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TIMES OF EXTREMES

Apocalypse, economic heart attack, turbulent progress, spectacular growth – today, anything seems possible. Yet alarmism is misplaced. Investors should be prepared for all scenarios, yet remain calm.

"The world will end in 2028" declared the *Neue Zürcher Zeitung* on the front page of a recent Sunday edition – with the subheading, in somewhat smaller type, "or even sooner." What followed was a catalogue of the most worrying issues of our time: a war against Russia and China, global warming of more than 1.5 degrees, a global financial crisis, artificial intelligence spinning out of control, a rise in authoritarian populism. The mood in autumn 2025 is indeed somewhat tense. In France, yet another government has failed in its attempt to prevent the nation's public finances from slipping further out of balance. In Germany, political dissatisfaction and economic unease are fuelling discussions of a "Plan B" – a fallback strategy should the worst occur. In the United States, meanwhile, Wall Street veteran Ray Dalio has attracted notice with his prediction that a debt collapse is ahead within one to five years, in the USA but also many other nations. He sets out his argument in detail in his new book, *How Countries Go Broke*, drawing on historical and current examples. For Dalio, the critical factor is debt servicing: with high levels of borrowing, interest costs eventually become unsustainable, leading to what he terms an economic "heart attack."

On the financial markets, however – and this is something we have been observing for some time now – there is little sign of apocalyptic sentiment. As economists, we tend to place greater trust in prices actually being paid in the markets than in surveys or media commentary. By this measure, equities currently show a fragile but generally positive momentum. The major indices are in positive territory year-to-date, at least in local currency terms. And most bond markets are signalling stable or even declining interest rates, with little expectation of inflationary pressure in the near term. Taken together, participants in what are arguably the world's largest and most efficient information-processing systems for economic and political risk do not appear unduly concerned. In aggregate, they remain invested, or are selectively adding to their positions.

Debt implosion?

So, at present, the world's most important and liquid markets are not sending clear warning signals – maybe with the exception of the US dollar, which has weakened by more than 10 percent against major currencies like the Euro or Swiss Franc since the beginning of 2025. In certain areas, however, there are noteworthy developments. One striking example is the gold price, traditionally viewed as a crisis indicator. Since the

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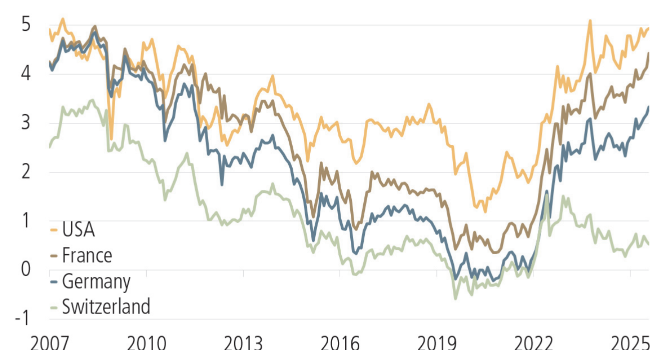
beginning of 2024, it has risen by around 80 percent in US dollar terms (up 70 percent in CHF and EUR), and by some 40 percent since January 2025 (up 25 percent in CHF and EUR). The gold market, however, is estimated to account for barely more than one per cent of the global volume of equities and bonds.

More attention in recent weeks has been directed towards another segment, usually followed only by specialists: 30-year government bonds. As our chart illustrates, yields in the USA, France and Germany have risen sharply, contrary to the long-term trend and despite the current downward trend in inflation figures. A notable exception is the 30-year Swiss Confederation bond segment.

YIELD ON 30-YEAR GOVERNMENT BONDS 2007-2025

FADING CONFIDENCE?



Source: Bloomberg. Yields of the respective indices for 30-year government bonds, January 2007 – end of August 2025.

Rising yields on government bonds send one clear signal: investors are demanding a higher risk premium for the money they lend. The most obvious reason would be a lack of confidence in a state's ability, or willingness, to honour its obligations in the future. Given the very high levels of indebtedness now visible across almost all major economies, it is not surprising that concerns are growing about the risk of an outright default, debt restructuring or creeping inflation and financial repression. It should be noted, however, that there can also be other reasons for rising yields (or interest rates), such as expectations of significantly increased investment demand due to the digital revolution, leading to greater capital scarcity.

Growth explosion?

The prospect of a world with massively higher investment needs, and correspondingly higher interest rates, was recently outlined in a special report by the British business magazine *The Economist*. The backdrop is the notion that technological progress could give rise to so-called artificial general intelligence (AGI): computer programs capable of learning and performing any intellectual task undertaken by humans. Unsurprisingly, such a vision provokes a wide range of anxieties. Yet it is worth considering this idea, particularly popular in Silicon Valley, from a purely economic perspective.

The classical theory of economic growth, developed by Robert Solow in the last century, is built on three input factors: capital, labour and technology. For centuries, labour was the decisive, and ultimately limiting, factor for economic development. The result was long periods of near stagnation, until the invention of the steam engine in the early 18th century. As technology and capital gained in importance, the global economy in the 20th century expanded at an average annual rate of 2.8 percent. This translated into a doubling of output roughly every 25 years – the foundation of the prosperity we know today.

This dynamic could, however, accelerate dramatically. A study published at the end of 2023 by the San Francisco–based think tank Epoch AI suggests that artificial general intelligence may trigger an explosion of ideas and production capabilities. Innovation processes would be vastly accelerated, while human labour as the limiting factor in the production function would all but disappear. What would still be required, beyond innovation itself, is substantial capital to secure adequate energy and infrastructure. Economic growth could quite literally take off, with talk of annual rates of 20 to 30 percent. Constant technological innovation, in this scenario, would recalibrate the entire framework of the economy: "Eureka, all day long."

Epoch AI estimates that the automation of one-third of all tasks could, in a first phase, generate GDP growth of around 20 percent. The authors do note a number of factors that could

work against such an outcome. Nevertheless, even if only a fraction of this potential were realised, financial markets could certainly see a few positive surprises in the near term. Is this what is driving equity markets and keeping valuations in the USA at levels close to their highest since the 2007–2009 financial crisis once again after 2019-2020 (see chart)?

PRICE-EARNINGS RATIOS 2007-2025

OVERPRICED?

Source: Bloomberg, data for January 2007 – end of August 2025. Shown here is the forward P/E ratio, which is based on the relationship between expected corporate earnings and the current price.

There is no doubt that US equity prices reflect high expectations for future corporate earnings. Yet they are still far from pricing in the kind of growth explosion described above. Valuations are high, but not alarming. Some degree of optimism may be embedded in certain companies' share prices, but unlike during the dotcom bubble of the early 2000s, today's drivers of innovation are generating decent profits. Firms such as Apple, Google, Microsoft, and the more richly valued Nvidia are generating robust profit margins of more than twenty percent. They possess proven business models, solid financials and healthy growth rates. In short: for now (at least), investors do not seem to have bought into Silicon Valley's bold vision in great numbers.

Attention and a good measure of calm

On the one hand, fears of collapse; on the other, visions of rapid progress. Between these extremes, almost anything seems possible today, and forecasts appear presumptuous, an overconfident claim to knowledge. Against this backdrop, even the widely expected trend towards falling (or at least stable) interest rates cannot be regarded as certain. So, what to do?

The fact remains that government debt has spiralled out of control in almost every major economy. Historically, this has often led to periods of financial repression, in which debt levels are gradually reduced through a combination of low short-term interest rates and somewhat higher inflation – in extreme cases, even accompanied by capital controls. This is a lengthy process. As the Swiss publication *The Market* recently noted, the USA experienced such a period of financial repression between 1945 and 1980. In such phases, real assets such as equities, gold or property have typically offered protection – though only for investors able to withstand considerable volatility.

It also seems clear that the world is currently experiencing a great wave of innovation, the full implications of which are difficult to predict. These innovation surges are driven by companies. Investors seeking to participate in such opportunities inevitably need exposure to equities – provided, again, that they are willing and financially able to tolerate the associated risks and volatility. After all, Schumpeter's process of creative destruction is relentless, but also unavoidable. But who is better equipped to navigate challenging times than well-managed companies?

"Just alarmism?" – that was the headline of the Sunday edition cited at the start, looking ahead to 2028. Our view: yes, alarmism. In times of extremes, one must be prepared for anything. Yet it would be unwise to fixate on any single scenario, whether positive or negative. Vigilance is certainly warranted, but when in doubt, a good measure of calm is equally important.

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IA, 30.09.2025

ON DEALING WITH BUZZWORDS

Those fortunate enough to have observed and commented on the economy over several decades do not easily lose their composure in the face of the latest fashionable buzzwords and trends. Undoubtedly, artificial intelligence (AI) is of enormous significance. Yet, in a few years, we shall have grown accustomed to it, and the world will neither have ended nor become markedly better than before.

My own recollection stretches back to the era when the "conglomerate" promised to solve all problems: vast, complex enterprises with inherent risk diversification. Siemens, IBM, General Motors and the like. Soon thereafter came the triumph of the delightfully uncomplicated single-focus enterprise, spurred by the insights of portfolio theory, which demonstrated that risk diversification is far more efficiently achieved outside the corporate walls – in the private and institutional coffers of investors. At the dawn of the 2000s, we witnessed the first Internet revolution under the sobriquet "Dot Com" with its attendant bubble, whose demise left a trail of devastation across the portfolios of all-too ebullient investors. Rather than keeping single-focus companies within a sufficiently diversified portfolio, one had become wedded to a solitary theme.

Technological progress can indeed upend established structures, though rarely in the locations one might expect.

It was almost exactly ten years ago when I first wrote on the so-called "Sharing Economy," endeavouring to gauge its prospective significance. Upon rereading that essay today, I must confess I allowed myself to be somewhat dazzled by the phenomenon. Uber and Airbnb, in particular, caught my fancy. I was captivated by the rigorous exploitation of dramatically lowered information and transaction costs – courtesy of technological progress – on platforms of every conceivable stripe. Among other forecasts, I ventured that the largely untapped human capital of ever-older yet healthier retirees would very rapidly be thrust back into the workforce. With the attendant disinflationary effects, naturally, and the alleviation of the chronic skills shortage. How delightful that would have been. Alas, not everything that is conceivable, or even logically compelling, comes to pass.

The "Sharing Economy" found its limits in the form of existing regulations and the societal cartels that arose from them. Uber, to be sure, exists, and indeed flourishes in certain corners of the globe; but the vision of a quasi-populist cottage industry of its drivers has, in most locales, amounted to little. Labour law and fiscal obstacles conspicuously forestalled any genuine triumph. Airbnb has carved out a niche alongside traditional hotels, with prices converging, as one might have expected. Yet tenant protection laws and strict building regulations have thus far stymied any great capacity revolution in the housing market.

The true revolution of the "Sharing Economy" has occurred where the public rarely casts its gaze: in industry and commerce. Over the past ten to fifteen years, warehousing and distribution have been utterly transformed. There is scarcely a vessel at sea that does not simultaneously serve as a warehouse for a multitude of clients. And few, if any, of the warehouses dotting the once-green fields around motorway interchanges are now used by a single party. Everywhere one looks, resources are shared.

Quintessential lesson: yes, technological progress can indeed upend structures – though often not where one might expect, given the publicity, but rather where, quietly and without the heavy hand of government, economic efficiency is sought and achieved. Blockchain currencies such as Bitcoin and Ethereum are fascinating; yet the blockchain technology itself, far more consequentially, has long since become embedded in modern industrial processes. So it is also with AI: it has already insinuated itself thoroughly into a vast array of processes, and it is there to stay.

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