

Investment Outlook

LIMBO

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RATES

USTs

We remain tactically NEUTRAL:

- 1) Long-dated UST yields are trading near 2025 lows, despite solid growth and tariff-related upside risks to inflation.
- 2) The longest US government shutdown in history has kept uncertainty elevated. We expect volatility to surge as macro data beings to be released.

We continue to recommend **increasing exposure at 4.50%-4.60% and turning SHORT at 3.80%.**

Strategically, we maintain a NEUTRAL position, but we have placed our stance under review. In addition to the upside risks to rates stemming from resilient growth, tariff-related inflation pressures, an overly dovish Fed, and a build-up of political risk premium, we now also see upside risks to rates coming from the Supreme Court ruling on tariffs and potential additional fiscally expansive measures targeting low- to middle-income families.

Depending on policy and macroeconomic assumptions, particularly regarding whether the Supreme Court rules against the legal use of IEEPA to impose tariffs, **10-year US Treasury yields could reach the 5.0%-5.50% range next year.**

A word of caution: The impact on the budget could be even more severe if President Trump proceeds with the plan to issue tariff rebate cheques of USD 2,000 to low-and medium-income voters (See *Rates Strategy Focus* for further details).

Bund

We remain tactically NEUTRAL, as we believe the risks of maintaining a LONG position remain asymmetric for the following reasons:

- 1) While scepticism around the implementation of the German fiscal package is increasing, we expect markets to give Germany the benefit of the doubt until proven otherwise. So far, our live fiscal tracker indicates that the government is swiftly deploying core budget spending. Combined with a substantial increase in supply, this creates upside risks for Bund yields, potentially reaching the 3% area.
- 2) While we continue to believe that the market's pricing of the ECB (7bp of rate cuts priced by March 2026) is too dovish, given ongoing disinflation and the poor quality of EA GDP growth, one more rate cut could squeeze long-term rates by no more than 10bps.

Against this backdrop, **we continue to suggest turning LONG at 3.00%-3.10%, and we would turn SHORT at 2.45%.**

Strategically, we remain NEUTRAL. With EA growth expected to accelerate in 2026 on a q/q basis and Bund supply rising sharply, the medium-term bias for Bunds remains upward, although strong demand for EA government bonds is likely to partially offset this upward pressure.

BTP

We remain tactically NEUTRAL. We continue to believe that the potential for a further decline in the spread in the near term is limited. At the same time, BTPs remain closely correlated with Bunds.

We maintain the accumulation range at 3.90%-4.0%, while we would turn tactically SHORT at 3.20%.

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 the European infrastructure, we do not expect a further sharp tightening of periphery spreads, as progress of macro convergence between the periphery and the core is likely to slow.
- 3) We expect solid demand for BTPs (due to appealing yields and a steeper curve compared with Bunds), and an improvement in the fiscal outlook to offset at least some of the upward pressure on yields.

EQUITY

We turn tactical NEUTRAL (previously LONG). We expect the current market volatility to continue as investors take some profits while assessing the balance of risks, especially around a potential US economy reacceleration and rising inflation. **That said, we would remain buyers of dips, expecting the rally to continue after a healthy pause.** This constructive view is supported by a still better than expected macro backdrop, with CESI indices in positive territory across the main regions, strong corporate guidance, and the CEOs' confidence picking up, but still not at a frothy level.

From a regional perspective, we reiterate our NEUTRAL stance on the main regions. Despite the high absolute valuations, US equities still appear appropriately priced given their level of profitability, both relative to other markets and their own history.

From a sector standpoint, we maintain a cyclical Growth tilt, but we suggest reducing exposure to long-duration sectors such as Media, which we have downgraded to NEUTRAL (previously LONG). Among traditional cyclical Value, we maintain our long-standing LONG stance on Banks, expecting them to benefit from the resilient macro backdrop and the anticipated ongoing curve steepening. Pharma remains our preferred defensive sector.

Strategically, we reiterate our OVERWEIGHT stance on equities and view any market weakness as a buying opportunity. We expect the global benchmark to gain momentum in 2026, driven primarily by high single-digit EPS growth. Already rich valuations limit gains from multiple expansion, which was the main driver of last year's rebound.

Through 2026, we anticipate continued growth in AI integration within business operations. However, we doubt that widespread AI adoption will sharply affect the labour market or company profitability in the short term. We expect any structural

change to unfold over several years rather than as a sudden disruption. For example, even during the 1990s internet revolution, US Net Margin took five years to rise by 1 pp and peak before the recession.

Regionally, we prefer the US and EM due to their predominance in the AI space and idiosyncratic catalysts. Sector-wise, we favour Cyclical over Defensives, leaning towards Growth-oriented stocks given our outlook for US GDP growth and inflation. However, if the US economy grows more rapidly and inflation picks up, we would shift our focus to traditional Value stocks and adopt a more selective approach towards long-duration sectors.

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