

## Investment Outlook

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## RATES

### USTs

**We remain tactically NEUTRAL and continue to recommend extending exposure at 4.30-4.40%.** In the near-term, risks to yields are broadly balanced:

To the upside:

- 1) Middle East instability continues.
- 2) US macro fundamentals at odds with level reached before the war.

To the downside:

- 1) Positioning is generally short, especially at the short-end.
- 2) Fed pricing has been significantly rebalanced and is now broadly in line with the Fed's dots.
- 3) Trump's tariff response to the Supreme Court ruling reduces near-term fiscal deterioration risks.

Meanwhile, **we leave the bar to turn SHORT at 3.75% and put it under review with risks tilted to the upside.**

**Strategically, we remain NEUTRAL, but we remove the NEGATIVE OUTLOOK,** for the following reasons:

- 1) The orderly response of President Trump to the Supreme Court's ruling makes further political risk premium increase unlikely.
- 2) We expect the Trump administration to do everything it can to avoid a tariff cliff in July for internal and external (geo)political considerations.
- 3) Middle East war costs + Trump's declining popularity among MAGA Republicans reduce the odds of electoral fiscal easing ahead of midterm elections.
- 4) Albeit marginally, Jan and Feb labour market data reduce the risk of US overheating.

### Bund

**We remain LONG tactically. We do not expect yields to increase much further from here** for the following reasons:

- 1) Unless the conflict persists over the medium-term (not our baseline), we do not expect the energy shock to translate into higher core inflation.
- 2) Against this backdrop, current ECB's pricing (almost two hikes by year-end) seems overly aggressive.

- 3) Unlike the US, higher energy prices in the EA primarily represent a negative terms-of-trade shock, which should ultimately weigh more on growth than on core inflation, but investors have not priced any negative effect on growth so far.

**We continue to recommend extending exposure at 3.00-3.10%** to take advantage of the current, misplaced market adagio, which seems to be taking for granted that the ECB will raise rates. Possibly twice this year. However, should this mystification further gain momentum, perhaps reaching 75bps hike priced in this year, we expect markets to begin to price in recession risks.

**We leave the bar to turn NEUTRAL at 2.45%.**

**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 in the long run.

## BTP

**We remain LONG tactically.** While the widening of BTPs vs. Bund since the start of the Middle East conflict has not been dramatic, BTPs have underperformed the rest of EGBs. This is because Italy is more vulnerable than other EA countries to the increase in energy prices, has little fiscal space to offset the adverse impact of higher energy prices and suffers more when the cost of funding rises. Against this backdrop, while we remain LONG as political stability and fiscal discipline will continue to protect BTPs from excessive widening in risk-off contexts.

Against this backdrop, **we lift our bar to add more exposure to 3.85-3.90%** (vs. 3.65-3.75% before) and **raise our bar to turn NEUTRAL to 3.20%** (vs. 3.10% before).

**Strategically, we remain NEUTRAL** at this stage. In case of a prolonged conflict, we would turn more negative strategically, as BTPs would probably underperform core bonds.

## EQUITY

**We remain tactically NEUTRAL, expecting volatility to remain elevated over the coming weeks.** Geopolitical tensions, potential supply chain disruptions linked to the conflict, and concerns around rising inflation and slower global growth could weigh on both market sentiment and corporate fundamentals.

**At the same time, risks are not unidirectional.** A better-than-expected earnings season, combined with supportive policy signals from the White House, could trigger a meaningful rebound in equity markets.

**Against this backdrop, we recommend maintaining existing exposure but refraining from adding risk on market pullbacks** until the macro and fundamental implications of recent geopolitical developments become clearer.

**From a regional perspective, we move to a neutral stance across regions, closing our previous active positioning** while awaiting further developments in the Middle East. Should geopolitical tensions persist, however, US equities are likely to

outperform the Rest of the World. The US benefits from relative energy independence and historically tends to outperform during periods of heightened risk aversion and a strengthening US Dollar. By contrast, Europe appears more vulnerable, given its greater reliance on imported energy and an already weaker macroeconomic backdrop. Emerging markets may also face headwinds from a stronger US Dollar and tighter global financial conditions, which have historically weighed on local economies and capital flows.

**From a sector perspective, we maintain a modest cyclical tilt.** We remain LONG Energy, which continues to act as a hedge against geopolitical risk and inflation. We also maintain a LONG stance on Materials, despite recent weakness, as well as Semiconductors, supported by strong structural demand. We upgrade Software to LONG (from NEUTRAL). We stay NEUTRAL on Banks, downgraded them from LONG in the aftermath of the strike on Iran, while we cut Diversified Financials to SHORT (from NEUTRAL). Within defensive sectors, Telecoms and Utilities remain our preferred picks.

**Strategically, we maintain our 12-month OVERWEIGHT view on equities under review, pending further developments on the geopolitical front.** The duration and intensity of the conflict will be key. The longer tensions persist, particularly if the Strait of Hormuz remains closed, the greater the potential impact on the global economic environment through higher energy prices, tighter financial conditions, and weaker growth.

While consensus expects Global EPS to grow by around 18% in 2026, we keep a more cautious view and forecast 12% growth, reflecting the potential drag from a more challenging macro backdrop.

## FX

**EUR/USD – Tactically, we remain NEUTRAL on EUR/USD and DXY.** Since the start of the Middle East conflict, the dollar has benefited on the one hand from its role as a safe-haven asset, and on the other from expectations of improvement in terms of trade following the increase in energy prices. Against this backdrop, the EUR/USD has depreciated partly because of dollar strength and partly because of the EA more vulnerable position in terms of external trade and growth performance.

That said, given the uncertainty regarding the duration of the conflict and on its ultimate macro impact, as well as a recent hawkish turn in the ECB's rhetoric, we prefer to remain NEUTRAL on EUR/USD and DXY. If the conflict were to end within the next few weeks, we would expect the dollar to erode at least part of its recent gains and the EUR to re-appreciate against the greenback.

**Strategically, we remain LONG on EUR/USD and SHORT on DXY, but we note that, if geopolitical instability in the Middle East continues in the medium term, this could be one more reason, together with increasing evidence that the political risk premium has peaked, to push us towards a more constructive stance on the dollar.**

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