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CIO letter

EUROPE, *THE FINAL COUNTDOWN*: EXAMINING THE ISSUES SURROUNDING EUROPEAN SOVEREIGNTY

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Ever since war returned to Europe, in conjunction with the harmful effects of the COVID-19 pandemic on the economic model of a continent that is largely open to the rest of the world, we have seen the expression "European sovereignty" used frequently in the rhetoric of leaders and people of influence. Yet, in the context of our history, this expression could be considered an oxymoron. In the dictionary, sovereignty is defined as the exercise of power over a geographic area and the population living there, or as the status of a state that is not governed by any other. In theory, sovereignty therefore pertains to states, whereas Europe itself is not considered as such. But that is not all. Europe is made up of states that have been in confrontation with each other for centuries – militarily, culturally and economically – all to defend their own sovereignty. The term "European sovereignty" is thus in itself an oxymoron. If the European Union had power over the people of Europe, its member states would not be sovereign. It is therefore vital to consider how this notion of sovereignty may be redefined in the 21st century, at a time when the whole world is linked through interactions that, though undoubtedly on the decline, will nonetheless continue to exist. "Sovereignty 2.0" – the kind of sovereignty that may well exist in 2023 for major world powers, such as China, the United States and India – could refer to their ability to trade with their partners while implementing their own principles on their own soil and in their relationships with other nations without having to adjust their values. This implies a certain degree of autonomy, economic resilience, and cultural, scientific and academic influence. Although it is unrealistic to think that states in the 21st century can be entirely autonomous, sovereignty assumes, at the very least, that dependence on others in certain areas can be offset through reciprocity. This is how we will approach the notion of European sovereignty in this letter. When the concept is defined in this manner, Europe's claim to be building sovereignty must be taken as legitimate, given the continent's history, values and current circumstances. The purpose of this letter is to show how the concept of sovereignty can generate considerable economic value for investors.

In this historical context, how might a policy of European sovereignty emerge? How might it continue to exist? What economic value might be generated by such a dynamic? What would this kind of policy actually involve?

We will attempt to cast light on these questions, concluding that **Europe potentially represents a unique investment opportunity amid the radical structural changes that are affecting the global economy**. The title of this letter is much more than a reference for fans of 80s music. Indeed, "countdown" refers to the time bomb imposed on us by the climate crisis, which constrains our development model. We will explain how **Europe has several major advantages in this situation that will allow it to implement a more sustainable economic model, which, in return, will guarantee its sovereignty and generate considerable financial value for investors, who will opt to allocate part of their capital to the continent.**

IS SOVEREIGNTY REALLY THE SOLUTION TO OUR PROBLEMS?

This is a legitimate question insofar as a return to sovereignty may seem paradoxical at the global level. At this key moment in the history of humankind, when the need to find joint solutions is essential if we hope to overcome the threat of our own self-destruction (international collaboration, knowledge sharing and intellectual property reform, knowledge integration, interdisciplinarity), the downturn in markets that increased sovereignty would entail does not seem to be a viable solution. However, the global solution may be to combine local solutions, in the knowledge that building resilience is the only possible way to deal with the excesses of globalised capitalism, which has caused vulnerability through corporate, social, financial and fiscal over-optimisation, the sole objective of which has been to create value for shareholders. We mentioned in our previous CIO letter[1] that a relocation of economic ecosystems might restore the human factor to the economy. Moreover, we remain convinced that restoring the human factor to the economy is the only viable solution if we are to steer our system towards a sustainable model and avoid our own self-destruction. Globalised capitalism in its current form (a quest for infinite growth made possible by the continuous fall in interest rates over the past 40 years and the over-optimisation permitted by globalisation) is dysfunctional to the point that it is threatening the continued existence of human life on this planet. This model has damaged biodiversity and the climate and has deepened inequalities, while fuelling speculative bubbles and the misallocation of capital. By prioritising efficiency over resilience, this model has compromised the long term in favour of the short term. Deglobalisation and higher interest rates will see the search for resilience dominate in the next 20 years. As a result, the growth cycle will be weaker and less optimised, using less leverage and requiring natural resource depletion to be taken into consideration. Extra-financial metrics will dominate financial performance, which is excellent news as large amounts of capital will only be channelled towards virtuous investments if these investments are financially profitable.

Faced with this new paradigm that equates globalisation with vulnerability, companies must build greater resilience by bringing their production closer to consumers instead of basing it in countries with the lowest costs, paying their taxes in the areas where they do business and operating with larger equity cushions and less leverage to cope with uncertainty. "Relocation" and the return of local ecosystems allows us to move towards a more sustainable, less optimised growth model. To build this resilience, businesses, public services and governments must invest heavily in a number of areas, which will constitute megatrends for strong growth in a world of weak growth as they will generate considerable investment needs. This quest for resilience

1. *Economic development, the climate wall and the human factor. Part 3 - The living world*, May 2023

involves creating more local ecosystems while also relocating the production of goods and services closer to consumers. It also implies paying taxes in the countries in which the business operates and using less optimised levels of equity to cope with uncertainty. The age of financial engineering is over. Companies and states that fail to remain consistent in the long term will suffer financial underperformance.

Since the First Industrial Revolution 250 years ago, and particularly since the end of the Second World War, economic growth has admittedly been generated by productivity gains but also, and most importantly, by the rise of two types of debt: financial debt and ecological debt. As a matter of fact, money creation[2] and the massive exploitation of our planet's resources have both contributed to creating a large proportion of economic value. This globalised development model, centred around Western culture, has prioritised efficiency over resilience, global over local, lower prices over higher wages, companies over individuals and standards over human beings. In our previous letters, we sought to show how reintroducing the human factor into the economy could forge a path not only towards a more sustainable economic system, but also towards a reunification of knowledge, which, by considering humankind as a whole, would bring about a rise in consciousness. In those letters, we emphasised our belief in the importance of local ecosystems from an economic and financial point of view, as well as from a social, environmental and governance angle. Because, whether we like it or not, reconnecting with the living world has major implications for business: the social aspect rebuilds human connections (getting to know your tenant or borrower) and restores the importance of local solidarity (mutual aid, solidarity economy, fulfilment from producing and consuming locally); the environmental aspect, for reasons that are now obvious, helps mitigate financial risk (energy savings, insurance costs and thecost of capital in relation to increasing ESG factors); and the governance aspect will prove essential to ensure proper allocation of capital in a context of deglobalisation and ecosystem relocation. **Against this backdrop, the concept of economic sovereignty takes on new meaning. Sovereignty 2.0 is not about withdrawing into ideas of "the nation", but about building the local resilience the world needs to make the transition to a sustainable economic system, which, if successful at the local level, will bring the satisfaction of seeing other geographic areas adopt the same model. Sovereignty 2.0 therefore entails persevering with dialogue and cooperation between geographic areas while also rebuilding more robust local ecosystems to respond to shocks, such as those brought about by the COVID-19 health crisis and the war in Ukraine.**

Sovereignty 2.0 appears to be taking root for a number of reasons. First of all, in 2023, having sovereignty over everything is practically impossible. The cost would be far too high. Not even the United States or China will manage it, despite their best efforts. Why not? Because complete sovereignty would entail a never-ending war for natural resources, which would prove far too costly. Despite rising tensions between the United States and China on the one hand and between all the major economic blocs on the other, some form of cooperation will always be necessary in order to avoid an all-out war for resources, which, in addition to being expensive, would swiftly lead to the total exhaustion of said resources, and ultimately to our own self-destruction. The cost of such an initiative would also mean increased debt for both the United States and China, which would have to be financed by foreign investors (primarily their own trading partners), going against the very idea of striving for self-reliance. Secondly, and again for cost reasons cost, the long-term transition to renewable energy necessitates international cooperation. In the short term, it is possible to remodel the existing system using tried and tested (low-tech) technologies. But in the long term, the advent of new energy sources such as nuclear fusion requires funding on a scale that no single nation is able to supply. Ultimately, an excess of debt around the world (the total debt stands at around three times global GDP), described by Ray Dalio[3] as the end of a long economic cycle, may present us with an opportunity... The opportunity to discourage any country from giving in to the temptation of autarchy. **In this context, it seems possible for Europe to transcend the notion of state sovereignty to build a sovereignty 2.0 at the level of the European Union, which, we remain convinced, will create considerable economic value for investors.**

IS EUROPEAN SOVEREIGNTY POSSIBLE IN PRACTICE?

We are convinced that European sovereignty makes sense in the emerging economic context. But is European sovereignty possible in practice?

EUROPEAN SOVEREIGNTY OR A UNION OF SOVEREIGN NATIONS?

After dominating the world from the Renaissance to the First World War, Europe shaped the global economy in its own image. Its decline since the end of the Second World War appears to be accelerating in the 21st century, as the United States and China compete for economic and monetary hegemony. Of the three major economic blocs, Europe has suffered most from globalisation, although it remains the largest economic area in the world: in 2021, the 27 member states of the European Union accounted for 14% of world trade in goods (second only to China) and 21% of global GDP (second only to the United States)[4]. The diversity of its domestic market and the absence of abundant raw materials across its territory have made it the economic bloc most open to international trade. While the United States has achieved energy independence and enjoys technological, military, and monetary dominance, and China benefits from the size of its

2. CIO Letter - *QEs are eternal...Act 2*, December 2019

3. *Principles for Dealing with the Changing World Order* – Ray Dalio, 2021
4. Source: Eurostat

domestic market, and its dominance in artificial intelligence and in multiple supply chains, including strategic metals refining, Europe appears by comparison to be the poor sibling of the three leading economic blocs. However, we believe that Europe could benefit from deglobalisation, strengthening its local ecosystem and generating considerable potential value, and we will explain why.

To this end, it is relevant to look back at how European civilisations gained the upper hand over others through conquest and colonisation and came to dominate the world after the Renaissance.

In his book *The Rise and Fall of the Great Powers*[5], Paul Kennedy begins by analysing the different forces at work on the continent at the start of the 16th century. This is the period identified by many historians as the beginning of the modern age in an attempt to explain how Europe was able, at the time, to gain the upper hand and dominate every other empire in the world. Circa 1500, the major centres of power were, the Ming dynasty in China, the Ottoman Empire, the Mughal Empire in India, Muscovy, the Tokugawa shogunate in Japan and the group of states in central and western Europe. With the exception of this last group, all the other powers were centralised, to the extent that their governments imposed the same beliefs and practices when it came to religion, trade and arms. Isolation of the elites, conservatism and the repression of any non-centralised initiatives undermined the other empires' ability to innovate. Compared with these great Eastern empires (which travellers' accounts describe as being endowed with extraordinary wealth and undeniable military power) to which Europe fell victim several times, including in 1453 when Constantinople was taken by the Ottomans, Europe appeared fragmented. It was competition between the various kingdoms, intensified by religious diversity as a result of the Lutheran Reformation, that stimulated the innovation and entrepreneurial spirit that drew the region into a virtuous cycle of economic growth and military progress, allowing it to colonise the world.

With the abdication of its last emperor in 476, the fall of the Roman Empire sounded the death knell for European unity; never again would the peoples of Europe be able to come together. The lack of connectivity between European rivers was a geographic barrier to the expansion of trade (despite the Mississippi network being the largest system of inland waterways in the world) and, by extension, to continental unity, particularly around the Rhine barrier. The emergence of Protestantism brought an end to any hope of religious unity. Whilst China, for example, possessed an indisputable cultural unity in the Middle Ages, Europe had to contend with a balance between national powers that fluctuated according to wars and alliances.

5. *The Rise and Fall of the Great Powers* – Paul Kennedy, 1987

“THE WESTPHALIAN ORDER ADOPTED THE PRINCIPLE OF MULTIPLICITY

In his book *World Order*[6], Henry Kissinger, the former secretary of state under the Nixon administration, emphasises the importance of the 1648 Peace of Westphalia treaties in the history of Europe and the world. After several decades of conflict, France and Sweden agreed to negotiate with the Holy Roman Empire. The treaty established the state, as opposed to religion, empire or dynasty, as the cornerstone of the European order. **With it, the concept of state sovereignty was born.** The treaty recognised the right of each signatory to their own internal organisation and religious orientation. There were even clauses stipulating that minority denominations would be able to practise their faith in peace. In this way, **the Peace of Westphalia introduced the principles that would underpin a system of international relations built on the mutual recognition of sovereign states governed by rules and limits, rather than on domination by a single country.** The Westphalian order adopted the principle of multiplicity. From then on, the Catholic Church lost all legitimacy in its desire to unify Europe by suppressing Protestantism. In diplomatic terms, the treaty does not envisage any European reunification on religious grounds. Unity, therefore, can only be achieved through military force. Napoleon was the first European sovereign to attempt unification without availing himself of the legitimacy of the Roman Catholic Church. He crowned himself emperor and refused to be knighted by the Church, which had allowed Charlemagne and Charles V to claim control of the European continent before him. This was later emulated by the Nazi regime, which met the same fate: failure.

Europe, therefore, has always evolved amid a shifting balance of regional powers triggered by armed conflicts. This has ultimately weakened the continent in relation to the United States – an emerging power in the 19th century and a dominant one in the 20th century, thanks in part to the preservation of its territory, which is protected by natural sea borders. Unlike Europe, the United States quickly embraced the notion of national unity during the War of Independence and has only experienced one civil war (the American Civil War from 1861 to 1865). As for China, the unity of its people is rooted in its ancestral culture and its glorious past as the world's largest empire at one point in history. For some Chinese people, this unity is more important than individual freedoms.

6. *World Order* – Henry Kissinger, 1979

Since the fall of the Roman Empire, Europe has not succeeded in achieving unity. **Ever since the end of the Second World War, the notion of a united Europe has been built not on a sense of belonging to a common culture, as is the case in the United States or China, but rather on the fear of history repeating itself after two bloody wars that brought the continent to its knees.** In this respect, the European Union has been a success, as it managed to keep armed conflict off the continent until the wars in Yugoslavia and, especially, the current conflict between Russia and Ukraine. This conflict has marked a resurgence of European sentiment within the Union, forcing extremist parties across the continent to reconsider their position on leaving the EU if they win their respective elections. **Given this, there may well prove to be a firm foundation for the legitimate construction of European sovereignty.**

THE WAR IN UKRAINE AND EUROPEAN SENTIMENT

Let us examine the resurgence of this European sentiment, given that the success of any potential European sovereignty could only be sustained if Europe were to enjoy incredibly high levels of support from its peoples.

However, the political parties in European countries have often used Europe as a scapegoat in order to conceal their own problems. A number of governing parties have often blamed Europe in their political discourse for their own inability to provide solutions to the effects of globalisation. Meanwhile, political parties and sectoral lobbies have equipped the European Union with complex institutions to prevent it from interfering in national affairs, on the one hand, and to open up the European market to trade within a context of globalisation and free trade, on the other. Extremist parties, for their part, have made use of the European bureaucratic structure for scaremongering purposes, suggesting that it threatens the sovereignty of the people. Therefore, the continued existence of European sentiment, which stems from the memory of the horrors of war in the 20th century, cannot automatically be taken for granted. But the return of war to European soil is changing the situation.

Let us now focus on the situation in Germany. In his book *The Shortest History of Germany*[7], James Hawes states that Berlin's geographic location enabled Germany to change course by focusing its efforts both westwards and eastwards. After the Second World War, the European Union and NATO allowed Germany to remain anchored in the West. **But it was the situation in the east of Germany that played a decisive role in the country's political orientation.** Historically, Germany's extremist parties have always found their electoral breeding grounds in former Prussia, which lies in the east of the country. Hitler was elected in 1933 on a massive Prussian vote. Every time that Prussia has given in to the temptation to vote for extremist parties, Europe has suffered a period of political instability that has often led to war. This may be why Joschka Fischer, the Green former vice-chancellor and foreign minister of Germany, published an article in October 2016 entitled "The West on the Brink"[8], which highlighted the common thread between the far-right Alternative für Deutschland ("Alternative for Germany") and the far-left Die Linke ("The Left"): their rejection of Western ties and return to their natural partner, Russia. When stepping down from his role as chancellor of Germany in 1998, Helmut Kohl gave a speech that was heavily loaded with meaning, pointing out that he was the last German chancellor to have experienced the horrors of war. In 2012, the newspaper Bild[9] published an interview with Helmut Kohl in which he expressed his fear that the financial crisis would lead to a reemergence of the temptation to question Germany's foothold in the European Union among younger German generations, citing the greatest legacy of 65 years of European unity: peace. **However, the war in Ukraine has brought an abrupt end to any temptation of continental rapprochement with Russia in Germany. From this perspective, the Russia-Ukraine war represents an opportunity for Germany to anchor itself in the European Union with strong support from its population.**

In other countries in the Union, weak economic growth and rising inequality are leading to the decline of the middle classes and the formation of geographic areas on the verge of economic desertification, with the result that more nationalist parties have risen to power or, if not strictly nationalist, parties that are more extreme in their relationship with the European Union. But here again, the Russia-Ukraine conflict has considerably strengthened European unity. From the very first hours of the conflict, not only did European leaders stand together, but the general population also expressed a deep sense of shared belonging, forcing parties on both the far right and the far left—particularly in France and Italy—to review their positions on European issues, thereby totally ruling out the idea of leaving the Union or even abandoning the single currency.

The return of war to Europe has strengthened European sentiment and forced political parties that are less "pro-Europe" to make concessions to Europe should they come to power in the years ahead (or if they are currently in power, as is the case in Italy).

7. *The Shortest History of Germany* - James Hawes, 2017

8. *The West on the Brink* – Joschka Fischer, 3 October 2016 – https://www.project-syndicate.org/commentary/western-elections-trump-le-pen-merkel-by-joschka-fischer-2016-10?barrier=accesspaylog
9. *Wie soll das Europa der Zukunft aussehen?* – Helmut Kohl for the newspaper Bild, 27 February 2012

A UNIQUE INVESTMENT OPPORTUNITY IN A DEGLOBALISING ECONOMY

The turning point that we have now reached in globalisation opens up a unique investment opportunity on the European continent. This may appear counter-intuitive at a time when Europe has never seemed so vulnerable: energy dependence on Russia, divisions brought to the forefront after Brexit, the large share of exports in the economy, American pressure to restrict growing relations with China, dependence on the dollar for trade, etc. However, the accelerating pace of deglobalisation could offer Europe a unique opportunity to turn these disadvantages into advantages and create considerable potential value for investors compared to other geographic areas. But why?

Of the three leading economic blocs, Europe is by far the most dependent on exports. And with good reason. While it is possible for American and Chinese companies to grow in a vast, homogeneous domestic market, European companies often struggle to expand into the eurozone outside their country of origin. This is likely one of the reasons why Europe does not have an industry leader in the field of technology. Amazon, Google, Tencent and Alibaba all had access to enormous domestic data markets. But the Spanish equivalent of these companies cannot easily access German or Italian data, for example. In some sectors, such as transport, European institutions have also viewed the rise of other European

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industry leaders as a threat to competition. European industry leaders have turned to exports without the benefit of a strong domestic base on a continental scale.

However, due to tensions between the United States and China, the COVID-19 crisis and the Russia-Ukraine conflict, the trend towards deglobalisation is accelerating. Against this backdrop, building resilience means strengthening ecosystems at the local level. This is where the size of the domestic market becomes particularly important. The European Union represents a market of almost 450 million people, one-third larger than the United States. The lack of any homogeneous domestic market has increased the need for rapidly growing European companies to use private equity. Bringing in a partner capable of supporting a national industry leader in its European development strategy is one alternative that hundreds of medium-sized companies might consider. If this partner can provide not just patient capital, but also a dense network of relations in the target countries and local operational expertise, considerable economic value can be generated in Europe, as has already been seen in the United States. Medium-sized companies account for around one-third of jobs and one-third of GDP in Europe. There is, therefore, significant potential for value creation. In a world where “local” is synonymous with resilience and “global” with fragility, Europe has considerable catch-up potential for investors wishing to support entrepreneurial success stories to expand their businesses throughout the continent’s domestic market. Deglobalisation makes the European market an indispensable investment area. **Here, acquisition financing through the private debt asset class is particularly attractive. Financing rapidly growing medium-sized companies helps create European industry leaders, which guarantees significant growth for this asset class on the continent.**

In addition, Europe remains one of the most politically stable regions on the planet, boosting the success of European integration. Despite all the challenges that it is facing in the 21st century, Europe remains a unique location for investment and continues to attract capital from all over the world. Its deeply rooted culture of investment and entrepreneurship is sustained by its rich history and high-performing education system. Young European graduates, who are often multilingual and highly educated, are a fantastic export. The legal systems that govern economic flows are stable. Deglobalisation, combined with the end of a long cycle of falling interest rates, has come hand-in-hand with growing divergence in the paths taken by different geographic regions, which has led to uncertainty. Europe’s stability, despite lower potential economic growth than other regions, makes it a key area for investment.

Lastly, Europe remains one of the only alternatives for global asset allocators seeking to deploy significant amounts of capital by diversifying their portfolios outside the American continent alone. In this sense, the combined depth, liquidity, diversity and stability of the European market represent a virtually unique alternative to North America when it comes to diversifying a global portfolio.

Europe’s potential is clear to see and it is no coincidence that a large majority of the world’s leading asset allocators—from sovereign wealth funds to pension funds—are seeking to increase the European share in their investments. It is now Europe’s turn to show its potential by harnessing deglobalisation to build a more resilient model that will, in turn, create more value. So, what should European sovereignty look like?

Sovereignty 2.0: the European version

"Create, don't compete". These words may spell out the conditions for success of a drive for European sovereignty. At a time when companies are questioning their *raison d'être*, it might be worth rolling out this exercise across the European Union. The United States and China have opted for technological, monetary and military domination in an attempt to hold on to their positions at the head of the global economy. As far as Europe goes, trying to compete in this domain would undoubtedly be most likely to fail.

We should not be under any illusions: in 2023, sovereignty is not the same as autonomy for any country or geographic area, for the reasons that we have explained in this letter. The obligation to sustain a certain level of international trade and scientific and technological collaboration ensures that peace continues in much of the world. Because the absence of dialogue leads to war. For Europe, it will be difficult to go without China for access to the refined rare-earth elements needed to make electric batteries, just as it seems unrealistic to manage without the United States for the cloud or the semiconductors needed to implement artificial intelligence. **European sovereignty, therefore, would involve strengthening the resilience of the economic system and creating centres of excellence that other powers will become dependent on. Dependence on China and the United States is acceptable if Europe can succeed in making itself indispensable in return, both for these two countries and for other major world powers in different areas. This will only be possible if the entire continent comes together, hence the urgent need to establish European industry leaders out of national ones in the fields of excellence of our choice.**

Let us now examine two aspects of European sovereignty in particular: creating areas of global leadership and building resilience.

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WHEN IT COMES TO TAKING EXTRA-FINANCIAL METRICS INTO ACCOUNT, EUROPE HAS A CLEAR HEAD START

IN WHAT AREAS IS EUROPE A WORLD LEADER?

The economic environment in the coming decades will see weaker, less optimised growth, making two conditions necessary to generate financial performance: on the one hand, taking extra-financial metrics into consideration and, on the other, positioning ourselves in several structural growth "megatrends". Every major economic power is striving to carve out a place for themselves in these growth megatrends. But when it comes to taking extra-financial metrics into account, Europe has a clear head start.

EXTRA-FINANCIAL METRICS THAT CREATE FINANCIAL VALUE

How does considering extra-financial metrics create financial value? Our previous three CIO letters[10] break down the firm beliefs that underpin Tikehau Capital's investment policy. Ignoring extra-financial metrics will not only destroy financial value but also generate considerable financial risks. Companies that do not perform well on extra-financial metrics already have access to smaller amounts of capital. Both their financing costs and costs of capital increase , placing them at a huge competitive disadvantage compared to their competitors who perform better on these metrics. We can observe this in our investment activities in debt (private debt and debt traded on capital markets) and in capital (private equity and listed shares), as well as in real estate and infrastructure. Insurance premiums for poor performers are also rising rapidly and the trend is accelerating. Traditional measures of growth and risk are no longer valid, as they fail to take into account the impact of the destruction of value brought about by exploiting labour and finite resources. Reality has caught up with the refusal to consider new measures: **the over-optimisation enabled by the continuous fall of interest rates and globalisation increases margins but undermines the system and heightens risk, threatening to destroy more value than the system creates. The COVID crisis is a clear illustration of this and serves as a warning. Climate change and the social unrest it brings with it will destroy even more value.** In the relatively short term, performance on extra-financial metrics could give companies a valuation premium. As well as generating strong growth, sectors that enable resilience to be built in the economy are likely to be valued more highly.

So, what are the barriers to entry in this area? First of all, it is to be hoped that they will not be too formidable and therefore allow other major economic

10. *Economic development, the climate wall and the human factor – Part 1: Human after all*, September 2022, *Part 2: The good, the bad and the ugly*, January 2023 and *Part 3: The living world*, May 2023

powers to seek alignment once there is sufficient evidence of value creation. But these barriers exist in the first place because, as in any investment strategy, track record counts. It is likely to be easier to take the human factor into consideration in the economy in regions under democratic or non-authoritarian rule. In the United States (at least for now), a deeply rooted, unwavering belief in the free-market capitalist system can be expected to hinder the development of a human-centred growth model. We continue to hope that this dynamic will change, but it will likely take longer to do so than in Europe.

Deglobalisation opens up an alternative path for Europe: the construction of a growth model that is sustainable and more local, allowing its businesses to expand across the whole of the huge European market. As it asserts itself as a global leader in sustainable investment and energy transition, Europe will validate its own growth model and continue to pursue its implementation. Yet, there is increasing tangible evidence that not only does overlooking extra-financial considerations destroy financial value, but incorporating them creates more and more financial value. **This is why, at the risk of going against the grain of current conventional wisdom, we affirm our belief that investing in Europe—a world leader when it comes to considering extra-financial metrics—represents a unique opportunity for value creation.**

At the start of this section, we mentioned the other condition for creating strong financial value in a low-growth environment: taking advantage of certain structural growth "megatrends".

> AS IT ASSERTS ITSELF AS A GLOBAL LEADER IN SUSTAINABLE INVESTMENT AND ENERGY TRANSITION, EUROPE WILL VALIDATE ITS OWN GROWTH MODEL AND CONTINUE TO PURSUE ITS IMPLEMENTATION

By focusing on these megatrends, investors can anticipate returns in line with those that the private equity industry has been able to generate in recent decades amid an environment of falling interest rates and a strong appetite for risk. Of course, all the major economic powers are seeking to position themselves as leaders in the same megatrends. **We have identified two of these megatrends in which Europe is perfectly placed to create more financial value than anywhere else in the world: the energy transition and acquisition finance aimed at turning national industry leaders into European ones.**

ACQUISITION FINANCING WITH PRIVATE DEBT

Financing for middle-market companies is a strategic issue for Europe. These companies account for a considerable proportion of GDP and employment in the region. In this context, direct lending by a private equity fund offers issuers an alternative, from bond issues on capital markets to bank loans. Worth more than 1.5 trillion dollars, one-third of which is in Europe, this global market is rapidly spreading

> INVESTING IN EUROPE—A WORLD LEADER WHEN IT COMES TO CONSIDERING EXTRA-FINANCIAL METRICS—REPRESENTS A UNIQUE OPPORTUNITY FOR VALUE CREATION

across the continent. It primarily, but not exclusively, seeks to finance company acquisitions. First appearing on a large scale in 2010 and backed primarily by large institutions, the financing made available by debt funds has since spread structurally to support both organic and external growth strategies. From what was originally a tailor-made proposal to respond to situations that were difficult for the established financing methods to handle, so too has this approach become a staple, with the benefit of more than a decade of hindsight. **We mentioned the need for Europe to transform national industry leaders into continental ones**. Indeed, many middle-market companies in Europe have built their success on exports to China or the United States. Deglobalisation is weakening this model, especially among the famous German Mittelstand and the highly dense fabric of Italian middle-market companies. In every EU member state, national leaders are looking for ways to consolidate their sector at the European level. At a time when banks are more conservative in granting bullet financing for regulatory reasons and when speed, flexibility and reliability are all essential for an effective strategy, acquisition financing with private equity, when practised in a selective, disciplined manner, is proving to be a significant driver of financial value. Funds acting primarily as sole lenders are also able to include extra-financial metrics in their lending criteria and measure the impact on the investments financed and jobs created. Active dialogue between a lending partner and a borrower (i.e. the human factor) enables considerable flexibility to be exercised when it comes to renegotiating the lending criteria to reflect changing circumstances. This is most likely the reason why the economic slowdown in Europe since 2022 has not affected the volume of transactions in acquisition financing with private equity. On the contrary, deal flow is accelerating because there is substantial demand for strong expertise among entrepreneurs at the European level. The greater the variety of situations and the higher the amount of potential financing through debt funds, the more deeply rooted the virtuous cycle has become, which has broadened and substantiated the range of possibilities for operations supported by debt funds.

THE ENERGY TRANSITION AS A VEHICLE FOR GROWTH IN A SOVEREIGN EUROPE

For companies all over the world, investing in the energy transition offers a genuine competitive advantage, as well as addressing the issue of climate change. The need to relocate production demands considerable investment and entails higher salary costs. Improving energy efficiency in buildings, vehicle fleets, industrial processes and supply chains will allow European companies that relocate and build resilience to remain competitive against their American counterparts, who have access to far cheaper energy. It is clear, therefore, that the energy transition is more than just a nice-to-have gimmick to "greenwash" communication. It is a competitive advantage that grants a licence to operate. Whatever the future may bring for the cost of carbon and the way in which it impacts companies' finances, the rise in the cost of capital, financing and insurance premiums for companies facing operational and reputational risks in this area is a given. If they do not perform well on energy efficiency, companies will lose their competitiveness and financial profitability. What's more, the energy transition creates jobs and thereby represents a factor in energy sovereignty for governments.

In order to attain the objectives set out in the Paris Agreement, six trillion dollars must be invested in the energy transition each year from now until 2050. 80% of this amount must be invested in transforming existing infrastructure, with the remaining 20% to be spent on new breakthrough technologies that will be effective in 10 to 15 years' time. The aim, then, is to earmark capital to improve the energy efficiency of buildings, industrial and agricultural processes and transport, as well as to produce renewable energy. The energy transition must take place over the coming 10 years using existing, low-tech technologies. American domination in high-tech technology is no obstacle to Europe's emergence as a leader in energy transition. Although transforming the European economic apparatus will come at a cost, it will become competitive again within a few years. Indeed, this is why the United States is also seeking to pick up the pace with the Inflation Reduction Act (IRA). **This megatrend will guarantee steady growth for companies capable of providing solutions to transform the existing system. These days, many of those that contribute solutions are located in Europe.**

As we have seen, the energy transition underpins the issue of sovereignty. China produces 90% of the refined rare earth elements needed to manufacture batteries. Europe will never succeed in becoming completely sovereign, but the competitiveness of its industry, agriculture and transport hinges on transforming existing infrastructure, and it can also reduce its energy consumption (a considerable proportion of which is imported) to build resilience. Against this backdrop, it is even more important for climate issues to be made a geostrategic priority. The United States and China will increasingly use the "resources needed for transition" as a weapon. **Therefore, the energy transition represents an opportunity both for extraordinary growth for European solutions providers who are leaders in this area around the world and for building resilience and sovereignty in the European economic system. For investors, this opportunity is twofold: not only can they invest heavily in European solutions providers that are developing global expertise, but they will also experience greater peace of mind when it comes to their investments in every sector in Europe thanks to the enhanced resilience brought about by the continent's progress towards energy transition.**

A MORE RESILIENT ECOSYSTEM

We have seen that Europe can indeed position itself as a world leader in sectors that we are certain will create considerable financial value: impact investing, energy transition and private equity financing to create European industry leaders. In order for European sovereignty to be a success, the other condition is that its economic system must be made more resilient. Several factors will contribute to this resilience.

1 CLEAR CHOICES ON PRIORITY SECTORS AT THE EUROPEAN LEVEL

Designing an industrial policy is about making choices. As we mentioned, full sovereignty will never be possible and the goal in this regard is to make the countries on which Europe depends dependent on certain areas of Europe in return. These choices must be made at the level of the European Union. It is evident that each country has its own issues and priorities. But we believe that the situation in Germany (which we will analyse later on in this letter) is conducive to aligning its national interests with those of the other European Union member states. Forced to speed up its energy transition and defence build-up and to resort to budget deficits to do so, Germany, which accounts for one-third of Europe's GDP, now has an interest in merging its strategy with that of the European Union. In these circumstances, there is hope for a common policy on energy, industry and defence. However, the more joint debt issued by Europe, as we saw for the first time during the COVID-19 pandemic, the more it will adopt a common vision and policy on climate or immigration and the greater the credibility of the euro as a reserve currency alongside the dollar or the renminbi in the multipolar world that is now emerging.

These strategic choices must, however, be realistic. In an opinion column in the newspaper Le Monde[11], the founder of Ekimetrics, a data strategy and artificial intelligence consulting firm in which Tikehau Capital has shares, acknowledges that Europe has fallen too far behind to compete with the United States. Indeed, Europe is comparatively out of its depth when it comes to designers of large language models, but it *is* capable of promoting the emergence of industry leaders that develop generative AI applications. Therefore, governments are responsible for ensuring that their industrial policy decisions do not lead to poor capital allocation.

National initiatives can also be rolled out at the European level. The aviation sector is interesting in this regard. The COVID crisis and grounding of air traffic weakened the supply chains of the major global manufacturers. In Europe, hundreds of small suppliers in the value chain were at risk of dissolution. Thanks to its expertise in the sector, Tikehau Capital is managing a French fund to boost the aviation sector, alongside public investors and large European aerospace companies. This initiative has been replicated in Spain. These funds are intended to consolidate the aviation value chain by building stronger, better-capitalised industry leaders through acquisition. The underlying issue here is the energy transition in air transport, which requires major investment. This type of sectoral initiative in areas in which Europe excels could be rolled out across the continent via public-private partnerships in which governments and European institutions direct private capital towards the investors best-placed to provide the resilience needed to build sovereignty.

2 EFFECTIVE PUBLIC-PRIVATE PARTNERSHIPS

Creating resilience requires considerable investment (energy transition, reindustrialisation, cybersecurity, defence). In a world in which growth will be less and less able to support a large stock of public debt, states and the European Union alone will be unable to fund this endeavour. The methods traditionally used in Europe, which continue to draw the attention of economists to this day—such as debt and taxation—are no longer suitable and offer governments little room for manoeuvre as they have been so frequently used in the past. It is unfortunate that many official reports to governments on these topics remain bound by the straitjacket of debt/taxation mechanisms and are not open to new solutions. Europeans' savings should be used to finance sovereignty by encouraging institutional and non-professional investors to allocate their capital to companies that are able to mould this resilience-building. This is the aim of some of the initiatives launched by member states to direct their insurers' asset allocation to financing the real economy. Measures must also be taken to educate non-professional investors on the benefits of investing in real assets (infrastructure, transformational real estate) and unlisted assets (development capital, private equity).

This public-private partnership also involves joint action from public investment banks in member states and the European Investment Fund (EIF), which do an excellent job not only by supplying capital to professional asset managers working to finance the real economy, but also by creating a knock-on effect on the world's major capital allocators (sovereign wealth funds, pension funds, insurers and private banks). By investing in funds led by selected asset managers, these public institutions encourage major allocators to imitate them, especially when it comes to their rigorous selection and due diligence procedures. This model is especially effective in Europe, where the complexity of the ecosystem may dissuade major asset allocators based in regions far away from the continent. The presence of the EIF or a public investment bank in a member state to support them may provide reassurance.

3 ENHANCING THE ENTREPRENEURIAL MINDSET

In order to guarantee its sovereignty, Europe will also need to rethink the way in which it perceives and rewards economic risk-takers. This is one of the major differences between Europe and the United States, where a successful entrepreneur enjoys a more favourable fiscal and economic environment in terms of financing at every stage of company development, as well being viewed far more positively. Restoring respect for successful entrepreneurs is a challenge for Europe, which will need to make sure it preserves its highly talented entrepreneurial ecosystem.

In this area, Europe has turned a corner in the past 10 years. Major European entrepreneurs have carried their companies to the top of the largest market capitalisation rankings in Europe. LVMH, AB Inbev and Adyen are all examples of this success. These entrepreneurs have themselves supported and nurtured an ecosystem of startups.

The expansion of private equity undoubtedly plays a part in the growth of entrepreneurship. The financial resources on offer to startups and fast-growing companies in Europe are far greater than they were 10 years ago.

11. *Vouloir développer un ChatGPT français ou européen relève du vœux pieux* [A French or European ChatGPT? Wishful thinking!], Le Monde – Jean-Baptiste Bouzige, 13 August 2023

Meanwhile, technology and social media have helped develop an entrepreneurial mindset among younger generations. Courses on how to start a business have become increasingly common in academic programmes, engineering schools, universities and other business schools. Today, these courses are some of those with the highest demand among young people, who no longer dream of working for big traditional companies. Finally, the return "home" of entrepreneurs who have been successful in America or Asia also contributes to reviving the entrepreneurial mindset.

4 DEEP AND EFFECTIVE CAPITAL MARKETS

Europe, as we have seen, is a complex economic area with considerable regional and national peculiarities. It is very difficult for investors who have no presence on the continent, or who have a single European office in London, Frankfurt or Paris, to invest well in Europe. "Good deals have no wheels" is our response here at Tikehau Capital when we are asked why we have opened offices in nine European countries to date. And good deals are in no short supply on this continent, packed as it is with economic and entrepreneurial culture. In Europe, you need to be local—that is, fully integrated into the national and regional ecosystems—and considered a local investor, which effectively places a firm barrier to entry and confers a competitive advantage on those who take this route.

Local connections help build expertise at the European level, allowing companies with a local presence to expand internationally by providing them with a network of offices in several European countries. Only a true understanding of the unique local context will permit European industry leaders to materialise. In this regard, private equity operators have all the tools needed to build European sovereignty in partnership with public institutions.

As for liquid markets, Brexit has clearly contributed to the growth of the financial markets in Amsterdam, Paris, Madrid, Milan and Frankfurt. These financial markets must now introduce initiatives to allow them to accept initial public offerings from unlisted European companies. This is particularly crucial in strategic sectors (technology, cybersecurity, health, energy transition and industry) if we are to ensure that European giants choose to go public in European markets rather than in Nasdaq or Hong Kong. To do so, there will need to be extensive dialogue between banks, financial market operators, venture capital investment funds and development capital investment funds to create a fertile ecosystem akin to the one in the United States. Europe is making excellent progress in this area, suggesting that there is considerable potential for investors to create value.

European sovereignty thus requires efficient capital markets, both listed and unlisted, for debt and equity instruments.

by Renan Devillières

5 INDUSTRY 4.0 – PIVOTING INDUSTRY FOR EUROPEAN SOVEREIGNTY

In the case of Europe, the issue is one of "misindustrialisation" rather than deindustrialisation. Some sectors in which the region has traditionally excelled, such as the luxury goods and agri-food sectors, are rising to the challenge and continue to be world leaders; some are in the midst of a battle for a contested leadership (space, aerospace, pharmaceutical and energy); others find themselves with their backs to the wall (automotive) and others have simply ceased to exist (textile, semiconductor). The COVID crisis showed us all just how weak supply chains can be if they are too globalised or stretched too taut in a world as uncertain as the one we currently live in. Given this situation, what can Europe suggest to an industrial sector that has long been undervalued and a public opinion that puts reindustrialisation among the eurozone's top three priorities?[12]

Let us begin with a little history. The Second Industrial Revolution, which began in Britain and France in the 19th century, was the direct consequence of a major technological disruption. The steam engine, followed by electricity, allowed physical operations once carried out by men to be mechanised. The social and economic upheaval brought about by this revolution was extremely violent; a group of terrorists called "Luddites"[13] even went as far as to destroy equipment at night to protest against this new normal. After a chaotic thirty-year period, Henry Ford invented a new production system known as Fordism, which rapidly came to structure global production. The social and economic model tailored to this technological disruption had not long been discovered and would spread over the subsequent 50 years.

The Third Industrial Revolution, a concept coined by Jeremy Rifkin, is the product of technological disruption, automation of repetitive and non-repetitive intellectual tasks and practically free circulation of information. It is subject to one constraint, however: planetary boundaries. On Rifkin's own admission, the world is currently experiencing a period of chaos and the production model to fit this latest disruption has yet to be found. Who will be the contemporary Henry Ford? What is the production model of our time? And the social and environmental model? What role will European sovereignty play in this production model?

Firstly, as this letter has shown in its entirety, full sovereignty is an illusion. The aim is therefore to select sectors and systems, protect interests, choose allies (or, failing that, friends), catch up where necessary and ensure that the European market offers a coherent vision for its industrial sector.

12. https://www.europarl.europa.eu/RegData/etudes/STUD/2021/653626/EXPO_STU(2021)653626_EN.pdf
13. https://journals.openedition.org/labyrinthe/2763?file=1

ON SELECTING SECTORS AND SYSTEMS:
European opinion is the most sensitive to environmental and social issues in the world. Local and international industry leaders could emerge from the need to create a production model that is consistent with public expectations. For example, even its competitors admit that Michelin, the world leader in tyre manufacturing, is "10 years ahead". The company is developing the "Tyre-as-a-Service" model, inserting RFID chips into its tyres and selling kilometres to its business clients, allowing Michelin factories to reduce the number of tyres produced, lower their carbon footprint and obtain considerably higher profits! This pivot towards circular production models, which make manufactured products more innovation- and technology-intensive, is an incredible driver of growth for Europe, as well as being aligned with its strengths[14]. A proactive policy to invest in this trend could lead to the continuation and emergence of future economic giants. Perhaps there will be multiple European Fords to show us the way towards a new production model.

ON PROTECTING INTERESTS:
At a time when global fair play is on the decline and economic warfare is intensifying, Europe can emerge stronger than ever by creating incentives not to favour underperforming local players, but to foster a local production model that is consistent with the population's aspirations. The American bloc has already dealt a heavy blow with the Inflation Reduction Act, which has brought large swathes of sectors back under the power of the dollar[15]. The Chinese bloc is injecting huge amounts of money into a proactive investment policy, while India has already taken over as the United States' new industrial ally. In this fast-changing environment, Europe can opt to breathe fresh air into its industrial sector with a kind of Green New Deal based on consistent rules and a clear environmental agenda[16].

ON CHOOSING ALLIES (OR EVEN FRIENDS):
The COVID crisis was a grim reminder that industry is built around dependencies, which are shaped by geopolitics. The companies that best weathered the supply chain crisis were not those with a strictly vertical structure, but those that had established the most meaningful relationships and obtained the most detailed knowledge of their suppliers and dependencies[17]. Europe, with some of its largest companies, is uniquely placed to be a global champion of this new normal, where the balance of relationships between nations and interests has become critical. Let us not forget that France is the only country capable of introducing a global oil giant to the world without any oil being present in its soil! Under this new production model, soft power may become increasingly important.

ON CATCHING UP:
In Europe, much of the infrastructure that is vital for a coherent economic bloc is non-existent or suffering from under-investment. In cloud computing, artificial intelligence, battery manufacturing and electricity production, European giants are necessary for genuine reindustrialisaton. How so? Because cloud computing is crucial in modern factories (in a Tesla factory, it accounts for 24% of software costs, compared to the European average of 3%), because artificial intelligence has become an inevitable component in the mechanisation of processes and R&D, because batteries will be needed in the drive to electrify all production processes and because affordable electricity is key to achieving satisfactory levels of industrial competitiveness. In these sectors, Europe is beginning

14. https://www.michelin.com/en/press-releases/michelin-receives-top-100-global-innovators-2022-recognition-by-clarivate/
15. https://www.mckinsey.com/industries/public-sector/our-insights/the-inflation-reduction-act-heres-whats-in-it
16. https://www.europarl.europa.eu/thinktank/en/document/IPOL_IDA(2023)740087
17. https://www.euronews.com/next/2023/02/15/from-chains-to-webs-businesses-rethink-their-supply-strategy-to-face-up-to-global-crises

to accept that it is catching up rather than leading. Proof of this can be seen in the ongoing race to host Asian gigafactories[18] with a view to onshoring expertise and production capacity and in the ability of visionary investors to tempt the French, former GAFAM executives, back from Silicon Valley to establish European industry leaders in artificial intelligence. This movement will continue to grow and increasingly recreate the conditions needed to reindustrialise the bloc.

ON A COHERENT VISION:
Nicolas Dufourcq's book *La désindustrialisation de la France* (Deindustrialisation in France) is a captivating read. Looking beyond technical expertise and targeted investment, the author observes that there is a lack of a coherent, shared vision of the new industrial sector at the French and European level. The vision that was predominant in the 1980s – "the world is flat" or Serge Tchuruk's "fab-less" – was based on a litany of ill-considered assumptions: it refused to acknowledge the environmental and social debt caused by a production model that was incompatible with public values and, rather condescendingly, believed that high added-value activities would be captured by countries with high labour costs, while "developing" countries would remain static. This vision has since been discredited, but the conceptualisation of what a production system that is consistent with a social model should look like is still in its infancy. As we wait for this new vision to emerge, our physical distance from industry has served as a means of delegating efforts to address this complex issue to others.

Neo-industrialists such as Ynsect, Mob-Ion and Backmarket have brought renewed momentum, proposing a new, more circular, more accountable, more equitable, more local vision of industry, which immediately aroused enthusiasm among consumers and the public. Europe is more than capable of inventing this new paradigm by creating more virtuous, more local ecosystems: entrepreneurs are available and capital will follow. The ongoing structuring of the European ecosystem around a series of core values and the presence of the technological infrastructure needed to invent this new model could well give rise to the future champions of this new normal and may even have an impact that reaches far beyond Europe, attracting other global hubs to a more desirable model.

18. https://cepa.org/article/europe-races-to-build-gigafactories-lithium-permitting/

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> **IN THE 21ST CENTURY, THOUGH, DATA HAS BECOME THE RAW MATERIAL FOR VALUE CREATION**

Europe's future will no doubt entail re-industrialisation or onshoring production to boost companies' resilience and create jobs. Reindustrialising means deciding what your priorities are and accepting that you cannot be good at everything. National industry requires strong demand, either stimulated by public procurement or by changes in corporate purchasing policies that support the development of a framework of local ecosystems. A change in individual behaviours that favour national industry is also part of the equation. The challenge that has arisen in this industrial renaissance is how to also reshape our system, which the crisis has revealed to be running out of steam. The crisis has revived the desire to produce, invent and innovate in Europe. This means investing in modernisation, as well as digitalising production processes and supply chains, but it also entails exposure to cyber risk. This is why cybersecurity must form part of any 21st-century industrial policy.

6 COULD CYBERSECURITY BE THE FOUNDATION STONE OF EUROPEAN SOVEREIGNTY POLICY?

The second industrial revolution came about when coal was replaced by oil. Oil's incredible energy efficiency made it possible to produce more machines and make them more powerful. According to Matthieu Auzanneau in his book on the history of oil, as soon as oil demonstrated its remarkable ability to create scale effects in production, the subjugation of entire societies became superfluous: all it took to gain access to oil concessions was to secure the support of a few tribal chiefs. The modalities of colonial control then passed from the military to the capitalist order[19]. In the 21st century, though, data has become the raw material for value creation. Just as most wars in the 20th century can be interpreted through the lens of oil, the future conflicts of the 21st century will likely revolve around technology and data, as illustrated by tensions around Taiwan and its position as a leader in semiconductor production. Collecting and using data creates economic value and there is even more money to be made when the quantities involved are huge. When it comes to cybersecurity, not only are China and America dominant, Europe is also politically weak on matters concerning the economy. There is no consensus among Member States on the need to implement a genuine industrial policy fostering the emergence of a European digital industry. While France and Germany speak of "digital sovereignty", northern European countries advocate for a much vaguer notion of strategic autonomy and see Europe merely as a market.

19. *Oil, Power, and War: A Dark History*, Matthieu Auzanneau, 2015

Yet **the need to build resilience is evident in the realm of cybersecurity**. Technology is ubiquitous in our everyday lives and this only raises the stakes around cybersecurity. Cybersecurity risks, alongside issues of public health and climate change, likely represent some of the issues that affect more people alive today than any other. In April 2021, the Chair of the US Federal Reserve cited cyber-attacks as the greatest risk to the stability of the global economic system. **From a European perspective, the expected inclusion of cybersecurity in the European social taxonomy is proof that this sector is central to the construction of more resilient ecosystems**. All economic actors are going to have to invest heavily in this area if they are to build resilience.

Despite its internal differences, Europe has laid the foundations for a unified vision of digital space based on a rejection of the commoditisation of personal data and mass surveillance. Beyond these key principles, the European Union has taken various steps and passed numerous pieces of legislation in the digital field, such as GDPR[20] and the Cyber Diplomacy Toolbox[21]. The recently adopted Digital Services Act[22] modernises the Electronic Commerce Directive of 2000 and the Digital Markets Act of October 2022[23] governs the commercial practices of online platforms, which play a part in building sovereignty in this area. In terms of industrial standards, the Cybersecurity Act, which entered into force in 2019, has established a cybersecurity certification framework that applies to all IT products, services and processes. Meanwhile, the Gaia-X project aims to create an interoperability standard to facilitate the exchange of data between cloud platforms to develop a "data economy". The crisis in Ukraine will likely end up bolstering European cohesion in the area of cybersecurity, despite the United States' extraterritorial impulses, which it will attempt to impose by monetising its dominant position in cloud computing and artificial intelligence.

The cybersecurity sector is made up of a large number of start-ups and medium-sized unlisted companies financed by private equity funds. **Alongside these small companies, a few large listed groups round out the cybersecurity ecosystem. Given its incredibly rapid growth, this ecosystem is not yet mature. Just like the transition to renewable energy, the sector represents a megatrend, making it a unique investment opportunity.** The global cyber ecosystem employs 3.5 million people but still needs around 3 million more employees[24]. Universities will struggle to train such a large number of specialists in a short space of time, exacerbating the critical need to automate cyber processes and leverage artificial intelligence to make up for the lack of human specialists. There is thus a huge need for investment in this area and Europe's cybersecurity capability is being forged through a close-knit web of relationships between capital providers, the public sphere, start-ups and large groups.

20. General Data Protection Regulation
21. https://www.iss.europa.eu/sites/default/files/EUISSFiles/Brief%2024%20Cyber%20sanctions.pdf
22. https://en.wikipedia.org/wiki/Digital_Services_Act
23. https://www.skadden.com/insights/publications/2022/10/eu-digital-markets-act-enters-into-force
24. https://www.weforum.org/agenda/2021/01/top-cybersecurity-challenges-of-2021/

7 ENERGY-EFFICIENT BUILDINGS AND FINANCING FOR SMALL-SCALE INFRASTRUCTURE: A KEY ELEMENT OF SOVEREIGNTY

Buildings account for 40% of Europe's total CO2 emissions. In economic terms, that adds up to a considerable energy bill. In Europe, the COVID crisis has triggered lasting changes in people's behaviour: out-of-town shopping centres are struggling to attract customers, businesses are opting for smaller city-centre offices coupled with remote working rather than bigger offices in outlying suburbs, e-commerce is changing logistical requirements, new forms of mobility are reshaping urban traffic flows and so on. All of this means it makes even more sense to buy assets that are not adapted to this new reality in high-quality locations and transform them into new solutions in the form of mixed-use zones that blend together offices, residential space, retail units and utilities. Indeed, this kind of transformation helps create green spaces and make buildings more energy-efficient, offering a solution that helps relieve traffic congestion and protect biodiversity in urban areas. Energy efficiency in buildings, coupled with the redevelopment of urban spaces to optimise traffic flows and introduce biodiversity-rich areas that help regulate urban temperatures and build resilience to climate events, is not only a key element of European sovereignty, it is also a source of global expertise that can help leading companies attract international talent and represents a considerable investment opportunity for investors. Europe is at the cutting edge in these areas and is already exporting its expertise.

Moreover, the success of the transition to renewable energy depends on the installation of small assets at the local level (such as heat pumps, agrivoltaic solar farms and electric battery charging points). Financing these small assets is a complex business for banks because of their granularity and specific local requirements. But converting end users is the key to a successful transition. Enabling end users to access this type of infrastructure through service agreements frees them from the need to own their own infrastructure, ownership of which can then be pooled. Combining these small assets into vehicles financed via a pooled fund offers investors an attractive risk/reward ratio and facilitates the large-scale development of these types of small infrastructure. In this field, the innovation brought to the table by the asset management industry is a strategic advantage and an aspect on which Europe is once again far ahead of the pack.

8 AGRICULTURE AND BIODIVERSITY

Following the Second World War, one-third of the world's population did not have enough to eat. Priority was rightly given to mass agricultural production by industrialising tasks that were still carried out using traditional methods in many geographic regions. This trend helped increase agricultural yields through the creation of large farms and the large-scale use of water and chemically produced products. But these practices also damaged soil: in 2023, 40% of farmland was considered degraded[25]. As well as depleting soil, destroying biodiversity and lowering the economic value of land, these practices have resulted in farmers taking on huge debt burdens to be able to purchase equipment, water, pesticides and optimised seeds. For the past few years, major agri-food and textile groups have been focusing their efforts on shifting the agricultural model onto a more sustainable footing through regenerative agriculture based on restoring soil vitality and making careful use of water and chemicals. One example is Unilever, which has joined forces with Tikehau Capital and AXA to make equity investments in innovative companies working on soil regeneration, biofertilisers and new agricultural technologies. These types of partnerships between major European groups and capital providers can help make agriculture more resilient not only in Europe but also in the world's other major farming regions. This new model reduces dependence on imports of chemicals and farming equipment, lowers public health costs, regenerates natural ecosystems—making them less vulnerable to extreme weather—and even facilitates social progress by restoring short supply chains and rebuilding local solidarity. It also plays a part in creating future European industry leaders in the domain of agricultural technology.

Monetising natural assets could also become an area of European expertise. Pioneers in this field include AXA Climate and Idverde, both of which are looking at how natural areas not used by their owners or considered constrained (e.g. green spaces around airport runways, railway lines and military sites) might be used to reintroduce biodiversity. In this way, what we might call "activating nature" can itself, if carefully thought through, create financial value.

Agricultural security is a necessary prerequisite for European sovereignty. However, by focusing on restoring biodiversity through regenerative farming and the monetisation of natural assets, Europe could extend its leadership well beyond the sphere of agriculture alone. This kind of sovereignty could deliver a high social impact and a sure financial impact by lowering public health costs and reducing subsidies for a sector restored to equilibrium.

25. *Global Land Outlook – United Nations Convention to Combat Desertification* – UNCCD, 27 April 2023

9 A COHERENT MIGRATION POLICY

As Europe's population ages, its economic challenges also hinge around migration flows. If its industry is to remain competitive, Europe must reckon with the demographic headwinds it faces. Philosophically open to the world and geographically more exposed than China or the United States to huge waves of immigrants from developing countries, Europe as conceived by the architects of the Schengen Agreement is currently being tested by migratory flows from Asia and Africa, exacerbated by neighbouring military conflicts, climate disruption and religious issues. Against this backdrop, can the spirit of Schengen withstand the new reality? The consequences in terms of labour, inflation, electoral support for extremists and religious conflict in secular states are huge. On this issue of selective immigration, the United States and China have adopted positions that are simple yet radical. Europe could adopt an effective migration policy that would help reinforce its sovereignty. At a time when labour costs are rising and accessing cheap energy is harder than ever, European firms are going to have to make strategic choices. Despite the appeal of some geographic regions, which now include the United States (thanks to its access to cheaper energy, subsidies under the Inflation Reduction Act and the depth of its capital markets), offshoring production is not conducive to sovereignty. Businesses are left with the options of using immigrant labour or investing massively in technology, first and foremost artificial intelligence. The answer probably lies in a combination of the two, but that presupposes an effective migration policy. Despite the major challenge posed by immigration, Europe must establish itself as a model for welcoming and integrating immigrants. This will mean upgrading its training and education systems at a time when other powers are closing their borders and falling prey to the temptation to retreat into protectionism.

Germany at the heart of European sovereignty

Germany accounts for around one third of eurozone GDP. It is impossible to talk about European sovereignty without taking an interest in the dynamics that drive this great country. And it is impossible to talk about the situation in Germany without mentioning a European dilemma that arose at the end of the Second World War and has remained constant ever since: the competing pull of Eurasia and America[26]. Germany's geographic location puts it at the nexus of these competing forces. Since reunification in 1990, which also marked an acceleration in globalisation as the Iron Curtain came down, Germany has built its economic prosperity on a model that blends Atlanticism with Eurasian development. By using cheap Russian gas to make high-quality goods that it mainly exported to China while enjoying American military protection, Germany avoided having to invest capital in defence while also buying cheap energy that enabled its industry to generate comfortable margins. Its lack of a budget deficit, modest debt and undisputed European dominance made Germany the cornerstone of Eurasian dynamics, along with Russia and China. These three countries alone account for no less than 18% of the earth's surface and 24% of global GDP. Unlike other countries, then, Germany has been able to benefit hugely from globalisation. Between 2005 and 2021, a period that corresponds to Angela Merkel's 16-year stretch as chancellor, Germany's GDP increased by 50% and its unemployment rate halved. Mid-sized German companies (*Mittelstand*) export their products all over the world, ensuring that Germany has a large trade surplus not only outside the European Union but also within it. The single currency has enabled this economy—more productive than

26. *CIO Letter – "All under heaven": a perspective on the Sino-American rivalry*, January 2022

any other in the region—to win market share throughout the eurozone without having to manage the relative strength of its currency. This position has also given rise to tensions within the European Union with regard to struggling countries (such as Greece in 2011), undoubtedly playing a part in slowing the process of fiscal union.

But tensions between China and the United States, the COVID crisis and the Russia-Ukraine conflict have caused globalisation to go into reverse, simultaneously sabotaging just about every aspect of the German model. Access to Russian gas has been cut off and the Chinese market is becoming more competitive with the emergence of local companies able to compete with German firms in the automotive sector, chemicals, industrial machinery, etc. Germany must now strengthen its security by budgeting substantial amounts for military expenditure at the very time when it also needs to finance a rapid transition to renewable energy. German exports accounted for a smaller share of global trade in 2022 than they did in 2004 or even in the year of reunification[27].

At the same time, the Franco-German axis seems to have become less fluid. The challenges faced by Germany are forcing it to reckon with complex bilateral relations with the United States, China and Russia, often provoking incomprehension in Paris, which is of the opinion that Berlin should be putting all its energy into bolstering Europe's strategic autonomy. European sovereignty is thus heavily dependent on the competing forces impinging on Germany, caught between a pro-European policy and its own domestic interests, which consist of carefully managing the three aforementioned major powers. When it comes to buying military equipment, will Germany play the European card or will it choose to prioritise its relationship with Washington? The same question applies to its supplies of energy and the metals it needs for the transition to renewable energy: will it favour a shared European policy or play the domestic card?

As regard to international influence, it would be in Europe's best interest to strengthen its strategic autonomy: the war in Ukraine has demonstrated the weakness of domestic military resources in terms of both manpower and equipment. A single European defence equipment strategy would be a lot more credible than a slew of domestic initiatives. Similarly, at a time when gradual deglobalisation is giving rise to tensions in areas that remain the cornerstone of global supply chains, chiefly the Indo-Pacific region, Germany owns 20% of the world's container shipping capacity but has no capacity to project military power, whereas France has both territories and forces in the Indo-Pacific region.

The economic and geostrategic situation facing Germany is thus radically different from that on which it has built its undeniable success since reunification.

27. *Les ambitions inavouées, ce que préparent les grandes puissances* [Hidden ambitions, what the major world powers are up to] – Thomas Gomart, 2023

Building resilience should be the number one priority for a country that has built its economy on exports thanks to a competitive advantage derived from cheap imports of Russian gas and a lack of defence costs thanks to American protection. As an example of the bind in which Germany now finds itself, consider the gas deal with Russia, which was struck in 2005 at a time when Germany and France were both opposed to US intervention in Iraq. Nord Stream 1 began operating in 2012 and Nord Stream 2, which was set to double the volume of gas imported, was completed in 2021. At a NATO summit in 2018, President Trump voiced his opposition to the project, reiterating that the United States contributed 70% of NATO's budget and claiming that Germany was "totally controlled by Russia"[28]. **This skirmish is indicative of the pressures on the German model in 2023, with war raging just a few hundred kilometres from Germany's eastern border.**

28. *Les ambitions inavouées, ce que préparent les grandes puissances* [Hidden ambitions, what the major world powers are up to] – Thomas Gomart, 2023

It is imperative that Germany upgrades its economic model, which has become vulnerable as a result of deglobalisation and the quest for resilience by the very powers with which it built that model. While the challenge is substantial, every crisis harbours an opportunity: at the European level, this situation could foster the emergence of a true policy of European sovereignty. If Germany is to maintain its industrial competitiveness, the foundation stone of its social stability, it must adopt a new energy policy: Europe is probably the answer. Germany must rearm: Europe is one of the two major options. Germany must reinvent its relationship with China: while it could, of course, choose to play its own hand, the prospect of a multipolar world including emerging giants like India, Brazil and, very soon, Indonesia and Pakistan (which have a population of 500 million between them) means European integration (450 million citizens) would give Germany a much louder voice with the world's future leading economic power. Germany must prepare for the future post-conflict stabilisation of Ukraine, the answer probably being its integration into the European Union. **In a multipolar world, Germany, which will quickly lose its status as the world's fourth-largest economic power to India, has every interest—as do France, Italy and the rest of the EU countries—in playing the European integration card to create the resilience it needs to secure its future.**

From a financial standpoint, the need to finance both its transition to renewable energy (to throw off its dependence on Russia) and its rearmament mean Germany is probably going to have to contend with a structural budget deficit. Paradoxically, this could be good news for the future of European fiscal policy. In having a budget deficit, Germany will be joining the other major eurozone countries, which means interests will be more aligned within the European Union when it comes to issues of debt. The single European currency was launched in return for France agreeing to German reunification in 1990. Today, the eurozone must reckon with 20 budgets that share the same currency (Croatia joined the zone in January 2023), upsetting the balance between structurally different economies. Germany, better disciplined than its European partners, made the most of this situation by exporting industrial goods to its partners—goods that had once again become competitive thanks to the integration of the former GDR in 1990—which enabled industrial firms to take advantage of more competitive local labour, and subsequently to the sacrifices made by German workers following the implementation of the Hartz reforms in 2005 and during the 2009 economic crisis. German workers opted to keep their jobs at the cost of agreeing to wage concessions so as to keep the unemployment rate low. This meant the German economy was able to benefit from the single market within a eurozone whose other economies were far less competitive. Consequently, Germany was able to export its unemployment to other eurozone countries.

The issuance of debt by the European Commission under its plan to revive Europe's economy following the COVID crisis is a useful first step towards union. The COVID crisis in 2020, followed by the Ukraine crisis in 2022, have thus fashioned a new European economic, political and cultural cohesion, cementing a genuine sense of shared belonging and laying the groundwork for a true EU-wide industrial policy.

UNITED KINGDOM, UKRAINE AND RUSSIA: THE UTILITY FUNCTION OF NEIGHBOURS

Three of the European Union's neighbouring countries have undergone radical change in the past few years, with major implications for the trajectory of Europe.

The United Kingdom completed its withdrawal from the European Union in January 2020, when the withdrawal agreement was ratified by the House of Commons and the European Parliament. Since then, the United Kingdom has been attempting to reinvent its model against a backdrop of high inflation and economic slowdown. Brexit could have triggered a negative trend in Europe by discouraging support for the European project, but the sharp economic slowdown in the United Kingdom and the Russia-Ukraine war have combined to prevent this sentiment from spreading. On the contrary, Brexit has accelerated the internationalisation of major European cities like Amsterdam, Paris, Milan, Madrid and Frankfurt, with executives of all nationalities—including European—arriving in these cities and strengthening the sense of belonging to a shared culture. It appears increasingly clear that the United Kingdom's future will, despite Brexit, be largely dependent on European cooperation, probably inspired by a model like the Swiss one or the European Economic Area that binds the European Union to Norway and Iceland.

To the east, we have seen how a hostile Russia has helped strengthen the sense of European belonging, with the probable result that Germany will remain firmly anchored in western Europe.

As for Ukraine, while the Russia-Ukraine conflict is nowhere near close to being resolved, a day will come when the region will once again be at peace. Ukraine could then join the European Union, where it would constitute a high-growth region and reconstruction could offer an opportunity to build an industrial and agricultural base that is high-performing and efficient in terms of both energy efficiency and the use of digital production processes. The European Union would thus count among its ranks an "emerging country" (in the sense of a country undergoing reconstruction), driving strong growth and serving as an industrial and agricultural test bed to help meet the technological and climate challenges of the 21st century. In the long term, Ukrainian membership within the European Union would represent considerable economic growth potential.

Conclusion

> THE ISSUE OF SOVEREIGNTY REQUIRES US BOTH TO CONSIDER THE LONG TERM AND TO ADOPT A BIG-PICTURE VIEW

The issue of sovereignty requires us both to consider the long term and to adopt a big-picture view. In our democratic societies, governments face two major challenges that reflect the challenges facing humanity more broadly. The first is the challenge of taking the long view at a time when overly short electoral mandates and pressure created by social and traditional media hype are driving increasingly short-term decision-making. Yet major decisions concerning capital allocation and industrial policy call for a multigenerational perspective. The second challenge is that of opting for a holistic view by pooling learning, decompartmentalising knowledge and avoiding goals that are too narrowly framed. This is particularly important for a successful transition to renewable energy. Making the right capital allocation decisions and strategic choices requires looking not at the direct impact of those decisions on the chosen benchmark (e.g. the number of electric cars on the road or CO_2 emissions from industry within a particular geographic region) but at their implications for the ecosystem as a whole (e.g. the environmental impact of battery production or the relocation of polluting industries if emissions are only measured across one geographic region). Avoiding self-destruction will necessarily require taking a holistic view, which presupposes making broad-spectrum decisions and fostering dialogue between scientists from different disciplines (medicine, biology, chemistry, physics), neither of which is currently happening.

> EUROPE HAS THE OPPORTUNITY TO CEMENT ITS SOVEREIGNTY BY BRINGING A MORE SUSTAINABLE GROWTH MODEL, FOCUSED ON RELATIONSHIPS WITH THE LIVING WORLD, TO THE GLOBAL TABLE

> BRINGING THE ANTHROPOCENE TO A CLOSE BY ADOPTING A MODEL FOR ECONOMIC DEVELOPMENT THAT PUTS RELATIONSHIPS WITH THE LIVING WORLD AT THE HEART OF THE ECONOMIC EQUATION WOULD BE A FITTING MILESTONE IN THE HISTORY OF HUMANKIND AS IT SEEKS TO SURVIVE ITS OWN SELF-DESTRUCTIVE URGES

Despite these constraints, the development of European expertise in extra-financial matters and its incorporation into the economic value creation process gives Europe a sure advantage in an economic environment of slower and less optimised growth. European firms carry less debt and the need to create European industry leaders generates the potential for economic re-optimisation in a more local environment. Europe has the opportunity to cement its sovereignty by bringing a more sustainable growth model, focused on relationships with the living world, to the global table. What makes this more achievable in Europe than anywhere else is the values on which European culture is founded and the excellence of European training and education.

The Anthropocene[29] began in Europe—in the United Kingdom, to be precise—with the Industrial Revolution and the advent of large-scale coal mining. Ever since then, economic growth has come at the cost of mounting ecological debt fuelled by the intensive exploitation of resources.

Since Europe is running out of fossil fuel resources, it must remain at the vanguard of the transition to renewable energy if it is to develop its sovereignty; whether this is an irony of history or a fitting reversal is a matter of debate. Bringing the Anthropocene to a close by adopting a model for economic development that puts relationships with the living world at the heart of the economic equation would be a fitting milestone in the history of humankind as it seeks to survive its own self-destructive urges. Will Europe have what it takes to rise to this ultimate challenge? European sovereignty depends on it. If it succeeds, the economic value created for investors will be considerable.

29. A proposed geological epoch said to have begun when humankind's influence on geology and ecosystems became significant relative to the Earth's history as a whole

At this stage in its development, Tikehau Capital mainly invests in Europe. The new economic landscape strengthens our conviction that, contrary to the messages being sent out by faraway actors, this geographic region constitutes a unique investment opportunity. With nine European locations enabling it to identify investment opportunities at the local level, Tikehau Capital has succeeded in innovating and establishing itself as the European leader when it comes to investing in the energy transition, cybersecurity, private debt financing for acquisitions, small infrastructure financing to improve energy efficiency and the transformation and management of real estate assets with a focus on energy efficiency. To round out the range of investment vehicles we offer our investors, we plan for our convictions to be reflected in an equity strategy that is dedicated to European sovereignty.

At a time when businesses are having to think about their *raison d'être*, it may be worthwhile for the European Union of the 21st century to do the same. The US and China have placed their bets on technological, monetary and military dominance as the way to secure or hold onto their global leadership. Is it really essential that Europe follow suit, even if the probability of failure is high? The "managed democracy" model espoused by China and Turkey prioritises economic development or certain strategic challenges, while individual liberties are sometimes sidelined. This model appears to be gaining traction in developing countries where the Western model of liberal democracy is no longer admired as much as it once was. Should Europe follow the trend or affirm its own *raison d'être*, which lies in its uniqueness, its rich cultural heritage and its excellence in certain fields? **Just as thinking about its *raison d'être* can help a company anchor its culture and prevent it from being carried along with the tide towards practices that are not aligned with its values, a similar exercise at the European level will help Europe avoid drifting towards the pitfalls of nationalism, protectionism, climate scepticism or simply cynicism and short-termism.** Although pursuing such a course will be no easy feat and will require a good deal of education and learning on the ground (which calls for a degree of political courage and a willingness to take risks), it is a critical exercise if Europe is not only to affirm its sovereignty and continue to exist and serve as an inspiration in the 21st century, but also to attract global savings to finance the real economy and maintain the social stability on which its democratic model depends.

European sovereignty will be built on a sustainable economic model that is focused on relationships with the living world and is particularly well suited to the economic and climate situation. Because this model is the only possible way to prevent humanity from being wiped out, Europe will export it and, in doing so, affirm its sovereignty. The economic value thus created will be considerable.

"EUROPEAN SOVEREIGNTY WILL BE BUILT ON A SUSTAINABLE ECONOMIC MODEL THAT IS FOCUSED ON RELATIONSHIPS WITH THE LIVING WORLD AND IS PARTICULARLY WELL SUITED TO THE ECONOMIC AND CLIMATE SITUATION. BECAUSE THIS MODEL IS THE ONLY POSSIBLE WAY TO PREVENT HUMANITY FROM BEING WIPED OUT, EUROPE WILL EXPORT IT AND, IN DOING SO, AFFIRM ITS SOVEREIGNTY. THE ECONOMIC VALUE THUS CREATED WILL BE CONSIDERABLE

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