

Investment Outlook

SLIPPERY SLOPES

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RATES

UST

We switch to a tactically NEUTRAL position (vs. LONG before). In our view, following the recent rally spurred by the Jackson Hole (JH) speech that turned out to be more dovish than expected, upside risks for UST yields have increased.

This is due to the following reasons:

- 1) We remain of the view that the US economy will avoid recession this year. We expect economic momentum to pick up in Q4, after troughing in Q3.
- 2) A more dovish-than-expected Fed should help reinforce our fundamentally based growth baseline. Post JH, a Fed seemingly more focused on growth than inflation reduces the risks that the economy will hit the wall.
- 3) We now expect the peak of tariffs' pass-through to inflation to happen in October (vs August previously).
- 4) Current Fed pricing is partly the result of political pressure on the Fed to cut. If political pressures on the Fed persist or even become successful, the build-up of term premium at the long maturities will likely continue, keeping the UST curve in a steepening mode. Even more so given still sound economic growth and slow tariff pass-through to inflation. In fact, the slower the pass-through, the longer the uncertainty regarding the new, post-tariff, price level equilibrium will last.

At the same time, we believe that the following factors could broadly offset upward pressure on UST yields in the near-term:

- 1) In July, the US Treasury announced that it will not increase coupon issuance, while it will increase the frequency of buybacks at the long end starting from Q3.
- 2) Tariff-related revenues could lead to a decline in the deficit in 2025 compared to 2024 and compared to investors' expectations.
- 3) In aggregate, evidence on foreign demand for USTs remains relatively benign.

Against this backdrop, **we now recommend increasing exposure only at 4.50-4.60% and turning SHORT at 3.80%.**

Strategically, we remain CONSTRUCTIVE with a NEGATIVE outlook, as the medium-term outlook remains highly uncertain and heavily dependent on the policies of the Trump administration.

Bund

We remain tactically LONG. Following the July ECB meeting, markets have turned even more hawkish on the ECB's monetary policy, pricing in around 35% probability of a rate cut by year-end, which we believe is too hawkish considering that we project EA growth to remain anaemic, and disinflation to continue for the rest of the year.

That said, **we keep our accumulation bar at 3.0-3.10% while continuing to recommend switching to NEUTRAL in the 2.50-2.60% range.**

- 1) With trade policy uncertainty having mostly dissipated, we continue to think that the bias for Bund yields is higher, as we expect investors to gradually start focusing on the implementation of the German fiscal package in the coming weeks (the votes on the 2025 and 2026 budgets are set to begin towards the end of September).
- 2) Following the last NFP print at the beginning of August, Bunds have continued to underperform USTs, with yields at the long end of the two curves decoupling (UST yields down, Bund yields up).

Strategically, we remain NEUTRAL, as we expect the German fiscal package and its implementation to become the main theme in rates markets over the medium term, possibly tilting the balance of risks perceived by the market for EA growth and inflation to the upside.

BTP

We turn tactically NEUTRAL (from LONG previously). At the end of July, 10Y BTP yields declined to the 3.40-3.50% area, the range we indicated for switching to NEUTRAL.

- 1) We believe that the potential for a further decline in the spread in the near term is limited.
- 2) At the same time, we continue to think that the bias for Bund yields is higher, and the correlation between Bunds and BTPs remains high.

Meanwhile, **we maintain the accumulation bar at 3.90-4.0%.**

Strategically, we remain NEUTRAL, as we anticipate that trade-related hit to growth will be counterbalanced by increased EU spending.

EQUITY

We reiterate our tactical NEUTRAL stance. Against a still solid fundamental backdrop, we expect the 25%+ rally that has unfolded since April to pause until seasonality turns favourable again and global trade policy uncertainty - especially around semiconductor - fades. Accordingly, we expect the equity market to move sideways over the next few weeks, while volatility eventually spikes from its current, extremely compressed levels.

A Q4 rally cannot be ruled out. Ongoing resilience of the US economy and the Fed likely entering easing mode should pave the way to the traditional end-of-year rally. **Accordingly, any market drawdowns would be a buying opportunity.** The ultimate price correction will come, but it is not around the corner yet; for that, signs of a looming economic recession must intensify.

From a regional perspective, we cut the US to NEUTRAL (from LONG previously), **while we upgrade Japan to LONG** (from SHORT). We stay NEUTRAL on Europe and EM, and SHORT on the UK.

From a sector standpoint, we now suggest a barbell approach in terms of market beta (previously a cyclical Growth tilt). We still like AI-related sectors as Semiconductors and Software and cyclical Value as Banks, but we offset such high-beta exposure by going LONG on Pharma (from NEUTRAL) and maintaining exposure to Telecoms.

Strategically, we reiterate our OVERWEIGHT stance on equities and view any market weakness as a buying opportunity. We expect the global benchmark to record new highs in the second half of the year, driven by an acceleration of US GDP in 2026 and fading inflation concerns.

Against this backdrop, **we continue to favour Cyclical over Defensives**, with a bias towards Growth-oriented names. Regionally, **we prefer the US**, anticipating its leadership in global equities will persist, driven by its Large Cap companies.

FX

EUR/USD – Tactically, we maintain a NEUTRAL stance (NEUTRAL on the DXY) as major near-term risks appear broadly balanced: fading trade tensions and eased Fed concerns are dollar-negative, but US economic and labour market strength versus the euro area supports the dollar (recent jobs data point to mild downside risks and potential short-term softness for the dollar, though). **Strategically, we remain LONG EUR/USD (SHORT DXY).** By 2026, we anticipate macroeconomic and monetary policy divergences increasingly to favour the euro. Moreover, with the US current account deficit hovering near historic lows, we expect its gradual return towards the long-term norm to act as a structural catalyst for sustained dollar depreciation against FX peers.

JPY – Tactically, we remain NEUTRAL. The recent rebound in global risk appetite is expected to curb the potential for any meaningful short-term yen appreciation, as investors reduce exposure to safe-haven assets and reallocate it towards higher-yielding markets. **Strategically, we remain LONG.** We still expect the Bank of Japan to deliver further rate hikes this year, supported by persistently elevated core inflation above target. That said, we believe the BoJ will moderate the pace of tightening to limit market volatility and provide clearer communication, particularly given persistent uncertainty surrounding US trade policy. Accordingly, we foresee the next hike in September, followed by another in December or early 2026.

GBP – Tactically, we remain NEUTRAL. The UK's trade deal with the US reinforces our view that domestic demand will sustain growth. Although 10% tariffs may slightly reduce net exports and modestly weigh on output in the near term, the overall impact should be limited. **Strategically, we stay SHORT.** We anticipate the Bank of England will respond to modest economic momentum and a softening labour market by delivering further monetary easing. In line with this view, we continue to project an additional 50 basis points of rate cuts spread across 2025, aimed at supporting demand and stabilising the broader economy. **We particularly like long EUR/GBP positioning.**

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