SARASIN

Q1 2026

HOUSE REPORT

LOOSE MONEY, HARD POWER

Central banks under pressure as the global order fractures

- Economics: the power of market regimes, and what we learn from them
- AI: history, investment, and the economic path ahead
- Financials: rhetoric versus reality in banking regulation

INTRODUCTION

STEPHEN ROTHWELL
EDITOR

Welcome to the latest edition of our House Report.

As we begin 2026, almost a year into President Trump's second term, the once isolationist America First agenda has evolved into a form of unpredictable unilateralism with wide-reaching consequences. Over the past 12 months, the US has launched military action in Iran, Iraq, Nigeria, Somalia, Syria, and Yemen, while the new year has already brought regime change in Venezuela and talk of a potential acquisition of Greenland.

And yet, despite the uncertainty and heightened geopolitical tension, risk assets have continued to rally. Global equity markets have posted new highs, credit spreads are near historic lows, and gold has surged by 70% over the past 12 months. As we return to our desks after the Christmas break, the question is whether the resilience shown by global investors can continue into the new year.

As Guy Monson explains in his contribution this quarter, significant risks remain in addition to the political backdrop – not least the high valuations of AI beneficiaries and the risk of a delay in the pay-back on the investment boom in data-centre construction. However, with strong global earnings forecasts providing fundamental support, Guy outlines what the team sees as five key opportunities for global investors in 2026.

Thorough analysis of market regimes which exist over decades helps us as investors to map out the investment landscape and create a solid framework for long-term thematic investing. Subitha Subramaniam's article sets out our approach to regimes and takes us through the six economic regimes which have shaped markets, inflation, interest rates and investment themes since the end of the Second World War. As we transition into an era we define as Global Fragmentation, Subitha examines the implications for asset allocation and investment selection.

The AI narrative continues to dominate markets. Adam Hamilton takes a step back to look at the long-term picture – how the technology has evolved over the decades, and how AI is best understood not as a single technological event, but as a long, capital-intensive economic transition. Patience will be needed as heavy up-front investment is required before productivity gains materialise, but growth and opportunity will exist throughout the journey.

Rounding off this edition, we take a fresh look at the financials sector in light of recent initiatives to loosen banking regulation. We offer two perspectives – across both fixed income and equities – from Artemis Vrahimis and Eoin Mullany.

We hope you find our insights useful and, as ever, we welcome your feedback and suggestions for future topics. Please get in touch at housereport@sarasin.co.uk.

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GUY MONSON
CHIEF MARKET STRATEGIST
& SENIOR PARTNER

View from the
Chief Market Strategist

LOOSE MONEY, HARD POWER

Key points

- Equity markets remained remarkably resilient in 2025, while credit spreads narrowed to near historic lows.
- Despite high valuations and an extraordinary geopolitical backdrop, we believe equity markets can continue to climb higher with five key strategies for 2026.
- We have remained overweight equities – with a focus on high-quality, defensive stocks – and gold and other alternatives, while staying cautious on bonds and credit.

After the extraordinary events of 2025, can the resilience of risk assets stretch into 2026?

The past 12 months have delivered an extraordinary sequence of geopolitical shocks, many of them coming directly or indirectly from the Trump White House. They began in April last year with the announcement of the highest US tariffs in 80 years and culminated in early January in the capture and arraignment of Venezuelan President Nicolás Maduro. In almost every instance (including even the bombing of Iran's missile bases), risk assets have rallied. This leaves global equities and gold at new highs, while corporate bond spreads trade near record lows. Both the dollar and oil have fallen. This combination of returns (gold aside) is almost the exact opposite of what one might expect in a world of elevated geopolitical risk.

How, then, should investors interpret this? Do they see Mr Trump as a peacemaker – and the most pro-business, pro-deregulation president in decades – or a hyper-active president whose policies, combined with mounting exuberance in the AI complex, argue for caution?

Reflecting on 2025

What made 2025 unusual was not merely the scale of the market rally following President Trump's Rose Garden speech of 2 April, but its breadth. After a weak start to the year equities rose strongly across both developed and emerging markets, while credit spreads narrowed to near historic lows. Gold surged by 70%, its strongest performance since 1979 – silver and copper also rallied strongly.[1]

Over the year, the US dollar fell sharply (-9% for the dollar index), in a move that has historically favoured international markets. This relationship held again in 2025, with global equities outperforming US equities by more than 10% – and close to 15% once currency effects are included.[1] So yes, although the MAG7 and other AI beneficiaries rose, this was not a year in which US exceptionalism dominated markets.

Our strategy

Our asset-allocation team has maintained an overweight to equities, funded by reductions in bonds and cash. In balanced portfolios, we added modestly to alternatives, with continued emphasis on gold, absolute return strategies and emerging market debt. We have held our underweight to the dollar (hedging a proportion of our US equity exposure), while continuing to minimise our direct and indirect exposure to oil.

While our asset allocation worked well in 2025, the greater challenge for us has been within equities themselves. Our positioning here has been overly cautious and defensive, with too strong a focus on quality. The result is that although our equity funds delivered positive absolute returns, they have notably lagged global indices. Yes, our thematic process provided exposure to semiconductors, defence and banks – among the year's best-performing sectors – but we needed to have held more across portfolios.

We also maintained a near-index weight in the US market, given the unique thematic qualities of so many American companies. This, though, leaves us with a higher dollar exposure than many of our competitors. We have hedged a portion of our US equities back into sterling, but this has still been a notable drag on returns.

Looking ahead

So, will this quality-based equity strategy work in 2026? To answer this, let's look first at nominal GDP growth, which should remain solid across most developed and emerging economies in 2026.

We believe, the US economy in particular is likely to accelerate as last year's headwinds turn into tailwinds. Trade-policy uncertainty is easing, fiscal policy is becoming more expansionary, and AI adoption is spreading across sectors. Modest gains in productivity (AI-led) and soft hiring should allow the Federal Reserve to remain accommodative (AI linked job losses are just starting to emerge – Chart 1.1).

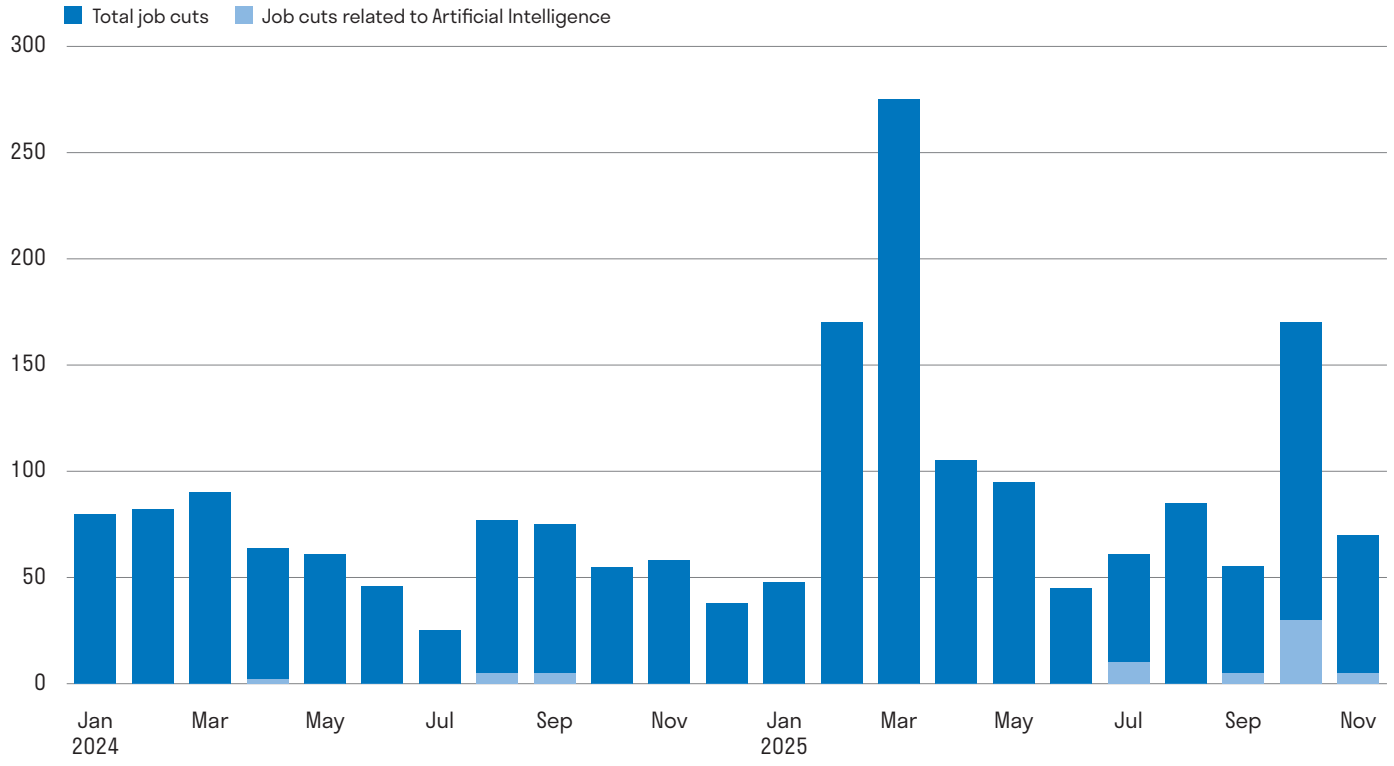
Other major advanced economies including the UK, Japan and Europe should also continue to see robust nominal GDP growth, with private sector spending recovering and government spending growth showing no signs of letting up. The UK Budget delivered government spending that is front-loaded, and tax rises that will be felt only in 2028-29. The key challenge for the UK and Europe is not spending but productivity growth.

China, by contrast, is set to rely more heavily on fiscal policy as it grapples with a prolonged property downturn and rising external pressures. With limited room for further monetary easing, policymakers are turning increasingly to targeted government spending to support activity. Expect an aggressive export strategy to non-US markets to continue – with Europe particularly exposed.

So, how will central bankers react against this backdrop?

We expect financial conditions to remain accommodative, with further rate cuts likely in 2026 in both the UK and the US. This suggests that the major central banks are going to allow economies to "run hot" in 2026, with the Federal Reserve becoming potentially more dovish as Trump-influenced appointments steadily grow. For investors, this policy mix is broadly supportive of equities and real assets, even if it means inflation remains above central-bank targets for a sixth year running.

CHART 1.1 JOB CUTS RELATED TO AI JUST STARTING TO EMERGE



Source: Empirical Research Partners, 2025

LOOSE MONEY, HARD POWER

Guy Monson, Chief Market Strategist & Senior Partner

Geopolitics: a philosophy of "might is right", but still broadly market-friendly

Mr Trump entered his second term of office promising to be a peacemaker. In practice, he has shown a readiness to use force. Beyond the capture of President Maduro, he has authorised air strikes in Syria and Nigeria, targeted nuclear facilities in Iran, attacked suspected drug-trafficking vessels in the Caribbean, and struck rebel forces in Yemen, armed groups in Somalia and Islamist militants in Iraq.

In most cases, though, markets have tended not to be too concerned. Either the economic impact is judged negligible, or the interventions themselves create commercial opportunities. Venezuela is the starkest example. Despite sitting on the world's largest oil reserves, it produces barely one million barrels a day, down from four million in 1974.[2] Years of corruption, neglect, fires and theft lie behind the collapse. If the Trump White House can begin to access these reserves for global markets, investors will likely look through the geopolitical aggression.

Taken together, White House policy argues for a world of geopolitical fragmentation, where international institutions are weakened as larger countries seek to carve out their respective spheres of influence. The impact on markets will, for the present, be surprisingly muted.

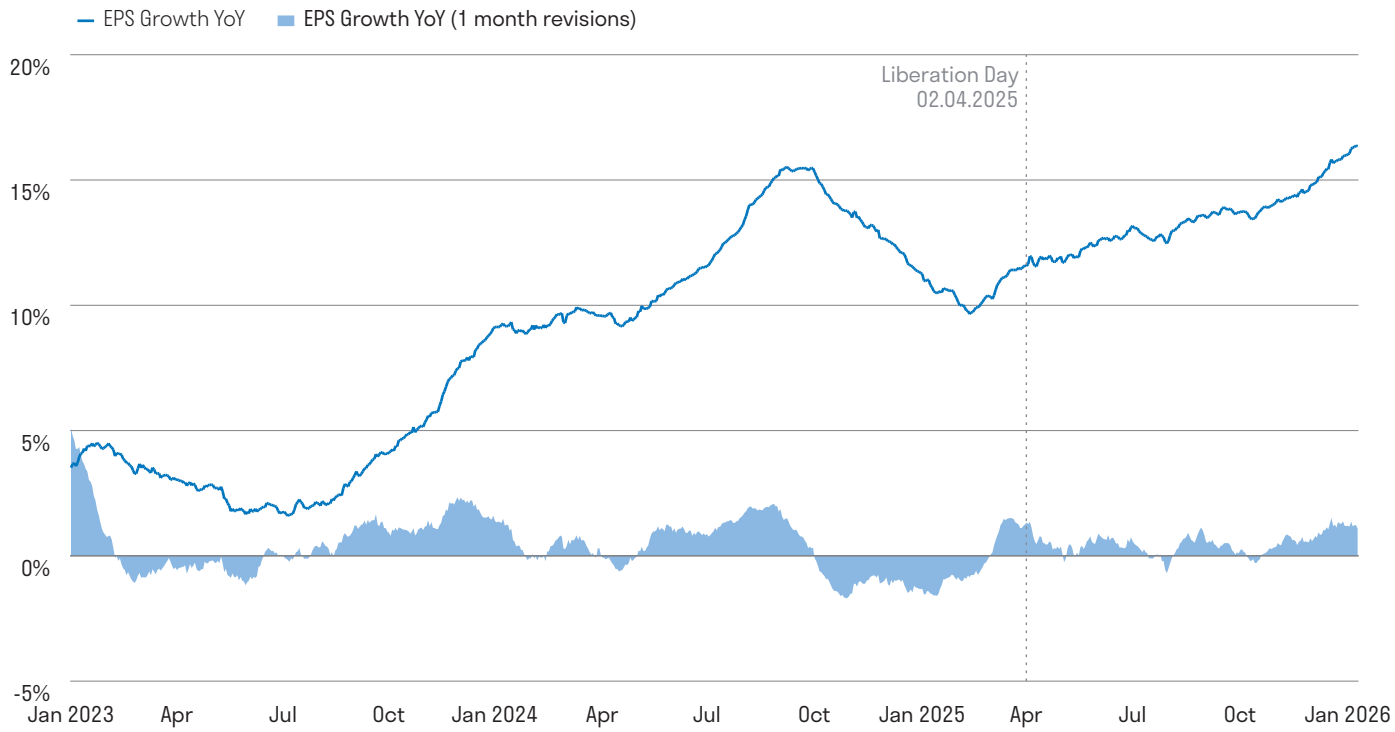
Market risks

Against this backdrop, there is clearly the risk of a reassessment of the potential of AI in the global economy. This would likely be coupled with a delay in the pay-back forecast on the vast data-centre projects we are seeing emerge around the world. However, we think that AI-related activity will still only account for a little under half of US GDP growth in 2025. Contrary to the claims by some commentators, the large diversified US economy would not be in recession without it. You can read more about this, as well as a contextual history on the development of AI, in Adam Hamilton's article (page 12).

Another trigger for a correction could be a sharp technical sell-off in the MAG7 and other AI beneficiaries. Valuations are certainly high, and investors are starting to worry about rising borrowings to fund data-centre construction. However, among the largest AI 'hyperscalers' (Google, Microsoft, Amazon and Meta), free cash flow is expected to rise to a staggering $240bn in 2026, while their debt-to-equity ratio climbs to just 30%.[3]

More generally, global earnings are forecast to rise by around 16% in the year ahead and revisions are positive (Chart 1.2) – this acts as a fundamental support to today's equity valuations.

CHART 1.2 GLOBAL EARNINGS GROWTH STILL ROBUST WITH ANALYST REVISIONS POSITIVE



Source: Macrobond, Sarasin & Partners, 2026

A further risk comes from the bond markets in the face of public borrowing that remains high, and mostly unchallenged. So far though bond markets seem to be looking through this with the US 10-year treasury yield falling over recent months, and UK gilt yields also lower. In short, the bond market vigilantes seem to be biding their time but as the pressures of an ageing population, rising defence spending and climate worsen they may yet reappear.

So, what are the winning strategies for 2026?

Against this backdrop, we see five key opportunities for global investors as they look to 2026.

1. **The world is becoming more competitive and rivalrous, and tariffs and sanctions will grow.** Investors should focus on national champions across equity markets and add to strategic assets (including metals, semiconductors and even food). The dollar will tend to weaken further as China and other surplus countries seek to diversify their reserves away from the US currency.
2. **The US is less willing to underwrite global security.** Defence and cyber spending will rise sharply as Europe and Asia dramatically accelerate their military spending. Companies involved in cyber security, missile-defence systems, drones and space satellite-based industries should all benefit.
3. **Government spending on ageing populations, climate and defence will continue to rise.** Expect higher bond yields, but also opportunities for banks (which benefit from rising long rates), alongside gold and, in the longer term, crypto assets.
4. **Less efficient supply chains, rising power demand for AI and growing climate risks all argue for higher and more volatile inflation.** Investors should favour real assets (equities and commodities), power generation, transition metals and other beneficiaries of the AI build-out, as every major country or region seeks its own large language model (LLM) capabilities.
5. **As AI diffusion gathers pace, productivity will start to pick up and an era of extraordinary innovation will unfold.** Expect growth in robotics, self-driving and robo-taxis, improved drugs and even nuclear fusion. Service industries will require fewer workers but could reap substantial productivity gains.

In short, quality thematic growth should work in 2026 - focusing on robust returns on equity, high margins and lower leverage remains a prudent way of managing a thematic portfolio that is rich in opportunity but faces unique geopolitical risks. In response, we have remained overweight equities, gold and other alternatives, while staying cautious on bonds and credit.

Our challenge, though, has been our high-quality, defensive equity strategy, which lagged market indices materially in 2025. Looking at the risks ahead, but also at the opportunities, we feel confident in how we are positioned for 2026.

[1] Marcrobond, 2025

[2] https://www.msn.com/en-us/money/markets/why-venezuela-struggles-to-produce-oil-despite-having-the-world-s-largest-reserves/ar-AA1TDEwV

[3] Empirical Research Partners, 2025

SIX MINUTE STRATEGY

Keep up to date with Guy's latest macro views, and our Global Strategy update, with our monthly Six Minute Strategy. Watch the videos at https://sarasinandpartners.com/think/

SUBITHA SUBRAMANIAM
CHIEF ECONOMIST
& PARTNER

Economist outlook

MARKET REGIMES, AND WHY THEY MATTER

Key points

- Identifying regimes can map out the broad contours of the investment landscape, driving the behaviour of variables like inflation, interest rates, term, growth, and economic volatility.
- The present regime of Global Fragmentation is dominated by power politics. In this less globalised world, governments must confront mounting fiscal pressures, climate-related challenges, ageing populations, and heightened geopolitical insecurity.
- Considering regimes, alongside a global thematic approach to investing, can create a solid framework for long-term investing.

At Sarasin, a key part of how we assess investment opportunities – particularly within equities – is through the lens of market regimes: the underlying foundations on which an investment environment is built and evolves over many years. In this article, we outline these post-war regimes and explain their importance within the context of our thematic investment approach.

What are market regimes and why do they matter?

Investment markets often move in distinct patterns for extended periods as slow-moving forces – such as demographics and technological change – interact with medium-term drivers including monetary and fiscal policy, as well as geopolitical developments. The intersection of these forces gives rise to a relatively stable set of conventions, behaviours, and institutional arrangements that characterise each period. These patterns persist for defined stretches of time that we at Sarasin refer to as *market regimes*. Identifying and interpreting these regimes sits at the core of our investment philosophy.

The regimes we have identified and outlined below span several decades, reaching back to the end of the Second World War in 1945. When examining these periods, it is important to recognise that, within any given regime, variables such as growth, inflation, interest rates, and bond yields oscillate around distinct trends. However, these trends do not persist indefinitely; regimes shift when imbalances accumulate over time – for example, during the global financial crisis of 2008–09, or the breakdown of the Bretton Woods system in the early 1970s[1] (which had maintained fixed exchange rates, with the US dollar convertible into gold at $35 per ounce).

Regimes can also shift in response to external shocks, such as the end of the Cold War in the early 1990s, or more recently, the global Covid-19 pandemic. These transitions are often marked by sharp market movements, followed by a gradual adaptation to the new trend. For us as investors, it is crucial to recognise that overlooking regime shifts can lead to misleading conclusions, based on anchoring to trends that no longer hold.

Our post-war regimes in historical context

With this in mind, we can look at these specific regimes in more detail. We divide the post-war period into six distinct regimes (Chart 2.1).

Looking back more than half a century to the period covered by *Multilateralism*, this era was characterised by the establishment of global co-operative institutions, reduced inflation and lower inflation volatility. A post-war baby boom and widespread reconstruction fuelled strong global economic growth.

Post-Bretton Woods covers the tumultuous period following the collapse of the gold standard in 1971, driven by persistent US current account deficits. The OPEC oil embargo of 1973,[2] followed by the Iranian Revolution in 1979, triggered a dramatic surge in inflation. With monetary and fiscal policies remaining too loose, inflation expectations became unanchored and the global economy entered a period of stagflation.

The 1980s and 1990s brought the *Great Moderation*, marked by the reassertion of monetary discipline, supply-side reforms and the end of the Cold War. This ushered in a multi-decade period of stable, low inflation and reduced economic volatility. Interest rates declined, and business cycle fluctuations diminished sharply.

China's accession to the World Trade Organization (WTO) and the expansion of internet connectivity across the economy represented a positive supply shock. Globalisation accelerated, goods prices experienced sustained deflationary pressure, and inflation continued to decline.

This regime of relative stability came to an end with the global financial crisis of 2008, which ushered in a prolonged period of deficient demand – *Secular Stagnation* – as the balance sheets of banks, households and governments came under severe strain. In response, central banks pursued an aggressive strategy of financial repression: policy rates were cut to the zero lower bound, and large-scale asset purchases compressed term premia across fixed-income markets.

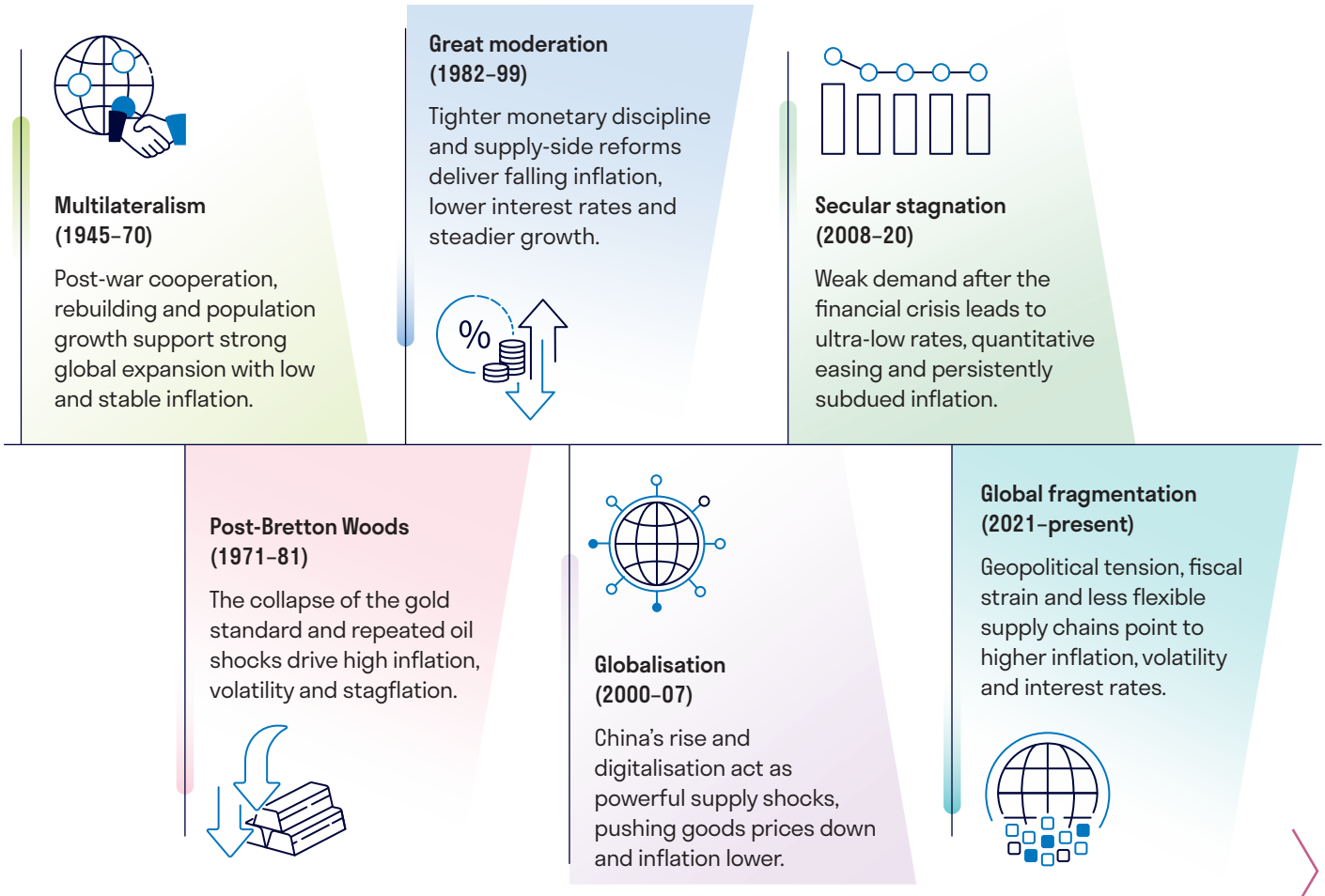
Weak private demand, combined with persistent goods-price disinflation driven by China's integration into global supply chains, exerted further downward pressure on inflation, causing it to remain persistently below central bank targets.

Crucially, we believe that in recent years we have entered a new regime of *Global Fragmentation*. The post-pandemic global economy is shifting decisively away from an open, co-operative framework towards a more fragmented system dominated by power politics. In this less globalised world, governments must confront mounting fiscal pressures, climate-related challenges, ageing populations and heightened geopolitical insecurity. These forces are likely to result in more frequent supply shocks and less flexible supply chains. As a consequence, inflation and its volatility are expected to rise, accompanied by higher interest rates and term premia.

Regimes in practice: the role of inflation

For us as long-term investors, these regimes define the broad contours of the investment landscape. They drive the behaviour of key variables that we monitor closely: inflation, interest rates, term premia (the extra return investors demand for holding longer-term bonds instead of rolling over short-term ones), growth and economic volatility.

CHART 2.1 FROM GLOBAL COOPERATION TO GLOBAL FRAGMENTATION
Six economic regimes have shaped markets, inflation and investment since the Second World War.



MARKET REGIMES, AND WHY THEY MATTER

Subitha Subramaniam, Chief Economist & Partner

In this context, regimes are best illustrated by the behaviour of inflation in the post-war US economy. While US inflation has averaged about 3.4% over the past 75 years,[3] there have been wide divergences sustained over long periods.

After 1945, as multilateral institutions were established, inflation averaged around 2%, and its volatility declined sharply. In the early 1970s, the breakdown of the Bretton Woods arrangement, coupled with accommodative monetary policy, unmoored inflation, which averaged nearly 7% per year. In the early 1980s, policymakers adopted aggressive measures to re-anchor inflation expectations. Supported by supply-side reforms, inflation fell to around 4% during the 1980s and 1990s.

With the acceleration of globalisation in the early 2000s, inflation declined further, averaging about 2.7%. Following the global financial crisis of 2008, inflation continued to drift lower despite unprecedented monetary accommodation, settling at an average of 1.7%. Today, inflation has proved more persistent, remaining around 3% since 2021, and we expect it to stabilise within a 2.5%–3% range.

Chart 2.2 illustrates the US Consumer Price Index (CPI) for headline inflation since the 1940s. It is worth noting that there can be persistence across regimes. For instance, inflation continued to fall on average through several of our identified regimes – from the 1980s to 2020 – encompassing the Great *Moderation*, *Globalisation*, and *Secular Stagnation*.

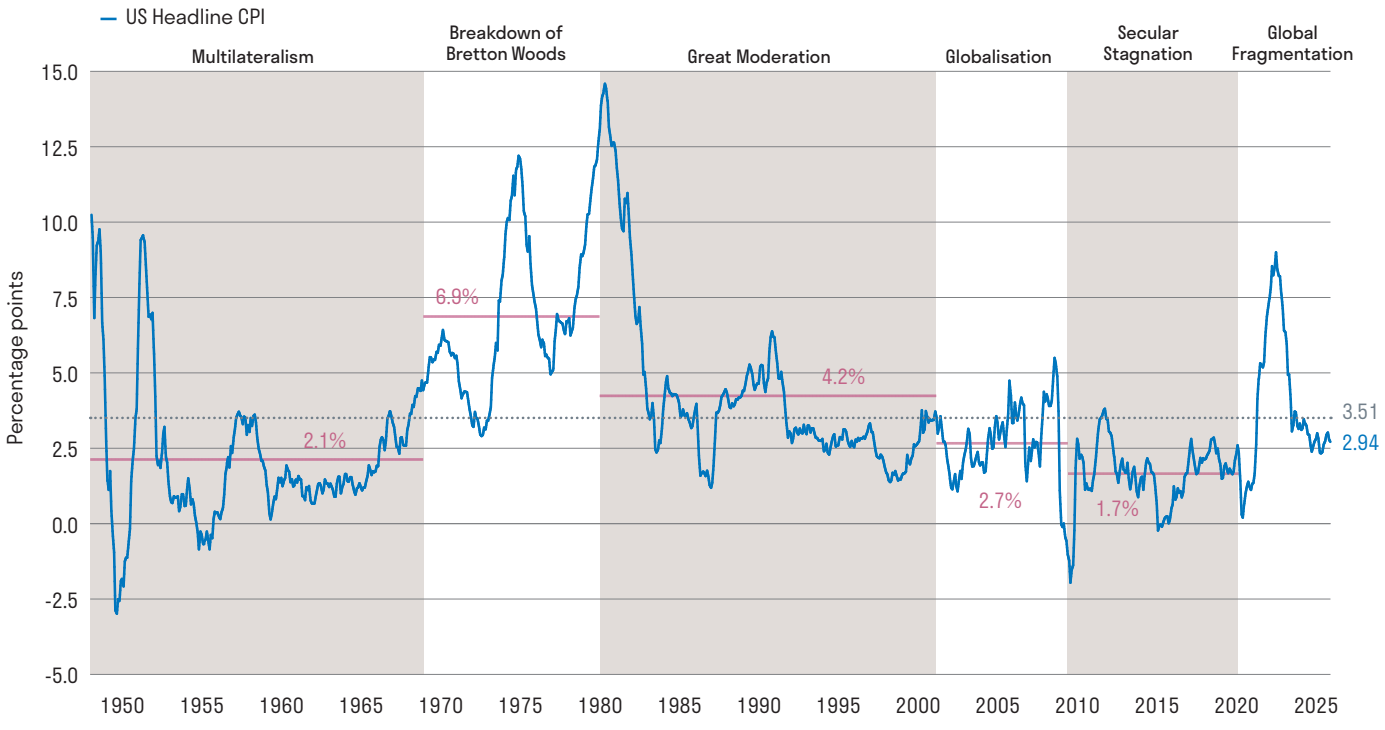
The drivers of this decline, however, have differed over time. During the *Great Moderation*, central banks adopted explicit inflation targets and pursued policies of opportunistic disinflation. In the era of Globalisation, China's integration into the global trading system *acted* as a sustained positive supply shock. During *Secular Stagnation*, the global economy experienced persistent shortfalls in demand as households and banks sought to rebuild their balance sheets.

Inflation is not the only variable to display regime-dependent behaviour. Interest rates, economic growth, term premia and volatility have also followed distinct patterns in response to shifting macroeconomic regimes. Chart 2.3 summarises how these dynamics have evolved within the US economy.

Regimes in the context of our themes

For us, examining long-term regimes goes hand in hand with our focus on thematic investing – capturing the enduring trends that influence markets and economies over extended periods. Slow-moving drivers such as demographics and technological change are key sources of thematic growth, expressed through our themes of Evolving Consumption, Ageing, Automation and Digitalisation. However, when a regime shifts due to material change in the macroeconomic or geopolitical environment, it can act as a catalyst for new thematic opportunities. At Sarasin, we have often introduced new themes at these regime turning points.

CHART 2.2 US INFLATION DURING MARKET REGIMES



Source: Macrobond, Sarasin & Partners, data spans 1948–2025

For example, in the early 2000s, as the *Globalisation* regime gathered momentum, we introduced our now-retired Global Convergence theme. This led to increased allocations to emerging markets – an approach that, in hindsight, proved highly successful. In the early 2010s, in the aftermath of the global financial crisis, we recognised the emergence of *Financial Repression* and reflected this in our asset allocation through a measured pro-risk bias. More recently, following the global Covid-19 pandemic, we identified the breakdown of *Secular Stagnation* and the emergence of a new regime, which we define as *Global Fragmentation*. We subsequently explored the implications of this regime shift for equity markets and, in 2024, introduced a new equity theme under the heading Security (see *House Report Q2 2025*).

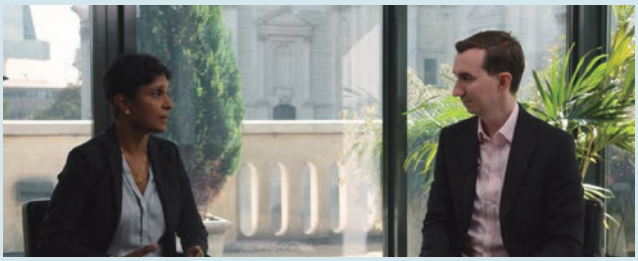
How regimes inform our investment choices

We believe that applying a regime lens enables us to calibrate investment decisions more effectively. As we have shown, the distinct behaviour of inflation, interest rates, term premia, growth and volatility within each regime shapes asset returns, correlations between asset classes and, ultimately, broader market structures.

While we were not personally investing fifty years ago, history offers clear lessons. After the breakdown of Bretton Woods in the 1970s, rising inflation pushed up both bond yields and equity risk premia, eroding their diversification benefits within multi-asset portfolios. In contrast, during *Globalisation*, disinflation supported both equities and bonds, resulting in a negative correlation that enhanced multi-asset portfolio performance. During *Secular Stagnation*, persistently low growth, subdued inflation and near-zero interest rates favoured long-duration and illiquid assets such as growth equities, infrastructure and private markets.

INVESTMENT INSIGHTS VIDEO

You can watch Subitha talk more about how we assess market regimes in a recent discussion filmed in conversation with Michael Jervis, Multi-Asset Portfolio Manager. Check out the full conversation here: https://sarasinandpartners.com/think/investment-insights-the-vital-role-of-regimes/



Today, as we transition into *Global Fragmentation*, we expect inflation to remain elevated by historical standards. This view is reflected in our strategic asset allocation: a long-term positive outlook for global equities, a preference for short-maturity bonds, and selective exposure to alternatives such as gold that can help protect against the rising cost of living.

We believe that viewing economic history through the lens of regimes – combined with our global thematic approach to investing – gives us a powerful framework for securing our clients' wealth over the long term.

[1] https://www.federalreservehistory.org/essays/bretton-woods-created

[2] https://www.federalreservehistory.org/essays/oil-shock-of-1973-74

[3] https://www.officialdata.org/us/inflation/1951-to-2025

CHART 2.3 DYNAMICS OF THE US ECONOMY THROUGH REGIMES

	Multilateralism	Breakdown of Bretton Woods	Great Moderation	Globalisation	Secular Stagnation	Global Fragmentation	Long-term average
Inflation	2.10%	6.90%	4.20%	2.70%	1.70%	2.75%	3.50%
Inflation volatility	2.38%	2.60%	2.84%	1.05%	1.40%	2.25%	2.87%
Interest rates	3.30%	7.30%	7.40%	2.70%	0.70%	3.40%	4.90%
Term premia	0.34%	1.65%	2.64%	1.52%	0.57%	1%	1.44%
Real GDP	4.20%	3.30%	3.20%	2.00%	2.10%	2.00%	3.10%
Equity bond correlation	-0.48	0.31	0.26	-0.90	-0.37	0.97	-0.01

Source: Sarasin & Partners, data spans 1948–2025

ADAM HAMILTON
ECONOMIST

Investment focus

AI: HISTORY, INVESTMENT, AND THE ECONOMIC PATH AHEAD

Key points

- AI hype is not a modern phenomenon: but only now is it truly fulfilling its potential.
- AI technology is no longer an experiment layered on top of the economy; it is becoming part of how the economy operates.
- However, patience is required as the technologies that matter most economically rarely deliver immediate gratification.

Artificial intelligence (AI) is often discussed as a breakthrough moment – a sudden leap in capability that promises rapid transformation. History suggests a different framing is more useful. The most important technologies are not those that deliver instant productivity gains, but those that quietly reshape investment, organisation, and behaviour over time. Electricity, computing, and the internet followed this path. AI appears to be doing the same.

Understanding AI as a general-purpose technology helps explain why its economic impact is likely to be substantial, gradual, and uneven – and why the near-term effects are showing up first in investment and demand rather than in headline productivity statistics.

From AI cycles to an economic ecosystem

Rather than just a modern phenomenon, AI hype spans the decades through what we see as three clear eras. Earlier AI waves ultimately disappointed because they lacked the economic and technological complements required for scale. The first AI wave from the 1950s to the 1970s relied on hand-coded rules and had no learning mechanism – being dependent upon human input was a huge limitation, compared to today's programmes that are more autonomous and can scale. The 'Expert Systems' of the second AI wave in the 1980s captured narrow expertise but were brittle, expensive, and difficult to maintain. In both cases, deployment was bespoke, local, and commercially fragile.

Today's deep learning and generative AI is fundamentally different. Modern systems learn directly from data, improve continuously, and are deployed globally through cloud infrastructure. Foundation models generalise across tasks – language, code, vision, and reasoning – and can be embedded directly into production processes. This shift from isolated software to scalable economic input is what distinguishes the current cycle.

Crucially, the surrounding ecosystem now exists: abundant data, specialised computing power, global cloud networks, and digitally mature firms. AI is no longer an experiment layered on top of the economy; it is becoming part of how the economy operates.

AI in historical perspective: Why productivity takes time

History offers a consistent lesson. General-purpose technologies require heavy upfront investment and organisational change before their benefits appear in terms of productivity. Electrification raised costs for years before factories were redesigned around electric motors. Information technology boosted investment in the 1990s, while its productivity impact became clearer only later.

AI fits this pattern. Early phases are characterised by experimentation, duplication, and learning. Firms invest before they fully understand where returns will come from. Productivity gains are real, but they are back-loaded – emerging only once workflows, skills, and capital structures adapt.

This helps explain why AI can be economically important even if near-term productivity statistics appear underwhelming. The early macro story is not efficiency; it is capital formation and diffusion.

How AI diffuses through the economy

AI does not transform entire industries all at once. Instead, it improves specific tasks within jobs. Evidence suggests that in tasks where AI can be used – such as coding, research, customer service, and professional writing – productivity gains, measured by time saved, are around 30% on average.[1]

To understand what this means for the whole economy, researchers start at the task level and work upward. First, they look at how much of each sector's work is exposed to AI. In sectors like IT and finance, roughly 70% of tasks could benefit from AI, while in sectors such as agriculture, the share is closer to 20%.[2]

Second, they account for the fact that adoption takes time. Firms need to reorganise workflows, invest in systems, and retrain workers. Based on past experience with technologies like computers and the internet, a reasonable assumption is that around half of these AI-exposed tasks are adopted over the next decade.

Putting this together implies a meaningful but gradual increase in productivity. For the US, these assumptions point to roughly one percentage point of extra labour productivity growth per year over the next ten years, similar to the boost seen during the 1990s technology boom. Over time, that compounding effect could leave the US economy more than 10% larger than it would otherwise be.

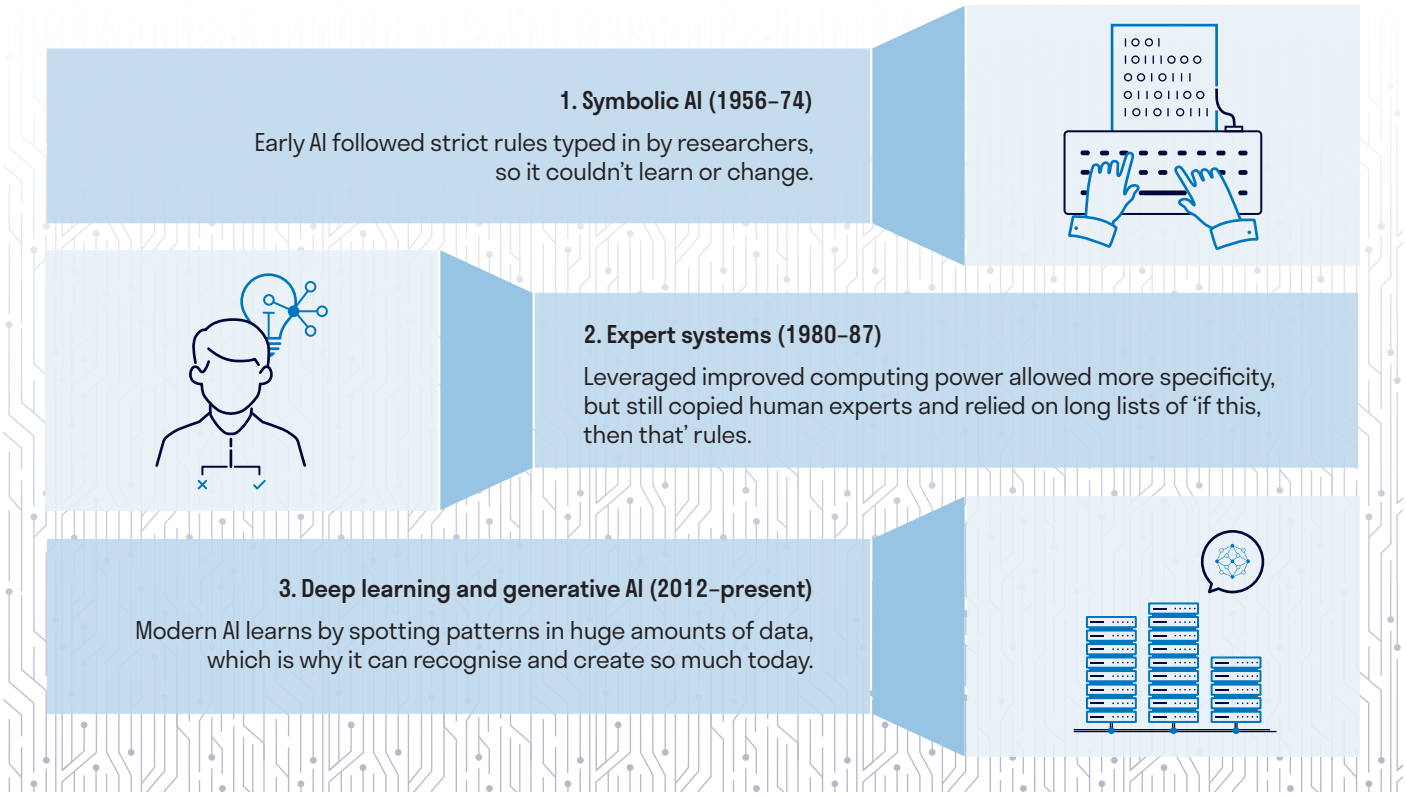
Other countries are likely to see smaller gains, reflecting differences in economic structure and adoption speed. The key takeaway is not the exact number, but the direction: AI's productivity impact is real, material, and takes time to unfold.

[1] https://academic.oup.com/qje/article/140/2/889/7990658

[2] https://www.pwc.com/gx/en/services/ai/ai-jobs-barometer.html

CHART 3.1 THE THREE ERAS OF AI

How AI shifted from fixed rules to systems that learn on their own, across three key phases.



AI: HISTORY, INVESTMENT, AND THE ECONOMIC PATH AHEAD

Adam Hamilton, Economist

Building the AI economy though investment

Before productivity shows up, AI's first major economic effect comes through investment. Data centres, power infrastructure, and supporting networks require large, sustained capital spending.

As Chart 3.2 shows, current estimates suggest that global data-centre investment could reach around $5trn between 2025 and 2030, with roughly $2–3trn in the US. Annual US AI-related investment is projected to rise from roughly $150bn mid-decade to around $400–450bn by 2030. After accounting for imported components and a positive multiplier to other sectors, this translates into a direct boost to US GDP growth of around 0.2–0.3 percentage points per year, with upside if hardware needs to be replaced more frequently or if complementary infrastructure investment accelerates.

Others have speculated that we could see much higher contributions to US growth for a variety of reasons. These include failing to account for imports, using real GDP contributions, which is unreliable because of the volatile price of investment over time, and focusing on the first two quarters of 2025 only (Chart 3.2).

This investment cycle is not occurring in isolation. It is supported by a rare alignment of forces that have been common to previous investment booms:

- Technological necessity: AI is capital-intensive by design, pulling forward investment in computing, energy, and networks.
- Strategic competition: Geopolitical rivalry and defence considerations create demand certainty for advanced computing and semiconductors.
- Policy support: Industrial policy, tax incentives, and public procurement reduce risk and anchor long-term projects.
- Financial conditions: A policy environment that favours production over consumption lowers effective hurdle rates for investment.

Together, these forces help explain why the AI investment boom looks durable, especially as it diffuses beyond data centres.

Future productivity, wealth effects, and today's household spending

Investment is not the only channel through which AI affects the economy. Expectations about future productivity and income may also be reflected in household behaviour today.

When households perceive stronger future income prospects, those expectations are capitalised into asset values. However, note that not all participants in an economy stand to benefit. For example, advances in AI can create uncertainty about the future income prospects for those on the first rung of the career ladder, with employers preferring to use AI rather than hire inexperienced workers.

However, in aggregate we believe that AI should have a positive impact on our wealth overall. Higher wealth reduces precautionary saving and allows spending to grow faster than current income for a period. In this way, wealth effects act as a bridge between future productivity and present-day demand.

Our own regression model (Chart 3.3) estimates suggest that higher household wealth, including the roughly 20% inflation-adjusted increase in US stocks in 2024, boosted US consumption growth by around 0.8 percentage points to around 2.75%, including indirect effects. In 2025, assuming more modest gains, the wealth contribution is expected to have eased to around 0.5 percentage points.

CHART 3.2 GLOBAL DATA-CENTRE INVESTMENT 2025–2030

US AI investment Short-term GDP impact	2025	2026	2027	2028	2029	2030
Nominal GDP ($bn)	30000	31350	32760	34235	35776	37386
US gigawatts added	3.7	5.0	6.6	8.2	9.7	11.2
Investment ($bn)	149.0	199.2	264.3	328.0	388.0	448.4
Imports ($bn)	59.6	79.7	105.7	131.2	155.2	179.4
GDP Impact ($bn)	134.1	179.3	237.9	295.2	349.2	403.6
GDP Growth ppts	0.2	0.2	0.2	0.2	0.2	0.2

Source: Sarasin & Partners, estimates for 2025–2030.
Notes: Cost per gigawatt assumed to be US40bn. Import component of investment assumed to be 40% on average, US share of global GW added is 40%. Multiplier on domestic investment spending is 1.5.

This perspective helps explain part of the reason why US consumption has remained resilient despite tariffs and broader policy uncertainty. Households appear to be partially internalising future income gains today, with AI-related optimism playing a supporting role.

Combining our investment and consumption contributions, we estimate that AI accounted for a little under half of US growth in 2025 when all is said and done. Contrary to the claims by some commentators, the US economy would not be in recession without it. The US economy is a huge diversified economy with many drivers.

Adjustment costs and constraints

None of this implies a frictionless transition. Investment booms come with adjustment costs. Labour markets must reallocate tasks and skills. Energy and construction constraints can raise prices in the short run. Political and regulatory pressures may slow deployment, particularly around data centres and power usage.

These frictions affect timing and distribution, not direction. They may delay benefits or make them uneven, but they do not undermine the underlying economic logic of AI as a productivity-enhancing technology.

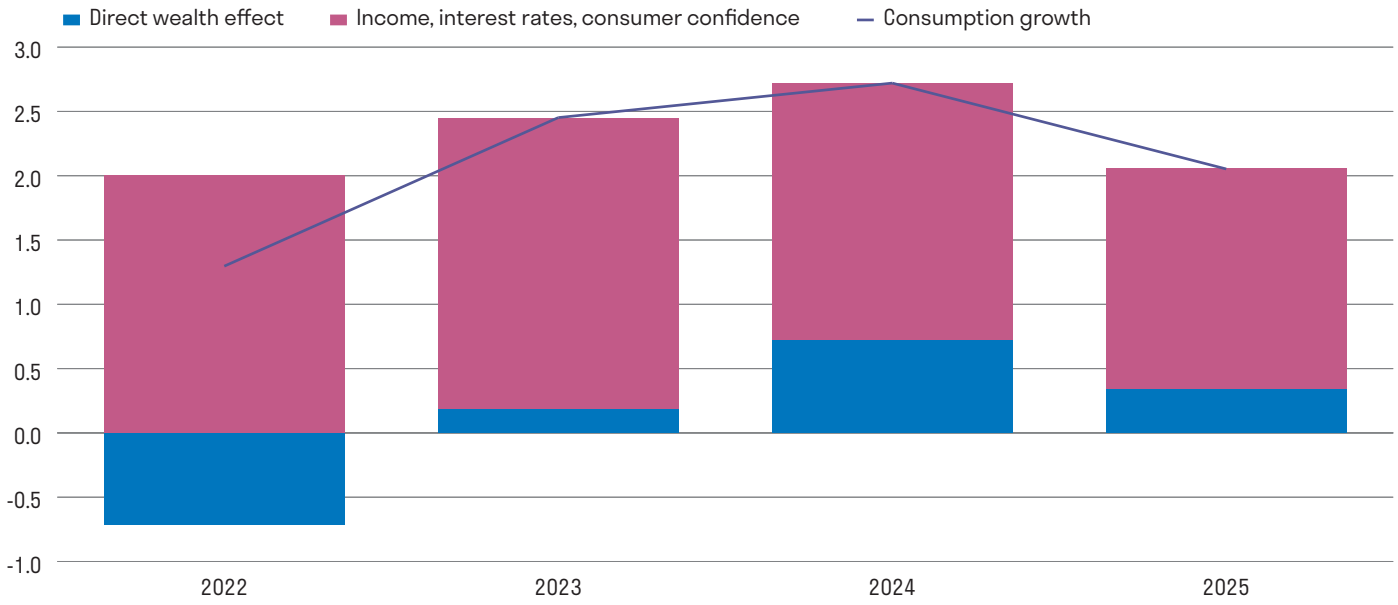
A slow-burn transformation

AI is best understood not as a single technological event, but as a long, capital-intensive economic transition. The early chapters of the modern era are being written through investment and demand, not instant efficiency gains. Over time, as adoption spreads and organisations adapt, productivity gains are likely to become more visible.

History suggests patience is essential. The technologies that matter most economically rarely deliver immediate gratification. AI appears to be following that familiar path – one that reshapes investment first, productivity later, and growth throughout.

From an investment perspective, this history argues for cautious optimism today. The underlying momentum behind AI diffusion across the economy continues to build, but the range of possible outcomes is wide and the journey unlikely to be smooth. In this environment, discipline, close observation, and a grounded historical perspective are essential.

CHART 3.3 US CONSUMPTION GROWTH DECOMPOSITION (%)



Source: Sarasin & Partners, 2025

EOIN MULLANY
ANALYST, GLOBAL EQUITIES

ARTEMIS VRAHIMIS
PORTFOLIO MANAGER, FIXED INCOME

Thematic investing

BANKING REGULATION: RHETORIC VERSUS REALITY

Key points

- We are seeing renewed attempts to loosen post-financial crisis era banking sector regulation, particularly within the US. However, despite the rhetoric, capital requirements are likely to rise due to Basel 3 but they could be offset by reduced systemic surcharges.
- While regulatory frameworks are being simplified and adjusted, this does not amount to widespread deregulation and any changes are unlikely to materially boost bank lending.
- Post-Covid, higher interest rates and benign credit quality in banks' loan portfolios have supported record or near-record profitability across much of the sector.

Financials, and in particular the banking sector, remain a significant part of our investment universe. We invest in the sector as part of our overarching Security theme, especially considering banks' limited exposure to geopolitical disruption.[1] Here we focus on a loosening regulatory environment, with perspectives from our analysts across both equities and fixed income markets.

Eoin Mullany, Analyst, Global Equities

Since Donald Trump returned to the US presidency, there has been renewed political momentum to reduce regulation, particularly in banking. The Federal Reserve's new Vice Chair for Supervision, Michelle Bowman, has emphasised the need for a regulatory framework that allows banks of all sizes to operate efficiently and support economic growth.[2]

In practice, proposed changes focus on simplifying rules rather than materially lowering capital requirements. One area attracting attention is the supplementary leverage ratio (SLR), which limits how much banks can expand their balance sheets relative to capital. While some argue that relaxing the SLR would allow banks to buy more US Treasuries, the more important aim is to ensure that banks can continue to intermediate Treasury markets during periods of stress, when balance sheets naturally expand.

Despite the deregulatory rhetoric, capital requirements for large US banks may still rise. Recent media reports suggest the Federal Reserve is considering a 3–7% increase in total capital requirements, only slightly below earlier proposals.[3] However, this increase could be offset by reduced systemic surcharges. Our own recent discussions with US regional banks suggest these changes are unlikely to have a meaningful impact on profitability.

Outside the US, the direction of travel differs by region. In the UK, regulators have modestly reduced banks' capital requirements following improvements in risk measurement and a reassessment of systemic risks.[4] While this lowers the capital buffer banks must hold, it does not represent a significant easing of financial safeguards.

In the eurozone, the European Central Bank is not seeking deregulation. Instead, it wants to simplify the framework by reducing complexity and duplication in reporting.[5] Proposed changes would reorganise capital buffers into clearer categories, without reducing the overall amount of capital banks are required to hold.

Switzerland stands apart. Following UBS's acquisition of Credit Suisse, regulators initially proposed a large increase in capital requirements for UBS. More recent signals suggest a softer stance, potentially reflecting concerns about UBS's global competitiveness.

A common argument for lowering capital requirements is that it would encourage banks to lend more. While banks do tend to lend less when capital requirements rise, the evidence that lower requirements lead to sustained increases in lending is mixed. During the pandemic, lending increased materially and evidence from the ECB shows that loans volumes were proportionally stronger in countries with a higher take-up of government guaranteed loans implying that government guarantees rather than lower capital requirements drove stronger lending volumes.[6]

Today, most banks hold capital well above regulatory minimums and management targets. In our view, the constraint on lending is demand rather than supply. As a result, any reduction in capital requirements is more likely to lead to higher shareholder distributions than a meaningful increase in lending.

The bottom line is that while regulatory frameworks are being simplified and adjusted, this does not amount to widespread deregulation. Capital levels remain high, and changes are unlikely to materially boost bank lending.

Artemis Vrahimis, Portfolio Manager/ Analyst, Fixed Income

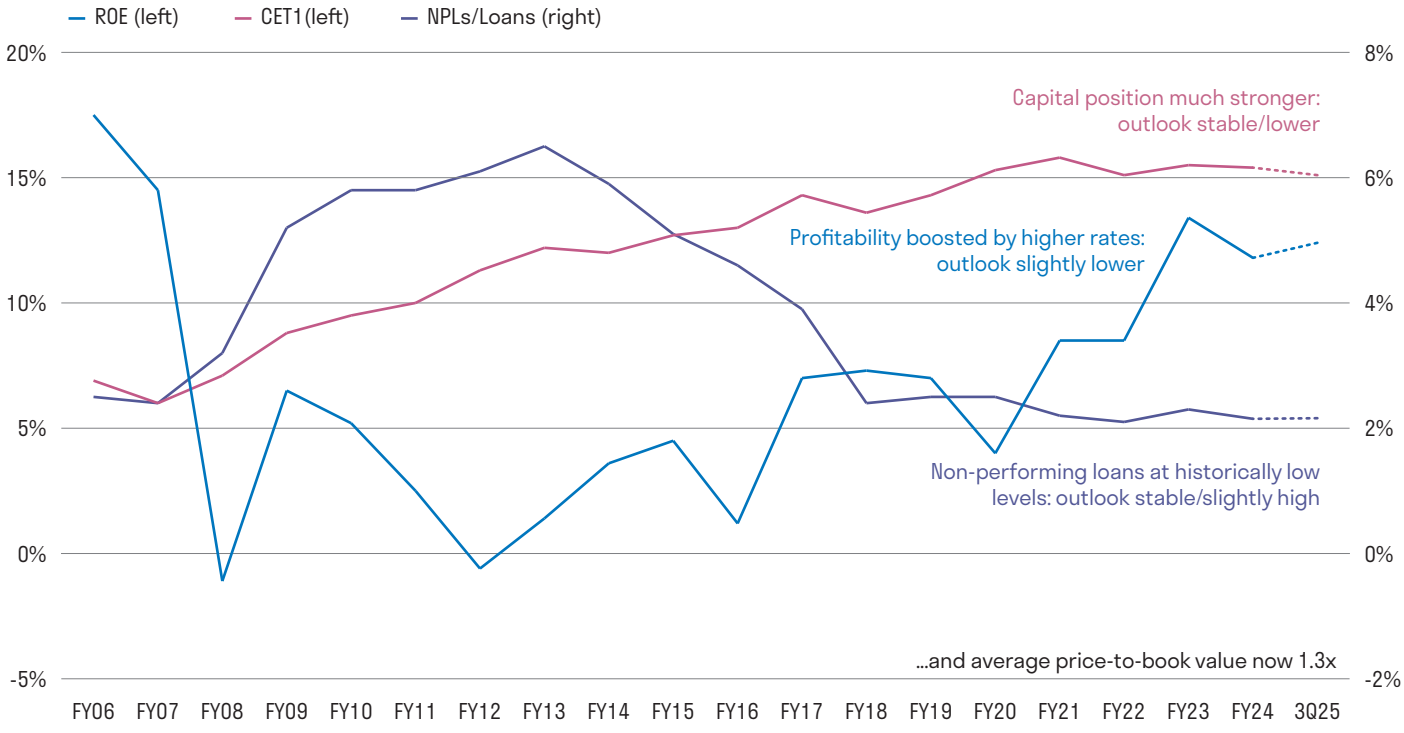
In the years since the global financial crisis in 2008, the increasingly tight regulatory environment that followed has been highly supportive of banks' credit profiles. This has enabled banks to strengthen their balance sheets through a prolonged period of de-risking and restructuring, leading to significantly stronger capital, liquidity and asset quality. These improvements supported credit for years to come, providing confidence for investors to explore opportunities lower in the capital structure, given the comfortable buffers above regulatory minimum requirements.

Post-Covid, higher interest rates and benign credit quality in banks' loan portfolios have supported record or near-record profitability across much of the sector.[7] Building on this strength, many institutions have generated significant amounts of capital while gradually increasing distributions to shareholders through higher dividends and buybacks[8] – all from a position of already strong capitalisation.

Loosening banking regulation has become a key theme for the US, UK and European sectors. Whether driven by concerns around competitiveness, the desire to simplify complex regulation, encourage higher lending, or by more politically motivated aims such as facilitating greater Treasury intermediation, elements of deregulation are emerging. While this has been mostly led by changes in the US, the UK appears to be following suit, albeit in a more conservative and incremental manner, while in Europe, policymakers' 'simplification over deregulation' stance appears more cautious. For bond investors, the key question is what these changes mean for bank fundamentals – and whether they risk undermining the fixed income market's long-standing confidence in the sector.

In the US and the UK, the most significant changes relate to capital requirements. In the US, looser leverage constraints for global systemically important banks (G-SIBs) – those whose size, complexity and interconnectedness mean their failure could seriously disrupt the global financial system – give the largest banks greater flexibility to expand balance sheets in lower-risk activities without the SLR acting as the

CHART 4.1 EUROPEAN BANK FUNDAMENTALS
ROE = Return on Equity, CET1 = Common Equity Tier, NPLs = Non-Performing Loans



Source: Sarasin and Partners, CreditSights, 2025

BANKING REGULATION: RHETORIC VERSUS REALITY

Eoin Mullany, Analyst, Global Equities, and
Artemis Vrahimis, Portfolio Manager, Fixed Income

binding constraint.[9] A clear example is intermediation in the US Treasury market, which policymakers explicitly intend to encourage.[10] In addition, a lower leverage requirement feeds through into total loss-absorbing capacity (TLAC) – measures ensuring systemically important banks can absorb losses and be recapitalised without taxpayer support – resulting in meaningful reductions in funding needs.

In the UK, the Financial Policy Committee has lowered its benchmark system-wide Tier 1 requirement from 14% to 13% of risk-weighted assets – equivalent to a common equity tier 1 (CET1) capital ratio of around 11% – and has opened the door to further fine-tuning of capital and leverage requirements.[11]

While the capital released from these regulatory changes is not significant, lower requirements can, in theory, be credit-negative if they lead to riskier lending or higher shareholder distributions. This could result in asset quality deterioration and/or a reduced ability to absorb unexpected losses in a downturn. Indeed, in the US we believe it is unlikely that banks will fully deploy the additional balance sheet capacity generated by the rule change into 0%-risk-weighted assets such as Treasuries. For policymakers, however, the adjustment preserves the sector's ability to step in to the Treasury market at times of heightened activity or stress.

In Europe, regulators appear to be taking a more cautious approach, avoiding outright reductions in capital requirements.[12] That said, certain proposals may lower operational costs by simplifying reporting obligations. However, the reforms also raise important questions about the future of Additional Tier 1 (AT1) instruments. If reforms make AT1s more equity-like – or phase them out in favour of CET1 over time – banks' funding costs could rise, potentially altering the relative attractiveness of different parts of the capital structure.

Within our fixed income portfolios and credit sleeves, we remain overweight banks in risk terms. Although deregulation introduces potential downside risks, we believe these are mitigated by the strong governance, conservative underwriting standards and robust capital buffers of the institutions we hold. On this basis, we intend to maintain our overweight positioning and would look to add selectively to our highest-conviction names if market volatility creates opportunities at more attractive spreads.

1 https://sarasinandpartners.com/think/security-a-new-theme-shaping-our-investment-approach/

2 https://www.federalreserve.gov/newsevents/speech/files/bowman20250205a.pdf

3 https://www.reuters.com/sustainability/boards-policy-regulation/us-fed-floats-plan-with-far-smaller-capital-hikes-big-banks-bloomberg-news-2025-10-22/?utm

4 https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2025/financial-stability-report-december-2025.pdf

5 https://www.ecb.europa.eu/press/key/date/2025/html/ecb.sp251211~3336189bc9.en.pdf

6 https://www.ecb.europa.eu/press/economic-bulletin/focus/2020/html/ecb.ebbox202006_07~5a3b3d1f8f.en.html

7 https://www.fnlondon.com/articles/investment-banks-scoop-103bn-in-second-best-year-on-record-801a2279

8 https://www.ft.com/content/597eb4dc-4002-4c36-95d3-8a7579e6745

9 https://www.federalreserve.gov/aboutthefed/boardmeetings/files/leverage-ratio-memo-20250625.pdf

10 https://www.congress.gov/crs_external_products/IF/PDF/IF13078/IF13078.1.pdf

11 https://www.bankofengland.co.uk/financial-policy-committee-record/2025/december-2025

12 https://www.reuters.com/sustainability/boards-policy-regulation/ecb-proposes-simpler-bank-capital-rules-2025-12-11/

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