Investment Outlook

OLD SCHOOL

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RATES

USTs

We remain LONG tactically, for the following reasons:

1) **We continue to believe that the US economy is not overheating**. In our baseline scenario, we see the US economy continuing to grow at around potential with limited risks of overheating, while the latest core inflation dynamics remain consistent with an ongoing disinflation trend.
2) **We remain of the view that market Fed pricing is overly hawkish.** Despite the reignition of tensions between the US and Iran, we believe that current Fed pricing (1-2 of rate hikes priced in by year-end) is still too hawkish, as our baseline is that the Fed will not deliver any rate hikes this year.
3) **Carry and political considerations remain supportive.** The yield level of USTs remains attractive, and USTs continue to trade close to post-Liberation Day levels, remaining near the Trump administration's pain threshold.

That said, in line with the last two months' recommendations, **we are not increasing our exposure further at current levels, while maintaining our threshold for further accumulation at 4.80%**. Meanwhile, we **keep our threshold for turning NEUTRAL at 4.20%.**

Despite the attractive levels of UST yields, risks continue to lean towards higher yields in the near term, for the following reasons:

1) **While labour market data confirmed that overheating risks remain limited, US economic performance remains solid and powered by AI investment.** Against this backdrop, markets will continue to price in risks of overheating.
2) **Inflation risk priced by markets is historically low.** Breakeven rates are trading at the lower end of recent ranges across maturities. At the same time, inflation risks remain to the upside according to FOMC officials, with rising concerns that AI-related investment could fuel upside price pressure despite the latest weak inflation reading.
3) **The term premium remains relatively low and below its pre-conflict average.** We believe the risks remain tilted towards a further increase in the term premium in the near term.
4) **Upside risks to the deficit are increasing significantly.** In June, IEEPA tariff refunds amounted to over USD 50bn, more than double the amount in May. While we expect refunds to slow down in the coming months, chances are that most of the refunds will be repaid this year. Against this backdrop, the deficit could be as high as 6.8%.

Curve-wise, we continue to prefer the 2-5Y maturities compared to longer ones and we would position for a steepening of the curve.

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Strategically, we maintain our NEUTRAL stance. Solid economic growth and a longer path for inflation to converge towards target point to yields remaining around current levels, or only slightly lower, in the medium term.

The main risk to both our tactical and strategic views remains that the US economy overheats.

Bund

We remain LONG tactically but increase our threshold for extending exposure to 3.25% (from 3.10% previously). Meanwhile, we raise our threshold for turning NEUTRAL to 2.75% (from 2.60%). For the following reasons:

1) The resurgence of geopolitical instability in the Strait of Hormuz and the increase in oil prices have hit Bunds more than USTs, in line with the reaction at the start of the conflict.
2) Bund real yields have continued to increase, lifted by a combination of higher monetary policy expectations and higher UST yields. While the movement continues to be at odds with medium-term EA growth prospects, we do not expect a downward correction in the near-term. The reasons are two-fold:
    a) The decline in energy prices, both in the run-up to and following the US-Iran agreement, likely supported a modest improvement in economic momentum at the end of the second quarter.
    b) The German government has announced that net borrowing in 2027 will be higher than in the initial multi-year fiscal package projections, with net issuance in 2027 likely to be higher than EUR 200bn (vs. EUR 170-175bn projected at the start of 2026).

Curve-wise, we continue to prefer the 2-5Y maturities compared to longer ones and we would position for a steepening of the curve.

Strategically, we remain NEUTRAL and maintain our positive outlook. Another potential rate hike by the ECB in Q3 could further weigh on economic momentum in the EA, increasing the likelihood that the ECB may eventually need to reverse course and deliver at least one rate cut from Q4 2026 onwards.

BTP

We remain LONG tactically, as we believe that constructive expectations regarding Italy's idiosyncratic factors – namely political stability and fiscal discipline – will continue to shield BTPs from excessive widening in risk-off environments, at least until the fall when the government will start discussing the 2027 budget and markets will start focusing on the 2027 political elections.

Consistent with our view on Bunds, however, we raise our threshold for further accumulation to 4.05% (from 3.90% previously).

Meanwhile, **we raise our threshold for turning NEUTRAL to 3.50% (from 3.20%).**

Strategically, we remain NEUTRAL and maintain our positive outlook. Another potential rate hike by the ECB in Q3 could further weigh on economic momentum in the EA, increasing the likelihood that the ECB may need to reverse course over time and eventually deliver at least one rate cut from Q4 2026 onwards.

EQUITY

We reiterate our tactical NEUTRAL stance. Global equity markets remain close to record highs but continue to trade within the narrow range established in mid-May, with the benchmark sitting around its 50-day moving average, which has so far acted as support. While macro conditions and company fundamentals remain supportive, we continue to see a less compelling near-term risk-reward profile. A sustained breakout from the current range would likely require renewed earnings upgrades or a more supportive shift in monetary-policy expectations.

Seasonality is also becoming less favourable. August and September have historically been challenging months for equities, typically characterised by weaker returns and higher volatility. Admittedly, August delivered positive returns in each of the past two years, highlighting the limitations of seasonality as a standalone signal. Nevertheless, reduced summer liquidity, elevated expectations and the gains already delivered argue for a more measured stance.

The Q2 reporting season will be the next major test. Analysts have continued to revise earnings estimates upwards despite a quarter heavily affected by the war in Iran, underlining the resilience of the fundamental backdrop. However, the higher bar leaves less scope for positive surprises: solid results may not be sufficient to drive further gains without stronger guidance and additional upgrades to forward estimates.

Market pricing also leaves limited room for error. Implied volatility remains subdued despite the demanding earnings backdrop, creating a less favourable asymmetry around incoming results and macro data. Positive surprises may generate only limited upside, while weaker guidance or disappointing data could trigger a more pronounced, albeit likely temporary, increase in volatility.

From a regional perspective, Europe remains our preferred market, while we maintain a NEUTRAL stance on the US. The latter continues to offer the strongest earnings and fundamental profile, but we do not believe this is the right point to express that preference aggressively at the index level. Europe appears better positioned to benefit from lower energy prices and improving geopolitical conditions, while its lower exposure to AI-related stocks should provide some insulation from the heightened volatility and sharp price action affecting the AI complex. We remain NEUTRAL on EM and SHORT Japan, where the market's sensitivity to currency appreciation creates a less attractive relative risk-reward.

From a sector perspective, we maintain a more balanced allocation, with reduced cyclical exposure and a more agnostic stance on style. We are not turning outright defensive, but the near-term risk-reward for Cyclicals has become less attractive, as expectations already embed a meaningful improvement in the outlook. **Elevated dispersion within Growth and AI-related sectors also argues for greater selectivity rather than a broad directional style call**.

Strategically, we maintain our 12-month OVERWEIGHT stance on equities.

Resilient growth, solid corporate profitability, and a reduced risk of a severe geopolitical shock continue to support the medium-term investment case. Tactically, however, demanding expectations, less supportive seasonality and the potential for profit-taking justify a NEUTRAL stance. We would continue to view any meaningful market weakness as a buying opportunity.

FX

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

Over the last month, EUR/USD has remained largely unchanged as on the one hand, the rise in geopolitical risk acted as a headwind, but on the other hand interest rate differentials moved moderately in favor of the EUR. In the coming weeks, we expect interest rate differentials to be neutral to moderately in favor of the EUR, as we expect a modest improvement in economic momentum at the end of the second quarter in the EA, while geopolitical developments in the Middle East will remain a wild card. Against this backdrop and taking into account the unpredictability of the duration of the current stalemate in the Strait of Hormuz, we keep our neutral positioning on EUR/USD and DXY unchanged.

Strategically, we remain NEUTRAL on EUR/USD and DXY. For the following reasons:

1) The US-EA yield differential and relative growth dynamics favor the dollar vs. the euro. In this context, we believe markets continue to underestimate the probability of ECB rate cuts in 2027. This should provide medium-term support to the US dollar against the euro.

2) We continue to believe that a gradual normalization of the political risk premium, alongside the approaching midterm elections, could prompt a shift away from a strategic negative view on the greenback.

3) That said, the dollar is trading at the highest level of the last 15-months range, making it difficult to bet on a further structural appreciation in the medium-term. Moreover, if geopolitical developments in the Middle-East turn constructive, the dollar will no longer profit from this factor.

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