Investment Outlook

NO FEARS, NO CHEERS

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RATES

USTs

We remain tactically LONG, as we continue to believe that the US economy is not overheating, that market pricing of the Fed's policy path is too hawkish, and that carry considerations remain supportive.

We maintain our accumulation range at 5.10-5.20% and our threshold for moving to NEUTRAL at 4.60%.

We believe current levels are attractive from a tactical perspective for the following reasons:

1) Following the stronger-than-expected October CPI reading and a marked hawkish shift in Fed rhetoric, markets have reverted to pricing in almost 90 bps of additional rate hikes by July 2027, close to the peak levels observed at the end of September.
2) Economic and inflation surprises are at/near their highest levels in more than a year. However, we do not expect the economy to overheat and anticipate a resumption of disinflation.
3) Futures positioning suggests that, since the onset of the recent UST sell-off, investors have primarily established new short positions and unwound existing long positions, shifting positioning towards the short side.
4) Should another bout of risk aversion emerge, bonds could benefit.

Regarding yield curve positioning, **we continue to favour the 2-5 year segment over longer maturities**. We remain cautious on the long end of the curve given the structural headwinds.

Strategically, we maintain our NEUTRAL stance. While we expect economic growth to remain close to its potential rate and inflation to converge to target and remain there in 2027, potentially supporting lower yields, several factors are likely, in our view, to prevent a rally in USTs over the coming months:

1) Real yields have recently become increasingly sensitive to uncertainty, particularly surrounding monetary policy, the fiscal outlook and exogenous price shocks.
2) As geopolitical, monetary policy and fiscal risks show no signs of abating, the risk of an increase in the term premium persists. The fiscal outlook, in particular, warrants close monitoring, as it is the only area in which Democrats and Republicans could reach a compromise. While we believe the likelihood of a substantially wider fiscal deficit is low, markets may nevertheless price in this risk.

3) Uncertainty surrounding the Fed's reaction function is unlikely to be resolved in the near term and will contribute to heightened volatility in the UST market.

4) Our political risk premium measure has already declined over the past three months, making further compression unlikely, even if a Democrat-controlled Congress acts as a check on Trump's policies.

Bund

We remain tactically LONG and further lower our threshold for increasing exposure to 3.40% (from 3.50% previously). **Meanwhile, we maintain our threshold for moving to NEUTRAL at 2.90%.**

We see scope for a moderate decline in yields: we expect euro area economic activity to lose further momentum during the winter, as renewed upward pressure on energy prices and tighter financial conditions increasingly weigh on domestic demand. Nevertheless, we do not expect a sharp rally in Bunds at this stage, for the following reasons:

1) An ECB rate hike in December remains in the cards.

2) We expect core inflation to remain broadly unchanged through the end of Q1 2027.

3) Energy prices remain a key source of uncertainty.

4) Risks to UST yields remain skewed to the upside.

Nevertheless, current yield levels appear attractive, particularly given that markets are pricing in almost three additional rate hikes by September 2027, while the ECB has adopted a significantly less hawkish tone in recent weeks.

Strategically, we maintain our POSITIVE stance for the following reasons:

1) At current levels, real Bund yields already price in all the improvements in the growth outlook and most of the anticipated increase in bond supply, largely driven by Germany.

2) At the same time, we believe that tighter financial conditions stemming from higher real yields, combined with elevated energy prices, could exert a moderate drag on economic growth over the next few quarters.

3) Meanwhile, the money market yield curve continues to price in an ECB terminal rate of over 3%, a level we believe is too high to be consistent with our baseline macroeconomic scenario.

BTP

We remain tactically LONG and maintain our threshold for adding to positions at 4.60% and our threshold for moving to NEUTRAL at 3.80%.

Although BTPs rallied in October, supported by strong performance in core government bonds and a decline in sovereign risk premia, the current upward trend in core yields, coupled with the ongoing French budget process, warrants caution regarding further accumulation at this stage.

Strategically, we maintain our NEUTRAL stance while retaining a positive outlook. Our strategic positioning in BTPs remains slightly more cautious than that in Bunds, given the Italian general election scheduled for 2027 (which could be held as early as April). While we expect the next Italian government to remain committed to fiscal discipline, it remains uncertain whether BTPs will continue to benefit from the same degree of political stability seen in recent years. Moreover, as evidenced by the recent spillover effects from OATs to BTPs, next year's French presidential and potentially parliamentary elections could trigger a widening of the BTP–Bund spread.

EQUITY

We maintain a tactical NEUTRAL stance on global equities, with our regional views unchanged from last month: NEUTRAL across all major regions. We remain neutral between Cyclicals and Defensives, while maintaining a tilt towards Quality. The latest earnings season has proved more challenging than expected, while credit conditions have tightened. Market reactions to earnings announcements have also become more selective: disappointing results or guidance, or concerns about returns on AI-related investment, have prompted sharp share-price moves.

The recent pattern - broader US equity market resilience amid weakening TMT leadership - echoes the market environment of 2000, but the similarities should not obscure important differences. Current evidence suggests less speculative excess and stronger underlying cash-flow support than at the turn of the millennium. The comparison should therefore be seen as a reminder of the risks associated with concentrated market leadership, rather than an indication that markets have reached the levels of exuberance seen during the dot-com bubble.

IPO activity, credit spreads and free-cash-flow yields all appear less extreme than in 1999–2000. Average first-day returns for US IPOs were 71% in 1999 and 56% in 2000, compared with 17% in the first half of 2026, despite headline issuance volumes being boosted by a small number of very large deals. US IG spreads stand at 89 bp, versus 146 bp in March 2000, while broad HY spreads are 326 bp, versus 580 bp. The TMT sector's free-cash-flow yield is 2.9%, compared with 0.9% in March 2000. These indicators do not rule out a correction, but they suggest that the historical parallel should not be interpreted as a signal to abandon equities.

We maintain our strategic OVERWEIGHT, while placing it under review. Resilient macro conditions contained broad-market credit risk and positive TMT free-cash-flow yields continue to support a constructive stance. However, the outlook depends increasingly on earnings delivery and sustained investment: IT accounts for around 80% of projected S&P 500 EPS growth in 2027, while AI-related capital spending is becoming an increasingly important driver of the real economy. A sharp investment slowdown could therefore weaken earnings beyond the technology sector and remove an important source of US growth.

We do not yet see sufficient evidence to downgrade our strategic view to NEUTRAL. We will, however, monitor whether AI capacity generates revenues and cash flows in line with expectations, and whether investment can continue without a material slowdown in broader economic growth.

FX

Tactically, we turn NEUTRAL on EUR/USD (from LONG) **and NEUTRAL on the DXY** (from SHORT).

After the sell-off in French government debt triggered a weakening of the euro at the end of September, the single currency declined further against the USD following stronger-than-expected US CPI data, which raised expectations for the Fed's policy rate path. On the other hand, some potential catalysts for euro appreciation, such as the narrowing of the 2-year interest rate differential in October, the post-midterm decline in energy prices, and heightened equity volatility surrounding AI (to which the euro area is less exposed), failed to provide support for the euro.

Against this backdrop, **we now turn tactically NEUTRAL on EUR/USD** (from LONG) **and NEUTRAL on the DXY** (from SHORT), for the following reasons:

1) A widening interest rate differential, driven by the stronger-than-expected US CPI reading, is supporting the USD. The market will probably wait until the next CPI release before reassessing monetary policy expectations.
2) Our correlation analysis shows that the USD is still supported by higher energy prices. While energy prices have recently been declining, we believe that, unless the US and Iran reach an explicit peace agreement, a further sizeable drop is unlikely at this stage.
3) Another risk-off episode would likely support the USD as a safe haven.

That said, **we do not move to an outright SHORT position on EUR/USD and a LONG position on the DXY, as the euro has now weakened considerably relative to its post-Liberation Day trading range**.

Strategically, we remain NEUTRAL on EUR/USD and SHORT on the DXY, with risks to our EUR/USD view skewed towards euro depreciation. Our positioning rests on the following considerations:

1) On the USD side:
    a. Our quarterly long-run equilibrium BEER model continues to indicate that the dollar is slightly overvalued relative to its fundamentals.
    b. We expect normalising US growth and gradual disinflation to erode the dollar's support from the relatively high US monetary policy rate path currently priced in by markets relative to those of other economies.
    c. A potential normalisation in energy prices should benefit the currencies of energy importers, including the euro and the yen.
    d. The large US federal deficit is also likely to fuel investor concerns, potentially adding downward pressure on the dollar.
2) On the EUR side:
    a. Slowing real GDP growth from late 2026 and a moderately negative fiscal impulse leave little scope for support.
    b. Political uncertainty could further widen euro area government bond spreads, weighing on the currency.
    c. Energy prices may normalise but remain relatively elevated, limiting the support they provide to the euro in 2027.

Taken together, these broadly offsetting headwinds underpin our NEUTRAL EUR/USD view in the absence of new catalysts. That said, relative to our baseline, the balance of risks to EUR/USD remains tilted to the downside.

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