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# WisdomTree Market Outlook: Easing into a soft landing



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# 1.

## Commodity Outlook: A strong setup for precious metals

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## **H1 2024 lookback**

Commodities had a good first half in 2024 but have trailed equities by some margin (Figure 1). However, with equity returns having been so concentrated, the performance of commodities is comparatively diversified. Most subsectors of the commodity complex have risen (Figure 2). The only subsector to have declined is agriculture, but within that sector, we have seen stellar rallies in coffee and cocoa and periodic bursts in the grains space.

Figure 1: Asset performance compared

	2014	2015	2016	2017	2018	2019
1	Real Estate 15.9%	Cash 0.2%	Commodities 11.8%	Equities 22.4%	Cash 1.7%	Equities 27.7%
2	Bonds 5.6%	Real Estate 0.1%	Equities 7.5%	Real Estate 11.4%	Bonds -2.4%	Real Estate 23.1%
3	Equities 4.9%	Equities -0.9%	Real Estate 5.0%	Bonds 10.3%	Real Estate -4.7%	Bonds 13.6%
4	Cash 0.2%	Bonds -2.8%	Bonds 3.6%	Commodities 1.7%	Equities -8.7%	Commodities 7.7%
5	Commodities -17.0%	Commodities -24.7%	Cash 0.5%	Cash 0.9%	Commodities -11.2%	Cash 1.7%

	2020	2021	2022	2023	10 Yrs	H1 2024
1	Equities 15.9%	Real Estate 27.2%	Commodities 16.1%	Equities 23.8%	Equities 8.6%	Equities 11.7%
2	Bonds 10.3%	Commodities 27.1%	Cash 1.7%	Real Estate 10.9%	Real Estate 4.5%	Commodities 5.1%
3	Cash 0.5%	Equities 21.8%	Equities -18.1%	Bonds 7.9%	Bonds 1.7%	Cash 2.0%
4	Commodities -3.1%	Cash 0.1%	Bonds -21.0%	Cash 3.9%	Cash 1.1%	Bonds 3.9%
5	Real Estate -8.2%	Bonds -3.5%	Real Estate -24.4%	Commodities -7.9%	Commodities -1.1%	Real Estate -7.9%

Source: WisdomTree, Bloomberg. Data until 30/06/2024. All returns are in USD; 10 years' returns are annualised from 31/12/2013 to 31/12/2023. H1 2024 performance is from 31/12/2023 to 30/06/2024. Data: Equity: MSCI World, Bond: Bloomberg Barclays Agg Sovereign TR Unhedged, Real Estate: EPRA/NAREIT Global, Commodity: Bloomberg Commodity Total Return Index, Cash: US T-Bill 3 months. **Historical performance is not an indication of future performance, and any investments may go down in value.**

Figure 2: Commodity sector performance compared

	2014	2015	2016	2017	2018	2019
1	Precious Metals -6.7%	Precious Metals -11.5%	Industrial Metals 19.9%	Industrial Metals 29.4%	Precious Metals -4.6%	Precious Metals 17.0%
2	Industrial Metals -6.9%	Agriculture -15.6%	Energy 16.3%	Precious Metals 10.9%	Agriculture -10.8%	Energy 11.8%
3	Agriculture -9.2%	Diversified -24.7%	Diversified 11.8%	Diversified 1.7%	Diversified -11.2%	Diversified 7.7%
4	Diversified -17.0%	Industrial Metals -26.9%	Precious Metals 9.5%	Energy -4.3%	Energy -12.7%	Industrial Metals 7.0%
5	Energy -39.3%	Energy -38.9%	Agriculture 2.1%	Agriculture -11.0%	Industrial Metals -19.5%	Agriculture 1.7%

	2020	2021	2022	2023	10 Yrs	H1 2024
1	Precious Metals 25.6%	Energy 52.1%	Energy 36.2%	Precious Metals 9.6%	Precious Metals 3.9%	Precious Metals 15.0%
2	Agriculture 16.5%	Industrial Metals 30.3%	Diversified 16.1%	Agriculture -4.4%	Industrial Metals 2.1%	Industrial Metals 9.0%
3	Industrial Metals 16.3%	Diversified 27.1%	Agriculture 15.5%	Diversified -7.9%	Agriculture 0.3%	Energy 8.0%
4	Diversified -3.1%	Agriculture 26.7%	Precious Metals 0.1%	Industrial Metals -9.1%	Diversified -1.1%	Diversified 5.1%
5	Energy -42.7%	Precious Metals -6.1%	Industrial Metals -2.4%	Energy -21.6%	Energy -9.6%	Agriculture -6.3%

Source: WisdomTree, Bloomberg. Data until 30/6/2024. All returns are in USD; 10 years' returns are annualised from 31/12/2013 to 31/12/2023. H1 2024 performance is from 31/12/2023 to 30/06/2024. Data: proxies for each commodity sector using Bloomberg subsector indices TR. **Historical performance is not an indication of future performance, and any investments may go down in value.**

Precious metals have led the rally, with gold reaching fresh highs on multiple occasions, and silver even outperforming gold. Interest rate cuts, while being favourable for the whole commodity complex, are particularly good for precious metals. The rate cuts are drawing investors who had sat on the sidelines for some time to precious metals. Base metals are the next best performing subsector. Some of the rallies in copper, for example, have widely been described as 'technical', but we believe there is more to it. Supply is tighter than most have appreciated. However, the dark clouds of trade restrictions loom, presenting a downside risk to the complex.

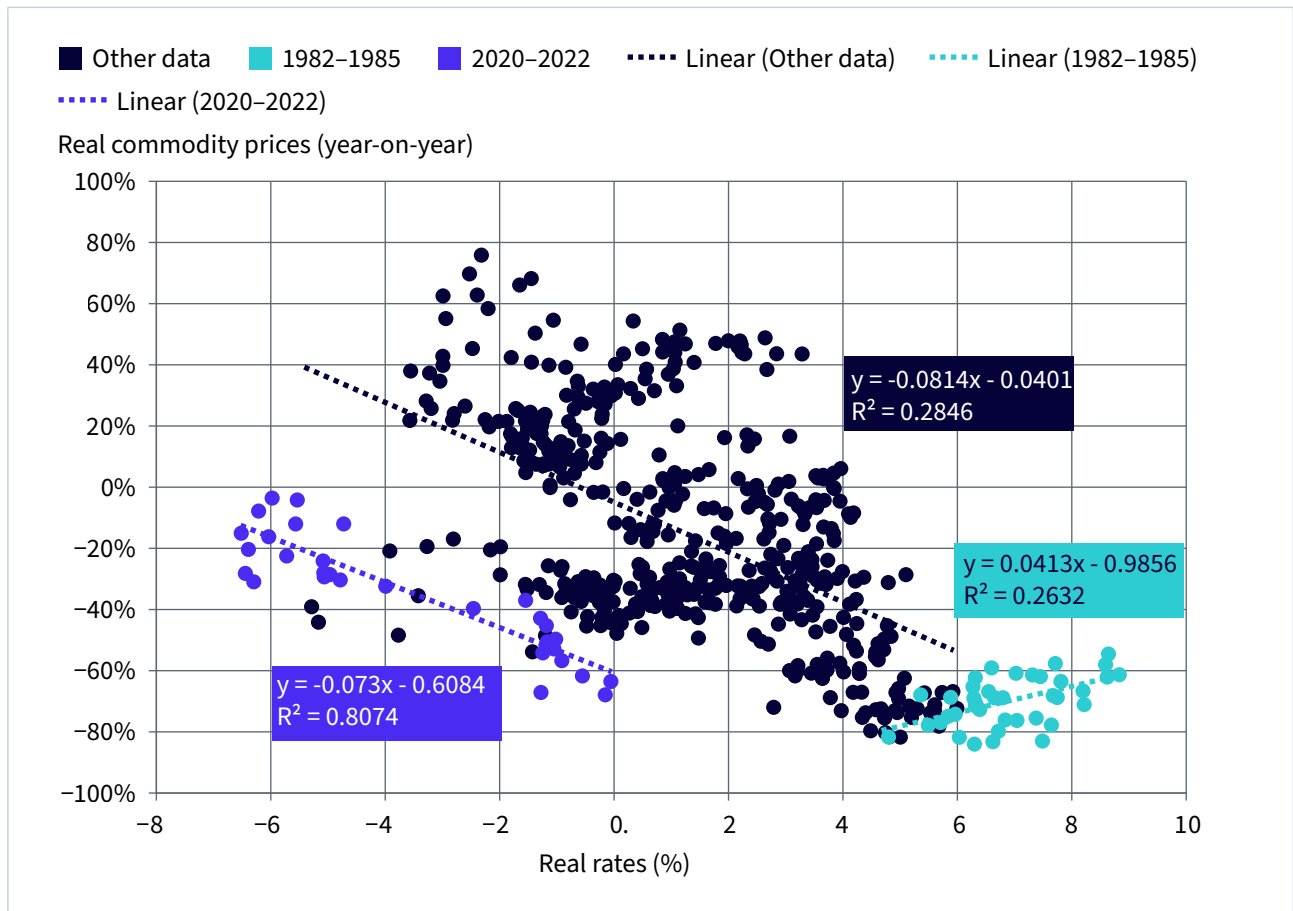
Precious metals have led the rally, with gold reaching fresh highs on multiple occasions.

### **Interest rate cut cycle begins**

With the US widely expected to join Canada and many parts of Europe in cutting interest rates, we believe the world economy could see some additional policy support. China has been waiting for others to loosen monetary conditions before it begins in earnest. More policy support from the world's largest commodity consumer should be a boon for the asset class.

Lower US interest rates have historically been a positive driver of real commodity prices (Figure 3). We note that the relationship inverted during the oil price crash in the 1980s. During the COVID-19 crisis, while lower rates were better for commodities (with a beta similar to other periods), the impact of the shock generally sent prices lower.

Figure 3: Real commodity prices and real interest rates

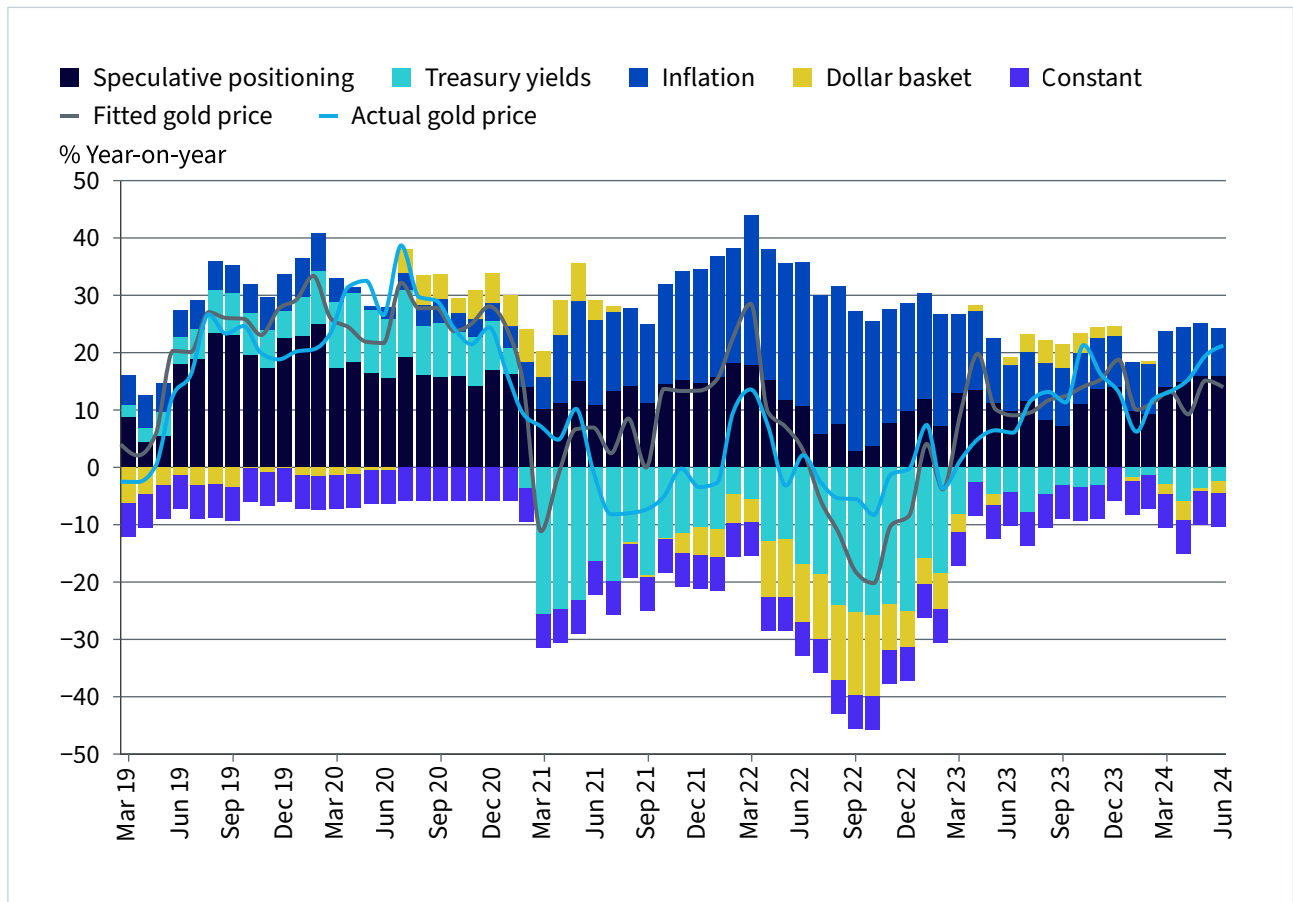


Source: WisdomTree, Bloomberg. Data from June 1976 to June 2024. Real commodity prices calculated using Bloomberg Commodity Price Index and US Consumer Price Index. Real rates calculated using nominal 2-year US Treasuries and US Consumer Price Index. The 1982-1985 period represents a negative oil price shock. 2020-2022 represents the COVID-19 shock. 'Linear' is the regression line for the relevant dataset. Regression equations are annotated on chart, where y is the real commodity price (dependent variable) and x is the real rate (independent variable). R<sup>2</sup> tells us how much of the variation in the dependent variable is explained by the independent variable (scale of 0 to 1). **Historical performance is not an indication of future performance, and any investments may go down in value.**

Low interest rates are good for all commodities. Precious metals, in particular, stand to benefit from policy rate cuts, as we expect the long-end yield curve to decline. Gold has a long-standing relationship with real 10-year Treasury yields. Since 2021, rising 10-year yields have been a source of price headwinds for gold (Figure 4). Should that start to reverse, we could see significant upside potential for gold. Also, with the US cutting interest rates, US dollar appreciation headwinds may also ease, allowing gold in dollar terms more capacity to gain.

Precious metals, in particular, stand to benefit from policy rate cuts.

Figure 4: Gold price attribution



Source: Bloomberg, WisdomTree price model. Data as of June 2024. Speculative positioning is net non-commercial positioning in gold futures markets (netting shorts away from long positions, as reported by the Commodity Futures Trading Commission). Treasury yields are the nominal yield to maturity on a 10-year US Treasury Bond. Inflation is the annual growth of the US Consumer Price Index. Dollar Basket (DXY) is a measure of the value of the US Dollar against a basket of currencies (euro, Swiss franc, Japanese yen, Canadian dollar, British pound, and Swedish krona). Actual Gold Price is the annual growth in spot gold prices. The fitted gold price is the price the model would have forecast. The constant does not have economic meaning, but is used in econometric modelling to capture other terms. It can be thought of as how much gold prices would change if all other variables were set to zero (although that would be unrealistic). **Forecasts are not an indicator of future performance, and any investments are subject to risks and uncertainties.**

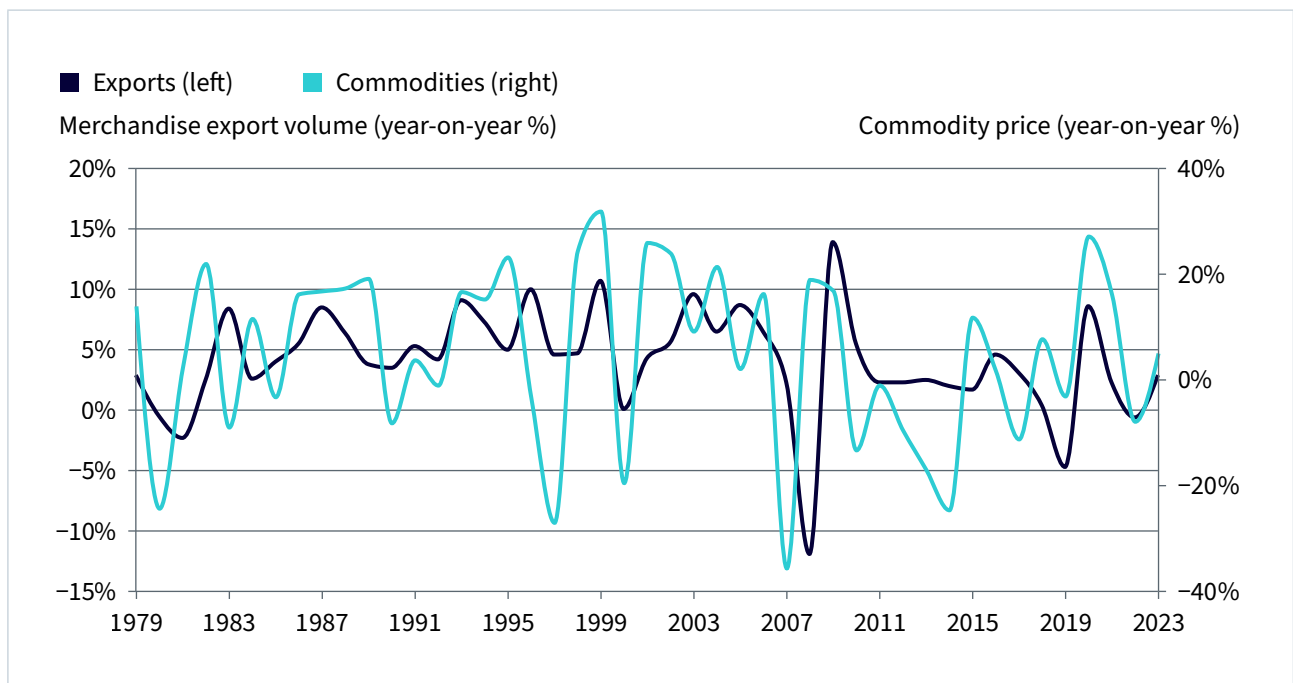
Silver, which has a strong correlation with gold, will also benefit from the rate cuts. Silver has been in a supply deficit every year since 2021, and we expect demand to outstrip supply by a similar magnitude in 2024 as we saw in 2023. Industrial demand for silver has been scaling new highs, propelled by photovoltaic demand and the increasing use of silver in 5G and electronics in cars. Photovoltaic installations significantly exceeded anyone’s forecast at the beginning of 2023, with new capacity additions forecast to reach another record high in 2024.

### Global trade

2024 has been and will continue to be a busy election year. The US presidential election is clearly one of the major events in this calendar year. Experience from elections elsewhere — France,

UK, India — has highlighted that outcomes are not easily predictable and almost anything can happen. At the time of writing, the betting markets are placing a 58.7% chance of Trump returning to the presidency (source: Real Clear Politics poll average, 19 July 24). However, we are drafting this just after Biden has pulled out of the race, and so betting odds are fluctuating more than normal. Trump and his running mate Vance have campaigned on a platform of being trade hawks. If they are successful in winning the White House and follow through with their campaign policies, we could see a negative trade shock, and that could eventually be bad for commodity prices. Figure 5 shows that historically, lower export volumes have been associated with lower commodity prices.

Figure 5: Export volume and commodity price performance



Source: WisdomTree, Bloomberg, World Trade Organisation. Data from 1979–2023. Commodities represented by Bloomberg Commodity Price Index. **Historical performance is not an indication of future performance, and any investments may go down in value.**

Should he be elected, it may take many months before Trump’s proposed plans for major tariffs on US imports are implemented. Bearing in mind that his inauguration would be 20 January 2025, if we assume an expedited three to four months for a US Trade Representative Section 301 process<sup>2</sup> and then another month to sign off, we will be in the middle of 2025. During that time, central banks around the world will have delivered several interest rate cuts, stimulating the

<sup>2</sup> Section 301 of the Trade Act of 1974 grants the Office of the United States Trade Representative (USTR) a range of responsibilities and authorities to investigate and take action to enforce U.S. rights under trade agreements and respond to certain foreign trade practices. Prior to the Trump Administration and since the establishment of the World Trade Organization (WTO) in 1995, the United States used Section 301 authorities primarily to build cases and pursue dispute settlement at the WTO. Former President Trump was more willing than previous officials to act unilaterally under these authorities.

global economy. As we discussed earlier, gold will benefit from the monetary stimulus, but fears about a potential trade war could drive the metal up even further. Gold is often seen as a hedge against geopolitical and economic turbulence.

We stress that at the time of drafting we don't know who the next US president will be. Even if Democratic nominee Harris is successful, the chances are that the US will tighten trade (but maybe not as a central part of the campaign platform). In May 2024, President Biden announced a widening of Section 301 tariffs on a number of Chinese imports to include solar panels, electric vehicles, batteries, green energy supply chain inputs, ship-to-shore port cranes, steel products, aluminium products, medical syringes, and personal protective equipment (PPE). If adopted, some of the new tariffs would take effect this year, while others would be phased in gradually in 2025 and 2026. There are notable carve-outs. For example, the increase in battery tariffs excludes lithium-ion batteries for electric vehicles (EVs).

Last year, the European Union (EU) introduced the Foreign Subsidies Regulation (FSR). These new rules enable the European Commission to address distortions caused by foreign subsidies. The rules limit investments when non-EU firms are found to unduly benefit from subsidies provided by their own governments. Such probes are now targeting Chinese cleantech manufacturers. The utilisation of these new rules could present a decline in trade from the EU as well.

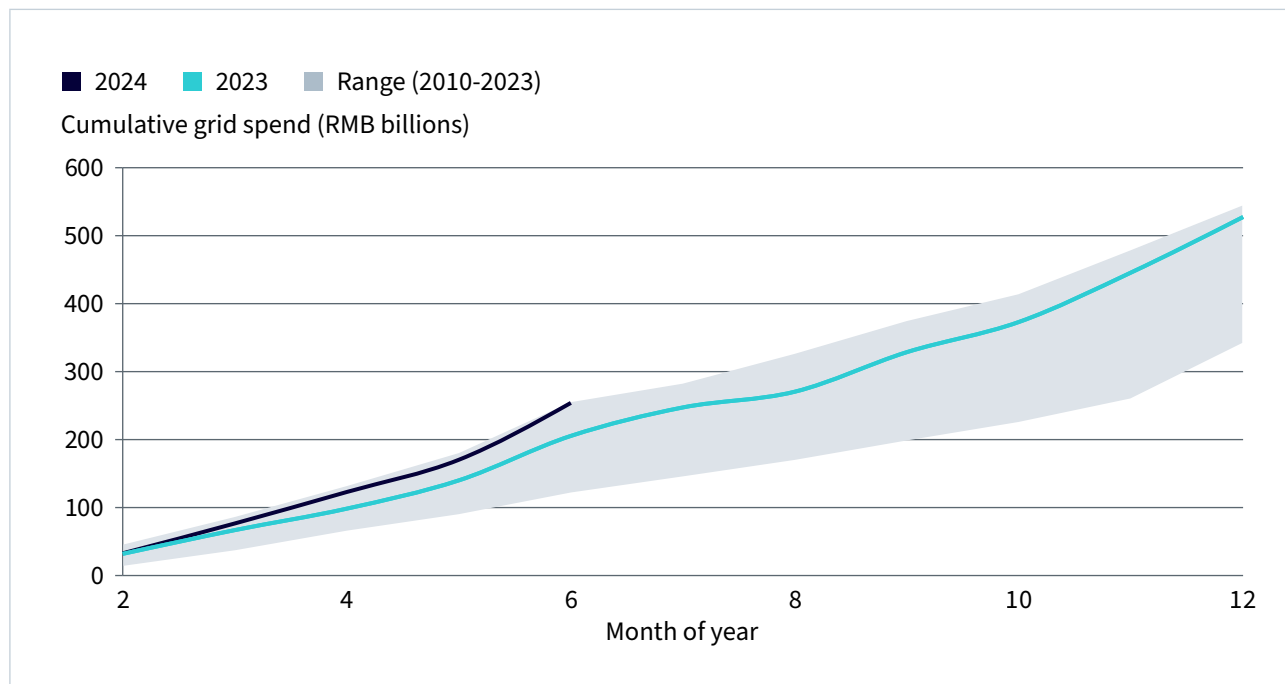
## China to double down on energy transition

China is likely to be the main target of additional tariffs and will have close to a year to formulate a plan for policy easing to counteract trade disruption. China's economy is already faltering under the pressure of a real estate implosion, and we expect the Chinese government to announce plans to stimulate its economy. In China's Third Plenum, which is normally very long-term focused, the government noted in its communiqué some near-term issues, potentially pointing to the urgency in dealing with its economic soft patch. The mid-year Politburo meeting, however, failed to articulate a meaningful plan, with some subtle tilts to stimulating consumer demand.

We believe that in order to meet growth targets, China will follow up with more meaningful stimulus that will lean heavily on energy transition – that is, a metal-intensive sector. China is already ramping up electric grid expenditure domestically, spending more money on transmission and distribution cabling, which is a copper and aluminium heavy sector. Figure 6 shows that spending on grid is at record highs in China in 2024 (above the 2010–2023 range for June, the last available data point) and far above 2023 spending at this time of the year.

China is already ramping up electric grid expenditure domestically.

Figure 6: China grid spending



Source: WisdomTree, Bloomberg. Data from 2010 to June 2024. **Historical performance is not an indication of future performance, and any investments may go down in value.**

In May, China eased limits on ‘curtailments’, indicating its willingness to allow renewable infrastructure to grow further. Curtailments refer to the reduction of output from renewable energy projects owing to grid constraints or lack of demand. The challenge is particularly common in the north, which has ideal wind and solar resources but limited local power demand. Excess power produced in these regions requires more grid infrastructure to move the electricity to higher-demand regions. Lifting the curtailment cap could trigger another 100 gigawatts of wind and solar installations according to Bloomberg New Energy Finance. Sanctioning this extra capacity indicates a strategic choice to move decisively with an energy transition strategy, with likely grid spend to match the production ambitions.

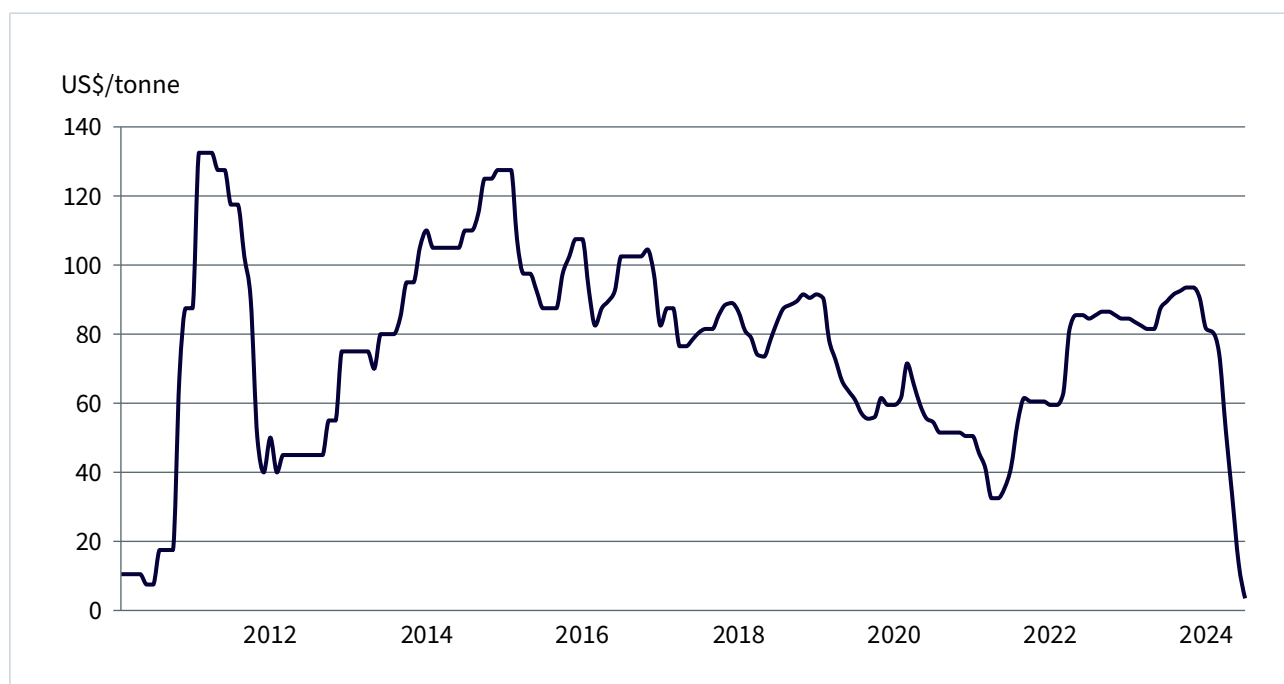
We believe China will also continue to expand the manufacture and deployment of EVs, solar panels, and batteries. EV sales already represent 40% of passenger vehicle sales in China, and we could see that becoming close to 50% by the end of year, with costs of the EVs now lower than their internal combustion vehicle equivalents in China.

There may even be a small opportunity for China to expand exports to the US and Europe just before higher tariffs kick in. We have certainly observed this phenomenon in the run-up to Biden’s tariffs being implemented.

The metal markets that will benefit from the energy transition pivot are giving mixed signals. For example, the exchange inventory of copper has risen, indicating that the finished metal is in plentiful supply. Conversely, treatment and refining charges have fallen close to zero in

China (Figure 7), indicating a lack of copper ore available to Chinese refiners to process.<sup>3</sup> Mining sector difficulties, including closures (Cobre Mine in Panama), declining ore grades, and delays in opening new mines have contributed to this problem. In addition, the willingness of China to produce more finished copper than needed immediately (because it's preparing for future demand) may also be driving the treatment costs lower. If China is indeed preparing for a higher consumption level in the future, this would be a strong signal for the market.

Figure 7: China copper concentrate treatment charges



Source: WisdomTree, Bloomberg. Data from 2010–2024. **Historical performance is not an indication of future performance, and any investments may go down in value.**

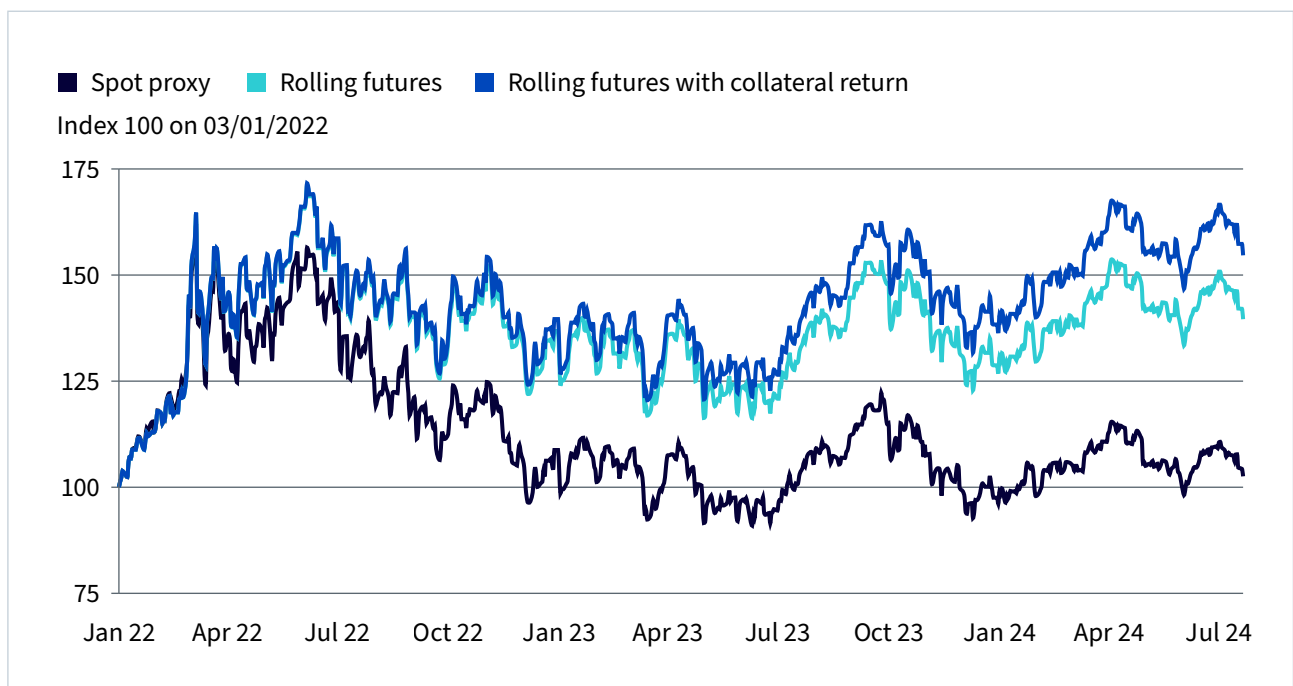
### OPEC+ instrumental to maintaining global oil balance and current futures curve structure

If Trump is elected, we expect he will be more friendly to the US oil and gas industry than the current administration and promote the expansion of US production from what's already the world's largest producer. We expect that to drive prices lower to the extent that they're not fully counteracted by OPEC+ restraint.

<sup>3</sup> The greater the competition for the ore, the lower the amount refiners will charge for treatment and refining.

Regardless of who wins the US presidential election, global oil demand is decelerating as subpar economic growth, greater efficiencies, and vehicle electrification act as headwinds. In early June, OPEC+ laid out a roadmap for unwinding extra voluntary supply reductions of up to 2.2 million barrels a day (mb/d) from Q4 2024 through Q2 2025. However, the group also provided assurances that it will pause or reverse these plans subject to market conditions. Assuming the group follows through with these assurances and doesn't unwind production restraints in September, we expect oil futures curves to remain in a state of backwardation and sharp declines in spot price to be avoided. Even if oil remains range-bound as it has been over the past year, positive roll yields and positive collateral yields would continue to make a rolling futures investment in oil attractive. Figure 8 highlights that while spot Brent oil prices have been close to flat over the past two and a half years, we have seen sizeable increases in rolling futures strategies, especially when incorporating the collateral return. In fact, if we look between 21 July 2023 and 23 July 2024, Brent oil prices started and ended the period at \$81 a barrel (bbl). However, with approximately 6% in roll yields and 6% in collateral yields, an investment in a rolling futures position in Brent oil generated a 12% return before fees.

Figure 8: Brent oil rolling futures versus spot



Source: WisdomTree, Bloomberg. Data from 03/01/2022 to 23/7/2024. Spot proxy: front month future prices (not incorporating rolls). Rolling futures: Bloomberg Commodity Brent Oil Subindex Excess Return. Rolling futures with collateral return: Bloomberg Commodity Brent Oil Subindex Total Return. All data were indexed to 100 on 03/01/2022. **Historical performance is not an indication of future performance, and any investments may go down in value.**

## The wild card of weather

A study in *Sciences Advances*<sup>4</sup> published in March 2024 concludes that since 1979, global heat waves are moving 20% more slowly — meaning more of us stay hot for longer — and they are happening 67% more often. The study found the highest temperatures in heat waves are warmer than 40 years ago, and the area under a heat dome is larger.

Rising temperatures appear to have many climatic impacts. For example, intense Atlantic hurricanes arrived earlier this year. Hurricane Beryl, the first hurricane of the 2024 Atlantic hurricane season, made landfall in late June, early July, and rapidly strengthened into a Category 5 storm unusually early in the year. This explosive strengthening was fuelled in part by exceptionally warm ocean temperatures. An El Niño weather phenomenon — which occurs when the ocean's temperature along the equatorial Pacific rises above average — may have contributed to overall ocean warming.

A switch to the opposite, La Niña (a lowering of equatorial Pacific Ocean temperatures below normal), has a 70% probability between August and November 2024, according to the World Meteorological Organization (WMO). However, it's unlikely to provide much relief to weather volatility. The past nine years have been the warmest on record, even with the cooling influence of a multi-year La Niña from 2020 to early 2023, according to the WMO. La Niña actually reduces Atlantic trade winds and leads to less wind shear (the changing of wind speed and direction with height) thus providing ripe conditions for hurricanes to intensify during peak hurricane season (mid-September).

Assessing the impact of long-range weather/ climate forecasts on commodities is a challenge. For example, higher temperatures can increase air conditioning demand, which in turn increases natural gas demand, which on its own would be a price-positive outcome for natural gas. However, increased hurricane activity associated with those higher temperatures can knock out gas infrastructure. Of particular concern is when liquefied natural gas (LNG) infrastructure is compromised as it inhibits the US's ability to export its natural gas. That would generate a domestic glut and drive the price of natural gas lower. Similarly, the impact of high temperatures on agricultural crops is highly dependent on the timing in the crop cycle.

Weather extremes will contribute to higher commodity price volatility and open up both long and short tactical investment opportunities.

4 <https://www.science.org/doi/10.1126/sciadv.adl1598>

The specific impacts of weather events are better assessed closer to the time of occurrence. However, while it's hard to forecast the direction of prices a long time in advance, we do believe that greater weather extremes will contribute to higher commodity price volatility and open up both long and short tactical investment opportunities in weather-affected commodities.

## **Conclusion**

All things being equal, lower interest rates are good for commodity prices. However, in a year when there's uncertainty around global trade, some commodities may face headwinds. Gold, which typically acts as a hedge against geopolitical, financial, and trade concerns, may however benefit. Closely correlated silver could also move on its coattails. China, the target of increased trade barriers, may react by doubling down on its domestic energy transition to provide a new avenue for economic growth. It may also have a small window of time to increase exports of cleantech before the increased tariffs are implemented. Ironically, these trade woes could trigger an increase in metal demand in this outlook timeframe.

Spot oil prices are likely to remain range-bound, but rolling futures strategies are likely to produce strong returns due to the policies that OPEC+ have pursued.

With amplified weather volatility, we can expect amplified commodity price volatility. While it may be difficult to make long-range price forecasts on the back of the weather, increased volatility is likely to open many short-term tactical plays in the asset class.

## 2.

# Equity Outlook: Breaking concentration with a plethora of opportunities

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Equities have displayed remarkable strength in H1 2024, led higher by the US, Europe, and Japan. Performance has been supported by robust earnings and positive momentum despite the re-rating of interest rate cut expectations. Yet, it's important to note that leadership within the stock markets remains quite narrow on a relative basis owing to earnings concentration and the AI frenzy. This has led market cap weighted indices to become richly valued. Front-end rates have remained anchored, resulting in equity risk premiums at their lowest level in 20 years. Looking across factors in developed markets, the first half of 2024 has been a mirror image of 2023, with growth and quality leading equity market performance. There is a high premium for higher quality parts of the market.

In the US, the gap between investor expectations for significant rate cuts early in the year versus the Federal Reserve's (Fed) conservative projections has narrowed. In lockstep, investors' expectations have adjusted to the higher-for-longer rate environment. At the turn of the year, we are seeing signs of moderating rather than collapsing US growth, normalising labour markets and disinflation, which support the case for the Fed to lean towards easing. Recession odds for 2024 have also fallen sharply, with underlying economic growth slowing, but not close to negative. The overall supportive backdrop confirms that we are in the mid to late cycle phase. Growing earnings alongside a dovish Fed are likely to provide support for the ongoing bull market, while political uncertainty should drive volatility higher.

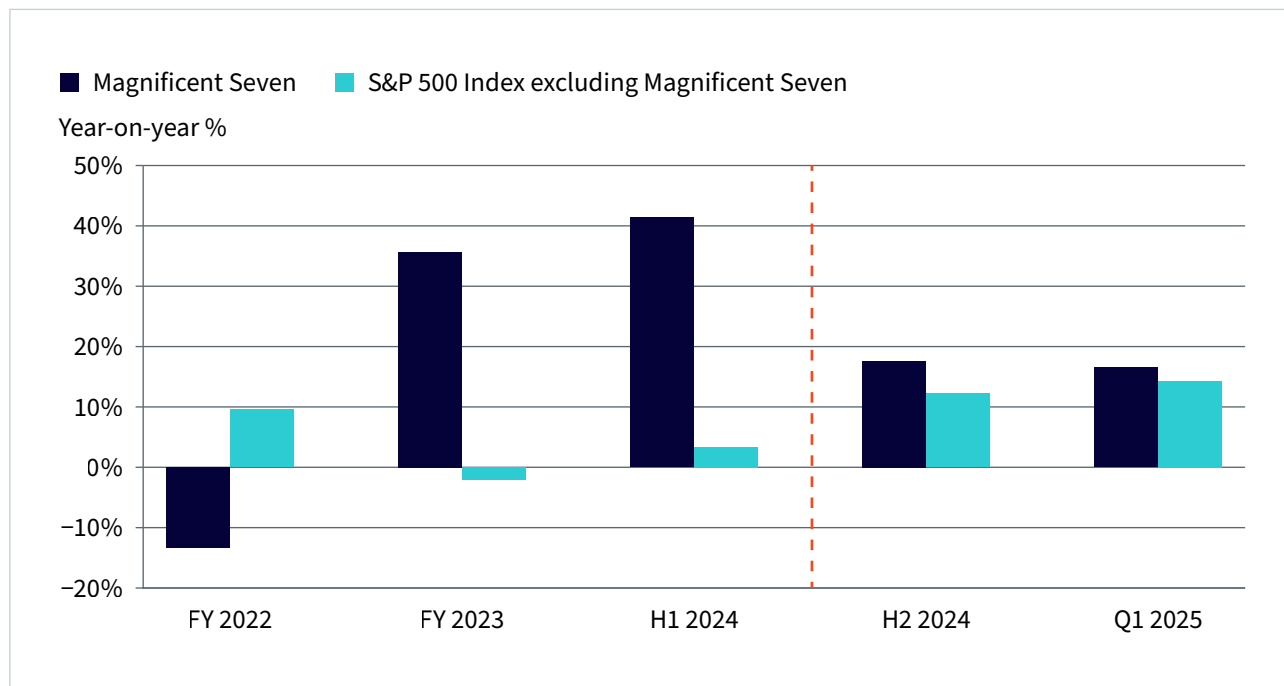
Growing earnings alongside a dovish Fed are likely to provide support for the ongoing bull market, while political uncertainty should drive volatility higher.

## US market's concentration conundrum

The Magnificent Seven<sup>5</sup> has been the most crowded trade amongst investors for 16 straight months. US equities have been more concentrated than at any point since the mid-1970s. A risk of returns being so concentrated within such a small segment of the market is that when those companies fail to meet expectations, their performance suffers. Forward earnings growth looks set to expand beyond the current leaders.

<sup>5</sup> Magnificent Seven is a group of mega cap stocks: Apple, Alphabet, Microsoft, Amazon.com, Meta Platforms, Tesla and Nvidia.

Figure 9: Comparison of earnings growth



Source: Factset, S&P, WisdomTree. Data as of 30/6/2024. Fiscal year (FY) is a 12-month accounting period that a business uses for financial and tax reporting purposes. It's also known as a financial year. **Forecasts are not an indicator of future performance, and any investments are subject to risks and uncertainties.**

### Small is big again

The Russell 2000 Index of small cap stocks has lagged in performance when compared to their large cap peers over the past decade. With nearly 40%<sup>6</sup> of the Russell 2000 Index having low or no earnings over the past 12 months, the higher rate environment has added to further downside pressure on small cap stocks. Timing means reversion can be challenging and might not be necessary with small caps. Instead, adopting a barbell approach that combines large cap equity exposure with small caps is likely to provide a more balanced US equity allocation.

### Value continues to thrive in emerging markets

In sharp contrast to the US, value stocks drove strong returns across EMs and have continued to outperform growth since 1990. EM equities rose by 7.5% in H1 2024, but still lagged developed market equities<sup>7</sup>. EMs have been resilient in the face of the high interest rate environment, China's growth challenges, and a stronger dollar in 2024. The International Monetary Fund (IMF)

6 Bloomberg, July 2024.

7 Bloomberg, MSCI Emerging Markets Index from 31 December 2023 to 30 June 2024.



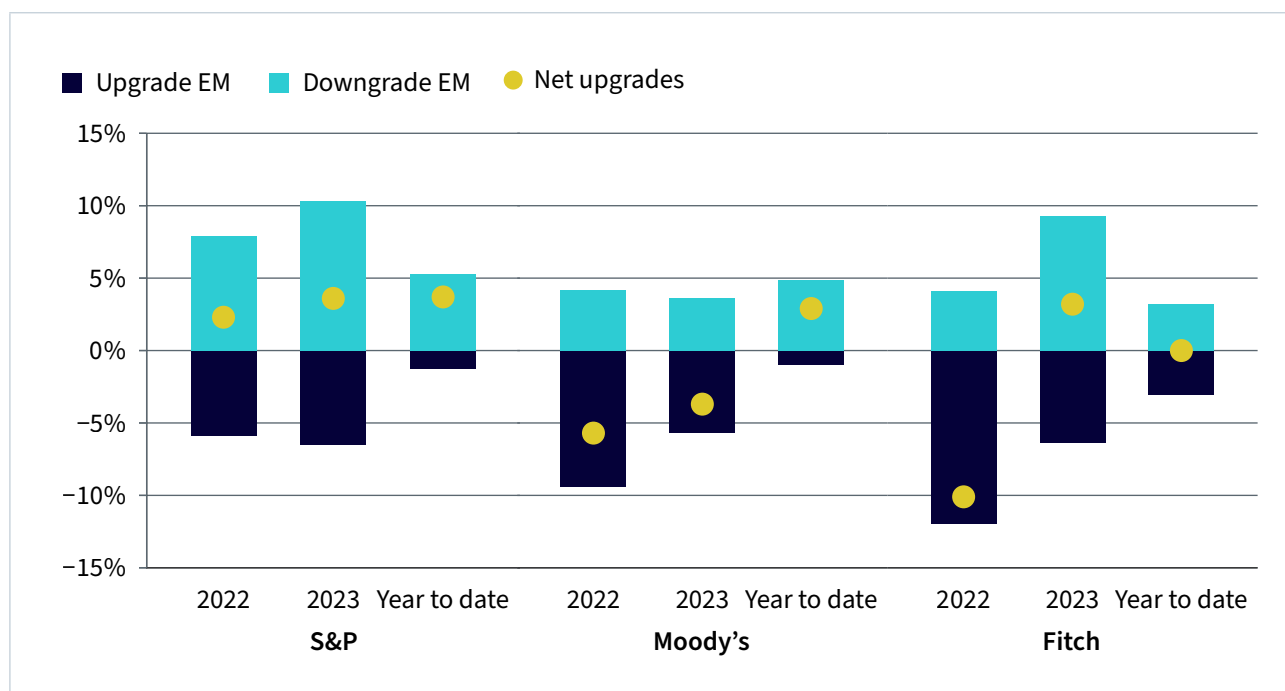
We expect resilient economic growth and supply chain rebalancing alongside a monetary easing cycle by the Fed to offer a plethora of opportunities across EMs.

slightly revised its global growth outlook, reflecting the unexpected resilience of the global economy<sup>8</sup>. While the IMF left its global growth forecasts for 2024 unchanged at 3.2%, it revised its 2025 forecast slightly upwards to 3.3% (from 3.2% in April), mainly due to EMs and developing economies<sup>8</sup>. World trade growth is also expected to recover to about 3.25% annually in 2024–25 and align with global GDP growth again.

Looking ahead, we expect resilient economic growth and supply chain rebalancing alongside a monetary easing cycle by the Fed to offer a plethora of opportunities across EMs. The improvement in growth and inflation fundamentals have been supported by a wave of structural reforms in Brazil, Indonesia, India, the United Arab Emirates, and Saudi Arabia. This has driven a wave of upgrades in EM sovereign credit ratings over the past two years. This remains key for EMs, as the combination of improving sovereign credit ratings alongside positive outlooks will have a meaningful impact on lowering their cost of debt over the medium term.

<sup>8</sup> *World Economic Outlook*, July 2024.

Figure 10: Number of emerging markets upgrades versus downgrades by rating agencies



Source: S&P Global, Moody's, Fitch, Bloomberg. Data as of 30/6/2024. **Historical performance is not an indication of future performance, and any investments may go down in value.**

### Emerging market growth beyond China

The Chinese economy continued to show waning momentum in its growth trajectory. Its ability to boost global growth is waning. The transition from an investment-driven to a consumer-driven economic growth model is taking longer than anticipated. Chinese consumers were scarred by the COVID-19 pandemic and the end of the housing boom, causing them to hold back on spending. The People's Bank of China (PBoC) is unlikely to loosen policy more aggressively than the Fed or the European Central Bank (ECB) for fear that rate cuts will further weaken the renminbi. Owing to this, China's ability to support EM growth is more limited, and investors are likely to turn to other sources of growth within EM:

- + The AI boom continued to be the main driver of growth in **Taiwan**. AI-related demand has contributed to exports and gross capital formation in H1 2024, thereby helping drive growth higher. The strong wealth effect aided by higher property and equity markets continues to support consumption in Taiwan.
- + **India** has emerged as a new source of global growth and has one of the youngest populations in the world. Indian Prime Minister Narendra Modi won a third consecutive term in a much tighter than anticipated general election in June. The political continuity after the elections,

business-friendly policies, strong domestic flows, and expansionary infrastructure plans, remain key growth drivers for India. Growth remains on a firm footing and India is expected to become the world's third largest economy by 2027.

- + In **South Korea**, the government's Corporate Value-Up programme aims to emulate Japan's success in improving capital management by listed companies. South Korean companies trade at valuations, which are on average the lowest among EM peers, despite being home to the most globally dynamic and innovative companies in the semiconductor and materials sectors.
- + **Latin America** continues to offer high nominal and real yields relative to history. Latin American equities posted a weak performance in H1 2024 on the back of concerns around fiscal policy, particularly in Brazil and Mexico. In **Mexico**, President-elect Claudia Sheinbaum's margin of victory in the June election raised concerns among investors that her ruling Morena party could push through constitutional reforms that could impact Mexico's business environment. Yet Mexico is poised to benefit from nearshoring efforts alongside high consumer confidence. **Chile** stands to benefit as an exporter of key commodities, including copper, which is crucial to the energy transition.
- + **Turkey** should benefit from efforts by European countries to nearshore their production, thereby boosting the manufacturing hubs in Turkey. A series of interest rate rises initiated in June 2023 have brought the main interest rate from 8.5% to 50%, lifting the rates for domestic savings in lira. Further confirmation of policy normalisation from the central bank continues to remain supportive of Turkish assets.

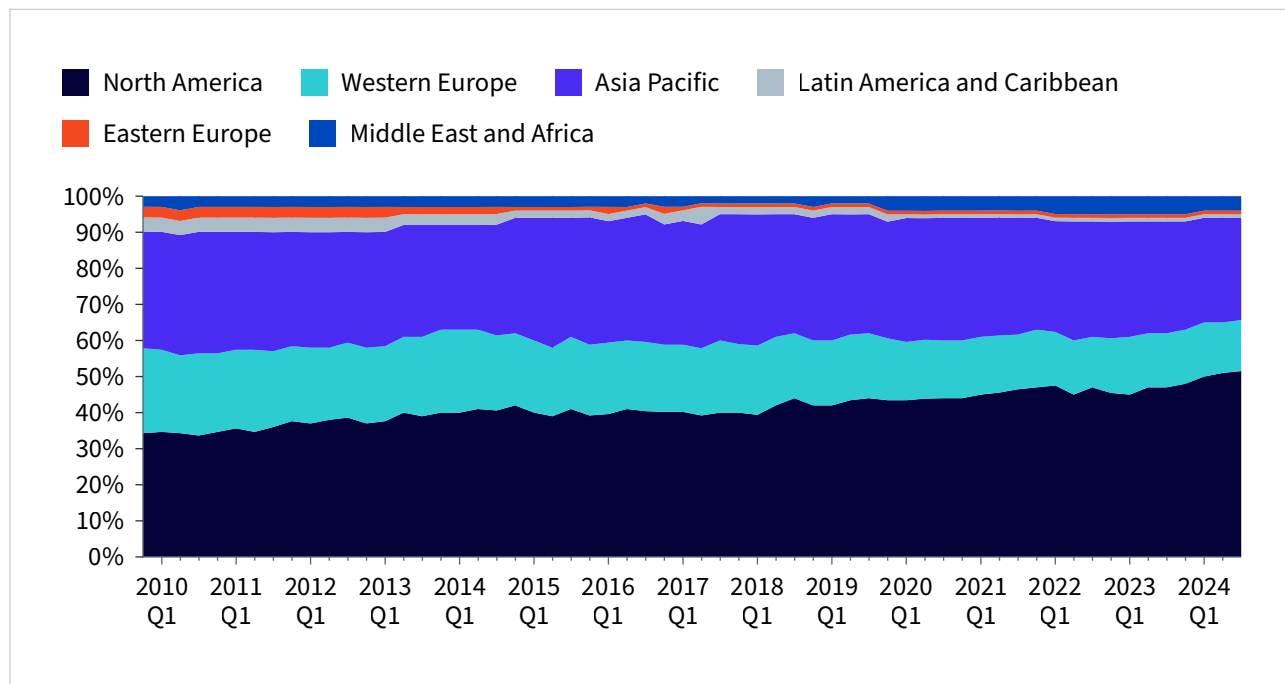
China's ability to support EM growth is more limited, and investors are likely to turn to other sources of growth within EM.

### Europe's share of global market capitalisation is shrinking

European equity indices are close to record highs. The strong equity market performance has been supported by an economic recovery in Europe driven by improvements in the services sector. At face value, things look good in Europe; however, if we look beneath the surface, Europe's share in global market capitalisation has been falling behind for many years compared to the US and EMs that have consistently outpaced Europe in terms of economic growth. This coincides with the shrinking of Europe's economy. Europe's share of global market capitalisation has declined from 30% in 2000 to just 14% as of Q3 2024. High fragmentation across the continent alongside lower liquidity and different sets of national rules have also played a role.

Industry-specific drivers such as the low share of technology firms across Europe also resulted in its dwindling share of total market capitalisation.

Figure 11: Share of total market capitalisation



Source: World Federation of Exchanges, WisdomTree. Data as of 30 June 2024. **Historical performance is not an indication of future performance, and any investments may go down in value.**

### Elections echo a theme of political fragmentation in Europe

France and Europe are celebrating the defeat of Marine Le Pen and her far-right National Rally following the second round of the parliamentary elections. Yet the election results produced no clear majority in the National Assembly, with a near-even split between the left, the centre, and the right. The new French government will be backed by a coalition of parties that have stood in opposition to each other. Under the Eurozone’s Excessive Deficit Procedure (EDP), EU member states must maintain their deficit below 3% of GDP. With France’s deficit at 5.5% of GDP in 2023<sup>9</sup>, there is a real need to make difficult decisions to address the deficit, but that has become incredibly unlikely amid political stalemate.

The 2024 European Parliament elections saw a shift to the political right. The Liberals and Greens stood out as the main losers, while the radical right parties have been strengthened alongside the mainstream right. At the same time, the pro-European centre of the party system continued

9 European Commission as of 31 December 2023.

to provide the basis for a centrist majority once again. The likely consequences for EU policy remain continued support for Ukraine and ramping up of European defence capabilities, while climate and environmental policies are likely to garner less support.

## **Implications of Europe's international footprint**

The volatile political landscape wreaked havoc on European equities in Q2 2024. It has since stabilised, but not fully recovered. Europe is a very global market from a revenue perspective, deriving more than half of its revenue (56%) outside Europe.<sup>10</sup> EMs are the most important region for European companies, accounting for 31% of the market's aggregate revenue, followed by North America at 22%. Amid the weaker backdrop in China, Europe faces a higher downside risk to the growth outlook in H2 2024. In addition, under the scenario of a Trump re-election, renewed trade frictions could have markedly negative effects on the eurozone, primarily via heightened trade policy uncertainty. This is likely to strengthen the case for European Central Bank (ECB) rate cuts in 2025. We continue to expect the ECB to cut rates twice in H2 2024, with the first cut in September.

ECB cuts should support investment activity. More importantly, rising wages and falling inflation are likely to raise the purchasing power of consumers. The European consumer contributes 17% of the total revenues for corporates.

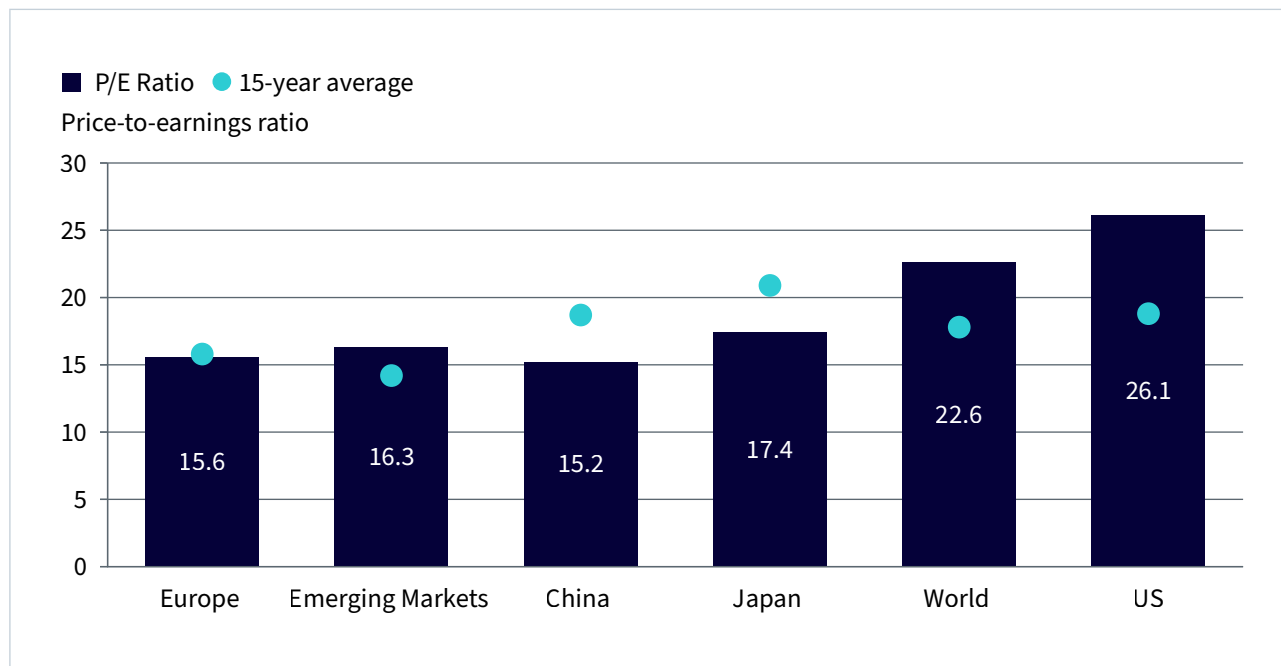
## **Europe offers deep valuation discounts**

Claiming European stocks are cheap is almost cliché at this point. Ordinary dividends (excluding special payments) are expected to reach 4% in Europe, reaching a new high of €463 billion.<sup>11</sup> In particular, we continue to favour value and small caps as core positions. The decline in interest rates could act as a catalyst for the small cap cohort, especially given their heightened sensitivity to tightening credit conditions. European small cap earnings have been outperforming those of large caps since mid-2023. In lockstep, European small caps are becoming more attractive in terms of valuation as the gap in price-to-earnings (P/E) ratio with large caps has widened to a 20-year high. Historically, small and mid caps outperform large caps following the first ECB rate cut after a hiking cycle.

<sup>10</sup> Factset, as of 30 June 2024.

<sup>11</sup> S&P Global, as of 31 May 2024.

Figure 12: Comparison of global equity market valuations



Source: Bloomberg, WisdomTree. Data as of 19 July 2024. **Historical performance is not an indication of future performance, and any investments may go down in value.**

### Rebuilding Britain – brick by brick

The outlook for growth in the UK is steadily improving. This is evident from declining inflation, real income growth, stabilisation in house prices, and strong business and consumer survey progress. This said, without a sufficient softening in wage growth it’s unlikely inflation will stabilise to a level that would give the Bank of England (BOE) comfort to embark on significant rate cuts. This is why the key risk to growth remains the path of inflation. If it remains unexpectedly high or volatile, the BOE could delay interest rate cuts and dampen growth. The Labour Party secured one of the largest majorities in post-war history in the recent UK election. Labour’s strategy for growth is centred on reforming industrial strategy and planning procedures with the goal of tackling low investment rates in the UK.

### Japanese equities provide high value with room to grow

Japan is emerging from a deflationary spiral. The Japanese equity market has continued to rally in 2024 with the Nikkei 225 Index and the TOPIX rising to a record high in July. Yet, the recovery in shares has not been even. Large cap value-oriented stocks have outperformed small cap stocks in 2024. Japanese exporters delivered strong earnings results aided by ongoing depreciation of the yen versus the US dollar. Japan’s economic growth should benefit from a technical upturn in H2.

We expect a rebound in growth of 0.5% quarter-on-quarter (QoQ) after the contraction in Q1 (revised downward to -0.7% QoQ). Past levels of private capital expenditures (CapEx) have been uniformly revised higher, with the annualised nominal CapEx after seasonal adjustment reaching JPY104.3 trillion.<sup>12</sup> CapEx is poised to remain on a firm uptrend supported by the need to address labour shortages, strengthen supply chains, and support decarbonisation. The recovery in CapEx is likely to be a potential theme supporting Japanese equities over the coming years.

The recovery in CapEx is likely to be a potential theme supporting Japanese equities over the coming years.

### **Corporate reforms increase the attractiveness of Japanese equities**

The price-to-book (PBR) reform initiated by the Tokyo Stock Exchange (TSE) is likely to continue to support value sectors in Japan. Currently a high percentage of nearly 40% of companies still trade at a PBR below 1, creating room to unlock shareholder value.<sup>13</sup> In March 2023, the TSE requested listed companies to improve their capital efficiency as return on equity (ROE) in Japan has been historically low by international standards. Companies were encouraged to set targets of dividends or share buybacks especially in April and May 2024 to coincide with their full year earnings. The ratio of companies that increased dividends in the last fiscal year reached the second highest since 1985. Share buybacks announced along with fiscal year results also reached their highest levels in terms of both number and value since FY 2009.

Ongoing reforms are likely to result in cash-rich firms utilising their excess cash more effectively by improving the companies' earnings or shareholder distribution. The slew of investments by foreign funds in Japanese equities can be seen as an encouraging reaction to corporate reforms.

<sup>12</sup> Japan Cabinet Office, Jan–March 2024 report.

<sup>13</sup> FactSet, WisdomTree, as of 30 June 2024.

Figure 13: Overseas fund's investment policy in Japan

Fund	Investment	Tenure
Bain Capital	Upcoming investment of JPY5trn in Japan	5 years
Blackstone	JPY1.5trn investment in Japan	3 years
KKR	Investment of more than JPY1trn in Japan, same scale as the investment since Japan entry in 2007	10 years
CVC	Establishment of Asia Fund including Japan of US\$6.8bn, 50% larger than previous fund. Approximately 20% allocation to Japan	
Carlyle	New JPY430bn fund specialising in Japanese companies. Carlyle will increase the investment in this fund contingent on bank financing	

Source: Nikkei Shimbun, WisdomTree. Data as of 30 June 2024.

Prime Minister Kishida's initiative to transform Japan into an asset management-led nation is bearing fruit. This is being done with the introduction of a revised Nippon Individual Savings Account (NISA) programme offering tax benefits and portability. The number of accounts for the NISA programme stood at 23,227,848, up 8.7% from the end of 2023 and up 24% from a year ago.<sup>14</sup>

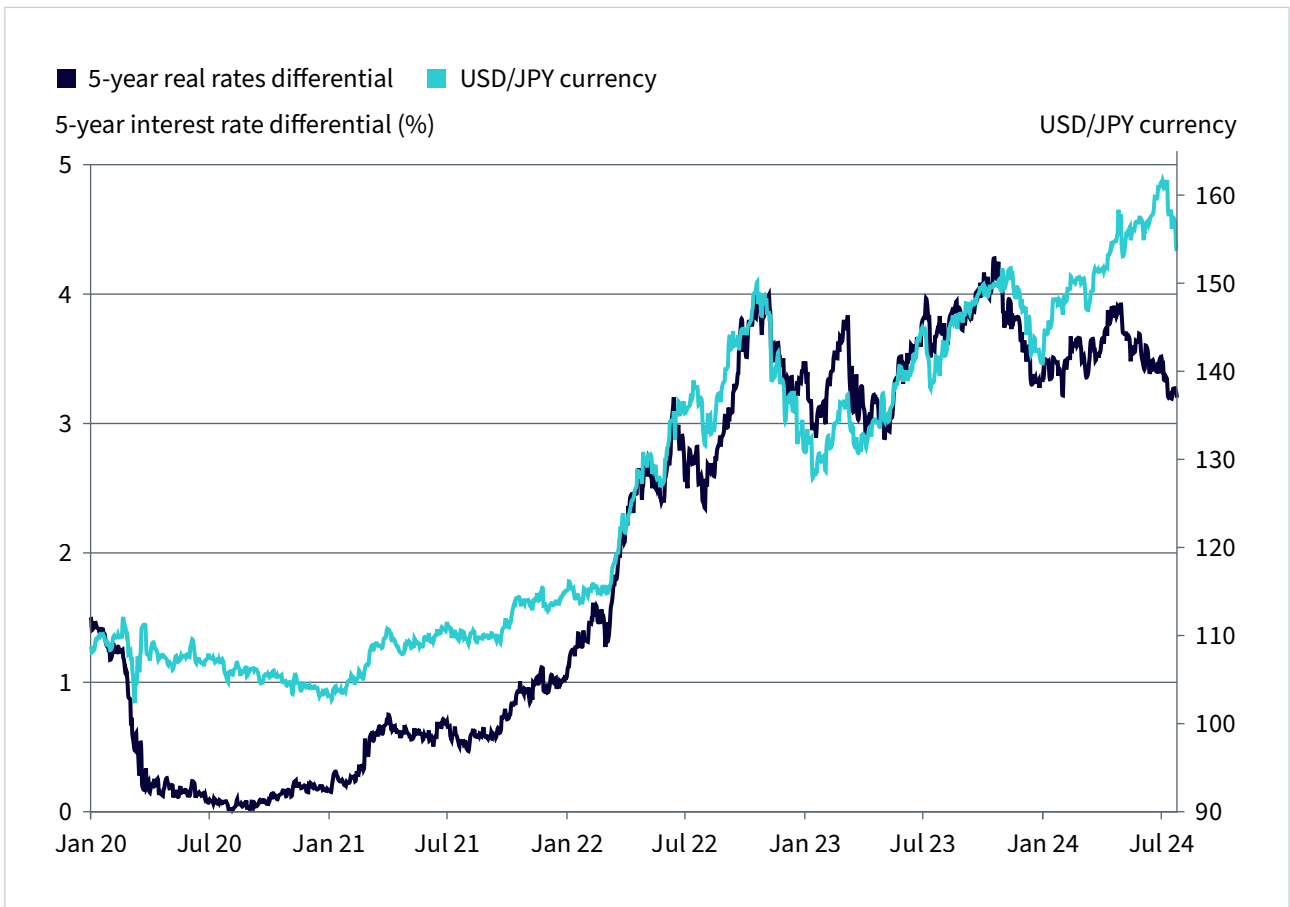
### Gradual yen strength not a headwind for stocks

The yen is likely to recoup some of its losses on the back of the narrowing interest rate differential between the US and Japan. The Bank of Japan (BOJ) is expected to proceed with gradual normalisation of monetary policy at a pace of around 25 basis points (bps) every six months, raising the policy rate to 0.75% by end FY25. This shouldn't be viewed from a negative lens. A weaker yen is bad for consumer spending. While wage increases (excluding bonuses) have reached their highest level since 1993, a sign of the growing transmission of negotiated wage increases (up 5.1% annually),<sup>15</sup> is that real incomes have still not risen (-1.4% annually). Sluggish domestic consumption was a major factor in the government's growth downgrade for the current fiscal year due to rising import costs linked to the weaker yen. A gradual yen appreciation would support recovery in real wages and revival of household purchasing power.

<sup>14</sup> Japan Financial Services Agency (FSA), as of 12 June 2024.

<sup>15</sup> Rengo Trade Union, as of 31 May 2024.

Figure 14: Real interest rate differentials versus USD/JPY



Source: Bloomberg, WisdomTree. Data as of 19 July 2024. **Historical performance is not an indication of future performance, and any investments may go down in value.**

Fundamentally, large cap Japanese export stocks remain in pole position. The current foreign exchange assumption is a conservative JPY144 per dollar, expecting a stronger yen. The yen's fall in April to June 2024 (average of JPY156 per dollar) served as a reserve. The yen would need to average JPY140 per dollar over the last three quarters of the fiscal year to align with the corporate assumption for FY24. Given the current pace of appreciation in the yen, we don't expect companies to have to lower their guidance.

## Conclusion

Equity markets posted a strong first-half performance in 2024. Continued global earnings growth should lend a positive tailwind for a continuation of the rally. Yet global equity markets are not only concentrated by name, but also by sector and factor, opening up a plethora of opportunities. The most attractive risk/reward prospects appear to be offered by overlooked areas of the market – small caps, dividend, and value stocks. From

here on, we expect the US election cycle to trigger volatility as investors assess and discount the various options before them. The odds continue to favour Trump, yet the odds of a red sweep in Congress have declined since Biden dropped out of the presidential race. China is up against some acute challenges, creating further opportunities across other EMs.

The most attractive risk/reward prospects appear to be offered by overlooked areas of the market – small caps, dividend, and value stocks.

# 3.

## Thematic Outlook: Seven AI trends that investors need to watch

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In 1997, IBM's chess-playing program Deep Blue defeated world champion Garry Kasparov in a historic six-game match, marking a significant milestone in the development of AI. Kasparov, who had beaten an earlier version of Deep Blue in 1996, faced a vastly improved machine capable of evaluating 200 million positions per second.

The turning point came in the second game, when Deep Blue made a surprising move that rattled Kasparov, leading him to suspect human intervention. This psychological impact influenced his subsequent performance. Deep Blue ultimately won the match, becoming the first computer to defeat a reigning world champion under standard chess tournament conditions.

Over the following three decades, there have been numerous such milestones for AI. In March 2016, Google's AlphaGo defeated Lee Sedol, one of the world's top Go players, in a five-game match. This victory marked a significant milestone in AI as it demonstrated the program's ability to master a game long considered too complex for machines due to its vast number of possible moves.

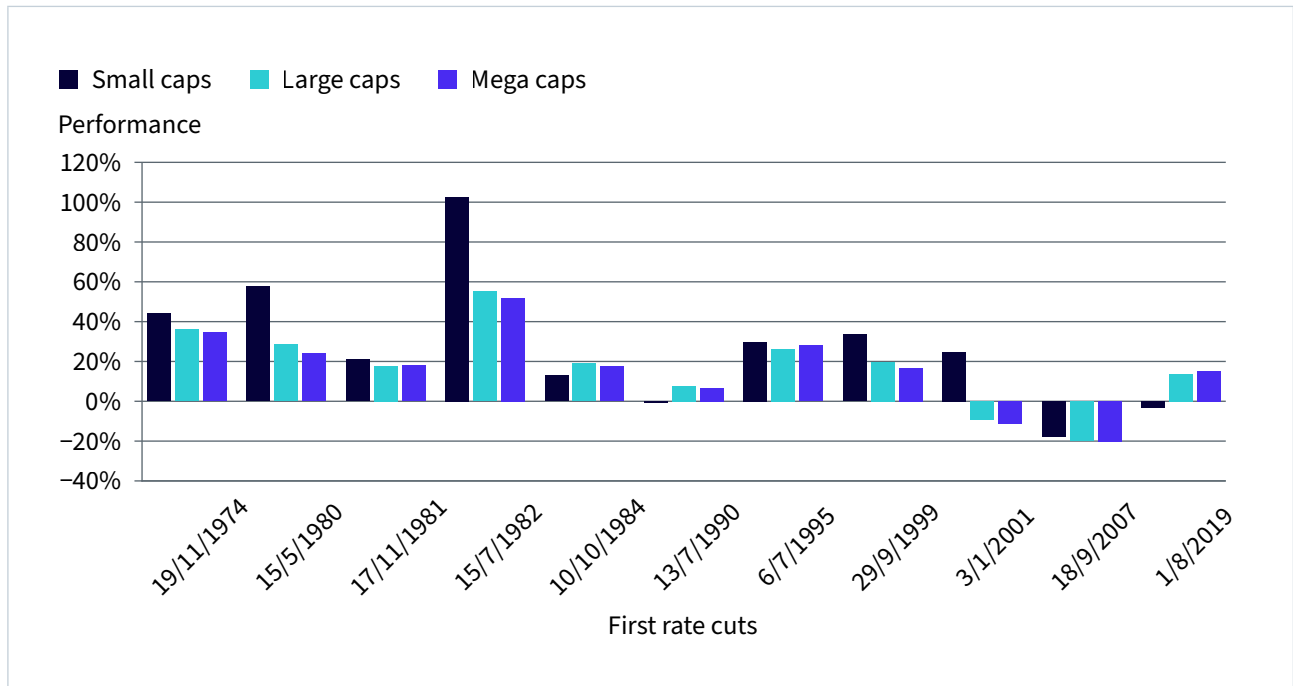
One-off instances of sheer brilliance from different programs have inspired awe over decades, but failed to propel AI into the mainstream. For AI to really take off, it needed a connected world that not only produced enormous quantities of data but also had the required computing power to process this data. This is why the current moment is different from anything that's come before in AI's journey.

With AI now in the mainstream, imagining what the future might bring is very exciting. So, what lies ahead? In this chapter, we present seven imminent AI trends which predict where this megatrend is headed and what it means for investors.

## 1. There will be a more favourable macroeconomic backdrop

A more dovish monetary policy is anticipated from central banks over the next 12 months, especially the Fed, which is likely to support mid and small cap companies.

Figure 15: Performance in the 12 months following the first Fed rate cut



Sources: WisdomTree, Ken French. Data as of May 2024, which represent the latest date of available data. Small Caps: Low 30% portfolio. Large Caps: High 30% Portfolio. MegaCaps: High 10% portfolio. Market: All CRSP firms incorporated in the US and listed on the NYSE, AMEX, or NASDAQ. **Historical performance is not an indication of future performance, and any investments may go down in value.**

Since 1974, equities have typically gained in the first 12 months following the initial rate cut, doing so in 9 of the last 11 rate cut cycles. In six of these nine cycles, small caps outperformed large caps and mega caps. Even in the two cycles in which equities performed negatively, small caps still outpaced large and mega caps, managing to post positive returns in one of those instances.

Investors seeking pure exposure to artificial intelligence and related themes will typically find themselves holding a healthy mix of mid and small cap companies.

Investors seeking pure exposure to artificial intelligence and related themes will typically find themselves holding a healthy mix of mid and small cap companies. Our prediction is that this approach is likely to prove fruitful for those investing in AI and related sectors.

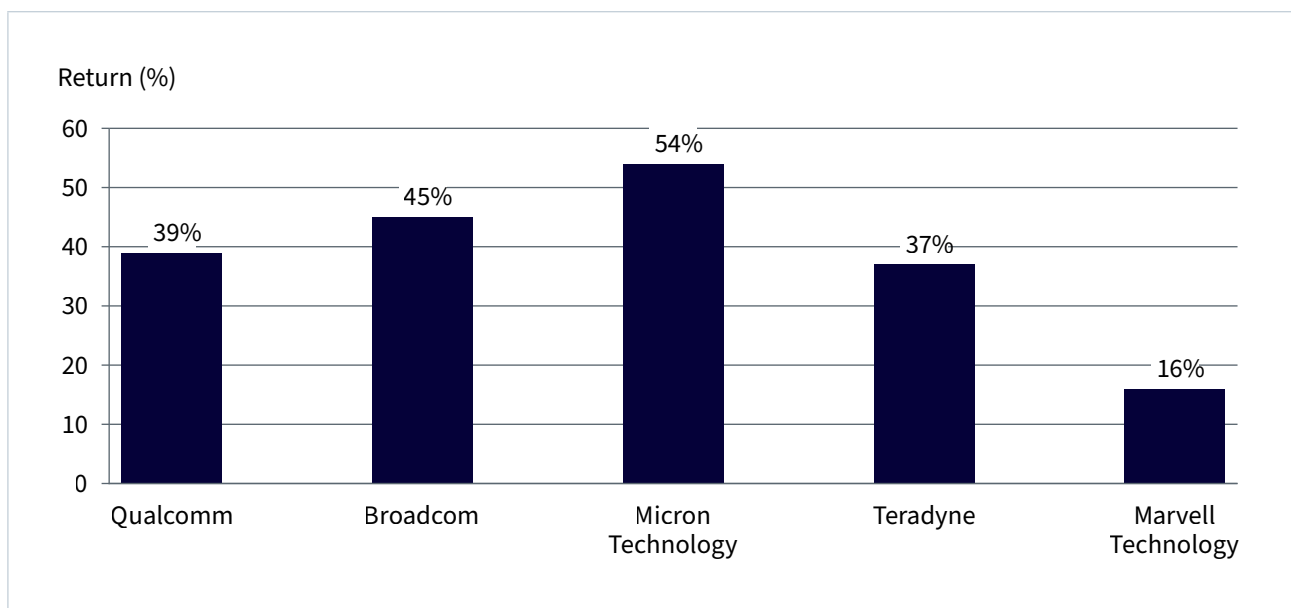
## 2. The hype will extend beyond just Nvidia

Semiconductors provide the hardware upon which the AI revolution is being developed. Nvidia has not only taken a meaningful lead in developing the most sophisticated semiconductor chips, but it’s also maintaining it by innovating at a pace that has so far exceeded expectations. In March 2024, the company announced its market-leading Blackwell architecture aimed at making it more efficient to run trillion-parameter large language models (LLMs). By June, it had announced the Rubin platform, Blackwell’s successor.

However, while Nvidia continues to achieve remarkable advancements, not every device in the world runs, or will run, on Nvidia chips. Apple and Samsung devices use chips made by Qualcomm; Google and Microsoft source chips from Broadcom; Dell and HP use technology built by Micron Technology; Intel and Texas Instruments are major customers of Teradyne; and Cisco buys from Marvell Technology.

These companies are examples of those making significant strides in terms of their business growth and stock market performance without attracting the same level of hype as Nvidia. We believe this will change as investors increasingly seek diversification across a wider set of players poised to benefit from the AI revolution.

Figure 16: H1 2024 returns for select US semiconductor companies

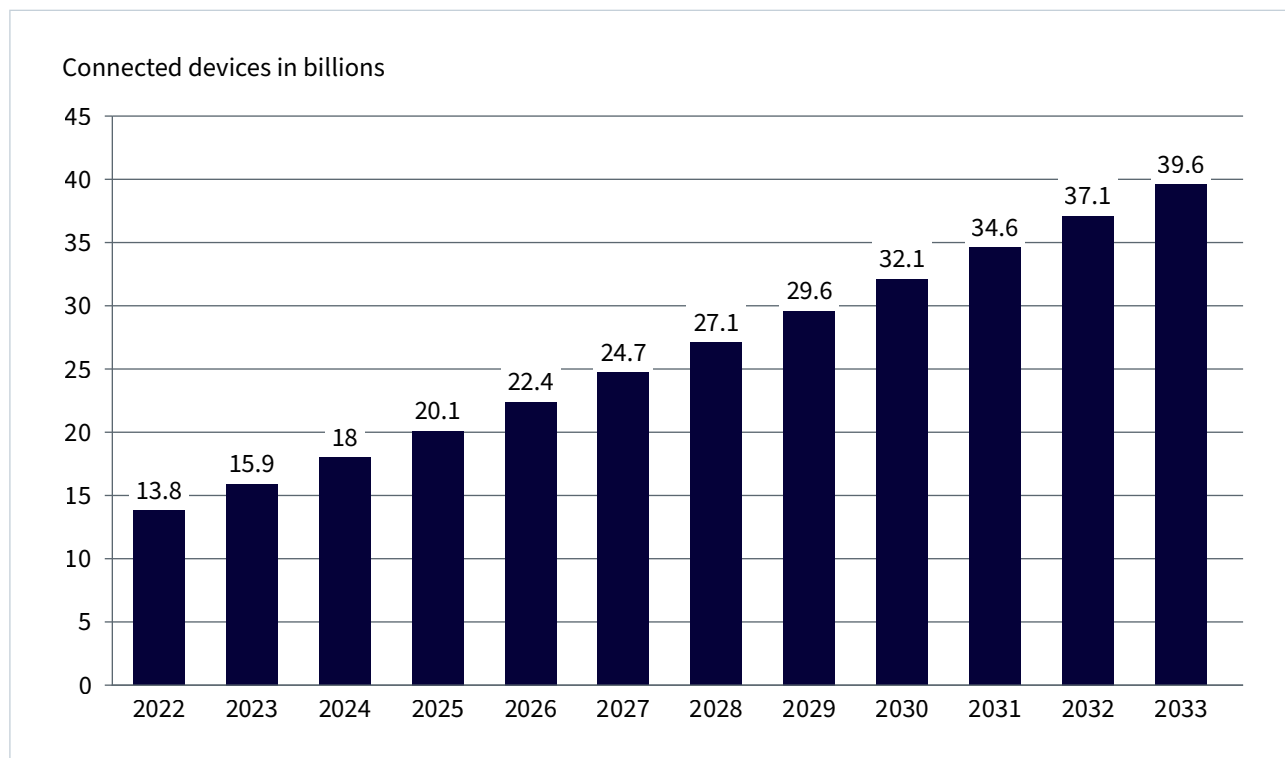


Source: Bloomberg. Returns based on stock prices. **Historical performance is not an indication of future performance, and any investments may go down in value.**

### 3. The internet of (AI-enabled) things is about to begin

The number of internet of things (IoT) devices is expected to nearly double by 2030, rising from under 18 billion in 2024 to over 30 billion.<sup>16</sup> Crucially, these devices will not only be connected, but many will also have AI capabilities.

Figure 17: Number of Internet of Things (IoT) connections worldwide



Source: Statista, in cooperation with Transforma Insights. Data as of June 2024. Forecasts from 2024 onwards. **Forecasts are not an indicator of future performance, and any investments are subject to risks and uncertainties.**

In June 2024, Apple announced Apple Intelligence, a clever wordplay on AI intended to make people associate AI with Apple. This framework is designed to integrate AI into daily life through Apple’s devices. With over a billion active iPhone users and another billion users of other Apple devices worldwide, Apple aims to become the primary physical interface for AI. Its partnership with OpenAI aligns with this goal.

Apple is not the only company that recognises the importance of this. A recent study<sup>17</sup> shows how AI models collapse when trained on recursively generated data. This means that when AI is

16 Statista, in cooperation with Transforma Insights, June 2024. <https://www.statista.com/statistics/1183457/iot-connected-devices-worldwide/>

17 Shumailov, I., Shumaylov, Z., Zhao, Y. et al. AI models collapse when trained on recursively generated data. Nature 631, 755–759 (2024). <https://doi.org/10.1038/s41586-024-07566-y>

trained using data generated by other AI, the quality of the output deteriorates with each layer added within that loop. Collecting real data that relates to real humans and real things is of paramount importance. The internet of AI-enabled things, where devices collect data directly from people, will make this possible.

From wearable gadgets to cars, devices will increasingly incorporate AI capabilities. The more seamlessly these devices work together, the better the user experience. It's therefore no surprise that Chinese mobile maker Xiaomi launched an EV. In the realm of AI-enabled IoT, Xiaomi hasn't just launched a car, but a computer on wheels. Many more such examples are likely to follow.

Investors will need to constantly reevaluate which companies can be classified as AI stocks and where they fit within the AI value chain.

#### **4. In some cases, David will beat Goliath**

It wasn't Google, Meta, or Amazon that unveiled an AI model that took the world by storm in November 2022; it was OpenAI, a private company. Many big tech names have since been scrambling to catch up in the AI race and develop their own models.

The AI revolution is about finding creative ways to solve problems and inspire people to do more. Smaller businesses, starting from first principles, often have an advantage. According to Bessemer Venture Partners (BVP), foundational AI models, such as ChatGPT, upon which further applications can be developed, are the new oil. According to BVP, in 2023 foundational model companies such as OpenAI, Anthropic, Mistral, and Cohere captured over 60% of total venture capital funding in AI. Tech giants, the Goliaths, will continue seeking to bring the most promising Davids to their team.

In public markets, smaller companies have the same potential to outwit the tech giants and either become targets for acquisition or grow as listed companies. If they follow the latter route, their stocks will be highly sensitive to policy from the Fed, a challenge small software companies faced in the first half of 2024 as rate cuts were pushed out. However, as discussed in our first prediction (see Figure 19), these smaller players may have an additional tailwind propelling them in the form of supportive monetary policy over the next 12 months.

Investors seeking exposure to giants shouldn't overlook smaller players that may be in the earlier stages of the hype cycle but may have immense potential.

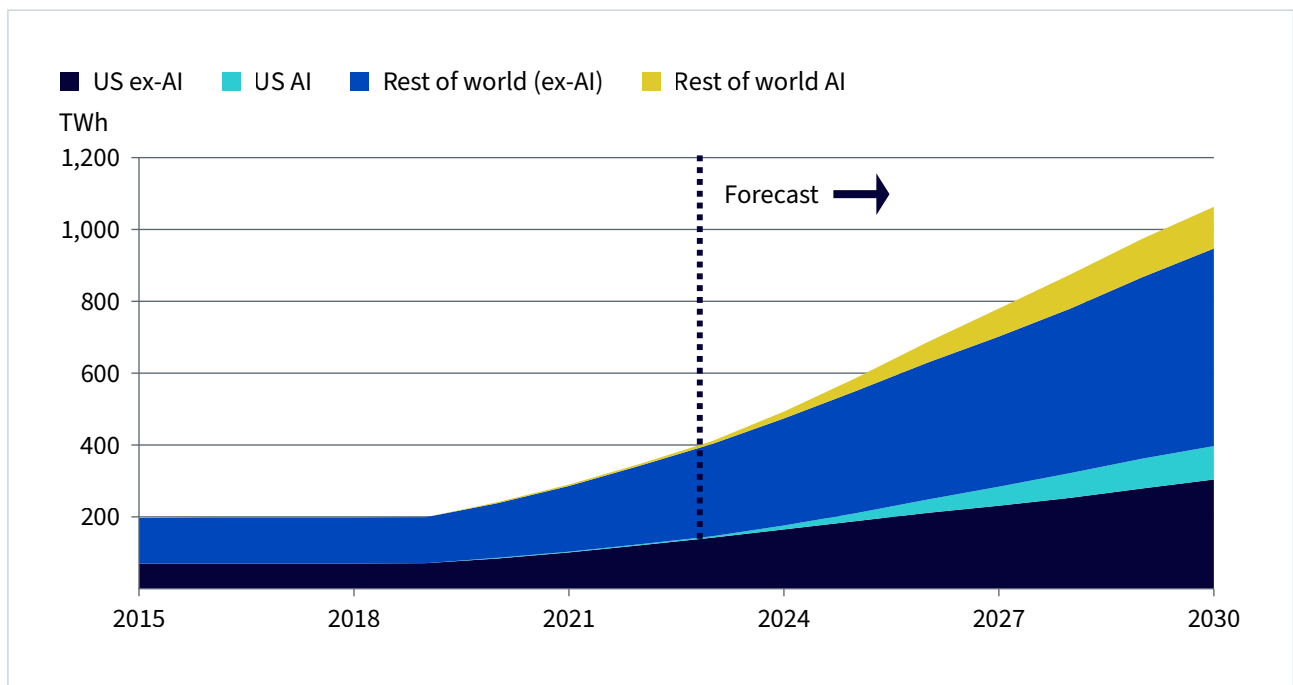
#### **5. Demand for clean, well-distributed energy will rise**

Amazon has pledged to invest \$150 billion over the next 15 years to build data centres in response to the explosion in demand for AI applications. But data centres don't just require capital to build; they also need large amounts of energy to run. For now, it appears that Amazon is rushing to build in places where there's access to any form of energy, ranging from nuclear to natural gas and solar.

According to Goldman Sachs, on average, one ChatGPT query needs nearly ten times as much electricity to process as a Google search. AI is poised to increase data centre power demand by 160% by 2030. Currently, data centres account for 1–2% of global power demand, which could rise to 3–4% by the end of the decade.

On average, one ChatGPT query needs nearly ten times as much electricity to process as a Google search.

Figure 18: Data centre power demand



Source: Masanet et al. (2020), Cisco, IEA, Goldman Sachs Research. Data as of June 2024. **Forecasts are not an indicator of future performance, and any investments are subject to risks and uncertainties.**

At the United Nations Climate Change Conference (COP28) in January 2024, world leaders pledged to triple global renewable energy capacity by 2030. Our prediction is that, even if tech companies initially rely on any available energy source to sustain the required growth in data centres, they will ultimately help develop more renewable energy capacity. This is because renewables are the fastest growing segment of the energy complex and help promote energy security by reducing our reliance on fossil fuels. Renewable energy sources including solar and wind can easily service data centres since these can be installed locally, reducing the burden on the overall energy grid. How tech companies power the AI revolution will become an increasingly hot topic very soon.

For investors, it's crucial to remain aware of the growing power demand from AI and the potential implications for providers of renewable energy generation and storage.

## **6. AI's impact across industries will be better appreciated**

It's now evident that AI will impact every industry. What is less clear is how and when this impact will unfold. As far as markets are concerned, there is scope for a better appreciation of this dynamic.

Take biotechnology, for example. This sector often experiences periods of subdued performance, only to see companies come to life with a breakthrough, such as a new drug or regulatory approval. A recent example is Eli Lilly's weight loss drug tirzepatide (marketed as Mounjaro), which led to a significant surge in the company's share price.

Although Mounjaro was developed using traditional methods, Eli Lilly has recently announced a partnership with OpenAI to leverage generative AI tools for faster drug discovery.<sup>18</sup> AI has the potential to greatly improve the odds of identifying promising drug candidates and reduce the time and cost of development. This is why Google DeepMind's AlphaFold3, which predicts protein structures with high accuracy garnered substantial media attention this year.

Our prediction is that we will see more frequent breakthroughs in the biotech sector, which should eventually reignite market interest in this field. Investors can uncover many such opportunities by exploring sectors where AI has a significant role to play, but where market hype has not yet fully materialised.

## **7. Cybersecurity will assume a wider role in society**

A recent study<sup>19</sup> by Google DeepMind on the misuse of generative AI found that the most common goal for exploiting the tool's capabilities was to shape public opinion, accounting for 27% of all reported cases. This includes the release of deepfakes of politicians and celebrities on social media at particularly sensitive moments, such as the deepfakes of former UK Prime Minister Rishi Sunak leading up to the July 2024 general election.

Our prediction is that the role of cybersecurity will extend beyond just defending against phishing attacks to encompass broader protections in the digital world. Until now, our biggest challenge with social media has been distinguishing between useful and disposable content, or perhaps engaging and less engaging content. Questioning the authenticity of what we saw with our own eyes was not typically required. However, with increasingly convincing deepfakes, our credulity will be challenged and, in many instances, likely fail. This is where cybersecurity will play a crucial role in helping us discern between what is real and what is not.

<sup>18</sup> <https://investor.lilly.com/news-releases/news-release-details/lilly-collaborates-openai-discover-novel-medicines-treat-drugs>.

<sup>19</sup> Nahema Marchal, Rachel Xu, Rasmi Elasmr, Iason Gabriel, Beth Goldberg, William Isaac, Generative AI Misuse: A Taxonomy of Tactics and Insights from Real-World Data, June 2024.

Cybersecurity firms will need to cater not only to the needs of chief information security officers (CISOs) but also find ways to communicate with and protect the average person in their daily lives.

From an investor's perspective, investing in cybersecurity represents an alternative way to access the AI revolution. Pure cybersecurity firms also tend to be younger, with relatively less well-established cash flows, making them highly sensitive to interest rates. This sensitivity might not be a disadvantage in the next leg of the economic cycle.

Investing in cybersecurity represents an alternative way to access the AI revolution.

## Conclusion

There are, of course, many risks and uncertainties. Regulation will inevitably evolve along with the technology and its use cases. Trade policies, especially those from the US following the presidential election, will undoubtedly be consequential. Additionally, geopolitics will remain relevant to discussions about AI, particularly given Taiwan's significance in the semiconductor industry.

Still, however, progress will continue to happen. Until a few years ago, we used to say, "There's an app for that." We will very soon start saying, "There's an AI for that." Not leveraging AI will be akin to using a typewriter when computers exist, copying books by hand in the era of the printing press, or sending letters when emails are just a click away. Just as we have embraced revolutionary technologies in the past, it's now time to do the same with AI. We may be Garry Kasparov, but now Deep Blue is here.

Just as we'll need to adapt the way we live, we'll also need to adapt the way we invest. Exciting times lie ahead.

Figure 19: Our predictions on future AI trends

	Our predictions	Considerations for investors
1	There will be a more favourable macroeconomic backdrop	Diversify by market cap through a pure exposure to the AI theme
2	The AI hype will extend beyond Nvidia	Seek broader exposure across the AI value chain
3	The internet of (AI-enabled) things is about to begin	Continuously reevaluate the identification and classification of AI stocks
4	In some cases, David will beat Goliath	Include innovative companies early in the hype cycle in an AI-focused portfolio
5	Demand for clean, well-distributed energy will rise	Invest in clean energy production and storage stocks benefiting from AI demand
6	AI's impact across industries will be better appreciated	Monitor sectors such as biotech, where AI's potential impact is underappreciated
7	Cybersecurity will assume a wider role in society	Consider cybersecurity as a high-growth theme and a way to invest in the AI megatrend

# 4.

## Crypto Outlook: Institutionalisation is underway

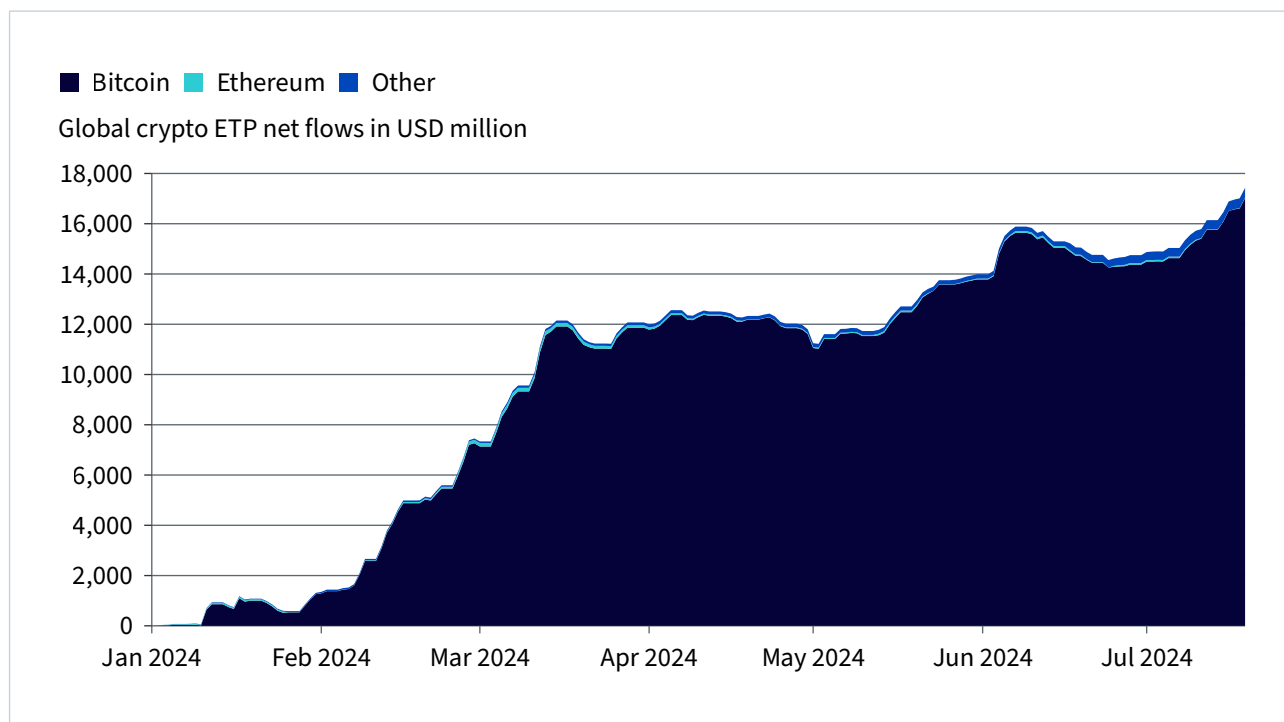
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## Institutional adoption and market maturity

2024 has marked several significant milestones for bitcoin entering mainstream finance and becoming more institutionalised. Earlier this year, the launch of spot bitcoin ETPs in the US garnered record inflows, marking a significant milestone for the maturity of this asset class. Following suit, in the summer of 2024, ether ETPs were approved in the US, leading to sizable flows during the first few weeks. Overall, the global crypto ETP space has seen net inflows of over US \$16 billion year-to-date, with now over US \$70 billion in assets under management (AUM).<sup>20</sup> As a result, crypto prices have surged with bitcoin up over 35% year-to-date.<sup>21</sup>

Figure 20: Global crypto ETP net flows, in US million



Source: Bloomberg. Data as of 19 July 2024. You cannot invest directly in an index. **Historical performance is not an indication of future performance, and any investment may go down in value.**

The flood of assets into these products so far this year not only underscores the trend of adoption, but also the popularity of accessing this nascent and rapidly growing asset class via ETPs. These regulated investment vehicles offer ease of access without the compliance and technological overhead of managing wallets and private keys, bringing familiarity and comfort to investors in an unfamiliar space.

<sup>20</sup> Bloomberg, 19 July 2024.

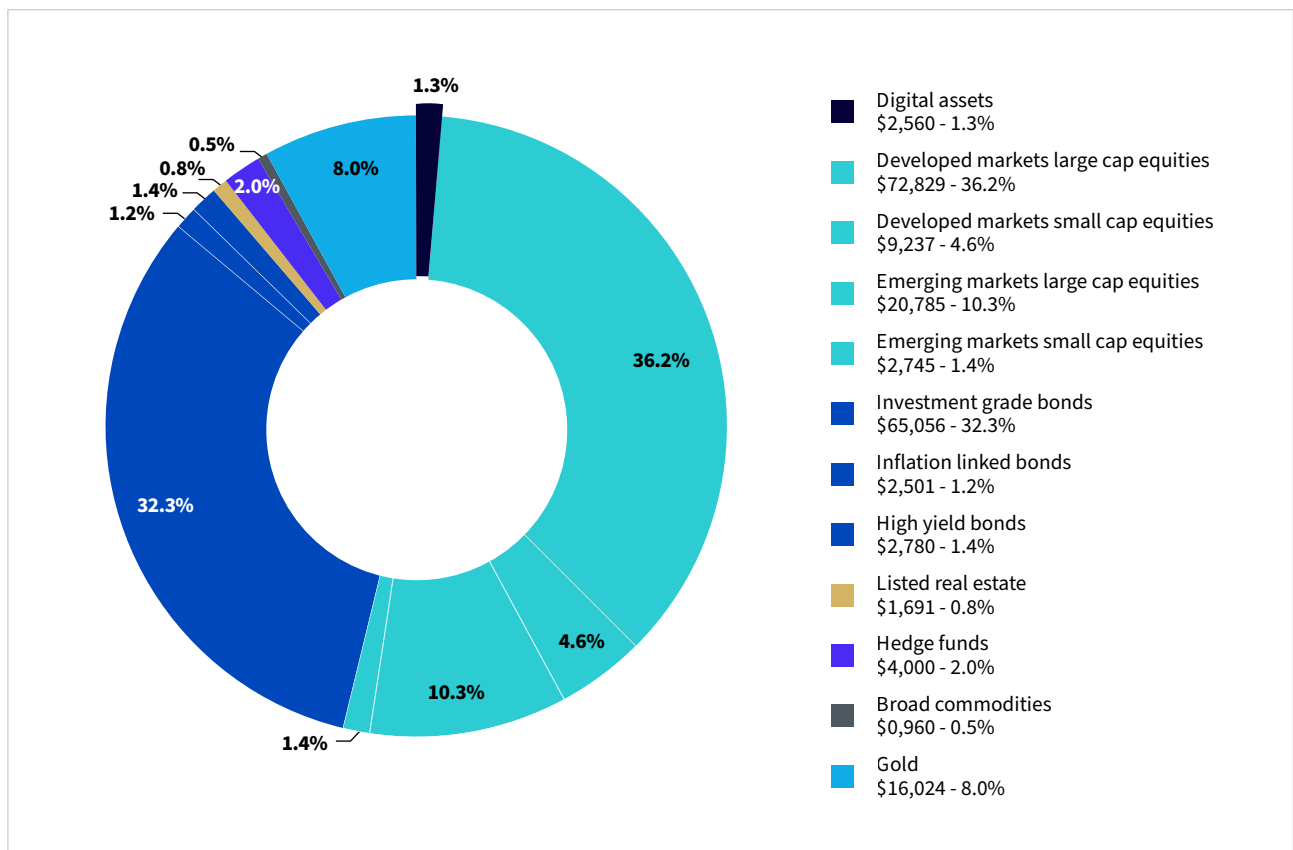
<sup>21</sup> Messari, 9 August 2024.

In addition to the above-mentioned bitcoin and ether ETP approvals in the US, other major financial markets – Australia, Hong Kong, and the United Kingdom – also approved crypto ETP listings during H1 2024. These approvals have also contributed to the substantial growth in AUM within crypto ETPs, highlighting a notable trend towards mainstream acceptance from both a regulatory and investor perspective.

With investors across the globe now having regulated ways to access spot bitcoin and other crypto exposures, the trend of institutional adoption is clearly underway. With the overall crypto market at approximately US \$2.5 trillion,<sup>22</sup> institutional investors are evaluating the asset for inclusion in multi-asset portfolios and are beginning to allocate strategically.

The trend of institutional adoption is clearly underway.

Figure 21: Market cap weighted allocation of an illustrative multi-asset portfolio



Source: Bloomberg, WisdomTree. Data as of 28 June 2024. Market caps are shown in USD billion. You cannot invest directly in an index. **Historical performance is not an indication of future performance, and any investment may go down in value.**

22 CoinGecko, 30 July 2024.

As previously stated, the overall crypto market now stands at an impressive US \$2.5 trillion,<sup>23</sup> which accounts for roughly 1.5% of the global opportunity set of listed, investable assets. As a result, investors seeking neutral market exposure need to have approximately 1.5% of their portfolios invested in crypto if they want to match this. By not having any exposure to this growing asset class, portfolio

managers are making an active decision to underweight the asset class. Typically, such active decisions would require a strong investment thesis against the asset class; for example, if portfolio managers decide not to invest in European equities, they usually have clear reasoning for such decisions.

This concept is becoming more widely realised amongst the investor community. It has been shown that integrating crypto into diversified multi-asset portfolios offers potential benefits in enhancing the risk/return profile of those portfolios. Even small portfolio allocations to crypto assets can make a significant difference. For instance, adding 1% of bitcoin to a global 60/40 portfolio would have added 0.7% to annualised performance over the past ten years while adding negligible volatility and meaningfully improving the Sharpe ratio.<sup>24</sup>

Notable institutional investors, such as the Wisconsin Investment Board, a pension fund managing the defined benefit retirement plan of State of Wisconsin employees, has taken action on the back of these realisations. As reported in recent Securities and Exchange Commission (SEC) filings earlier this year, they now include bitcoin in their portfolios.<sup>25</sup>

In addition to institutional investors using crypto within their multi-asset portfolios, we also observe hedge funds using crypto ETPs for basis trades. To implement a basis trade, investors simultaneously take a long position in the spot market and a short position in futures contracts. The key components for both bitcoin and ether basis trades are available in liquid, transparent, and easily accessible forms: ETPs for long spot and CME futures for short futures trades.

Investors seeking neutral market exposure need to have approximately 1.5% of their portfolios invested in crypto.

<sup>23</sup> CoinGecko, 30 July 2024.

<sup>24</sup> Bloomberg, WisdomTree. Data from 31 December 2013 to 28 June 2024. In USD. Based on daily returns. The 60/40 Global Portfolio is composed of 60% MSCI All Country World and 40% Bloomberg Multiverse.

<sup>25</sup> WhaleWisdom, SEC 13-F Filings, March 2024.



Greater waves of adoption typically occur in cycles. For instance, in 2017, we witnessed the initial coin offering (ICO) craze, which led to the launch of numerous tokens, increased adoption, and soaring crypto prices. At the start of 2024, we saw strong crypto performance following the introduction of crypto ETPs in the US with early movers such as the State of Wisconsin Investment Board taking the lead in making allocations as a large institutional money manager. As more institutions follow, could this next ‘institutional’ wave of adoption be the impetus for the next bull market cycle?

### **Crypto market cycles and trends**

One of the key influencers of crypto market cyclicity is bitcoin halving events, which take place once every four years. The last halving was in April 2024 where the newly issued bitcoin supply was reduced from 6.25 to 3.125 per mined block (roughly every ten minutes). These halving events will continue for decades to come, until the maximum supply of 21 million is reached in approximately year 2140.<sup>26</sup> Approximately 19.7 million bitcoin (nearly 97% of the total supply) are currently in circulation, with as much as a million or more lost forever.<sup>27</sup> In the wake of halving events, the increased supply pressure has led to positive price action, introducing some cyclicity in the crypto market.

<sup>26</sup> ig.com, July 2024. **Forecasts are not an indication of future performance, and any investments are subject to risks and uncertainties.**

<sup>27</sup> Fortune.com, 24 April 2024.

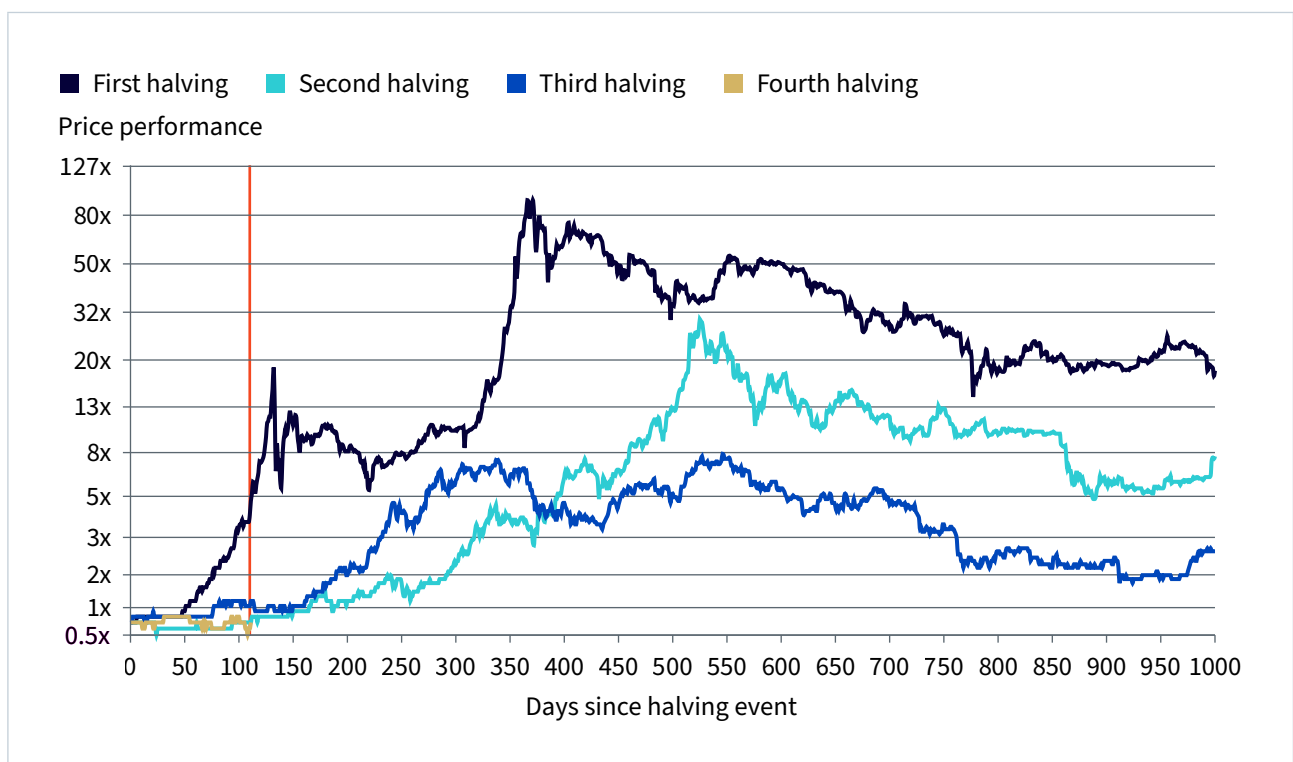
Figure 22: Bitcoin calendar year performance

2014	2015	2016	2017	2018
REITS (15.9%)	<b>Bitcoin (36.2%)</b>	<b>Bitcoin (120.3%)</b>	<b>Bitcoin (1,403.2%)</b>	Treasuries (-0.4%)
Infrastructure (7.4%)	REITS (0.1%)	High Yield (14.3%)	Equities (24.0%)	Gold (-0.9%)
Equities (4.2%)	Small Caps (-1.0%)	Commodities (11.8%)	Small Caps (23.8%)	IG Bonds (-1.2%)
Corporates (2.9%)	Equities (-2.4%)	Small Caps (11.6%)	Gold (12.7%)	Corporates (-3.2%)
Small Caps (1.8%)	High Yield (-2.7%)	Gold (8.1%)	REITS (11.4%)	High Yield (-4.1%)
IG Bonds (0.6%)	IG Bonds (-3.2%)	Infrastructure (8.0%)	High Yield (10.4%)	REITS (-4.7%)
Gold (0.1%)	Treasuries (-3.3%)	Equities (7.9%)	Infrastructure (9.8%)	Infrastructure (-5.3%)
High Yield (0.0%)	Corporates (-3.6%)	REITS (5.0%)	Corporates (8.9%)	Equities (-9.4%)
Treasuries (-0.8%)	Infrastructure (-6.2%)	Corporates (3.7%)	IG Bonds (7.4%)	Commodities (-11.2%)
Commodities (-17.0%)	Gold (-12.1%)	IG Bonds (2.1%)	Treasuries (7.3%)	Small Caps (-14.4%)
<b>Bitcoin (-57.5%)</b>	Commodities (-24.7%)	Treasuries (1.7%)	Commodities (1.7%)	<b>Bitcoin (-74.3%)</b>
2019	2020	2021	2022	2023
<b>Bitcoin (94.8%)</b>	<b>Bitcoin (305.1%)</b>	<b>Bitcoin (59.8%)</b>	Commodities (16.1%)	<b>Bitcoin (152.9%)</b>
Equities (26.6%)	Gold (24.6%)	REITS (27.2%)	Gold (0.4%)	Equities (22.2%)
Small Caps (24.7%)	Small Caps (16.3%)	Commodities (27.1%)	Infrastructure (-4.7%)	Small Caps (16.8%)
REITS (23.1%)	Equities (16.3%)	Equities (18.5%)	High Yield (-12.7%)	Gold (14.6%)
Infrastructure (21.6%)	Corporates (10.0%)	Small Caps (16.1%)	IG Bonds (-16.2%)	High Yield (14.0%)
Gold (18.4%)	Treasuries (9.5%)	Infrastructure (9.5%)	Corporates (-17.0%)	REITS (10.9%)
High Yield (12.6%)	IG Bonds (9.2%)	High Yield (1.0%)	Treasuries (-17.5%)	Corporates (9.2%)
Corporates (10.7%)	High Yield (7.0%)	Corporates (-3.2%)	Equities (-18.4%)	IG Bonds (5.7%)
Commodities (7.7%)	Infrastructure (0.1%)	Gold (-4.3%)	Small Caps (-18.7%)	Treasuries (4.2%)
IG Bonds (6.8%)	Commodities (-3.1%)	IG Bonds (-4.7%)	REITS (-24.4%)	Infrastructure (3.4%)
Treasuries (5.6%)	REITS (-8.2%)	Treasuries (-6.6%)	<b>Bitcoin (-64.2%)</b>	Commodities (-7.9%)

Source: Bloomberg, WisdomTree. Data from 31 December 2013 to 30 June 2024. In USD. **You cannot invest directly in an index. Historical performance is not an indication of future performance, and any investment may go down in value.**

Over the last decade, bitcoin has been the best performing asset in seven of those ten years. Its best performance took place in the years prior to and following halving events, while the worst years for bitcoin have historically been midway between two halvings. Interestingly, these halving events also coincide with the US election years. Given political turmoil and high government budget deficits, the timing of these events in the bitcoin market cycle is significant, reinforcing its investment thesis as an alternative currency that avoids the centralisation and debasement issues of fiat currencies managed by central banks. With a contentious US election on the horizon, it may be a prescient time for revisiting [bitcoin’s investment case](#).

Figure 23: Bitcoin price performance post-halving events



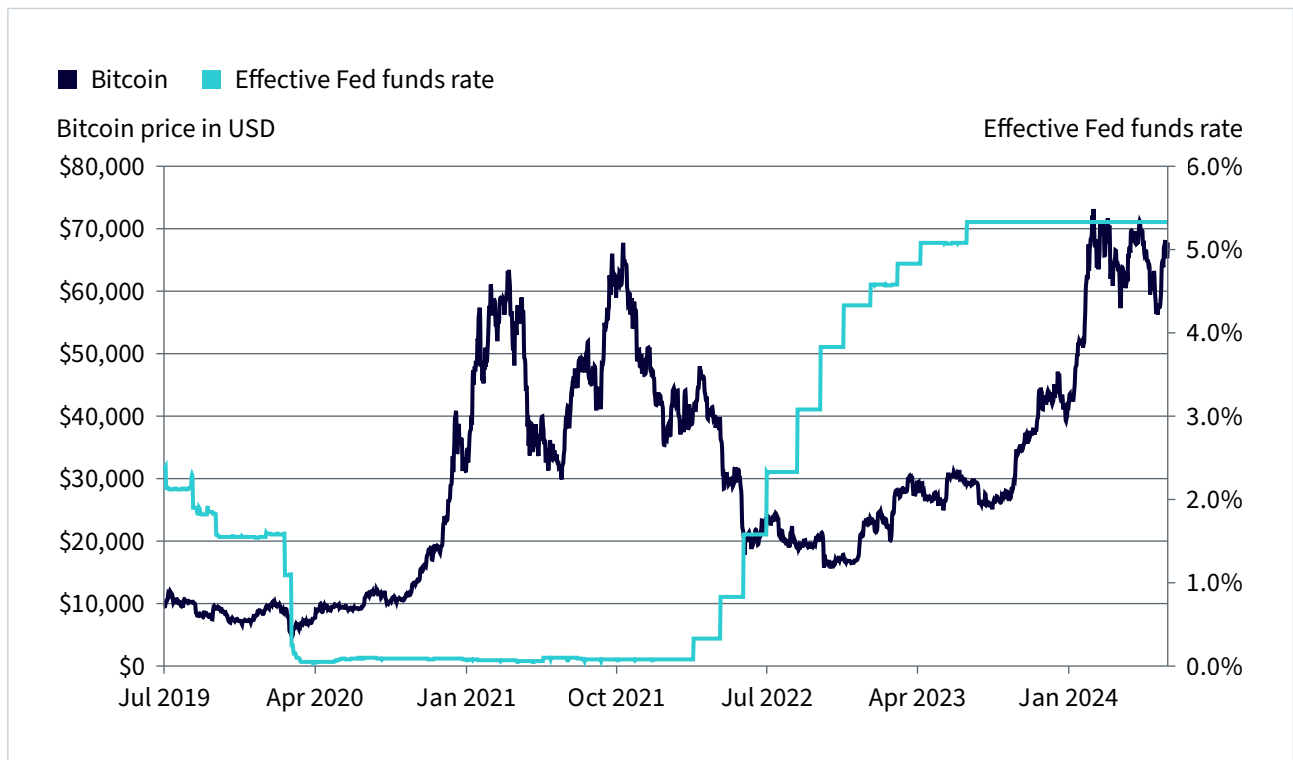
Source: Glassnode. Data as of 8 August 2024. **You cannot invest directly in an index. Historical performance is not an indication of future performance, and any investment may go down in value.**

Currently, we are 100+ days past the most recent halving event. As shown above, significant price changes following halving events are not always immediate. Two of the last three halvings saw delayed price increases, a pattern we have witnessed so far in 2024. This underscores the importance of patience for investors awaiting the ‘halving trade’ to play out. For context, bitcoin closed just under US \$64,000 on 20 April (halving date), and the current price is around US \$61,000<sup>28</sup> at the time of writing.

<sup>28</sup> Messari, 9 August 2024.

Another key area of influence in market cycles is macroeconomic policy impacts. With more liquidity in the system and lower central bank policy rates, we have seen in the past that this has benefitted crypto prices, as demonstrated by Figure 24. If we were to look at history, back in the low interest rate period in the early 2020s amidst the COVID-19 pandemic, crypto prices skyrocketed, with altcoins outperforming bitcoin and ether.

Figure 24: Bitcoin versus Fed funds rate



Source: Bloomberg. Data as of 26 July 2024. Index tickers: XBTUSD, FEDL01. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investment may go down in value.**

The Fed is likely to join other central banks in cutting interest rates due to improved inflation reads, and the market is pricing in rate cuts deep into 2025. This may lead to additional capital flowing into risk assets as investors look further out on the risk spectrum to source positive returns to the portfolio as the risk-free rate is reduced.

The potential for looser monetary policy on the horizon could benefit the entire crypto market, with altcoins particularly well positioned to capitalise on this environment given their high ‘crypto beta’. However, altcoins present high risk and reward due to their volatility and pursuit of product-market fit, so diversification remains key to managing risk. Ongoing institutional adoption and tighter supply on the back of the halving positions bitcoin quite well to benefit from this market environment. Couple this with a year of global political turbulence, and bitcoin’s unique role as ‘digital gold’ positions it to potentially outperform other cryptocurrencies.

However, it's crucial to remember that the crypto market is not only influenced by cyclical trends and macroeconomic factors, but also significantly by technological advancements and other on-chain activity. As blockchain technology continues to evolve, it has the potential to drive new trends and reshape the market landscape. Therefore, it's essential to examine things more closely as we look ahead.

Bitcoin's unique role as 'digital gold' positions it to potentially outperform other cryptocurrencies.

### **On-chain developments and technological innovations**

As we delve deeper, several notable developments have emerged this year. First, the Ethereum Dencun upgrade has enabled layer 2 solutions including Base, Optimism, and Arbitrum to settle transactions faster and cheaper using the Ethereum blockchain. This upgrade is a crucial step in scaling Ethereum, which has faced competition from emerging blockchains offering similar capabilities, particularly Solana.

Solana is also gearing up for significant upgrades, including the Firedancer software update in 2025, which will allow it to surpass a million transactions per second. Despite the competition, Ethereum's strong network effect has created a substantial moat, allowing it to dominate the smart contracts space in terms of market cap, total value locked, and – until only recently – usership, by active wallet addresses. This dominance has attracted financial institutions such as BlackRock and others focused on tokenisation to the Ethereum blockchain. Ethereum remains the largest 'economic centre' in the decentralized blockchain world, and the Dencun upgrade has further strengthened its position.

With upgrades such as Dencun, lower barriers of entry are set for new users to access the numerous decentralized applications available, such as the most prominent and mature exchanges, lending protocols, and infrastructure services that have been living on Ethereum for years.

These fee-generating applications often have their own tokens, governance, and value accrual mechanisms, offering a unique opportunity for investors to evaluate the services on the blockchain not only for their usage, but also for investment. In Figure 25, we observe the billions of dollars held in smart contracts of the most prominent decentralized financial services, along with their fees generated, and a ‘valuation ratio’ of the market capitalisation over the annualised fees. The decentralised world is not so different from traditional finance after all.

Figure 25: Decentralised finance applications on Ethereum

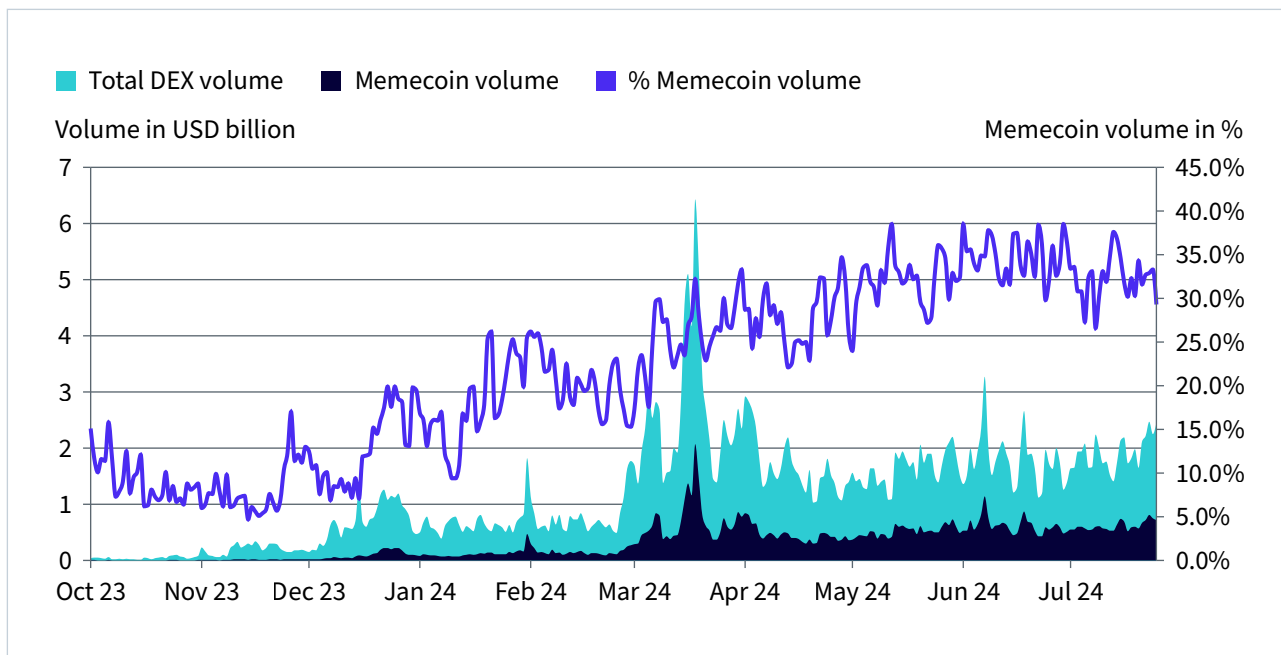
	Lido	Uniswap	AAVE	Maker
Use case	Liquid staking	Exchange	Lending	Collateralised debt
Total value locked (TVL, USD billion)	\$33.74	\$4.75	\$18.50	\$7.99
Fees 30 days (USD million)	\$88.35	\$31.91	\$24.15	\$19.37
Market cap/fees	1.5x	10.6x	4.83x	10.79x

Source: DefiLlama. Data as of 22 July 2024. **Historical performance is not an indication of future performance, and any investment may go down in value.**

More recently, Solana has experienced significant growth in decentralized exchange activity and a spike in user engagement, surpassing that of Ethereum. Over the past 90 days, Solana has seen twice as many average daily addresses interacting with its blockchain compared to Ethereum, with over 900k compared to 400k for that of Ethereum. At first take, this is quite profound, but when delving deeper, we see what these users are up to.

The recent introduction of the Pump.fun memecoin marketplace has driven a surge in memecoin trading activity on Solana, totalling over US \$120 billion in trading volume in the last 90 days. This figure is comparable to Ethereum’s US \$170 billion in trading volume activity. As a result, memecoin trading now dominates much of the decentralized exchange activity on the Solana network.

Figure 26: Solana daily decentralized exchange (DEX) volume



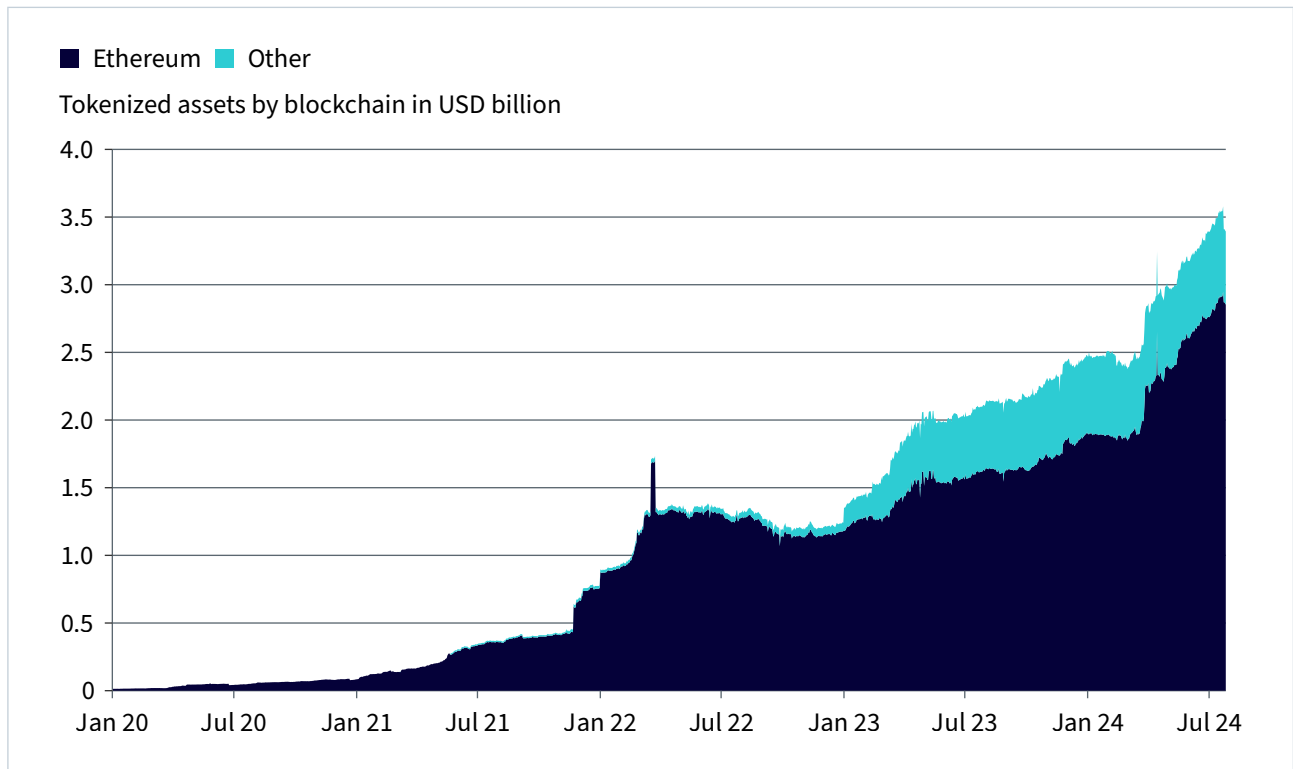
Source: DuneAnalytics. Data as of 25 July 2024. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investment may go down in value.**

While memecoins may not be the most productive use case, the cheaper and faster transactions on Solana enable more experimentation and innovation. This environment fosters the development of new applications and technologies, as well as greater user adoption. It will be interesting to see whether these users are here to stay, and whether further innovations emerge from Solana’s increased activity, potentially leading to more productive applications. A more productive example is Visa and other payment companies settling transactions on the blockchain, leveraging its speed and low cost.

Moving beyond memecoins to a more institutional use case, the space of tokenized assets is showing significant promise. The tokenization of traditional assets on blockchains has grown exponentially over the past few years, starting primarily with tokenized USD stablecoins. Since then, various other assets, including commodities, fixed income, equities, and real estate, have emerged. Some firms are even tokenizing private assets, such as private credit and private equity funds. Asset managers across the globe have launched tokenized funds that offer investors access to traditional investment products and financial services with the added benefits of blockchain’s transparency and efficiency.

The space of tokenized assets is showing significant promise.

Figure 27: Tokenized assets by blockchain



Source: DuneAnalytics. Data as of 26 July 2024. **You cannot invest directly in an index. Historical performance is not an indication of future performance and any investment may go down in value.**

The potential of tokenized assets is substantial, with estimates suggesting that up to US \$2 trillion in assets could be available for tokenization by 2030.<sup>29</sup> This growth is driven by the numerous advantages tokenization offers, including improved liquidity, fractional ownership opportunities, and streamlined trading processes. As these benefits become increasingly apparent to businesses globally, we can expect a gradual transition of traditional financial infrastructure towards

We can expect a gradual transition of traditional financial infrastructure towards blockchain-based systems.

<sup>29</sup> McKinsey, 2024.

blockchain-based systems, often operating seamlessly in the background without end users even being aware of the underlying technology.

These are only a few of the many ways technological innovations on-chain are transforming the digital asset landscape. While Ethereum remains the dominant player in the smart contract platform space, where most of the 'primary' activity takes place, Solana's rising usage indicates a competitive environment fostering rapid advancements. Scalability and efficiency upgrades are prime examples of how these innovations drive new growth and activity. The growth of applications such as tokenized assets, decentralized finance and other blockchain-based solutions underscores the sector's potential for substantial growth ahead.

## **Conclusion**

Several key trends are converging that collectively paint a promising outlook for the cryptocurrency market in the second half of 2024. The rise in institutional adoption signals increased confidence and participation from major financial institutions, opening the door to new sources of demand. Institutional interest in the largest tokens, namely, bitcoin and ether, is accelerating, supported by regulated vehicles such as ETPs. The recent bitcoin halving has tightened supply by reducing the issuance of new bitcoin, effectively reducing the supply available to meet this demand. Additionally, a more accommodative interest rate environment may attract more investors seeking risk-on exposures, buoying crypto prices with greater investment. Furthermore, new innovations and increased activity are driving greater adoption of decentralized blockchains, fostering their growth and embedding them into the fabric of our society. If all these trends converge, the crypto market may see significant tailwinds that jolt it into the next bull market by year-end.

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