Connecting the Dots: CIO Mid-Year Outlook. Adapting to the new investment landscape

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Transcript:

[00:00:00] **Fabiana Fedeli:** It feels almost like we don't have a rule book anymore. Like there are no set rules anymore and investors are really looking at the fundamentals.

[00:00:15] **Mason Woodworth:** Hello, I'm Mason Woodworth, Head of Investment Solutions, here with Fabiana Fedeli, our CIO of Equities, Multi Asset and Sustainability, Andy Chorlton, our CIO of Fixed Income, and Emmanuel Deblanc, our CEO of Private Markets. We're here to discuss our views for the second half of 2026. It's fair to say it's been an eventful first half of 2026, dominated by the continued AI theme, persistent inflation on the back of rather an unexpected war in the Middle East. Interested to hear your thoughts on how this first half has been and Fabiana maybe you could kick us off.

[00:00:53] **Fabiana:** Thank you, Mason. I've been in markets now for quite a few years, and I've seen my share of crashes, of rebounds, but this is actually one of the most complex markets I've ever seen. You have different asset classes that are being driven by different narratives. At the same time, you're seeing some really, really fast and large moves in the equity market. And it doesn't appear that markets are taken into any consideration. The fact that we could eventually have a demand slow down, which is due to the fact that should the peace in the Middle East endure, still there is a lot of need to rebuild infrastructure to clear bottlenecks and therefore energy prices are likely to stay higher for longer. And that doesn't seem to be taken into account by any asset class. So Definitely interesting times for investors.

[00:01:51] **Mason:** Andy, we've just had the first decision of the Warsh Fed. It's a really interesting time in fixed income markets. Do you wanna give us your views and the views of the team?

[00:02:02] **Andy Chorlton:** What we saw from the first meeting under the new chair is that it's very different when the eyes of the world are on you and you're in the decision-making seat than it is when perhaps you're pitching for the job and throwing rocks from the outside because all of a sudden the focus on inflation has been elevated, the recognition that persistent inflation is damaging, is corrosive to consumers and to the US economy. I think what we saw from the Fed is clearly that that is a concern. It's a concern that we believe central banks have been very focused on, which is why they haven't cut rates anything like as much as the market would expect in recent years. Yes, the Fed's got the dual mandate, full employment and stable prices, but I would argue that the stable prices is kind of first and most equals of those two objectives on the basis that the impact of inflation is so corrosive. So now we've got a full rate hike priced in, clearly no expectation of rate cuts. I think that's going to be one of the real interesting dynamics is the market was so keen and so optimistic to see a dovish Warsh, but they're actually really, they're getting the same as before, which is a clear focus on inflation and once they feel that that has been maybe not conquered, but certainly restrained, then they can look at being more accommodative to stimulate growth, but the first priority is getting inflation below target because it's been above target for a long time now.

[00:03:32] **Mason:** Really interesting point. Emmanuel, maybe to come to you, private markets have seen a lot of news and headlines in the markets about stress, particular names, a number out of the U.S., but I think certainly within our group, we're still seeing a lot opportunity and an importance about being really careful about where you look. Could you give us some more detail about how you're seeing the market right now for private assets?

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[00:03:55] **Emmanuel Deblanc:** Two things have happened. Earlier this year. First, obviously, the war, which has created some uncertainty and slowed down the pace of M&A for the mid-market specifically. So that has meant that the catch up in M&A that we were expecting has been delayed, that's clearly one thing. The second one is the "SaaS-pocalypse", where I think now it has settled in a way. Investors seem to understand where the areas of risk is going to take time to mature, but there is clearly a bifurcation on the quality. I think there is an understanding of the issues we've seen around the BDCs [Business Development Companies] in the US being a relatively contained and relatively small part of the market, taking the risk of it being complacent maybe, but that actually it's not such a systemic issue, certainly not in Europe. I think we went through this fear in Q1, a bit in early Q2, but we're now pretty much out of this with, I would say, some renewed cautious optimism in private markets.

[00:05:00] **Mason:** That's great definitely important to look for the opportunities rather than assume it's a broad market context. I think maybe Fabiana, coming back to you, we've got global equity markets certainly in the U.S. approaching all-time highs. We first had the SpaceX IPO, a lot of action at the top end of the market. What the S&P 500, 25 stocks now, 50% total index? That's an awful lot of concentration. How do you think about that?

[00:05:30] **Fabiana:** So it's actually now, as of this week, 24 stocks that are half of the market cap of the S&P 500. The concentration is significant and that is what concerns me from an index standpoint. You have a large concentration in just a few names. You have very large moves in equities at the moment. If one or two or just a few of these names have large drawdowns, then a portfolio that is passively exposed to the index would be hurt significantly. This is why our preferred way to invest in the market is a very active investment process.

And the truth is, the market is rewarding that. Because if you look at the price dispersion, and take the MSCI All Country World, which is one of the broad indices representing global equities. You can see that the price dispersion between stock and stock is actually continuing to rise and is well above the 10-year median. So there is a lot of differentiation that investors are making between different companies and their stock prices, which means that if you do your work and you pick the right name, you can significantly outperform the index.

[00:06:57] **Mason:** Really important point, I think, for everyone to take into account, diversification at an index level is an interesting question right now, given the levels of concentration. I think that's true in equity, but also even to an extent in bond markets. But bond markets, we're still talking about inflation, and we've been talking about inflation now for years. How are you seeing the opportunity in government bond markets and the dispersion that's happening in inflation around the world, and credit markets also kind of underlying that. They're just sitting there at kind of all time tights.

[00:07:31] **Andy:** Yes, I think it's a really interesting dynamic that government markets are very aware of the potential risks, whether it's inflation or fiscal position of different countries or political pressure in certain countries, but are priced accordingly. You know, compared to, say, 22, when we had the last big inflationary impulse after the invasion of Ukraine, back then real yields were deeply negative. Now real yields are sharply positive. So there's risk from a macro perspective affecting government markets, but those risks are pretty well known. And I think that's probably why yields have stayed persistently positive, real yields, persistently positive in recent months. So we actually feel that it's an attractive entry point. And then when investors are looking at credit markets, I think it's important to recognise that depending on the market, 80% of the yield you're getting when you're buying a credit product is coming from the government bond or the cash rate. So we see the value much more in the government side and that dispersion between countries is creating opportunities. You know, suddenly Japan is… Is something that we're paying much more attention to than perhaps we did the first 30 years of my career. And then on the credit side, whatever your expectation or your scenario analysis is for what's gonna happen in the world, it feels that credit markets are only pricing one scenario and pricing it with certainty, and that's that spreads will remain tight the longer.

And the interesting thing is Fabiana was talking about the impact of some of these big tech companies on the equity world. That historically hasn't really mattered to the fixed income world because they were so cash-generative, they didn't really need any debt. Now we're seeing the big build-out of AI and give you one example, Meta is due to spend 600 billion on their infrastructure build-up. The bulk of that will be funded by the bond market rather than the equity market. And that shift in strategy will completely change the shape of fixed income indices, as those sectors that were effectively net… Cash positive will become significantly indebted, but also that amount of issuance will soak up a lot of the demand that's been sitting on the sidelines.

[00:09:34] **Mason:** That's going to be a big shift. And as you say, the level of issuance and the impact that's going have on the broader market is going to really, really interesting thing to watch. And for people looking just inside the index, you need to look deeper. Emmanuel, how are you seeing the opportunity between private credit, private equity, and the full space within the asset class?

[00:09:55] **Emmanuel:** Indeed, I think there is a dynamic between public and private markets, especially in the credit world, where the vast amounts that are going to be issued in IG, and it's already started this year, is going to create more opportunity for the private market unavoidably. It's just mechanical. The inflation, though is causing the recovery in some of the markets which we thought would benefit from the next phase, real estate to be specific. Again we're going to see a slower recovery than what we expected just because of the headwinds on the rates caused by inflation in the main so that's going to be one negative you could say but on the other side of it the macro backdrop is relatively supportive and so for those strategies that might be higher risk higher return we would expect that to be a great time to deploy. Equally, the entry point in real estate right now is very attractive in Europe, we think. So if you're patient, that's probably a good entry point.

And then there are segments of the market, which have a need for financing the AI story or the segment. And that permeates a few of the segments of private equity now in the growth equity world, specifically where quite a lot of the economy in Europe specifically needs that funding.

We've seen a lot of European entrepreneurs going on the other side of the Atlantic. It's been recognised that Europe needs to do more to support its economy and innovation and the future and therefore we are seeing this momentum if you want to retain more of the talents to support the entrepreneurs here and finance them and obviously we are late in the AI wave but it's coming throughout the system in pockets maybe not in the huge wave of data centres that we're seeing in the U.S. There are some data centres here. There are also all those companies that are using AI or benefiting from it if you want and that need financing and we're seeing some great opportunities there and you know obviously being based in London is not a bad position to be in not just because you know the Eurostar lands in King's Cross but also because of the great universities around here.

[00:12:19] **Mason:** Yeah, so the infrastructure theme, the power demand theme, real estate associated, particularly with data centres, still a big driver of a lot of underlying dynamics. I think the questions that we're getting from clients are really all about this challenge of understanding where to look or where to go next. If you had to pick where are you looking in the second half of this year and beyond that you think that our clients should be most interested in following us. So maybe Fabiana, you could go first.

[00:12:52] **Fabiana:** So the first point to make is, it's never good to be either all in or all out. You generally make returns with balanced views. And if you look at the AI theme, it is so pervasive. AI is increasingly getting into every area of our daily lives and our work. So AI is there to stay, but there is a transition that we believe is going to happen in the AI-theme for investors. First and foremost, there is still opportunity in areas that are what we call AI enablers, because there is still going to be a lot of CAPEX spent in the area, financed by credit. We see now some large IPOs. Those IPOs are financing some of that CAPEX. And so there are still opportunities on the hardware side if you want.

We also see opportunities in those companies that have kind of been dismissed by the AI theme. So this extreme sell-off of all software companies, because there was a fear that AI would pretty much replace them at low cost or replace part of the business at low costs. Well, some of them most likely will be able to utilise AI to make their businesses even more powerful. Some others will not be able to do so. So there is still opportunity in that software area, particularly when companies are trusted by companies such as ourselves, for example, for their systems of record. And then there is opportunity in other sectors where companies are increasingly adopting AI to improve their operations, make them more efficient, but also, for example, to more effectively reach out customers to develop new materials to, for example, in healthcare to develop new compounds. So the AI theme per se is not going to go away, but there will most likely be an evolution. And as investors, that is what we need to continue to follow.

[00:15:00] **Mason:** Andy, where are you looking?

[00:15:05] **Andy:** Broadly, public fixed income has got kind of three worlds. Developed market governments, developed market credit, and emerging market debt, which has local, hard currency, and corporates within it. I think credit is largely priced to perfection, so we're not particularly attracted by that at the moment. Developed-market governments. A lot of the bad news is priced in, as I mentioned earlier, real yields are healthily positive, but at the same time, we're really concerned, I think a lot of investors are. That fiscal discipline is constantly under threat. But in contrast, emerging markets, we think the valuations are attractive and the fundamentals are actually improving and you do have much more fiscal discipline. You've got much more proactive central banks. So we think that whilst you've got the two extremes in DM between government debt and corporate debt, in emerging markets there's a much nicer balance and it's such a vast opportunity within that universe.

[00:15:52] **Mason:** I'm smiling because you said earlier about how you hadn't thought about Japan in the first 30 years of your career. Here, we talked about emerging markets for so long as something that was kind of different and edgy, and now they're the responsible ones. Emmanuel, where are you seeing the big opportunities in the future?

[00:16:08] **Emmanuel:** So maybe just picking up on what was just said, while the real yield might reflect, the risk on that. On our side, we see maybe a potential re-rating of the corporate world, or in relative terms, it might be that there is a potential substantial downside that is not necessarily priced in on the government side and there are various ways of diversifying away from that. The emerging market seems to be, we've never been more in agreement on something. I think that we're getting investors but also we look at relative valuation and it's absolutely compelling right now. The challenge is getting a diverse book of assets in emerging markets, it's not that straightforward. So that's one very strong conviction across the floor, I think. The second one is the re-rating of the world away from maybe some of the sovereign. And some of those that were probably seen as safe havens. One could see that taking 100% of your portfolio into US treasuries might not be the most risk-free portfolio that some of us have learned at school. So on the back of that, yes, corporate spread and private credit can give you some extra spreads above that, but there might be a broader re-rating. Now, it could be that it happens in sequences and that there has to be further adjustment to the sovereign debt for everything to readjust. But it looks to me that anything that's either corporate and therefore they can be printing of new money on the same assets should be quite attractive. And then the ultimate position on that theme is real-asset backed positions. On the equity and it can be real estate obviously, but also infrastructure.

[00:18:10] **Fabiana:** Can I actually latch on to something that Emmanuel said, because besides the AI theme, which is really pervasive across so many areas of the market, two areas that we continue to like are the low carbon economy and infrastructure. After the conflict in the Middle East, a lot of the infrastructure needs to be strengthened, made more resilient, some of it needs to rebuilt. And at the same time energy security, which for many countries, including European countries, means really a more efficient and optimal use of low carbon energy sources, is going to become absolutely key. And so we see these two themes, infrastructure, the low carbon economy, pairing up with AI, and often they actually show up in the same companies and becoming the drivers of the markets from here onwards.

[00:19:09] **Mason:** That's a really interesting point. Emmanuel, you made another important point in the context of the challenging environment. A lot of the classic ideas about diversification that we used to see in building portfolios have certainly come into question. Positive correlation between equities and bonds is an easy one, but questions about the role of U.S. Treasuries in portfolio and yield curve dynamics in the relationship to equity markets. Maybe just a quick thought from each of you on how people should think about diversification in an environment like that where so many of the underlying dynamics are changing and we're starting to see increased fragmentation, differentiation around the world. What's the opportunity? How should people think about building resilient portfolios?

[00:19:58] **Fabiana:** So the rule book has changed. Those rules of thumb that we used to have, this is a risk-free asset, or if something happens geopolitically, fixed income is gonna outperform equities. The dollar will just have a fantastic rise and everybody will move to dollar-based assets. It feels almost like we don't have a rule book anymore, like there are no set rules anymore. And investors are really looking at the fundamentals. And this is actually very interesting, also from a large asset owner's viewpoint. More and more of them, instead of thinking of strategic asset allocation in if you want a more fixed way, they're thinking about total portfolio allocation, which implies a less dogmatic and more. Dynamic way of allocating across asset classes, not based on pre-specified rules, but actually on what they feel the fundamental drivers of each asset class are.

And if you translate this and what it means for us as investors, it really means know where you put your money. Understand the companies you invest in, understand what the drivers are, understand the opportunities, understand the exposures, because some companies may be overly exposed to energy prices, and that might become a hindrance for them in the foreseeable future. And this is also what is driving the market at the moment, which is this trying to understand companies for their very specific characteristics, and that is what is driving the dispersion on the market. I have a feeling this is gonna continue.

[00:21:55] **Mason:** Emmanuel, you want to go first?

[00:22**:] Emmanuel:** Private markets, the benefit of it is accepted. I think that it offers a diversification in a portfolio. But I would just maybe caution against that. I think we need to be watching for what are the back swans out there. Going back to the sovereign debt issue, the fading away of fiscal discipline as a philosophy in pretty much every large economy. And what does that mean across the portfolio? Because it's not insulated to the sovereign debt. At the end of the day, governments can either tax more to solve their issue that will impact the corporates, or they will change the rules of game in regulation. And think about some of the utilities, which may have a very nice indexation to inflation for their revenue caps but suddenly the rules of the game could change because it's all nice to be to be indexing when it's a three percent inflation when it's 12 it's not politically acceptable and it's looking beyond that what could happen if there is a need to adjust the debt ratios so when we look at the portfolio and the diversification I think it's looking at those scenarios, looking obviously at the opportunities of the AI theme, for example, but also at those kind of black swan events and how would they come through in the portfolio in the corporate world, be it credit or equities.

[00:23:34] **Mason:** Again, a really bottom-up story, know the asset, really understand what's driving it. That's key to building in resilience into the portfolio if not diversification. I mean, so, Andy, how does that play through in the fixed income space, which is often heavily factor-driven?

[00:23:51**] Andy:** So, obviously, I'm not going to repeat what Emmanuel and Fabiana said, but I guess the common theme that they both alluded to is that some of the old relationships have changed, that the rules of the game have changed. And I think that means that you need to be diversified clearly, but you also need to be nimble, and liquidity is a key factor in that. So we think of diversification as risk and reward. I think you add liquidity because as those things evolve, not only do you want to be protected on the downside. But you also want the ability to take advantage of it and have the liquidity to allocate to real estate or infrastructure or equities as it changes.

So one of the things that we talk to clients a lot about is whilst traditionally you'd always have your domestic allocation and maybe a sprinkling of something global, now you need to think much more clearly about what that balance is between your domestic and your non-domestic allocation and it shouldn't perhaps just be global but it might be Asia fixed income, it might emerging markets, it might something that will give you an opportunity to take advantage of difficult times or provide liquidity in difficult times because it's not quite as highly correlated or the factors affecting, say Europe, isn't necessarily affecting traders in Brazil or Singapore.

[00:25:02] **Mason:** Really interesting. So I think you guys have been very kind in going through the questions. Maybe we can wrap up with a little bit of a lightning round. If you had to tell investors one other place to look in the second half of 26, where would that be?

[00:25:16] **Andy:** I feel like I'm repeating myself, but I think emerging market debt, it's beginning to get interest, but it still remains a very small part of people's portfolios. I don't think they necessarily realise how much concentration they typically will have in very highly correlated U.S., Europe, or developed market govies and credit. So diversifying into something a little bit different that zigs when the rest of the world is zagging, be that EM or Asia, I think makes a lot of sense.

[00:25:40] **Fabiana:** So actually look everywhere in name of diversification. But if I have to think of one place where investors have apparently stopped looking, that's Europe. Europe is a region where we're going to need more investment infrastructure, energy security, development of AI and use of AI. And therefore we should be finding many opportunities that align with where the CAPEX is going.

[00:26:20] **Emmanuel:** We spend a lot of time looking at the US and at football pitches or soccer pitches in the US, and back to the theme on emerging markets. It's sufficient to see the quality that's coming through on the pitch from Morocco, Congo, Senegal, and there's an interesting, not convergence, but a reduction of the difference between the quality of the games and it's almost a metaphor for what we're seeing on the on the fiscal side and the attractiveness of this of this market. So we also have a very strong conviction on the benefit of emerging market debt, but also actually on the equities, so long as you can access it, those two on a diversified basis.

[00:27:07] **Mason:** A great segue to, we can't go through the World Cup period here without asking for a prediction. I mean, Andy, you're almost at an advantage given that your team's built a reasonably competent prediction model. So maybe just go around and everyone's best guess at who's going to be in the final and the score.

[00:27:29] **Andy:** I'll go first, it's coming home. But maybe not to the UK, just to Europe. I think it'll be a European team that wins it. And yeah, shout out to the Bond Vigilantes team and their model. They not only predicted the first two games in terms of who was going to win, they got the exact score prediction right. So a combination of the FIFA world rankings and economic statistics turns out isn't a bad contribution to predicting scores in football.

[00:27:56] **Fabiana:** I'm more of a rugby fan, so I will leave it to Emmanuel to give his own prediction.

[00:28:02] **Emmanuel:** So I fear I've gone native and it will hurt my French compatriots but I think England might be too early to tell but looks extremely good and they might not win but they very likely will make it to the finals.

[00:28:15] **Mason:** Score?

[00:27:20] **Emmanuel:** 2-0 for France in the final.

[00:28:23] **Mason:** Brilliant! Thank you very much guys, it's been great to chat.

[00:28:29] **Fabiana:** Thank you.

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