Investment Outlook

RISK & CARRY

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RATES

USTs

We remain tactically NEUTRAL, and we continue to recommend increasing exposure when yields are at 4.50%-4.60% and turning SHORT when they reach 3.80%.

Since the start of the year, UST yields have increased moderately at the short-maturities, while they have traded within tight ranges at the long-end.

If, on the one hand, we continue to believe that the bias for UST yields in the medium-term is upwards, on the other hand, long-end USTs have so far been largely insensitive to constructive growth data, hawkish revisions to monetary policy expectations and the threat of additional fiscal easing, while investors continue to show a dovish bias in their interpretation of economic data.

We keep our strategically NEUTRAL stance UNDER REVIEW, with a negative outlook.

In the last few weeks, downside risks to UST yields have emerged, in particular from:

1) a more favourable-than-expected funding mix in 2026;

2) the purchases of MBS by Fannie Mae and Freddie Mac mandated by the US administration;

3) the US attack on Venezuela.

While these factors might mitigate upward pressure on the term premium, we believe that none of these risks constitutes a game changer or a major driver of USTs in 2026.

On the contrary, we continue to think that that UST performance in 2026 will be driven by macro fundamentals and the fiscal outlook, as well as the political risk premium. All these factors point to higher UST yields in the medium term.

For the following reasons:

1) We now expect an annual growth rate of 2.7% in 2026 (vs. 2.0% previously), with growth remaining above potential throughout 2026. Against this backdrop, the risks of overheating have increased.

2) The risk of a higher-than-forecast fiscal deficit is rising, as Trump seeks to address the affordability crisis in the US and stem his loss of popularity from multiple angles.

3) We expect the political risk premium to remain high or even increase further. The unprecedented launch of a criminal investigation into Fed Chair Powell by the Department of Justice confirms that unorthodox moves by the Trump administration are likely to continue in 2026.

Bund

We remain tactically NEUTRAL but lower the accumulation bar to 2.90% (vs 3.00%-3.10% before).

While we still believe that in the medium-term 10Y Bund yields could climb above 3%, in the short-term we think that the momentum has largely exhausted, for the following reasons:

1) While Germany net-net issuance (including ECB's QT) will increase by EUR 40bn in 2026 (from EUR 219bn in 2025 to EUR 259bn in 2026), the increase is in line with market expectations, and it will be evenly split between Bubills and Bunds.

2) The first couple of weeks of sizeable issuance activity in EA showed that demand for EGBs is solid across all investors categories. This has so far prevented a sharp rise in yields.

3) We do not expect monetary policy expectations on the ECB to turn more hawkish in the absent of a sharp upside surprise in growth (not our baseline).

4) Overall developments of fiscal spending in Germany have been constructive so far. We believe that more positive evidence on the implementation of the package would be needed for Bund yields to rise significantly from current levels (not our baseline).

Meanwhile, we now suggest turning SHORT at 2.55% (vs. 2.45% before), as we believe that very disappointing growth data or expectations of inflation falling persistently below 2.00% would be required for 10Y Bund yields to fall below 2.55% in the near term.

Strategically, we remain NEUTRAL. We believe that a successful implementation of the German fiscal package could trigger a further increase in Bund yields above 3% in the medium-term, as investors price in expectations of higher growth potential in Germany and the EA.

BTP

We remain tactically NEUTRAL, but following our change in stance on Bund and a moderate decline in the BTP-Bund spread, we now suggest starting to gradually accumulating duration in the event of 10Y BTP yield spikes above 3.55% (vs 3.90-4.00% before), while we would still turn tactically SHORT at 3.20%.

We continue to believe that the potential for a further decline in the spread in the near term is limited, and BTPs remain closely correlated to Bunds.

Strategically, we remain NEUTRAL:

1) The strong and positive correlation with Bunds suggests an upward bias for BTP yields in the medium term.

2) In the absence of a decisive improvement in European infrastructure, we do not expect a further sharp tightening of periphery spreads, as progress in macroeconomic convergence between the periphery and the core is likely to slow this year.

3) We expect solid demand for BTPs (driven by appealing yields and a steeper curve compared with Bunds), and an improvement in the fiscal outlook to help offset at least some of the upward pressure on yields.

EQUITY

We reiterate our tactically LONG stance. We expect global equities to keep grinding higher over the next few weeks driven by another better-than-expected reporting season and a healthy macro environment across the board.

However, we expect increased market volatility driven by headline noise rather than any actual deterioration in hard data. As the US mid-term elections approach, President Trump is adopting a more outspoken approach, resembling his behaviour at the beginning of his new mandate last year. So far, he has targeted credit-card issuers and real-estate investment funds, aiming to make life more affordable for US consumers. Not necessarily everything that is positive for consumers is positive for stock prices, at least from a trading perspective. **That said, we will continue to buy on dips, anticipating that the rally will persist, albeit with more volatility.**

The main risks to our constructive outlook stem from any dramatic shift in expectations about the Fed's next moves or a significant reduction in liquidity. We view any rise in geopolitical tensions as a potential buying opportunity, provided that China is not directly involved. Escalations in Latin America or the Middle East are seen marginally supportive.

From a regional perspective, we reiterate our NEUTRAL stance on the main regions. We see all regions moving in sync with the expected extension of the rally.

From a sector standpoint, we maintain a cyclical tilt, raising the exposure to traditional cyclical Value sectors (previously agnostic). That said we upgrade Capital Goods to LONG (previously SHORT) re-engaging with Aerospace and Defence. Within Growth, we reduce both Software and Tech to NEUTRAL (previously LONG), as we anticipate their sluggish performance will persist even though their fundamentals remain strong. We believe the market will reward these sectors positively, along with Media (NEUTRAL), once there are clear signs of AI monetisation. Pharma continues to be our top pick among Defensive stocks.

Strategically, we reiterate our OVERWEIGHT stance on equities and view any market weakness as a buying opportunity. We expect the global benchmark to accelerate in 2026, driven mostly by earnings growth. Our new GDP forecasts for US suggest Global EPS will rise by around 12% in 2026 (previously high single digits). Already rich valuations will limit gains from multiple expansion, whose impact has been progressively decreasing since 2023.

Regionally, we still favour the US and EM for their leading roles in AI and unique catalysts, although performance may become more aligned across regions over the next 12 months. **Sector-wise, we favour Cyclicals over Defensives**, neutralising our previous Growth tilt.

FX

EUR/USD – Tactically, we remain NEUTRAL on EUR/USD and DXY.

In the last couple of weeks, the dollar index has regained some ground against the EUR, mostly due to cyclical reasons, as investors turned relatively more positive on the US economy compared to the EA economy. The trend was briefly interrupted by the news that the US Department of Justice has launched a criminal investigation into Fed Chair Powell, which confirmed the Trump administration's threat to Fed independence as a negative driver of USD performance.

In the short-term, with both the Fed meeting (28 January) and the ECB meeting (5 February) likely to leave both monetary policy outlooks unchanged, we expect the DXY performance to be driven by a combination of cyclical factors (which should be marginally USD-positive) and political developments (which should remain marginally USD-negative). Meanwhile, we expect EA data (Q4 GDP and January flash CPI) to remain consistent with our outlook of slightly accelerating but still moderate growth and with a continuation in the disinflation process, leaving monetary policy expectations on the ECB largely unchanged. Against this backdrop, we do not see the emergence of a clear trend in the EUR/USD or DXY in the near-term.

Strategically, we remain LONG on EUR/USD and SHORT on DXY, but we acknowledge that the balance of risks is shifting towards a more NEUTRAL stance.

While we remain of the view that in H1 2026 the dollar could come under renewed pressure (albeit more moderately than in 2025) and the EUR/USD could further appreciate, we think that the USD-positive and EUR/USD-negative factors in the medium term are gradually gaining importance, challenging the positive drivers for EUR/USD.

On the DXY-positive /EUR-USD-negative side:

1) We have revised upwards our 2026 US growth forecasts to 2.7% (vs 2.0% previously) and acknowledge that risks of overheating are rising.
2) Ongoing geopolitical tensions in Latin America, Middle East/Iran, and between China and Taiwan – although less likely – are supportive for safe-haven assets such as the US dollar.
3) A sharp decline in the US trade deficit could indicate that going forward the role of the US current account performance may be neutral, compared with the USD-negative impact seen in recent months.
4) We think that it will be very difficult for the ECB's stance to become even more hawkish in the absence of a sizeable upside surprise in growth this year (not our baseline, and in our view the balance of risks is tilted in the opposite direction.).

On the USD-negative side:

1) Gradually slowing portfolio inflows into US assets, particularly from central banks.
2) Continued hedging flows by foreign investors.
3) Uncertainty surrounding the Fed's independence.

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