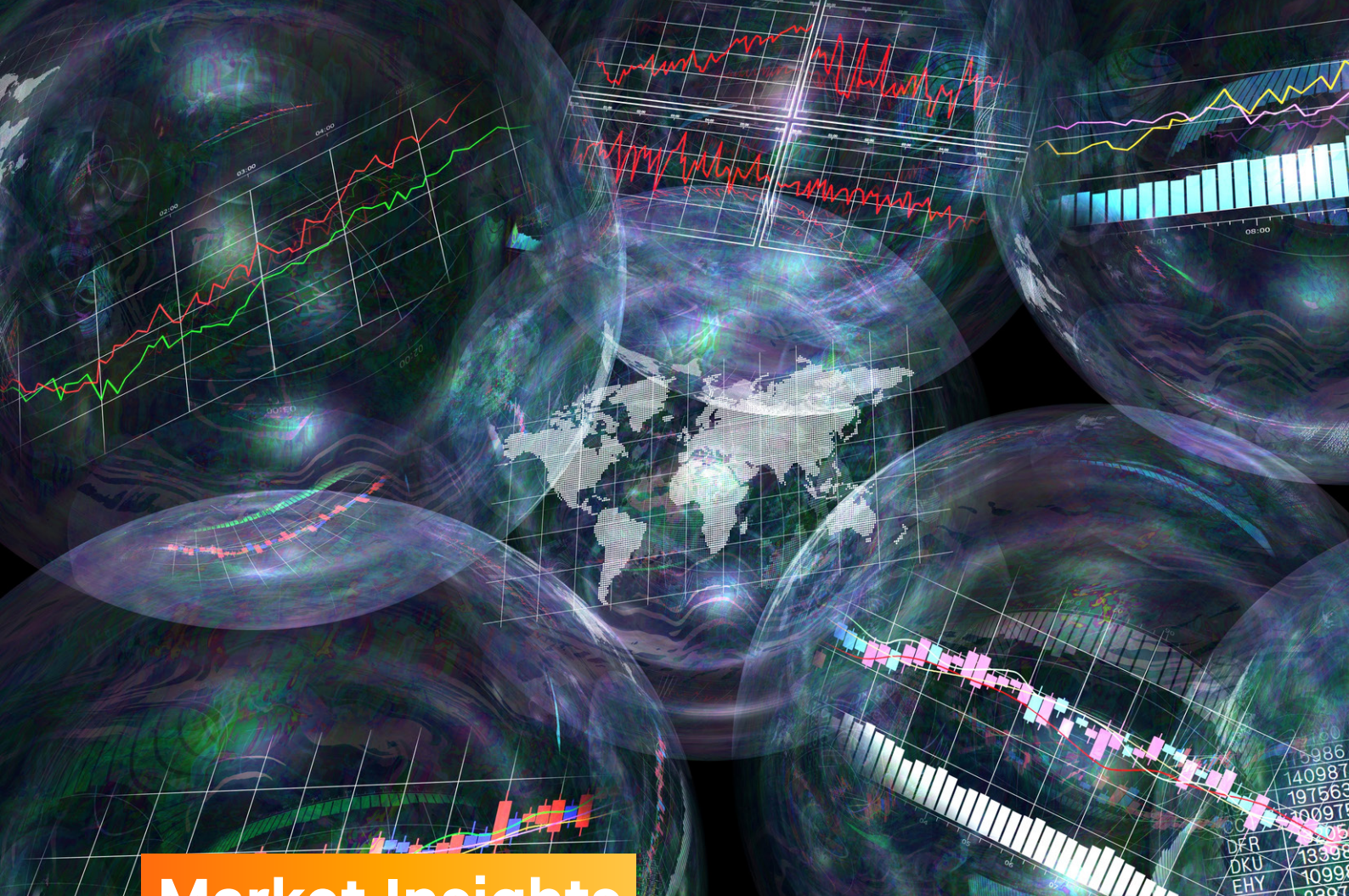


# Market Insights

**Q2-2026**

**GEOPOLITICAL CROSSWINDS:  
WHERE MARKETS  
GO FROM HERE**





# Market Insights

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# Geopolitical crosswinds: where markets go from here

After one of the most turbulent quarters in recent memory, investors enter Q2 2026 navigating a landscape that has been fundamentally reshaped by geopolitical shock, policy uncertainty, and accelerating structural change.

Q1 began with considerable promise. Equity markets rose on strong earnings, enthusiasm around artificial intelligence, and expectations of Federal Reserve rate cuts. The global economy appeared on track for what we described as an “Indian summer” — a prolonged phase of steady growth and contained inflation, supported by fiscal stimulus across the US, Europe, and China. That constructive backdrop did not last. The outbreak of conflict in the Middle East, the effective closure of the Strait of Hormuz, and the sharpest oil price surge in three decades rapidly shifted the landscape, forcing investors to reassess their assumptions across every asset class.

As we look ahead to Q2, our central message is one of measured confidence. We remain long-term positive on equity markets and believe the current correction will provide attractive entry points. The war in Iran represents a temporary geopolitical shock, not a structural turning point for financial markets. The Iranian military has lost air supremacy, and its capabilities are being systematically degraded. We do not expect Iran to control the Strait of Hormuz for long and anticipate a negotiated end to the conflict within weeks — after which oil prices should start to ease.

Beyond the immediate geopolitical picture, several other developments support a constructive outlook. The US Supreme Court has struck down the administration’s trade tariffs as unconstitutional, with effective tariff rates expected to fall below 10% once only legal measures under Sections 232 and 301 remain in force. This removes a significant source of uncertainty that weighed on markets through much of 2025. Meanwhile, the widely anticipated appointment of Kevin Warsh as Fed Chairman should ultimately lead to an easing of monetary policy, with lower interest rates likely to benefit investors through much of 2027.

On the political front, the US midterm elections of November 2026 carry a growing probability — now around 85% on prediction markets — of a Democratic majority in the House. History shows that a split Congress has typically been a constructive environment for financial markets, as it limits the scope for disruptive legislative action in either direction.

We are also mindful of the concerns that have emerged around private lending. However, in our assessment, non-bank credit does not pose a systemic risk comparable to the 2008 subprime mortgage crisis. The market is smaller, better underwritten, and far less leveraged. The stress we observed in software-related loans during Q1 is idiosyncratic, not systemic.

Taken together, we believe that March’s equity pullback should be seen as a correction within a long-term bull market. Investors who bought during the US tariff crisis of 2025 were rewarded handsomely. We expect the same will hold true now, and that markets will end 2026 above their current levels. We also believe that our main investment call for 2026, “the broadening”, still holds true. We recommend remaining well-diversified across sectors and regions in 2026. We see compelling value in US mid-caps, non-US international and Emerging Markets. Gold, hedge funds, and fixed income remain portfolio diversifiers.

That said, risks remain real and should not be dismissed. The duration of the Middle East conflict, the trajectory of energy prices, and the pace of central bank responses all carry the potential to shift our outlook meaningfully. As always, we stick to our SAA (Strategic Asset Allocation) and will use our TAA (Tactical Asset Allocation) opportunistically.

The sections that follow provide our detailed analysis across macro, equities, fixed income, commodities, currencies, and alternatives — each grounded in the conviction that volatility, managed wisely, can be a source of opportunity rather than merely a source of risk.



# 2026 Q1 in 10 stories

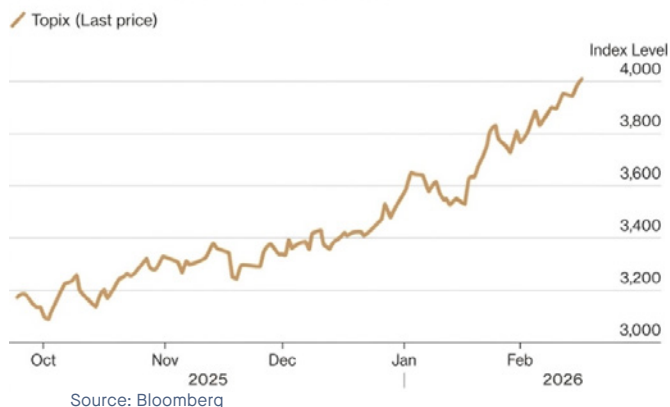
Investors faced one of the most turbulent quarters in recent memory during Q1 2026. The year began with optimism, but markets were soon affected by the outbreak of conflict in the Middle East, a historic surge in oil prices, significant movements in bonds and currencies, and the rapidly growing impact of artificial intelligence. In the sections below, we recount the story of Q1 2026 in ten charts, from the initial equity rally to the lasting opportunities in fixed income.

## Story #1

### Equities start 2026 on the front foot

The first weeks of 2026 offered a deceptively calm start for investors. Equity markets rose on strong Q4 2025 earnings, enthusiasm for AI-driven productivity, and expectations of at least one Federal Reserve rate cut. Value stocks outperformed growth early, while emerging markets, especially Taiwan and South Korea, benefited from AI-related semiconductor demand. Japan's TOPIX led major markets, up 3.6%, supported by yen weakness and the ruling Liberal Democratic Party's February election win, seen as pro-stimulus. The FTSE All-Share gained 2.4%, aided by commodity exposure and a softer sterling. However, cracks emerged in mega-cap tech as investors questioned whether hyperscalers could justify surging AI capital spending and deliver returns to shareholders a concern that would intensify throughout the quarter.

TOPIX Performance at the Start of 2026

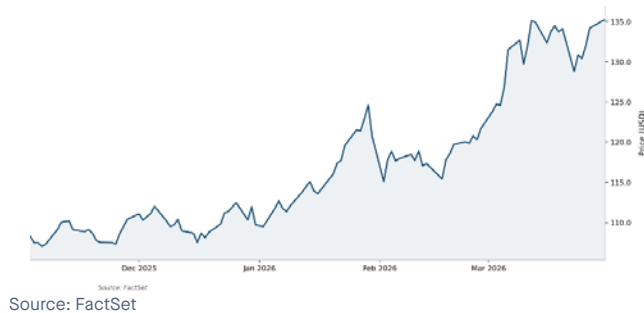


## Story #2

### Gold and silver volatility surges while Bloomberg Commodity index is the top performer in Q1

Precious metals started 2026 on strong footing, with gold at high levels and silver rising, supported by inflation-hedging demand and industrial use linked to the energy transition. Yet the quarter brought unexpected volatility rather than a steady climb, as both metals saw sharp swings that surprised many systematic and momentum-driven funds. Gold was initially a widely favoured trade, paired with emerging market equities as a hedge against a weaker dollar and geopolitical risk. But when the Middle East conflict broke out and the US dollar surged, these crowded positions unwound quickly, driving simultaneous declines in gold and EM equities. Silver's higher beta magnified the swings. Despite this, the Bloomberg Commodity Index led the quarter, up 24.4%, driven mainly by energy, while precious metals' volatility remained a standout story.

Bloomberg Commodity Index Performance

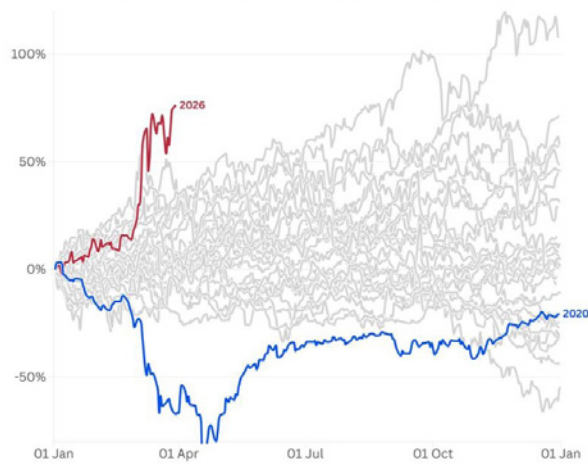


### Story #3

## Oil's most violent start to a year in 3 decades

The defining macro event of Q1 2026 was the escalation of conflict in the Middle East, which quickly reshaped the investment landscape. The conflict severely damaged regional energy infrastructure and effectively closed the Strait of Hormuz, a critical route for over 80% of Asia-bound global oil and gas. The impact on energy markets was immediate and dramatic: Brent crude surged 63% in March alone, marking the largest monthly increase in 40 years. Grain and other agricultural commodities also jumped, as the Strait is vital for food shipments. The supply shock posed a major challenge for central banks. The Fed, ECB, and Bank of England faced rising inflation while weighing growth support, with the BoE keeping rates steady in March amid unprecedented uncertainty.

Brent Crude year-to-date price change for each year since 1996



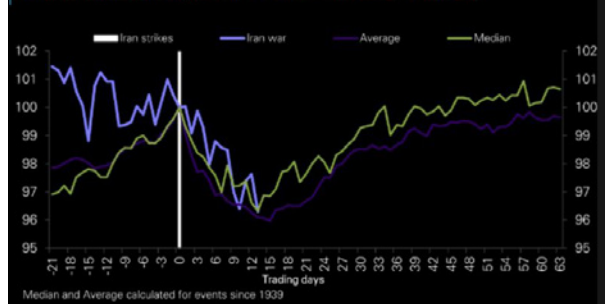
Source: Bloomberg, Arkeviem Research • Each line represents the cumulative percent change in Brent Crude price from January 1st of that year. ARKEVIUM  
Source: Maxence Visseau & Arkeviem Research

### Story #4

## The Middle East shock

The geopolitical shock turned an already uncertain equity market into a highly volatile one. The S&P 500 fell 4.3% for the quarter, but this headline masked extreme internal divergence. BlackRock reported that 74% of its constituents moved more than 5% in either direction, with dispersion reaching the 98th percentile, levels last seen during the Global Financial Crisis. The sell-off was global. The MSCI World dropped 3.5%, while European equities (MSCI Europe ex-UK) fell 2.3%, pressured by soaring gas prices and growth concerns. Emerging markets were broadly flat (-0.1%), though Asia's oil exposure weighed on some markets, while Taiwan and Korea benefited earlier from AI. In the US, value stocks (+1.3%) outperformed growth (-8.4%), and technology, the most crowded sector early in the year, fell 3.8% in March. Higher-quality tech names held up better, as investors favoured cash flow visibility amid heightened uncertainty.

Figure 1: S&P 500 around over 30 major geopolitical events since 1939. As events in the Middle East get more worrying, we are approaching the usual bottom in terms of timing... will this time be the same or different?



Source: DB

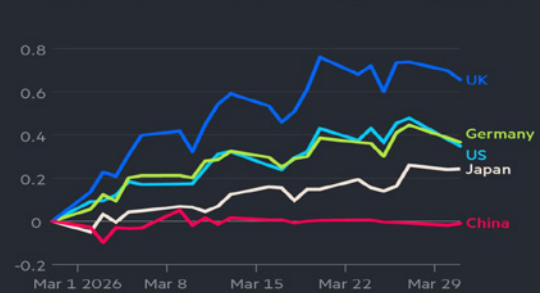
### Story #5

## Bond markets whipsaw

Government bond markets saw some of the quarter's most dramatic repricing. At the start of Q1, most major central banks were expected to cut rates multiple times in 2026. By March, markets had sharply reversed, pricing in potential rate hikes, triggering notable losses across sovereign bonds. UK Gilts fell 2.0%, the worst-performing major market, while European bonds declined 0.6% as the ECB hinted at a possible hiking bias. Japanese Government Bonds dropped 1.6%, with long-dated issues selling off ahead of the February snap election amid expectations of looser fiscal policy. ECB projections suggested headline inflation could reach 3.1% year-on-year in Q2, before the March oil peak. US Treasuries stood out, ending the quarter flat. As a net energy exporter, the US was less affected by oil, and a cooling labour market non-farm payrolls fell 92,000 in February helped moderate domestic inflation. The Fed kept rates unchanged in March, maintaining a dovish outlook for one cut in 2026, in contrast to the more hawkish BoE and ECB.

## Middle East war pushes up borrowing costs, except in China

Change in 10-year yields since Feb 27 (percentage points)

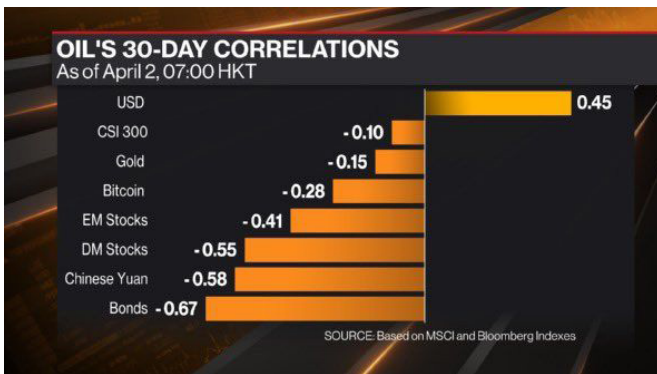


Source: Financial Times

### Story #6

## The dollar surges

The geopolitical shock was the sharp rise of the US dollar. As tensions escalated and global risk appetite weakened, investors moved into dollar-denominated assets, unwinding positions that had been built on expectations of a weaker dollar. This reversal hit gold and emerging market equities especially hard, as both were widely held as hedges against dollar weakness. When the dollar surged, these crowded trades declined quickly, highlighting how fast sentiment shifts can force investors to exit. Dollar strength also created headwinds for emerging market debt, which fell 1.1% during the quarter, as borrowing costs increased and import pressures intensified. In contrast, a weaker sterling supported UK equities with international exposure, helping the FTSE All-Share post a positive return.

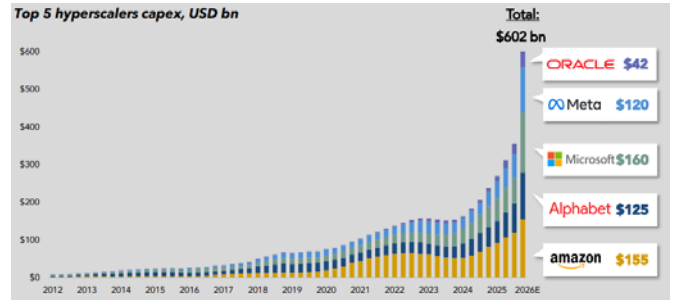


Source: Bloomberg

### Story #7

## AI crosses from thesis to reality

One of the most structurally important stories of Q1 2026 unfolded quietly within corporate financials: artificial intelligence shifted from an investment idea to an operational reality. Microsoft reported that AI now writes 35% of its code, Meta cut 21,000 jobs while boosting productivity, and Intuit, ServiceNow, and Salesforce each saw efficiency gains of 15–30%. The move to agentic compute AI systems managing other AI systems accelerated in late 2025 and continued through Q1 2026, pushing enterprise adoption from augmentation to automation. BlackRock noted that coding questions on Stack Overflow, once over 300,000 per month in 2020, are now near zero, highlighting deep labour and cost implications. Hyperscaler capex is projected to reach more than \$600bn in 2026, up from \$360bn in 2025, while global AI infrastructure spending could exceed \$2.2tr by 2028. Companies successfully turning AI into sustainable cost advantages and cash flow resilience are pulling sharply ahead, contributing to record equity market dispersion.



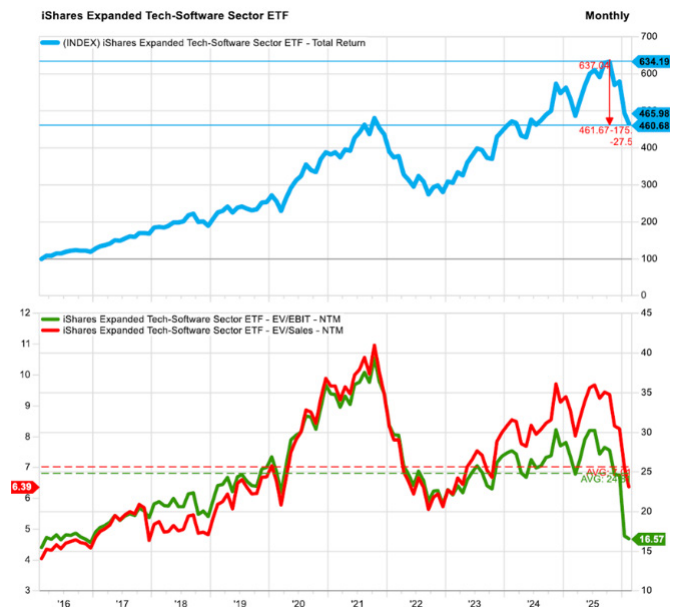
## Hyperscalers Expected to Fund ~50% of Data Center Spend

Source: IEEA

### Story #8

## Software: a 30% sell-off

One of the clearest impacts of AI's rapid progress in Q1 2026 was seen in the software sector. US software stocks dropped 23% from the start of the year to late February, with losses reaching around 30% for the full quarter, bringing valuations back to 2021 levels. This decline reflected a deeper shift, as investors questioned whether the SaaS model can remain viable in a world where AI agents can perform many of the same tasks. The pressure extended beyond equities. Software-related leveraged loans fell 15-20 points, affecting business development companies and alternative asset managers with heavy exposure. Around 80% of these loans are tied to private equity-backed firms, with over 15% originated during the high-valuation 2020-2021 period. More broadly, traditional market correlations began to break down. While software fell 30%, semiconductors rose 30%, creating a 60-point gap in just a few months. What was once a unified trade fragmented, highlighting the need for investors to focus on company-specific fundamentals rather than broad sector positioning.

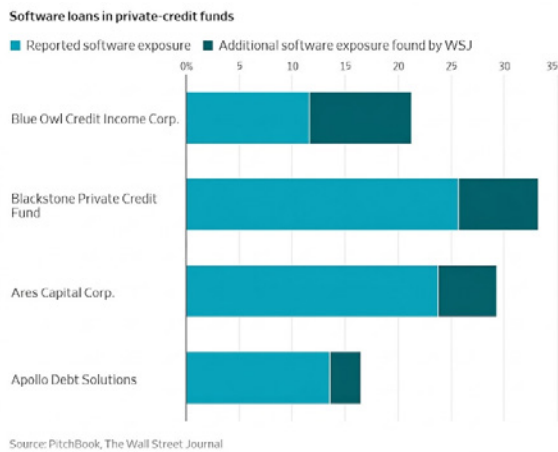


Source: FactSet

### Story #9

## Private credit feels the pressure

Q1 2026 revealed early signs of stress in parts of the private credit market, particularly loans tied to software. Roughly \$400bn of software-related loans within the \$2.5tr private credit universe came under pressure as public software valuations tumbled. Many deals from 2020-2021, originated at peak SaaS multiples, are still held at valuations that don't reflect today's disruption risk. About 30% of these loans mature by 2028, creating refinancing risks amid a tougher operating environment. Funds heavily exposed to 2020-2021 vintages faced material mark-to-market losses, with software-related leveraged loans selling off 15-20 points, even without actual defaults. BlackRock emphasised this is an idiosyncratic, not systemic, stress: even a 25% default with minimal recovery would imply \$80bn in losses against \$232tr of global private-sector net worth. For exposed investors, however, it's a stark reminder of the importance of vintage selection and rigorous cash-flow underwriting in private credit.



Source: PitchBook

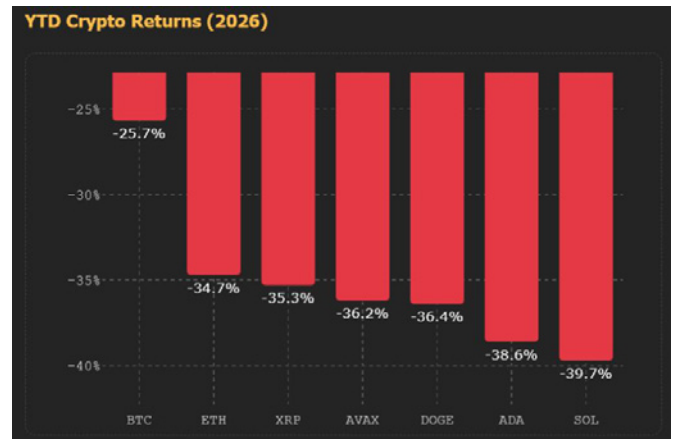
### Story #10

## Crypto's worst quarter since 2018

Cryptocurrencies faced a harsh Q1 2026, with Bitcoin posting its worst opening quarter in eight years. BTC began at \$87,500, briefly touched \$95,000 in early January, then slid to \$60,000 in early February before partially recovering to close near \$67,000, down about 25% year-to-date. Ethereum performed worse, falling 35%, and the total crypto market cap dropped roughly \$900bn, from \$3.4tr to \$2.5tr, leaving BTC around 45% below its October 2025 all-time high.

Three main factors drove the decline. First, the Middle East conflict dashed rate-cut hopes as the Fed raised its 2026 inflation forecast, with over 60% probability of unchanged rates through July. Second, Bitcoin ETF outflows amplified selling, with AUM falling 41% to \$96bn by mid-February, though net inflows of \$18.7bn resumed in March. Third, large holders realised roughly \$30.9bn in losses.

The quarter underscored that Bitcoin remains a high-beta risk asset: while gold surged 19% on the same shock, Bitcoin fell 25%, showing a 44-point divergence. Despite this, institutional engagement persisted, order-book liquidity recovered, and BTC dominance stayed above 50%. Bright spots included AI-linked tokens HYPE and TAO rose 39-50%, reflecting AI-driven themes reshaping markets. For mainstream crypto, Q1 2026 was a sobering reminder that macro conditions dominate in the short term.



Source: Trend Spider

## Macro and monetary policy update: the Middle East shock dominates Q1



We entered 2026 with a constructive macro-outlook: a world poised for a prolonged “Indian summer” of steady growth and contained inflation, supported by significant fiscal stimulus in the US, Europe, and China, along with a broadening global manufacturing recovery. These conditions guided the first two months of the quarter and underpinned our generally positive stance on risk assets.

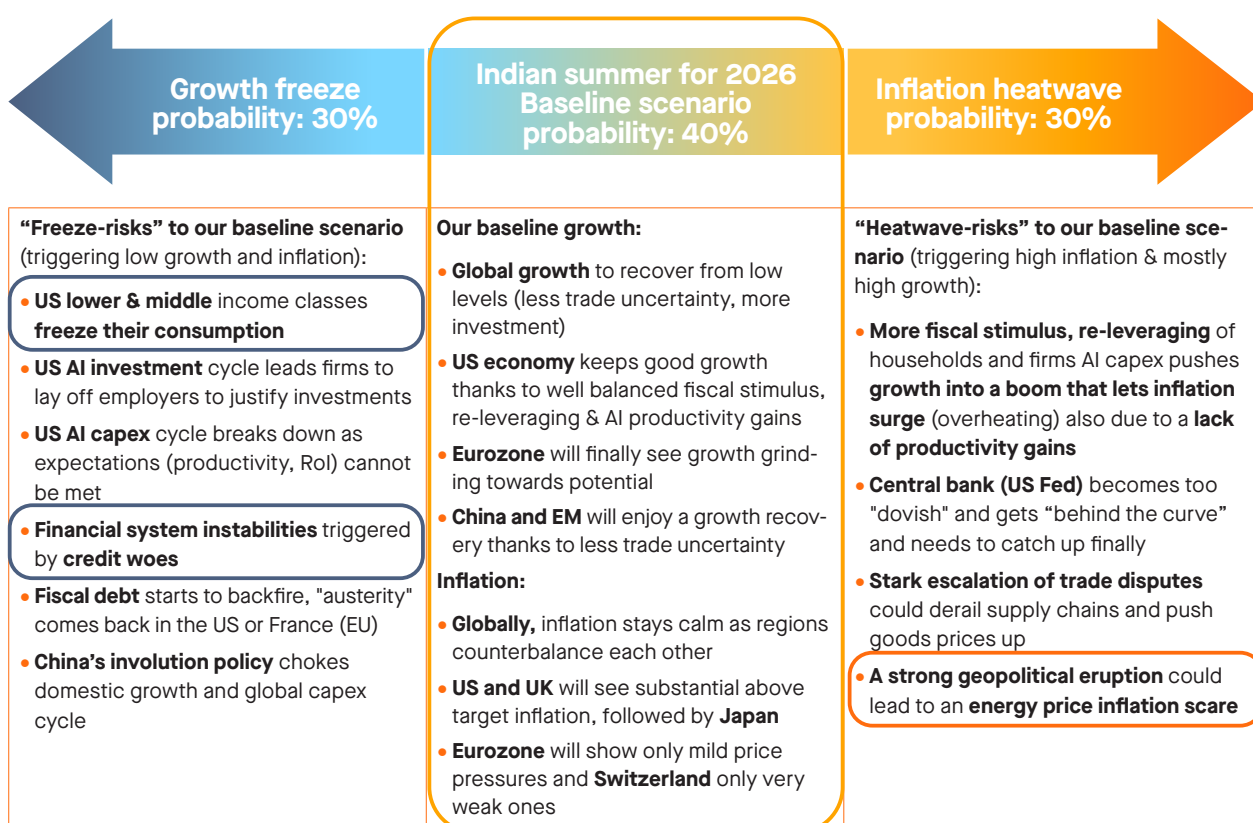
Then came an unforeseen shock faster and more severe than our scenarios anticipated but captured on the extreme side of our “inflation heatwave” scenario: the conflict in the Middle East, the effective closure of the Strait of Hormuz, and the sharpest surge in oil prices in three decades. The potential economic fallout from higher inflation, squeezed consumption, and a meaningful slowdown in global growth may prove more persistent than markets currently expect, especially for energy-importing regions in Europe and Asia.

Here’s a look at where we stand today and what to expect across our key macro themes in the coming months: A macro and monetary policy update: the middle east shock dominates Q1.

## The “Indian summer” scenario

The first quarter of this year feels like a whole year. Until the end of February, the global economy was on track for a prolonged “Indian summer” economic scenario, with a decent growth and inflation rate neither too hot nor too cold (see chart 1). This was a good economic environment for financial markets. We expected the US to be a bit warmer in terms of growth and inflation than the global average, as fiscal stimulus in 2026 looked even more ample than, for example, in Europe or China. But also, the Eurozone was on track to a growth recovery, with inflation already below the central bank’s target and the manufacturing cycle finally showing signs of picking up. Similarly, China, who started to profit from the global broadening of the manufacturing cycle, which also supported India’s economy and other Emerging markets. Given such a scenario we still expected the US central bank to lower its key rates back to the neutral rate of around 3-3.5% and the European and Swiss central bank to keep their rates stable throughout 2026.

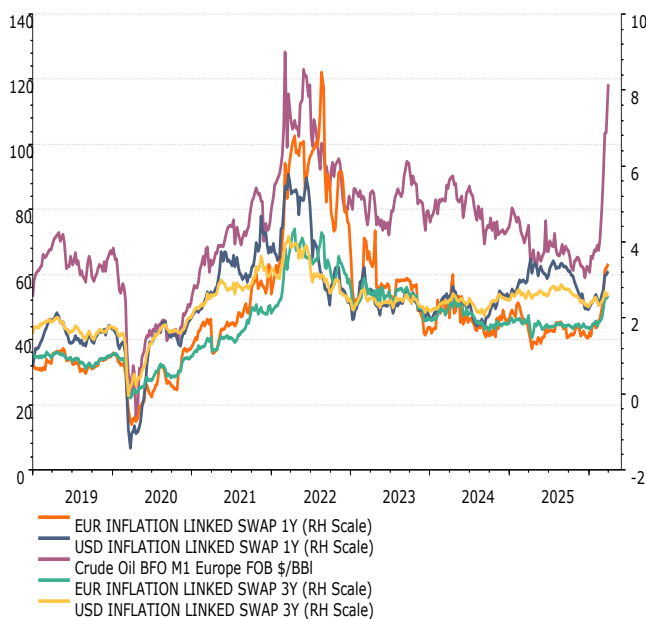
Chart 1: Scenario overview



## 1. Global trade and geopolitics enter more uncertain times

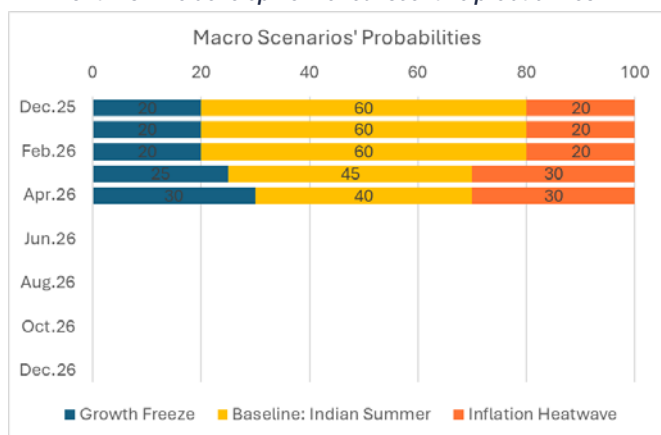
Then came the US and Israeli military strikes against Iran, which tangibly shifted the picture and increased the likelihood of our alternative scenario “inflation heatwave” substantially. Iran started to close the Strait of Hormuz, a sea passage where about 20% of the global oil and natural gas supply is shipped through. The resulting spike in energy prices let markets’ short-term inflation expectations jump higher (see chart 2) and triggered us to increase the probability of the “inflation heatwave” scenario (see chart 3).

**Chart 2: Energy price increase triggers spike in short-term inflation expectations**



As usually higher energy prices affect the economy similarly to an extra tax on consumption that reduces demand, the energy price spike also let us adjust the probability of a growth freeze scenario higher, as shown in chart 3. In such a scenario, the consumers would start to feel the pain of higher energy prices and lower their spending, leading to less growth in the economy.

**Chart 3: The development of our scenario probabilities**



## 2. Middle East crisis scenario adjustments

In our current scenario analysis of the Middle East crisis, we had to increase our probability for the more negative outcomes of a “prolonged energy constraints” and of a “true oil crisis”. We reduced the likelihood for our original base case of a “sharp but short-lived spike” over time. We currently have the highest probability for a “prolonged energy constraints” scenario, as can be seen in Chart 4. Looking forward, the big question marks remain the duration and the magnitude of the escalation in the Middle East. The longer the crisis keeps energy prices high and the more profound the destruction of the Middle East’s energy production and refining and transportation capacities, the higher the upward pressure on inflation and the more negative the impact on the growth rates.

## 3. Incentives of key players and baseline view for the Middle East crisis

Examining the incentives of the main players, at least three out of four have reasons to shorten the conflict: the US, Iran, and most global powers aside from energy net-exporters like Russia.

- ▶ **The US:** higher energy prices and inflation are politically sensitive, particularly with mid-term elections approaching in November. Current polls already anticipate a Democratic sweep, i.e. Democrats taking the majority in the congress.
- ▶ **Iran:** the country suffers substantially from instability, which undermines the current leadership’s authority and economic power.
- ▶ **Other global powers:** countries like China and the EU are struggling with higher energy costs. Rising fertiliser and food prices also pressure emerging economies, encouraging a swift end to hostilities.
- ▶ **Israel,** however, may aim for a prolonged campaign to overhaul Iran’s leadership and dismantle its armed forces.

Yet geopolitically, Israel is weaker than other players, so we still expect most hostilities to end by April. The start of the US holiday season in mid-April adds a psychological factor, as gasoline prices above \$4 per gallon become politically harmful.

If such a baseline scenario for the Middle East conflict turns out to be correct, and the crisis will de-escalate in April and energy prices will grind lower towards between 80-90 USD a barrel in May, we still think that a strong global demand destruction can be averted. The world economy could find back to its Indian summer scenario during the second half of the year, which would be a positive outlook for markets. We still think that several other macroeconomic factors can help the economy to remain on this positive trend. These include significant fiscal stimulus in the US, Europe, and China. In addition, the recovery of the global manufacturing cycle and the strong capital expenditure in the US are providing support. Finally, there is still lagging support from central banks, which have lowered key rates over the past 12 months in the US and elsewhere.

Chart 4: Middle East - energy crisis analysis

Prolonged Energy Constraints Scenario 1 – probability: 50%	Extended Energy Constraints Scenario 2 – probability: 30%	True Oil Crisis (Regional War) Adverse scenario 3– probability: 20%
<b>Duration:</b> +2 to 3 months	<b>Duration:</b> +3 to around 6 months	<b>Duration:</b> 7 months and more (quasi a “new normal”)
<b>Brent oil:</b> 100-110 USD/bbl sustained (on avg.)	<b>Brent oil:</b> 105-120 USD/bbl sustained (on avg.)	<b>Brent oil:</b> 130-150 USD/bbl (but even 200 possible in peaks)
<b>Hormuz:</b> Disruption ongoing, quasi full closure	<b>Hormuz:</b> Disruption ongoing, quasi full closure	<b>Hormuz:</b> Near total blockade + attacks on energy infrastructure
<b>Global GDP Impact:</b> -0.3 to -0.5pp (approaching global recession)	<b>Global GDP Impact:</b> -0.5 to -1.0pp (drifting into global recession)	<b>Global GDP Impact:</b> -2pp and more = global recession
<b>Global CPI impact:</b> +0.5 to +1.0pp	<b>Global CPI impact:</b> +1.0 to 1.6pp	<b>Global CPI impact:</b> +3.0 to 4.5pp
<b>Key Drivers:</b> Iran is able to sustain counter-offensives, Hormuz mostly closed; rerouting of shipping lines and ships from Hormuz are missing in global system, trade system chaos	<b>Key Drivers:</b> Iran is able to sustain counter-offensives, Hormuz closing persists, but only minor additional damages to energy infrastructure; rerouting of shipping lines and ships from Hormuz are missing in global system, trade system chaos	<b>Key Drivers:</b> Strait of Hormuz permanently closed but also GCC energy infrastructure and transport facilities damaged; conflict might even spread to a real regional conflict; a loss of 10mb per day of oil “new normal”
<b>Our current baseline scenario is the new Scenario 1</b>		

## 4. The Fed could still ease, but the ECB faces an even more difficult balancing act

In this current base case, we expect the Federal Reserve still to be able to deliver one rate cut in the second half of the year and the ECB and the SNB to keep its key rates stable. But the odds for a “pre-emptive” hike of the ECB are still high and much more pronounced than for the Federal Reserve or the SNB, as the EU economy is more sensitive to energy prices and several larger EU countries already announced subsidies or tax cuts on energy prices, which could lead to an inflation spiral. Such a development would likely provoke the ECB to raise rates before other central banks.

Due to high uncertainty in the Middle East, **alternative scenarios** remain plausible:

- ▶ **Inflation heatwave:** a strong, prolonged rise in energy and overall prices could reduce consumption and investment.
- ▶ **Growth freeze:** weak demand from consumers and firms suppresses growth.
- ▶ **Stagflation (extreme scenario):** high energy prices persist, pushing inflation up while growth stagnates – a particularly difficult combination for markets.

**Bottom line:** we continue to view the incentives for an early cessation of hostilities in the Middle East as strong enough to suggest that the current escalation is likely to be protracted but not prolonged—lasting around two months rather than extending beyond three at this stage. This should bring us back to more “normal” territories in May, regarding energy supply and prices. As we expect the underlying economic trajectory to be still strong enough to “survive” the roughly two months of escalation in this baseline scenario, we expect the global economy to find its way back to our “Indian summer” scenario in the second half of the year. However, uncertainty remains elevated, and new developments could quickly shift our outlook toward other scenarios—such as an inflation heatwave, a growth freeze or even the or even the more severe risk of stagflation. For now, we remain modestly constructive that these adverse outcomes can ultimately be avoided.

## THE WEIGHT OF THE EVIDENCE

Our **asset allocation preferences** are based on five-pillar framework: Macro Cycle, Liquidity, Earnings Growth, Valuations, and Market Factors to derive our tactical asset allocation. The weight of the evidence suggests a constructive view on equities (positive). Below we review the main drivers for each of them.

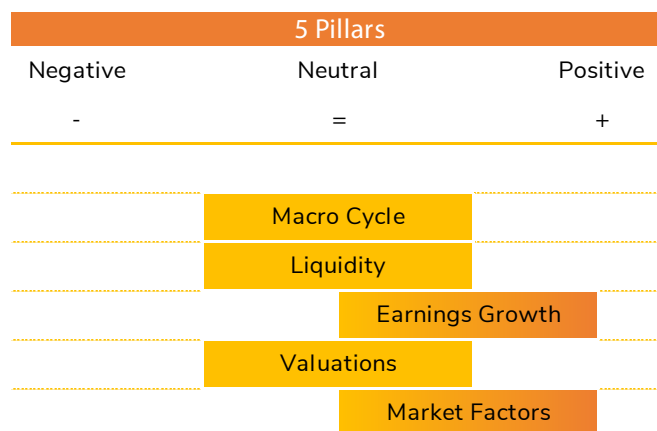
**Macro cycle (neutral):** the conflicts in the Middle East pushed energy prices higher and triggered a partial energy shortage in several countries. This dampens global growth substantially for every week the conflict stays hot and energy prices high. However, the underlying positive trajectory of the global, and particularly the US economy, seems to remain intact. We still expect the conflict to partially calm down during April and anticipate the global economy to be resilient enough to get back to the growth trend over summer into H2. So, for now, we keep our “neutral” macro assessment, although the risks to our baseline view are large and particularly the downside is substantial.

**Liquidity (neutral):** liquidity conditions for financial markets were weakening as the geopolitical escalations in the Middle East let the US dollar appreciate and hampered the positive financial conditions we had before the military conflict. Overall, our liquidity indicator did stabilise on solid levels but is not improving further, which, in combination with the deteriorated financial conditions, indicated a “neutral” for our 2<sup>nd</sup> pillar.

**Earnings (neutral to positive):** earnings momentum remains supportive, with 2026 EPS expectations still resilient despite the Middle East war and energy shock (S&P 500 +16%, Stoxx Europe 600 +10%, MSCI Japan +6%, MSCI AC Asia ex Japan +35%). If the shock remains contained and short-lived (less than 3 months), the earnings backdrop should stay firm, although some lagged downward revisions remain likely, particularly in more energy-sensitive regions.

**Valuations (neutral):** valuations are not cheap, but not broadly excessive either: the S&P 500 remains demanding at 19.5x forward P/E, although this is less stretched on an equal-weighted basis (16.5x), while MSCI Japan (17x), Europe (15x), and Asia ex-Japan (12x) remain more reasonable. The key risk is that a persistent energy shock would keep upward pressure on inflation expectations and bond yields, thereby reducing valuation support for equities.

**Market factors (positive to neutral):** raw scores stand slightly above 50% in both the US and Europe, supporting a 50% allocation to equities, evenly split between the two regions.



Indicator	USA	Europe
Trend	NEGATIVE	POSITIVE
Technicals	POSITIVE	POSITIVE
Market Breadth	NEGATIVE	NEUTRAL
Sentiment	POSITIVE	NEUTRAL
Volume	POSITIVE	NEGATIVE
Aggregate	NEUTRAL	NEUTRAL

# Asset allocation views

## 1. EQUITY

### Overview

Equities remain constructively positioned in the near term, provided the energy shock de-escalates and remains short-lived (less than three months). Earnings momentum remains intact and continues to support the asset class. However, the risk-reward has become more asymmetric: while aggregate earnings expectations have held up so far, history suggests revisions often react with a lag to energy and geopolitical shocks. The case for staying invested remains valid, but it calls for greater caution.

### So far, the correction has been driven by valuation rather than earnings.

The March equity market correction has been driven far more by a repricing of the discount rate than by any meaningful deterioration in earnings expectations. Equities have been pressured by a higher required return reflecting a rise in geopolitical risk premia, firmer inflation expectations, and a significant upward repricing in both short- and long-term bond yields rather than by a collapse in the earnings outlook. This distinction matters. When markets correct because discount rates rise, the drawdown is initially concentrated in valuation multiples rather than in earnings per share. That is precisely what we are observing today.

### Corporate earnings remain resilient

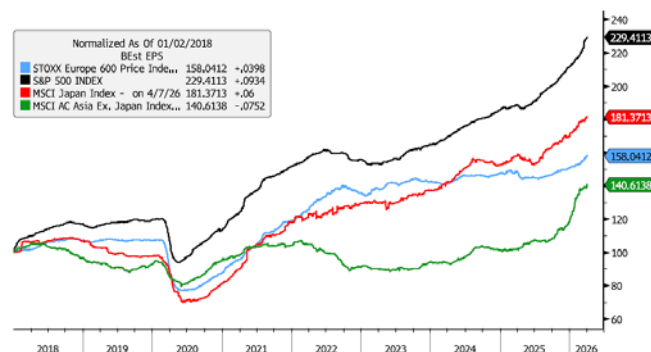
At the company level, the Middle East conflict has so far led to isolated warnings and a more cautious tone in a few exposed industries, particularly in energy-intensive sectors such as industrials, chemicals, airlines, logistics, and selected areas of consumer goods.

A few recent examples illustrate the transmission channels:

- ▶ **Solvay** cut its EPS guidance, citing higher energy and raw material costs.
- ▶ **Wizz Air** lowered its 2026 ASK growth guidance to 10% year-on-year, with higher jet fuel prices and Middle East-related disruption contributing to a €50mn downgrade in fiscal 2026 net income guidance.
- ▶ **Renault** has also flagged higher energy and logistics costs as a potential pressure point should the conflict persist.

These examples matter, but they remain idiosyncratic rather than systemic. At this stage, there is still no evidence of broad-based downward earnings revisions at the index level. In aggregate, 2026 EPS growth expectations remain robust: around +16% for the S&P 500, +10% for the Stoxx Europe 600, +6% for MSCI Japan, and approximately +35% for MSCI AC Asia ex Japan.

**Chart 1: World indices – Forward 12-month EPS**  
Despite the rise in geopolitical tensions, forward 12-month EPS estimates continued to be revised upward through March



Source: Bloomberg

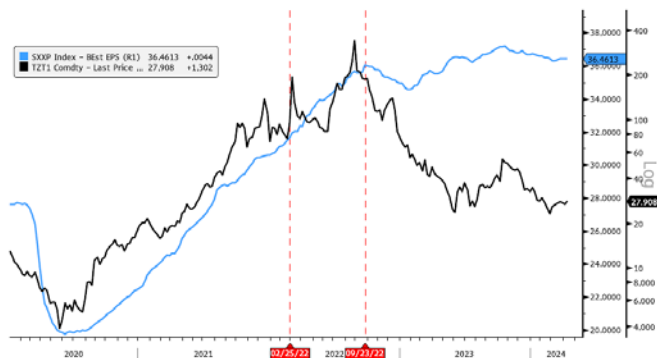
### Earnings growth is broadening an important positive

Another constructive feature of the current backdrop is that earnings growth is no longer as narrowly concentrated. The improvement is broadening across both sectors and market-cap segments. In the US, earnings growth is no longer solely dependent on the "Magnificent 7." EPS growth expectations for the Russell 2000 are now running at roughly twice the pace of the S&P 500, pointing to a healthier and more diversified earnings cycle. A similar pattern is visible in Europe, where MSCI Europe mid-caps are expected to deliver around 17% EPS growth, compared with roughly 10% for the Stoxx Europe 600. This broadening is also visible at the sector level. On a global aggregate basis, all 11 GICS sectors are currently expected to contribute positively to 2026 earnings growth, with particularly strong contributions from Energy, Materials, Industrials, and Information Technology.

### A note of caution: earnings revisions often lag the shock

History suggests that earnings revisions tend to lag macro and geopolitical shocks rather than react immediately. A useful reference point is the initial shock of the Russia and Ukraine war beginning in 2022. Despite the sharp surge in European natural gas prices, the impact on forward EPS expectations was not immediate. It took roughly seven months after the start of the war (first red horizontal line) for earnings expectations to begin moving materially lower. Importantly, by the time revisions finally rolled over, the Stoxx Europe 600 had already completed most of its correction.

**Chart 2: In 2022, Forward 12-month EPS (blue) vs EU Natural Gas (black) This is a useful reminder: markets tend to discount the shock before analysts fully embed it in their models.**



Source: Bloomberg

**Valuations are not cheap, but not broadly excessive either**

Valuation remains an important part of the equation. The S&P 500 still trades at a demanding 19.5x forward P/E, but this remains heavily skewed by the largest-cap growth names. By contrast, the equal-weighted S&P 500 trades closer to 16.5x forward earnings, broadly in line with its median since 2010. Outside the US, valuations are more reasonable. MSCI Japan trades at around 17x forward earnings, while Europe and Asia ex-Japan are even more attractive, at approximately 15x and 12x respectively.

**Energy shock transmission: amplitude matters, but so does duration**

A sharp but short-lived move in energy prices does not have the same earnings consequences as a more moderate but persistent rise. In practice, four mechanisms typically delay the transmission of higher energy prices into corporate margins: hedging programmes, inventory buffers, contractual pricing lags, and short-term demand flexibility.

As a result, an energy shock contained within roughly 90 days is unlikely, on its own, to trigger broad-based EPS downgrades. Earnings risk becomes more material only if the shock persists long enough for these buffers to unwind when hedges roll off, inventories are replenished at higher spot prices, and contractual repricing begins to hit the P&L.

The same duration logic also applies to valuation. If the shock remains short-lived, current equity multiples can likely be sustained. But if it proves more persistent, it will likely put further upward pressure on inflation expectations and interest rates, improving the relative attractiveness of bonds versus equities and reducing valuation support for risk assets.

**Conclusion**

Our base case remains that the Middle East shock is currently being transmitted to equities primarily through sentiment, risk premia, inflation expectations, and interest rates, rather than through broad-based earnings revisions. For now, EPS expectations continue to support equities, provided the shock remains contained in scope and limited in duration—less than 3 months. However, the risk is clearly asymmetric: if the shock proves more persistent, the earnings backdrop would likely deteriorate with a lag. In this context, a prudent near-term stance is warranted until visibility improves.

**2. FIXED INCOME**

**Overview**

Economic momentum and fiscal trajectories are diverging sharply across regions, forcing investors to rethink duration, credit exposure, and geographical allocation. While the US faces fiscal tightening alongside slowing growth and persistent inflation, Europe is ramping up public spending just as economic data improves and inflation normalises reinforcing a growing transatlantic shift in momentum. This divergence was thrown into even sharper relief during Q1 2026, when the Iran conflict triggered a major stagflationary shock: oil prices surged 94% over the quarter, inflation expectations spiked, and central bank rate expectations reversed dramatically. Together, these developments mark a clear inflection point for fixed income strategy.

**Governments bonds**

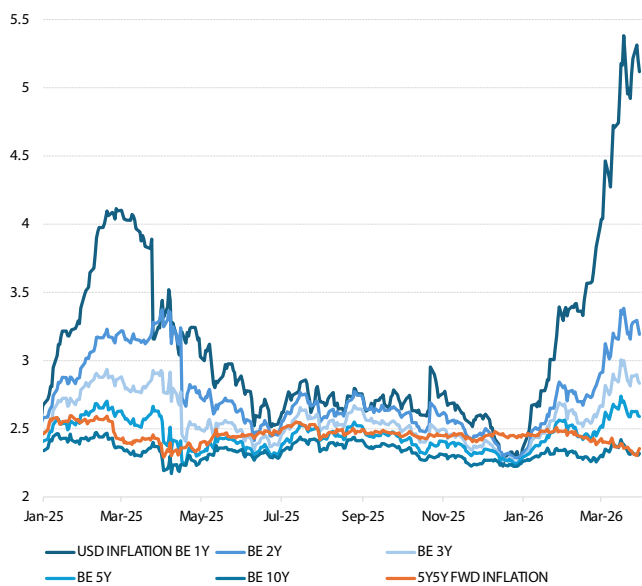
**A broad-based rate sell-off and negative performance**

Government bond yields rose markedly across all major regions and maturities over the quarter, driven primarily by the sharp move recorded in March. In the United States, front-end rates led the sell-off, with the 2-year yield climbing 32 basis points to 3.79%, while the 10-year and 30-year yields rose by 15bps and 7bps, respectively. Europe followed a similar pattern, with even stronger moves at the front end: German and French 2-year yields surged by 49bps and 50bps respectively, reflecting an aggressive repricing of policy expectations. Peripheral spreads also widened moderately, with Italian 10-year yields rising 36bps and Spanish yields 22bps. Other developed markets followed suit, including the UK (+44bps on 10-year yields) and Japan (+29bps).

**An inflationary shock perceived as temporary**

The spike in energy prices drove a sharp rise in short-term inflation expectations, clearly visible in the move higher in short-dated inflation breakevens. Medium-term infla-

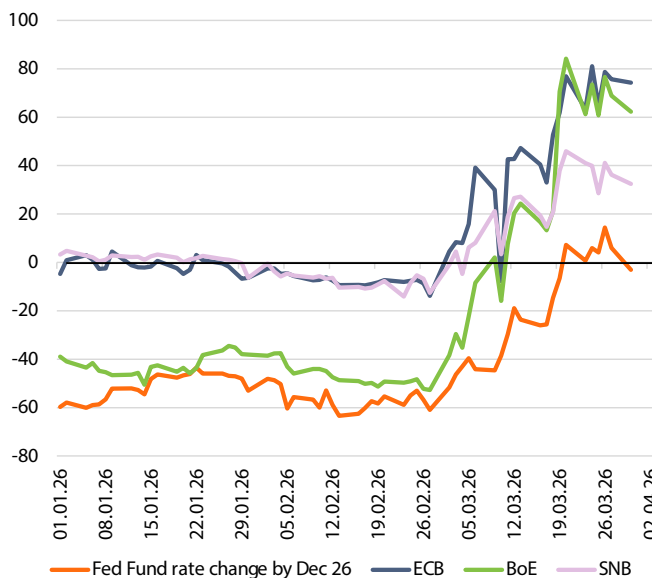
tion expectations, however, have remained relatively well anchored. Measures such as the 5y5y forward inflation breakeven have only edged marginally higher in Europe and have actually declined in the US, suggesting that markets continue to view the current inflationary episode as transitory rather than structural.



Source: Bloomberg

### A sudden repricing of central bank expectations

The inflation shock prompted a significant and rapid shift in monetary policy pricing. Markets moved from anticipating rate cuts to pricing in renewed tightening across major central banks. By the end of March, the European Central Bank was expected to deliver close to three rate hikes by year-end, while expectations for the Bank of England shifted from two cuts to at least two hikes. Even the Swiss National Bank was seen tightening policy. In the US, expectations for Federal Reserve rate cuts were fully priced out. This repricing reflects heightened sensitivity to inflation risks, though the outlook remains highly dependent on the duration of the energy shock and whether stagflationary dynamics become more entrenched.

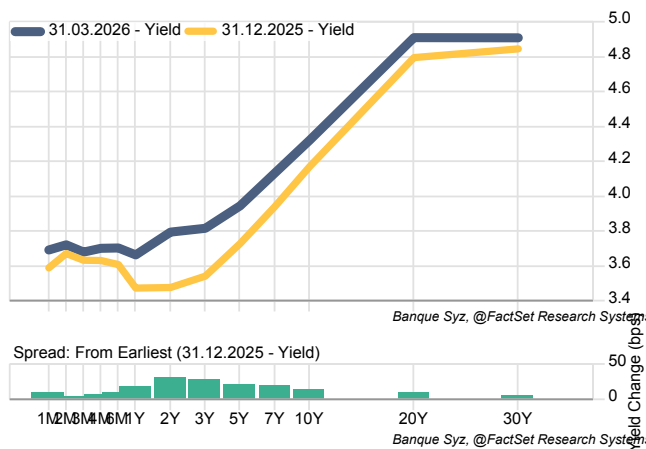


Source: Bank Syz, FactSet

### Yield curve bear flattening dynamics

The rate adjustment has produced a pronounced bear flattening of yield curves, particularly in the US, with the sharpest increases concentrated in short- and medium-term maturities where rate-cut expectations had previously been priced in. Long-end yields also rose, though more modestly, reflecting continued market confidence that inflation will not become entrenched over the longer term. Overall, yield curves continue to signal a temporary shock rather than a lasting regime change.

#### United States Treasury Yield Curve



Source: Bank Syz, FactSet

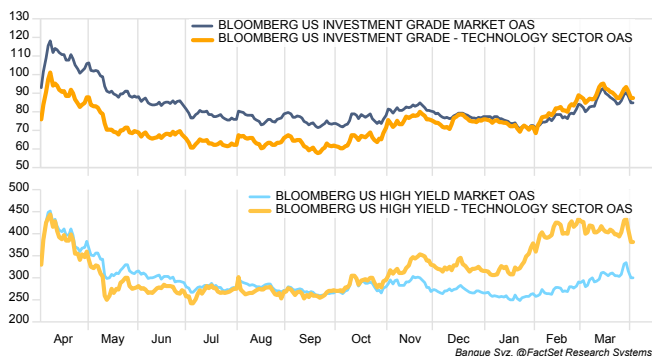
## Credit

### Credit markets: resilience amid volatility

Despite the rate shock, credit markets have shown relative resilience. Investment Grade spreads widened only modestly, while High Yield spreads moved more meaningfully, particularly in March. Even so, spreads remain below the levels seen during the “Liberation Day” tariff shock less than a year ago, suggesting markets are interpreting recent developments primarily through an inflation lens rather than as a deterioration in credit fundamentals. That said, as the conflict persists, concerns are gradually shifting toward growth implications, which could place further pressure on credit.

### Sector divergence: technology under pressure from AI concerns

A notable theme this quarter was the underperformance of technology in credit markets, predating the Middle East conflict. Both Investment Grade and High Yield technology issuers saw spread widening as investors reassessed risks tied to the disruptive impact of artificial intelligence. Investment Grade tech spreads moved above the broader market for the first time in two decades, highlighting a structural shift in how credit markets are pricing sector-specific risk.



Source: Syz Bank, FactSet

### Outlook and positioning

Looking ahead, the environment remains challenging for fixed income:

- ▶ **Government bonds** appear unattractive given persistent inflation pressures, reduced expectations for monetary easing, and unfavourable yield curve dynamics. They don't provide diversification in a multi-asset portfolio in environments where inflationary concerns prevail.
- ▶ Investment Grade credit remains appealing from a carry perspective even if spreads remain tight from a historical perspective, but with a focus on medi-

um-term maturity. Longer maturities are not attractive in an environment of heightened uncertainties around the interest rate outlook.

- ▶ In High Yield credit, a preference for short-duration bonds remains warranted, balancing attractive yields against rate sensitivity and macro risks.
- ▶ Emerging market debt continues to offer attractive opportunities, supported by solid fundamentals in some regions, but requires careful issuer selection amid an uncertain global backdrop.

## 3. COMMODITY

The commodity complex delivered a mixed performance over Q1. Strong gains in the energy complex offset weaker performance in both precious and base metals. Market dynamics were mainly driven by the escalation of the US-Iran conflict and the closure of the Strait of Hormuz, a key route for global commodity flows.

### Precious metals: falling short of expectations

Gold has so far fallen short of expectations, despite what appears to be a prolonged geopolitical conflict. Nevertheless, it remains a reliable store of value, a hedge against risks, and a key portfolio diversifier. We expect its long-term fundamentals to remain supported by geopolitical tensions and strong structural demand notably from central banks and new buyers, such as Chinese insurers. At these levels, we continue to see gold as an attractive opportunity for investors navigating current uncertainties. We believe that gold could regain further support if growth concerns add to inflation pressures and lead to the Fed cutting rates later this year. Some risks remain, as different governments are liquidating gold reserves to fund their war efforts or to finance military spending or cover budget deficits, especially among oil-importing economies. Emerging markets such as China, India, and Brazil could scale back their purchases if global growth weakens. Silver underperformed gold due to its smaller and more volatile market size and its exposure to industrial demand. Despite the recent pressure, its long-term outlook remains constructive, supported by tight supply and steady demand linked to the energy transition. PGMs have been more challenged. Palladium's outlook remains weak due to the shift toward electric vehicles and high recycling rates. Platinum, however, benefits from relatively stronger fundamentals, supported by supply constraints, particularly in South Africa.

**Gold-silver and gold-platinum ratios –  
Silver, platinum rerating could fade if gold upside narrows**



Source: Bloomberg

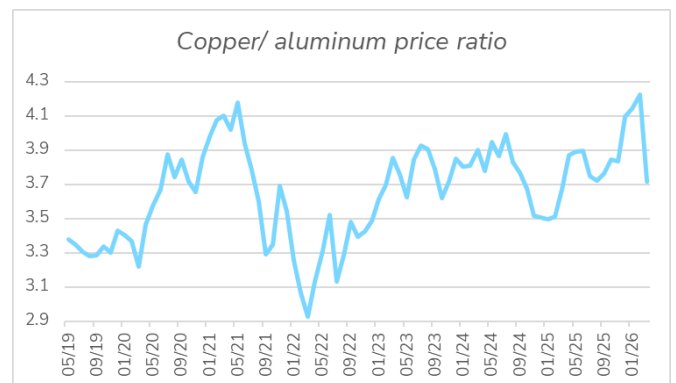
**Oil: is the endgame in sight?**

Developments in the US-Iran war have dominated energy market headlines over the past month. The initial US expectation of a short conflict with limited economic impact has obviously proven too optimistic. Oil and related products' prices have been significantly affected, despite efforts to ease supply concerns. The International Energy Agency announced the largest coordinated release of strategic oil reserves in its history (around 400 mn bbl) and the US allowed the purchase of Russian oil that was already "stranded at sea." However, these measures have failed to stabilise the market. On Wednesday 8 April, the US and Iran have agreed to a two-week ceasefire, with Tehran "committing to the immediate and safe reopening of the Strait of Hormuz". Prospects for a lasting peace agreement remains uncertain, as Washington has received a "10-point proposal" from Iran calling, among others, for the lifting of all US sanctions, the release of frozen Iranian assets, and compensation for war damages. More importantly, the proposal reaffirms Iran's intention to continue its uranium enrichment activities possibly one of the main obstacles to reaching a deal. Even if a final agreement is reached, the longer-than-expected conflict is likely to keep pressure on the energy markets for the next couple of months. Shipping disruptions will not normalise quickly, as a backlog of oil shipments and a shortage of available tankers could slow the return to normal full flows. This situation is further complicated by damage to key energy infrastructure on both sides of the conflict. For the time being, uncertainty remains around whether the 15-day ceasefire will mark the endgame, as Iran's 10-point proposal could prove to be a hurdle in reaching a final agreement.

**Copper and aluminium: resilient despite geopolitical risks**

Most base metals sold off amid concerns that the ongoing Iran war could lead to a broader economic slowdown and weakening demand from China. After reaching an all-time high at the beginning of the year, copper corrected following the outbreak of hostilities, but ultimately proved more resilient than other industrial metals, supported by its strong fundamentals. Its demand growth in recent years has been driven by structural trends such as electrification, grid investments, and data centres build outs and more, rather than from purely cyclical factors not coming from cyclical demand. In fact, the current conflict should even accelerate the shift away from hydrocarbons. As a result, copper demand is expected to remain relatively resilient. Aluminium outperformed the complex, as disruptions in the Middle East have put it under the spotlight. The region accounts for around 8-10% of global production, and many producers had to recently declare force majeure due to gas shortages and the closure of the Strait of Hormuz. This situation, combined to the increased copper-to-aluminium substitution earlier in the year as copper prices reached record highs, has driven inventories even lower.

**A copper-to-aluminium price ratio of above 3.5x since 2023 makes substitution economically compelling**

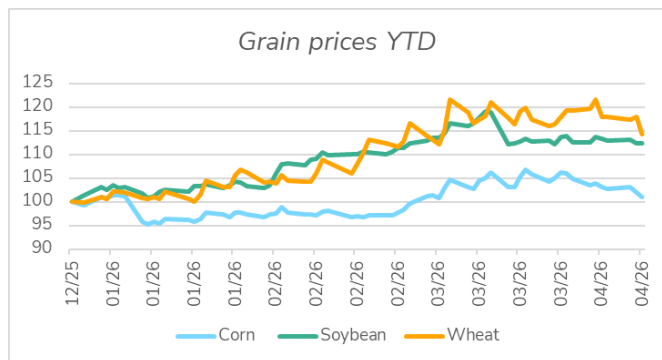


Source: Bloomberg

Overall, both copper and aluminium remain supported by supply constraints and strong energy transition demand.

### Grains: holding firm even as oil prices move lower?

The grain markets moved higher as the closure of the Strait of Hormuz raised concerns over fertiliser supply and energy costs. As a key route for global fertiliser distribution, supply issues supported prices for fertiliser-intensive crops such as wheat and corn. Wheat performed strongly, also supported by weather concerns that could hurt yields and global crop quality. Demand so far has been steady but stronger Middle East buying (the region is a big wheat buyer) could further boost prices. Soybeans followed a similar trend initially, but demand concerns emerged as Chinese buying slowed due to continued trade tensions with the US. Furthermore, the US biofuel policy was not supportive enough as blending targets came in below expectations, limiting future biofuel-related demand. Corn showed a mixed performance due to the deceiving biofuel policy as well; the market expected stronger support for ethanol demand. On the supply side, conditions remain generally favourable, with a large crop expected in Argentina adding to the already large global supply. So far, the situation remains under control. However, should the current peace talks do not lead to a favourable outcome and oil prices continue to rise, higher input costs could increasingly feed through into crop prices.



Source: Bloomberg

### 4. FOREX VIEW

Last December, in our annual 2026 outlook report, we projected a period of relative stability or modest strength for the US dollar in the first quarter, followed by a gradual depreciation against most major currencies. This forecast was embedded in our broader macroeconomic scenario, which we called an “Indian summer.” Just as this term describes warmer-than-expected weather late in the year, economically it reflects a phase where the global and particularly the US economy continues to perform stronger than anticipated toward the end of the cycle (see the macro section for details).

Our prediction of a stronger USD in Q1 2026 proved accurate, though the extent of the appreciation exceeded expectations. We also did not foresee a military escalation in the Middle East, which played a significant role in the market’s dynamics. By the end of March, the Dollar Index (DXY) had risen over 3.5% from mid-February lows, before the onset of military actions against Iran. The DXY represents a weighted average of the USD against major trading partner currencies such as the Euro, Japanese yen, British pound, and Swiss franc.



Source: LSEG Datadream, Bank Syz

The sharp rise of the USD can be attributed primarily to two factors. First, the geopolitical escalation triggered a “flight to safety.” Investors sought refuge in the USD, which remains the world’s largest and most liquid financial market and continues to be widely perceived as a haven. Second, the surge in crude oil prices dropped from roughly \$70 per barrel at the end of February to over \$110 in March, a 60% increase differentially impacted inflation across regions. The US, relatively insulated from higher energy costs compared to the Eurozone, saw its currency strengthen as markets anticipated more pronounced

inflation effects in Europe, weakening the Euro versus the USD. The Swiss franc initially benefited from similar haven flows but lost its gains due to verbal and tangible interventions by the Swiss National Bank.



Source: LSEG Datadream, Bank Syz

Within our FX framework, other indicators such as central bank rate differentials, economic activity surprises, and medium-term government bond yields are currently overshadowed by these two dominant drivers: safe-haven flows and the trade-related impact of energy price shocks. We expect this dominance to persist until the geopolitical tensions ease and energy prices moderate. Our baseline scenario anticipates this moderation in April, with oil prices gradually returning to \$80–\$90 per barrel by May (detailed scenarios are in the macro-outlook section).

If this baseline holds, strong global demand destruction can likely be avoided. The economy may revert to the “Indian summer” trajectory in the second half of 2026, providing a favourable environment for markets that thrive on stability rather than overheating or sharp slowdown. Under this scenario, growth should remain solid while the initial spike in energy prices and inflation “heatwave” gradually cools over summer. Central banks would face limited pressure to intervene, supporting our expectation of a continued slow narrowing of key rate differentials between the US, Eurozone, and Switzerland through H2 2026.

However, if the Indian summer scenario materialises, the USD could face more challenging conditions in the second half of the year. Relative to the Eurozone and Switzerland, US economic recovery may be weaker post-crisis, which should benefit the euro as a cyclical currency and the Swiss franc due to their exposure to European recovery.

Looking further ahead toward year-end, our fundamental view remains that the USD is likely to weaken. Factors include looser US monetary policy relative to the euro and Swiss franc, ongoing political intentions to weaken the dollar, and the persistent twin deficit both budgetary and current account. This would likely widen further following the conflict, especially relative to other regions also affected by higher energy costs.

Finally, the US midterm elections in November 2026 could materially influence the USD. Forecasts suggest a potential “Democratic sweep,” which may reduce investor concerns about Fed independence, institutional stability, and the political drive to weaken the dollar, thereby potentially supporting the USD in the longer term. Yet this effect will likely unfold gradually. For now, the Middle East conflict continues to support the USD, while the eventual easing of tensions should reverse safe-haven flows back to more cyclical, energy-exposed currencies like the euro. Should the conflict extend and inflict long-term damage particularly on energy-dependent economies like the Eurozone, the euro could face prolonged weakness against the USD and Swiss franc. Nevertheless, this is not our baseline scenario.

## 5. ALTERNATIVES

Hedge funds remain a valuable source of diversification within alternatives, particularly in an environment defined by dispersion, idiosyncratic opportunities, and an active event landscape. Strategies such as market neutral, relative value, merger arbitrage, and macro are well positioned to benefit from uneven growth and shifting policy expectations. In this setting, manager selection is key, as the ability to control risk, preserve capital, and adapt to changing market regimes will be the main driver of outcomes.

Private equity remains an important pillar of a diversified investment strategy. We favour high-alpha segments where returns are driven by complexity and operational improvement rather than financial leverage, offering greater downside protection. In particular, we see strong opportunities in European small-cap buyouts, where meaningful value can be created under the right stewardship. This requires a highly selective approach, partnering only with top-tier teams, where access is often limited. By focusing on platform investments, the digital transformation of IT infrastructure, and opportunities in the secondary market, we aim to deliver resilient and attractive returns for our clients in a changing global environment.

Private credit remains a compelling allocation for income and diversification, but the recent noise around redemptions, gating, defaults, and valuation marks underscores the importance of discipline and selectivity. In our view, these developments do not signal a systemic crisis, but rather a stress test of the evergreen model and a nor-

malisation of credit conditions after an extended period of unusually low defaults. We continue to prefer senior secured direct lending, backed by conservative underwriting and meaningful downside protection.

Infrastructure continues to stand out as an appealing source of defensive growth within alternatives, supported

by long-duration assets, visible cash flows, and links to structural themes such as electrification, digitalisation, and transport. The asset class has become more diverse, spanning regulated utilities, communications, energy transition, and digital infrastructure, which makes manager selection and capital discipline increasingly important.

## 6. CURRENT TAA (Tactical Asset Allocation)

The Iran conflict has sparked a significant oil shock, and how long the disruption lasts will be critical in shaping both economic and market outcomes.

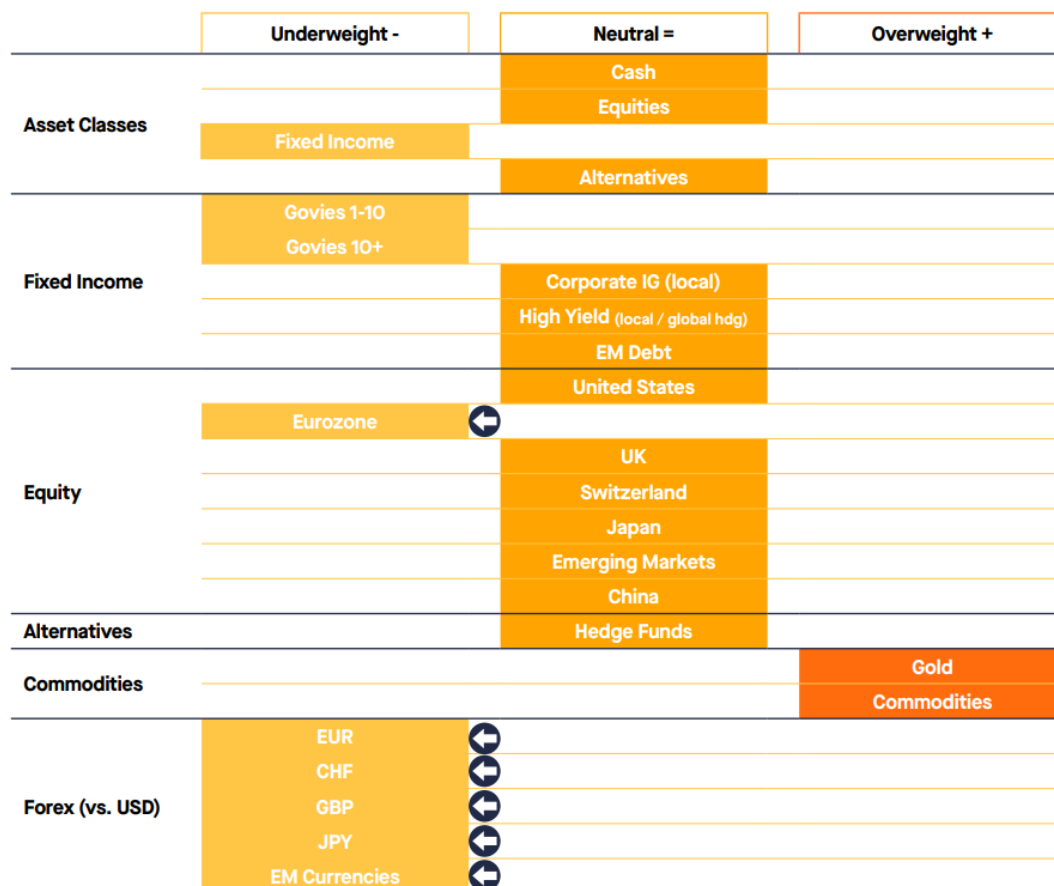
However, this situation is unlikely to mirror the 1970s. Energy represents a smaller portion of consumer spending today, the US is more insulated on the supply side, and the economy overall is less dependent on oil. That being said, the biggest energy importers including the emerging markets and Europe might be more impacted.

Our base case assumes a sharp but temporary (1 to 3 months) increase in oil prices. The impact on economic growth and inflation will depend on the length of the energy shock. In the meantime, the Fed is expected to

remain cautious. Policymakers are likely to look through a one-off, energy-driven inflation spike, though inflation expectations will remain a key factor to watch.

Market volatility may stay elevated, but solid underlying fundamentals should offer some support. If oil prices remain high, energy stocks, US large caps, and technology may prove more resilient. Conversely, if tensions ease, small caps, value stocks, and international equities could take the lead.

Given the high level of uncertainty in the near-term, we are currently neutral equities. We also added some de-correlated trades, the long dollar and additional exposure to commodities.



← → Arrows show our latest TAA moves.



# Private Credit under fire: why the headlines tell only half the story

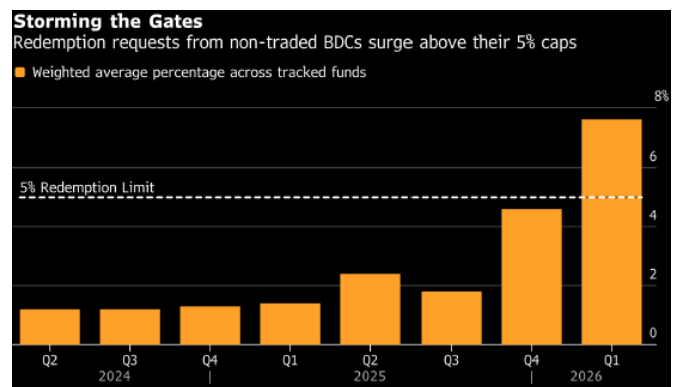


Source: iStockphoto.com/sankai

Redemptions, gates, defaults, AI fears, valuations, the noise around direct lending has never been louder. But a closer look at the data tells a more nuanced story.

If you have followed financial news over the past few weeks, you would be forgiven for thinking private credit is in crisis. BlackRock capped withdrawals from its \$26 billion HPS Corporate Lending Fund after investors demanded nearly double the 5% limit. Blackstone allowed a record 7.9% redemption from BCRED, backstopped by \$400mn of internal capital. Blue Owl halted redemptions from OBDC II and sold \$1.4bn of loans. Cliffwater faced requests reaching 14% of shares, the list goes on and on and is expected to continue in the coming days.

The headlines are real, the anxiety understandable. But the narrative that private credit as an asset class is broken deserves scrutiny. What we are witnessing is not a credit crisis. It is a stress test of the distribution model, and a correction that will ultimately separate disciplined managers from the rest.



Source: Bloomberg

## 1. The liquidity paradox: a distribution problem, not an asset problem

The core tension is structural. Private credit loans are illiquid by design. Yet the industry's biggest growth story has been packaging these assets into non-traded BDCs in the US, UCI Part II SICAVs and ELTIFs in Europe, offering quarterly redemptions typically capped at 5% of NAV. In addition, most of these funds have a soft-lock feature putting emphasis on the longer time horizon of a direct lending investment (a penalty that the investor should pay if he decides to redeem before and agreed period, usually 12 to 18 months). Finally, the quarterly liquidity is always subject to an approval (optional).

As the FT's Robert Armstrong put it, there is no such thing as an investment product being a little bit liquid. At some point in every cycle, investors will want more than the structure can give, and when told "no," their demands only increase.

This is exactly what is happening now. Redemption requests from non-traded BDCs surged past the 5% quarterly threshold in Q1 2026 in many funds.

We hear saying that there is an "illiquidity mismatch" in these direct lending funds, but is that simple? Goldman Sachs's Vivek Bantwal called withdrawal limits "features and not bugs." Apollo's John Zito said BlackRock's gating decision was exactly right, noting these products exist to match fund liquidity to the natural liquidity of assets. In other words, the liquidity in these products is a liquidity option.

Private credit evergreen funds are long-term capital allocation vehicles with limited, conditional liquidity features, they are not money market funds. Therefore, how the liquidity terms are communicated to clients is of utmost importance. Was it the industry that failed to communicate the true nature of these products, or were investors so captivated by the returns that they heard only what they wanted to hear? Most likely, the answer is complicated and should be analysed on a case-by-case basis.

## 2. Shadow defaults and PIK: more noise than signal

One of the most prominent narratives has been the rise of the "shadow" default rate, an umbrella term lumping together PIK interest payments, maturity extensions, covenant waivers, and other amendments. While these can signal borrower stress, they are not defaults. They are tools private lenders use to stabilise businesses and avoid costly bankruptcy proceedings.

StepStone Group's February 2026 paper provides helpful data here. As of December 2025, the shadow default rate for middle-market loans had declined to around 4.5% from a top at 5.72% in Q4 2023. During the same period, the default rate slightly increased. This must be put in context of an unusually low default post Covid environment, where government support program artificially pushed default rates lower.

### Middle Market Default Rate



Source: Stepstone, S&P Global, as of December 2025

PIK provisions have also drawn significant attention, but the picture is more granular. According to S&P Global data, PIK toggles are overwhelmingly concentrated among larger issuers: 44% of borrowers with over \$1 billion in debt have PIK optionality, compared to just 3% below \$350mn. This should be observed in greater context: larger companies can choose to finance through the broadly syndicated loan or high-yield bond markets, where documentation standards are typically more permissive. To remain competitive and justify the higher spreads that direct lending commands, private lenders have increasingly offered targeted flexibility, including PIK toggles, as a way to bridge the gap between what borrowers can get in public markets and what private capital demands in return.

Not all PIK is created equal. A PIK toggle negotiated at origination, so-called "good PIK", is a pricing feature: the borrower secured flexibility upfront, the lender accepted it knowingly in exchange for a wider spread, and it may never be exercised. A PIK imposed through a loan amendment after the borrower can no longer service cash interest, "bad PIK", is a workout concession that increases total debt, defers cash recovery, and typically signals deteriorating fundamentals. The distinction matters enormously when assessing portfolio risk, but it is almost absent from the headlines.

That said, the bear case deserves a hearing. Pimco's Christian Stracke called the current environment a "crisis of really bad underwriting." Partners Group's Steffen Meister warned defaults could double, particularly where lenders are exposed to AI-driven disruption. While AI-related fears have added urgency to the sell-off, UBS projected a worst-case 15% default rate for software-exposed portfolios, a forecast Ares CEO Mike Arougheti publicly called "irresponsible". The reality is that AI disruption will happen but will take time, and senior secured positions with sub-50% LTVs provide meaningful cushion. These are legitimate concerns. But they describe normalisation from exceptionally low post-Covid levels, not systemic distress, and many high-profile defaults involve large-cap syndicated loan borrowers or asset-based structures outside the scope of traditional middle-market direct lending.

### 3. Valuations: imperfect by design

Valuation becomes very important when you give investors a liquidity option. The valuation debate has arguably generated the most heat. Glendon Capital Management publicly questioned Blue Owl's loan marks, alleging funds had underreported losses. Bloomberg detailed how Apollo and FS KKR valued the same Medallia loan at 77 and 91 cents on the dollar respectively, a 14-point gap that has become a poster child for mark-to-model scepticism. In addition, we have seen loans going from 100% to 0% which strongly question the validity of the initial 100% mark.

These are valid criticisms, and the industry must address them with more transparency. But the data does not support the conclusion that private credit valuations are systematically inflated. StepStone's analysis of historical BDC data shows that during periods of financial stress, cumulative markdowns have consistently exceeded realised losses by roughly 1.7 to 2.5 times. In other words, private credit managers have historically been too conservative in their markdowns, not too generous. Is this time different?

The recent sale of Blue Owl OBDC II seems to indicate a mixed picture: it sold \$1.4bn of its portfolio at 99.7 cents which represented roughly 30% of investor capital. This seem to indicate that at least for this part of the portfolio the marks were not disconnected to an actual transaction price. Only the future will tell how the remaining part of the portfolio (deemed riskier) will perform.

As Lincoln's Ron Kahn noted, marks on performing loans are tightly clustered, divergence emerges only when borrower performance deteriorates and lenders reach different conclusions about recovery.

A loan that is marked from 100 to 0 poses other questions as it looks more like a failure of process rather than a failure of credit (unless a case of fraud appears): why weren't the marks adjusted progressively? Was it avoiding triggering redemption anxiety? Or was it genuine analytical disagreement about recovery?

### 4. Private equity interconnection

Private credit is now a \$1.8tr market, deeply intertwined with private equity, which relies on direct lenders to finance leveraged buyouts, refinancings, and add-on acquisitions.

I have heard many commentators describe recent events as the beginning of the end for private credit. But even in a negative scenario coupled with a deteriorating macro environment, the systemic importance of the asset class means there is a high probability that the industry will not collapse as a whole. There is too much capital, too many institutional commitments, and too much structural reliance from private equity sponsors for the asset class to

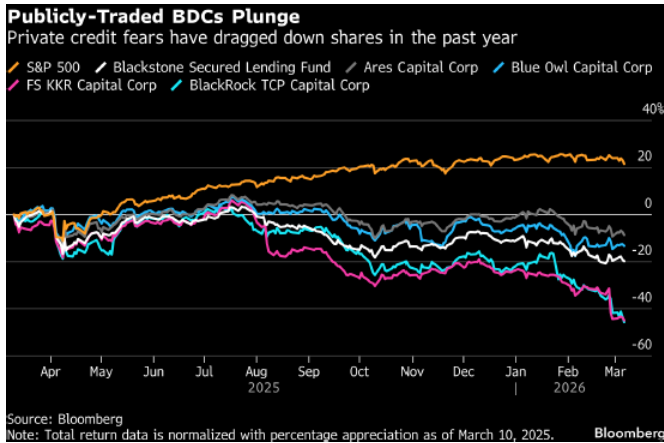
unwind. In addition, more private companies are remaining private for longer, also a strong argument for Private Credit. What can and likely will happen is that weaker managers, those with concentrated portfolios, more aggressive marks, or poor underwriting discipline, will be forced to consolidate or exit. For the survivors, the current events will be an opportunity: thinned competition, wider spreads, and more disciplined deal flow.

Indeed, spread widening in periods of stress is precisely the mechanism through which disciplined lenders get rewarded. Managers with dry powder can deploy into a market where borrowers have fewer alternatives and lenders can demand better terms, tighter documentation, and wider spreads. The best vintages in private credit have historically been assembled during periods of dislocation, not during the competitive frenzy that preceded them.

This dynamic also exposes an underappreciated structural weakness of evergreen fund: when investing in an evergreen structure, you delegate part of the vintage diversification to the fundraising team of the fund. Unlike closed-ended vehicles, which draw on committed capital regardless of market sentiment, and where the LP can decide how to allocate between vintages, evergreen funds are highly dependent on ongoing subscriptions to deploy into new deals. In a year like this one, where gates are being activated and net inflows are turning negative, evergreen funds may find themselves capital-constrained at precisely the moment the opportunity set is most attractive. Closed-ended funds from the same manager, by contrast, can continue to call and deploy committed capital into a dislocated market. The important question this raises is: will we see a meaningful performance gap emerge between evergreen and closed-ended vehicles of the same GP over the coming vintages?

### 5. What public markets are telling us

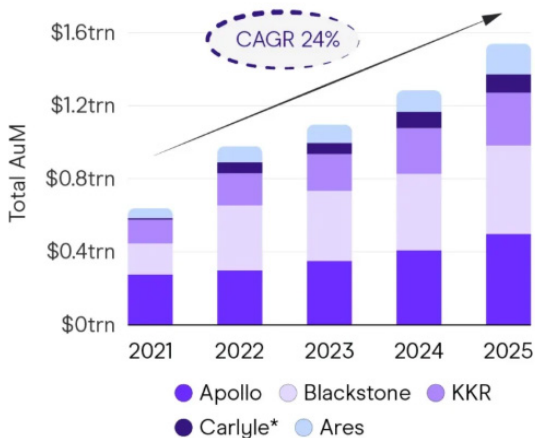
Multiple listed BDCs are trading at or near all-time lows, at steep discounts to reported net asset values. The weakness extends across the sector, but the repricing has not been uniform. Discounts vary significantly from one vehicle to the next, driven by a combination of factors: perceived portfolio quality, sector concentration (software exposure in particular has drawn scrutiny) the proportion of equity and payment-in-kind positions, the mix between pure senior direct lending and broadly syndicated or publicly traded loans, dividend sustainability, and simple liquidity. The BDC universe is far more heterogeneous than the label suggests, and markets are pricing these vehicles accordingly, with discounts ranging from modest to severe depending on how investors assess these overlapping risk dimensions. Technical factors, retail flows, index inclusion, yield-chasing dynamics, further amplify the divergence.



Source: Bloomberg

Blackstone, the world's largest alternative asset manager, is down roughly 30% from its November 2024 highs. It recently touched its lowest level since late 2023, as concerns around private credit redemptions and the evergreen model weighed on sentiment. Private asset manager stocks were priced for years of compounding fee growth, driven by the expansion of private credit into the wealth channel. That narrative, which underpinned much of the sector's re-rating in 2023–24, now appears to be on pause.

### Five largest listed private credit managers, perpetual capital AuM



Source: With Intelligence

None of this is to say public markets are wrong. They may be correctly discounting a deterioration in credit quality that private marks have yet to acknowledge. What we can say is that the signal from listed markets deserves serious attention but should be read for what it is: a reflection of liquidity, positioning, and sentiment, not a real-time audit of underlying portfolio health.

### 6. Looking ahead: a stress test, not a death sentence

If there is a single takeaway for investors, it is this: dispersion across managers is widening, therefore manager selection is now even more important.

The private credit industry is going through its first real test of its evergreen structures. If the fire does not grow too big, which remains our base case, the outcome will be constructive: weaker players will be eliminated, and the industry will emerge with higher standards. The rapid growth of the past five years attracted new entrants, some of which were asset gatherers drawn by high fees rather than firms with genuine underwriting expertise. That distinction is now being laid bare.

The liquidity mismatches, shadow defaults, valuation debates, and gate decisions headlines will continue, and that is a positive for the industry. Greater transparency into portfolios and valuations is likely to become the new normal. In addition, we may even see fee compression as investors demand gets weaker. Private credit has become too important an asset class to disappear, and it will come out of the current fire stronger.

The headlines will persist. But for investors with the discipline to look through the noise, select the right managers, the right structures, protections, and maintain a long-term horizon, private credit remains a compelling proposition in fixed income today.



## The search for a new reserve north star



“Risk free” used to be a number on a government bond curve, today it is also a judgment about politics, sanctions and access. When a G20 central bank can see its reserves frozen overnight and an energy shock can move gold, US Treasuries and Chinese bonds in three different directions, the old definition of safety no longer fits.

### Introduction

In a matter of weeks, the war involving Iran and its neighbours has pushed Brent crude above \$100 per barrel and forced the International Energy Agency to release hundreds of millions of barrels from emergency reserves, an energy shock already compared to the oil crises of the 1970s.

This should have been a defining moment for reserve assets. Instead, gold has fallen around 14% since the start of the conflict, pulling back sharply from its record highs set in January. US Treasuries have struggled to deliver their traditional “flight-to-quality” rally, with 10-year yields holding near 4.4%. Chinese government bonds however have shown relative stability despite the volatility driven by oil and inflation.

## Resilience through crisis

For decades, US Treasuries have stood at the core of official reserves, valued for their depth, liquidity, and enduring safe-haven status. In the post-Bretton Woods era, they became the natural anchor: the US dollar's share of allocated reserves peaked near 71% in 1999 and held above 60% well into the 2010s (IMF COFER). Transparent markets, reliable settlement infrastructure, and the implicit backing of the Federal Reserve cemented their role as the default store of value for central banks focused on capital preservation.

That dominance was first meaningfully tested in early 2020. The pandemic-driven “dash for cash” exposed fragilities within even the deepest markets, as leveraged investors unwound positions and foreign official holders reduced exposure. Liquidity in Treasuries deteriorated sharply, forcing the Federal Reserve to step in with roughly \$1.6tr in purchases to restore market functioning. In contrast, gold delivered positive contributions to diversified reserve portfolios even at modest allocations, while Chinese government bonds (CGBs) remained comparatively stable, supported by limited exposure to dollar funding stress. The episode did not displace Treasuries, but it did challenge the assumption of unconditional liquidity.

The shock of 2022 went further. The freezing of Russia's central bank reserves reframed the risk embedded in dollar- and euro-denominated assets, introducing a new dimension of sovereign vulnerability. Simultaneously, aggressive Fed tightening triggered the sharpest drawdown in long-duration Treasuries since the 1980s, with losses approaching 30% on the long end. Gold, by contrast, remained resilient, supported by record official sector purchases and a rising geopolitical premium. CGBs increasingly entered the conversation as a reserve diversifier, offering positive yields and insulation from sanction risk in a world of near-zero rates elsewhere.

Gold entered 2026 with strong momentum, but that strength quickly reversed as the geopolitical backdrop shifted. Since the escalation of the Iran conflict, the metal has come under pressure, falling sharply despite the very conditions that would typically support it. Prices have declined by double digits since early March, marking one of the weakest performances during a period of heightened global risk.

Renewed tensions in the Middle East did not trigger a traditional flight to gold. Instead, the shock transmitted through energy markets: oil prices surged above \$100 as disruptions in the Strait of Hormuz fed into inflation expectations. Higher inflation, in turn, pushed bond yields and the US dollar higher, raising the opportunity cost of holding non-yielding assets. In that environment, investors rotated toward cash and yield-bearing instruments, with some selling gold after a crowded rally in 2025.

### HISTORICAL PERFORMANCE ANALYSIS OF MAJOR ASSETS

Asset	Post-Covid	Post-Ukraine	Iran War	Since 2012
US Treasuries (TLT)	✗ Poor	✗ Poor	✗ Poor	✗ Real Losses
Chinese Gov't Bonds	✓ Rose	→ Flat	✓ Held	✓ Beat Inflation
Gold	→ Modest	→ Flat	✗ Down 24%	✓ Strong

Source: Gavekal Research

## Different reserve assets, different strengths

No single reserve asset dominates across the core criteria of liquidity, capital preservation, sanction-risk insulation, and crisis behaviour. Each instrument brings a distinct set of structural strengths and weaknesses, creating unavoidable trade-offs for central banks and official reserve managers.

US Treasuries remain the global benchmark for liquidity and financial integration. Their strength extends beyond market depth, anchored in the broader weight of the United States as the leading military, financial, and technological power, supported by strong institutions, rule of law, and its role as a major energy and agricultural producer. Together, these factors sustain confidence in Treasuries as a reserve asset. Yet that dominance is increasingly debated. The growing “weaponisation” of the dollar through sanctions has raised concerns among reserve holders, while rising fiscal deficits, particularly in periods of geopolitical strain, have started to weigh on long-term attractiveness. More subtly, evolving forms of conflict, from cyber to drone warfare, are challenging traditional assumptions about US power projection, feeding into a gradual reassessment of dollar-based assets.



Chinese government bonds offer a different profile. Backed by China's position as the world's industrial and electricity powerhouse, they provide a credible diversification channel and have been among the few major sovereign bonds to outperform US inflation over the past decade. They have also shown relative stability through recent shocks. Still, their role remains constrained. They are often treated as an “emerging” alternative, with broader adoption tied to renminbi internationalisation and deeper financial integration. Geopolitics remains the limiting factor, with persistent tensions capping their potential as a dominant reserve anchor.

A defining feature of their recent appeal has been the widening divergence in interest-rate cycles. Since 2022, US 10-year yields have moved into the 4–5% range as the Federal Reserve tightened policy, while Chinese yields have drifted below 2% amid weaker growth and a more accommodative stance. The resulting gap has reinforced capital flows toward the US, strengthening the dollar and

putting pressure on the renminbi, while highlighting a broader macro divergence between an “overheating” US economy and a “cooling” Chinese one.

### Performance Trend: China and US 10-Year Yields



Source: LSEG | Chan K. S. | Jan. 22, 2025

Source: LSEG Chan K.S

Gold occupies a distinct position as a neutral, non-sovereign store of value. Since the early 2000s, it has been a preferred long-term reserve asset, particularly in environments where interest rates remain below nominal growth conditions that still broadly hold today. Gold offers no credit or counterparty risk and acts as an “anti-fragile” hedge in periods of systemic stress.

This backdrop makes its recent move striking. Since the escalation of the Iran conflict and disruption of the Strait of Hormuz, gold has fallen around 14%, despite conditions that would typically support safe-haven demand. The shock has come through inflation and rates rather than risk aversion: higher oil prices have pushed yields and the dollar higher, raising the opportunity cost of holding gold. Sources of demand have also weakened. Oil-driven disruptions have compressed surpluses in Gulf economies, reducing petrodollar recycling into reserves, while China’s growth slowdown has weighed on reserve accumulation. This reveals a paradox. Gold does not always rise in times of geopolitical stress. It rises when liquidity flows toward it. At the margin, the emergence of CGBs as a credible alternative has also diluted gold’s role as the default diversification asset.



Source: Facset

Crisis behaviour further highlights these differences. Treasuries retain safe-haven characteristics, but episodes such as the 2020 liquidity squeeze and the 2022 inflation shock have shown that returns are not immune to stress. Gold has historically provided stronger diversification in crisis environments, even if recent dynamics have been more nuanced. Chinese government bonds have demonstrated resilience in recent shocks, supported by domestic policy stability, though their track record remains shorter and less tested than that of Treasuries.

### Future strategic positioning

Central banks and sovereign investors do not allocate reserves like traditional asset managers. Their decisions are primarily shaped by governance frameworks that prioritise liquidity and capital preservation over return. Guidelines, often aligned with institutions such as the International Monetary Fund and the Bank for International Settlements, impose strict limits on credit quality (typically AAA or equivalent for the liquidity tranche), duration, and currency exposure. As a result, any change in reserve composition is gradual and institutionally constrained rather than reactive to short-term market movements.

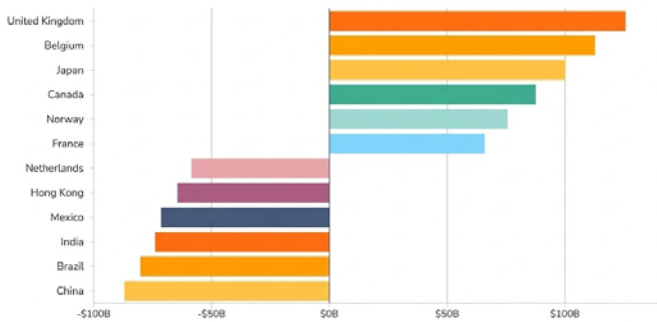
Within this framework, tranching is the central organising principle. Reserve portfolios are typically divided into a liquidity tranche and an investment tranche. The liquidity tranche is designed to meet short-term needs such as currency intervention and is therefore invested in highly liquid, low-risk assets primarily short-term US Treasuries. This explains why Treasuries remain structurally dominant despite recent challenges: their operational role is difficult to replace.

The investment tranche, by contrast, allows for a longer horizon and broader asset universe. It is within this segment that diversification is gradually taking place, including increased exposure to gold and, to a lesser extent, Chinese government bonds. These adjustments can occur without disrupting core liquidity functions, if they remain within predefined risk limits.

Recent developments in China illustrate how these choices are implemented in practice. Since late 2025, Chinese authorities have actively reduced their exposure to US Treasuries, with holdings falling to around \$682bn in November the lowest level since 2008 reflecting a broader diversification strategy. Over a slightly longer horizon, China has cut tens of billions of dollars in Treasury holdings since November while simultaneously increasing gold reserves and encouraging domestic institutions to limit exposure to US debt. This shift does not represent a sudden exit from dollar assets, but a controlled rebalancing within existing governance constraints.

**China has decreased its Treasury holdings by \$86 billion since last November**

Largest increases or decreases in official holdings of US Treasuries (year-over-year)

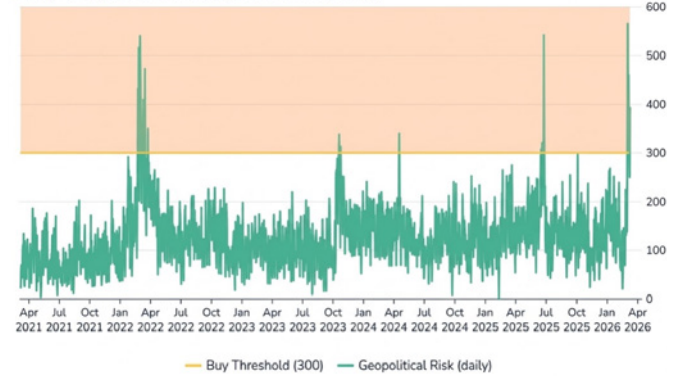


Source: US Treasury • Data shows change from November 2024 to November 2025

Source: US Treasury

Risk tolerance remains a key differentiating factor and varies across different countries. Those with large reserve buffers can accept more volatility and therefore diversify more easily. In contrast, reserve-scarce economies must prioritise liquidity, anchoring their portfolios in Treasuries. Geopolitical risk particularly after the 2022 reserve freeze has become an explicit part of reserve management. Rather than triggering abrupt reallocations, it shapes marginal decisions within existing frameworks.

**Daily Geopolitical Risk Over Time (GPR)**



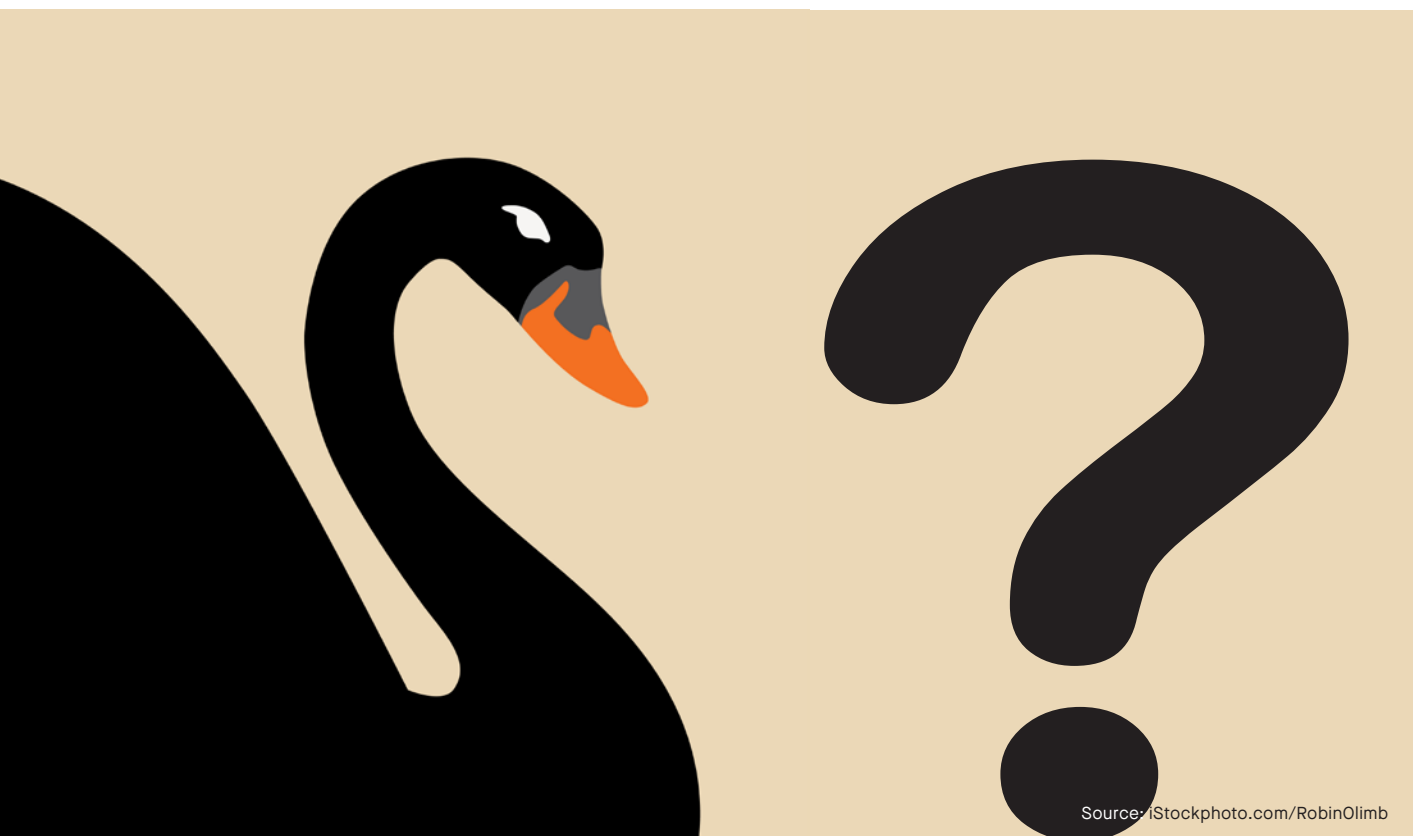
Source: Sentiment Market

**Conclusion**

The 2020s have reshaped what a reserve portfolio looks like. Treasuries, gold, and Chinese government bonds have all provided protection at different moments, but each has also revealed its own set of vulnerabilities, whether in liquidity, valuation, or geopolitical exposure. There is no single asset that is completely safe; each comes with its own mix of liquidity, real-value, and geopolitical risks. Central banks are adjusting at the margin, building portfolios that can hold up across different scenarios rather than relying on a single anchor.



## The next black swan?



Think The Big Short but for AI, JPMorgan just launched the AI Hyperscaler Credit Default Swaps Basket, a one-click trade to short the debt of Alphabet, Amazon, Meta, Microsoft, and Oracle. As these tech giants ramp up borrowing to finance massive data center buildouts, Wall Street is effectively offering the same instrument Michael Burry used in 2008 to bet against credit risk.

### Introduction

JPMorgan has introduced a credit default swap (CDS) basket linked to Alphabet, Amazon, Meta, Microsoft, and Oracle, allowing institutional investors to hedge or speculate on the credit risk of companies funding America's AI infrastructure. Each trade is set in \$25 million increments, with \$5 million allocated to each firm, allowing hedge funds and asset managers to express clear views on their creditworthiness.

This launch comes as s financing needs accelerate sharply. Analysts expect an additional \$100 billion to \$300 billion in AI-related bond issuance in 2026, and total commitments including future data centre leases now exceed \$969 billion. Alphabet even issued a rare 100-year bond in February 2026.

Risk profiles vary across the group. Oracle stands out with a Baa2/BBB rating and \$124 billion in debt, carrying a higher debt-to-enterprise-value ratio than peers, which generally remain below 5%. JPMorgan also highlights potential broader impacts: \$40 billion to \$150 billion in leveraged loans held in collateralised loan obligations (CLOs) could face disruption from AI-driven changes in the software sector.

## 1. The 2008 parallel, where the analogy holds

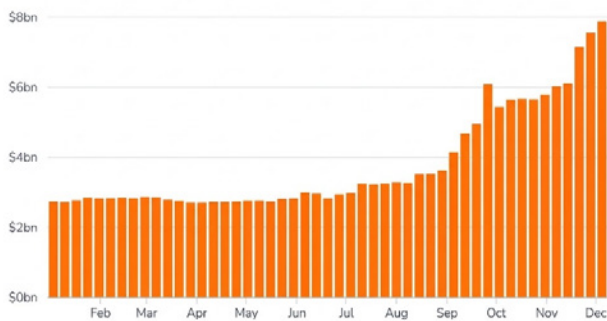
In 2008, a few analysts spotted the US housing market's hidden risk, subprime mortgages were bundled, mislabelled as safe, and sold worldwide. When defaults surged, the system collapsed. The lesson? When everyone believes something is "too big to fail", that's often when danger emerges. Today, artificial intelligence is the new "AAA" a shiny asset attracting massive capital. Venture capital, corporate spending, and infrastructure investment are pouring in, all under the shared belief that AI will transform everything, the returns on data centre infrastructure, GPU capacity, and cloud build-out will justify the capital being deployed, echoing the psychology that fuelled the housing boom.

Just as in 2005-2006, when investors like Burry and Paulson had to build bespoke CDS to bet against subprime mortgages, JPMorgan's ready-made hyperscaler basket signals that taking a bearish view on AI debt is now tradable.

The most obvious parallel is the sudden emergence of a market for credit derivatives on companies once considered almost risk-free. Data from the Depository Trust & Clearing Corporation (DTCC) shows that single-name credit default swaps (CDS) tied to major US tech firms surged 90% between early September and December 2025. A year earlier, CDS on companies like Meta and Alphabet barely traded at all. This rapid market development mirrors the mid-2000s, when mortgage-backed securities went from perceived safety to complex, layered instruments that amplified risk.

### US AI Companies' CDS: Rapid Growth over the Last Year

Weekly net notional outstanding for AI investment forefront companies



Source: Depository Trust & Clearing Corporation

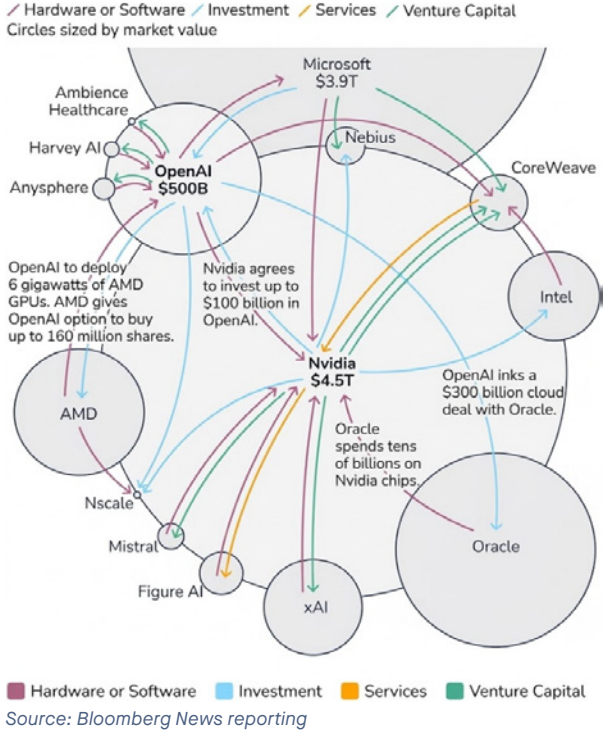
The scale of debt driving this growth is equally remarkable. In autumn 2025, Meta, Amazon, Alphabet, and Oracle collectively raised \$88 billion to fund AI infrastructure. Hyperscalers issued over \$121 billion in US investment-grade bonds in 2025, compared with roughly \$28 billion annually between 2020 and 2024. JPMorgan projects investment-grade tech companies could raise \$1.5 trillion by 2030. Concentrating such large amounts of debt on a single theme, AI infrastructure, echoes the frantic collateralised debt obligations (CDO) issuance of 2005-2007, when capital flowed into one asset class without clear pricing of risk.

JPMorgan's CDS basket highlights concentrated risk, with equal exposure to five companies Alphabet, Amazon, Meta, Microsoft, and Oracle each closely tied to AI investment outcomes. If the AI thesis weakens, there is limited diversification to offset losses, as performance across these firms is likely to move together. This dynamic echoes pre-crisis CDO tranches, where shared exposure to the same housing markets amplified losses.

In 2005-2006, the ABX index made shorting subprime possible, and falling levels triggered bank losses, forced sales, and wider spreads a self-reinforcing loop. In the hyperscaler CDS market, rising spreads could similarly increase borrowing costs for AI capex, challenging ROI assumptions. Narrative momentum amplifies the risk: just as housing relied on the belief that prices could not fall, today's AI boom is driven by expectations of transformative returns, estimated by Goldman Sachs at up to \$20 trillion, which reinforce investor confidence.

Circular financing loops and narrative risk. Tech giants are investing heavily in AI startups, which in turn become major customers for their cloud and chip services. This revenue reinforces the appearance of AI success, attracting further capital and fuelling a self-reinforcing cycle. While profitable today, the loop echoes pre-crisis CDO dynamics, the numbers can look strong until underlying assumptions break down. Narrative momentum also amplifies this effect, as confidence in generative AI's transformative potential drives investment, much like the belief that housing prices could never fall.

**THE AI MONEY MACHINE: Nvidia and OpenAI's Ecosystem Dynamics**



Investors are taking notice. Specialist asset managers note that credit risk, once deemed negligible, now varies by company and warrants hedging. Some acted decisively, Benedict Keim of Altana Wealth shorted Oracle's CDS in October 2025. Oracle's five-year CDS later rose fourfold to roughly 198 basis points, reflecting a repricing reminiscent of early 2007, as sophisticated hedging emerged before the market fully grasped the risks.

**Oracle Credit Default Swaps (CDS) Hit Multi-Decade High**

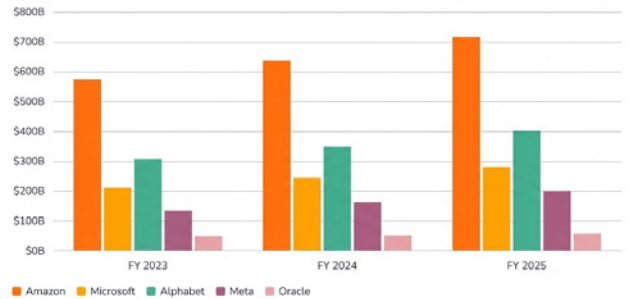


**2. Where the analogy breaks down**

Comparing today's hyperscaler CDS market to the 2008 subprime crisis can be analytically useful, but the differences are substantial and they matter when assessing systemic risk.

Credit quality is far stronger. Unlike the subprime mortgages during the 2008 crisis, which were extended to borrowers with poor credit histories and little documentation, the debt referenced in JPMorgan's CDS basket comes from five of the world's most profitable companies. Alphabet, Microsoft, and Meta generate hundreds of billions in projected cash flow, while even Oracle, the weakest name, is a mature, profitable enterprise with recurring revenue. The probability of an outright default, what would trigger a CDS payout, is far lower than in 2008.

**US Tech Giants: Annual Revenue by Company (USD Billions)**



The regulatory environment today is fundamentally different. After 2008, Dodd-Frank required central clearing for most CDS contracts, dramatically reducing the counterparty chain risk that had allowed AIG's \$440 billion notional exposure to nearly collapse the global financial system. Basel III significantly increased capital requirements, the Volcker Rule limited proprietary risk-taking by banks, and stress testing became routine. These reforms directly addressed the mechanisms that amplified a housing correction into a systemic crisis. Today, counterparty risk in the CDS market is largely contained through central clearing a safeguard that simply didn't exist in 2006.

Transparency is another major difference. Pre-crisis CDOs were notoriously opaque, investors often didn't know which mortgages were in the tranches they owned, and rating agencies assigned AAA ratings based on flawed models. In contrast, the five companies in JPMorgan's basket file detailed quarterly earnings, follow SEC disclosure rules, and are among the most closely monitored corporate borrowers in the world. Investors buying protection on this basket know exactly what they own. The opacity that caused systemic mispricing in 2007 is largely absent today.

Leverage dynamics are also less extreme. In 2008, AIG and a network of shadow banks sold huge amounts of credit protection without sufficient collateral, turning the CDS market into a hidden leverage amplifier. Today, the hyperscaler CDS market, while growing rapidly, is relatively contained. Oracle's CDS alone averages over \$830 million in weekly trades (Bloomberg, March 2026), substantial, but tiny compared with the synthetic CDO structures that nearly brought down the global banking system.

### 3. What the product launch, actually signals

The launch of JPMorgan's AI Hyperscaler CDS basket in early 2026 marks a significant shift in how financial markets are pricing AI-related risk. Historically, AI investments were largely an equity story, reflected in the valuations of technology companies, GPU manufacturers, and data centre operators. The emergence of a standardised credit instrument indicates that AI execution risk is now being systematically incorporated into credit markets, including leveraged loans, CLO tranches, and CDS baskets. This expansion in risk pricing means that if AI monetisation falls short, the impact won't be limited to tech stocks it could spread across the entire capital structure, affecting credit spreads, loan markets, and structured products linked to hyperscalers.

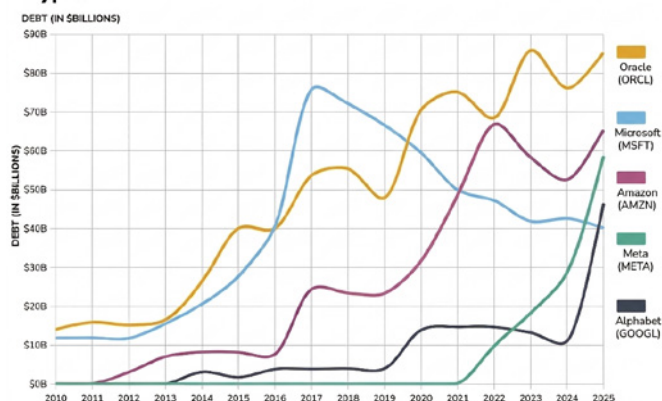
The basket responds to several underlying factors. Hyperscalers, once largely debt-free and funded by cash flows and equity, have become major issuers in the investment-grade bond market, with JPMorgan projecting they could account for roughly 30% of net IG supply in 2026. This concentration creates pressure on spreads and drives genuine institutional demand for hedging instruments. Single-name CDS on companies like Meta and Alphabet were largely illiquid until late 2025, and the basket fills this gap, allowing banks and asset managers with large tech exposures to manage portfolio concentration risk efficiently.

At the same time, the product reflects a growing recognition of real AI credit risk. Massive AI infrastructure spending projected to exceed \$600 billion industry-wide, with hyperscalers alone potentially accounting for \$400 billion creates structural funding gaps that cash flows cannot fully cover. If AI returns fall short due to demand shocks, competitive disruption, or regulatory challenges, these companies' debt-funded expansion becomes vulnerable. The basket acts as insurance against such scenarios rather than signalling imminent default. JPMorgan's scenario analysis assigns a 40% probability to AI success, 45% to a moderated slowdown, and 15% to a systemic shock, demonstrating that even the originator does not view AI as risk-free.

In the end, the AI Hyperscaler CDS basket is not a warning of impending crisis, it is a clear marker of market maturity. Hyperscaler debt now represents a measurable share of major investment-grade indices. A sharp rise in protection demand could therefore trigger index rebalancing and forced selling, pushing up borrowing costs, slowing capital expenditure, and transmitting mild headwinds to broader economic growth. The existence of this liquid, standardised instrument shows that credit markets are now approaching the AI infrastructure boom with rigorous, professional scrutiny. They recognise its immense potential but are equally focused on managing the risks tied to such a capital-intensive cycle. In other words, while the gold rush is still in full swing, sophisticated investors have already started quietly building their exits.



#### Hyperscalers' Debt Evolution



Source: Facset (Long Term Debt)

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