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**Insight**  
INVESTMENT

# ABDALLAH NAUPHAL

## A NEW WORLD ORDER

APRIL 2025



# EXECUTIVE SUMMARY

## Abdallah Nauphal



Abdallah has been CEO of Insight since July 2007, before which he was Chief Investment Officer, and then Deputy Chief Executive. He has overseen the transformation of Insight from a traditional investment manager to a specialist solutions provider across LDI, fixed income and absolute return. During this time, the scope and complexity of Insight's business and governance structures has evolved significantly.

The global economy is undergoing a profound transformation, marked by unprecedented uncertainty and rapid change as a new world order emerges. This paper delves into the critical factors driving this reshaping and examines the potential implications for investors and policymakers.

- **The multilateral order is unravelling:** Pax Americana, which embodies the rule-based order and common ideals that united nations since WWII, is crumbling. Faced with the headwinds of deglobalisation, demographic decline and the debt overhang, the system is no longer able to generate sufficient growth to sustain itself.
- **Enhancing GDP per capita has become imperative:** Without population growth, the only path to sustainable economic growth is to expand GDP per capita. However, productivity has been declining, and labour intensity faces significant challenges in an aging society.
- **Artificial intelligence is a potential catalyst for revolutionary productivity gains:** This exciting new technology may have the potential to restore growth in GDP per capita but will require vast amounts of resources. Given debt levels, the competition for resources will be a stark reality to face in future.
- **Inflating away our problems carries risks but may become inevitable:** Ailing economies could attempt to inflate the problems away and central banks may be forced to relax inflation targets as it becomes politically unpalatable to suppress wage growth.
- **The path to interregnum and a new world order:** Governments have been exhausting every available policy tool and are likely to resort to even more interventionist policies in the years ahead as they attempt to safeguard the system.
- **Accept uncertainty and build resilience:** As we review the investment landscape, it's not just the components of the game that are being changed, but the very rules themselves that are being radically altered. This creates a very different level of uncertainty. Now is not the time for heroics; stay focused on your objectives and maintain optionality with liquid assets that can be swiftly redeployed if uncertainty declines and opportunities arise.



# THE MULTILATERAL ORDER IS UNRAVELLING

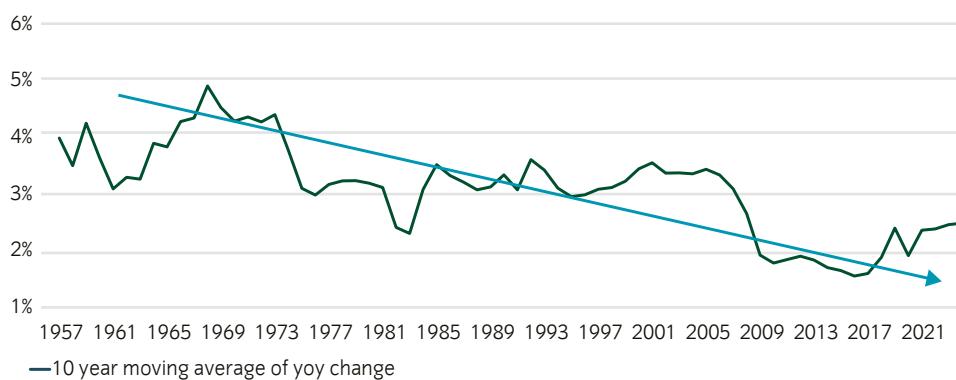
## PAX AMERICANA IS FAILING

Pax Americana, the concept of relative peace established by US power since WWII, transcends mere American leadership. It embodies the multilateral, rule-based order that has united nations through shared ideals such as free trade and liberal ideology. These foundational pillars are now crumbling. This is not solely an American issue; we are witnessing the disintegration of the global order that has governed our world for decades.

Much has been written to try to explain this phenomenon, but the explanations are often broad and generalised. They talk about multipolarity, protectionism, and nationalism. However, the reality is much more complex and nuanced. At this stage, there is scant insight into the implications.

At the core of this issue is the failure of Pax Americana to generate sufficient growth to sustain itself. The long-term chart for US GDP (see Figure 1), representing the most vibrant economy within the Pax Americana Club, shows a clear downward trend. Any system that stops delivering on its intended purpose becomes obsolete and outdated, and consequently I see no potential to salvage Pax Americana.

Figure 1: US real GDP is clearly trending lower, leaving Pax Americana unable to sustain itself<sup>1</sup>



To understand why this is occurring, we must delve into the factors that are holding back growth and causing the system to fail. Many of the tailwinds that once propelled Pax Americana in its early decades have now become serious headwinds.

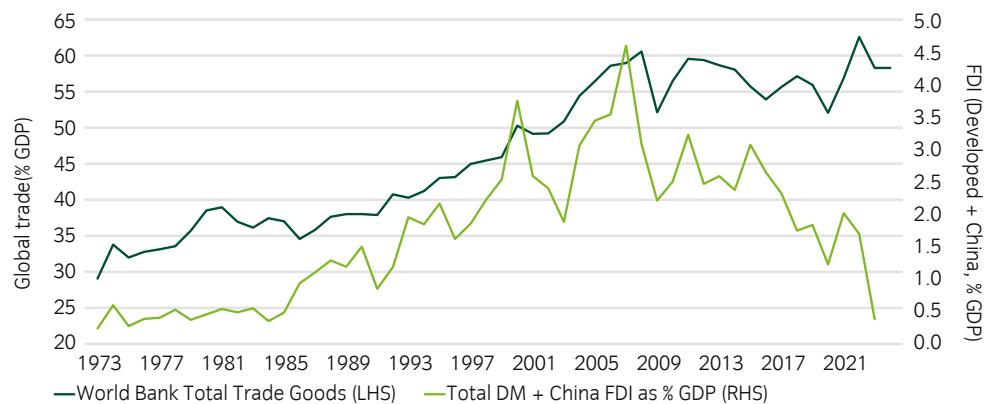


<sup>1</sup> Source: Bloomberg and Insight as at 31 December 2024.

## FACTOR 1: DEGLOBALISATION

It is clear that globalisation is in retreat, a phenomenon we can term de-globalisation. Aggregate data indicates that total global trade has plateaued over the last 15-20 years, showing no real growth. Additionally, capital flows, particularly foreign direct investment (FDI), have been collapsing (see Figure 2). Much of this has been blamed on supply chain restructuring in the wake of the pandemic. However, if supply chain de-risking or nearshoring were the true culprits, we would see a decline in the geographical distance travelled by goods around the world. Interestingly, this distance has remained flat during this period, suggesting that other underlying factors are at play.

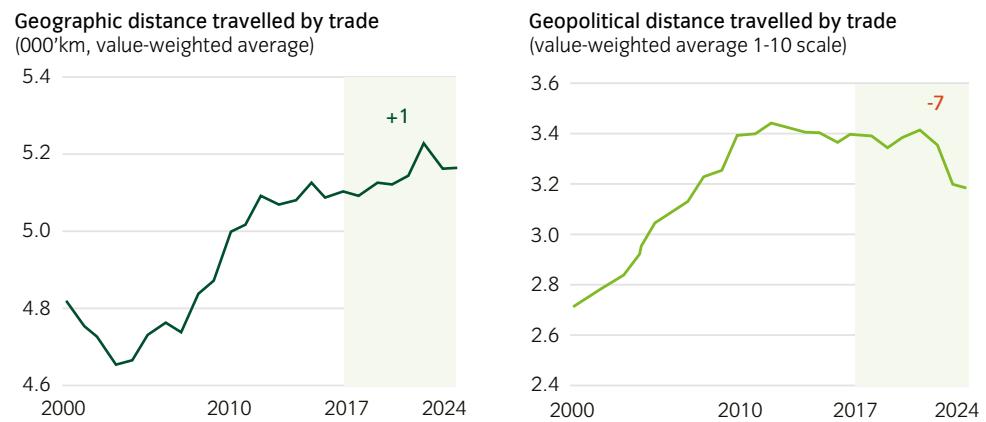
Figure 2: Global trade has trended sideways for more than a decade, while FDI has collapsed<sup>2</sup>



The McKinsey World Institute offers a compelling perspective on this. They measure the political dynamic between trading partners, and the data reveals that geopolitical distance has become a more significant issue for trade than geographical distance (see Figure 3). This suggests that the current challenges extend beyond supply chain restructuring for risk management and are deeply rooted in national security concerns. Arguably, it highlights a resurgence in old-fashioned protectionism aimed at shielding uncompetitive industries.

To some extent, what we are witnessing today is globalisation turning against its masters. While it may be advantageous for a multinational company to outsource the production of components to a country with low production costs, the dynamic changes significantly when the low-cost producer starts to compete on high-value products and cutting-edge technology. At this juncture, globalisation has transformed from a net benefit to a loss.

Figure 3: Geopolitical concerns have become more important than geographic distance<sup>3</sup>



<sup>2</sup> Source: Bloomberg and Insight as at 31 December 2024.

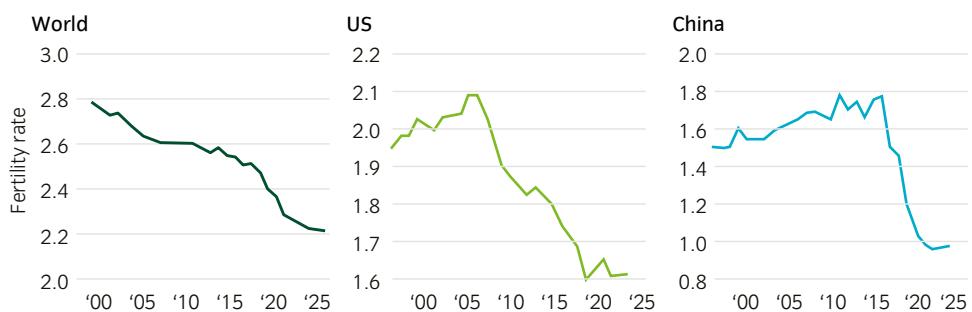
<sup>3</sup> Source: UN Comtrade, Voeten (2017) and UN Digital Library, CEPPII, McKinsey Global Institute analysis. Evolution of goods trade indicators, 2000-2024E

While we can't pinpoint the exact cost of deglobalisation, several studies, including those by the IMF, suggest that if the US imposes a 10% tariff on all imports and China and Europe retaliate, it will have a negative impact on GDP growth of 0.8% in 2025 and 1.3% in 2026. Another model estimates that if the world fragments into regional zones, with the US and China at the centre of the two largest, it could reduce GDP by 1% per annum after five years, and as much as 2% per annum in the longer run. This is a very expensive exercise that will be a significant headwind to growth.

## FACTOR 2: DEMOGRAPHIC DECLINE

This is potentially the most formidable challenge our societies face. During the early days of Pax Americana, high fertility rates and the post-war baby boom significantly bolstered the workforce, driving robust economic growth. However, fertility rates have since plummeted (see Figure 4), resulting in a shrinking workforce and presenting a profound economic challenge.

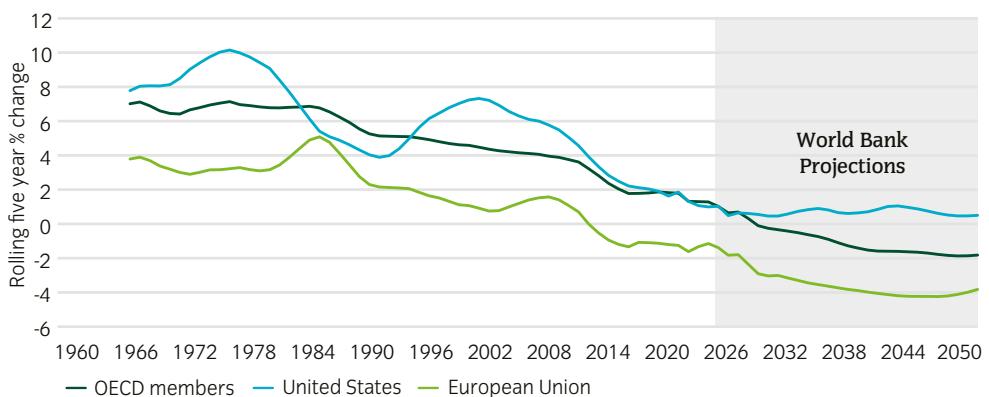
Figure 4: Fertility rates have fallen below replacement levels in the US and China<sup>4</sup>



Worryingly, not only have fertility rates fallen sharply around the world, but they have also in many countries dropped well below the replacement level of roughly 2.1%, which is needed to keep the population constant. At the same time, life expectancy has broadly trended upwards, with the two factors a toxic combination for economic activity.

The decline in working age populations is already a significant problem, especially in Europe. The World Bank projects that the working age populations of OECD members, in aggregate, will soon begin to contract (see Figure 5). This demographic shift threatens to stifle economic growth, accelerating the decline in Pax Americana because, in its simplest form, economic activity is simply the number of people employed multiplied by what those people produce.

Figure 5: Working age populations are in decline<sup>5</sup>

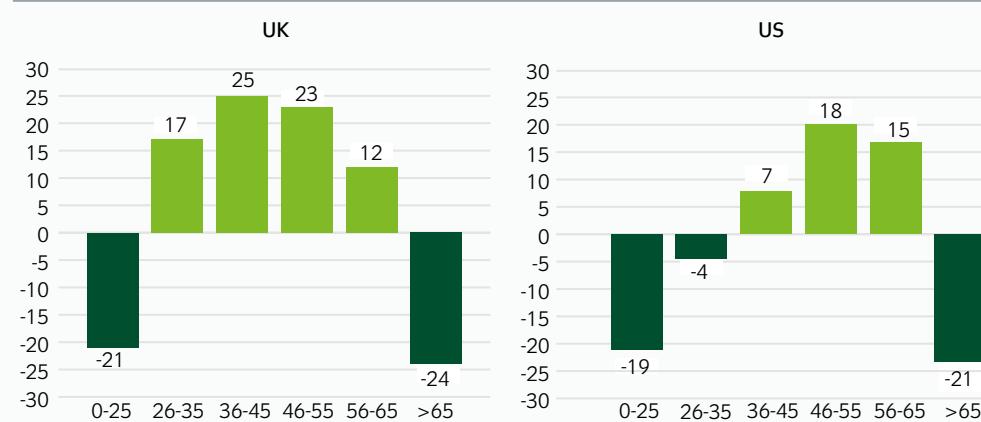


<sup>4</sup> Source: World Population Prospects 2024, United Nations, McKinsey Global Institute analysis as at 31 December 2024.

<sup>5</sup> Source: World Bank as February 2025. 16-64 year olds, 5 years average growth.

As the demographics shift, there are also fiscal implications. When examining the primary budget balance by age group, it is clear that both the young and the elderly generate budget deficits, consuming more government resources than they contribute (see Figure 6). In contrast, the working-age population between these two groups generates budget surpluses. However, this middle group is shrinking in size relative to the rest of the population, a trend that appears likely to persist. This will make it increasingly challenging to generate sufficient surpluses to offset the deficits on either side. Any shortfall must be borrowed.

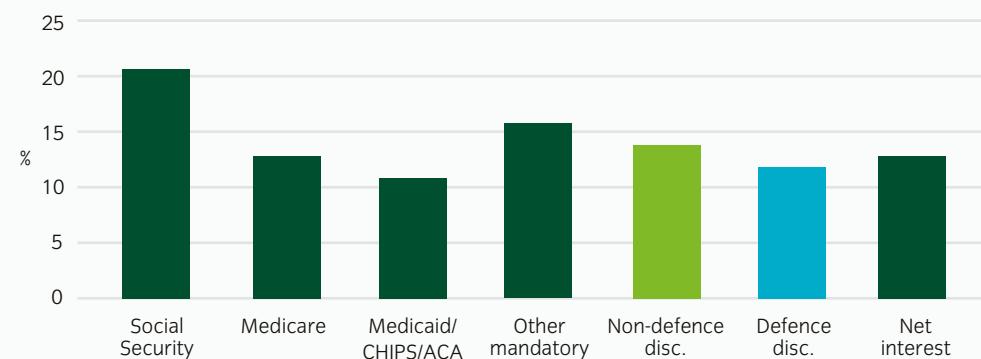
Figure 6: Government primary surplus/deficit per capita by age in 2023 (\$000s 2021 PPP)<sup>6</sup>



### FACTOR 3: THE DEBT OVERHANG

When we look at US federal expenditure for 2024 (see Figure 7), mandatory programmes, which are coloured in dark green, dominate the budget. These do not require annual budget approval from Congress and continue automatically. This situation is only going to worsen over time. Interest costs are already higher than defence spending but are projected to double as debt matures and gets refinanced. As the population ages, social costs will continue to grow.

Figure 7: 2024 US federal expenditures are dominated by mandatory programmes<sup>7</sup>

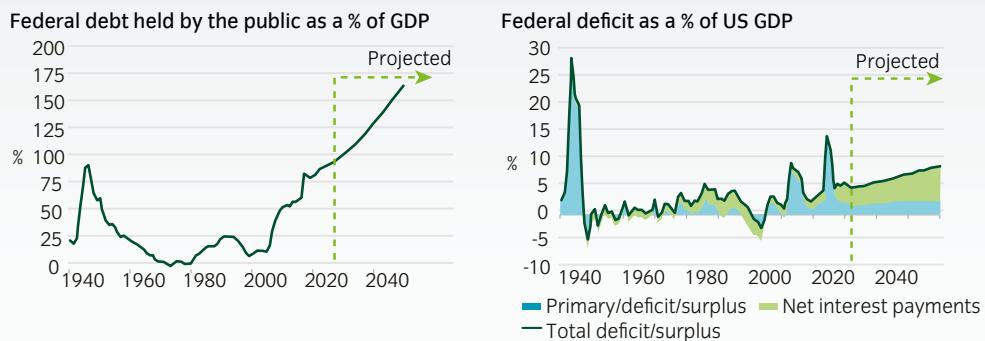


If we had managed our finances more prudently over the past 30 years, we might have had some leeway to address these challenges. However, we are starting from a position of record levels of debt, not just in the US but globally. The total federal debt as a percentage of GDP is already higher than it was after WWII and is projected to rise significantly over the next decade. This trend is being driven by ever-widening deficits, a function of rising interest costs and expensive social programmes (see Figure 8).

<sup>6</sup> Source: World Population Prospects 2024, United Nations, UK Office for Budget Responsibility Tax Foundation, OECD, CaixaBank Research, McKinsey Global Institute analysis. For illustrative purposes only.

<sup>7</sup> Source: US Treasury.

Figure 8: Fiscal dynamics are unsustainable<sup>8</sup>



Given these projections, it's hard to be optimistic. The Congressional Budget Office's estimates are conservative and don't account for potential extensions of policies like the Tax Cut and Jobs Act, which could add trillions to the deficit. This leaves us with a daunting fiscal trajectory that will constrain growth and exacerbate the debt problem.

## THE IMPERATIVE OF ENHANCING GDP PER CAPITA

Without population growth, the only viable path to sustainable growth is to expand GDP per capita at a faster pace than populations decline. Quite simply, GDP is equal to GDP per capita multiplied by population.

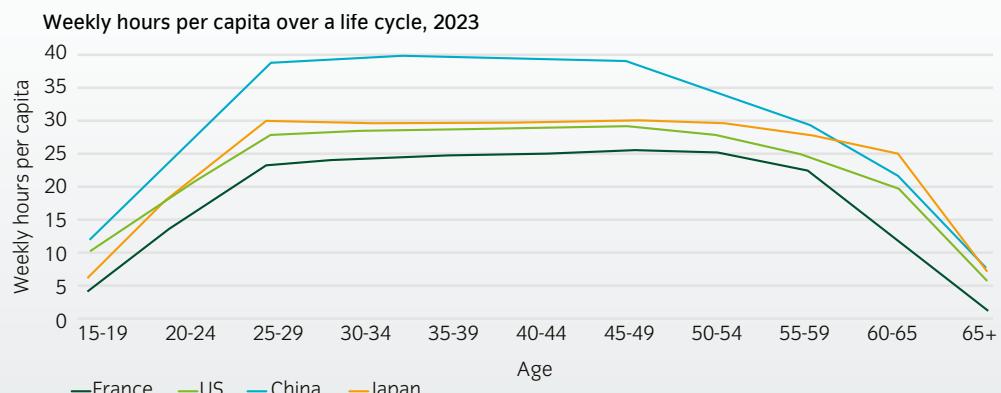
GDP per capita is influenced by three key factors: the age mix of the population, which includes fertility, longevity, and migration patterns; labour intensity, which encompasses participation rates and hours worked; and productivity, which involves labour productivity, physical capital productivity, and technological innovation.

As we've discussed, fertility and longevity are not going to come to the rescue, and sentiment is turning against immigration in developed economies, effectively closing that avenue. These leaves us with only two other options.

### IMPROVING LABOUR INTENSITY IS CHALLENGING IN AN AGEING SOCIETY

Labour intensity encompasses participation rates, the extent to which people are actively seeking and securing jobs, and the number of hours they are willing to work. Figure 9 illustrates how the average number of hours worked, and consequent labour intensity, varies by both age and country.

Figure 9: Hours worked tends to decline rapidly after the age of 50<sup>9</sup>



<sup>8</sup> Source: Congressional Budget Office (2023) and authors' calculations as at 31 December 2023.

<sup>9</sup> Source: World Population Prospects 2021, United Nations, ILOSTAT, The Conference Board, McKinsey Global Institute analysis.

What is evident across all countries is that after the age of 50, there is a pronounced and rapid decline in the number of hours worked. In an aging society, this presents a significant challenge. Japan, which is at the forefront of the demographic crisis, has managed to somewhat flatten this distribution by increasing the participation rate for the 50 to 64 age group from around 73% to 84%. However, the Japanese experiment has demonstrated that this increase is far from sufficient to counterbalance the overall decline in aggregate hours worked.

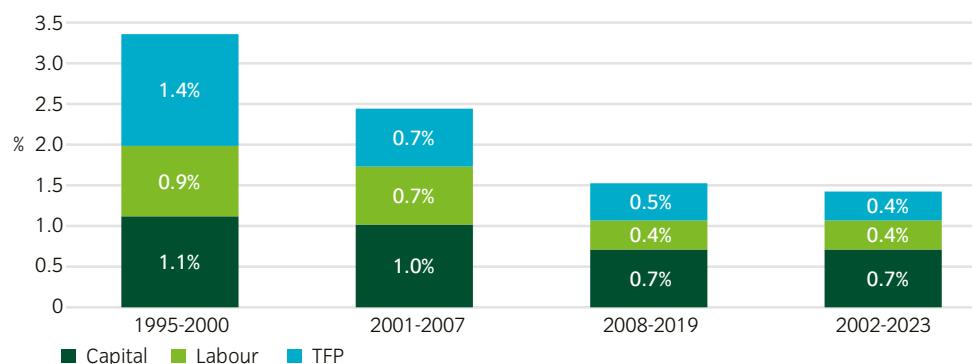
From this, we can conclude that although incentivising improvements in labour intensity is a worthwhile goal for governments to pursue, it won't meaningfully alter the outlook.

## THERE ARE NO SIGNS OF A PRODUCTIVITY REVIVAL AT THIS STAGE

The aggregate productivity of advanced economies has been declining for some time. While the US performs better than Japan, and Japan better than Europe, the overall trends in labour productivity, capital productivity, and their combined impact have been consistently downward (see Figure 10). Productivity must turn around, and currently, we are not taking the necessary steps to achieve this.

For us to return to the level of GDP per capita growth that we need, productivity across the developed world would need to at least double. This represents a huge challenge.

Figure 10: Productivity in advanced economies has been trending in the wrong direction<sup>10</sup>



## ARTIFICIAL INTELLIGENCE HAS THE POTENTIAL TO DRIVE PRODUCTIVITY ENHANCEMENTS

There is one innovation that has the potential to save the day – artificial intelligence. However, to restore growth in GDP per capita to levels that would create sustainable growth, productivity across the economy would need to roughly double from current levels is a monumental task. To achieve this will require AI to be both pervasive and transformative, creating entirely new forms of production. It must intersect with robotics to produce cheaper goods, revolutionise services, and drive innovation across all sectors of the economy. The potential for AI to achieve this is immense, but it will require a level of technological advancement that would fundamentally alter the way we work and live.

To assess the potential for AI to achieve these goals we need to consider the process of creative destruction, described by Joseph Schumpeter in 1942. Schumpeter explained that creative destruction is the evolutionary mechanism at the heart of capitalism: a continuous process of innovation that creates new production structures, replacing outdated ones.

The problem is that there are winners and losers in this scenario – and the losers, the old systems, fight fiercely for survival. New technologies can be stifled by competitive acquisition, non-competitive patenting can be used to create obstacles, and political connections can be leveraged to create barriers that act to protect the incumbents.

<sup>10</sup> Source: World Bank as February 2025.

To create the radical change necessary for AI to have a profound impact on productivity will not be easy, as it will be accompanied by social and economic disruption. For some, the process will be a painful experience.

There will also be an enormous cost. AI will require vast amounts of resources, including water, capital, and energy. This demand will need to compete with other important initiatives such as climate change adaptation and mitigation, the modernisation of infrastructure, and the constant demand from social programmes. Given high levels of debt, competition for resources is going to a stark reality we must face in the years ahead.

## INFLATING AWAY OUR PROBLEMS CARRIES RISKS BUT MAY BECOME INEVITABLE

If AI does not turn out to be the solution, then there are few options left. One would be to attempt to inflate our problems away.

### **INFLATION IS ALREADY BECOMING EMBEDDED INTO THE SYSTEM**

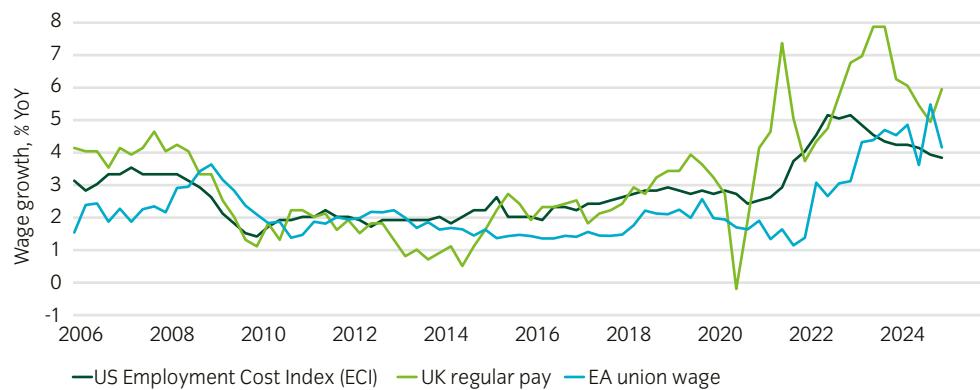
Historically, our economies have experienced two primary dynamics that result in periods of higher inflation. The first is the wage-price spiral, where rising wages lead to higher prices, in turn leading to demands for even higher wages. This cycle can perpetuate itself, creating an inflationary loop. The second, often linked, dynamic is the expectation loop, where deteriorating long-term inflation expectations cause consumers and firms to accelerate their purchases, further fuelling inflation.

In the most recent economic cycle, we have observed the emergence of more concerning inflationary trends. While it is premature to conclude that these trends have become so entrenched as to become self-reinforcing, longer-term trends point to stubbornly higher inflation ahead.

Inflationary pressures will only intensify as these economies experience a demographically induced shrinkage in labour forces. With immigration being curtailed, and globalisation retreating, access to cheap labour from abroad is diminishing. This combination of factors is already creating labour shortages, especially for skilled labour, which will in turn drive up wages as workers demand higher pay and are more willing to fight for it.

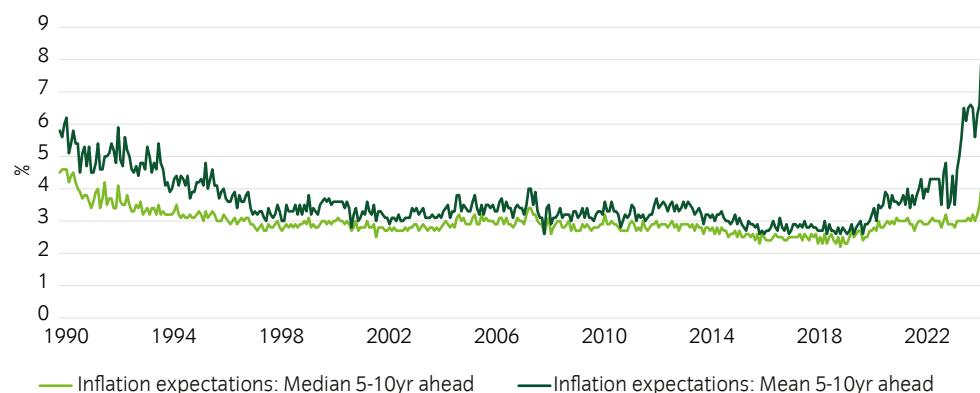
This has become apparent in wage data (see Figure 11) even before the full impact of the underlying structural trend takes place. It's too early to class what we're seeing as a full wage spiral, but the pressures we're discussing will continue to push in the same direction – toward less supply of labour relative to demand, particularly with onshoring and similar trends. It wouldn't be surprising to see a continued higher equilibrium for wages for many years to come.

Figure 11: Wages are increasing and wage growth could remain structurally higher in the years ahead<sup>11</sup>



Inflation expectations data is also a cause for concern. In Figure 12 we can see US consumer inflation expectations 5 to ten years in the future. The light green line represents the median, and the darker green line represents the mean. The median has been trending upwards, indicating that the average person in the US expects higher inflation in the future. However, if you look at the mean, it has exploded, suggesting that a section of the population is significantly worried about future inflation rates.

Figure 12: Inflation expectations are concerning<sup>12</sup>



## CENTRAL BANKS WILL BE FORCED TO RAISE OR ABANDON INFLATION TARGETS

If my view is correct and the path of least resistance is towards higher inflation, then this will become a problem for central banks as they struggle to maintain inflation around target levels. But they may adapt with surprising rapidity.

Historically, central banks were created with a very different role than they have now, with their primary function to fund the government. When money was needed for war, the central bank provided an entity with the creditworthiness necessary to borrow and fund it.

As a lender of last resort, central banks evolved to serve as a backstop to commercial banks and, more recently, to the entire financial system. This role is arguably the most important function they have played and will continue to play. Their role as inflation fighters only emerged after the collapse of Bretton Woods, when inflation surged and created a confidence crisis in then newly unpegged currencies.

<sup>11</sup> Source: Insight and Bloomberg as at 31 December 2024.

<sup>12</sup> Source: University of Michigan as at 31 March 2025.

Inflation targeting is an even more recent phenomenon, started in around 1988 by the Reserve Bank of New Zealand. The concept wasn't the result of serious academic study as you might think, but followed an offhand comment from New Zealand's Finance Minister, Roger Douglas. When asked in an interview if he was happy with inflation dropping from 15% to 10%, he replied, "Absolutely not. Inflation needs to be between zero and 2%." The Reserve Bank of New Zealand were left to follow through.

The UK and Canada followed with their own inflation targets, but it wasn't officially adopted in the US until 2012. While it may be tempting to imagine central banks as adapting their policy frameworks in a linear progression based on solid economic theory, the reality is far more complex. Historically they have adapted policies to reflect the prevailing conditions and circumstances in which they need to operate.

In my view, it will be extremely challenging for central banks to stick to current inflation targets if it results in a significant decline in output merely to prevent wages from rising. This will be particularly difficult given wages have been declining as a share of GDP for the last 20-30 years. The political environment is no longer conducive to such measures. Should central banks attempt to do this, their independence will be seriously questioned. This leads me to believe they will be forced to relax their inflation targets in the years ahead.

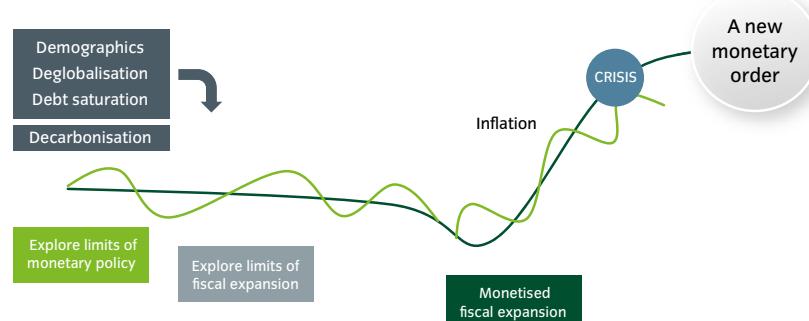
## THE PATH TO INTERREGNUM: A NEW WORLD ORDER

The world is filled with contradictions. We desire more growth, yet we pursue short-sighted policies that hinder it. We seek social stability, but we also want the benefits of creative destruction. We need substantial new capital, but our balance sheets are already stretched, and higher inflation will only exacerbate the problem.

We must confront these contradictions head-on. The path we choose will determine whether we can navigate these challenges successfully or succumb to the pressures they create. But unfortunately, I don't think the political cycle aligns with the timeframe required to tackle these challenges. My feeling is that we will ultimately wait for a crisis to force our hand before we deal with these issues.

The way I perceive this transition's evolution is depicted in Figure 13. In a very stylistic way, it illustrates the forces acting to constrain growth. Governments have been exhausting every available policy tool as they fight to sustain the status quo. They have explored the limits of monetary policy, even venturing below the zero bound in some cases, and now we are pushing the boundaries of fiscal policy. We have even experimented with monetised fiscal expansion in moments of desperation.

Figure 13: The path to interregnum<sup>13</sup>



<sup>13</sup> Source: Insight, for illustrative purposes only.

Over time, these forces have intertwined to embed inflation deeply into our system. Many argue that inflation is now the only democratically palatable solution to our debt problem. While there may be some truth to this, inflation is never a panacea. It doesn't necessarily resolve our problems and could potentially trigger a crisis of confidence in both governments and fiat currencies.

At that stage, I believe governments will resort to even more interventionist policies to safeguard the system. The resurgence of protectionist tariffs is likely just the beginning. Within the next decade, we might witness the return of capital controls or alterations in accounting rules, such as eliminating the requirement to mark certain assets to market. This scenario is not far-fetched, especially considering that the foremost advocate of free trade has rapidly transformed into one of the world's most protectionist economies. It's not a significant leap to anticipate that more extreme measures follow.

What deeply concerns me is the apparent disregard for these critical issues among political leaders and advisers. A survey conducted by the World Economic Forum, which included responses from about a thousand experts and government officials, revealed a startling oversight. Debt and inflation did not even make it into the top 10 global risks. Over the next two years, debt was ranked 15th and inflation 29th. Alarmingly, over the next decade, these issues were ranked even lower, at 20th and 32nd. This lack of prioritisation is not just troubling; it is a glaring indication of the disconnect between the pressing economic realities and the focus of our policymakers.

## CONCLUSION: EMBRACE UNCERTAINTY AND BUILD RESILIENCE

Depending on the timeframe you are looking at you may have completely different expectations and views, as the distance over which you're trying to forecast will alter the narrative you have. If I had to think about 50 years from now, I would be much more positive. I would talk about progress across a broad range of facets of human life. Scientific advancements and technological breakthroughs will ensure that we continue to progress along these dimensions.

But when I focus on the next five to 10 years, there are critical contradictions within the system that must be resolved, and the resolution will inevitably entail economic or social pain.

I think you're probably tired of hearing people say the world is uncertain. The future is always uncertain, but I'm not sure it's ever been as unpredictable as it is today. Today's uncertainty is not just about the outlook for asset markets; it extends to the very rules of the game being radically altered.

To illustrate that we can perhaps use the analogy of a football team. I can change all of the players within a football team, and it will still be a football team, regardless of the capability, sex or age of the players. They will still play under a similar set of rules with the objective of kicking the ball into the back of the net more times than the other team. But if I radically change the rules, if I allow players to carry the ball, everything changes. Then I'm no longer playing football, I'm playing something entirely different.

Perhaps the best way to view this unprecedented level of uncertainty is through a framework, one that we can adapt from fields where professionals routinely confront deeper levels of uncertainty than our industry traditionally has. Such a framework is outlined in Figure 14. In these fields, uncertainty is viewed as a spectrum, ranging from complete certainty on one end to complete ignorance on the other. Within this spectrum, there are generally agreed-upon levels of uncertainty. By adopting this nuanced approach, we can better understand and manage the complexities we face today.

Figure 14: The uncertainty spectrum<sup>14</sup>

Complete certainty	LEVEL 1	LEVEL 2	LEVEL 3	LEVEL 4	Total ignorance
	<ul style="list-style-type: none"> <li>• Clear enough</li> <li>• Small error margin</li> </ul>	<ul style="list-style-type: none"> <li>• Can be described probabilistically</li> <li>• Predictable alternative future</li> </ul>	<ul style="list-style-type: none"> <li>• Limited set of plausible scenarios</li> <li>• Unpredictable within range</li> </ul>	<ul style="list-style-type: none"> <li>• Number of outcomes unidentifiable</li> <li>• Impossible to predict</li> </ul>	
	<ul style="list-style-type: none"> <li>• DCF analysis</li> <li>• Big bets</li> </ul>	<ul style="list-style-type: none"> <li>• Portfolio theory</li> <li>• Optimal portfolio</li> </ul>	<ul style="list-style-type: none"> <li>• Scenario analysis</li> <li>• Robust portfolios</li> </ul>	<ul style="list-style-type: none"> <li>• Lock outcome</li> <li>• Optionality</li> </ul>	

#### LEVEL 1

Uncertainty has a very small error margin, and things are reasonably clear. For example, when does the postman come to your house to deliver the mail? It's usually around 10 o'clock every day, sometimes at 9:30, sometimes at 11. You can predict it with a fair degree of accuracy, and if it's wrong, it's not a big deal. This represents the lowest level of uncertainty beyond complete certainty, creating an environment conducive to taking large bets on the market.

#### LEVEL 2

This level can be described in probabilistic terms. You know what the probability distribution looks like, and you can work within that framework. This is where investment typically pretends to be, regardless of where we are on the investment spectrum. We can focus on creating optimal portfolios and projecting returns based on probability distributions.

#### LEVEL 3

At this level, while the exact distribution of probabilities remains unknown, you can identify two or three likely scenarios and evaluate the potential performance in those scenarios. Rather than seeking an optimal portfolio, the focus shifts to constructing a robust portfolio. This portfolio is designed to perform consistently well across a range of scenarios, even if it doesn't excel in any single one. This approach ensures resilience.

#### LEVEL 4

The final level is complete uncertainty, where the unknowns are so significant that predicting outcomes becomes extremely challenging. Arguably, this is the environment we are in today. With such high levels of uncertainty, locking in outcomes becomes the most effective way to navigate extreme fluctuations. However, it is equally important to incorporate some optionality into your portfolio. This means utilising safe and liquid assets that can be swiftly redeployed when uncertainty declines and opportunities arise.

Interestingly, Warren Buffet is already taking the approach we see in level 4. Just as many US investors are now almost entirely exposed to equities, he is doing the opposite, building his cash levels to 30% of his portfolio. He is building a defensive portfolio that has optionality, and you know that he will be ready to grab opportunities when they arise. I think this is good advice; build optionality and you will be strongly positioned to make decisions in the future.

<sup>14</sup> Source: Insight, for illustrative purposes only.

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