Investment Outlook

STAY PUT

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RATES

USTs

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

We welcome the Fed's move to resume rate hikes. While we cannot rule out yields rising another 10-20bp from current levels, we think the Fed's action has re-established some order in the chaotic response of the Trump administration to the rise in yields, especially at the long end, removing investors' concerns about the Fed's credibility, at least in the near term. Moreover, we think that in the Fed's September Summary of Economic Projections, growth projections are too optimistic and inflation forecasts are too high.

Against this backdrop, we stick to our tactical August recommendation of **accumulating exposure to USTs in the 4.90-5.00% area, while we maintain our threshold for turning NEUTRAL at 4.40%.**

Curve-wise, we continue to prefer the 2-5Y maturities over longer ones.

Strategically, we maintain our NEUTRAL stance. While our view that economic growth will remain around potential and that inflation will converge to target and remain around target in 2027 might lead to lower yields:

1) The Fed outlook beyond December remains very uncertain. While Chair Warsh has made progress in explaining his inflation framework, the outcome of the various task forces will only be known around year-end and there will have to be a broad agreement within the FOMC about how to incorporate the results into the Fed's monetary policy framework. Against this backdrop, markets might again price in a higher uncertainty premium again at the long end of the curve.
2) While the deficit/GDP ratio could be lower in 2027 compared to 2026 (due to the fact that the Treasury will reimburse most of the IEEPA-related tariffs in 2026), UST net issuance will still likely be north of USD 2tn, while global gross issuance from hyperscalers might increase further compared to this year, leading to a degree of crowding out.
3) Demand for USTs from foreign private investors is slowing down. While we do not think this is the beginning of a structural trend, it could signal increased price sensitivity among this category of key investors.

Bund

We remain LONG tactically but further raise our threshold for extending exposure to 3.65% (from 3.35% previously). **Meanwhile, we leave our threshold for turning NEUTRAL at 2.90%.**

While Bunds continue to trade cheap compared to macro fundamentals, we do not see any catalyst for a sharp rally in the near term. For Bunds to rally from current levels, the necessary conditions are: 1) The Middle East conflict is at least suspended, leading to lower energy prices. 2) Growth in the EA starts slowing down, either for endogenous reasons or because high energy prices start hurting consumers. On the other hand, at the moment the risk is that Bund yields keep rising if energy prices stay high.

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

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

1) At current levels, Bund real yields have priced in all the positive news in terms of growth, and most of the increase in supply pressure going forward (mainly from Germany).
2) At the same time, we believe that the tightening in financing conditions coming from higher real yields, coupled with high energy prices, could hurt growth in the next few quarters.
3) Against this backdrop, we expect EA inflation to decline to target in 2027, with the ECB delivering one to two rate cuts in H2 to reverse some of the monetary policy restriction delivered in 2026 and bring the deposit rate back to neutral territory.

BTP

We remain LONG tactically but, in line with Bunds and maintaining a small additional room for spread widening, we further increase our threshold for extending exposure to 4.60% (from 4.25% previously)**. Meanwhile, we leave our threshold for turning NEUTRAL at 3.80%.**

Strategically, we remain NEUTRAL and maintain our positive outlook. Our strategic position on BTPs remains slightly more cautious than on Bunds due to the general elections in 2027 (the window opens as early as April). While we expect the next Italian government to remain committed to fiscal discipline, we cannot yet be sure that BTPs will continue to benefit from the same level of political stability as they have over the last few years. Moreover, with presidential and possibly parliamentary elections in France next year, some (moderate) spillover could lead to a higher BTP-Bund spread, given that current levels of sovereign spreads are historically low. Last but not least, Italy is more exposed than other EA countries, to high gas prices.

EQUITY

We maintain our tactical LONG position on global equities. The initial market response to the Fed's decision suggests renewed confidence in its commitment to containing inflation. While it is too early to conclude that pressure on long-term yields has eased durably, greater policy credibility could help stabilise real yields and support valuations. An outright decline would provide an additional near-term tailwind.

The macroeconomic backdrop supports our confidence that earnings expectations are achievable. Recent US company results confirm resilient profitability and sustained AI investment, while economic data in both the US and Europe have generally surprised to the upside. Q3 US earnings estimates have risen by 1.4% since the end of June, compared with the cuts normally recorded at this stage of the quarter. Broader market participation further supports the constructive picture.

Stronger corporate balance sheets provide a buffer against higher financing costs. In the corporate universe covered by our analysis, financial leverage has declined since 2024 to its lowest level in ten years, while interest coverage has returned to its historical peak. This greater debt-servicing capacity supports our expectation of contained credit-spread widening, provided earnings hold, although more leveraged borrowers remain vulnerable.

Our tactical exposure nevertheless remains moderate. Geopolitical risks, elevated oil prices, softer consumer momentum, and high long-term yields constrain the upside. A prolonged tightening cycle that weakens activity and profits would pose a more significant challenge. Our constructive stance does not require a substantial bond-market rally: stable real yields would ease pressure on multiples and allow earnings growth to translate more fully into equity returns.

Our regional and sector preferences remain unchanged. We continue to favour the US over the rest of the world, supported by stronger earnings visibility and exposure to AI investment, while maintaining our SHORT stance on Japan given BoJ normalisation and the potential for yen appreciation. At the sector level, we retain a cyclical tilt while remaining agnostic between Growth and Value. We also maintain our LONG position in Energy as a hedge against geopolitical risks and higher oil prices.

Strategically, we maintain our rolling 12-month OVERWEIGHT stance on equities, with returns increasingly driven by earnings growth. Further increases in real yields could trigger valuation corrections, which we would regard as manageable provided earnings expectations remain intact and credit spreads stay broadly stable. Under these conditions, meaningful pullbacks would offer opportunities to add exposure. A material deterioration in earnings revisions, credit conditions or AI investment plans would require us to reassess our stance.

FX

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

In the last month, the dollar has regained some ground on higher monetary policy expectations and the Fed delivering a rate hike, while the EUR has been losing steam despite the ECB raising rates. We think that monetary policy expectations are near their peaks, especially in the EA, but unless the Middle East conflict is resolved or at least suspended, it is difficult to see markets becoming more dovish on central banks on either side of the Atlantic.

Strategically, we remain NEUTRAL on EUR/USD and switch to a SHORT position on DXY for the following reasons:

1) We believe that the macroeconomic and monetary policy outlook, as well as policy and fiscal uncertainty, should return to weigh on USD performance in the medium term, once we get past the impact of the Fed's hikes and the mid-term elections.
2) At the same time, we believe the EUR has priced in all the positive news from the macro side. If the Middle East conflict persists, we believe that high energy prices will start to hit the consumer, leading to a slowdown in growth. Moreover, in the next few months, the EUR could start pricing in political uncertainty, given that in 2027 general elections will take place in France, Italy, Spain and Greece.

Against this backdrop, while the DXY might suffer, negative factors in the US and the EA might offset each other in the medium term.

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