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The challenges of a K-shaped economy and equity markets also create investment opportunities

Since 2020, five major shifts have led to the current K-shaped growth structure of the global economy and equity markets, with huge divergence between winners and losers.

Today, economic growth and equity market leadership are very narrow and rely on a few. This has created a more volatile and uncertain environment, but also opportunities for active investment management.



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Five factors of change

The five important factors of change over the past 5 years have been 1) rising real rates going from being negative into a positive territory, 2) geopolitical fragmentation, 3) post-Covid disruptions, 4) the rise of AI, and 5) the dominance of passive flows.

- The transition from near-zero rates to a range of 4–5% with real rates now in positive territory has reset the global anchor for financial markets. The very low rates rewarded sectors like technology and renewables with valuations implying flawless growth. This has later spread to other parts of the broader market, inflating multiples in consumer, health-care, and industrials well beyond sustainable levels. The tightening cycle forced a reset and consolidation, where the share price of many long-duration companies suffered as the valuation steadily declined despite their continued stable earnings growth. We believe this devaluation and consolidation of long duration assets is now largely behind us.
- The re-election of President Trump has underscored the shift away from a rules-based global order toward more by power politics, regionalisation, and nation-states. One clear consequence is the reconfiguration of supply chains: rather than optimising purely for efficiency and profit, companies are now building for geopolitical resilience. That means more duplication, less inter-regional reliance, and a new capital expenditure cycle as firms adapt production and logistics to a more fragmented world.
- The aftermath of the pandemic created rolling recessions across sectors, as business cycles and inventories took much longer to normalise than expected. While these effects are now fading, they left deep marks on global supply-demand dynamics. As a result, companies that built resilience during the turbulence are emerging stronger, while more cyclical businesses may face structurally lower predictability.

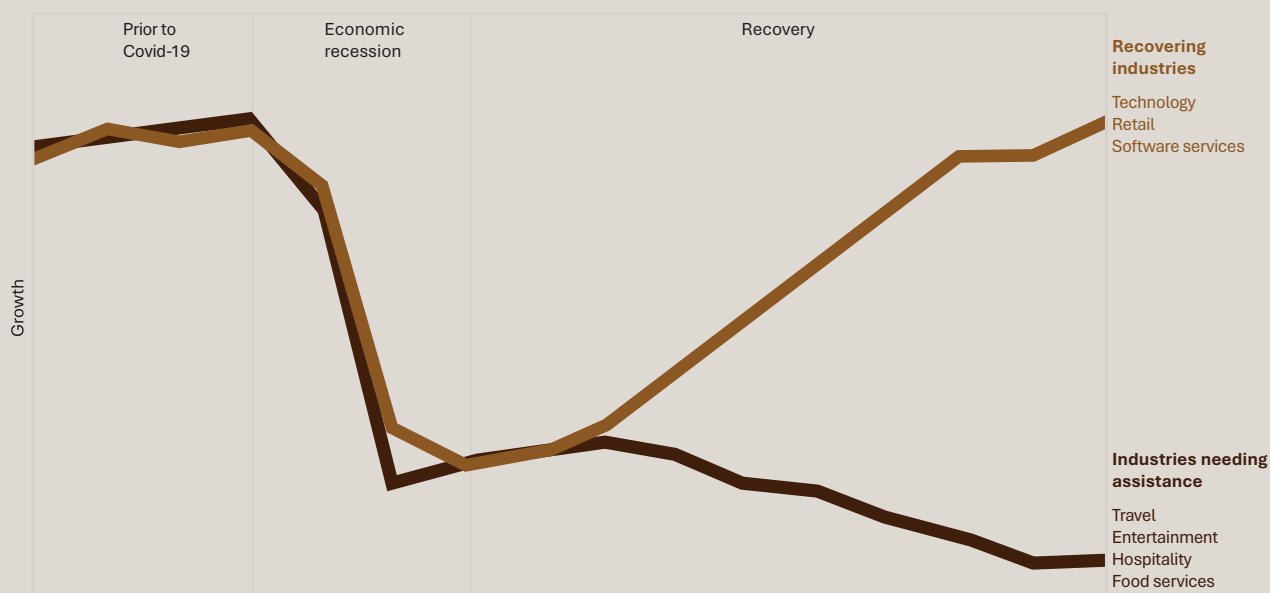
- AI has driven one of the most powerful and concentrated investment booms in history. A handful of companies have benefited disproportionately, creating a “winner-takes-all” dynamic. While valuations appear stretched for certain companies, AI could represent a structural shift that reshapes the global economy for years to come. However, AI is not a rising tide lifting all boats. We must separate true beneficiaries from those riding temporary enthusiasm, and balance short-term market concentration with the long-term transformation AI may bring across industries.
- The continued rise of passive investing has concentrated more capital into a small number of mega-cap companies. This trend shows no sign of slowing and has magnified the gap between market-cap-weighted indices – which are at record highs – and equal-weighted indices, which have been largely flat. This market concentration has, especially over the past two years, challenged active investments. On the other hand, the wave of passive and highly concentrated indices can distort capital allocation, leaving more room for skilled active investors to add value.

A narrow K-shaped economy and equity market driven by a few

Today, the global economy (especially the US economy) and equity markets are a story of two tales with narrow growth drivers and an extreme concentration of equity returns. The real economy is experiencing genuine demand, but it is narrow – centred on AI and sovereignty-linked projects, not broad-based private consumption and investments, as depicted in figure 1 on the next page. According to Rothschild and Redburn, spending on AI investments accounted for all of the GDP growth in the US in the first half of 2025.

AI-related activities power ahead on secular drivers while non-AI activities are weighed down by uncertainty, tariffs, lower immigration and somewhat restrictive Fed rates. The gap between

Figure 1

K-shaped Recovery

Source: US Chamber of commerce, October 2025

US GDP growth and growth ex-investment in IT equipment and software was a historically wide 140bp in the 1H of 2025. This K-shaped activity contributes to divergent consumption patterns where higher-income consumers with exposure to AI-related stock price gains remain strong, while lower-middle-income consumers experience weaker real labour income growth. As AI assets soared, those owners became disproportionate beneficiaries of the stimulative monetary and fiscal policies, leading high-income households to account for a disproportionate share of spending, making current private consumption reliant on the asset-rich. The cost of living has risen approximately 30% since Covid, which has led to broad de-premiumization and substitution to more affordable consumer products. On the other hand, affluent households continue to prioritise travel, healthcare, and leisure, while demand for autos,

apparel, and durables remains weak. As a result, consumption is increasingly defined by the top 10%, while the rest of the economy trades down or cuts back.

Within capital spending, hyperscaler datacenters (AWS, Microsoft Azure, Google Cloud Platform) are the dominant incremental growth engine, cascading into demand for electricity, switchgear, and construction, like building materials. This surge is amplified by FOMO among hyperscalers, each fearful of being left behind. According to McKinsey (April 2025), 60% of spending will go to chips and other hardware, 25% to power, electrical equipment and cooling and 15% to construction. Despite massive spending, monetisation remains limited, creating a capex supercycle without proven returns. Oppositely, general corporate willingness to invest in broad-based capital investment has been

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depressed by the successive tariff rounds, increasing cost uncertainty, fearing retaliation risks, and the erosion of globalisation's efficiency dividend.

Crosscurrents influence equity markets at all-time highs with headwinds from tariffs and a slowing US labour market, but tailwinds from expected Fed cuts and enthusiasm around AI. The “Magnificent Seven” continues to dominate, representing approximately 30% of the S&P 500 market cap and the vast majority of 2025's return. Some of this market concentration is supported by earnings, as Technology and Communications is the current key driver of market EPS growth. Industrials, Staples, Utilities, and Real Estate remain flat or negative. Just as household consumption relies on the affluent, equity markets are highly dependent on hyperscaler capex and the execution of the mega-cap companies.

A key factor for the equity market outlook is the continued funding of the AI investments. In the short term, lower interest rates will help

sentiment, and we see the beginning of vendor financing with Nvidia, investing in OpenAI. Vendor financing is, longer-term, a red flag, and we still need a successful monetisation of AI, to secure a sustainable return on investments.

Investment reflections on the challenges of narrow markets

The concentrated and narrow equity market, where short-termism dominates, has made it difficult for most long-term active managers to outperform the benchmarks. In 2025, about 75% of active managers have underperformed the global benchmark. In the US, year-to-date, five stocks have contributed to almost half of the market return. Without at least a market weight in these stocks, it has been very difficult to outperform.

As the saying goes, “Financial markets are there to humble as many as possible.” In recent periods, this humility has been particularly difficult,



and we are acutely aware that despite the exceptional market conditions that have not lived up to our clients' relative performance expectations, especially in the past couple of years. Periods of underperformance are never easy, but they fuel our determination to reflect deeply and continue to learn and evolve.

Quality is the foundation of our long-term philosophy, and we define quality by three traits: a permanent right to win, a repeatable and durable business model and industry dynamics that support sustainable growth. However, our ability to adapt to the new and changing circumstances is key to long-term investment success. Therefore, we are continuously fine-tuning and making thoughtful adjustments to our process while staying true to our long-standing framework of core beliefs.

Managing relative and shorter-term risks

Our risk objective has always been to manage portfolios with an absolute mindset, aiming to deliver strong long-term returns while keeping volatility in line with the index. However, for the first time in decades, a handful of individual companies now carry index weights larger than entire countries. This concentration creates new "tail risks" if left unaddressed. In response, we will embed relative risk assessments earlier into our investment research and apply our research process to those whose sheer market cap could influence relative outcomes.

We are maintaining our long-term horizon, while at the same time more actively considering shorter-term relative risks. In addition, we are sharpening our focus on companies that combine enduring quality with positive change – businesses where

fundamentals are strengthening and the overall landscape is becoming more favourable.

Our DNA, our bedrock of beliefs, remains intact. High-conviction stock-picking with a longer-term investment mindset remains our guiding principle.

A K-shaped market structure also creates opportunities

Five years ago, with negative real interest rates, long-duration quality assets were in high demand and highly valued. In hindsight, we underestimated the rise of interest rates, and while our companies delivered strong earnings growth, valuation pressures weighed on returns. Today, the picture has reversed with our high-quality portfolio companies attractively priced compared to their history and continued positioned for sustainable growth – in our view creating an attractive opportunity, when the narrow and K-shaped equity market broadens-out.

From a portfolio risk perspective, we think a stabilisation of uncertainty should be positive enabling equity market leadership to broaden-out. Also, we see several important market trends that could turn in our favour, and we believe that there are many things that can go right going forward.

We have bundled our three key areas of investment convictions into the following:

1. Convictions within AI and IT

Within IT and AI, we think investors will broaden the current focus on training of LLMs to wider leading-edge applications. The sheer size of the AI investments create significant executions risks with returns on AI capex investments still unclear and the leading AI infrastructure companies have high

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expectations embedded in their valuations. Wind of change could come to these one-directional investment bets of the past two years. We foresee that semiconductor capex will broaden out, favouring more leading-edge technology to the benefit of companies like ASML, TSMC and Hoya. Competition between incumbent internet platforms like Microsoft, Google and Amazon and new entrants like OpenAI will increase, although we expect the incumbent companies to be relative winners. We see the Chinese players as well-positioned to benefit from monetisation of the AI investments, which is the reason we recently added Prosus (owning a large part of Tencent) to our global portfolio. Also, key data owners should benefit from monetisation as AI technology reaches practical usage.

2. Financial convictions

Western banks, together with AI and defence, have been the star performers over the past 12 months. We have a strong preference for emerging markets financials that are supported by rising penetration of financial services and a positive demographic backdrop, whereas we fear the value trade of Western banks will fade, especially as credit risks could reemerge. Also, asset light financials like exchanges and payment gatekeepers like Visa are long-term well positioned.

3. Revival of the tangible economy

Besides AI investments, we see several structural capital investments trends as countries need to upgrade industrial infrastructure to support increased defence production and the core industrial infrastructure, which is a prerequisite for a strong defence capacity. This includes upgrading of electrical infrastructure, investments to support reshoring and automation. We also believe that solar and wind will be a part of these solutions. More than 20% of the investments in the global strategy are related to this infrastructure theme.



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