BANQUE HERITAGE

Letter from The CIO

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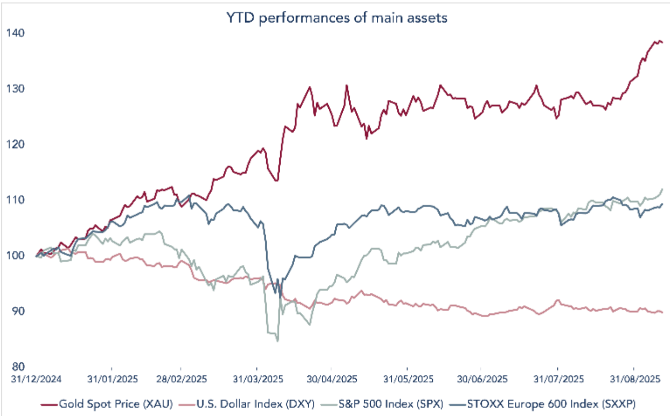
Towards Global Reflation, but Under Certain Conditions

- **A moderate recovery in global growth** appears to be taking shape, driven by emerging markets and Europe.
- **Equities are advancing, supported by defensive stocks,** while bonds are diverging; gold is rising, and oil is retreating.
- **Political uncertainty persists,** particularly in light of the risk of White House interference in the Fed.

Despite emerging pressures following the implementation of U.S. trade barriers, equity market momentum remained strong in August, supported by encouraging economic data and broadly contained inflation. The U.S. labor market represents one of the main headwinds with a marked slowdown observed in recent weeks. The earnings season confirms the resilience of the U.S. economy, with nearly 80% of S&P 500 companies exceeding, albeit cautious, analyst expectations. The recent Jackson Hole meeting marked a turning point: Jerome Powell adopted a more accommodative tone, acknowledging that the slowdown in employment and growth could justify monetary easing. Markets now anticipate a high probability of a 25 basis point cut to the Fed's key rate as early as September.

In this favorable context, equities continued to advance: the S&P 500 rose 2.03%, supported by "value" stocks. The materials and healthcare sectors stood out, while industrial and technology companies saw slight declines. Defensive strategies were favored, with the MSCI USA Defensive up 3.5% versus +0.7% for MSCI USA Cyclicals. Small and mid-cap stocks recorded a spectacular rebound, with the Russell 2000 surging 7%.

In Europe, equity performance was more mixed: the EuroStoxx 600 gained +0.9%, but Germany and France ended slightly lower (-0.7% and -0.8%), while the UK outperformed (FTSE 100: +1.2%). Sector rotation favored the "Value" style (MSCI Europe Value +2.04% vs Growth +0.3%). Switzerland stood out with the SMI up +2.9%, led by Logitech (+8.5%) and Novartis (+7.4%), despite declines in Alcon (-11.3%) and Geberit (-3%). Emerging markets also benefited from the momentum and a weaker dollar, with the Shanghai Composite index up +8.1% and the Bovespa index rising +6.3%.

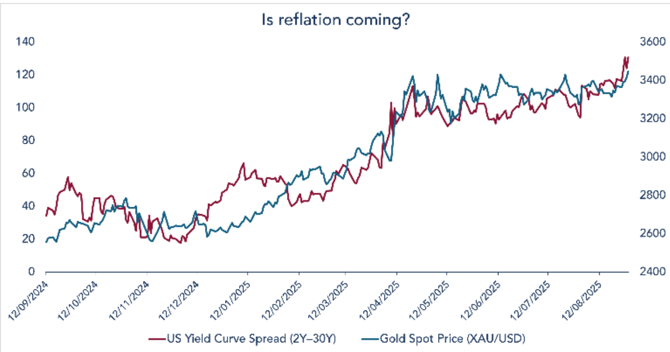


Source: Bloomberg / Banque Heritage

The fixed income markets showed a mixed performance. In the United States, the 10-year Treasury yield fell from 4.38% to 4.23%, supported by signs of an economic slowdown and expectations of accommodative monetary policy, while the Bloomberg U.S. Aggregate Bond Index rose +1.2%. In Europe, German yields remained stable whereas French yields increased to 3.49%, reflecting political instability and bringing French sovereign risk closer to that of Italy.

Regarding commodities, gold rose 4.8% to $3,448 per ounce, supported by expectations of rate cuts and increased demand from investors and central banks. Energy moved in the opposite direction: Brent fell -5.9% to $67.44 and WTI dropped -7.4% to $64.15, due to higher expected supply and weaker demand.

Finally, in the foreign exchange market, the U.S. dollar declined against major currencies as investors priced in potential rate cuts in the United States. The weakness was particularly notable against the Japanese yen (-2.45%) and the euro (-2.3%).



Source: Bloomberg / Banque Heritage

The macroeconomic data released over the past few weeks have been broadly reassuring, pointing to a potential initial rebound in global economic activity, excluding the United States. In Asia, China appears to be stabilizing, with the manufacturing PMI hovering around 50 (49.4 in August 2025), supported by targeted fiscal and monetary stimulus measures as well as a rebound in key industrial sectors including electronics and semiconductors. Other economies in the region such as Vietnam and Thailand seem to be further along in the economic cycle, benefiting from stronger domestic consumption and export growth. Overall, the ASEAN region could achieve growth of between 4% and 5% in 2025, reflecting both structural resilience and ongoing policy support.

In Europe, which has faced headwinds since the onset of the war in Ukraine, early signs of recovery are emerging. The final reading of the Eurozone HCOB Manufacturing PMI reached 50.7 in August, signaling expansion for the first time since June 2022, while the composite PMI stands at 51.1. Inflation remains broadly contained with the core CPI at 2.3%, slightly above the European Central Bank's target, indicating that price pressures are manageable. At this stage it appears likely that the current cycle of monetary easing will be effectively concluded for 2025, with the ECB poised to focus on maintaining price stability while supporting a gradual and sustainable recovery.

The U.S. economy remains under a restrictive monetary policy and is showing signs of fragility. Although second-quarter GDP surprised on the upside (+3.3%), this figure should be interpreted with caution: massive inventory restocking by companies in the first quarter, in anticipation of new import tariffs, artificially boosted growth in the second half of the year. As a result, the third quarter data will provide a more accurate picture of the underlying economic dynamics.

At this stage, some leading indicators such as the Atlanta Fed's GDP Now model point to growth around +3.0%, which could surprise to the upside and suggest that the U.S. economy retains a degree of resilience despite the restrictive policy environment. However, cracks are becoming more evident on the labor market front. In August 2025, the economy added only 22,000 jobs, significantly below expectations, while June data were revised to show a net loss of 13,000 jobs—the first decline since December 2020. Concurrently, the unemployment rate rose to 4.3%, its highest level since 2021, indicating that the labor market is beginning to soften.

These signals suggest that, while the economy remains resilient, the pace of job creation is slowing, something which could weigh on consumer spending and broader economic momentum if the trend persists. At the same time, corporate fundamentals remain solid. The earnings season has been robust, with nearly 80% of S&P 500 companies exceeding analysts' expectations, reflecting ongoing strength in corporate profitability and balance sheets.

Inflation remains under close scrutiny, despite a slight rebound in August. The Core PCE rose to 2.9%, remaining broadly stable and under control, though still slightly above the Federal Reserve's target. Jerome Powell has indicated that the long-awaited policy pivot could occur as early as September, with a 25 basis point rate cut currently priced in by the market. This could be followed by one or two additional reductions by the end of the year, though all moves will remain data-dependent. Powell emphasized that any easing cycle will be cautious, aiming to strike a careful balance between mitigating labor market risks and maintaining control over inflation, reflecting a Fed that is attentive to both economic growth and financial stability.

Our central scenario now incorporates a moderate probability of a rebound in global growth over the coming months, accompanied by a gradual entry into a reflationary phase. This momentum could be supported by several factors: the more advanced stage of the economic cycle in emerging markets (China, ASEAN), a tentative recovery in Europe, expansive fiscal policies that may stimulate demand, and the impact of U.S. trade barriers.

In such a scenario, financial markets could continue to benefit from this dynamic. However, caution is warranted: a faster-than-expected economic deterioration or a weakening labor market could weigh on risk assets. Additional factors, such as political interference from the White House in Fed policy or a sharp deterioration of the budget deficit, could quickly act as a reality check for equity markets.