Investment Outlook

LET'S GET PHYS(I)CAL

We think the market has likely entered a new chapter. A softer stance on tariffs from the Trump administration has reduced growth and inflation risks while (re)energizing systemic confidence in the US system. We expect the market to look through any likely short-lived loss in growth momentum and/or a pickup in goods inflation that is likely to materialise by the end of H1 amid lingering tariff tensions. Going into H2, we believe the focus will shift to the ramifications of the fiscal bill currently under discussion in Congress for growth, inflation, and the Fed. While the size and composition remain highly uncertain at this stage, we expect the market to begin entertaining the prospect of higher equities, yields, and USD.

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Completed: 19 May 2025

RATES
UST

We remain tactically NEUTRAL. We shifted mechanically to NEUTRAL from MODERATELY LONG at the end of April as 10Y UST yields fell below our take-profit level of 4.20%.

We still believe the next move will be upward. However, compared to last month, the forces driving this shift have broadened and diversified:

1) Trade tensions are de-escalating rapidly. The new global trade equilibrium is likely to be less favourable than the pre-US election period, yet far more functional than the scenario once threatened by the Trump administration on Liberation Day.

2) As corollary to #1, we believe that concerns over de-dollarisation have declined significantly among global investors. This removes the pain threshold ceiling of 4.50%, at which we would have expected either the Fed to intervene or the US administration to back down. In other words, as the risk that the US may have lost its safe-haven status has subsided, amid a softer tariff stance from President Trump, we expect yields on USTs to return to trading "freely", driven by market/macro considerations, rather than being influenced by risks of a potential secular change in global asset allocation preferences among international investors.

3) Building on point #1, we have revised down the projected likelihood of the US economy entering a recession from 45% to 25-30%. At the same time, we now view the risks around our baseline growth forecast, which still anticipates a slowdown, as skewed to the upside.

4) Despite being significantly reduced, the remaining tariffs will likely slow the pace of inflation convergence towards the target compared to expectations prior to the election.

5) We expect the market to turn its attention to the upcoming Budget. In this context, there is a risk that the already unfavourable supply/demand balance in USTs could worsen, depending on the final version of the budget bill currently under discussion in Congress.

6) While market expectations for the Fed this year have now aligned with both our view and the Fed's, anticipating two rate cuts, down sharply from four at the end of April, we do not rule out the possibility that the market could adopt an even more hawkish stance, particularly if data and/or fiscal policy begins to surprise to the upside.

Against this backdrop, we are raising the threshold to begin gradually accumulating exposure to 4.70-4.80% (previously. 4.50-4.60%). However, we think that the risks around this level appear skewed to the upside.

Strategically, we remain CONSTRUCTIVE with a NEGATIVE outlook, as a more accommodative than expected fiscal stance could lead to an increase in the term premium. That said, we believe the strategic outlook remains highly uncertain and may evolve depending on developments in the growth outlook and fiscal policy over the coming months.

Bund

Tactically, we remain LONG and we continue to recommend increasing exposure at 2.70-2.80% and taking profit at 2.30-2.40%.

While recent developments on tariffs may ease investor concerns about their impact on euro area (EA) growth, we still expect EA growth to slow down between Q2 and Q3, as trade uncertainty is likely to persist longer than in China and the UK. Unless the EU agrees on a Trade Commissioner, there is a risk that the US will resort to multiple bilateral agreements, which could prolong the negotiation period and weigh on activity. Meanwhile, the fiscal stance remains growth-neutral this year.

Strategically, we remain NEUTRAL, as the US tariff policy has raised the likelihood of further institutional progress in the EU, particularly in advancing common defence initiatives and the proposed European Union for Savings and Investment. In addition, increased fiscal spending in Germany should help counteract some of the downward pressure on yields resulting from tariffs, though implementation risks are rising amid potential frictions within the ruling coalition. In what we regard as a warning shot from the Bundestag, Chancellor Merz secured a majority only in the second round of voting - an unprecedented failure in post-war Germany history, which we see as a serious setback to his standing and to hopes for prompt and substantial spending measures.

BTP

In line with our view on Bunds, **we remain LONG tactically** and continue to recommend adding exposure at 4.0% and taking profit at 3.50%.

Following the decline in BTP spreads over the past month, we believe that without concrete progress on the institutional front in the euro area, further compression of BTP spreads is unlikely in the near term. In the meantime, we expect BTPs to continue closely tracking Bunds.

Strategically, we remain NEUTRAL, as we anticipate that trade-related uncertainty will be balanced by increased EU spending.

EQUITY

We remain tactically NEUTRAL, although we see upside risks increasing. We expect trade tensions to continue easing, US fiscal policy to potentially surprise on the side of further easing, and the US economy to remain resilient, avoiding a recession even in 2025.

While these tailwinds have already been partially priced in during the recent rally, we believe there is still room for stock prices to rise, given the currently light positioning.

Against this backdrop, **we maintain a NEUTRAL stance due to the highly fluid geopolitical and macroeconomic environment, especially as we approach a seasonally unfavourable period. However, we continue to recommend a buy-the-dip approach**.

From a regional standpoint, we now upgrade US to LONG (previously NEUTRAL) on the back of still-light positioning, likely enhancements in earnings revisions, which have declined sharply in recent weeks amid tariff concerns, and improved corporate guidance after a year of overly conservative messaging. **We remain NEUTRAL on Europe and EM; while we downgrade the UK and Japan to SHORT** (from NEUTRAL).

From a sector standpoint, we are turning more constructive on Cyclicals (previously barbelled), **with a mild preference for Growth sectors** (previously agnostic on style). We continue to selectively favour the Magnificent 7, along with Banks and Diversified Financials on both sides of the Atlantic. We downgrade tariff-insulated sectors such as Utilities and Telecom to NEUTRAL (from LONG), as we expect trade tensions to continue easing.

Strategically, we reiterate our OVERWEIGHT stance. At this stage, downside risks (such as a recession) and upside risks (including supportive fiscal policy and a potential peak in tariffs) appear balanced. In this context, **we favour Cyclicals over Defensives, with a preference for Growth names** (previously agnostic). Regionally, we favour the US, which has been among the hardest hit so far, expecting its IT and financial mega-caps to lead the performance, at least during the early stages of the rally.

FX

EUR/USD – Tactically, we turn NEUTRAL (previously LONG and SHORT DXY). US-China negotiations regarding reciprocal tariffs unfolded constructively, with both countries agreeing to a 90-day “truce” and de-escalating tensions. This outcome was unexpected, and we believe the resulting buoyancy in risk sentiment will support the USD in two key ways: 1) Primarily, by removing the negative dollar sentiment that had been building among market participants since Liberation Day; 2) Subsequently, by allowing the usual “risk-on, dollar down” correlation to resume, enabling EUR/USD to trend within the 1.10–1.13 range. **Strategically, we remain NEUTRAL (NEUTRAL DXY)**, as several conflicting forces keep the USD outlook unusually uncertain. On the one hand, following the China/US de-escalation, we still expect the US economy to slow in 2025, but not enter a recession (USD-neutral). On the other hand, US fiscal policy is likely to become the next key market focus, with a wide range of possible outcomes. Finally, the ECB is expected to maintain a more dovish stance compared to the Fed, which could prove USD-positive.

JPY – Tactically, we turn NEUTRAL (previously LONG). As the US and China have agreed to lower tariffs for 90 days, we expect improved risk sentiment to limit yen gains in the short term. **Strategically, we remain LONG** as we expect the BoJ to continue raising rates this year, with core inflation remaining above target.

GBP – Tactically, we remain NEUTRAL. As the UK has secured a trade deal with the US, we still believe that growth momentum is likely to decelerate further, as domestic demand softens. The 10% baseline tariffs on UK exports should act as a drag on growth in the coming quarters, as tariffs remain higher than they were before Liberation Day. **Strategically, we remain SHORT**, as we believe market participants are underestimating the BoE's willingness to ease monetary policy, given the weak growth and loosening labour market conditions. We continue to project an additional 75bp of cuts in 2025.

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