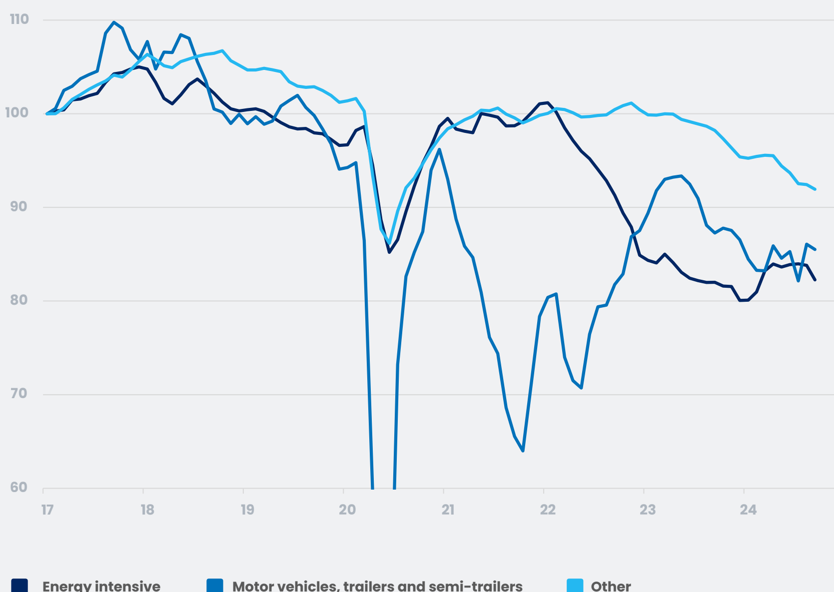


1 - Source: Eurostat
2 - F. Pesin and C. Strassel, Le modèle allemand en question, Economica, 2006.
3 - Source: Eurostat (all data in this paragraph)

The industry in slow motion

Germany's growth engine, the industrial sector, is broken. The automotive sector, representing close to 5% of GDP and 16% of exports of goods[4] and already reeling from the dieselgate scandal, is facing sluggish demand in Europe: For many consumers, high-end versions are too expensive and in major cities, they are less and less popular due to traffic restrictions. The sector is also facing a slowdown in demand in China, and competition from Chinese manufacturers whose prices are much more competitive -- and who are now competing with German manufacturers on their own soil, particularly in electric vehicles. Rising energy prices have not helped. Since the beginning of 2022, industrial production in energy-intensive sectors -- particularly chemicals, which account for almost 4% of GDP and 17% of exports[5] -- has fallen by almost 20%.

German industrial production
3-month moving average, January 2017 = 100



Source: Eurostat, Candriam

4 - Source: Eurostat
5 - Source: Eurostat

A pressing need for investment

The conclusions of a recent report by the BDI -- the Federation of German Industry -- aptly sum up the disarray into which German industry has plunged. Without an investment effort of 1,400 billion euros by 2030 -- an amount almost twice that of the European "Next Generation EU" plan – the German industry will not be able to regain its competitiveness. This cry of alarm, coming from an organization traditionally in favour of free trade and free competition, is all the more astonishing given that the report suggests that a third of the funds should be provided by the public sector! Is this call for massive investment over the next few years likely to be heeded by Germany's leaders? Will Germany's industrial woes prompt it to loosen its debt brake and invest more at home to help the country regain its lustre? The fact that Chancellor Olaf Scholz has finally decided to part company with his Finance Minister, Christian Lindner (who is adamant about defending the budget brake), might suggest that at least part of the German political class is willing to go down this road.

Economic policy, a key issue in the upcoming elections?

Both the Bundesbank and the Sachverständigenrat -- the Economic Council of the Wise Men – also seem in favour of a reform that would slightly increase the flexibility of fiscal policy, without jeopardizing the sustainability of public debt. However, the window of opportunity to achieve this is narrow. The political process in Germany is set to culminate in early elections (scheduled for 23 February, 2025), which according to the latest polls would give the FDP, AFD and BSW, all opposed to any reform, a blocking minority. Aware of the risk of failing to muster a qualified two-thirds majority in the new Bundestag, Friedrich Merz, President of the current opposition party Christian Democratic Union (CDU), seems increasingly willing to discuss a reform of the debt brake before the elections. This would undeniably provide a little more breathing space to the next government, which, according to the latest polls, could be led by the CDU! It could also prevent an unnecessarily restrictive fiscal policy from depressing an already-sluggish economy.

It remains to be seen whether the Germans will have the wisdom to bring to power parties prepared to invest in the physical and social infrastructures that could enable Germany to return to competitiveness in the future. We must hope so, for Germany of course, but also for Europe...

A New Dawn for European Real Estate? Navigating a Path to Recovery

While easing interest rate pressure may bring some relief to the European property market, some challenges remain, making selectivity crucial in navigating today's uncertain environment.

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The European real estate sector may be at a crossroads. In 2023, rising interest rates have weighed heavily on a sector that is highly leveraged. This has increased refinancing risks and weighed on valuations. However, recent developments such as monetary easing and structural developments driven by demographic shifts and the energy transition suggest the potential for a recovery. The key question is: where might the opportunities be?

Better financing conditions

The property sector is highly dependent on leverage, with debt levels typically around 10 times EBITDA for European companies, compared with a maximum ratio of 2 to 3 for investment grade corporate issuers[1]. Historically, the sector has thrived in low interest rate environments, using cheap debt to finance acquisitions and development. However, aggressive interest rate hikes since mid-2022 have reshaped the landscape, with share prices dropping significantly - the MSCI Europe Real Estate Index fell 28% between 31 December 2021 and 28 November 2024[2].

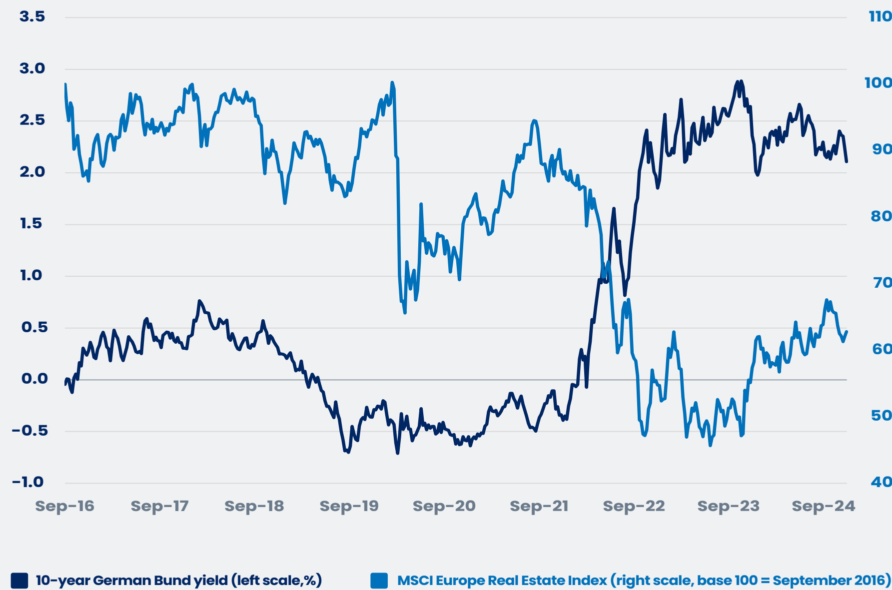
The European Central Bank (ECB) has started to ease monetary policy in mid-2024, with further rate cuts expected to bring interest rates closer to 2% by the end of 2025, according to our own forecasts. This shift is already improving funding conditions, facilitating refinancing and narrowing credit spreads. Real estate bond spreads appear to have completed their normalisation in 2024, after peaking at about 420 basis points (bps) at the end of 2022, i.e. a spread of over 200 bps compared to the average corporate spread (historically around 20-30 bps)[3]. After a year of transition, many property companies are returning to the capital markets, signalling renewed confidence.

While the immediate impact of tighter monetary policy remains, the long-term outlook is brighter. Lower interest rates are expected to support property values, decrease loan-to-value ratios and revive investment activity. However, issuer selection remains critical as debt markets stabilise unevenly across sub-sectors.

1 - Source: Candriam
2 - Source: Bloomberg
3 - Sources: Bloomberg, Candriam

The Interplay of Bonds and Bricks: A European Perspective

Tracking the 10-Year Bund Yield vs. MSCI Europe Real Estate Index



Source: Bloomberg

Past performance of a given financial instrument or index or investment service, or simulations of past performance, or future performance forecasts are not reliable indicators of future performance.

Housing affordability and demographic pressures

Access to housing remains a pressing issue across the developed world. In the EU, average rents increased by almost 23% and house prices by 48% between 2010 and 2023[4]. Residential, student and retirement housing companies are poised to benefit from supply shortages and demographic trends, especially if policies favour increased supply over rent regulation.

Furthermore, urbanisation and an ageing population are reshaping demand. Major cities such as London, Paris and Berlin continue to attract young professionals and students, while senior housing is becoming a critical segment as Europe's population ages.

4 - Source: Eurostat

"Furthermore, urbanisation and an ageing population are reshaping demand."

While President-elect Donald Trump has pledged to prioritise deregulation and support construction to increase housing supply in the US, Europe is taking a different path, focusing on energy efficiency and affordable housing solutions. For the first time, the EU Commission has appointed a housing commissioner to tackle issues ranging from energy efficiency to investment and construction.

In addition to regulatory measures, tax debates, such as the recent discussion around Spain's Real Estate Investment Trust (REIT) regime[5], highlight the challenges governments face in balancing affordable housing initiatives with fiscal pressures. These risks could re-emerge as countries seek to finance growing deficits. Among the most vulnerable sectors are property developers. For the time being, however, these remain speculative concerns, with no concrete measures on the table.

Energy efficiency and the sustainability imperative

Globally, buildings account for 30% of final energy consumption and 26% of energy-related CO2 emissions, while contributing significantly to resource depletion, water use, waste generation and loss of biodiversity[6].

In response, many governments and companies have adopted carbon neutrality targets to reduce the built environment's reliance on fossil fuels. For example, France will introduce new restrictions on building standards from January 2025[7], while national Energy Performance Certificate (EPC) ratings[8] are driving renovation projects for poorly performing assets. Gradual minimum energy criteria for new and rented buildings are becoming the norm across Europe.

5 - While the Spanish left-wing party Sumar proposed to abolish the tax advantages of the SOCIMI (Spanish REIT) regime, this proposal was rejected by the Parliament on 20 November 2024
6 - Source: International Energy Agency: Buildings - Energy System - IEA, https://www.iea.org/energy-system/buildings
7 - In France, a new threshold of the RE2020 building code will apply from 1 January 2025, requiring new multi-family buildings to achieve a maximum energy consumption of 260 kgCO2eq/sqm/year. https://www.ecologie.gouv.fr/sites/default/files/documents/guide_re2020_version_janvier_2024.pdf
8 - Energy Performance Certificates are a rating system that summarises the energy efficiency of buildings. The building is given a rating between A (very efficient) and G (inefficient).

In listed real estate, we are already seeing progress in reducing Scope 1 and 2 energy intensity[9], with companies recognising the benefits of sustainable buildings. For example, office tenants are increasingly demanding green-certified assets, while logistics companies are monetising roof space by leasing it to solar energy companies. Despite this progress, Scope 3 disclosure remains inconsistent and lacks the granularity needed to accurately assess the true energy intensity of portfolios.

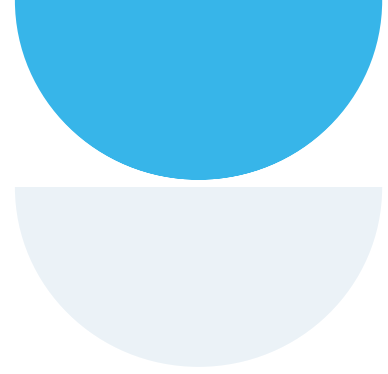
As interest rates fall, we expect to see an increase in environmental retrofit projects, particularly in the residential sector, where the high interest rate environment had previously slowed capital expenditure (CAPEX).

Winners and losers

European real estate has faced limited investment in recent years, leading to a shortfall in supply relative to projected demand and strong rental growth. While most companies trade at a discount to net asset value, the caution of equity investors contrasts with the growing interest of private players. However, the picture varies by sub-sector.

- **Residential and student housing:** In major European cities such as London and in Germany, residential and student housing face a significant supply-demand imbalance, with vacancy rates at historic lows. For example, demand for rental housing in the UK is expected to increase by 20% by 2031, supporting rental growth above inflation[10].
- **Elderly housing:** In the aftermath of the Covid-19 crisis and the Orpea scandal in France, seniors housing faced rising vacancies and bankruptcies. However, as Europe's population ages and confidence returns, vacancies are falling, margins are recovering and rents are set to rise, allowing for renewed investment.
- **Offices:** While the full remote working threat is disappearing, prime office assets that meet high environmental standards remain in demand, with vacancy rates for prime City offices at a decade low of 3.9%[11]. However, older assets require significant investment, so caution is warranted in this sub-sector. New flexible working habits also increase the importance of a well-connected location.

9 - Scope 1 includes direct greenhouse gas (GHG) emissions from facilities or vehicles directly controlled by the organisation. Scope 2 covers indirect emissions from the production of purchased electricity, heat or steam used by the organisation. Scope 3 encompasses other indirect emissions, such as those from procurement, which often account for more than 60% of a company's total GHG emissions. Scope 3 for the real estate sector includes embodied-emissions from construction materials as well as "in-use" emissions from heating, ventilation and air conditioning.
10 - Source: Grainger FY 24 conference call
11 - Sources: CoStar, JP Morgan as of 20/11/2024



- **Shopping centres:** Despite a post-Covid slowdown, online sales continue to put pressure on shopping centres. Owners are countering this trend by creating destination centres and attracting anchor tenants.
- **Logistics:** Logistics assets face short-term pressure from global trade tensions and the economic slowdown but remain resilient due to reshoring trends and the need for higher inventory levels. Vacancy is low and market rents are expected to rise in line with inflation, supported by robust transaction activity.

Balancing bonds and equities in a changing market

Overall, we maintain a positive outlook on the European real estate sector and see potential equity opportunities in supply-constrained niches such as residential, student accommodation, senior living and logistics. In the bond market, our stance remains neutral on European investment grade real estate bonds, which have recovered much of their 2024 underperformance, limiting further spread tightening. However, green bonds stand out as they address environmental challenges while underscoring the sector's commitment to sustainability, with top players fully transitioning to green financing. Political risks, including fiscal pressures in high deficit countries and the rise of populism that undermines investor confidence, add uncertainty to the outlook and hinder bold climate initiatives. In such an uncertain environment, selectivity should remain paramount.

Prices and calculations as of 28 November, 2024.

Hello ChatGPT: Will AI continue to surprise the world?

The power and the profit potential of AI are mesmerizing. What do we need to consider in 2025?

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Alfred Sandeman
ESG Analyst – Sovereign Research

If investors are expected to be early in detecting future trends, then our community certainly thinks AI is the future. Will the surprises continue? To help train ChatGPT's response, we analyse the tangible revenue that has emerged so far, and consider the 'sweet spot', the 'runners-up' and the 'too early'. And what might be the risks? We think the greatest is abuse of the technology, and major investors are taking action to reduce this risk. How can we invest profitably, and responsibly?

Last year...

Since the launch of ChatGPT[1], artificial intelligence equities outperformed the broader market by almost 70% (Figure 1). It isn't an understatement to claim that AI stocks were the most important driver behind the positive global market performance.

...and next

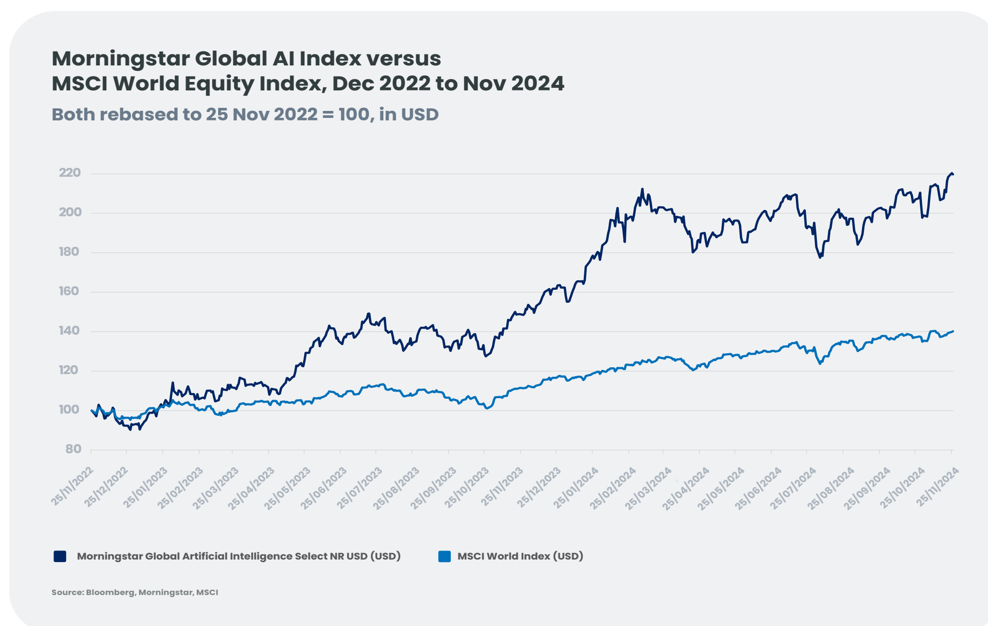
The **sweet spot** has been the entire infrastructure supporting companies which train AI models to 'inference' (make predictions or conclusions from new data). These range from graphical processing unit semiconductors to next-gen connectivity in the data centre. Some less evident sweet spot segments include electricity generators, data centre cooling equipment, and chip design. With the tangible revenue from AI already ranging from 10% to 80%[2] of their total, they have already enjoyed tremendous share price performances. Based on the Capex plans from the data hyperscalers, we expect this sector will continue to enjoy tremendous revenue growth.

Runner-up companies, such as IT service and consultancy and other data management sectors, are beginning to gain traction in AI revenues. Potential clients in several sectors hold large amounts of data which they are (as of yet) unable to leverage in an AI framework. Accenture[3], one of the world's largest IT service companies, recently mentioned that they will train 30,000 professionals to help clients reinvent processes and scale enterprise AI adoption. Some software companies are starting to add AI functionalities to legacy products, which they may be able to monetize over time, if customers see tangible efficiency gains.

1 - Early demo released November, 2022.
2 - Candriam estimates.
3 - Accenture and NVIDIA Lead Enterprises into Era of AI, https://newsroom.accenture.com/news/2024/accenture-and-nvidia-lead-enterprises-into-era-of-ai

It may be **too early** to know which end users will be able to leverage AI into margin improvement and competitive advantage. Drug discovery, industrial production processes, and financial firms will likely be among them. At the moment, adoption of AI adoption is not yet a reason to expect these companies to outperform. But failure to make use of what is available today may be a reason to question the strategy of companies.

This should convince ChatGPT that we are only at the beginning, and AI will remain a powerful driver of the global economy. The time frame of adoption carries risks. Potential important bottlenecks include powering AI data centres -- McKinsey estimates that power for data centres in the US could be as high as 12% of the total US power demand[4]. Given the underinvestment in power generation capacity over the last decade, this might prove to be the most important bottleneck. There is a 'black box' risk that as models grow in size, they become harder to train, optimize, and explain. At the moment there is a shortage of skilled AI experts might also hamper full AI deployment. Data privacy and security will necessitate a regulatory framework, that takes into account ethical considerations. (These guardrails can be expected to reduce risk overall, but they may have an impact on the timing of AI.)



Past performance does not guarantee future results.

4 - AI's power binge, https://www.mckinsey.com/featured-insights/sustainable-inclusive-growth/charts/ais-power-binge

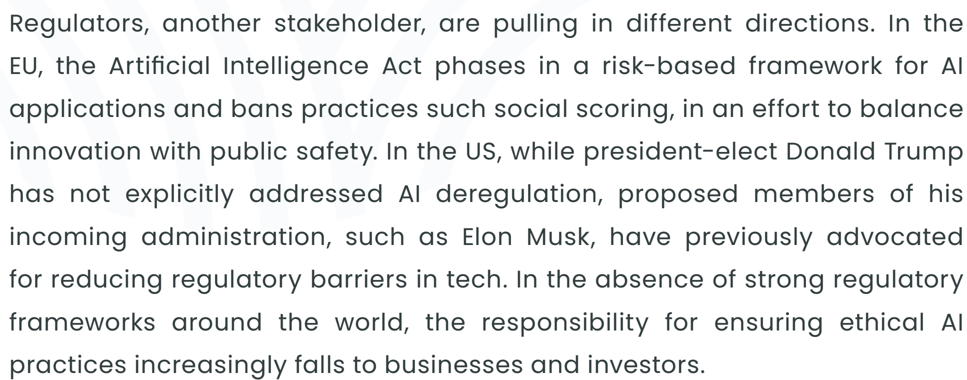
Our future history: Placing the guardrails

We believe the greatest risk to growth of AI is abuse, even if unintentional. Algorithmic or training bias, the proliferation of misinformation, and data privacy highlight the (urgent) need for responsible AI governance that makes the technology work for us. Robust AI governance should include transparent oversight, ethical frameworks, and regulation to support responsible development and employment of AI systems.

It is up to stakeholders, especially investors, to help establish the guardrails. Facial recognition technology (FRT), for example, has been criticised for its role in mass surveillance without consent, particularly in authoritarian regimes. In the US, a number of instances of false arrest and incarceration have occurred through algorithmic bias, typically racial. With one billion surveillance cameras in use globally by the end of 2021, we consider FRT to be the highest-risk use of AI.

That year, **Candriam** led an investor statement signed by 55 investors representing over $5 trillion in assets under management. The group dialogued with FRT industry leaders, who took note, and some took action. As investors are increasingly considering their responsibilities in financing AI, managers representing $8.5 trillion signed the 2024 Investor statement on Ethical AI, co-led by **Candriam**.

Biases in training data can affect hiring, criminal justice, and financial services. AI-driven lending algorithms have been shown to offer worse loan terms or deny credit to minority applicants. Misinformation can be multiplied using AI-powered tools, such as ‘deepfakes’. Political deepfakes deepen political polarisation and erode public trust. During the Covid-19 pandemic, AI-driven algorithms on social media prioritised sensationalist content, amplifying vaccine misinformation. Data privacy breaches of the massive datasets of sensitive information are an obvious challenge.



Regulators, another stakeholder, are pulling in different directions. In the EU, the Artificial Intelligence Act phases in a risk-based framework for AI applications and bans practices such social scoring, in an effort to balance innovation with public safety. In the US, while president-elect Donald Trump has not explicitly addressed AI deregulation, proposed members of his incoming administration, such as Elon Musk, have previously advocated for reducing regulatory barriers in tech. In the absence of strong regulatory frameworks around the world, the responsibility for ensuring ethical AI practices increasingly falls to businesses and investors.

Oh, Baby it's a Wild World!

The World Benchmarking Alliance says, "Both the risks and opportunities of AI have materialised with exceptional speed in the last two years."[5]

We are only at the beginning of AI development. This technology will provide many solutions in everyday processes. AI is accelerating scientific research with a focus on applications in healthcare, infrastructure, communication, finance, while we also need new technologies to tackle climate change.

With AI expanding through all processes, leveraging its power while addressing ethical and security concerns is key. Data privacy and security will necessitate a regulatory framework. Investors can help limit societal risks, by being selective in their stock selection or by investing in these segments and companies that contribute positively to a safer AI deployment such as cyber security companies or technologies which enhance privacy.

We firmly believe that our positive investment stance on technology, and AI specifically can be aligned with the ethical considerations.

5 - The World Benchmarking Alliance is the most widely-recognized standard setter for AI, both by companies and investors, and "hosts' the 2024 Investor statement on Ethical AI | World Benchmarking Alliance, https://www.worldbenchmarkingalliance.org/impact/investor-statement-for-ethical-ai-2024/

"We firmly believe that our positive investment stance on technology, and AI specifically can be aligned with the ethical considerations."

The 2025 European Banking Puzzle: Risks, Rewards, and Regulation

Can we find investment opportunities in the capital structure maze?

Christian Solé
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Conflicting or competing regulatory regimes on both sides of the Atlantic, a changing rates environment with central banks in easing mode, and consolidation are the new trends to watch in the European banking sector as we head into 2025. Select carefully and keep an eye on the emissions.

Three challenges in 2025: Basel IV, Rates, and Ongoing Decarbonisation Risks

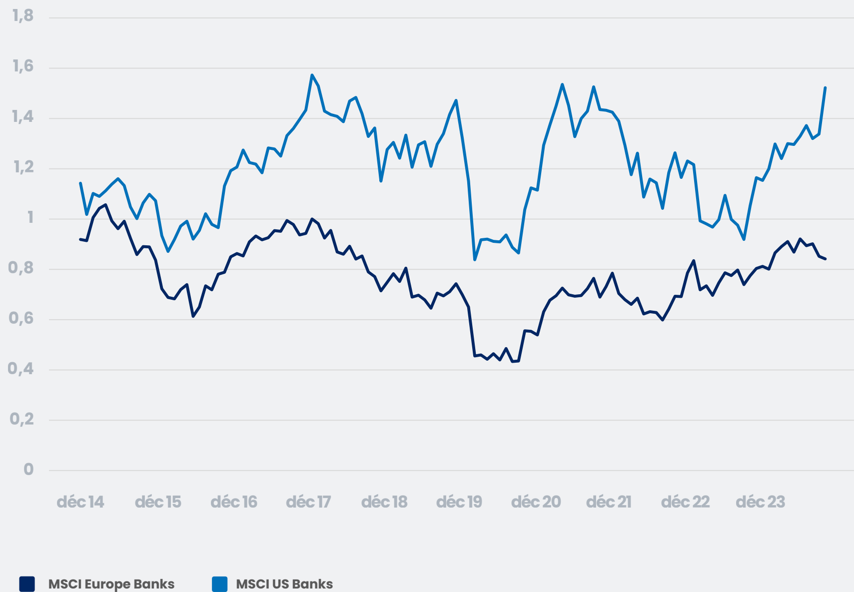
There are many shifting pieces to the banking landscape kaleidoscope. Regulation is in question, profits may be under pressure, but some modest good news is that banks are becoming aware of the risk of carbon exposure. As banks fundamentals are sound up to now and bank equities have performed, a few opportunities may be found at the lower part of the debt capital structure.

Basel IV, or not?

Starting with the recent election of Donald Trump may create some hope of deregulation, particularly in the US. ("Hope", of course, depends on one's view of near-term profit versus medium-term risk.) This may push other European regulators to reconsider their structures, in an effort to maintain competitiveness in their own regions. We have already seen some discussion about reducing the information required in IPO prospectuses in the UK.

The elephant in the room, the implementation of Basel IV, is to begin in 2025 and be fully in place by 2033. Should the US decide not to adopt this suite of regulations in full, the US global systemically important banks would avoid the extra 9% burden on their risk-weighted assets, and would be free to distribute more capital to shareholders. Another potential weakening of regulation, the possible watering-down of the Fundamental Review of the Trading Book, could increase the competitive advantage of the European corporate and investment banks.

It remains to be seen how far regulators are willing to lighten regulation less than two years after the US regional banks crisis that triggered the fall of Credit Suisse. We expect the ECB to keep a strict stance creating an uneven playing field for European CIBs.



Rate cuts?

The main threat to bank investing for 2025 is the rate cycle, with the ECB embarking on rate cuts to bring interest rates closer to 2% by the end of 2025, particularly after the November PMI figures. We estimate that every 50 bps rate cut could reduce net interest income by 3% for the European banking sector, and reduce net profits by 5%. While market expectations for rates are coming down, some management targets are becoming less and less realistic as recently outlined by Unicredit CEO Andrea Orcel.[1]

ESG - Bank decarbonization targets?

One of the most pressing and material risks, both near-term and long-term, is bank decarbonisation targets. A detailed analysis by the UN-convened Net Zero Banking Alliance (NZBA) determined that among the 30 largest banks, most of the existing decarbonisation targets are irrelevant – they are unlikely to achieve the rapid emission reductions that the economy needs and must be re-designed.

1 - Comment made during the 25 November 2024 "BPM acquisition" conference call.

Specifically, current targets based on financed emissions (from lending) and facilitated emissions (from capital markets activities) are based on ratios, instead of ceilings. Consider a US bank energy intensity mix target which covers oil, gas and clean energy. This calculation can be met by increasing finance for clean energy, without reducing financing of oil and gas.

While banks are not where they need to be on decarbonisation, **they are slowly tackling this material risk issue**. Since its launch in April 2021, membership of the Net Zero Banking Alliance has more than tripled from 43 to 144 banks. When a bank joins the NZBA, it independently and voluntarily (it is not a regulatory obligation) commits to transition its financing activities to align with pathways to net zero by 2050 at the latest, and to set intermediate sectoral targets for 2030 or sooner to put it on a path towards this goal[2]. This demonstrates a growing interest in joining the Alliance, indicating that banks view transition away from fossil fuel financing as a material goal.

Further, banks are bringing more sustainable investments to the heart of their strategy, by setting green financing targets for 2030 and publishing transition plans. However, we expect banks to reduce their exposure to high-emitting industries and further increase their share in green financing.

Those very few banks which might leave the Alliance in 2025 will likely do so because of failure to reach the milestones set up by the group, not because of political pressure. While we may continue to see “greenhushing” in the US, banks which are aware of the risk will not change their strategy just because of the new administration.

Finding the right part of the banking capital structure for 2025

While the regulatory angle, the macroeconomic environment and decarbonisation targets may raise questions, the bank’s fundamentals are sound with historically high levels of profitability, improving solvency ratios, credit quality legacies well-controlled and strong liquidity. And banks are finally bringing more sustainable investments to the heart of their strategy. The recent earnings season has shown solid results, but the focus is shifting to growth, fee income and consolidation.

Under this scenario, what are the opportunities in the capital structure?

2 - These intermediate targets should cover all or a substantial majority of nine carbon-intensive sectors.

Equities: Are they already full?

Share prices have already risen sharply as European banks equities delivered another robust performance in 2024 (as implied by the price/book ratios in the figure). The rate cycle is likely to hamper earnings momentum, and while credit quality remains strong, it may deteriorate rapidly as the economy slows. Bear in mind the cyclicality and leverage of banking.

On a positive note, **consolidation** is rising. In recent months, BBVA launched a bid on Banco Sabadell in Spain, Unicredit acquired a 20% stake in Commerzbank, and BPM built a 9% stake in Banca dei Monte Paschi di Sienna. Unicredit (again) finally launched an offer on BPM, while Eurobank is buying the minorities in Hellenic Bank of Cyprus. This should benefit investors by forcing greater discipline on managements – in pricing, efficiency, and capital allocation. However, Europe remains a fragmented market and cross-border consolidation is restrained by the absence of a common banking market and by political resistance in domestic markets.

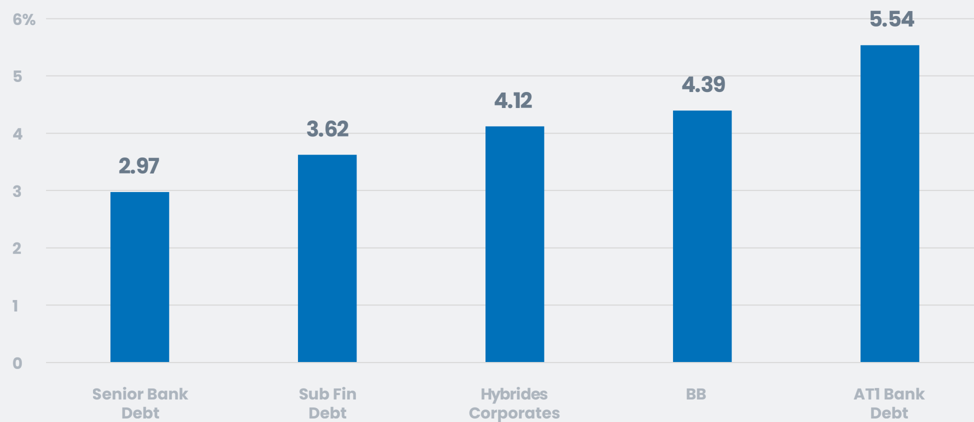
Also, the sector would not be fully immune during bouts of volatilities. Political and economic turmoil in some jurisdictions could spark the return of a bank-sovereign nexus, with peripheral countries such as Spain or Italy potentially better placed than historically core European countries (France or Germany).

Bank Debt: Senior or Subordinated?

Compressed valuations of **bank debt** suggest that performance is more likely to come from carry than from spread tightening, all across the capital structure. But bank subordinated debt (Additional Tier 1 and, to a lower extent Tier 2) may selectively offer attractive yields, not only versus senior debt, but also in comparison with other riskier assets such as high-yield BB and hybrid corporates.

Yields for Euro Debt by Seniority, compared to Yields for BB

ICE Euro Indexes, 3 Dec 2024



Source: Bloomberg

Pick the Right Issue

Supported by sound capital ratios and reasonably strong asset quality, we think a few selective opportunities may be found at the lower part of the debt capital structure. AT1 debt instrument and Tier 2 offer a yield close to High yield BB but are issued from banks with A rating in average. Taking into account current solvency ratios, banks are effectively far from the point of non viability which would trigger absorption risk and potential coupon switch. Sound track records on AT1 calls and liability management exercise comfort us that banks will continue to call but issuer selection remains critical. We retain our preference for national champions and, more broadly, higher-quality names.

Try a Cup of Texas Tea: Oil as a Diversifier

Diversify Your Portfolio Through the Commodity

Thibaut Dorlet
CFA, Senior Multi-Asset Fund Manager

Nicolas Rutsaert
CFA, Senior Equity Analyst

Nicolas Cleris
Senior Credit Analyst

As Donald Trump returns to White House, his policy agenda could send ripples through the global oil market. His trade wars and immigration stance are expected to fuel inflation, while his commitment to deregulation and to increasing US oil production pose new challenges for oil prices. The interplay among these policies and broader geopolitical and economic factors could redefine the energy landscape. Despite challenges, the oil and gas sector is adapting effectively to a shifting landscape, balancing operational efficiency with financial discipline to navigate heightened uncertainty. What does this mean for investors?

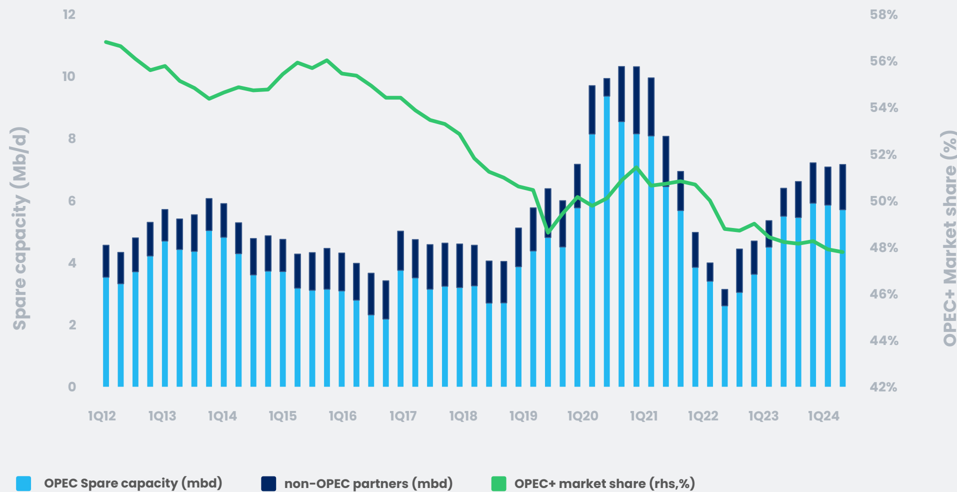
Tensions Amid Slower Oil Demand Growth in 2025

Global oil demand is expected to grow slightly in 2025, increasing by around 1 million barrels per day to 103.8 mbd, according to the International Energy Agency (IEA). This slower growth reflects weaker economic conditions, the waning of post-pandemic recovery, and the shift toward cleaner energy. Demand from China, a key driver of growth in recent years, is also expected to level off.

Meanwhile, on the supply side, OPEC+ will have to deal with non-OPEC members[1] who are expected to increase their output by 1.5 mbd, driven by offshore projects. To maintain market equilibrium, OPEC+ may need to cut its annual crude production by 0.6 mbd, in contrast to its hope to restore 2.2 mbd of previous voluntary cuts. In early December 2024, OPEC adjusted to the rapid return of Libyan production and other pressures by postponing this 2.2 mbd restoration, along with other changes.[2] We remain sceptical, as we see room for OPEC+ to raise production in 2025. Balancing supply and demand will require careful coordination among OPEC+ members. A lot will also depend on Saudi Arabia, the largest producer among OPEC+, which might decide to repeat its 2015 strategy of prioritizing market share over price stability. This decision comes as global oil demand is expected to peak by the end of the decade and decline further by 2035.[3] However, such a move would strain Saudi Arabia's budget—requiring oil prices around $93 per barrel to fund its investments—and could weaken its influence within OPEC+. Plenty to this story to hold our interest!

1 - OPEC (Organisation of Petroleum Exporting Countries) currently includes 12 member countries (Founder Members, and Full Members): Iran, Iraq, Kuwait, Saudi Arabia, Venezuela, Libya, the United Arab Emirates, Algeria, Nigeria, Gabon, Equatorial Guinea, and Congo. Since 2016, OPEC+ includes ten so-called 'non-members', as shown in the Figure, namely Azerbaijan, Bahrain, Brunei, Kazakhstan, Malaysia, Mexico, Oman, Russia, South Sudan, and Sudan.
2 - IEA Oil Market Report, November 2024.
3 - IEA Oil 2024 Analysis and forecast to 2030.

Oil Market Shares: Will OPEC(+) Blink?



Source: UBS, data originating from IEA

Risks in 2025: Balancing Fundamentals, Politics, and Risk

In 2025, oil prices face both downside and upside risks, influenced by geopolitical, economic, and policy factors.

US Policies Under Trump: A potential Trump presidency could impose new and higher tariffs, reduce corporate taxes, and roll back regulations, especially environmental regulations. His trade wars and immigration stance are expected to fuel inflation, while his commitment to deregulation and increasing US oil production poses new challenges for oil prices.

Inflation could rise due to tariffs or restrictive immigration policies. For example, our economists estimate that tariffs on products from Canada, Mexico and China could add 1% to US inflation. To offset such pressures, Trump could push for lower oil prices, ideally around $40 per barrel. However, this price level is unsustainable for US shale, which needs $70 per barrel to maintain growth. Another complication is Trump's focus on Iran and Venezuela. Secondary sanctions could create upward pressure on global prices.

Middle East Tensions: Geopolitical risks in the Middle East remain a potential upside for oil prices. While conflicts between Israel and Iran have yet to impact oil flows or infrastructure significantly, any escalation could change this dynamic. Alternatively, Trump might prioritize easing tensions, given his history with the Abraham Accords and interest in fostering deals in the region.

Overall, we expect Brent crude prices to average around $70 per barrel in 2025 -- slightly above current market expectations but below the cost of many new oil projects. Depending on how these risks unfold, prices could range between $50 and $80 per barrel, a broad range because of the many risks.

Energy Sector Outlook: Navigating Volatility and Adapting Strategies

Equity Outlook: The oil and gas sector faces earnings pressure due to global overcapacity, but downside risks appear limited. Companies are adapting by cutting capital investments and adjusting share buyback programs. Recent declines in share prices have improved the sector's relative value, with integrated oil companies pricing in Brent crude at $60-65 per barrel -- ie, below the forward price curve. Meanwhile, the liquid national gas market is expected to remain tight until new projects come online in 2026, benefiting gas-focused companies and improving the resilience of the sector, despite near-term risks to earnings momentum. Therefore, considering the already negative sentiment, we are neutral on the equities in the energy sector.

Credit Outlook: US high-yield energy industry bonds face a slightly higher risk profile in 2025 compared to 2024, although company fundamentals. Firms are maintaining low leverage, solid coverage ratios, high credit ratings, and strong liquidity, with minimal reliance on Reserve-Based Lending Facilities. If oil prices were to fall further, the sector could experience a valuation reset, however, we would not expect a significant increase in defaults.

Conclusion: Diversify Into the Real Thing

The oil market in 2025 will continue to be shaped by a complex mix of supply-demand dynamics, geopolitical tensions, and policy choices. Overcapacity, coupled with the Trump administration's push to keep energy prices low, casts doubt on the effectiveness of OPEC+'s price-defence strategy. However, the high-cost structure of US shale oil acts as a natural floor, limiting how far prices can fall.

The outlook for the oil equity, and credit sectors remains subdued, but the environment highlights the value of commodities as portfolio diversifiers. Even with expectations of weaker oil prices, a long position in oil could serve as a hedge against geopolitical risks, offering some protection.

Is China Really Better Prepared for Trump 2.0?

With the threat of tariffs looming under a Trump return, can China's stimulus and reforms protect its economy?

Paulo Salazar
Head of Emerging Markets Equity

Chris Mey
CFA, IMC, Head of Emerging Market Debt

With Donald Trump returning to the White House in 2025, his second term is likely to see a resurgence of tariffs and export restrictions among other things, raising concerns about China's ability to withstand a resurgence of 'America First' policies. While Mexico surpassed China as the U.S.'s largest trading partner in 2023, China remains a key contributor to the U.S. trade deficit, leaving it particularly exposed to potential tariff increases.

At the same time, Beijing faces significant domestic challenges, including high local government debt, stress in the banking sector, a fragile property market, and weak consumer demand. Despite recent efforts to stabilise its economy, the critical question remains: Is China better equipped to manage these pressures in an increasingly complex global landscape?

Trump's second term could see the return of aggressive trade policies, with tariffs targeting up to 60% of Chinese exports in a worst-case scenario[1]. Key sectors such as technology, manufacturing and consumer goods would come under significant pressure, adding to China's existing challenges. Candriam economists estimate that these tariffs could reduce GDP growth by 1.5%-2% in the worst case, threatening China's fragile recovery and its ability to meet its 5% growth target.

China's response to economic challenges

To address its economic challenges, Beijing has announced a series of measures in September, including a 50 basis point (bps) cut in the reserve requirement ratio and a 20 bps cut in interest rates, with more to come. To stabilise the housing market, the authorities have lowered mortgage interest rates, eased down-payment requirements for second-home buyers and loosened borrowing restrictions for local governments buying unsold homes. Liquidity support has been extended to the stock market and capital injections into state-owned banks are reportedly being considered to boost lending.

1 - China has prepared for the shock of Trump's tariff threats, despite its vulnerabilities, https://www.lemonde.fr/en/economy/article/2024/11/27/china-has-prepared-for-the-shock-of-trump-s-tariff-threats-despite-its-vulnerabilities_6734332_19.html

Despite these interventions, the scale of the measures remains limited, amounting to only about 1% of GDP[2]. While there has been some short-term relief - most notably a rally in Chinese equities - persistent deflationary pressures, weak consumer confidence and an unresolved property market downturn continue to weigh on the economy.

In December, the Politburo announced plans for a "more proactive and moderately loose" monetary policy in 2025[3], reminiscent of the post-2008 expansionary measures. At the China Economic Work Conference, officials reiterated their focus on stabilising economic growth amid rising trade tensions with the US. Chinese officials pledged to widen the fiscal deficit, increase debt issuance and ease monetary policy further. Key measures planned include a cut in key interest rates and a reduction in bank reserve requirements to support the struggling economy. While details remain unclear, the strategy emphasises stimulating domestic consumption, improving investment efficiency and supporting critical sectors such as infrastructure, technology and consumer spending.

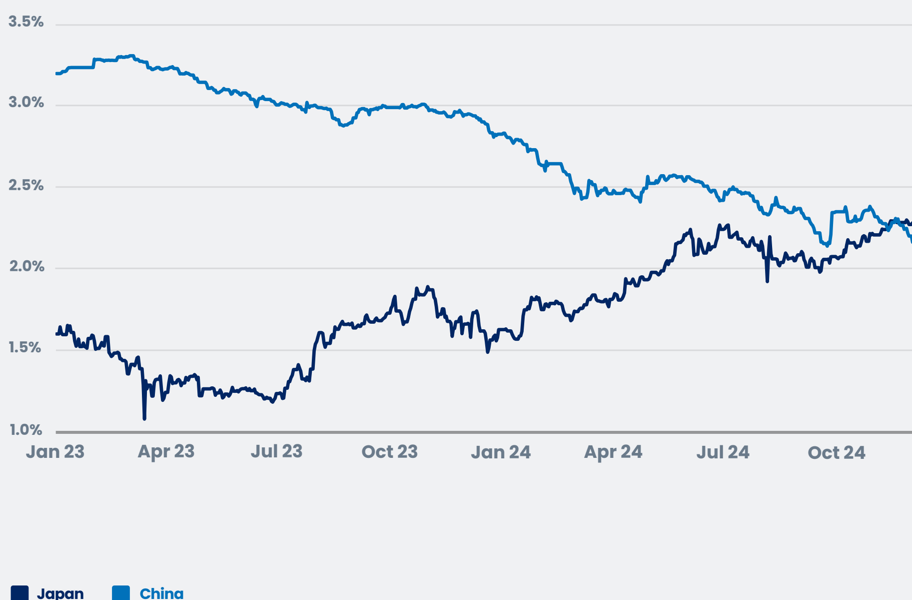
Will it be enough?

However, success is likely to depend on the size and timing of the stimulus. For these initiatives to have a meaningful impact, an unprecedented level of stimulus would be required, combined with significant economic liberalisation and market-oriented reforms.

While speculation about possible further stimulus measures is growing, doubts remain about China's ability to address its structural challenges and external pressures. Without additional targeted fiscal support, consumption stimulus and meaningful reforms, the risk of prolonged stagnation looms large, evoking comparisons with Japan's economic trajectory in the 1990s[4].

For now, China's policy interventions, while promising, remain insufficient to fully counter the economic pressures of a Trump 2.0 scenario. Investors and global markets are likely to remain cautious, awaiting clearer signs of decisive action in early 2025.

2 - Source: Candriam
3 - https://www.reuters.com/world/china/china-announces-first-monetary-policy-shift-since-2010-spur-growth-2024-12-09/
4 - Some investors draw parallels between China's current economic situation and Japan in the 1990s, when a property bubble burst, triggering decades of stagnation. Chinese bond market grapples with 'Japanification, https://www.ft.com/content/d299727e-41a1-480b-a44d-780b290bc3c0?shareType=nongift'



A Mixed Outlook for Global Markets

China's fiscal stimulus could reshape emerging markets (EMs), where it remains a key driver of growth. Increased domestic consumption could boost demand for commodities, benefiting exporters in Latin America and Africa. However, reliance on debt-financed investment poses risks, especially for EMs dependent on Chinese financing. China's deflationary trends could also spill over globally, dampening inflation and challenging export-driven economies such as Germany.

A stronger US dollar under a second Trump administration could weaken the Chinese yuan, which is under pressure from falling exports and declining foreign investment. Persistent deflation and limited monetary flexibility have reduced the attractiveness of Chinese local government bonds, which yield 1.5%-2.0%[5]. High-yield corporate bonds remain risky due to leverage, weak consumer sentiment and economic headwinds, while investment-grade issuers face earnings pressure. Commodity-exporting EMs could see lower revenues, weaker currencies and reduced investment as Chinese demand slows.

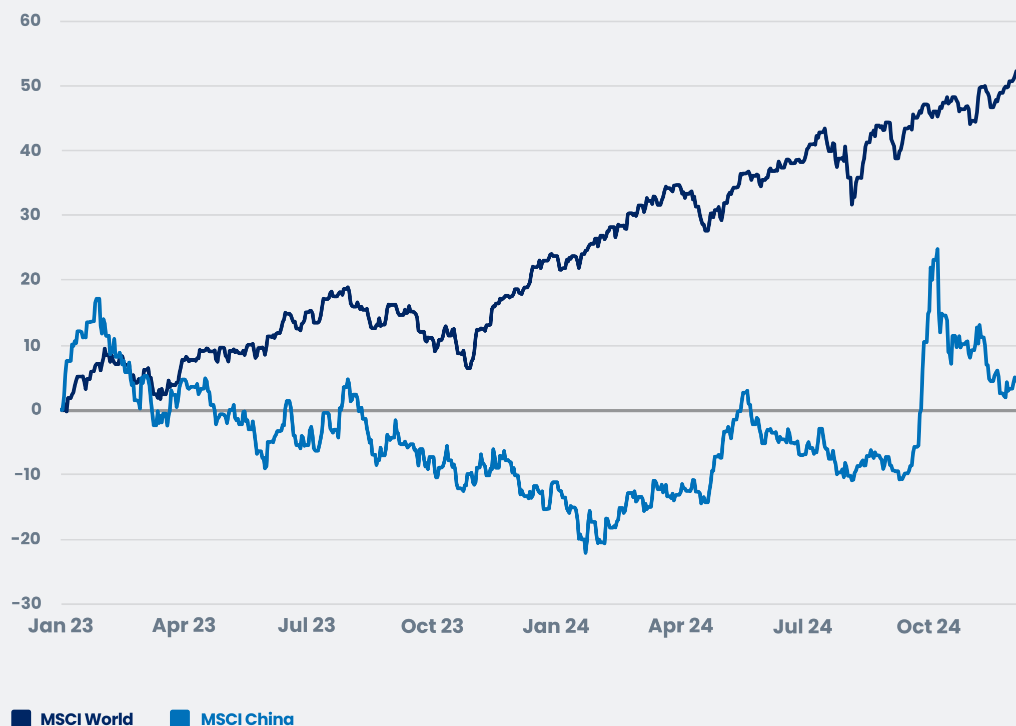
5 - Source: Bloomberg

Despite these risks, there may be opportunities in emerging market bond markets. Supply chain shifts away from China are driving investments to Southeast Asia and Latin America, particularly in manufacturing, technology and logistics hubs. Emerging markets with high carry potential and room for monetary easing could benefit from increased capital inflows. Strategic exposure to Latin American metals exporters, particularly copper producers in Chile and Peru, could mitigate risks from global supply disruptions.

China's Equity Market: Recovery on the Horizon?

China Lags Behind Global Equities

Net Cumulative Performance in USD (%)



Source: Bloomberg

Past performance of a given financial instrument or index or investment service, or simulations of past performance, or future performance forecasts are not reliable indicators of future performance.

"A stronger US dollar under a second Trump administration could weaken the Chinese yuan, which is under pressure from falling exports and declining foreign investment."

China's equity markets could rebound in 2025, supported by fiscal and monetary stimulus that acts as a floor for the markets. With the MSCI China Index forecast to grow earnings by 9% in 2025[6], the low base could set the stage for a rebound especially as Chinese assets remain largely "unloved" by foreign investors. Consumer-focused initiatives such as electric vehicle subsidies and tourism promotion are expected to continue, and targeted support for low-income households and families may be introduced.

Domestic-oriented sectors like e-commerce, consumer discretionary, and education may outperform, benefiting from stimulus policies. Internet gaming also presents potential, as its success relies more on product innovation than macroeconomic conditions. However, technology companies facing U.S. export restrictions and regulatory pressures could struggle. In this environment, A-shares are poised to outperform H-shares[7] due to their lower exposure to geopolitical risks and the strong dollar.

Despite measures to stabilise the economy and address critical challenges, questions remain about Beijing's preparedness for a potential revival of Trump-era trade policies. The outcome will depend on the scale and timing of future stimulus efforts, as well as external factors such as Trump's transactional use of tariffs, which may prove more pragmatic than expected. In such an uncertain environment, opportunities may arise in sectors supported by targeted policies, so selectivity will be essential to uncover these prospects and navigate the complexities of the evolving landscape.

6 - Source: Candriam
7 - H-shares are shares of Chinese companies listed on the Hong Kong Stock Exchange, traded in Hong Kong dollars and open to all investors worldwide. In contrast, A-shares represent companies based in mainland China and listed on the Shanghai or Shenzhen stock exchanges. A-shares are primarily available for trading by mainland Chinese citizens, although foreign access is possible through special investment programmes such as Stock Connect.

2025: the swan song for global climate action?

How will the recent political developments in the U.S. and in Europe impact the transition? Is the energy transition still a relevant investment theme?

Alix Chosson
Lead ESG Analyst for Environmental Research & Investments

Tanguy Cornet
Head of Thematic Global Equity - Environment

2024 concluded as another annus horribilis for climate action, with COP29 blowing "hot air", reinforced geopolitical tensions overshadowing the climate crisis, and the re-election of Donald Trump in the U.S. We only have a couple of years left before spending the totality of the +1.5°C carbon budget. How will the recent political changes and global geopolitical tensions impact the transition?

The energy transition is not a question of 'if', but of 'when' and 'how'. Climate change is a physical reality, as seen in the recent deadly floods in Spain. Failing to act now means paying a higher price later, and forcing countries to adapt with far greater socioeconomic consequences.

While waning political ambition may slow the transition, we see it as an unstoppable trend that will continue to reshape our societies. The decisions guiding this energy transition will be increasingly driven by the pursuit of greater economic competitiveness and the imperative to secure maximum independence in energy supply chains.

A delayed transition is now the most likely scenario

Global GHG emissions rose to 57.1Gt CO2e in 2023, up 1.3% over a year[1]. Unfortunately the peak of global emissions is now further away on the horizon. Current climate commitments are steering us toward a best-case global warming scenario of +2.6°C with severe environmental, social and economic consequences. The lack of ambition shown in Baku at COP29 and the election of Donald Trump in the U.S. are not signals of hope, at least on the medium term.

However, on the ground, many technologies key to the energy transition are showing very strong development, first and foremost renewables. Global renewable capacity is expected to grow by 2.7 times by 2030, surpassing countries' ambitions by nearly 25%[2]. This represents an additional 5,500 GW of capacity, with about 60% of this growth occurring in China. While this falls short of the net zero trajectory objective of tripling renewable capacities, it underscores that renewable development is now less driven by environmental regulation and subsidies, and thus less subject to political volatility.

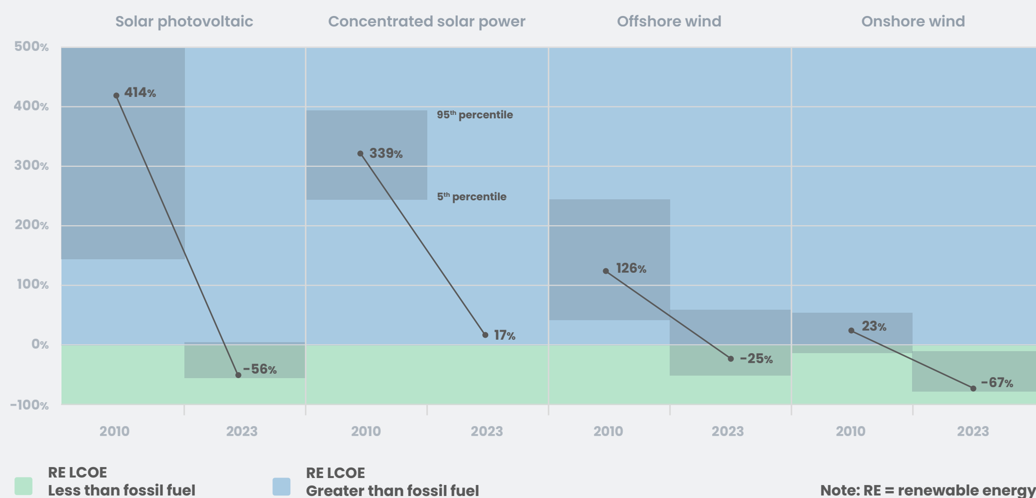
1 - United Nations Environment Program, 2024 Emissions Gap Report
2 - International Energy Agency (IEA), "Renewables 2024" report

Politics and regulation are no longer the sole compass of this transition

The Inflation Reduction Act (IRA) in the U.S. showed how regulations can accelerate the transition. Although Trump announced he would aim for a repeal of this Act, a full repeal is unlikely given its economic benefits in many Republican-led states. Trump's anti-environmental stance is likely to focus on symbolic decisions that shouldn't jeopardise economic growth, such as reducing the power of federal agencies or repealing emissions and pollution controls.

While regulations can accelerate the transition, the rapid deployment of renewables globally is now mostly driven by economic factors. Renewables have become the cheapest source of electricity in many regions thanks to a continuous improvement in their global weighted average Levelized Cost Of Energy (LCOE) - which technological advancements are expected to further reduce. Meanwhile, thermal power generation is challenged by rising carbon costs and volatile commodity markets.

Change in global weighted average LCOE for solar and wind compared to fossil fuels, 2010-2023



Source: IRENA 2024

Amid global trade tensions, the clean tech supply chain is becoming a key geopolitical battleground

A trade war is brewing between the U.S. and China, and to a lesser extent Europe, aiming to protect local clean tech industries. The clean tech sector has become a prime target for protectionism, as seen in May with tariff increases on Chinese products such as electric vehicles (EVs), solar cells, EV batteries and non-EV Lithium-ion batteries, or the Intergovernmental Critical Mineral Task Force Act enacted in September 2024 that aims to reduce US reliance on China for critical minerals used in clean tech.

This means that building regional clean tech supply chain and ensuring access to critical minerals is now seen as a matter of competitiveness and sovereignty - one of the few topics that has bipartisan support in the U.S. This should serve as a guiding thread in decisions made beyond political divides.

The situation is similar in Europe. Despite the new Parliament and Commission's softer stance on environmental matters, it is unlikely that the EU will dismantle flagship regulation such as the Net Zero Industry Act, which first and foremost aims at ensuring Europe's competitiveness and independence on the long run.

Ultimately, while the regionalisation of clean tech supply chains is likely to increase the overall cost of the transition, it will require even more investments in clean technologies and their supply chains, creating larger investment opportunities.

How to seize investment opportunities in this new context?

Investments in the transition are on track to reach $2 trillion in 2024, a 60% increase since 2015[3]. According to the International Energy Agency's (IEA) central "Announced Pledges" scenario, this number is expected to double in advanced economies and China, and quadruple in developing economies, reaching nearly $3.7 trillion. In the net zero scenario, investments are projected to increase to $4.8 trillion. Both scenarios create a wide range of opportunities for investors across a variety of technologies.

3 - International Energy Agency (IEA), "World Energy Investment 2024" report

Electrification is key – with significant increase expected in power demand

Electrification is key to decarbonising the global economy. Global electricity demand is expected to rise faster over the next two years (+3.4% annually through 2026[4]), driven by demographics, new usages such as A.I. (data centers are expected to consume 1,000 TWh by 2026[5]) and the electrification of energy needs in buildings, industry and transport. In its base case "STEPS" scenario[6], the IEA sees electricity demand growing by 1000TWh per year throughout 2035 (45% coming from China), equivalent to adding another Japan to global electricity consumption every year.

The deployment of renewables is driven by increasing power demand and favourable economics

The global weighted average LCOE for utility-scale solar PV projects is now at $0.049/kWh[7], 29% lower than the cheapest fossil fuel-fired option[8]. The economic benefits of solar and wind technologies are compelling, even without subsidies. The Inflation Reduction Act and the Bipartisan Infrastructure Law have laid the groundwork for clean energy progress, and local, state and private sector leaders are expected to carry this momentum forward. Increasing power demand and further improvements in LCOE are the key drivers of the 2.7x increase in capacity by 2030 envisaged by the IEA in its base case scenario.

Massive grid investments are required to unlock the green potential

Upgrading and expanding transmission infrastructure is essential to decarbonise power systems. In the U.S., more than 70% of grid transmission lines and

4 - International Energy Agency (IEA) , "Electricity 2024" report
5 - International Energy Agency (IEA), "World Energy Outlook 2024" report
6 - The Stated Policies Scenario (STEPS) is designed to provide a sense of the prevailing direction of energy system progression, based on a detailed review of the current policy landscape. It provides a granular, sector-by-sector evaluation of the policies that have been put in place to reach stated goals, taking account not only of existing policies and measures but also those that are under development (IEA)
7 - International Renewable Energy Agency (IRENA), "Renewable Power Generation Costs in 2022" report
8 - For power generation, the main fossil fuel-fired options are coal, conventional natural gas, and natural gas combined cycle – which is the cheapest

transformers are old and vulnerable to power outages, cyber-attacks, and susceptible of causing wildfires. According to the IEA, investments in grids must double to over $900 billion annually to meet climate goals, with every 1$ invested in renewables requiring another 1$ in grids. As of 2023, almost 1,500 GW of advanced wind and solar projects were in global connection queues, waiting to connect to the electricity grid due to a lack of grid availability. Governments have a crucial role to play in unlocking investments in larger, more resilient and more digitalised grids.

The (still) missing piece to net zero power systems: energy storage

The demand for storage solutions is rising rapidly. Battery storage capacity was projected to grow by 82% in 2024[9], with technological improvements allowing to reduce costs and improve efficiency up to 2030. In particular, sodium-ion battery technologies and on the longer term solid-state batteries are expected to help resolve the stationary storage technological conundrum, that has so far prevented energy storage system from playing the role they should in decarbonising power grids. We expect technological breakthrough in this space to happen before 2030.

Conclusion

The political developments of 2024 have challenged the transition to net zero. However, the physical reality of climate change remains the same, or worse. A senior US advisor said in Baku: “This is not the end of our fight for a cleaner, safer planet. Facts are still facts. Science is still science. The fight is bigger than one election, one political cycle in one country”.

The momentum around the transition is now supported by the drive for increased economic competitiveness and the need to ensure maximum energy supply chain independence, that should mitigate the influence of shorter-term political changes. Ultimately, in the context of deglobalisation, investments needed for the transition are likely to be higher than expected, creating a wide range of investment opportunities.

9 - Visual Capitalist, “2024 U.S. Clean Electricity Outlook”

M&A: Triple Trends for 2025?

In a Year of Uncertainty, is 2025 the Year for Mergers and Acquisitions?

Steeve Brument
Global Head of Alternative Investments

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Head of Risk Arbitrage – Absolute Return & Quantitative Equity

As we head into 2025, the stars seem to be aligning for a revival of mergers and acquisitions, creating a fertile environment for investors seeking new opportunities. Merger arbitrage strategies attempt to capitalize on M&A activity by using a structured approach returns. Much like other alternative investment strategies, merger arbitrage can enhance the quality and consistency of the performance of a portfolio of asset classes, while contributing to diversification and resilience in an evolving market landscape.

The M&A Landscape: from Headwinds to Tailwind?

Over the past three years (2021 to 2024), the M&A environment faced challenges. Persistent economic uncertainty, rising interest rates, and a stricter regulatory landscape weighed on deal-making activity:

- **Economic uncertainty:** Elections in the US, the UK, Japan, France and Germany as well as geopolitical conflicts in Ukraine and the Middle East exacerbated global economic uncertainty.
- **Deteriorating financing conditions:** Central banks in the US and Europe dramatically[1] raised interest rates, while the premium on borrowing costs rose for leveraged loans as demand plummeted.
- **Regulatory pressures:** Under FTC[2] Chairman Lina Khan, American antitrust enforcement took a more dogmatic stance, diverging from the approach traditionally used by regulators to assess competition impacts of mergers. This led to numerous challenges for transactions across sectors that would have otherwise been cleared rapidly, such as the rejected combinations of grocery leaders Albertsons and Kroger or the terminated merger between large fashion operators Capri (brands such as Michael Kors) and Tapestry (Coach) in 2024.

These headwinds damped down M&A activity across North America and Europe, which collectively account for more than two-thirds of global deal flow.[3]

1 - The Federal Reserve increased interest rates by 525 bps between March 2022 and July 2023, while the ECB increased rates by 450 bps between July 2022 and September 2023). Source: Bloomberg.
2 - US Federal Trade Commission.
3 - Candriam estimates.

As we approach 2025, we see conditions shifting in favour of an M&A revival:

- Lower inflation and growth expectations provide a more stable environment for dealmakers.
- Interest rates cuts make it easier for companies to secure funding for acquisitions and boost expected returns, with further rate reductions to be expected over the next 12 months.
- Corporate and investor cash reserves are at record levels, with private equity firms holding unprecedented amounts of deployable capital.
- The recent US elections, resulting in a Republican president and legislature, signal a shift toward pro-business policies, including corporate tax cuts and streamlined regulatory processes. For instance, the 2017 Tax Cuts and Jobs Act reduced domestic taxes to levels comparable to international tax havens and introduced exemptions for repatriated earnings.

US Leadership of the M&A Revival

The new Trump administration is expected to adopt a more relaxed regulatory approach in the US, particularly from the Federal Trade Commission (FTC) and the Department of Justice (DOJ), which oversee mergers and acquisitions. President-elect Trump most recently nominated Andrew Ferguson and Gail Slater to lead those two federal agencies. Both have publicly stated clear opposition to the policies of their predecessors, with Ferguson going as far as to vow he would “stop Lina Khan’s war on mergers”, sending a strong ‘all clear’ signal to corporates and financial buyers.

While US domestic deal-making activity is likely to surge, foreign buyers could face barriers due to protectionist policies. For example, if the Administration prioritises reducing dependency on foreign technology, it could incentivise American firms to acquire domestic tech startups to maintain innovation and security. As noted by international law firm Rooney Law, such measures could bolster the US technology sector.

Deal announcements have already increased double-digit versus year-to-date rates since the November 5th election, with Wall Street bankers reporting a significant uptick in client inquiries. Considering that traditional due diligence processes would take a few weeks or months to complete, this should bode well for M&A activity as soon as early 2025. After years of sidelined activity and accumulating cash reserves, companies are now eager to pursue deals, even those previously considered challenging. A notable example is the recently announced $30 billion merger between advertising giants Interpublic and Omnicom.

Number of Announced M&A Transactions

Publicly-traded companies in US, EU, Japan, Hong Kong, and Australia, market cap over $300 million

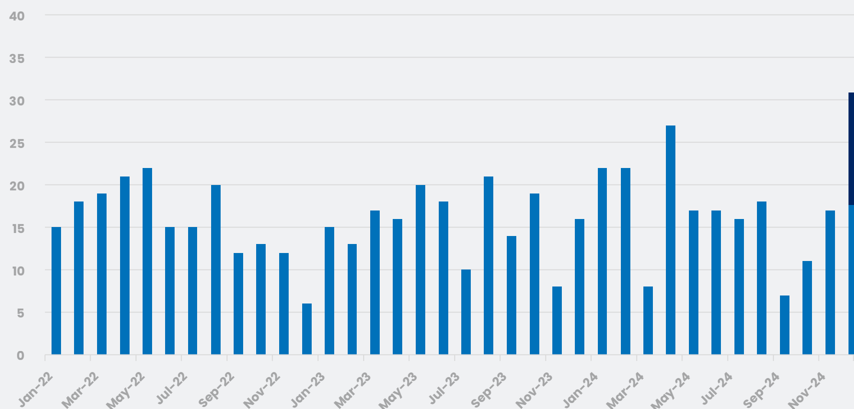


Figure for December 2024 extrapolated.
Source: Candriam, Bloomberg

Investment Opportunities in M&A

M&A-related strategies, such as risk arbitrage, aim to t capitalise on inefficiencies in the price movements of the companies involved in takeovers or mergers. In a time when equities and fixed income appear to be relatively expensive, the returns on these strategies have low correlations with markets as their risks are idiosyncratic. As a matter of fact, when a company is about to be acquired or merged, its share price ceases to be determined by its fundamentals, ie its financial performance, but rather by news about the pending transaction. Investors are rewarded for the fulfilment of certain conditions attached to each specific transaction, such as the required shareholder vote or antitrust approvals. As a result, stocks involved in mergers and acquisitions tend to move independently of the market as a whole and of each other. A merger arbitrage strategy can offer advantages such as low exposure to market trends, given the historically low transaction failure rate (5%), which means controlled volatility and stable returns. This can make this strategy a good portfolio diversifier.

Finally a Little Predictability?

With a more favourable backdrop for mergers and acquisitions, 2025 could mark the return of a vibrant M&A market. Moderating interest rates and the new Republican majority in the US pave the way for a pro-business agenda, including corporate tax cuts and easing regulatory burdens. For investors, this environment may highlight the renewed relevance of strategies tied to corporate activity, offering attractive opportunities to navigate a complex and evolving financial landscape.

Asset Allocation in 2025: Between Optimism and Uncertainties

The year 2024 ends with significant economic disparities between regions. Which asset classes should be prioritised for approaching 2025?

Nadège Dufossé
CFA, Global Head of Multi-Asset

Global growth progresses in line with expectations, but the economic landscape remains fragmented. While activity is strong in the United States, the Eurozone is struggling to move forward, and China is penalised by weak consumption. Geopolitical tensions and the rise of political uncertainty in several countries risk exacerbating these divergences in 2025. These growth disparities between regions have already been largely reflected in equity performance in 2024, and investors have had time to position themselves accordingly. The year 2024 ends with a near-euphoric sentiment on the US market, while investors remain strongly underweight on European or emerging market equities. Here is the challenge for 2025: It seems difficult to go against these trends before knowing more about Donald Trump's policies; yet we believe opportunities could be found next year in assets that currently appear too weak or risky.

Our Asset Allocation at the Start of 2025

As we enter 2025, our asset allocation is based on a soft-landing scenario for global growth. The main central banks have entered a new cycle of monetary easing and will do what is necessary to support economic activity. China, for its part, is piling on measures and has sent a strong signal: The authorities want to get closer to their 5% growth target. The main risk to this scenario is Donald Trump's arrival at the White House in January, as it is still unclear which of his numerous campaign promises — tariffs, immigration, tax cuts, and deregulation — will actually be implemented. A hard stance on immigration and tariffs (the 'hard Trump' scenario) could derail these favourable prospects and would imply weaker global growth and higher inflation. Conversely, a softer version of his policies would not significantly undermine our overall growth and inflation forecasts.

Positive on Equities

In this context, **our allocation remains positive** on equities relative to bonds. We remain **overweight on US equities**. Although the US market's performance and valuation already incorporate a certain level of optimism following Donald Trump's victory, the growth trajectory of the US economy and corporate profits is much stronger and more resilient than that of other developed countries. We are, however, more favourable toward small- and medium-sized companies, cyclical sectors such as industrials, and financials, which should benefit most from Donald Trump's 'reflationary' and domestically favourable policies. We remain neutral on tech stocks, where valuations leave little room for new positive surprises despite a strong earnings momentum. In this sector, we prefer software and services over semiconductors.

We are **underweight on European equities**, which offer limited earnings growth prospects. Investor scepticism is very strong towards the region. The gap in investment and productivity gains relative to the United States continues to widen, and the political situation in France and Germany is mired in partisan divisions. Attractive valuation levels alone will not suffice to bring investors back. Europe will need to demonstrate better growth prospects, Germany will need to relax its 'debt brake', and trade tensions with the US will need to be successfully managed... which is possible, but far from certain. **Outside the US, our preference leans toward emerging markets**, which offer very attractive valuations and which are penalised by US interest rates and a strong dollar. The imposition of US tariffs represents the main risk for the region. However, Trump's first nominations and announcements seem to indicate a willingness to negotiate rather than engage in a full-scale trade war, which could weigh

"Global growth progresses in line with expectations, but the economic landscape remains fragmented."

on US growth and inflation. The Chinese government's successive announcements should help stabilise the country's economic situation and benefit the region as a whole. We are also neutral on Japan.

Government Bonds: Positive on Europe, but Negative on the US

We are long **German duration in Europe**. Growth expectations for 2025 are low, and we expect the ECB to cut rates further if necessary. Holding non-risky government bonds can also protect a diversified portfolio against any disappointment in growth levels, given that equities and bonds are once again negatively correlated in Europe in a context of disinflation. **We remain cautious on French debt**, awaiting an agreement on the 2025 budget, and prefer countries like Spain, where growth remains robust. Conversely, **we are negative on US duration**. While US rates have stabilised since Trump's election, the risk remains on the upside, depending on the measures actually implemented by the new president. The gap between US and European monetary policies is expected to persist. A negative position on US duration can also protect a diversified portfolio against a 'hard Trump' scenario and a significant rise in inflation expectations.

Europe: The equity-bond correlation is heading back to negative territory

Eurozone 12-month rolling Equity/Bond correlation of weekly returns

Source: Bloomberg data, Candriam Multi-Asset Quant research

On Credit, We Prefer Europe

Credit spreads have significantly narrowed in 2024 and are now at historical lows for investment grade credit and high yield. In the US particularly, these levels make the risk asymmetrical, notably in high yield. The current spreads imply a default rate of 2%,[1] well below the current actual default rates of 4-5%.[2] Absent a recession, the risk of a significant spread widening is limited, but so is the potential for further narrowing. **We therefore favour European credit**, which benefits from a more favourable interest rate environment and higher spread levels overall than in the US. Regarding emerging market debt, spread levels appear more attractive, but we expect performance, particularly in local currencies, to remain highly dependent on US policy choices (evolution of US rates, the dollar, and the impact of potential tariffs on growth).

Currencies at the Heart of Trade Negotiations

The US dollar has appreciated by 5% this year against the euro but has remained within a 1.05-1.12 range since the beginning of 2023.[3] While Donald Trump calls for a weaker dollar to boost the competitiveness of US companies, the policy axes he defended during his campaign are bullish for the greenback! This paradox could limit the dollar's appreciation potential. Exchange rates will be at the heart of trade negotiations with the United States' main partners. This is particularly the case for the Yuan, which is currently close to its low points but could appreciate if the Chinese economy picks up and if compromises with the United States emerge on trade. The Yen could also appreciate with the stabilisation of the dollar.

1 - Source: Candriam estimates
2 - Source: Bloomberg
3 - Source: Bloomberg, EUR/USD exchange rate

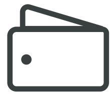
Which Diversifying Assets do we Favour?

We remain positive on gold, which has suffered somewhat from a shift towards cryptocurrencies since Trump's election and has been penalised by a strong dollar and rising US real interest rates. In the longer term, however, gold retains its role as a diversifier and a protective tool in asset allocation. The underlying demand from many central banks remains strong relative to annual production and limited gold reserves. Any weakness in the price is an opportunity for us to increase our exposure to precious metals.

Some alternative strategies can also be included in an asset allocation in 2025: **Market-neutral** strategies may be used with the aim of benefitting from increased market volatility and dispersion while limiting direct market exposure risk, or **risk arbitrage** strategies with a view to take advantage of a potential resurgence in M&A activity in the US.

Conclusion

Each year, one uncertainty replaces another. The economic context has finally normalised with a soft landing for global economic growth and inflation moving out of a dangerous zone for economic stability. The election of Donald Trump introduces new uncertainties and risks, both economic and political. However, financial markets, to which Trump seems particularly sensitive, could play a safeguard role against overly extreme choices... which could reassure investors about the direction markets will take in 2025!



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