

Investment Outlook

BACK TO THE FUTURE

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RATES

USTs

Over the month, **our positioning turned tactically LONG** (vs. NEUTRAL previously) as 10Y yields reached our recommended accumulation threshold of 4.30-4.40% (20 March). Looking ahead, **we remain LONG tactically**, for the following reasons:

- 1) Carry considerations.
- 2) Any sell-off should be relatively limited, as in our baseline scenario we assume that oil prices are near their peaks, while markets have not priced in any adverse impact of the crisis on growth.
- 3) The Fed's pricing is overly hawkish (around 10bp of cuts priced in by year-end).
- 4) Revenues from tariffs in March were only slightly lower than in February, confirming that the deficit in 2026 should be around 6% of GDP.

We raise the bar for further accumulation to 4.40-4.50% (vs. 4.30-4.40% before):

- 1) High rates volatility.
- 2) Low inflation risk premium and term premium set against high geopolitical risks and the health of the economy.

Accordingly, **we also raise the bar to turn NEUTRAL to 3.95%** (vs. 3.75% before).

Strategically, we remain NEUTRAL:

- 1) From a medium-term perspective, macro fundamentals do not justify a much lower level of yields compared to the current one by year-end.
- 2) While Middle East war costs and Trump's declining popularity among MAGA Republicans reduce the odds of electoral fiscal easing ahead of the midterm elections, we see the risk of higher deficit in 2027 mainly due to rising defence expenditure.

Bund

We remain LONG tactically. Bund yields have little room to increase from current levels, for the following reasons:

- 1) Unless the conflict continues over the medium term (which is not our base case), we do not expect the energy shock to feed through into higher core inflation.
- 2) In this context, current market expectations for the ECB - which imply more than two rate hikes by year-end - appear too aggressive.
- 3) If, instead, core prices were to increase, and the ECB react, we expect investors' attention, now squarely focused on inflation risks, to shift to those related to growth prospects.

Until there is clarity on when traffic in the Strait of Hormuz will resume, we expect volatility in Bunds to remain high. Against this backdrop, **we slightly raise the accumulation bar to 3.10-3.20%** (from 3.00-3.10% previously).

Meanwhile, **we raise the bar to turn NEUTRAL to 2.60%** (from 2.45% previously). In the near term, unless energy prices quickly correct downwards towards pre-war levels and/or real yields rally sharply (which we would expect in the event of very negative surprises in economic data), we do not see Bund yields testing the 2.60% support.

Strategically, we remain NEUTRAL at this stage, as in our baseline scenario any inflation and growth impact of the Middle East conflict would be transitory, while the fiscal package in Germany would keep yields at high levels.

If the Middle East conflict continues for longer than expected, however, we would switch to a more constructive strategic stance. A prolonged conflict would lead the EA economy towards a stagflationary scenario, with the ECB likely turning more hawkish and further worsening the growth outlook. Against this backdrop, long-term yields would be lower than current levels over the long run.

BTP

We remain LONG tactically, as we believe that constructive expectations regarding Italy's idiosyncratic factors (political stability and fiscal discipline) will continue to shelter BTPs from excessive widening in risk-off contexts. Meanwhile, until there is clarity on when traffic in the Strait of Hormuz will resume, we expect volatility in BTPs to remain high.

Against this backdrop, **we recommend gradually extending exposure on sell-offs to the 3.95-4% area** (vs. 3.85-3.90% previously), and **we keep our bar to turn NEUTRAL at 3.20%**.

Strategically, we remain NEUTRAL.

EQUITY

We remain tactically LONG. The latest Middle East news flow has deteriorated marginally following the collapse of US-Iran talks in Islamabad and Washington's decision to impose a naval blockade on Iranian ports, a move that has pushed oil back above \$100/bbl and revived some near-term risk aversion.

Even so, **we would view any renewed equity weakness as a buying opportunity**, provided the conflict stops short of a broader escalation involving other major powers directly, such as China. Unless that tail risk materialises, our base case remains that markets should increasingly look through the geopolitical noise and rotate back towards the next key catalysts: the reporting season and Fed repricing.

Earnings season is only just beginning, but it should accelerate quickly over the coming days, and a solid set of results would help validate the recent rebound. On rates, we continue to see room for a supportive repricing in policy expectations. **We retain our baseline of three Fed cuts this year**, although risks remain skewed towards only two. Even so, current market pricing still leaves scope for a more supportive rates backdrop, which should remain a tailwind for equities.

From a regional perspective, we continue to prefer the US over the rest of the world, supported by relative energy independence, a more resilient domestic

backdrop and stronger earnings visibility, alongside potential support from flows as investor positioning normalises. By contrast, Europe remains more exposed to the energy shock, while EM should benefit from lower oil prices and a softer USD, although we still prefer the US on a relative basis.

From a sector perspective, we continue to favour Cyclical over Defensives, while maintaining a Growth tilt. Materials and Semiconductors remain our preferred exposures. We also maintain a LONG stance on Energy, which continues to offer a useful hedge despite the recent compression in the oil risk premium. Within Financials, **we upgrade Banks to LONG** (from NEUTRAL) and remain SHORT Diversified Financials. Within Defensives, Utilities remain our preferred pick.

Strategically, we maintain our 12-month OVERWEIGHT view on equities. The recent de-escalation in the Middle East reduces the risk of a more severe and sustained macro shock, but some uncertainty remains and the path is unlikely to be linear. In the near term, markets should increasingly be driven by earnings delivery, policy expectations and the evolution of growth data, rather than by pure geopolitical risk premium.

FX

Tactically, we remain NEUTRAL on EUR/USD and DXY. While the de-escalation of tensions is, in principle, dollar-negative and EUR-positive, we prefer to maintain a neutral positioning on both EUR/USD and DXY for the following reasons:

- 1) Oil prices remain well above pre-war levels, which is supportive of the dollar given the US's improved terms of trade.
- 2) The US economy remains in good shape.
- 3) While speculative positioning on the EUR indicates that short positions have been building up to very high historical levels, the fact that investors are underestimating downside risks to EA growth stemming from the energy shock, resulting in a very hawkish ECB pricing, is a negative factor for the EUR.

Strategically, we remain LONG on EUR/USD and SHORT on DXY, reflecting the rise in hedging of USD assets and a continuation of foreign outflows from USD assets. That said, **we continue to signal that the likely peak in the political risk premium and the approaching midterm elections could lead us to shift to a more constructive strategic position on the greenback.**

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