MACROECONOMIC AND INVESTMENT OUTLOOK

2026 outlook: Markets at the crossroads of cycles

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2026 outlook: Markets at the crossroads of cycles

Since the beginning of the year, risk assets have continued their upward momentum, despite ongoing tensions related to Donald Trump's trade policy.

Several key factors have supported the markets:

- **The economic environment has been resilient overall**, both in Europe and the United States. Furthermore, growth could pick up again in 2026 on both sides of the Atlantic.
- **Monetary policies normalised, particularly in Europe.** The European Central Bank (ECB) ended its cycle of rate cuts given the visibility on the inflation trajectory. Conversely, the government shutdown slowed the US Federal Reserve's (Fed) rate cut trajectory, as it continues to face a dilemma: inflation or employment.
- **Earnings growth remains broadly well oriented**, as reflected in third-quarter results. Fundamentals remain positive, although they are normalising in some sectors, and companies seem to be successfully navigating the effects of tariffs for the time being.

We believe that the factors driving the market will continue to support performance in 2026. However, valuations have risen across the board, both for equities and credit, and now leave little room for error in a still fragile climate (tariffs, geopolitical tensions, budget deficits, AI issues).

1 Is credit still attractive?

Credit remains an essential asset in any allocation due to their ability to generate yield, carry and capitalisation.

In European high yield in particular, we believe that issuers' fundamentals remain strong: default rates are low[1] and net margins are holding steady at comfortable levels in Europe,[2] although certain sectors that are particularly sensitive to tariffs are struggling. In addition, technical factors continue to contribute to the tightening of risk premiums. Indeed, we are still seeing capital inflows into the asset class[3] at a time when the size of the European high yield market is shrinking[4] (from around €500 billion in 2021 to €390 billion today). As a result, volatility in the high yield segment continues to decline, offering what we believe to be particularly favourable risk/return characteristics.

We continue to favour building portfolios around high yield issuers with reasonable debt levels and yields of between 4% and 7%.[5] There is no need to venture into overly complex issues prone to refinancing problems in order to find carry, as even high-quality signatures now offer attractive yields. To this foundation can be added more satellite strategies, aimed at optimising the portfolio's potential yield while taking advantage of the sharp market dislocations observed.

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[1] TIM, FactSet, Goldman Sachs Global Investment Research, data as of 10/31/2025.
[2] TIM, FactSet, Goldman Sachs Global Investment Research, data as of 09/30/2025.
[3] TIM, J.P. Morgan, Bloomberg Finance L.P, data as of 10/31/2025.
[4] TIM, Bloomberg, data as of 11/20/2025.
[5] TIM, Bloomberg, data as of 11/20/2025.

SELECTION OF LOWER-RATED INSTRUMENTS, PARTICULARLY CCC

In Europe, the outperformance of the BB segment has reduced its attractiveness as risk premiums are now close to their historic lows relative to the high yield market as a whole.[6] Moving away from the BB universe to target issuers considered to be high quality but with lower ratings, particularly CCC, can therefore generate additional carry. With a yield of around 15%[7] despite default rates of only 3-4%,[8] this cohort offers an attractive pool for rigorous and selective investors.

We invest little in issuers rated CCC.[9] Within this universe, our approach is to target issuers rated B/B- on senior debt but with unsecured subordinated bonds rated one notch lower, i.e., CCC. This allows us to seek an additional potential 3 to 5% yield within the same capital structure.[10]

SUBORDINATED FINANCIAL BONDS

We believe that the fundamentals of the European banking sector remain solid,[11] as evidenced by the earnings releases published quarter after quarter. Within financial bonds, we particularly favour AT1 subordinated bonds, which offer what we consider to be attractive absolute and relative yields compared to corporate bonds (with an estimated average yield pick-up of around 160bps[12] between AT1 and corporate bonds with the same rating).

Within the banking sector, we are mainly targeting Portuguese, Spanish, Italian, and Greek banks that have made considerable efforts to clean up their balance sheets in recent years.

However, the continued tightening of risk premiums on AT1 instruments makes them, in our view, more sensitive to downside risk. Although we do not identify any strong or imminent catalyst likely to cause a marked widening of spreads in the short term, we have tactically adopted a more neutral stance and remain extremely selective on primary issues, some of which are oversubscribed by up to 10x.

Furthermore, we continue to favour limited sensitivity to interest rates: the current flatness of the high yield credit curve reduces the appeal of longer maturities.[13] In addition, we believe that pressure on long-term interest rates will remain a key market theme in the coming months, given the need for issuance to finance persistently higher budget deficits.

Finally, **we remain attentive to the potential contagion of AI risk on bond markets**: although this phenomenon remains centred on the United States for now, it could gradually spread to European credit.

[6] TIM, Bloomberg, data as of 11/20/2025.
[7] TIM, Bloomberg, data as of 11/20/2025.
[8] TIM, FactSet, Goldman Sachs Global Investment Research, data as of 10/31/2025.
[9] Investments relate to investments made by entities within the group, in particular Tikehau Investment Management funds.
[10] TIM, Bloomberg, data as of 11/20/2025.
[11] TIM, bank publications, Bloomberg, data as of 10/31/2025.
[12] TIM, Bloomberg, data as of 10/31/2025.
[13] TIM, Bloomberg, data as of 11/20/2025.

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How to invest in equities?

Although high valuations, particularly for US equities, leave little room for error for investors, **we believe that increasing dispersion offers investment opportunities in certain well-identified segments**:

In Europe, the historical discount relative to US markets, coupled with the rise of notions of sovereignty, autonomy, and resilience, is creating attractive investment opportunities in strategic sectors such as defence, technology, and industrials.

In the United States, the technology sector remains essential in any equity allocation.

Finally, **the theme of rotation and leadership expansion** should become a central theme in the coming months, opening the door to new investment opportunities in both Europe and the United States.

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EUROPEAN EQUITIES: HISTORIC DISCOUNT COMPARED TO THE UNITED STATES

For the first time since the end of World War II, Europe has all four elements that we believe create economic value:

- A fiscal stimulus policy
- An accommodative monetary policy
- Attractive valuations, with a historic discount compared to US markets[14]
- Lower average leverage among companies than in the US[15]

Within European equities, **the emergence of the concept of European sovereignty continues to offer investment opportunities in the Old Continent**. The defence sector is a perfect example. In our view, Europe has one of the world's best ecosystems of defence companies, both major contractors and suppliers. These companies face significant challenges, not in terms of expertise, but rather in terms of production capacity. Order books are at historic levels,[16] requiring an unprecedented increase in production rates to speed up deliveries. We believe that the growth prospects for these companies remain attractive. Furthermore, despite the remarkable performance of this segment, European defence continues to trade at a discount to its US counterparts, even though its growth prospects are 3 times higher.[17]

> **Within European equities, the emergence of the concept of European sovereignty continues to offer investment opportunities in the Old Continent.**

US EQUITIES: AI AND US TECH GIANTS

Over the past decade, **tech companies' earnings have grown faster than the market**,[18] thanks in particular to online advertising, artificial intelligence, and the cloud. **Nvidia's latest results are a perfect illustration of this and confirm the strength of the AI cycle.**

Nevertheless, questions remain about the sustainability of demand, visibility beyond the next few quarters, and the quality of order books. The market is debating a possible marginal slowdown in innovation and a still uneven return on investment (ROI). Finally, the circularity of financing, increased use of debt (including private debt), and the energy constraints necessary for mass deployment are fuelling mistrust of the sector.

Despite these points of caution, we believe AI remains a structural megatrend. Its adoption is tangible in terms of usage, and the first signs of productivity gains are becoming apparent. We believe hyperscalers have solid balance sheets and the cash flow needed to finance the investment cycle. Consequently, maintaining exposure seems appropriate in the long term, while favouring a selective approach focused on players with visibility on demand, pricing power, and the ability to generate cash flow to cover investments. At the same time, it will be important to monitor the effective transformation of order books, financial discipline, the trajectory of investments, and access to and cost of energy.

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[14] TIM, Bloomberg, data as of 11/20/2025.
[15] TIM, Bloomberg, data as of 11/20/2025.
[16] TIM, company earnings releases, data as of 10/31/2025.
[17] TIM, Datastream, Factset, Goldman Sachs Investment Research, data as of 09/19/2025.
[18] TIM, Datastream, Worldscope, Goldman Sachs Global Investment Research, data as of 09/03/2025.

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