Secular Outlook 2026

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Overview

The days of easy returns are over. A sharp scaling back of fiscal and monetary stimulus, sticky inflation and high initial valuations for both bonds and stocks mean investors will have to work much harder to secure attractive real returns over the coming decade. The options are riskier. Investors will need to diversify beyond the traditional bond/equity portfolio, embrace secular trends like the rise of artificial intelligence (AI), capitalise on stronger growth in emerging markets and exploit currency fluctuations to maximise returns.

Encouragingly, the macroeconomic outlook is moderately positive. We forecast global GDP growth to average 3% per year over the next decade, broadly in line with the past 10 years but still 1 percentage point below pre-2008 crisis levels. Inflation will remain elevated and volatile for much of our forecast period, but will ultimately converge towards central banks' targets.

The boost from adopting and deploying AI should prove material, contributing some 0.3 percentage points to growth each year on average over the next decade. Already, AI-related capital expenditure in the US is running at around 3–5% of GDP, roughly half the level seen during the railway boom of the late 1800s.

The next frontiers in AI – artificial general intelligence (AGI) and humanoid robots – will probably be reached in the next 10 to 15 years. But the AI story could yet be derailed. A political backlash could emerge, fuelled by fears of rising inequality, job displacement, higher energy bills and, potentially, the crossing of social or ethical red lines. That could lead to calls for higher taxation, tighter regulation or some form of nationalisation of AI champions. In fact, if left unchecked, the AI boom could threaten democracy and free-market capitalism.

Because of these concerns, we envisage a controlled, gradual adoption of AI – one that limits job displacement and redistributes AI windfalls through higher taxes on wealth, capital gains and excess profits.

The uplift from AI will be partly offset by the grim reality of public finances and the reduced firepower of central banks across most major economies. With policy stimulus in short

Adopting and deploying AI should contribute

c0.3 PERCENTAGE POINTS

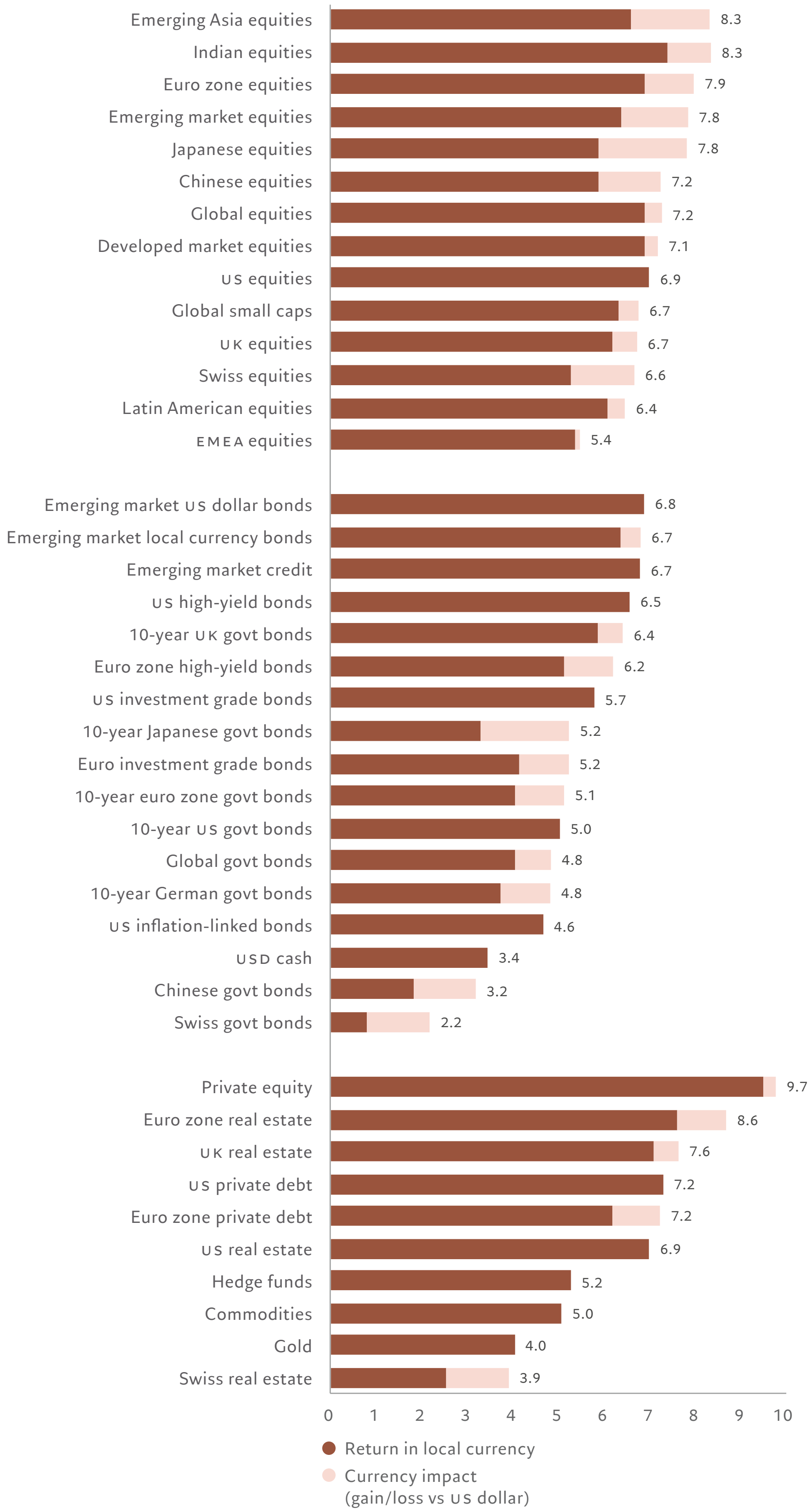
to growth each year on average over the next decade.

Source: Pictet Asset Management

FIGURE 1

Asset class returns, 10-year forecast

%, annualised



Source: LSEG, Bloomberg, Pictet Asset Management.
Forecasts covering period 30.04.2026-30.04.2036.
For forecast assumptions and methodology, see Appendix.

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supply, growth, inflation and monetary cycles are likely to converge worldwide. According to our economic projections, the sick men of the world economy – Europe, Japan and Latin America – will recover somewhat, while the US, though resilient, will grow less than in the previous decade. Meanwhile, China and India will account for more than half of the world's GDP growth.

For investors, this economic backdrop is moderately positive – it augurs well for corporate earnings and equities in particular. But returns are also influenced by initial valuations, and these aren't favourable for most asset classes. Decades of fiscal largesse accommodated by low real rates and boosted by a rise in private savings have generated a liquidity boom, compressing risk premia significantly. While we expect risk premia to remain below historical norms, we see limited scope for further compression, reducing the potential for future outsized market rallies.

We forecast most asset classes to deliver positive – but unspectacular – annual returns in the range of 4–7%. These will look even more modest when adjusted for average global inflation of 2.7% per year.

In equities, potential returns will be capped by already stretched valuations and corporate margins. Global bond markets have regained their footing after a brutal secular bear market in the early 2020s, and nominal returns look set to track their long-term average of around 4% per year. However, much of that will be absorbed by inflation. It will be a similar picture for commodities and hedge funds, with returns likely to fall in the range of 4–6%.

> Global multi-asset investors will need to diversify extensively, make tactical allocations and seek exposure to superior growth themes to achieve an acceptable rate of return.

These uniformly modest returns will be a challenge. Global multi-asset investors will need to diversify extensively, make tactical allocations and seek exposure to superior growth themes to achieve an acceptable rate of return. Our analysis, based on historical correlations and forecast returns, suggests investors should trim global equity exposure, focus on US Treasury Inflation-Protected Securities (TIPS), credit and emerging market debt within fixed income, and keep a significant share of their portfolios in alternative asset classes such as hedge funds, gold and selected private assets. Within equities, we see potential in sectors and regions with strong secular tailwinds, such as tech, industrials, emerging Asia, the euro zone and mid-caps.

The greatest upside surprise would be a sharper-than-expected AI productivity surge, strong inflows from retail investors as part of a new "cult of equity" era and a significant decline in energy costs due to the rapid adoption of new green technologies and advances in nuclear power.

On the downside, leaving aside the unpredictable variable of geopolitical upheaval, the greatest threat comes from the emergence of a left-wing business-unfriendly version of economic populism, which is already gaining traction in several countries. With inequality reaching new highs and the spreading fears of an AI-related job apocalypse, politicians may yield to calls for tighter regulation, redistribution of wealth and capital-based taxation.

> We see potential in sectors and regions with strong secular tailwinds, such as tech, industrials, emerging Asia, the euro zone and mid-caps.

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Trends identified in previous editions of the Secular Outlook gain momentum

We highlight the themes identified in previous Secular Outlooks to assess how they are evolving in practice. We find that these forces are not only persisting but gaining momentum across markets and sectors, reinforcing their relevance for investors.

1. Geopolitical fragmentation

A new, multipolar financial order is emerging – one that is less reliant on the US and the US dollar. In this world, investors should expect a diminished role for the dollar and US Treasuries, whose appeal as risk-free assets will fade.

Changes will also occur in the plumbing of global finance. The US had until recently a near-unassailable monopoly in international payments but now faces intense competition from China, whose own payments system is currently processing some 5% of global cross-border transactions and growing at an annual rate of 20%.

At the same time, the world is embracing "stick-holder" capitalism, which prioritises domestic security over efficiency, leading to the duplication of supply chains and to more debt-financed public spending on defence, IT and energy. All this suggests a recovery in manufacturing, with growth likely to track GDP. It also implies that investors should reduce their US exposure in favour of Europe and Asia, while retaining sizeable investments in gold and industrial metals.

2. Tech supremacy

We expect technology stocks to account for an even greater share of global equity indices, rising from some 40% currently to above 50%. Yet the future winners, following the surge in the share prices of AI enablers and hyperscalers, will be those companies that reap rewards from the adoption of AI. First-mover advantage, after all, has a mixed record in the tech industry.

3. Longevity

The ageing of the world population is accelerating at a much faster pace than assumed just a few years ago, largely due to collapsing birth rates. Over the past two decades, the world's median age has risen by 20% to 32 years, fertility rates have fallen by 15% and life expectancy has increased by 9%. This should create investment opportunities in sectors such as healthcare, robotics, property and infrastructure.

4. Energy upheaval

The green transition is well underway, supported by subsidies and technological advances that have reduced the unit cost of renewable energy. Over the past 10 years, renewable energy costs have halved on a levelised cost basis (LCOE), while the cost of fossil fuels has edged higher. Renewables are gaining market share even in the US, where a record 17% of last year's electricity generation came from wind and solar. We believe this trend will accelerate in the next decade, benefiting industrial and utilities stocks as well as net energy importing regions like Europe.

5. Inequality

A sustained rise in public debt has coincided with a significant increase in private wealth. As this represents a massive transfer of wealth from the public to the private sector, inequality has grown. Testifying to this, wages as a share of US equity market capitalisation are at a record low. To buy the average US stock, a US employee needs to work five times longer than in the 1990s. The post-pandemic inflationary boom has benefited companies at the expense of workers. Since the end of the pandemic, real corporate profits are up 50%, while the proportion of economic output paid out as wages has fallen to a record low. While such inequality is not sustainable in the very long term, we expect it will persist through the next decade. Governments still have some room to delay difficult decisions. Meanwhile, companies will continue to enjoy margins close to record highs thanks to moderate labour costs and dominant market positions. For investors, this means emphasising equities over bonds and holding gold. Currencies of countries with solid public finances, political stability and higher domestic savings, such as the Swiss franc, should appreciate.

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Rebalancing the global economy

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OUR VIEW

Global growth will be in line with the previous 10 years, with regional dispersion: slowing in the US and China, while accelerating in Europe due to significant fiscal expansion.

Inflation will settle close to central bank targets, but higher volatility means higher inflation premia.

AI progress is accelerating and transformative, leading to an annual 0.3% productivity boost and service price disinflation.

Tail risks include economic populism and fiscal dominance, which could lead to central banks losing credibility and public debt surging.

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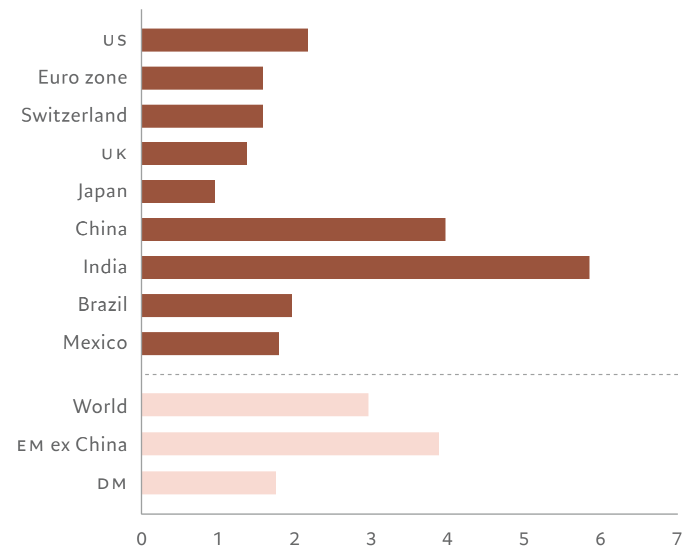
LUCA PAOLINI
Chief Strategist

Rebalancing will be a feature of the global economy over the next 10 years, presenting both opportunities and risks for investors. AI is set to reshape the jobs market and lift productivity, trade flows are likely to change power dynamics across the globe and, within individual countries, a new balance may be found between fiscal and monetary policy.

The risks facing the economy are difficult to ignore: an ageing and less geographically mobile population, limited room for fiscal stimulus, and governments' growing protectionist impulses worldwide. But, in our view, the outlook for the world economy remains relatively positive: we forecast global GDP growth roughly in line with the previous decade, at around 3% per year on average in volume terms.[1]

FIGURE 2
Steady growth
Real GDP growth forecast,
% annual average over 10 years



Source: Pictet Asset Management.
Forecasts covering period 01.01.2026-31.12.2035.

RESILIENCE

Recent history gives us grounds for optimism. One of the positive surprises of the past five to 10 years has been the economy's remarkable resilience in the face of frequent, significant shocks, including the Covid-19

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1 Long-term economic growth forecast via a production function based on total factor productivity, the single most important driver of rising living standards over time, and on the increase in capital and labour, with the latter being proxied by population growth

pandemic, the inflation surge that followed, Russia's invasion of Ukraine, US tariff hikes and, this year, the biggest-ever disruption to global oil supply.

In our view, this underlying strength stems from seven factors, all of which we expect to persist over the medium term:

1. **AI boom:** The world is witnessing perhaps the strongest capital expenditure cycle in history, funded by deep-pocketed tech companies racing for first-mover advantage in a transformative technology.
2. **Wealth creation:** A surge in wealth has left consumers less vulnerable to rising rates and inflation.
3. **Post-pandemic innovation boom:** The pandemic highlighted the efficiency and adaptability of current economic models, reinforcing entrepreneurship and value creation.
4. **"Everlasting policy stimulus" mindset:** While not sustainable, frequent government bailouts have reduced investors' fears of tail risks – or unexpected, outlier developments – encouraging greater risk-taking.
5. **Structural reforms:** Europe is pushing ahead with economic integration, Japan has defeated structural deflation and some emerging market (EM) countries have adopted more pro-growth agendas (Argentina being the poster child).
6. **Resilient global trade:** While globalisation has peaked, the emergence of strong regional trading blocs will continue to boost trade. The tariff shock was real: the US effective tariff rate is now 13.5% versus 2.5% in 2024. But, largely thanks to a lack of retaliation (the worldwide effective tariffs on US imports are still only 3.5% and ex-US tariffs have been cut), trade has been reoriented rather than destroyed. Trade volumes rose by 5.1% in 2025, driven by services and digital sectors, and the International Monetary Fund (IMF) forecasts a further 2.8% increase this year.
7. **Lower leverage:** The private sector has learned from the global financial crisis. Leverage is very low by historical standards, which could serve as a buffer in the event of economic stress.

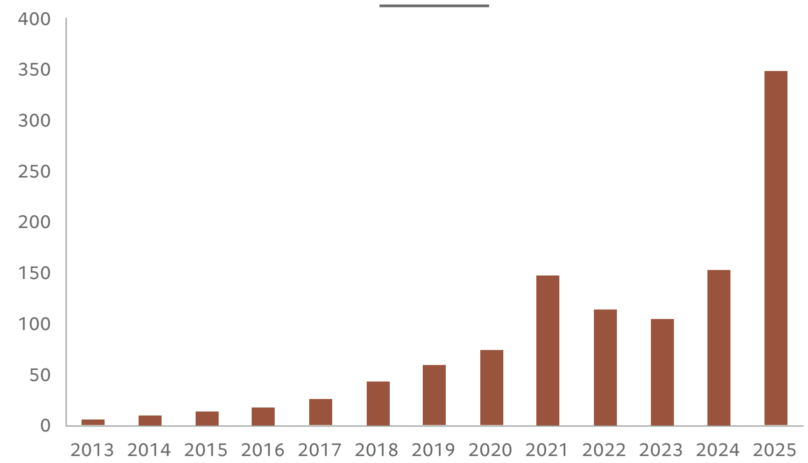
AI TRANSFORMATION

Of these factors, we believe that AI is a truly transformative force for the global economy, set to shift the balance in the jobs market, productivity and inflation. In 2025, global private investment in AI more than doubled to USD 344.7 billion.

FIGURE 3

AI boom

Global private investment in AI,
2013-2025, USD billion



Source: Quid, AI Index Report.
Data covering period 01.01.2013-31.12.2025.

Generative AI is gaining traction faster than the personal computer or the internet ever did. We expect the rapid adoption of AI among companies and consumers to translate into roughly a 0.3% annual boost to total factor productivity growth, adding around 3% to developed world GDP over 10 years.

Productivity gains from AI are greatest in structured, measurable work tasks where outputs are easy to monitor. Studies report gains of 14–15% in customer support, 26% in software development and 50% in marketing output.[2]

We believe the impact of AI on economies will be proportional to their service share of total employment, which gives developed countries with advanced service industries a clear advantage over their emerging market rivals. A quarter of service sector jobs may be displaced but, in our view, this is unlikely to lead to a material increase in unemployment or a decline in working hours. We expect jobs to be replaced by new ones with limited net effects, repeating the experience of past technological breakthroughs.

INFLATION OFFSET

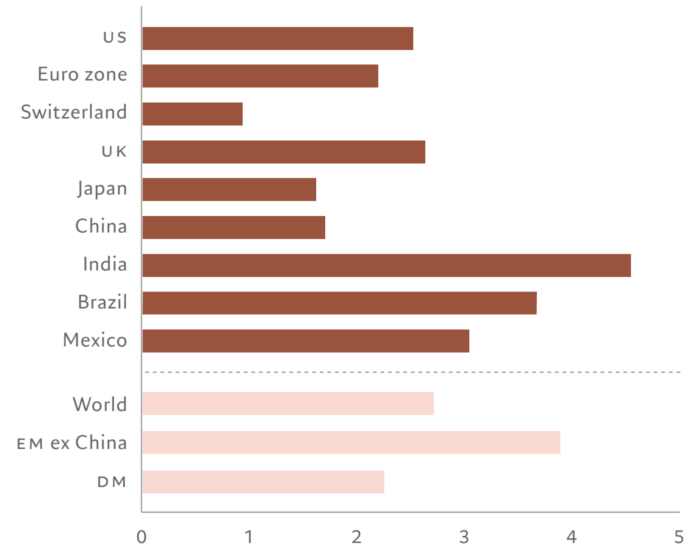
AI's disinflationary impact will also probably be most felt in service industries, largely through greater competition in the jobs market. As a result, the gap between services and goods inflation should narrow to multidecade lows in most developed countries, and overall inflation rates should largely return to pre-pandemic levels in the next 10 years.

2 AI Index Report 2026

However, we do not expect inflation to decline beyond that, as downward price pressures from AI are likely to be partly offset by the inflationary effects of rising trade protectionism, ageing populations and some "passive" fiscal tightening.

Our basic assumption is that while prices will be more volatile and cyclical, most central banks will meet their existing inflation targets.

FIGURE 4
Prices rising
CPI inflation forecast,
% annual average over 2026-2035



Source: Pictet Asset Management.
Forecasts covering period 01.01.2026-31.12.2035.

The major exception will be the US, where our forecast of an average annual inflation rate of 2.5% over the next decade implies that the US Federal Reserve will have missed its 2% target for 15 years. That is the longest losing streak of any major central bank. Some impact on financial markets will be inevitable, but we expect it to be limited as our forecast is not far off current implied inflation in fixed income markets.

SLOWER SPEED FOR US

Our favoured way to gauge the outlook for world growth is to compare trend growth with trend inflation – the "cruise speed" of economies. Over the very long run, in developed economies at least, this ratio has fluctuated around parity, and we expect it to remain there for the next 10 years. However, some countries should fare better than others, shifting the balance of power from the previous decade.

Overall, Switzerland and emerging Asia score the best in our forecasts.

In contrast, the US ranks below average, suggesting its growth potential may be overestimated. This largely reflects how, since the financial crisis of 2008, the US economy has been propped up by an unsustainable rise in government borrowing: US sovereign debt has doubled to 100% of GDP since 2009. While we do not think the US is heading towards financial Armageddon, we believe some kind of fiscal discipline will be forced upon its government – either domestically via higher inflation and rates, or externally via a notable increase in risk premia demanded by foreign lenders. This would put a significant constraint on US growth over the next decade.

China, too, has witnessed the doubling of public debt in recent years, compounded by a decline in its working population. We now estimate its trend growth at 3.7–4%, which is less than half the pace it achieved in the previous half-century. Nonetheless, massive investment in R&D, green tech and digital infrastructure should help China continue to move up the value chain, consolidating its leadership in advanced industries such as electric vehicles, batteries, renewable energy, 5G, high-speed rail, commercial drones and biotech.

In effect, China has become "the factory to the factories" and its geopolitical clout is set to increase at the expense of an increasingly insular US. The reward will be a much larger role for the renminbi in the global monetary system. Given our growth forecasts and the expected real appreciation of the renminbi, we estimate that China's nominal GDP gap with the US could narrow to almost zero by 2036 in dollar terms.

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Europe's potential

From Europe, we expect a positive growth surprise. Despite mounting geopolitical and economic challenges (trade conflict with the US, industrial hollow-out due to Chinese competition and military threat from Russia), the potential for self-help is immense. Europe can:

Streamline intra-regional trade
While direct tariffs do not exist within the EU, non-tariff regulatory frictions act as hidden barriers, equivalent to a levy of some 44% on goods and 110% on services for internal trade.[3] These high costs stem from fragmented national regulations, which reduce competitiveness and crimp growth.

Encourage retail investment in equities
Only 10–15% of euro area households hold equities versus 55% in the US. A mobilisation of savings towards riskier investment would spur economic growth and could be achieved with fiscal incentives, e.g. de-taxation of capital gains on EU equities.

Deepen financial integration
A fully operational capital markets union has been in the works for over a decade but is yet to materialise. There is still no euro zone-wide deposit insurance scheme, while joint bond issuance is limited in size and scope. At approximately EUR 700 billion, joint EU bonds issued by the European Commission account for only about 5% of the region's sovereign debt market. We think that the EU will slowly but surely progress towards greater integration over the next decade.

Boost fiscal spending
Europe has already moved away from the dogma of fiscal rectitude, with Germany announcing a de facto suspension of the debt brake, opening the door to potentially unlimited and debt-financed investment in infrastructure and military equipment. Our economists estimate that euro area GDP could get a 4% boost over the next 10 years from the combined impact of Germany's investment plans, a step-up in defence spending to 4.5% of GDP by 2029, remaining investments under the NextGenerationEU (NGEU) scheme and EU participation in Ukraine's post-war reconstruction.[4]

The risk is that another existential crisis may be needed to trigger the necessary changes. We remain optimistic over the long run, but the journey will not be smooth.

To read more about European reform, please see our paper: Europe's economic comeback, published in 2025 on am.pictet.

3 https://www.imf.org/en/news/articles/2024/12/15/sp121624-europes-choice-policies-for-growth-and-resilience
4 https://am.pictet.com/ch/en/institutions/investment-research/european-equity-and-private-asset-markets

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MAIN RISKS TO OUR OUTLOOK

Long-term economic expansion depends critically on a market and regulatory environment that is both reliable and pro-growth, so the rise of economic populism is a key concern. With inequality extremely high and voters fretting about the cost of living crisis, a shift to more left-wing, anti-business politics cannot be ruled out.

Then there is the risk of the AI boom turning to bust: a regulatory backlash, higher energy costs or ethical concerns could slow down investment, or companies could simply overinvest and go out of business.

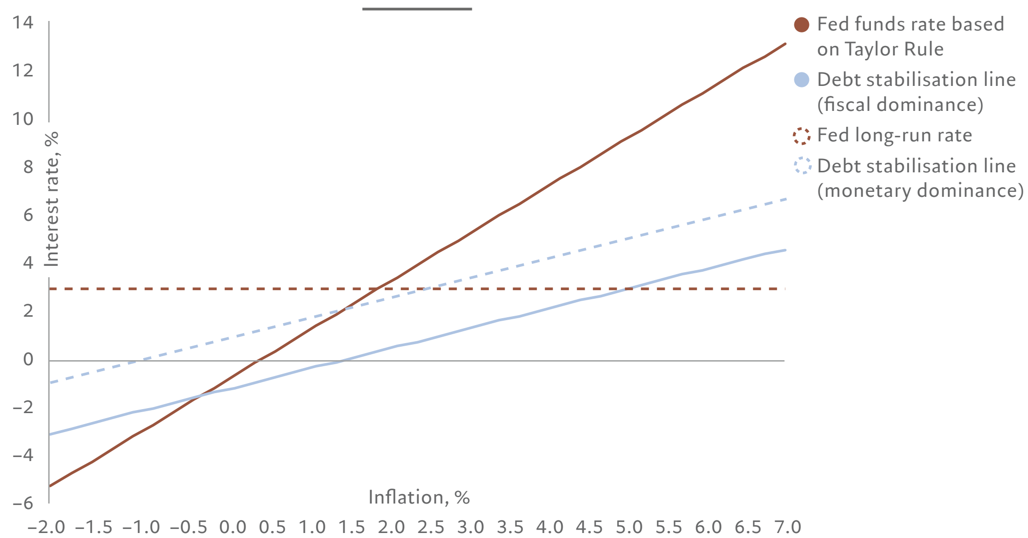
However, the biggest risk for us is the emergence of fiscal dominance. Governments unable to rein in spending to please an angry electorate may be tempted to force central banks to accommodate higher fiscal deficits via unsustainable lower interest rates.

The risk is higher in the US, where the fiscal maths looks particularly challenging and President Donald Trump has already openly asked the Fed to cut rates to 1%. A shift to fiscal dominance would take US inflation from our baseline of 2.5% up to 4%, even allowing for some modest additional fiscal easing.

FIGURE 5

Battle for dominance

US inflation and Fed fund rates required to achieve fiscal stability and monetary objectives under selected scenarios



Source: LSEG, Pictet Asset Management.
Data covering period 15.03.1985-12.03.2025.

More plausibly, a new equilibrium will emerge over the next decade: interest rates a bit lower than indicated by the Taylor Rule, slightly above-target inflation and some modest, passive fiscal tightening. Debt-to-GDP ratios will continue rising but at a slower pace. The major risk for investors will be the de-anchoring of long-term inflation expectations, rather than the bursting of an AI bubble.

2

The structural sources of asset classes' total return

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OUR VIEW

Certain structural factors have a strong influence on asset class returns over periods of 10 years or more. Our regression analysis shows that stocks' initial valuations, the ratio of GDP growth to inflation, and the gap between bond yields and nominal GDP account for more than 80% of the 10-year return on US equities.

Government bonds, meanwhile, can reasonably be expected to generate a return that is largely in line with the security's initial yield. Still, the actual return can differ from the initial yield for a number of reasons: the income originating from reinvested coupons and the gains or losses arising from the regular rebalancing of bond indices can both affect the final return.

Inflation is among the economic variables that have the strongest influence on currencies. But its impact is often misunderstood: higher inflation does not always signal currency depreciation.

LUCA PAOLINI
Chief Strategist

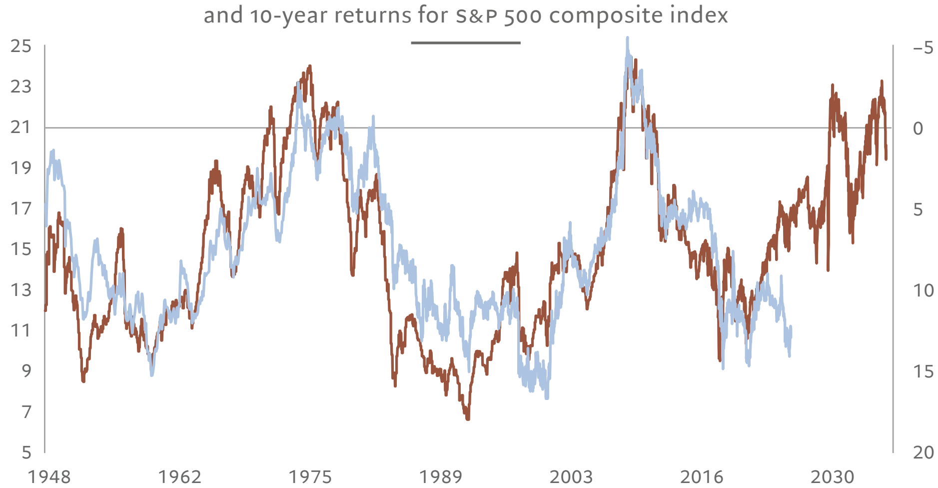
This year, we are extending our secular forecasting horizon from five to 10 years – with the aim of reducing the impact of cyclical factors on our estimates.

In this chapter, we focus on what drives returns over long investment horizons. Specifically:

- we analyse the performance of all the major asset classes across different time horizons;
- we illustrate how the drivers of performance change with the investment horizon;
- we find that, as a general rule, for investment horizons of 10 years or longer, the main factors determining performance are initial valuations and mean/trend reversion.

Looking at US equity returns over the past 75 years, a clear picture emerges. With very few exceptions – and exhibiting a high R^2 of 0.7 – the initial price-to-earnings (P/E) ratio has proved to be an accurate predictor of a stock's return on a 10-year view. Put differently, the 12-month forward earnings yield is a good indicator of future returns.

FIGURE 6
Initial valuations matter
Shiller price-to-earnings ratio
and 10-year returns for S&P 500 composite index



● S&P composite index, P/E ratio (10-year lead)
● S&P composite index, % price return p.a. over 10 years (RHS)

Source: LSEG, IBES, Robert Shiller, Pictet Asset Management.
Based on Shiller's CAPE until 1985 and on 12-month forward P/E after.
Data covering period 13.04.1948-14.04.2026.

The accuracy of the 10-year forecast is further improved by enhancing the framework with two additional variables. The first is the pace of economic growth, which is a reliable proxy for corporate earnings growth. The second is financial conditions, captured by the gap between a country's nominal GDP growth rate and its

10-year government bond yield – where a wider gap signals a more accommodative monetary regime, and vice versa.

Our regression analysis shows that, taken together, stocks' initial valuations, the ratio of GDP growth to inflation, and the gap between bond yields and nominal GDP account for 83% of the 10-year return on US equities. The actual return falls within a range of ±3% of the model return with a probability of 90%, representing a 60% improvement on a random walk forecast.

This means if stocks' initial valuations sit below their long-term mean, GDP growth is accelerating and monetary policy remains accommodative, equities should deliver above-average returns across a 10-year period.

Dividends also have a significant part to play. While they don't explain the variance in equity returns – primarily because they tend to rise steadily and in line with inflation – they still constitute roughly 20% of stock returns over the past 20 years and about 40% over the last century. We believe dividends' contribution to total equity returns over the next 10 years will be higher than average.

Our regression analysis shows that, taken together, stocks' initial valuations, the ratio of GDP growth to inflation, and the gap between bond yields and nominal GDP account for 83% of the 10-year return on US equities.

The model presented here forecasts an annualised return of some 6% on a 10-year view for stocks in the MSCI World Index. The returns projected by this model, however, may deviate slightly from those presented in section 2 of this report, which draw on a more granular set of data and input variables.

Beyond these broad return forecasts, the model doesn't indicate which equity investment style will dominate over the next 10 years. This sits at odds with academic literature, including the UBS Yearbook, which points to the long-term outperformance of value, low volatility, momentum and small-cap stocks. When it comes to industry sectors, our analysis suggests equity market leadership shifts from one sector to another within a given decade.

BOND RETURNS

For investment horizons equal to the maturity of a bond, bonds can reasonably be expected to generate a return that is largely in line with the security's initial yield.

But the actual return can differ from the initial yield for a number of reasons: the income originating from re-invested coupons and the gains or losses arising from the regular rebalancing of bond indices can both affect the final return.

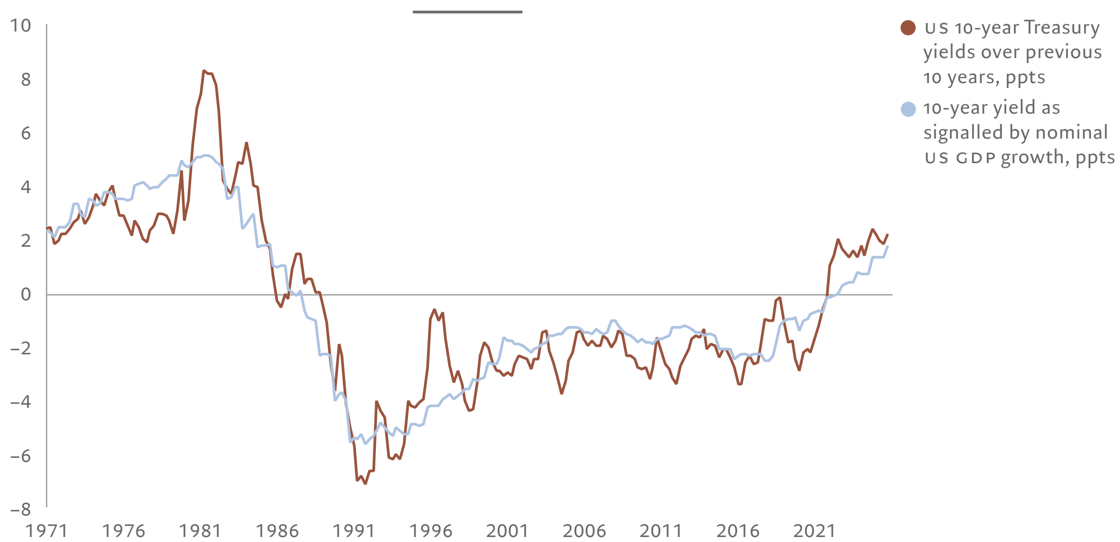
We find that, on average, the actual 10-year total return of a 10-year US Treasury bond fluctuates within a ±1% range from the initial yield. Our calculations also show there is 90% probability that the return will be ±1.5% relative to current yield. This may look immaterial at first glance, but the compounding effect is significant whenever initial bond yields are low.

The deviation of the actual return from the initial yield is largely explained by a change in the growth rate of nominal GDP, which acts as the valuation anchor for bond yields and aligns with the assumptions of the Solow/Phelps growth model.

FIGURE 7

Slower growth signals lower yields

Actual change in 10-year US Treasury yields versus change signalled by nominal GDP growth, ppts



Source: LSEG, Pictet Asset Management.
Data covering period 15.04.1971-15.04.2026.

If the difference between the final expected bond yield and the initial yield is taken into account, the model's return forecast error over the 10-year period is reduced by some 20–25%, while the R^2 increases to 0.95.

Over the long term, inflation has a greater influence on bond yields than economic growth. By using a combination of real GDP (weighted at 33% in our model) and inflation (weighted at 67%) rather than nominal GDP in our regression, we find a meaningful improvement in the model's forecast accuracy.

None of this is to ignore the effects of changes in the health of public finances on bond returns. This is especially relevant for the US.

The country's fiscal position is the most challenging it has been in decades, raising the risk of fiscal dominance – whereby policymakers prioritise debt sustainability over inflation control. This is the main reason we expect longer duration US Treasuries to carry a higher term premium in the years ahead and explains why we see yields moving above the levels our model would suggest.

When it comes to forecasting the returns of corporate bonds, the initial yield is a much less reliable indicator.

> Inflation is among the economic variables that have the strongest influence on currencies. But its impact is often misunderstood: higher inflation does not always signal currency depreciation.

This is particularly true for high-yield bonds, largely because they are more likely to suffer defaults.

For these bonds, we find the most accurate forecast of future returns is a weighted average of equity and government bond returns (weighted at 0.3 and 0.7, respectively), adjusted for the initial level of high-yield debt spreads. The R^2 using this method is close to 0.65.

DEEP DIVE

Returns over shorter time frames – what matters?

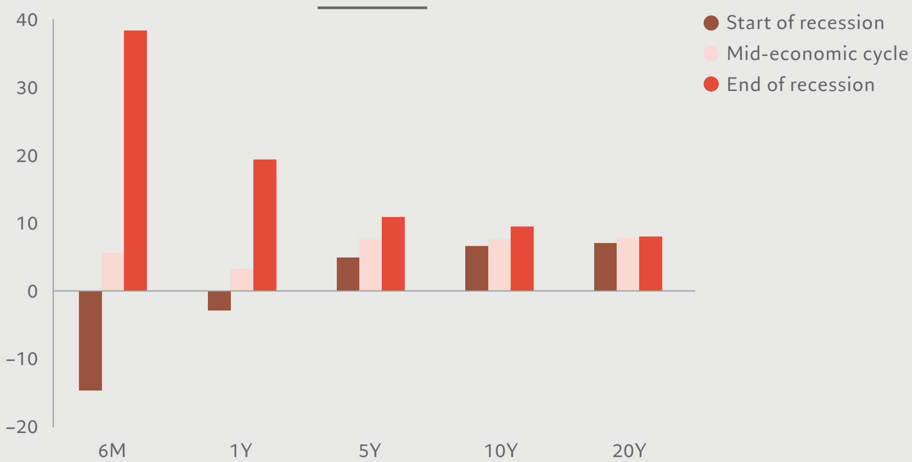
Interestingly, when the investment horizon is shortened to, say, five years or fewer, cyclical factors have a much greater bearing on bond and equity returns. US GDP growth and inflation rates have an especially strong effect. We find that the acceleration in US real economic growth alone accounts for some 70% of the total return of world equities. We get similar results for government bonds using nominal rather than real economic growth acceleration. Over shorter time horizons, the business cycle always matters: as the economy moves from recovery to expansion to recession, equities trace what is known as the smile performance pattern. They outperform other asset classes both at the start and the end of a cycle. Even on a 10-year horizon, the business cycle cannot be totally ignored by investors as stocks can deliver some 1.5 percentage points more if the investment is timed towards the end of a recession rather than at the beginning.

Over the very short term (one year), stock returns are heavily influenced by unexpected changes in corporate earnings forecasts. For example, a surprise 10% reduction in a company's earnings growth versus the consensus tends to generate negative returns. For bond returns over a one-year period, interest rate expectations are key. Here, the general rule is that for every 100 basis points overshoot in official interest rates relative to the consensus forecast, yields on 10-year government bonds tend to rise by the same amount.

FIGURE 8

Timing matters

Annualised median S&P 500 price performance, based on when investment was made in the business cycle, %



Source: LSEG, Bloomberg, NBER, Pictet Asset Management. Recession dates based on NBER data; mid-economic cycle refers to the chronological mid-point between the end of one recession and the start of the next one. Data covering period 03.01.1928-27.02.2026.

CURRENCY COMPLICATIONS

Currency movements are generally considered to be particularly difficult to forecast. That said, basic valuation indicators are reliable and currencies show a strong tendency to revert to their mean levels. Inflation is among the economic variables that have the strongest influence on currencies. But its impact is often misunderstood – higher inflation does not always signal currency depreciation.

In the short term, higher inflation tends to push up expected domestic interest rates. This, in turn, bolsters the carry or yield of currency, typically supporting near-term appreciation. But over the long term, higher inflation erodes the real value of a currency – leading to its depreciation. This is why the purchasing power parity (PPP) of a currency is a reliable valuation gauge over the long term.

Among free-floating currencies, the ratio of GDP growth to inflation is a reliable gauge of a currency's trajectory. Real GDP growth is a good proxy for the demand for a currency (via higher carry and transaction demand) while inflation is a good proxy for the supply of a currency (excess money fuels inflation).

Broadly speaking, low inflation, strong GDP growth, sound economic policy (in the form of low current account and public sector deficits) and political stability tend to support currency appreciation. These explain the strength behind currencies such as the Swiss franc, the Polish zloty, the Israeli shekel and the Singapore dollar.

Although many currencies exhibit strong long-term upward or downward trends, the dollar's distinguishing feature is that it moves through protracted periods of appreciation and depreciation over five to 10 years, both on a trade-weighted and a real effective exchange rate basis. All of this makes the timing of a portfolio's dollar exposure a material consideration.

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COMMODITIES AND REGIMES

Long-duration assets such as gold, commodities and, potentially, cryptocurrencies such as bitcoin tend to be heavily influenced by structural factors and long cycles.

Commodities are generally characterised by super cycles and long-lasting downturns. While the trajectory of the dollar and global economic growth are good predictors of commodity returns over the medium to short term, mean reversion holds sway over the long term. This shouldn't be surprising, as mean reversion reflects the time lag between the discovery of a mineral deposit and the establishment of extraction and production facilities.

THE GEOPOLITICAL CONUNDRUM

A final issue remains: how to account for an increasingly fragmented and volatile geopolitical environment.

Geopolitical trends are difficult to incorporate into asset return forecast models. Recent experience suggests that even dramatic geopolitical events – whether the Ukraine war, sudden US import tariff increases or the Iran conflict – do not significantly alter already well-established macroeconomic trends. In our view, the only geopolitical development of significant long-term economic and financial impact was the Yom Kippur War of 1973, which transformed the economic environment,

"Geopolitical trends are difficult to incorporate into asset return forecast models. Recent experience suggests that even dramatic geopolitical events – whether the Ukraine war, sudden US import tariff increases or the Iran conflict – do not significantly alter already well-established macroeconomic trends."

LUCA PAOLINI
Chief Strategist
Pictet Asset Management

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ending a period of high growth and low inflation and ushering in one characterised by decade-long stagflation. Geopolitical risks and trends are therefore better addressed by using scenario analysis, where the focus falls on risk mitigation rather than forecasting asset class returns.

TABLE 1
Performance drivers of major asset classes: short, medium and long term

	KEY DRIVERS		
	SHORT TERM (SURPRISES VERSUS CONSENSUS)	MEDIUM TERM (ECONOMIC CYCLE & FUNDAMENTALS)	LONG TERM (TREND/VALUATION/ REGIME CHANGES)
	← 1 YEAR →	← 5 YEARS →	← 10 YEARS + →
EQUITIES	Earnings revisions	Business cycle & valuation	Growth/inflation mix & valuation
GOVERNMENT BONDS	Rate expectations/ economic surprises	Nominal GDP & valuation	Initial yield and change in yield
CORPORATE BONDS	Credit rating & risk appetite	Nominal GDP & initial spread	Initial yield and change in spread
CURRENCIES	Interest rate expectations	GDP/inflation and mean reversion	Inflation, productivity, external balance
GOLD	US dollar & uncertainty	US dollar, inflation, interest rates	US dollar and inflation
COMMODITIES	US dollar & global growth	US dollar, global growth & supply	US dollar & mean reversion
EMERGING MARKETS	US dollar	US dollar, growth & inflation	Economic policy & terms of trade

Source: Pictet Asset Management.

3

Emerging market equities: reversal of fortune?

OUR VIEW

Returns from emerging market stocks have not been commensurate with the developing world's healthy levels of economic growth.

We find that governance failings, poorly devised regulations, earnings dilution and structural flaws in index design are largely to blame.

There is, however, evidence to suggest that at least some of those factors might be less of a restraining force in future. The implication for investors is not to abandon emerging markets but to allocate capital with greater precision to those sectors where economic growth converts more reliably into earnings growth for listed companies.

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ARUN SAI
Senior Multi Asset Strategist

Emerging market (EM) equities boast a compelling, if well-worn, investment narrative: abundant growth, cheap currencies and attractive valuations.

Yet investor returns have been underwhelming, to say the least.

True, if the investment horizon is extended back to a period before modern benchmarks were established, the numbers are positive. Since 1960, the annualised return of EM equity markets in US dollar terms has been 10.9%, exceeding the 9.6% yearly return generated by developed markets.

But few investors will have benefited from that performance.

Shorten the time horizon to the past 20 years and the picture changes sharply: EM equities have merely matched the returns of developed markets, excluding the US, despite strong GDP growth and significant socio-economic advances over the period.

Perhaps the most striking disappointment is China. Chinese equities have delivered an annualised total return of just 4%, only marginally outperforming the local bond market.[5]

Given the growing economic weight of the emerging world, it is important to understand why EM equities have lagged. Our analysis identifies several factors that have prevented superior GDP growth from translating into superior investment returns. Just as importantly, however, the evidence suggests these same factors are now weakening.

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The implication for investors is not to abandon emerging markets, but to allocate capital with greater precision to those sectors where economic growth converts more reliably into earnings growth for listed companies.

5 See UBS Global Investment Returns Yearbook 2026

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THE EARNINGS CONUNDRUM: GROWTH WITHOUT RETURNS – AND WHAT INVESTORS CAN DO

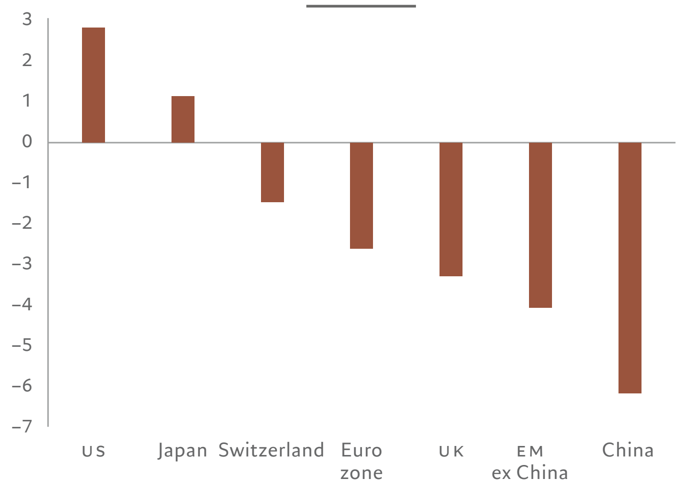
In the developed world – particularly in the US – GDP growth broadly feeds through into corporate revenues and profitability. That has not been the case in emerging markets.

Over the past 15 years, corporate revenue growth in China has trailed adjusted nominal GDP growth by around 6 percentage points. Across the rest of the emerging world, the picture is little better, with an aggregate shortfall of around 4 percentage points. By contrast, in the US, the increase in earnings per share has exceeded nominal GDP growth by roughly 3 percentage points per year.[6]

FIGURE 9

Disappointment, quantified

Earnings growth less nominal GDP growth, % over last 20 years



Source: MSCI, IBES, LSEG, Pictet Asset Management.
GDP measured as composite global nominal GDP weighted according to each market's revenue exposure. Data covering period 01.05.2006-01.05.2026.

There are four factors to blame for this transmission failure. The first two – weaker governance and structural reform shocks – are interlinked and together account for most of the performance lag. Both are common features of developing capital markets, though their intensity varies by country. The latter two factors – EPS dilution and a mismatch between equity index composition and the structure of the underlying economy – add to the damage.

6 Figures based on a global composite index that calculates sources of revenue for each company represented in the relevant equity benchmark

THE INSTITUTIONAL DRAG: GOVERNANCE AND STRUCTURAL REFORM

Governance failings and regulatory shocks are often treated as separate phenomena. Across emerging markets, however, they are closely intertwined.

Concentrated company ownership and weak minority shareholder protection – both widespread across the emerging world – tend to result in capital misallocation. This can manifest as excessive leverage among property developers or distorted cross-subsidisation of state-owned enterprises (SOEs). The regulatory response that follows is therefore not independent of these problems; it is their direct consequence.

Put differently, regulatory shocks are typically the result of preceding governance failures.

This sequence – governance weakness leading to economic or financial imbalances, followed by blunt regulatory intervention that ultimately damages corporate earnings – is evident across emerging markets.

In India, for example, lax oversight of infrastructure financing led to a surge in non-performing loans across public sector banks between 2015 and 2019.

Elsewhere, Brazil's state-directed "national champions" became vehicles for the corruption exposed by the Lava Jato bribery scandal.

China displays a similar pattern. The government's deleveraging campaign in 2016–2017 was a response to excessive borrowing enabled by weak SOE governance, while the regulatory crackdown on the technology sector several years later targeted monopolistic practices that had previously been allowed to take root.

A. Governance discount

Weak governance has been a major drag on EM equity returns, not least because much of the incremental value created by companies tends to flow to insiders rather than shareholders.

Part of the problem is that, across much of the emerging world, companies are held back by deep-rooted conflicts of interest. Majority owners – whether families or the state – often bear down on minority investors. In many cases, governments with controlling stakes place political and social objectives above profit maximisation.

Concentrated ownership and opaque cross-holding structures create strong incentives for "tunnelling" – the systematic redirection of profits to controlling shareholders.[7]

7 See https://www.nber.org/digest/sepoo/tunneling-directs-profits-controlling-shareholders?page=1&perPage=50

Our empirical work[8] confirms that ownership structures have a material impact on profitability. Companies with more dispersed ownership generally achieve higher profits. In our study, we ranked companies in the MSCI Emerging Markets Index by the proportion of shares held by strategic investors. Those in the top quintile – the most dispersed – reported profits 1 percentage point higher than those with the most concentrated ownership, adjusted for sector effects. The same pattern holds when company-level governance scores from the London Stock Exchange Group (LSEG) are used instead of shareholding calculations. This separate study found that companies with consistently low governance scores posted profits 4 percentage points lower than those with the highest scores.

According to a study by the IMF,[9] companies with stronger governance and investor protection achieve superior operational performance, default less frequently and can secure cheaper financing. Their stocks are also less volatile and often prove more resilient during global crises.

> Equities in countries with weaker shareholder protection trade at lower valuations and tend to deliver weaker returns after controlling for fundamentals.

Markets have learned to discount this: equities in countries with weaker shareholder protection trade at lower valuations and tend to deliver weaker returns after controlling for fundamentals.

The same IMF study, covering 600 non-financial emerging market companies from 25 countries, concluded that better company-level governance scores are associated with a statistically significant improvement in their stocks' Tobin's Q ratio – a measure of market value relative to book value – compared to the average. A similar uplift was observed in the valuation of stocks from countries with stronger minority shareholder protection frameworks. A separate International Finance Corporation (IFC) study, analysing companies across 45 emerging nations, found that those in the top quartile of governance scores generate a return on equity 20% higher than those in the bottom quartile. It also determined that companies that meaningfully improved their governance during the holding period saw materially superior operational and financial performance.

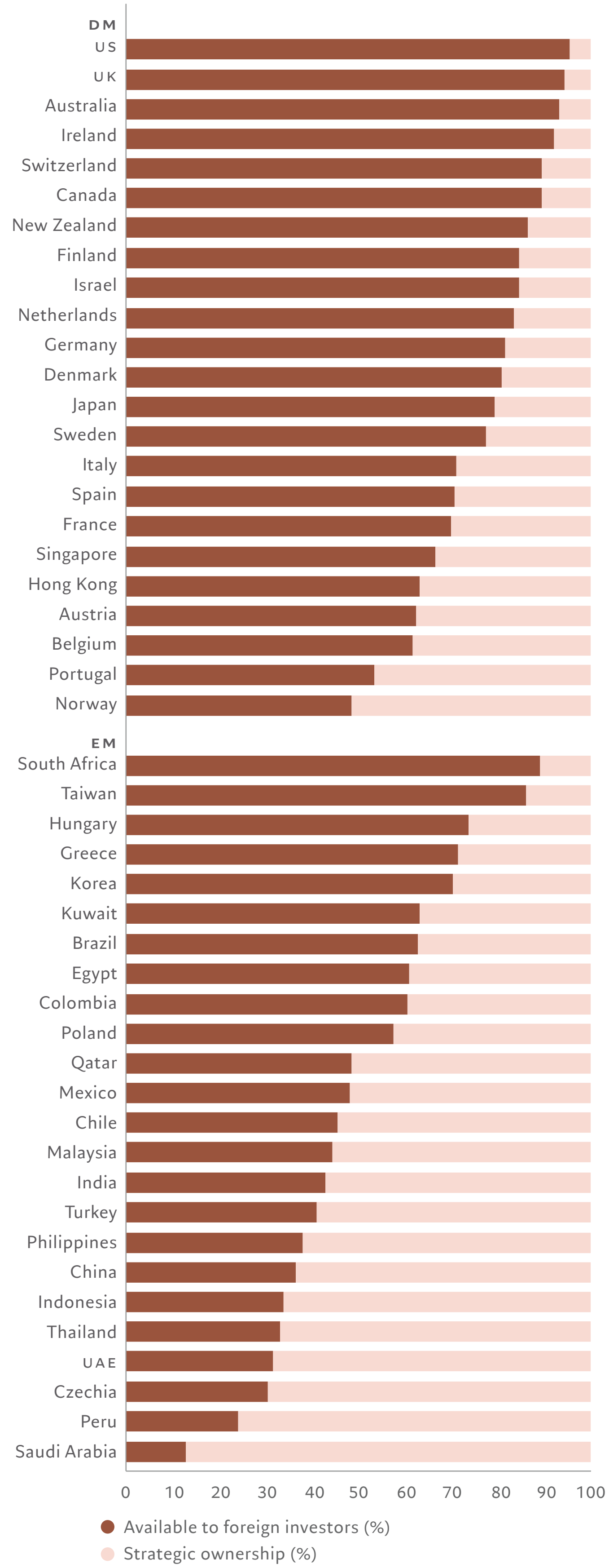
8 Our proprietary study of the MSCI Emerging Markets benchmark constituents shows that the top quintile of companies by percentage of non-strategically held shares achieve sector-adjusted profitability more than 1 percentage point higher than those in the bottom quintile. Extending the analysis to governance scores from LSEG, we found that companies consistently placed in the top two quintiles of company-level governance scores since 2010 improved profitability over their sector peers by 1 percentage point and, more strikingly, those consistently in the bottom two quintile suffered a 4 percentage point erosion in profitability compared to their peers.

9 See https://www.elibrary.imf.org/display/book/9781513559582/ch003.xml

FIGURE 10

Closely held

Strategic share of the market versus share available to foreign investors



Source: MSCI. Data as at 20.04.2026.

B. Structural reform shocks

EM stocks have also been held back by repeated structural reform shocks – the blunt, poorly devised regulatory measures that policymakers put in place to address corporate governance failings.

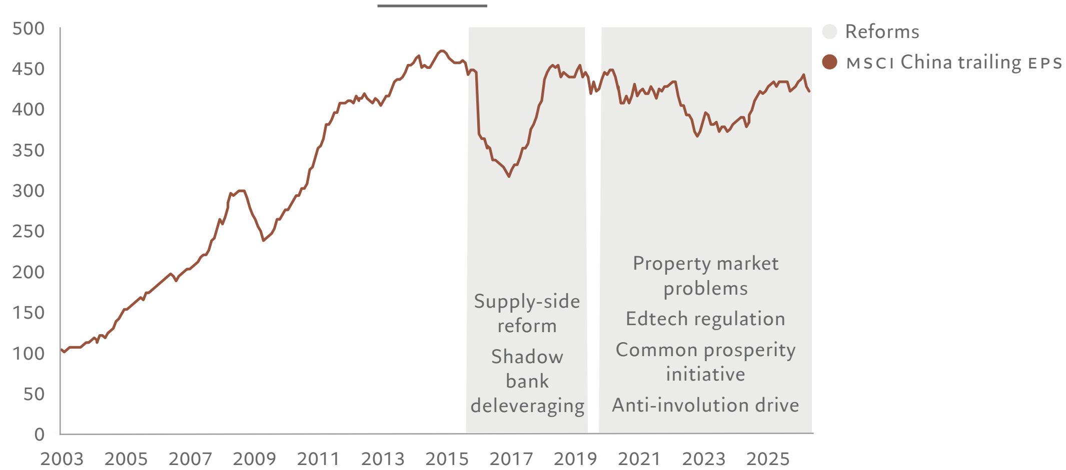
The pattern is consistent across the emerging world. Companies build profitable businesses with governance structures that are in keeping with the prevailing institutional frameworks, only to face sudden and severe regulatory intervention when the state decides those frameworks have distorting effects.

Across developing economies, reforms aimed at addressing macroeconomic imbalances have often weighed on the earnings of established listed companies. In China, this has been especially visible through the 2016–2017 deleveraging drive and the subsequent anti-monopoly and "common prosperity" initiative, which affected sectors from property to internet platforms.

FIGURE 11

China's lost decade

MSCI China trailing EPS (100=01.01.2003) and reform programmes



Source: MSCI, IBES, Pictet Asset Management.
See next chart for details on reforms.
Data covering period 01.01.2003-01.05.2026.

Having suffered repeated, heavy-handed state intervention, China's listed companies have proved to be particularly poor investments.

TABLE 2

China reform programme and implications for incumbents

			TARGET	MOTIVATION	MARKET IMPLICATION
1	Supply-side structural reform	2015–2018	Steel, coal, heavy industry	Eliminate excess industrial capacity crowding out private investment.	Downstream manufacturers absorbed higher input costs with no net earnings gain. Limited impact on profitability.
2	Shadow banking deleveraging	2017–2019	Non-bank financials, property developers	Eliminate unregulated credit intermediation sitting outside regulatory capital requirements.	Companies reliant on shadow financing saw a decline in profitability. Bank net interest margins compressed.
3	Big Tech clampdown	2020–2022	E-commerce, fintech, ride hailing and online gaming	Reassert state oversight over private data, financial flows and market power concentrated outside state control.	Total market cap of Chinese internet companies fell from USD 2.5 trillion at peak to USD 1.4 trillion by 2022. Incumbents starved of growth capital.
4	Common prosperity	2021–2022	Private sector broadly, high-margin consumer businesses	Redistribute income and cap "unhealthy" sectoral returns in pursuit of social equity objectives.	Terminal value compression led to a 50% derating, impacting multiple sectors.
5	Education "Double Reduction" policy	2021–2022	For-profit K-12 academic tutoring, edtech platforms	Eliminate the profit motive in compulsory education and reduce the expenditure burden that was entrenching inequality.	TAL and New Oriental revenues collapsed by around 70% in 12 months. A USD 120 billion listed sector was legislated out of existence in a single policy stroke.
6	Real estate "Three Red Lines" policy	2020–2024	Property development, construction, property management	Reduce developer leverage to prevent a disorderly systemic correction.	New residential sales collapsed by around 50%, compressing developer revenues and creating a cascade of non-performing loans (NPL), which eroded earnings of regional banks.
7	Anti-involution	2022–ongoing	EVs, solar, steel, chemicals	Address chronic overinvestment in priority sectors and ease self-destructive pricing competition.	Aggregate earnings remain depressed; profitability recovery requires incumbents to exit over a prolonged period – a process incumbents are individually incentivised to delay.

Source: Pictet Asset Management.

Even if the world's second largest economy is a hub of innovation and a global leader in key technologies such as electric vehicles and humanoid robotics, its highly volatile regulatory landscape means investors should consider treating Chinese stocks as a separate allocation. The behaviour of Chinese stocks strengthens the argument for such an approach. Our analysis reveals a clear distinction between what drives equity market gains in China and what drives returns across the rest of the emerging world. The correlation between Chinese stocks and the broader EM equity market has fallen over the decade, from an average of 75% in the prior decade to just 35% today.

Further evidence of this trend comes from MSCI's factor model.[10]

10 See https://www.msci.com/research-and-insights/blog-post/rethinking-em-equity-investing-as-em-ex-china-and-china-diverge

The equity style factors that contributed to the returns in the MSCI China Index over the past 30 years were different from those that drove returns in the MSCI Emerging Markets ex China Index. The same study found that factor overlap in style factors was far stronger between Chinese stocks and their US and European counterparts.

DILUTION AND SECTOR MISMATCH

Aside from institutional weaknesses, two other structural factors have weighed on EM stock performance. The first is a systematic dilution of companies' EPS; the second a persistent misalignment between the structure of emerging world economies and the composition of their domestic equity markets.

DILUTION DILEMMA

Across developing economies, corporate EPS have been consistently diluted. One reason is a shift in index composition that has given greater weight to less profitable industry sectors. Our calculations suggest the outsized footprint of these companies in EM stock benchmarks has reduced EPS by 2 percentage points per year over the past two decades.

A further drag on EPS has been the high volume of secondary shares issued by EM companies.

The divergence in share count between EM and US equities is particularly obvious. MSCI index data indicate that EM share count has consistently increased over the last two decades, fuelled by sustained net issuance and index additions.

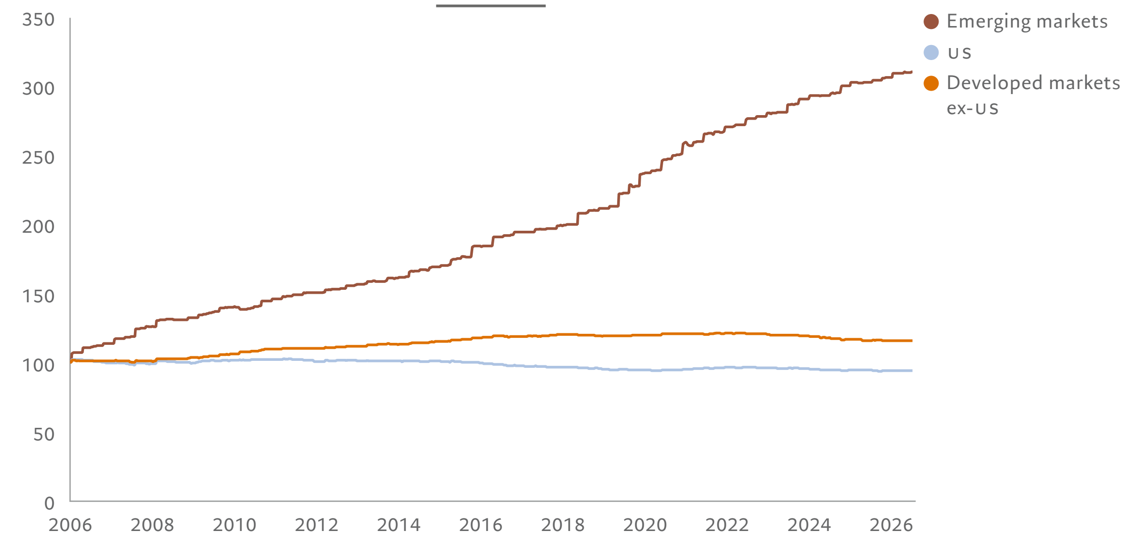
US share count, by contrast, has declined modestly, thanks to share buybacks. Increasing share counts have weighed heavily on returns for EM equity investors, offsetting improvements in underlying corporate profitability.

STRUCTURAL MISMATCH ECONOMY VS INDEX

Another persistent problem facing investors in EM equity is that the composition of the stock markets has not kept pace with changes in the structure of underlying economies.

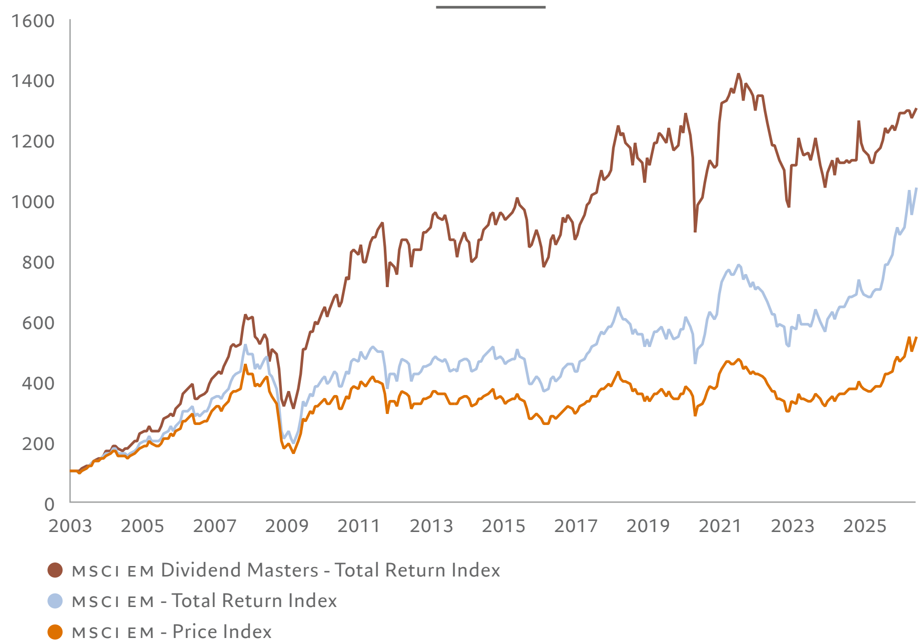
Historically, consumer-facing companies have been underrepresented in EM stock benchmarks, while capital intensive, state-directed industries such as the energy, materials, utilities and banking sectors, have been overrepresented.

FIGURE 12
Dilution in action
Changes in share count for selected region
(100=18.05.2006)



Source: MSCI, Pictet Asset Management.
Share count includes net buybacks and index changes.
Data covering period 18.05.2006-14.05.2026.

FIGURE 13
Dividends pay off
EM dividend masters vs standard benchmark,
index performance (100=01.01.2003)



Source: MSCI, LSEG.
Data covering period 01.01.2003-01.05.2026.

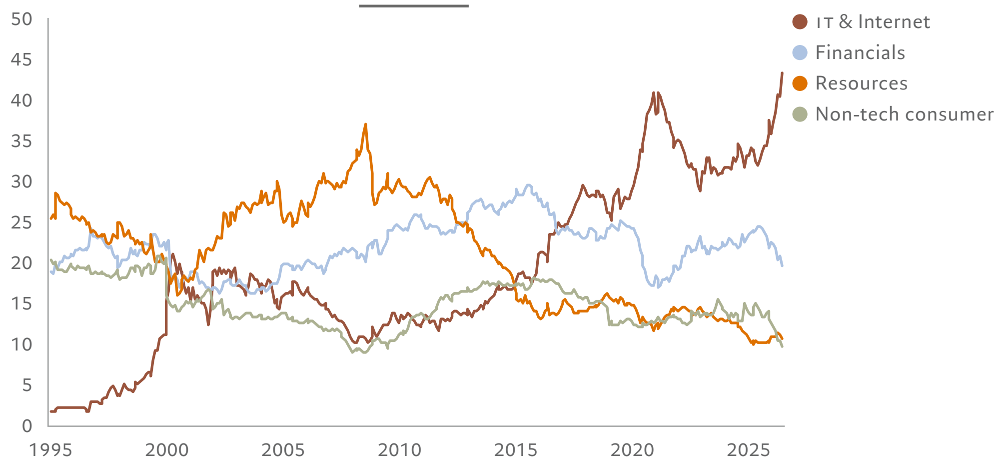
This means that even when domestic economies grow strongly, index investors are systematically exposed to sectors with weaker governance and greater vulnerability to state and regulatory interference.

India is a clear example. Energy and materials companies are overrepresented in its stock indices, while consumer-facing companies have a fraction of the footprint their economic weight would warrant – despite being the main beneficiaries of the country's consumption growth story, driven by a burgeoning middle class.

FIGURE 14

Shifting sectors

Weight of selected sectors in MSCI Emerging Markets Index
% of total



Source: MSCI, LSEG.
Data covering period 02.01.1995-01.05.2026.

Even when index composition begins to shift due to initial public offerings (IPOs) from companies in high-growth sectors such as IT, new problems emerge.

In the developing world in particular, companies in high-growth sectors have a tendency to issue IPOs at valuations that already embed much of their expected future growth. When these more expensive companies enter an index, the average valuation for the entire index rises with them, which can weigh on returns for passive EM stock investors.

REASONS FOR OPTIMISM

The weak link between EM GDP growth and EM equity returns is not accidental. It is the result of powerful structural forces. Governance failings, poorly devised regulations, earnings dilution and structural flaws in index design are to blame for the weak returns EM stocks have generated over the past 20 years.

That said, there is evidence to suggest that at least some of these constraints might be less problematic in future.

Take governance and regulatory frameworks, both of which are strengthening. Across a growing number of emerging economies, policymakers are pursuing reforms aimed at improving governance and reducing stocks' valuation discounts.

Such reforms are particularly prevalent in Asia. Korea's 2024 Corporate Value Up Program encourages companies to publish medium-term plans on capital efficiency, payouts and investor engagement. China has taken a more directive route: 2024 reforms and the China Securities Regulatory Commission (CSRC) guidelines emphasise shareholder returns and require disclosure from companies trading below book value for a sustained period, alongside SOE KPI adjustments.

Governance failings, poorly devised regulations, earnings dilution and structural flaws in index design are to blame for the weak returns EM stocks have generated over the past 20 years. That said, there is evidence to suggest that at least some of these constraints might be less problematic in future.

Taiwan has introduced a similar value enhancement framework with dedicated disclosure channels.

Elsewhere, a different set of regulatory reforms are progressively expanding the investable universe, raising minimum free float stock thresholds and reducing the proportion of index-ineligible locked-up shares. According to MSCI's own analysis, such changes tend to reduce stock price volatility and support higher valuations.

In tandem with regulatory improvements, action is also being taken to reverse the damage caused to EPS through the excessive issuance of secondary shares.

In China, a new set of guidelines introduced by the CSRC in 2024 represent a credible systematic attempt to slow or halt the sale of secondary shares by companies represented in benchmark indices.

The results have been positive so far: 2024 was the first year in Chinese equity market history in which the net buyback yield (buybacks less dilution effects as a proportion of the market cap) made a positive contribution to annual returns, according to MSCI data. There was also a noticeable acceleration in share buybacks from mega-cap and internet platform stocks. Korean authorities have moved in the same direction.

The centrepiece of Korea's new governance overhaul is the creation of a Korea Value-Up Index, which, alongside tax incentives, is designed to increase shareholder returns by encouraging companies to raise dividend payments and share buybacks.

Any increase in the pace of buybacks from EM companies would be especially timely. With US companies redirecting capital towards AI investment, share repurchases there are now in retreat – meaning EM equity markets could gain a performance advantage over the US.

CONCLUDING THOUGHTS AND INVESTMENT IMPLICATIONS FOR EM EQUITY INVESTORS

The case for investing in EM equities, therefore, rests not on macroeconomic transformation, but on whether the structural forces that have prevented GDP growth from translating into investment returns begin to weaken.

Our analysis points to several strategies EM equity investors can deploy to improve their chances of success.

To begin with, investing in EM stocks will increasingly demand a more selective approach to capital allocation. There is a strong case for holding overweight positions in markets where reform commitments are institutionalised and enforcement is credible. Parsing EM equities in this way, investors might also conclude that companies with a track record in paying dividends – a hallmark of a financially disciplined, well-run company – should feature more in an EM equity allocation.

Dividends' contribution to EM equity returns is often overlooked – yet over the last two decades, they have accounted for 60% of the asset class's total return. The added advantage of focusing on dividend-paying companies is that it solves one of the structural problems that has long held back EM stocks: controlling shareholders monopolising profits.

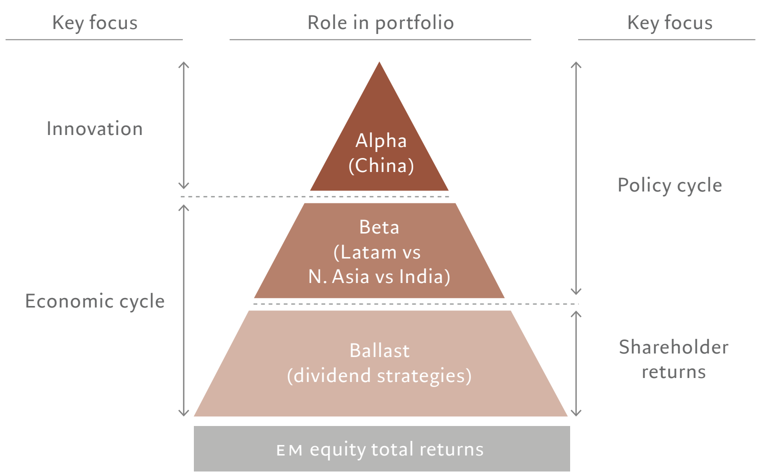
A sharpened focus on governance may also lead to a reassessment of Chinese equities.

China's distinctive governance framework and the steady – but persistent – decline in the correlation of returns between Chinese and other EM stocks means it should not be grouped with its peers. Its stocks warrant treatment as a distinct portfolio building block. The practical solution is an allocation to EM ex China and a separate allocation to China.

Another important conclusion from our analysis is that investors would be mistaken to assume that indices give access to the most dynamic sectors of an economy. Nowhere is this more evident than in India. Consumption across the country is booming, yet consumer-facing companies are markedly underrepresented in its stock indices. One solution that has proved especially effective in Indian stocks markets – and could work well in other countries where household wealth is rising – is to invest in the banking sector. Shares in Indian banks have outperformed those of their US peers over the past 20 years.

As emerging markets continue to evolve, investors who look beyond indices and focus on areas of dynamic growth and reform will be best positioned to capture the opportunities these markets offer.

FIGURE 15
Emerging market equities investment framework



Source: Pictet Asset Management.

“As emerging markets continue to evolve, investors who look beyond indices and focus on areas of dynamic growth and reform will be best positioned to capture the opportunities these markets offer.”

ARUN SAI
Senior Multi Asset Strategist

SECULAR TRENDS

4

The hunt for a risk-free asset: a synthetic solution

OUR VIEW

Traditional safe assets, such as US and German government bonds, have failed to live up to their "risk-free" label in the past few years. This is forcing investors to rethink the concept altogether as risk-free characteristics increasingly depend on the source of market stress and prevailing macroeconomic conditions.

Our analysis suggests the risk-free asset should no longer be a single, static instrument. We propose a synthetic solution – a portfolio of several different building blocks with dynamic allocation, built to preserve capital across different market, economic and policy environments.

SECULAR TRENDS

10-YEAR ASSET CLASS RETURN PROJECTIONS

LUCA PAOLINI
Chief Strategist

ARUN SAI
Senior Multi Asset Strategist

The risk-free asset is the bedrock of a diversified portfolio. Over the past few decades, US and German government bonds served as the default defensive investments, delivering predictable streams of income and returns that were negatively correlated with equities.

But the experience of recent years shows that neither can be labelled risk free.

Treasuries and Bunds have lost a cumulative 35–40% in real value from their 2020 peak. Episodes of market stress – such as the April 2025 "Liberation Day" tariff shock – have further exposed their vulnerability. In a highly unusual move, Treasuries even fell alongside both equities and the US dollar.

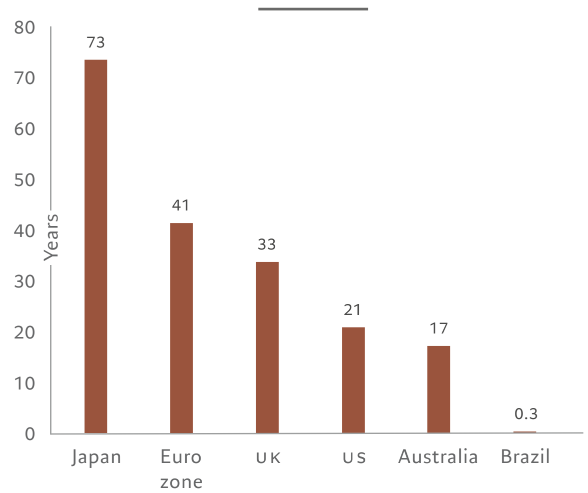
This presents investors with a serious problem: assets once considered defensive no longer reliably preserve capital, weakening one of the foundations of portfolio construction.

Our calculations show US bondholders would need around 20 years to recoup their inflation-adjusted losses from the 2020 peak at current real yields; for European investors, the time frame exceeds 30 years (see FIGURE 16).

FIGURE 16

Long road back to peak

Years required to go back to real return



Note: Years required for real bond return to regain its previous 2020 peak at current real yield. Nominal bonds deflated by actual CPI to date and by current inflation-linked bonds. Data as at 12.05.2026.

Investors hoping for a long-lasting reversal of these trends are likely to be disappointed. Surging public debt, especially in the US, and higher inflation mean bonds will struggle to function as a safe asset, except when held to maturity – and even then, only in nominal, not real, terms and in local currency.

SECULAR TRENDS

10-YEAR ASSET CLASS RETURN PROJECTIONS

QUALITIES OF A RISK-FREE ASSET: A RARE COMBINATION

To identify a viable alternative to sovereign debt, it is useful first to define what makes an asset truly risk free.

We have identified six key qualities of a risk-free asset:

As TABLE 3 makes clear, no single existing asset satisfies all these conditions.

TABLE 3

Being truly risk free

Six qualities of a risk-free asset

	PRINCIPAL NOT AT RISK	LOW VOLATILITY	LOW CORRELATION WITH RISK ASSETS	HIGH LIQUIDITY	NON-NEGATIVE REAL RETURNS	BUYER OF LAST RESORT
US Treasuries	√	×	×	√	×	√
US inflation-protected bonds	√	×	×	√	√	√
AAA corporate bonds	√	×	×	×	√	×
EU-common bonds	√	√	×	√	×	√
China bonds	√	√	√	×	√	√
Swiss bonds	√	√	√	×	√	√
Market-neutral hedge funds	√	√	√	×	√	×
Gold	√	×	×	×	√	×
Bitcoin	×	×	×	√	√	×

Source: Pictet Asset Management.

Gold may appear to be a strong candidate given its track record as a reliable long-term hedge against inflation, but the precious metal is volatile, prone to severe price declines and also tends to move in lockstep with several other asset classes.

Among currencies, the Swiss franc and Singapore dollar both exhibit haven properties. These currencies benefit from political stability, stable growth and credible central banks. Yet neither is liquid enough to serve as a dependable safe harbour.

The US dollar has maintained its safe haven status over the years, outperforming in periods of market stress, most recently at the onset of the Iran war. Dollar-denominated deposits or very short-dated bonds could potentially be considered risk free, but they fall short for non-US investors given volatile currency rates. What's more, these bonds typically generate no return after accounting for inflation.

DIVERSIFICATION WITH BONDS

Within fixed income, we have identified four asset classes that could qualify as safe assets, albeit with caveats.

- AAA corporate bonds. The most creditworthy companies account for much of the market, but the investable universe is narrowing.
- Joint euro government bonds. Would require a credible capital market and political union, which is unlikely within the next 10 years.
- Chinese bonds. Offer diversification due to China's distinctive monetary policy cycle, but cannot function fully as defensive assets while China's capital account remains closed.
- Treasury Inflation-Protected Securities (TIPS). Protect against inflation but remain exposed to rising real yields, as the steep declines in 2022 demonstrated.

US government bonds have the potential to re-establish themselves as reliable risk-free assets. Yet we believe the damaging fiscal policies being pursued by the current US administration will not be easy to reverse. Even under optimistic assumptions, US public debt is forecast to rise to 120% of GDP by 2035, up from the current 100%.

To stabilise US debt, one of three conditions would need to be satisfied: interest rates falling to 1%, the level favoured by President Donald Trump; fiscal tightening equivalent to around 4% of GDP; or an average inflation rate of 4%.

DEFENSIVE EQUITIES AND HEDGE FUNDS

Quality equities – defined by MSCI as companies with strong profitability, stable earnings and low financial leverage – used to be a standard defensive allocation in a diversified portfolio. That is no longer the case.

The two largest quality stock sectors, pharmaceuticals and software, have suffered sharp declines in recent years, raising doubts over their ability to generate stable cash flow as governments cut spending and AI disruption ripples through sectors.

Beyond defensive equities, hedge funds may work well as a diversifier, but high fees and reliance on relative performance mean only a few could reliably fulfil a risk-free role.

DIVERSIFICATION OR REDEFINE RISK FREE?

With no risk-free asset genuinely worthy of the label, investors seeking a defensive allocation have two options: combine imperfect assets through diversification, or rethink the concept altogether.

Diversification aims to generate long-term returns broadly in line with a passive balanced portfolio of 60% equities and 40% bonds, but with lower average risk or at least shallower peak-to-trough declines in capital value.

A well-diversified portfolio can, at times, replicate some of the stabilising functions of a risk-free asset.

Our analysis covering the past 50 years finds that only a small group of assets – the US dollar, short-duration US Treasury bills, Chinese bonds and market-neutral hedge fund strategies – have provided reliable protection in periods when both equity and bond markets decline at the same time, as in 2022, 1994, 1981 and 1977.

That said, the experiences of the global financial crisis, quantitative easing, Covid-19, the inflation boom and today's unpredictable geopolitical landscape make any very long-term analysis of diversification problematic.

A NEW SOLUTION: SYNTHETIC AND VARIABLE STRATEGY

If no single asset can fulfil the role, investors must construct one.

In other words, the risk-free asset should no longer be a single, static instrument. Our proposed solution is a synthetic risk-free asset – a portfolio of several different building blocks with dynamic allocation, built to preserve capital across different macroeconomic and policy environments.

The risk-free solution is, in effect, a set of different configurations of defensive assets, each designed to provide a capital buffer in specific market conditions (TABLE 4). The opportunity set is deliberately limited to liquid, mainstream assets, though a more complete, real-world implementation could feasibly extend to derivatives and yield curve trades explicitly designed for different risk regimes.

We've tested our synthetic configurations to observe their performance during the 15 major equity market declines seen since 2007, grouping them into four broad regimes; episodes may span multiple regimes when market drivers overlap.

The analysis replicates a global investor's portfolio in US dollar terms. Global equities are held constant at 60% (MSCI ACWI), with the remaining 40% allocated across

TABLE 4

How to build a synthetic strategy

Regime-dependent optimal mix of defensive assets

RISK REGIME	PROMINENT INSTANCES	OPTIMAL MIX OF DEFENSIVE ASSETS
Growth shock	2020 pandemic sell-off, 2015 China hard landing fears, 2008 global financial crisis	20% US Treasuries, 15% Japanese government bonds, 5% gold
Inflation shock	2026 Iran war, 2022 inflation surge	15% Chinese government bonds, 15% US TIPS 10% gold
Policy shock	2025 Liberation Day, 2013 sovereign debt crisis	15% Japanese government bonds, 15% Swiss bonds, 10% US Treasuries
Liquidation event	2023 Silicon Valley Bank crisis, 2010 flash crash, 2018 "Volmageddon"	20% US Treasuries, 15% Japanese government bonds, 5% Chinese government bonds

The analysis covers mainstream asset classes and gold, and does not consider an exhaustive set of assets, including equity and fixed income derivatives. The analysis replicates a global investor's portfolio in US dollar terms. Global equities are held constant at 60% (MSCI ACWI), with the remaining 40% allocated across a broad universe of defensive assets or potential diversifiers, including global bonds, US Treasuries, European nominal and inflation-linked bonds, Swiss, Chinese and Japanese government bonds, gold and bitcoin. For each regime, we used daily return data observed during the relevant drawdowns and identified the defensive allocation that maximises cumulative portfolio value across all historical episodes. The results are based on a constrained optimisation. Individual defensive assets are capped at 15% of the total portfolio, with US Treasuries permitted to reach 20% to reflect their depth, liquidity and reserve asset status.
Source: Pictet Asset Management.

a broad universe of defensive assets or potential diversifiers, including global bonds, US Treasuries, European nominal and inflation-linked bonds, Swiss, Chinese and Japanese government bonds, gold and bitcoin.

Our results show the composition of the defensive allocation is not static, but changes materially depending on the underlying source of market stress, with turnover between regimes frequently exceeding 20% of portfolio weight.

When the market suffers growth shocks, holding long-duration fixed income assets – such as long-dated US Treasuries and Japanese government bonds – offers sufficient protection.

Inflation shocks call for a different mix: Chinese government bonds, gold and US TIPS.

Policy shocks are most effectively hedged with Japanese and Swiss government bonds, while in liquidation events – credit crises such as bank busts – US Treasuries and Japanese government bonds provide solid protection.

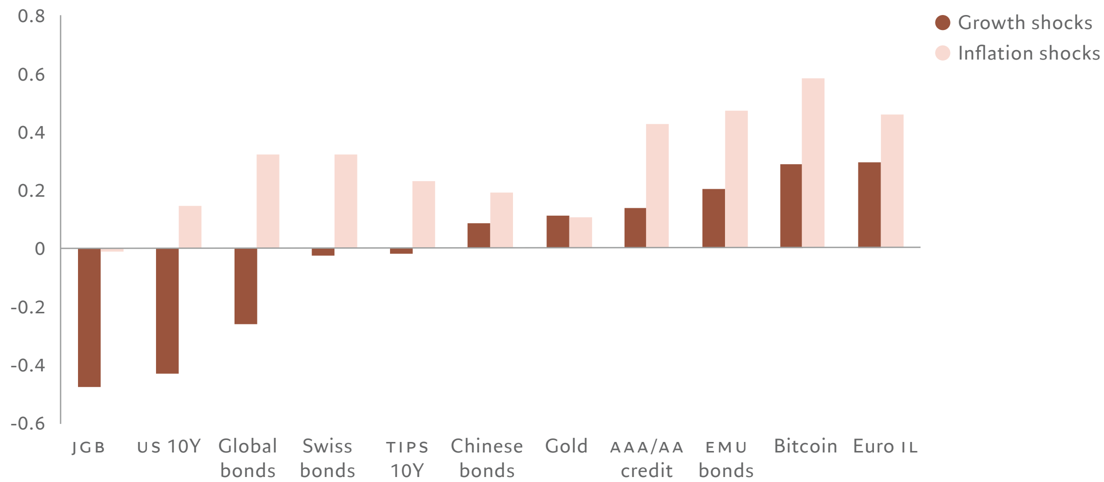
Our analysis shows that some defensive assets perform this function only in a very narrow range of environments. Swiss government bonds, for example, become safe assets only when policy shocks trigger market declines. Chinese government bonds, meanwhile, are a hedge against inflation shocks but little else. Gold's defensive qualities come to the fore during inflationary shocks, offering little protection otherwise.

Bitcoin does not feature in any optimal defensive allocations, mainly because it behaves more like a high-beta risk asset than a reliable diversifier.

FIGURE 17

Shifting correlations

Correlation coefficients of selected assets vs global equities



Source: LSEG, Pictet Asset Management.
Data covering 15 risk-off episodes since 01.01.2007, categorised into different risk regimes. All returns in USD terms.

US Treasuries and Japanese government bonds are the only assets that emerge as reliable stores of value across multiple regimes, although their portfolio weightings vary considerably.

A DYNAMIC SOLUTION FOR PORTFOLIO RESILIENCE

Safe assets, in the traditional sense, no longer exist. What investors should consider as "risk free" in practice now depends on the source of market stress and prevailing macroeconomic conditions. Even the most trusted instruments, such as US Treasuries and Japanese government bonds, deliver uneven protection and fail to function as static anchors across market cycles.

Our analysis suggests the role of the risk-free asset is not fixed but dynamic. It should be managed as an active function within the portfolio. By building a synthetic risk-free portfolio that adapts to shifts in market and economic regimes, investors can better protect their capital.

10-year asset class return projections

SECULAR TRENDS

10-YEAR ASSET CLASS RETURN PROJECTIONS

A new diversified portfolio for a new age

The next decade promises to be a demanding one for investors. A positive development is that the diffusion of AI will raise productivity, adding some 0.3% to GDP growth on average per year. This should provide a boost to corporate profitability. But there will be some countervailing economic forces, too. Chief among them is the exceptionally high level of public debt across the developed world, which will limit how far governments can support growth. Inflation could be also troublesome for some major economies: although we expect it to fall to within official central bank targets over the next several years in most cases, price pressures will remain volatile, particularly in the US.

TABLE 5

Global multi-asset portfolio: boost non-US assets & alternatives

Pictet AM model portfolio vs benchmark for US dollar-based investors

PORTOFLIO WEIGHT	BENCHMARK	PICTET ASSET MANAGEMENT RECOMMENDED PORTFOLIO
EQUITIES	55%	55%
US equities	35%	25%
Non-US DM equities	14%	20%
EM equities	7%	10%
FIXED INCOME	39%	35%
Government bonds	22%	10%
Inflation-linked bonds	2%	1%
Corporate bonds	11%	15%
EM bonds	5%	9%
ALTERNATIVES	6%	10%
Hedge funds	0%	5%
Commodities	0%	2%
Gold	6%	3%
PORTFOLIO METRICS		
Return		6.5
Volatility		10
Risk-adjusted return		0.64x

Source: LSEG, Bloomberg, Pictet Asset Management. The benchmark portfolio is a proxy designed to show a typical allocation and is adapted from aggregated data provided by State Street as at 31.10.2025. Benchmark indices: MSCI indices for domestic and international ACWI ex-domestic equities, 10-year domestic government bond index, equally weighted, ICE BofA US investment-grade and US high-yield indices, J.P. Morgan GBI-EM local currency bond and J.P. Morgan EMBI dollar indices for emerging market sovereign and corporate bonds, HFRI fund weighted for hedge funds, MSCI private equity and Cliffwater Direct Lending. Data as at 30.04.2026 while forecast period runs to 30.04.2036

SECULAR TRENDS

10-YEAR ASSET CLASS RETURN PROJECTIONS

Economic conditions, then, should be moderately positive for riskier asset classes over the next 10 years – underpinning corporate revenue and earnings growth. But investment returns are also influenced by initial valuations, and these are less favourable, particularly for equities. Risk premia are unlikely to fall from what are already low levels, tempering future returns.

Against this backdrop, we expect equities to deliver annualised returns of up to 7% over the next decade – below the double-digit yearly returns seen over the past five years. Within stocks, the dominance of the tech industry is likely to endure, supported by strong fundamentals, corporate pricing power and reasonable valuations. Over time, however, market leadership will gradually broaden beyond today's dominant players as the benefits of AI spread more widely across the economy. This argues for a more balanced approach to managing equity allocations and against abrupt rotations away from market leaders. In other words, investors should maintain exposure to mega-cap leaders, while steadily building exposure to the next generation of winners via, for example, mid-cap stocks.

The US equity market will continue to outperform, but its exceptionalism will fade enough to allow the rest of the world to catch up; the euro zone and emerging Asia stand out as bright spots.

In other developments, fixed income will regain relevance following the repricing of the early 2020s, with nominal returns expected to be in line with long-run averages. Investors should allocate more of their capital to instruments offering resilience and income, including inflation-linked securities such as US TIPS, credit and selected emerging market debt. At the same time, the notion of government bonds as a reliable "risk-free" anchor is less certain, requiring a broader defensive allocation.

Currency dynamics are also set to play a more prominent role in portfolio construction. A combination of moderating US growth and persistent inflation points to a gradual weakening of the dollar. This should support emerging Asian currencies, while the euro may benefit from improving regional fundamentals. Traditional safe havens such as the Japanese yen and Swiss franc are also likely to regain appeal in a more uncertain macroeconomic environment.

Taking all our forecasts into account, multi-asset portfolios will take on a different complexion. Investors will need to distribute their capital across a broader range of assets and be prepared to change their allocations more frequently than in the past. In TABLE 5, we compare our proposed portfolio to what we consider to be a benchmark allocation. Our recommendation is based on our return projections for individual asset classes and assumes investors maintain their current risk budgets. The weighting calculations also incorporate the results of a portfolio optimisation exercise that takes the volatility of the benchmark as an input.

We recommend investors lower their exposure to US stocks in favour of European and emerging Asia stocks. Credit should also feature more prominently in portfolios, as should alternative sources of return such as hedge funds, gold and selected private assets.

Equities:
held back by thinner profit margins, high valuations

OUR VIEW

Global equities should deliver an annualised return of 7% over the next decade, half the yearly gains of the previous 10 years. Companies around the world are unlikely to maintain today's exceptionally strong profit margins while stocks' high initial valuations will also prove a drag. Returns will be more evenly distributed across regions, improving diversification opportunities for global investors.

The euro zone and emerging Asia stand out as bright spots. The global technology industry will remain dominant, and the broadening AI cycle should also benefit industrials and utilities sectors.

The Covid-19 pandemic, the Ukraine conflict, US trade tariffs, the Iran war and the energy crunch: whatever the crisis that confronts global stocks, nothing has prevented them from reaching new highs.

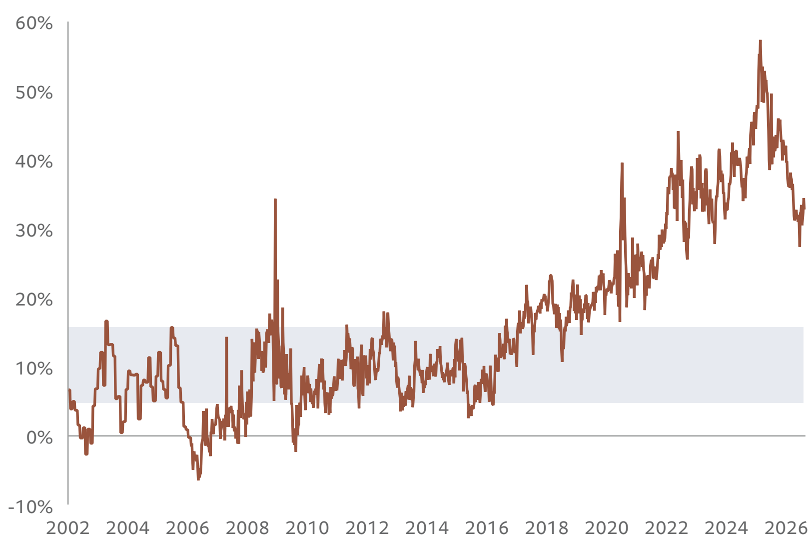
The MSCI World Index has risen by 13% every year since 2020. But the coming decade may prove less benign for stock investors. We expect world equities to deliver an annualised return of 7% over the next 10 years, half the yearly gain of the previous 10-year period.

The stock market strength of recent years owes much to robust corporate earnings. Since the mid-2010s, and especially in the period following the post-pandemic rebound, companies have steadily rebuilt profitability through a combination of cost discipline, effective supply chain management and demonstrably strong pricing power. Building on this trend is the current wave of earnings upgrades, the strongest since 2003–2004, when

FIGURE 18

Unwinding premium

US equities sector-adjusted P/E ratio vs rest of the world



Source: MSCI, LSEG, Pictet Asset Management. Sector valuations for US reweighted to MSCI ACWI weights. Data covering period 01.01.2002-19.05.2026.

higher commodity prices lifted profits, growth and investment expectations, and triggered a widespread rally in global markets.

Profit margins tell a similar story. Over the past five years, margins have expanded markedly across most sectors, reflecting not only companies' ability to pass on higher costs, but also structural shifts such as digitalisation, automation and more asset light business models.

Take the technology sector. Even before the current AI frenzy, tech companies spent years consolidating their platforms and pursuing high recurring revenues, while also taking steps to strengthen their grip on pricing. The current imbalance between surging demand for AI and infrastructure shortages has reinforced these advantages, allowing large technology firms to convert structural strength into sustained earnings growth.

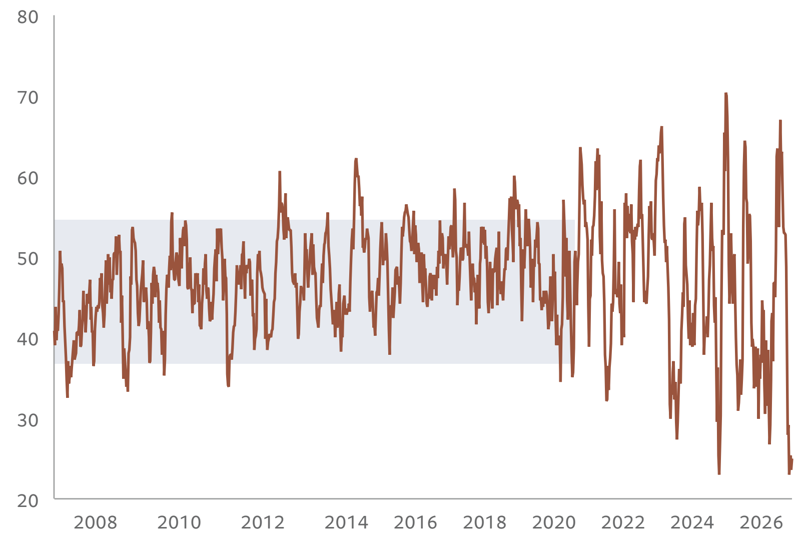
However, such exceptional profitability will be difficult to sustain over the long run. As more AI data centres are built in the coming years, supply constraints should ease and demand begin to plateau. This will place downward pressure on the margins of many of today's tech leaders. We see margins peaking in the coming years before gradually normalising over much of the forecast horizon, even though some of this adjustment may be offset by AI-related productivity gains spreading more widely across the economy.

The pressure on equity returns will not only come in the form of lower profit margins. Valuation multiples are also set to contract modestly across all major regions as global excess liquidity conditions continue to normalise. Current valuations already reflect strong expectations for higher growth and productivity. Even if AI delivers on this promise, sustaining today's elevated multiples would require outcomes beyond what optimists would consider a stretch.

FIGURE 19

Peak concentration

Percentage of S&P 500 stocks outperforming the index in previous 10 weeks



Source: LSEG, Pictet Asset Management.
Data covering period 01.012007-08.06.2026.

In the US, the anchor for our forecasting process, we expect S&P 500 multiples to settle at around 19 times, below the current level of 21 times but still above the historical average.

Unsustainable profit margins and high initial valuations leave little room for strong gains over the next 10 years. In effect, investors are paying for today's bonanza with lower future returns. As a result, global equities are unlikely to deliver the level of returns investors have become used to, although our forecast is still in line with the long-term average.

REGIONAL CONVERGENCE

Returns across different regional equity markets are likely to converge over the next 10 years.

This is because, as our forecasts illustrate, most of the world's major economies will experience similar growth and inflation patterns. Companies around the world are also stepping up efforts to return cash to shareholders, closing another gap with the US, where buybacks are set to moderate as companies redirect their cash flow into investments in AI.

US equities will just about retain their global leadership, outperforming the rest of the world in local currency terms by only a small margin. Already, the valuation premium of the US market has fallen to half of its 2024 peak (see FIGURE 18), pointing to a more modest form of US exceptionalism – the idea that the US economy and equity market can consistently outperform.

Euro zone equities represent a bright spot. The single currency bloc is embarking on an ambitious programme of public investment and structural reform that stands to boost the region's growth over the coming years and benefit domestic equities, including mid-cap companies. Germany alone will invest EUR 1 trillion in infrastructure and defence, directly benefiting companies in construction, engineering, capital goods, transport and smart utilities.[11]

11 https://am.pictet.com/ch/en/institutions/investment-research/european-equity-and-private-asset-markets

We expect euro zone stocks to end the decade with the strongest performance after the US, at 6.8% per year.

Emerging Asia stocks are on course to outperform the wider market, supported by a combination of strong technology leadership and improving corporate governance. Companies in Korea and China, in particular, have been increasing share buybacks to counter persistently low valuations and attract investors.

This enthusiasm does not quite stretch to Chinese equities. While China is a hub of innovation and a world leader in several crucial technologies, including humanoid robotics, the benchmarks commonly used by global investors offer little exposure to these areas. With a slowing economy and recurring policy intervention impacting earnings of established companies, broad benchmark exposure to China runs the risk of picking up both winners and losers. In our view, China is best approached with active strategies designed to identify idiosyncratic opportunities.

AI BENEFITS TO BROADEN OUT

When it comes to sectors, the dominance of the global technology industry shows staying power, with returns of around 9% per year.[12] Sustained investment in AI infrastructure is likely to broaden, benefiting not only core technology companies but also parts of the industrials and utilities sectors.

Companies at the centre of the AI theme – semiconductor makers, hyperscalers and AI infrastructure providers – now make up around 30% of global equities. This concentration has contributed to unusually narrow market leadership, with the number of stocks outperforming the S&P 500 index falling to its lowest since at least 2007 (see FIGURE 19).

Investors should focus less on broad, index-level gains or traditional style factors and more on allocating capital to companies with a long-term competitive advantage and pricing power.

Yet we believe concerns over the extent of market concentration are overblown. Historical analysis of similar episodes offers little evidence that high concentration and narrow market leadership are a barrier to future equity returns. Concentrated leadership does, however, tend to increase market volatility and exacerbate selloffs when sentiment shifts or macroconditions deteriorate. As a result, we expect equity returns to not only be lower, but weaker still on a risk-adjusted basis.

The current phase of AI adoption – which has so far favoured a relatively small group of technology companies – points to a period of market adjustment and volatility. Some jobs may be displaced, while productivity is taking a temporary hit at many companies where heavy front-loaded investment in data infrastructure, organisational restructuring and workforce retraining is running ahead of measurable gains.

Over time, however, as with all past technological breakthroughs, the benefits of AI will spread more broadly across the economy and companies that use these technologies most effectively should see improvements in productivity and profit margins, helping to broaden market leadership.

This calls for a reassessment of popular investment processes through which investors use structural, multi-year style cycles such as value and growth to determine their asset allocation. The secular winners of the next decade in areas such as AI, electrification and defence cut across traditional classifications, combining features of both styles. As such, style labels may lose their usefulness as reliable differentiators of performance.

Instead of relying on these backward-looking frameworks, investors should focus on identifying companies with enduring competitive advantages and the best long-term growth prospects.

DEMANDING BUT REWARDING

Over the next decade, the forces that have driven exceptional returns over the past few years – margin expansion and rising valuations – are unlikely to repeat themselves at the same scale. Instead, equity returns will be lower, more evenly distributed across regions and perhaps accompanied by greater volatility.

At the same time, powerful secular trends such as AI and electrification are likely to open up new sources of growth. As the emerging technology is embraced right across the global economy, leadership should gradually extend beyond today's dominant companies to a wider set of firms that are able to translate technological change into productivity gains.

Against this backdrop, investors should focus less on broad, index-level gains or traditional style factors and more on allocating capital to companies with long-term competitive advantage and pricing power. They should position their portfolios for a more complex and demanding, but ultimately more rewarding, equity market – one that is more diversified and offers attractive opportunities in the years ahead.

12 MSCI ACWI Information Technology Index

Bonds:
attractive valuations eclipse debt and inflation risks

OUR VIEW

The next decade should see government bonds break out of the bear market they have witnessed over much of the past four years.

Initial valuations for bonds are in line with fundamentals and coupon rates exceed anticipated inflation across most markets.

In general, fixed income assets are set to generate positive real returns that are roughly in line with, and in some cases above, historical averages.

Credit should deliver the highest risk-adjusted returns. Initial valuations are favourable, being lower than those of equities.

The bear market in government bonds that resulted in steep losses over most of the past four years appears to be coming to an end. Relative to their recent history, bonds should deliver acceptable returns over the next 10 years. But significant risks remain.

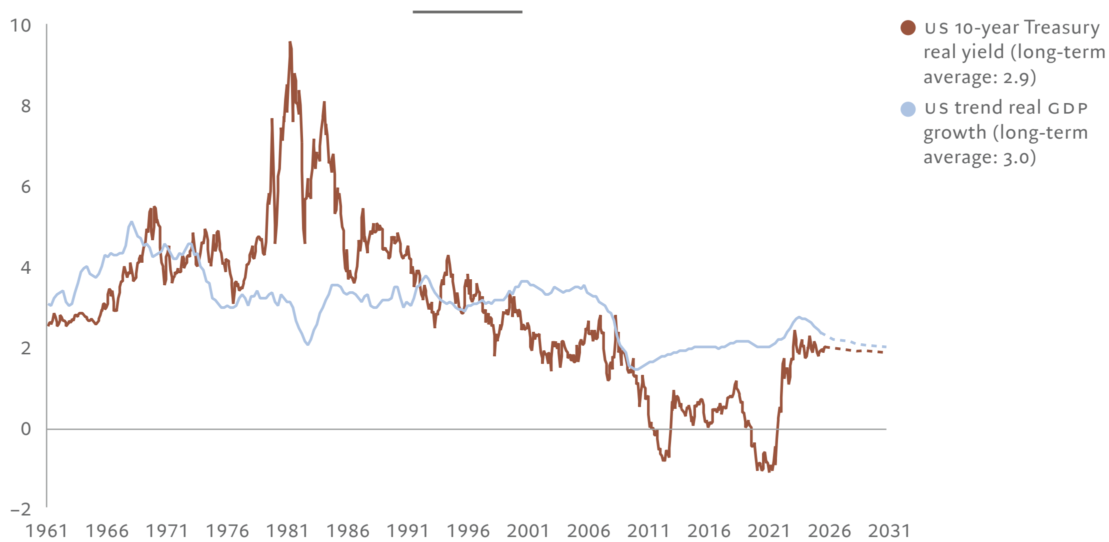
Public finances are deteriorating across the developed world, inflation will be slow to dissipate and the era of financial repression – or ultra-low official interest rates – will be no more.

A further concern is the shift in the ownership structure of the US Treasury market. Our analysis of US flow-of-funds data finds that the share of the US Treasury market owned by official investors such as the Fed, US banks and foreign central banks has fallen to just 32% – the lowest level since the early 1990s. Price-sensitive investors have taken their place. And with a less stable investor base, bond markets could become more volatile.

FIGURE 20

Valuation aligned with fundamentals

US 10-year Treasury real yields compared to US trend real GDP growth rate, %



Source: LSEG, CBO, Federal Reserve, Pictet Asset Management. Yield based on 10-year TIPS yield after 2003, and 10-year US Treasury yield minus Cleveland Fed 10-year inflation expectations (and 10-year CAGR of US CPI before 1982). US GDP growth based on CBO forecasts. Data covering period 05.06.1961-05.06.2026.

That said, fixed income assets are set to generate positive real returns, roughly in line with, and in some cases even above, their historical averages. This is due to the fact that after a full normalisation of rates and yields, current valuations are now fully aligned with fundamentals, with coupon rates exceeding anticipated inflation across most markets.

And this matters because, typically, the return on government bonds over a 10-year period is equal to the current yield within a range of ±1.5%, with a probability of 90%. The path and final level of yields also have a bearing on bonds' total returns and are generally linked to the evolution of nominal growth over the investment horizon, consistent with standard economic theory.

While our regression analysis shows that initial valuations and the rate of future nominal economic growth account for some 90% of the total return over a period of 10 years, three other factors also play a role.

The monetary regime

This factor affects the term premium, i.e. the extra yield investors demand for holding longer-dated bonds. We believe that term premia will trend higher in the coming years, most notably in the US, where the premium could reach 1.3% versus 0.8% today. This mainly reflects what we see as the rising risk of fiscal dominance – government interference in rate policy – and the Fed's failure to anchor inflation at the 2% target. While the era of financial repression appears to be ending, central banks are likely to maintain an easing bias, partly to keep debt servicing costs at manageable levels.

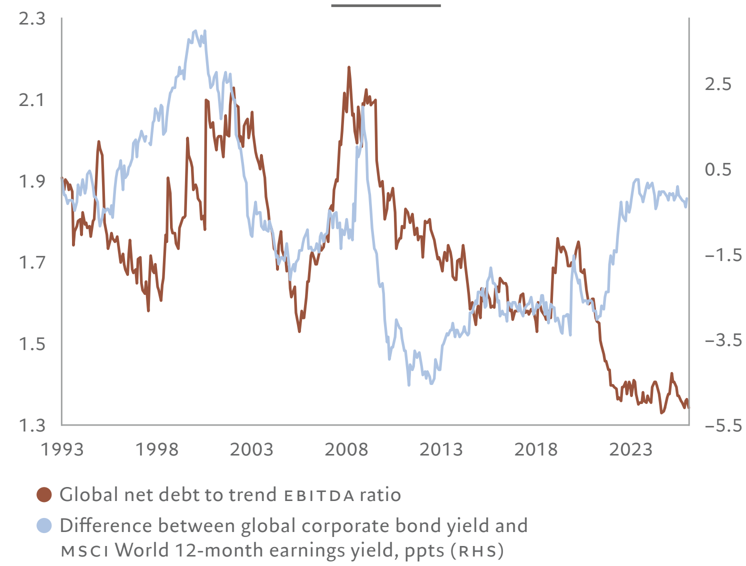
The level of domestic savings

This factor shapes net demand for bonds. Countries with excess savings such as Japan, several European nations and China (i.e. a positive net international investment position) tend to have lower bond yields.

FIGURE 21

Credit: better valued than equities, stronger fundamentals than government bonds

Difference between global corporate bond yield and global equities' 12-month forward earnings, compared to net debt to EBITDA ratio



Source: LSEG, MSCI, Bank of America, Pictet Asset Management. Corporate bond yield based on a 70% investment-grade and 30% high-yield portfolio. Data covering period 05.06.1993-05.06.2026.

Fiscal policy

This factor determines the net supply of bonds but also affects demand for them through perceptions of credit quality. The deteriorating fiscal outlook is consistent with upside risks to both nominal and real rates, especially in the US. We expect the US debt-to-GDP ratio to expand further by some 20 percentage points over the next decade – with a "fiscal equilibrium" resting on below-fair-value interest rates, inflation running slightly above the official target and passive fiscal tightening.

Overall, we forecast US 10-year yields will reach 4.75% – taking them to only 100 basis points lower than emerging market (EM) local currency bonds, the narrowest gap ever. UK and Japanese yields are likely to stay close to current levels, at 4.75% and 2.5%, respectively, while euro zone yields are expected to rise, with 10-year German government bonds poised to deliver some 3.3% by the end of our forecast horizon. Chinese yields are projected to move up to 2.9%. In terms of expected returns, the best opportunities continue to be in EM, where we anticipate returns of some 7% per year on average, and in the UK.

Within fixed income, credit should deliver the highest risk-adjusted returns. Initial valuations are favourable, being lower than those of equities. Corporate borrowers also carry better fundamentals than government bonds (see FIGURE 21). Yield spreads will widen marginally but remain low in a historical perspective – and the same holds for default rates.

For high-yield corporate bonds, we find that the most accurate indicator of future return is a weighted average of equity and government bond return forecasts – 0.3 for equity, 0.7 for government bonds – adjusted for initial spread levels. The R^2 of this approach runs close to 65%.

Currencies:
a descent for the dollar

OUR VIEW

Investors should expect a steady decline in the dollar in the face of slowing growth and stubborn inflation.

The flip side to the greenback's depreciation will be a gain for EM Asian currencies, which will receive a boost from the boom in AI.

The Japanese yen and Swiss franc will also do well, while digital currencies will continue to grow in prominence.

We believe the dollar's decline, which started in earnest last year, is set to persist.

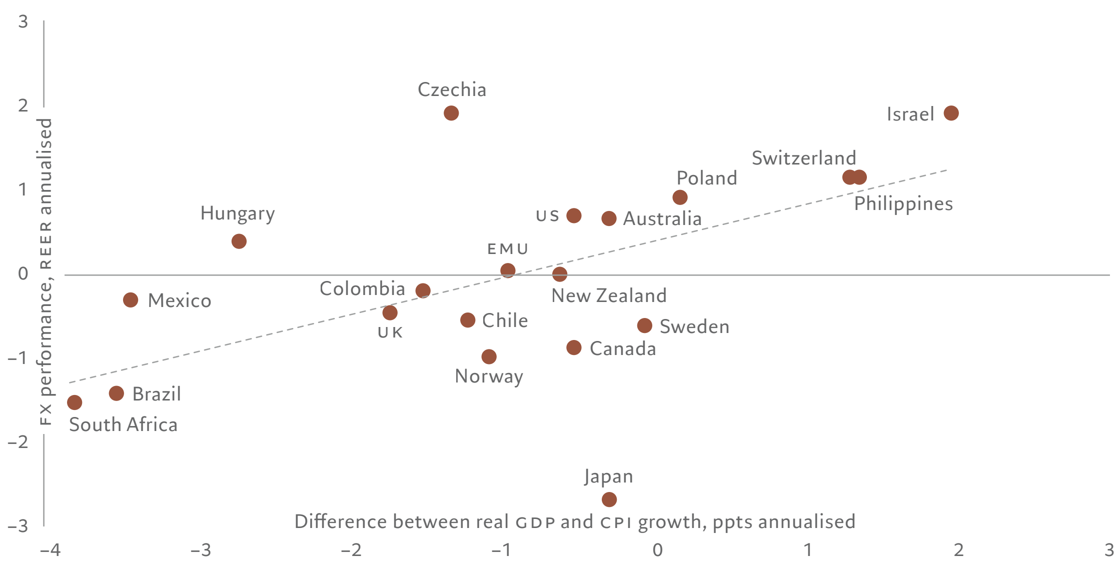
Both structural economic trends and market behaviour point to a continued downtrend. As FIGURE 22 shows, a currency's underlying strength is inextricably linked to the gap in a country's growth and inflation rate. The wider the gap in favour of growth, the greater the scope for currency appreciation.

When it comes to the dollar, our forecasts show the gap narrowing. We expect US growth to slow over the next decade compared with recent history. Granted, inflation will ease over the same time period, but it will remain above the Fed's 2% target. Meanwhile, other major economies, such as Europe and Japan, will see material improvements in their growth-to-inflation differentials. The US will thus lose some of its economic advantage on a relative basis, which, by extension, will reduce the appeal of the dollar.

FIGURE 22

Low inflation, strong growth leads to currency appreciation

Correlation of currency performance to real GDP growth relative to inflation over the past 20 years for free float and unmanaged currencies

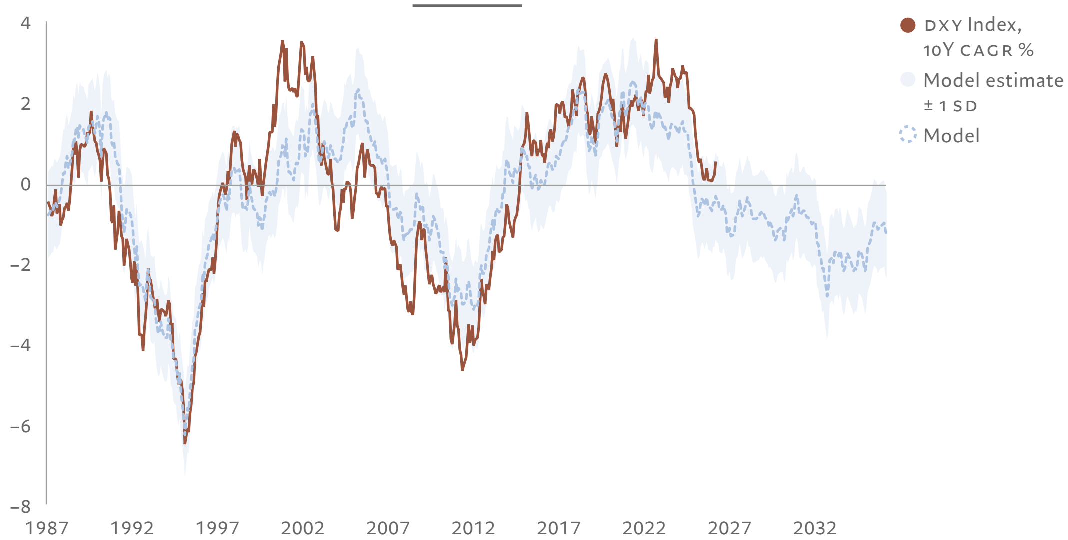


Source: LSEG, Pictet Asset Management.
Data covering period 30.03.2006-30.03.2026.

FIGURE 23

Dollar depreciation on the cards

Trade-weighted US dollar, 10-year rolling performance in %, actual and model forecast



Source: LSEG, Pictet Asset Management.
Data covering period 08.02.1987-08.04.2026.

The picture is similar when we perform a more comprehensive analysis. Two models in particular inform our decisions. The first is a cointegrated model based on cross-country inflation differentials, productivity differentials and net international investment positions.

The second uses growth-to-inflation differentials alongside mean reversion and a valuation adjustment to account for the gravity of the trend in the dollar (see FIGURE 22).

Each model indicates a modest but clear decline in the dollar, averaging around 1.1% per year over the next 10 years. That will bring the DXY Index to 88, implying a 23% drawdown from the modern era peak set in 2022.

Away from economic fundamentals, we believe market behaviour will also evolve in a way that bears down on the greenback. Its weakness during last year's global trade tensions reminded foreign investors of the risk of under-hedging currency exposure. We foresee hedging becoming more prevalent, removing a pillar of dollar strength from the 2010s, when it was supported by persistent unhedged inflows into US assets.

Crucially, our expectations of narrowing interest rate differentials between the US and other regions, especially Europe, mean that currency hedging will become materially cheaper for investors.

Of the major currencies set to gain at the dollar's expense, the Swiss franc and the Japanese yen emerge as the standout performers.

The franc's secular bull trend is underpinned by Swiss GDP growth consistently outpacing inflation, thanks to elevated productivity and a robust macroeconomic backdrop. Switzerland's fiscal discipline, strong net foreign asset position and political stability reinforce this view. We expect the franc to gain 1.4% annualised against the dollar over the next 10 years.

The Japanese yen, arguably, has even greater appreciation potential. The growth-to-inflation outlook for Japan is poised to improve considerably over the next decade. The end of financial repression and the likelihood of higher Japanese interest rates should reduce the prevalence of the yen-funded carry trade. Add in the yen's current undervaluation and the prospect of a narrowing rate gap with the US, and we have a constructive backdrop for a recovery of roughly 1.9% per year on average.

In the euro zone, meanwhile, higher rates, increased fiscal spending and the potential for market reforms – particularly those that enable securitisation and investment – should support the single currency and provide a counterweight to its structural headwinds. As the US premium fades, the euro is likely to benefit from both a repricing of risk and a rotation of global capital. We forecast a euro/dollar exchange rate of 1.30 in 10 years' time, compared with current levels of around 1.15.

Sterling, by comparison, is likely to see only a very muted appreciation to USD 1.43 by 2036 (from USD 1.33). Valuation is not attractive, with sterling's real effective exchange rate (REER) at pre-Brexit levels.

Emerging market currencies also look set for a comeback. Improved credit quality, attractive valuations and a waning US dollar should push up the EM currency complex by an average of 1.4% annualised (based on MSCI Emerging Markets Index country weights).

Asia to lead EM currency appreciation

EM Asia currencies look particularly attractive given their importance in, and the world's reliance on, the AI supply chain – spearheaded by Taiwan and Korea.

From a fundamental perspective, China should see a favourable growth-inflation mix and positive real rates boost the renminbi. However, as a managed currency, its appreciation is likely to be gradual and controlled – around 1.3% per year on average.

The Indian rupee will also benefit from supportive macroeconomic dynamics, but the importance of exporters to the local economy will likely limit the scope for meaningful appreciation.

Our expectations of narrowing interest rate differentials between the US and other regions, especially Europe, mean that currency hedging will become materially cheaper for investors.

Looking at Latin America, Brazil's real will strengthen according to our calculations. While inflation there should remain comfortably above 2% and higher than the GDP growth rate, the gap is set to narrow materially from current levels. At the same time, continued elevated rates make for attractive carry trades, particularly in periods of low market stress. We therefore expect the Brazilian real to strengthen.

The outlook for the Mexican peso is more challenging. Nearshoring, trade deals and remittances have supported the currency in the recent past, but these tailwinds are fading while other fundamentals are weak. Our models suggest a depreciation of the peso by 2.1% annualised versus the dollar.

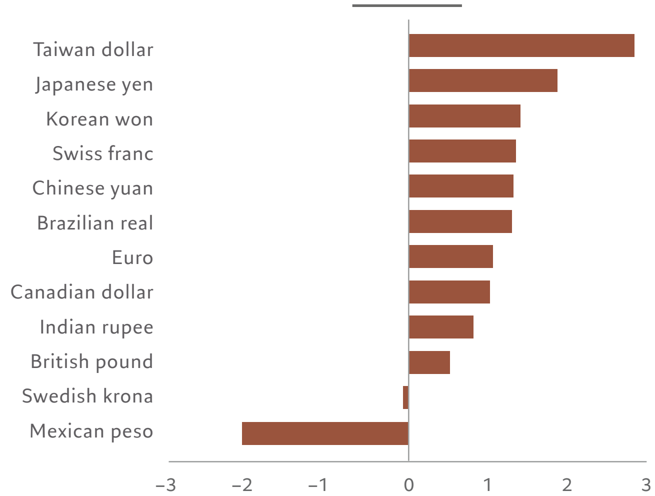
Beyond traditional currencies, cryptocurrencies – particularly bitcoin – will remain firmly on investors' radars. Despite ongoing regulatory uncertainty and volatility, crypto-assets have demonstrated resilience and are increasingly viewed as a potential hedge against fiat debasement, especially as fiscal discipline weakens in major economies. While not a core holding for cautious investors, the growing institutional and retail acceptance of bitcoin, alongside regulatory milestones such as the approval of spot bitcoin exchange-traded funds, suggest that crypto will remain a firm feature of the global investment landscape.

Overall, the global currency market will be shaped by the interplay of shifting growth-inflation dynamics, valuations and capital flows. The dollar's secular decline, the resilience of the Swiss franc and yen, the euro's reform-driven upside, selective opportunities in EM and the growing prominence of digital assets will be among the most prominent trends investors should seek to position for over the coming 10 years.

FIGURE 24

Asia in the lead

Forecast return for currencies vs USD, average % p.a. over 10 years



Source: Pictet Asset Management.
Forecasts covering period 01.01.2026–31.12.2035.

Alternatives: opportunities in real estate and hedge funds

OUR VIEW

Alternatives offer investors positive real returns and diversification benefits. We see some of the best opportunities in real estate and hedge funds. In private equity and private debt, manager selection will be key. Digital assets will continue to rise in importance, with tokenisation likely to disrupt the investment industry.

REAL ESTATE

We believe property is one of the most attractive asset classes for an ageing society, with the additional tailwind of being largely shielded from the disruptive forces of AI. It offers income, inflation protection and a long-time horizon – attributes that will be in high demand as the median age of the population rises. While some areas of the real estate market are overvalued, especially residential, the sector's investment potential is underappreciated.

After a volatile two decades, valuations have normalised and cap rates are now high enough to offer a reliable buffer. We forecast annual returns of around 7% in the US, Europe and the UK over the next 10 years – roughly in line with equities.

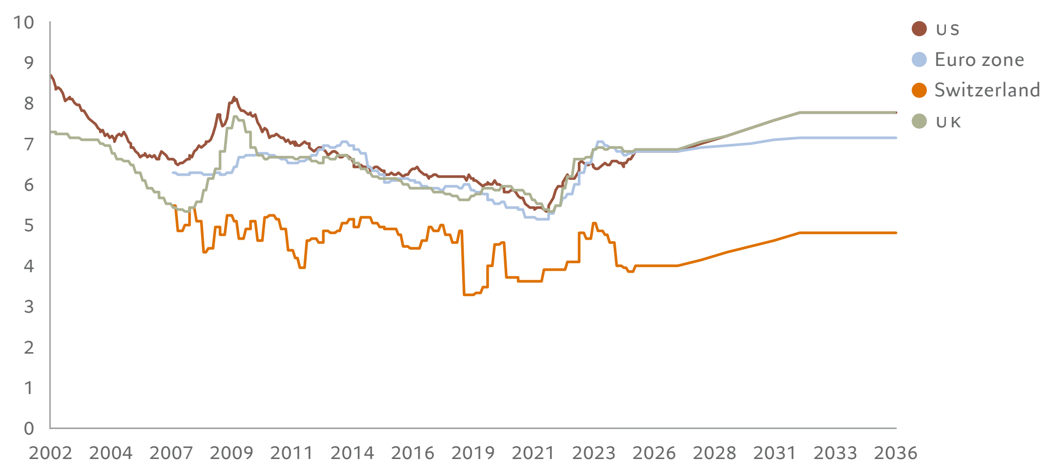
HEDGE FUNDS

Prospects also look relatively bright for hedge funds. In risk-adjusted terms, we expect them to deliver some of the most attractive returns among all the asset classes we cover.

FIGURE 25

Attractive entry point

Real estate transaction based capitalisation rates, all sectors, %



Source: RCA Trends Global, Pictet Asset Management.
Data covering period 31.03.2002-30.04.2026.
Pictet AM forecasts covering period 01.05.2026-31.12.2036.

History shows that when the correlation of individual stock returns is low (a by-product of rising market concentration), market volatility is high and equity risk premia are modest, hedge funds tend to fare well.

Indeed, when we calculate the optimal weights of a global multi-asset portfolio based on historical volatilities, correlations and our 10-year return forecasts, our model suggests that investors should allocate as much as 10% to hedge funds – the same proportion as US Treasuries.

PRIVATE EQUITY

For private equity, we expect annual returns of 9–10% over the next decade (versus 14% over the last decade), representing a reduced but still positive illiquidity premium of 2.5 percentage points over public equities (compared with the long-term average of around 5 percentage points).

With some USD 2.1 trillion of dry powder, competition for quality assets is intense. Returns are increasingly driven by operational value creation rather than financial engineering (multiple expansion and leverage). As we expect interest rates to remain at current levels, the pressure on highly leveraged portfolio companies could be compounded by a refinancing wall.

Although exit conditions have improved, private equity holding periods have lengthened to a median six years (from around four years in the 2000s), thus extending the time-weighted exposure to private equity and making the return profile more uncertain.

Positive drivers for the asset class include the rapid growth in secondary private equity markets, which will help address portfolio construction and liquidity management concerns. The proliferation of general partner (GP)-led continuation vehicles has provided some liquidity relief to fund investors while retaining ownership of high-conviction assets.

In risk-adjusted terms, we expect hedge funds to deliver some of the most attractive returns among all the asset classes we cover.

Private equity is also opening up to retail investors, with asset managers pivoting to semi-liquid "evergreen structures". However, strict liquidity gates typically cap quarterly redemptions at 5% of fund net asset value (NAV) – a level likely to be breached in periods of market stress.

The real value-add from private equity allocation will come from alpha (manager selection), rather than beta (broad exposure). Typically, the dispersion between the top and bottom quartile of returns is almost four times that of active public equity funds; this is all the more relevant in today's context of weaker aggregate tailwinds.

PRIVATE DEBT

The environment for private debt has become more challenging, but we do not think the asset class's recent travails are material. Attractive investment opportunities may be harder to find, but private credit still has the potential to deliver reasonable returns (averaging 7.2% per year) and diversification benefits.

We believe default rates will rise to 4%, above the historical average of around 2.5%, implying a 1.8% per year drag on total returns. This reflects private debt's high exposure to sectors heavily disrupted by AI such as software that accounts for 20% of total assets under management.

What's more, lower-rated entities constitute a high proportion of the universe, with B-minus rated borrowers making up 76% of the market and CCC-rated borrowers 15%. Also weighing on the asset class's prospects are the weaker lending covenants that have been applied in recent years; these will likely reduce recovery rates on defaulted debt to around 55% on average.

COMMODITIES

The outlook for commodities is mixed. We forecast an average annual return of 5% over the next 10 years, down from 9% over the previous decade.

The macroeconomic backdrop is favourable: commodities tend to perform well in periods when the US dollar weakens and global growth is solid, especially in manufacturing. Furthermore, the three major secular trends that form part of our investment framework – AI-driven data centre boom, electrification and increased defence spending – are all very commodity-intensive, while supply is unlikely to expand significantly.

However, there are two significant headwinds. First, valuation. Real commodity prices[13] are back to the peaks set in 2011 and 2022, and are likely to mean revert over the next 10–15 years. Secondly, commodities do not pay dividends or coupons. The opportunity cost of owning commodities is equal to the US real rate of interest, which we expect to average 1% over the next 10 years (versus -0.75% over the previous 10 years).

The biggest upside is in industrial metals (8–9% return per year), where supply is tight and demand is surging. Conversely, we expect the oil price to decline to as low as USD 70 by 2036 – a drop of some 50% in inflation-adjusted terms.

13 Bloomberg Commodity Spot Index divided by US CPI

GOLD

The outlook for gold is less attractive than a year ago. Real gold prices have surged and the upside now looks limited. Our models based on the US dollar, real interest rates and US growth point to a 4% return per year, sharply down from the 14% per year achieved in the previous decade.

Central banks are reducing their purchases of gold and high prices are damping demand from retail investors and consumers alike. However, gold will remain an attractive inflation hedge.

Even if it is not, and will never be, a risk-free asset (because it is too volatile), we think that independently of the expected future returns, a significant strategic allocation to gold is essential for cautious global multi-asset investors.

DIGITAL ASSETS

Digital assets will continue to rise in importance, but we see the greatest potential in tokenised real-world assets (RWAs) rather than crypto.

Tokenisation is taking hold across private credit, US Treasuries, commodities and institutional fund structures, supported by regulated pilot schemes and industry participation.

We believe tokenisation could disrupt the investment industry – similar to the rise of exchange-traded funds (ETFs) over the past two decades. It is set to strengthen efficiency, transparency and operational consistency by consolidating onboarding, registry maintenance, servicing and reporting within a unified infrastructure.

Cryptocurrencies – both bitcoin and stablecoins – are now considered “mainstream” asset classes by a significant proportion of investors. We see great potential for the wider adoption of stablecoins, but believe they will mostly remain a bridge between fiat and digital currencies. Central bank digital currencies (CDBCs) will encroach on that function too.

We are more sceptical of bitcoin, and whether it can play an important role in a balanced portfolio.

Bitcoin's limited supply has led some to argue that it could be an effective inflation hedge. In theory, that sounds plausible but so far El Salvador is the only country that accepts it as legal tender; in other words, bitcoin still needs to be converted into local currency to buy a comprehensive basket of goods and services. This means the price of bitcoin relative to the domestic currency is the dominant driver of inflation for bitcoin holders.

As bitcoin swings violently in price, its inflation rate in the US has proved anything but stable. Since 2020, the bitcoin inflation rate on a 6-month annualised basis has averaged 16%, much higher than actual inflation (4%). In contrast, US inflation for payments in gold has averaged a negative 10%.

Bitcoin has also proved to be a weak diversifier, displaying very high correlation with software stocks.

> A significant strategic allocation to gold is essential for cautious global multi-asset investors.

Put simply, bitcoin may be disrupted too. It is down nearly 50% from its peak in October and the cryptography algorithm on which it is based will be challenged by advances in quantum computing and AI. It is code-money, not really digital gold.

Our models based on its historical correlation with tech stocks, gold and US dollar – as well as other valuation metrics – suggest more upside to bitcoin but, on balance, we continue to believe that bitcoin and crypto do not belong in a cautious global multi-asset portfolio. They are speculative assets and should be treated as such.

We forecast a five-year total return of 7% per year for European private debt, with an average spread of 550 basis points. Returns will be somewhat curtailed by a lower ECB base rate and by defaults edging higher than last year.

SECULAR TRENDS

10-YEAR ASSET CLASS RETURN PROJECTIONS

Pictet Asset Management's Strategy Unit (PSU)

The PSU is composed of Pictet Asset Management's most experienced multi-asset and fixed income portfolio managers, economists, strategists and research analysts located in various offices. This investment group is responsible for providing asset allocation guidance over the short- and long-term horizons across stocks, bonds, commodities and alternatives.

Every year, the PSU produces the Secular Outlook: a publication providing asset class return forecasts for the next five years. The research embeds, and is a reflection of the PSU's investment philosophy.

"We believe understanding how the economic landscape changes over time is both a fundamental component of strategic asset allocation and crucial for investment success over the long run."

OLIVIER GINGUENÉ
Chairman of Strategy Unit, CIO, Multi Asset & Quantitative Investment

SECULAR TRENDS

10-YEAR ASSET CLASS RETURN PROJECTIONS

We believe…

Macroeconomic forces have a bigger influence on asset class returns over the medium and long term than any other factor; understanding how the economic landscape changes over time is both a fundamental component of strategic asset allocation and crucial for investment success over the long run.

Over the short run, markets are more volatile than is warranted by underlying economic conditions. Moreover, the relationship between asset classes is not stable through time. This leads to a mispricing of assets, which presents opportunities for tactical asset allocation.

Every asset class carries a risk premium, which rises and falls as the business cycle progresses from one phase to another. The focus of our research is to identify how the macroeconomic environment is changing and how this is likely to affect the risk premium attached to each asset class.

The skilled deployment of both strategic and tactical asset allocation can deliver superior investment returns over the long term.

SECULAR TRENDS

10-YEAR ASSET CLASS RETURN PROJECTIONS

Appendix

Equity forecast

	Yield	Earnings and buybacks: Sales growth*	Margin change **	Net buybacks ***	EPS growth p.a.	P/E ratio: 12M P/E	Forecast in 10 years ****	% change p.a.	Total return p.a. (%): Total local currency	FX impact	Total in USD
US	1.2%	6.0%	-1.0%	1.6%	6.6%	20.8	19.0	-0.9%	6.9%	0.0%	6.9%
Euro zone	2.8%	3.7%	-0.7%	1.2%	4.2%	14.5	14.3	-0.2%	6.8%	1.1%	8.0%
Switzerland	2.8%	2.1%	-0.6%	1.2%	2.7%	18.1	17.5	-0.3%	5.2%	1.3%	6.6%
UK	3.0%	3.0%	-0.7%	1.3%	3.6%	12.6	12.0	-0.5%	6.1%	0.5%	6.6%
Japan	1.9%	4.0%	0.0%	1.0%	5.0%	16.7	15.0	-1.1%	5.8%	2.0%	7.9%
Developed markets	1.5%	5.1%	-1.3%	1.5%	5.3%	19.2	17.7	-0.8%	6.8%	0.2%	7.0%
China	2.2%	3.7%	0.0%	0.0%	3.7%	11.6	11.5	-0.1%	5.8%	1.3%	7.2%
India	1.4%	8.1%	-0.4%	-0.5%	7.2%	20.7	18.5	-1.1%	7.4%	0.8%	8.3%
Emerging Asia	1.8%	5.5%	-1.1%	0.0%	4.3%	12.1	12.5	0.3%	6.4%	1.7%	8.3%
Latin America	4.0%	3.5%	0.0%	-1.0%	2.5%	10.1	9.7	-0.4%	6.0%	0.3%	6.3%
EMEA	3.8%	3.0%	-0.2%	-1.0%	1.7%	10.2	10.0	-0.2%	5.3%	0.1%	5.4%
Emerging markets	2.1%	5.0%	-1.0%	-0.2%	3.8%	11.7	12.0	0.2%	6.3%	1.4%	7.8%
Global equities	1.6%	5.1%	-1.2%	1.3%	5.0%	17.7	16.7	-0.6%	6.8%	0.4%	7.2%

Source: LSEG, MSCI, IBES, Pictet Asset Management. Forecasts covering period 30.05.2026–30.05.2036.

* Proxied by our forecast for nominal GDP growth (average 2026 to 2036), adjusted for regional revenue exposure. Reflecting historical trend, structural tech leadership and regulatory environment, we adjust for a market's ability to translate nominal GDP growth into revenue growth.

** IBES net profit margin, based on impact of operational leverage due to change in trend GDP, reversion to current trend, a global convergence adjustment for EM markets and FX impact.

*** Expected buybacks net of dilution from secondary issuance (forecast net buyback yield in line with 20-year average in US, 10% above average in Europe and Japan).

**** US P/E based on our forecast of median US stock P/E (based on our assumption for 10Y bond yield, inflation, trend growth) and mega-cap premium staying at current level. DM regional P/E forecast is a combination of return to trend multiple relative to US adjusted for anticipated change in trend GDP growth and return to 10-year average absolute P/E levels. EM regions to return to average of current, mean and trend relative multiple to MSCI Emerging Markets.

Fixed income forecast

	DURATION (YEARS)	CURRENT YIELD	TERMINAL YIELD*	ANNUALISED ROLL **	DEFAULT/ RATING DRIFT	RETURN IN LOC CUR. P.A. (%)	FX RETURN, P.A. (%)	USD RETURN, P.A. (%)
10-year US Treasuries	8.1	4.4	4.8	0.6	0.0	5.0	0.0	5.0
10-year German Bunds	8.2	3.0	3.3	0.7	0.0	3.7	1.1	4.8
10-year Euro zone govt bonds	7.3	3.3	3.5	0.6	0.0	4.0	1.1	5.1
10-year Swiss govt bonds	9.0	0.4	1.2	0.5	0.0	0.8	1.4	2.1
10-year Japanese govt bonds	8.6	2.5	2.5	0.7	0.0	3.2	2.0	5.3
10-year UK gilts	7.7	5.0	4.8	0.7	0.0	5.8	0.5	6.3
10-year Chinese govt bonds	9.0	1.7	2.9	0.2	0.0	1.8	1.3	3.1
10-year US inflation-linked bonds	4.4	1.9	2.2	0.3	0.0	4.6	0.0	4.6
Global govt bonds	6.8	3.5	3.8	0.6	0.0	4.0	0.8	4.8
US investment-grade bonds	6.5	5.2	5.7	0.7	-0.3	5.7	0.0	5.7
US high-yield bonds	3.8	7.3	8.0	0.3	-1.4	6.5	0.0	6.5
Euro zone investment-grade bonds	4.5	3.7	4.1	0.5	-0.2	4.1	1.1	5.2
Euro zone high-yield bonds	3.4	6.0	6.6	0.2	-1.3	5.0	1.1	6.2
Emerging market dollar bonds	6.4	7.0	8.0	0.7	-0.8	6.8	0.0	6.8
Emerging market local currency bonds	5.3	6.3	5.8	0.1	0.0	6.3	0.4	6.7
Emerging market corporate bonds	4.4	6.5	7.1	0.7	-0.6	6.7	0.0	6.7
US dollar cash	0.2	3.7	3.4	0.0	0.0	3.4	0.0	3.4

Source: Pictet, Bloomberg, LSEG, J.P. Morgan, BofA. Forecasts covering period 30.05.2026–30.05.2036.

* Policy rate assumption: Fed 3.25%, ECB 2.25%, BoE 3.25%, SNB 0.5% and BoJ 1.25%, based on our neutral rate and trend inflation estimate. Slope of government bond based on respective macro conditions. JPM EMU 10Y govt 20 basis points spread above JPM Germany 10Y. Bloomberg Global Agg Treasuries weighted average used on roll, yield change and return calculation for global bonds. Credit spreads and EM bond yield based on our respective fair value models and default estimates. Recovery rate assumed to be 40% for DM HY and EM hard currency sovereign and corporate debt.

** Adjusted roll yield according to pace of central bank normalisation and our expectation of curve steepness in year 5. IG corp roll assumes curve steepens proportionally with government bonds.

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