CIO OUTLOOK

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Looking ahead to 2025

TIKEHAU CAPITAL

Foreword

The shift from an economic model built until recently on the quest for endless growth in a environment characterised by low, or even negative, interest rates, for which efficiency and optimisation were the bywords, towards a more local model viewing resilience as essential, is setting the stage for radical changes in our economies and in the way we invest.

In our previous edition published in September 2023, we had expressed our belief that this paradigm shift would have four main consequences that would shape 2024:

- value creation founded on resilience at the expense of efficiency;
- misalignment of interests between central banks and governments;
- rising costs of both capital and liquidity;
- structurally higher risk premiums.

How should we view our projections made in 2023? Have events of the past months indicated that we were right? With the end of 2024 coming into view, we open this edition with a look back at these four points.

After that, we discuss what we think will be the trends to watch in 2025, namely:

- increasing government intervention in economic affairs;
- the steep rise in investment spending worldwide;
- continuing deglobalisation towards a multipolar world, with the Indo-Pacific region emerging as the main growth driver.

Another key theme that cannot escape anyone's notice is, of course, artificial intelligence (AI). Indeed, current valuations are justified by hopes of lower interest rates and investors' belief that artificial intelligence will usher in a new era of strong growth. After having addressed the issue of interest rates in our previous edition, this year we analyse the impact of AI on our economies, with all the necessary caveats due to the uncertainties surrounding this technology. Given all the excitement around technology innovation, the fact that return on investment depends on an investment's profitability over time as well as its initial cost can often be overlooked.

Lastly, we highlight the investment opportunities that these trends will bring and that may be performance drivers in the long term.

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A review of our insights for 2024

RESILIENCE, CENTRAL BANKS VS GOVERNMENTS,
COST OF CAPITAL AND LIQUIDITY, AND RISK PREMIUMS

1

Towards a resilience-based economy

For 2024, we had anticipated the shift from an economic model built on efficiency to a resilience-based economy. This trend now seems to be well under way and is still being driven not only by business leaders, but also by political and economic decision-makers.

We expect this transition to a resilience-based economy to advance and even gather pace in 2025 and beyond, with the following possible consequences: increased government intervention in economic affairs, a steep rise in investment spending worldwide and continuing deglobalisation leading to a multipolar world.

> **“This return to more local ecosystems should ease the move towards a growth model that would be more sustainable, although likely less optimised.**

This return to more local ecosystems should ease the move towards a growth model that would be more sustainable, although likely less optimised. This could also lead to the emergence of megatrends with high growth potential, which will concentrate the bulk of value creation in a world marked by slower growth.

2

Misalignment of interests between central banks and governments

We had also mentioned the lack of alignment between the interests of central banks and governments as a key element in 2024. On the one hand, central banks in the West having to fight a structural inflation. On the other hands, governments opting for aggressive fiscal policies in order to finance spending on health and defence as well as the energy transition.

This led to our conclusion that, in contrast to what many market observers were expecting in light of inverted yield curves, the problem was not in the fact that short term interest rates were viewed as too high but rather in long term interest rates being too low. Recent economic indicators suggest our earlier predictions about short-term interest rates may have been on the right track, but long-term interest rates have remained low amid recession fears.

We stand firm in our assessment and think that the steepening of the yield curve should mainly occur through a rise in long-term rates, given the need for bond issues to fund growing budget deficits. As for short-term rates, the continuing disinflationary trend on both sides of the Atlantic and the US economic slowdown should trigger a pivot in monetary policy towards the prospect of rate cuts. However, we believe that this readjustment will happen gradually and we remain cautious about the pace at which lower interest rates will be introduced.

3

Rising cost of both capital and liquidity

Fuelled by the monetary and fiscal policies of the last 15 years, negative interest rates and abundant liquidity resulted in both an excessive amount of debt and capital misallocation. At the same time, the rise in interest rates initiated in 2022 led to a liquidity dry-up in the markets.

We expect this liquidity dry-up to continue for two main reasons.

First, although central banks in the West are starting to cut rates, inflation is still being boosted by structural developments relating to demographic factors, energy mix changes and deglobalisation. Inflation tends to be driven less by demand than by supply, on which monetary policies have little or no effect. Second, the pivot of monetary policy by the Bank of Japan has put an end to the outflow of Japanese savings to geographies offering higher interest rates. Abundant Japanese savings should thus be more domestic in 2025, drawing liquidity from other markets.

4

Towards an era of structurally higher risk premiums?

This has not yet come to pass in 2024, with risk appetite remaining robust in the first half of the year, driven by the expectation that interest rates will decline once inflation has cooled off and the belief among investors that AI will bring about a new era of strong growth.

> Nevertheless, we remain convinced that geopolitical tensions and the deglobalisation of the world economy, together with the social changes amplified by technology, and AI in particular, will bring greater uncertainty, and therefore volatility, to the valuation of financial assets.

Nevertheless, we remain convinced that geopolitical tensions and the deglobalisation of the world economy, together with the social changes amplified by technology, and AI in particular, will bring greater uncertainty, and therefore volatility, to the valuation of financial assets. **This unpredictability and chronic instability, on both political and economic fronts, should result in structurally higher risk premiums** than those observed in the past 40 years, which were characterised by declining interest rates and growing globalisation.

Outlook and themes for 2025 and beyond

INCREASED GOVERNMENT INTERVENTION, A BOOM IN CAPITAL EXPENDITURE, ARTIFICIAL INTELLIGENCE, A MULTIPOLAR WORLD AND THE RISE OF THE INDO-PACIFIC REGION

1

Increasing government intervention in economic affairs

The need to build resilience amid deglobalisation and geopolitical tensions is accompanied by the return of industrial policies and strategic plans motivated by sovereignty. It is therefore not surprising to see governments adopting aggressive fiscal policies to direct investments toward building resilience.

> **“Geopolitical and economic tensions are shifting the focus of value creation from generating efficiency, in a period of globalisation and lower interest rates, to generating resilience, an objective in which governments play a vital role.**

In all of the largest economies around the world, government intervention in economic affairs is increasing. Geopolitical and economic tensions are shifting the focus of value creation from generating efficiency, in a period of globalisation and lower interest rates, to generating resilience, an objective in which governments play a vital role.

Towards industrial production and a tech sector in the hands of Beijing

In China, access to abundant savings allows the government to direct investments toward its own priorities: industrial production and technology. This helps Beijing safeguard jobs and reduce its dependency on the West. China's economy is thus once again almost entirely owned and controlled by the state. All of its economic growth results either from public spending in sectors deemed strategic by the government, or from exports. This state allocation generates industrial excess capacity and deflation, although this deflation is not exported in full since Western countries may ban Chinese goods produced at a loss.

In particular, the Asian behemoth exports automobiles, batteries and solar cells. In these three segments, Chinese products are extremely cheap, preventing possible competitors from being profitable, putting countries exporting automobiles and industrial goods, like South Korea, Japan and Germany, in a difficult position. In railways, nuclear power and aeronautics, Chinese products and services are also especially competitive, or will be in short order. **Consequently, Chinese savings are expected to absorb the future write-down of surplus industrial production capacity from the 2020s. In the area of technology, the Chinese state is offsetting the withdrawal of financing for the country's start-ups by foreign, and especially US-based, funds.** The Chinese tech sector is thus once again being supported and financed by the state, which means that financing choices will be dictated by its strategic interests.

Towards ever higher US and European debt

In the West, most governments find it necessary to maintain their level of military spending due to current geopolitical tensions. **In the case of the United States** – which is geographically isolated from Europe, Asia and Africa, the regions that will account for the vast majority of the global population in 2100 – **the only way to retain monetary and economic leadership would be to preserve military and technological dominance.** This could allow Washington to extend the reach of its power to distant regions that will see most of the growth in the coming decades. **Meanwhile,** and this is unprecedented for a developed country in modern history, life expectancy in the United States has declined during peacetime. Costs associated with obesity, cancer, diabetes and opioids are increasing. **The US government will need to shoulder some of these public health expenses, on top of subsidising the energy transition** (notably by way of the Inflation Reduction Act). **The country will therefore need to issue more and more debt, charting a conclusive budget path: in less than 10 years, the total value of outstanding US Treasury bonds will have risen from $20 trillion (2017) to $40 trillion (2025 forecast).**[1] As for the cost of the national debt, it has crossed the $1 trillion mark, thus a total amount of interest payments equivalent to Switzerland's GDP each year.

[1] American Institute for Economic Research - aier.org/article/34-trillion-and-climbing/

Europe is subject to the same trends. European governments will need to continue financing welfare state provisions due to their ageing populations. In addition, given the resurgence of conflicts on the continent, most European countries have announced **significant increases** in military spending.

These same countries must also fund their energy transition, among other reasons to prepare for any sudden stoppage of Russian natural gas flows, a very cheap source of energy. And this situation comes at a time when the European Union's budget deficit is close to record levels.[1]

This trend toward increased government intervention in economic affairs seems structural and little affected by changes in political regimes, due to the fact that all political parties currently appear to favour aggressive fiscal policies. This phenomenon raises several questions.

Who will absorb the increase in bonds issued by Western governments?

We included a detailed discussion of this topic in our 2024 Outlook and still stand by the findings of the analysis produced last year. Taking things a step further, the question can also be formulated as follows: **Is a debt crisis in developed countries in the cards,** a "1998 in reverse"? There is no way to know for certain, of course, **but the scenario of a debt crisis in developed countries cannot be entirely excluded in the medium to long term.** This hypothesis relates to a specific set of circumstances: financing requirements of Western countries are increasing, whereas key creditors (China, GCC countries) are looking to reinvest in their own economies, while rising interest rates and the yen's appreciation have prompted the repatriation of some Japanese capital invested abroad. The markets seem to have already taken this into account, as some emerging market bond index returns are already lower than those of US Treasury bonds.[2] Is this really an anomaly, or does it reflect a new reality?

What consequences would there be for financial returns?

Major economies have a duty to protect their companies from international competition. We can therefore expect an increase in protectionist measures. Deglobalisation should also gather pace and non-economic considerations – political, strategic or ideological ones, for example – are likely to have more influence on investment or financing decisions. **The share of public investment should continue to grow,** via industrial policies and strategic initiatives across various economies, particularly in the US, the European Union, China, Japan and India. **This trend could lead to less optimised capital allocation and a possible decline in financial returns.** This is due to the fact that, with rare exceptions like Singapore, countries do not generally have an excellent track record when it comes to capital allocation.

[1] ec.europa.eu/eurostat/web/products-euro-indicators/w/2-22042024-ap#:~:text=In%20the%20euro%20area%20the,from%2083.4%25%20to%2081.7%25

[2] Source: Bloomberg. Data at 12 August 2024. ICE BofA Investment Grade Emerging Markets Sovereign Bond Index used as the benchmark for sovereign bond performance in emerging markets.

2

Huge and necessary capital expenditure requirements

The 4Ds – decarbonisation, defence, deglobalisation and digitalisation – are considered as the drivers of history's next great investment spending cycle. **In 2022, the consulting firm McKinsey & Company** estimated the amount of investment spending needed by 2027 at $130 trillion, thus exceeding the global GDP.[1]

Massive investments on the horizon for decarbonisation

Investment spending needed for the transition to a low-carbon economy, to meet water requirements and to strengthen transport and other essential infrastructure will amount to $6 trillion per year over the next decade.[2] Decarbonisation investment alone would therefore represent a quarter of global investment volumes over five years.

Increases in military spending

In the area of defence, military spending is surging worldwide. The target agreed by Nato in 2014, requiring its member countries to commit at least 2% of their GDP to military spending, hadn't been reached by the members states up until the start of the war in Ukraine. But since, military spendings have been getting closer to this target. By the end of 2024, European Nato members will have invested $380 billion in defence, equivalent to 2% of their combined GDP.[3] The military budget of the United States continues to set new records and still represents the largest portion of the federal budget spendings, standing at nearly $850 billion.[4]

[1] Capital Investment is about to surge : are your operations ready ? Mc Kinsey April 2022 mckinsey.com/capabilities/operations/our-insights/capital-investment-is-about-to-surge-are-your-operations-ready
[2] The 6 trillion dollars plan – Goldman Sachs Reasearch, 2022 goldmansachs.com/insights/articles/unleashing-new-waves-of-green-investment
[3] nato.int/cps/en/natohq/news_222664.htm
[4] Source: US Department of Defense, 2024

A boom in AI investments

Investment spending on AI regularly makes headlines. Most of this AI-related spending is being carried out by private companies and mainly by Big Tech players, who are investing considerable sums in R&D and in building computing capacity (through new data centres). Over the next five years, AI investments are projected to reach around $1 trillion.[1] For the first six months of 2024, Microsoft, Alphabet, Amazon and Meta all announced significant increases in their AI expenditure, totalling $106 billion in the period.[2]

It is clear that the Big Tech leaders are more concerned about the risk of underinvestment, which might cause them to lose their competitive advantage, than that of overinvestment, which could destroy economic value. As confirmed by Google CEO Sundar Pichai, "In tech when you are going through transitions like this . . . the risk of underinvesting [in AI] is dramatically higher than overinvesting."[3] The collective forecasts of these leaders indicate that Big Tech's AI-related investments could more than double by the end of the year. Analysts at Dell'Oro Group now predict that as much as $1 trillion could be channelled into infrastructure such as data centres in the next five years.[4] However, the Big Tech companies are still having difficulty in convincing investors that their customers are ready to spend big on AI products and services, in order to ensure a return on these investments.

> **"Over the next five years, AI investments are projected to reach around $1 trillion.**

For example, Meta chief Mark Zuckerberg estimates that the amount of computing power required to train his company's next large language model would be "almost 10 times higher" than was the case for the previous version, even while conceding that it will take years for these models to be profitable.[5]

The geographical distribution of infrastructure investment needs is very wide. But given demographic and economic developments, the Indo-Pacific region should attract a significant share of these investments, particularly for infrastructure such as roads, ports and airports, but also relating to energy, and especially renewable energy. In this context, China, which controls between 65% and 95% of the supply chains for energy transition infrastructure (solar panels, wind turbines, electric batteries and vehicles),[6] is expected to benefit from significant growth drivers.

Demand for the raw materials required to build this infrastructure should remain robust. Combined with protectionism and efforts to secure supplies, this phenomenon is expected to result in structural inflation pressures, fuelled by the lower efficiency brought about by deglobalisation.

[1] Source: Goldman Sachs Research, To of mind – Gen AI, too much spend, too little benefit ? - 2024
[2] Source: Company earnings announcements. Data at 30 June 2024.
[3] ft.com/content/b7037ce1-4319-4a4a-8767-0b1373cec9ce
[4] delloro.com/news/ai-infrastructure-spending-forecast-to-be-over-a-trillion-dollars-over-the-next-five-years/
[5] Meta's second-quarter earnings conference call, July 2024.
[6] weforum.org/docs/WEF_Greening_the_Renewable_Value_Chain_2024.pdf

Is this a good thing?

Provided that investment spending creates economic value, massive capital expenditure requirements in a given economic segment are a positive sign, because this spending should theoretically create new jobs or improve the productivity of existing jobs. However, experience shows that this is rarely the case. Why? Because only the most skilled management teams are able to efficiently allocate their company's free cash flow to productive investments. Building a factory is one thing, but building it at the right time and in the right place with a long horizon that can make the investment obsolete before it begins to make money is another. Most of these investments fail to generate the expected value.

It is also essential at times to know how to resist the temptation to overbid. Whenever a company's main rivals start making huge investments, it can be tempting to follow them, whether through emulation or as a response to pressures from the market, the latter fearing that any company not committing this expenditure will find itself quickly left behind. This is what we saw in 2024 for AI-related R&D expenditure. And yet, it can sometimes be wiser to opt for a return of liquidity to shareholders, by way of dividends or share buy-backs. In short, only the best management teams can successfully carry off investments that create value, because only they know how to estimate the future return on an investment in relation to its cost. This is why the shares of companies in highly capital-intensive sectors, like the automotive industry, heavy manufacturing or nuclear and energy infrastructure, have long had a lower return on investment than those of companies in less capital-intensive sectors. Financial analysts often express the opinion that capital expenditure is the enemy of equity investors.

Consequently, this colossal need for investment spending, required to build resilience in our economic system, may result in lower financial returns than anticipated for investors. The growing involvement of the public sphere in investment decisions, combined with short-term pressures on company managers to adapt to new technologies, will probably lead to disappointment regarding returns on investment, as has occurred in every economic cycle. **This means that we need to remain selective, rigorously analyse the quality of management teams and bring heightened attention to the measurement of the long-term return on invested capital. We can therefore expect higher dispersion, with increased disparity between companies, and between nations (assessed via the financing cost of their debt).**

> **“ Consequently, this colossal need for investment spending, required to build resilience in our economic system, may result in lower financial returns than anticipated for investors.**

This surge in investment requirements, driven by the 4Ds (deglobalisation, decarbonisation, defence and digitalisation), therefore represents both an investment opportunity and a risk for investors lacking the necessary discipline in their selection process.

3

Is AI a revolution or an economic mirage?

In 2024, the belief that generative AI would radically transform economies was a major source of financial value creation in listed markets. Investor attention currently seems to be focused on those putting forward the most powerful generative AI applications, without really looking at the direct and indirect costs of their development, nor considering how these applications will be integrated by the companies making use of this technology.

In our view, it is just as important to analyse the real added value brought by these solutions in relation to their costs as the degree of innovation they could deliver.

Firstly, experience shows that heavy investment spending tends to hold back financial returns for shareholders. And we must bear in mind that AI requires high levels of investment. It will therefore be interesting to study investment returns in the coming years.

Challenges relating to data centres

Progress in AI is closely tied to the deployment of computing power in data centres. Data centres are often specific, purpose-built sites that use not only electricity, but also a great deal of water to cool the servers. Furthermore, they create very few jobs. These factors could pose obstacles for their development, since political decision-makers may have difficulty convincing their constituents that hosting a data centre not involving the creation of jobs and with high water and electricity requirements would be a good thing for their district. In addition, the rapid obsolescence of data centres due to exponential advances in computing power is a source of concern. How long can these purpose-built infrastructure assets be expected to retain their usefulness?

Of course, data centres do bring significant investment opportunities, in terms of both financing and capital. These opportunities relate in particular to the need for digital sovereignty, which is prompting authorities to develop and maintain local data centres. But strict discipline is important to achieve long-term value creation.

AI's costs: a persistent stumbling block?

Daron Acemoglu, a professor of economics at MIT, remains sceptical about the economic value created by this investment spending in the short and medium term.[1] Inventions that have genuinely transformed society, like the internet, led to breakthroughs that have radically reduced costs compared to earlier solutions. But AI is still a costly technology. Will AI's costs ever decline enough to make automating a larger share of tasks affordable given the high starting point? Will AI boost the valuation of companies using this technology on a lasting basis? This will depend on the actual productivity gains delivered by AI and on its ability to solve complex problems, which does not yet seem to be the case. At present, nothing indicates that these gains will be sufficiently high to spur a revolution on a par with the introduction of coal, oil or computers.

It is likely that AI will revolutionise some sectors and bring about a change in our ways of interacting and accessing information, at least to a certain extent. However, from the viewpoint of an investor, if instead of asking, "How should AI be used?" (the question on everyone's mind), we ask, "What is the best way to invest in companies that will be creating economic value using AI?" the latter question is far more difficult to answer given the sector's high valuation levels and the amounts of capital deployed in investments by AI players. **As was the case for the dot-com bubble peaking around 2000, it is possible that this new technology will in fact turn out to be revolutionary, but that its biggest winners will only emerge in a second phase.**

[1] Source: Goldman Sachs Research, To of mind – Gen AI, too much spend, too little benefit ? - 2024

4

The Indo-Pacific region, the future nerve centre of a deglobalised economy

In 2100, Asia will be home to 5 billion people and Africa to 4 billion, out of a total world population of 11 billion[1]. After the Atlantic in the 20th century and the Pacific in the 21st, **the Indian Ocean will likely become the world's economic centre of gravity in the next century. The Indo-Pacific region thus has strategic importance, and China is strengthening its presence there by promoting the yuan (RMB) as an alternative to the US dollar (USD).** This is the arena where the Chinese and American currencies will be jockeying for position.

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The opening of RMB swap lines, China's launch of RMB-backed oil and gold futures, and the purchase of Russian oil by India in currencies other than the US dollar are all signs that the latter's dominant role in this region of the world for trade transactions will face greater challenges in the future.

[1] Source: Factfulness - Hans Rosling, 2019

Deglobalisation or regionalisation?

Viewed from the West, deglobalisation seems to be a clear trend. But viewed from the East, it looks more like economic regionalisation, with the Indo-Pacific region as its centre. It would seem that China is not seeking to control the world economy, but rather to become a regional superpower, and Indo-Pacific development could mean that China would be able to offset its decline in domestic growth, driven by adverse demographic factors and an economy still largely under state control.

Catalysts for regional integration

The US sanctions against Russia have accelerated the economic integration of the Indo-Pacific region. They have pushed several countries to trade in currencies other than the US dollar, and in particular the yuan. These sanctions have also accelerated the redirection of investments in some of the region's countries toward their domestic economies and away from assets in developed countries (US Treasury bonds or property assets in major world capitals) with the aim of strengthening their economic resilience. Furthermore, it is worth noting that China's two state-owned policy banks, China Export-Import Bank (Exim Bank) and China Development Bank (CDB), granted more RMB loans to their business partners (in Asia, Africa and the Middle East) than USD loans in 2023.

This region, which is home to about two-thirds of the world's 100 largest cities, will continue to enhance interconnections, with the ramp-up of infrastructure projects to link cities and thus drive economic growth. The Indo-Pacific also has deep pools of capital, not only in China, but also in the Middle Eastern countries and soon in India. **It is therefore likely that most of the world's economic growth will be concentrated in this region over the coming decades.**

Main investment opportunities in 2025

CREDIT, ENERGY TRANSITION, EUROPEAN SOVEREIGNTY
AND VALUE-ADD REAL ESTATE

1 Credit: serving as a liquidity provider in a tighter liquidity environment

Private financing has become an attractive alternative for mid-sized companies in the United States, Europe and now Asia, in between bonds issued on capital markets and traditional bank loans. The convergence of these markets, which today are of similar size, offers issuers access to different sources of capital and liquidity. With key interest rates remaining at higher levels than anticipated in early 2024, the expected returns for this asset class are still attractive. Although short-term rates should continue to decline in 2025, this should not call into question the attractiveness of private debt. With increasing dispersion, the most disciplined investors will likely set themselves apart from their rivals. Providing liquidity in a market where the latter is becoming increasingly scarce creates significant investment opportunities.

In the secondary debt market, the increase in volumes reflects a real need among investors to access this liquidity, with a discount to valuations. This discount means that a disciplined buyer having a portfolio with exposure to a range of investments can foresee higher returns while enjoying regular and more rapid liquidity flows than one having a portfolio with few investments. The US market still has a dominant position in this segment and accounts for most of global investment volumes.

In the primary market, we favour Europe, which has lower levels of financial leverage than the United States, for comparable yield expectations. Furthermore, in a context of deglobalisation, building resilience requires the strengthening of more local ecosystems. This is where the size of the domestic market plays a key role.

The total population of the European Union is almost 450 million, a third larger than that of the United States. Hence, in a world where local is synonymous with resilience and global with fragility, Europe offers considerable potential for investors, who wish to support entrepreneurial successes across the continent, to level the playing field. Given the size of the European market, deglobalisation makes it an essential investment destination. **In this context, financing acquisitions via private debt is particularly attractive.** By financing mid-market companies seeing strong growth, it is possible to create European champions, thus guaranteeing significant growth for this asset class across the continent.

Against the backdrop of less abundant liquidity and pressures on company margins, we are also seeing a proliferation of special situations. Refinancing needs, whether relating to property assets or companies facing significant amounts of maturing debt, offer particularly attractive opportunities for liquidity providers, as long as they remain disciplined and selective.

Lastly, and although risk premiums in listed bond markets have tightened, **the credit market continues to see historically attractive yield levels: credit has become a yield product and no longer a spread product.**

In general, providing liquidity over the entire capital structure (senior debt, mezzanine, private convertible bonds, etc.) to solid companies facing a liquidity gap can result in significant value creation.

2

The energy transition: a strategic imperative

In an environment where seeking resilience will be paramount, companies will need to invest locally to remain competitive. A large share of these investments should logically go to projects related to the energy transition. Apart from addressing climate issues, the energy transition offers a crucial competitive advantage in a context of deglobalisation. The need to relocate industrial production to the countries where consumers are located entails heavy investments and higher labour costs. By making possible a reduction in costs that would partly offset those incurred by the relocation, the energy transition should provide a competitive advantage for companies, all around the world and in every sector. **Investing in energy efficiency for buildings, production processes, supply chains and vehicle fleets will enable companies to remain competitive.**

To reach the goals set by the Paris Agreement, $6 trillion must be invested each year in the energy transition between now and 2050. 80% of this amount must be dedicated to the transformation of existing infrastructure,[1] as opposed to investment in new disruptive technologies, which will only be effective in 10 or 15 years. This megatrend should ensure steady growth for companies able to offer solutions to transform current systems. Companies whose core business addresses the implementation of the energy transition thus benefit from a trend that is worldwide in scope. We see this in the growth achieved by our portfolio companies, which now generate revenue in many world regions. **Companies in Europe, the world leaders in this area, should reap the greatest benefit from this trend.**

> “Apart from addressing climate issues, the energy transition offers a crucial competitive advantage in a context of deglobalisation.

In 2024, the market for investment in the energy transition is already twice as large as that for fossil fuels: $2 trillion for the low-carbon value chain as against $1 trillion for fossil fuels.[2] In other words, for each dollar invested in fossil fuels today, two are invested in the energy transition. This ratio still does not fully represent the reality, since it does not include the market relating to the necessary adaptation of our economic system to global warming, which is also estimated at about $2 trillion.[3]

[1] Source: International Renewable Energy Agency (IRENA), 2021.
[2] Source: International Energy Agency (IEA), 2024.
[3] IEA, June 2024 – World Energy Investment 2024.

3

European sovereignty: a strength in a changing world

The turning point reached by globalisation seems to offer Europe a unique investment opportunity.

The spectacular acceleration of globalisation after the fall of the Soviet Union established the economic dominance of the United States and paved the way for China's emergence as its potential successor. Forced to take a back seat in this globalisation during the 20th century, Europe confronted major challenges at the start of the 21st century. Wedged in by these two giants, Europe had to find its own path to reinvent itself, while maintaining its relations with these superpowers: the United States, because it guarantees Europe's military protection and has imposed its currency for international trade, and China, because it is an essential business partner at the other edge of the Eurasian continent.

But Europe now has a leg up on the two necessary conditions for delivering financial performance in the coming decades: the integration of extra financial criteria and a strong position in relation to a number of structural growth megatrends. And we firmly believe that in the years to come delivering financial performance will depend on these two elements.

From the extra-financial perspective, the need for a more sustainable growth model has become clear and has only been accentuated by the successive crises of Covid-19 and the conflict between Russia and Ukraine. These crises have revealed the extraordinary vulnerability of growth models based on the over-optimisation of production costs, taxes and capital. The quest for endless growth to justify high valuations and debt levels exacerbates climate change and biodiversity loss (E), widens social inequalities (S) and leads to bubbles as well as poor capital allocation (G). Ignoring ESG criteria would thus not only destroy financial value, but also generate considerable financial risks. **Today, Europe is leading the way in the integration of these extra-financial criteria and has expertise that other world regions are now looking to acquire.**

Just as the energy transition is a major growth driver, all companies will need to invest heavily in cybersecurity and the digitalisation of production processes and supply chains. In Europe, 76% of mid-sized companies consider digitalisation as a priority.[1] By positioning around these megatrends, investors can expect returns in line with those generated by the private equity industry over the past few decades. Capturing these growth megatrends will be essential to deliver financial performance in the future, and Europe is particularly well positioned in this area.

[1] KfW, June 2019 – "Going digital: The challenges facing European SMEs" – European SME Survey 2019.

4

Value-add real estate–Investing in a new era

Changes in society emerging in the post-pandemic world, coupled with valuation adjustments and the scarcity of financing, are creating significant investment opportunities through change-of-use real estate schemes.

On the one hand, the abrupt rises in interest rates in 2022 and 2023 led to a significant decline in transaction volumes, now offering attractive valuation levels for liquidity providers. These new market conditions give access to entry points that come along very rarely, essentially a twice-in-a-lifetime opportunity: the most recent correction of this magnitude took place during the financial crisis more than 15 years ago and the previous one in 1993, just over 30 years ago.

On the other hand, in Europe, a financing deficit of around €100 billion is expected during the next four years.[1] This deficit will need to be offset by new sources of capital, thus opening up unprecedented opportunities for property asset managers.

Lastly, recent lifestyle trends have led to major transformations in both the residential and commercial property markets. The emergence of new technologies and the Covid-19 crisis are among the contributing factors behind these upheavals. Remote working created a glut of office space in both the United States and Europe, where less centrally located offices were the most affected and had difficulty finding tenants. Some of this excess supply will need to be taken off the market to be transformed for another use, leading to a considerable decline in value for the current owners, who had purchased leasable space and find themselves saddled with a building plot. In addition, e-commerce has reshaped logistics requirements and new forms of mobility are remodelling urban traffic flows. Furthermore, improvements in building energy efficiency, the redevelopment of urban spaces through flow optimisation and the integration of biodiversity spaces to regulate temperatures in cities and enhance climate resilience are among the essential challenges to be faced by the sector in the coming years. The creation of assets tailored to these new realities, situated in prime locations, and their possible transformation for mixed use are expected to represent one of the most significant investment opportunities for the years ahead.

[1] CBRE, December 2023 – “The debt funding gap for European real estate”.

Identifying the sectors and assets that will offer the best alignment with these structural megatrends is essential to investing in this new era:

- **In order to adapt to the demands of consumers, there is a considerable need for repositioning in the hotel industry,** whether in relation to business or leisure travellers. This repositioning requires significant investments that the owners, some of whom are heavily in debt and were taken by surprise by the rise in interest rates in 2022 and 2023, are not able to make. Acquiring these assets and making the necessary investments should generate significant value, but it is important to be disciplined.

- **The repositioning of well-located office buildings is also a source of opportunities** and should contribute to a recovery in transactions (renovation of office space or repositioning the assets for mixed use).

- **The demand for logistics facilities, tied to the rapid growth of e-commerce, also offers opportunities.** According to CBRE, for each $1 billion in additional sales for e-commerce, nearly 100,000 square metres of additional logistics space are required to ensure the processing of orders.[1] This asset class has been robustly revalued and the excessively low capitalisation rates of the 2020-2022 period have normalised. However, it is important to remain vigilant with regard to locations due to greater selectivity by tenants in 2024.

- **The shopping centre and retail segment is also going through an unprecedented reconversion phase.** Many assets are no longer suited to the use for which they were originally intended, creating a host of opportunities in urban areas and on the outskirts of cities.

> “2025 should thus see a significant recovery in transactions for these market segments. We see this area as one of the major investment opportunities for the years to come.

[1] CBRE, July 2023 – “The future of logistics: The long-term drivers and the current market conditions”.

KNOWING HOW TO SEIZE OPPORTUNITIES:

Tikehau Capital's advantages in the current environment

Tikehau Capital stands apart due to its rigorous investment culture and its very high degree of selectivity (only 5% of projects studied lead to financing). Backed by 20 years of experience in the deployment of capital for private and listed assets, we believe that only the most disciplined asset managers are able to offer good results in the current economic context.

With 17 offices on three continents[1], our investment teams benefit from their strong local roots. Given this strategic presence, we are able to seize the best investment opportunities based on our in-depth understanding of local markets.

Tikehau Capital has solid capital resources and liquidity ready to be deployed through the funds we manage, the transactions we initiate and via the funds and transactions of third parties. This advantage serves as the backbone for our dynamic and fertile ecosystem.

We favour strategies avoiding the use of extensive leverage. In a lower growth environment, where generating resilience has become vital, we firmly believe that the quality of investments will be the main driver of value creation, as opposed to the use of leverage to deliver financial performance.

[1] As of June 30 2024

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