



Briefing from the ARVEST Investment Committee

There has been a notable change in the monetary policy environment over the past quarter. On 16 September, the US Federal Reserve increased its policy rate for the first time since 2023. Long-term yields continued to rise in the weeks following this decision. The most obvious explanations for this are economic growth and expectations of further interest rate increases in response to persistent inflationary pressure.

However, in our view, these factors only partly explain the development. Long-term inflation expectations have remained stable, and the increase in long-term yields is mainly due to higher real interest rates. This reflects greater uncertainty surrounding the future monetary policy regime under the new Fed Chair, Kevin Warsh. His reduced willingness to communicate the future path of interest rates in advance makes it more difficult for investors to predict how the central bank will respond to new economic data and tensions. At the same time, we view the Fed's September decision as confirmation of its independence and determination to contain inflation. Since the 1980s, it has been a tradition among Fed Chairs to send clear signals of monetary policy firmness shortly after taking office. Greater

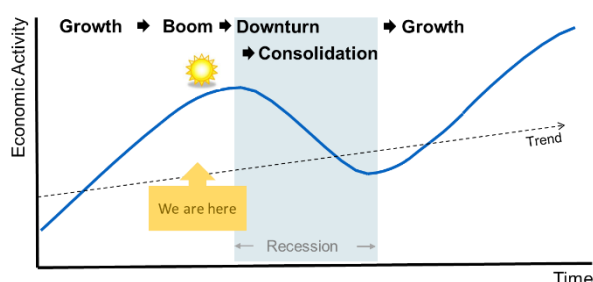
confidence in the fight against inflation can coexist with greater uncertainty about the future path of interest rates.

As mentioned in the July Investment Commentary, the boom in AI investment remains a key driver of the global economy and corporate profits. This rising tide lifts many boats. Historically, residential construction shaped the US economic cycle, partly through debt-financed consumption. Today, however, residential construction remains weak, while data centres and other AI infrastructure are increasingly playing a similar role. Nominal construction spending on data centres, once merely a footnote, has now surpassed the all-time peak in spending on conventional office buildings. Investment in chips and technical equipment comes on top of this. Hence, economic growth is less broadly based than it appears at first glance.

The financing of this boom also came under closer scrutiny in the third quarter. Major technology companies are increasingly supplementing their cash flows with debt. By early August, US hyperscalers had issued around USD 220 billion in bonds this year alone. These substantial issues compete with

government bonds and other borrowers for investors' capital. In our view, this increased demand for capital is one of the reasons why investors are asking for higher yields. Rising financing costs are emerging at a time when different sectors of the economy are experiencing very different rates of growth. Interest-sensitive sectors, such as residential construction, are likely to be affected more severely than the major technology companies that are driving the investment boom.

In the equity markets, the strength of AI stocks also masks the divergent performance of many individual shares. The major market-capitalisation-weighted indices present a more favourable picture than that of many individual stocks outside the AI value chain. At the same time, we are witnessing increasingly speculative behaviour. Options with very short maturities and trading strategies that mainly follow existing price trends further amplify market movements.



Outlook

In our view, the AI investment cycle is poised to likely continue. Major technology companies have well-established business models and generate substantial cash flows. This allows them to fund part of their investment in-house while having easy access to capital markets. The US government is also supporting demand through its large budget deficit. So far, markets have not punished it for causing long-term inflation expectations to rise. The financial

foundations of today's boom therefore differ significantly from those of earlier speculative phases. Many dot-com companies in the late 1990s were not profitable. Meanwhile, before the financial crisis, many people bought properties with too little equity, and the risks of bundled mortgages were underestimated.

More efficient AI applications could also help to sustain the investment cycle. As costs fall, they become more economical for users. If this leads to a strong enough increase in usage, the demand for computing power could continue to grow. This would encourage further investment in data centres and the associated infrastructure, although this scenario is by no means guaranteed.

We therefore remain committed to our investment process. In September, the Investment Committee reaffirmed its decision, made in June, to reduce the equity allocation by five percentage points by the end of the year for most investment strategies. Our phase model does not require us to predict the exact turning point of the equity market. We accept that we may underperform the major indices if the AI rally continues. At the same time, high-quality US dollar bonds are becoming an increasingly attractive option for us. We favour a duration of two to seven years and appropriately limit currency risks in client portfolios. In the event of an equity market downturn followed by interest rate cuts, these bonds could help stabilise portfolio performance. Our goal remains to limit risk in a disciplined manner and preserve our clients' capital in the long term.

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On behalf of the Investment Committee

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