Investment Outlook

PLEASE STAY

RATES

AUTHORS

Fabio Fois
Head of Investment Research & Advisory
fabio.fois@animasgr.it

Chiara Cremonesi
Senior Rates Strategist
chiara.cremonesi@animasgr.it

Cosimo Recchia
Senior Equity Strategist
cosimo.recchia@animasgr.it

Francesco Ponzano
Junior Equity Strategist
francesco.ponzano@animasgr.it

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.

While UST yields remain vulnerable to upside risks, not least because the inflation risk premium is still negative, we think current yield levels provide a sufficiently large cushion against a further sell-off (we calculate that, over a one-year horizon, current 5Y UST yield levels provide protection against around 110bp rise in yields, which would push the 5Y UST yield towards 6%). That said, compared with our September recommendation and taking into account the sell-off since then, **we raise our accumulation range to 5.10-5.20% (from 4.90-5% previously) and our threshold for moving to NEUTRAL to 4.60% (from 4.40% previously)** as market fixation on real rates keep overshooting risks high.

In terms of curve positioning, we continue to prefer the 2-5Y segment over longer maturities. We remain cautious on the long end of the curve given the structural headwinds.

We regard TIPS as attractive instruments for diversification purposes. Our framework suggests that real yields are well above levels implied by macroeconomic fundamentals and we expect limited additional upward pressure from AI-related investment. Moreover, breakeven rates continue to reflect a historically low inflation risk premium.

Strategically, we maintain our NEUTRAL stance. While our expectation that economic growth will remain around its potential rate and that inflation will converge to and remain at target in 2027 could support lower yields, several factors warrant caution:

1) The outlook for Fed policy beyond December remains highly uncertain, particularly in light of the forthcoming findings of the various task forces.
2) While the deficit-to-GDP ratio could be lower in 2027 than in 2026 (as the Treasury is expected to refund most of the IEEPA-related tariffs in 2026), net UST issuance is still likely to exceed USD 2tn, while global gross debt issuance by hyperscalers is likely to increase further relative to this year, leading to some crowding-out effects.
3) Demand for USTs from foreign private investors continues to weaken. While we do not believe this marks the beginning of a structural trend, it could signal increased price sensitivity among this key investor group.

Bund

We remain tactically LONG and lower our threshold for increasing exposure to 3.50% (from 3.65% before). Meanwhile, we maintain our threshold for moving to NEUTRAL at 2.90%.

Despite lowering our accumulation threshold with respect to last month, we still leave a small room between current trading level and the new accumulation point, as the exceptionally high level of interest rate volatility still warrants some caution over the tactical horizon, for the following reasons:

1) While the ECB has recently softened its rhetoric and shifted its focus to the sharp tightening of financing conditions, another rate hike at the December meeting remains on the table, especially if EA economic growth remains resilient.

2) Over the past month, Bunds have benefited from selling pressure on French government bonds, with Bund yields at times even decoupling from movements in other EA sovereign bond yields, consistent with a typical flight-to-quality dynamic. While we believe that volatility in OATs will persist, we do not see this as a repeat of the 2011 sovereign debt crisis (not least because the EA institutional framework is now much more robust), and we do not expect Bunds to benefit to the same extent as they have over the past month from further selling pressure on French sovereign bonds.

3) Over the past month, Bunds have significantly outperformed USTs. Unless there is a sudden deterioration in EA growth, a dovish shift in the ECB's policy stance, or a further wave of selling pressure on OATs, we expect Bund outperformance to lose momentum in the near term.

4) Following our revision to our EA inflation forecasts, we now expect core HICP inflation to remain stable at 2.5% y/y in Q4 2026, up from 2.3% in our previous baseline scenario. Persistently elevated core inflation could lead to heightened volatility in Bund yields over the coming weeks.

5) Geopolitical instability in the Middle East remains high, and energy prices remain elevated.

In terms of curve positioning, we continue to prefer the 2–5Y segment over longer maturities, and we favour positioning for further curve steepening. While the curve has steepened over the past month, we remain cautious on the long end of the curve given the structural headwinds.

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

1) At current levels, Bund real yields already reflect all the positive developments in the growth outlook and most of the anticipated increase in bond supply, primarily from Germany.

2) At the same time, we believe that tighter financing conditions resulting from higher real yields, coupled with elevated energy prices, could weigh moderately on economic growth over the next few quarters.

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

BTP

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

We believe that the widening of the BTP–Bund spread has been largely driven by technical factors (futures data show mixed positioning in both BTP and Bund futures since the spread began to widen) rather than contagion effects. While BTP yields remain vulnerable to upside risks, particularly if discussions over the French budget fail to yield a constructive outcome, we believe that near-term risks to the BTP–Bund spread have become more asymmetric.

Strategically, we remain NEUTRAL while maintaining our positive outlook. Our strategic stance on BTPs remains slightly more cautious than that on Bunds due to the 2027 Italian general election (which could be held as early as April). While we expect the next Italian government to remain committed to fiscal discipline, we cannot yet be certain that BTPs will continue to benefit from the same degree of political stability that they have enjoyed in recent years. Moreover, as illustrated by the recent spillover effects from OATs to BTPs, the presidential and potentially parliamentary elections in France next year could lead to a widening of the BTP–Bund spread.

EQUITY

We move to a tactical NEUTRAL stance on global equities (from LONG). The earnings reporting season is proving more challenging than expected, while credit conditions have tightened materially. High-yield spreads have widened to levels last seen at the outbreak of the Iran war and around Liberation Day. **The move is therefore consistent with our view that widening credit spreads, rather than the level of interest rates alone, weigh on equities**.

We adopt a more cautious asset-class stance while maintaining that the broader bullish case remains intact. We expect range-bound trading to persist until after the US midterm elections. A Democratic "blue sweep" appears increasingly plausible and, in our view, could prove the least favourable outcome for near-term market performance.

Regionally, we move to NEUTRAL across all major areas. Ongoing geopolitical tensions in the Gulf keep us from turning LONG Europe, despite its relative insulation from AI-related market volatility. In Emerging Markets, expected US dollar weakness could partly offset the headwinds from AI-related uncertainty. We downgrade the US to NEUTRAL (from LONG), reflecting its high exposure to the AI theme and idiosyncratic political risks. We upgrade Japan to NEUTRAL (from SHORT).

At sector level, we adopt a more cautious and defensive stance, moving away from our previous cyclical tilt. We downgrade Banks and Semiconductors to NEUTRAL (from LONG). Banks are increasingly exposed to wider credit spreads, which could weaken credit quality and earnings expectations. Within Semiconductors, divergent fundamentals across AI computing, foundries, networking, analog and memory support selectivity over a broad sector position.

We upgrade Media & Entertainment to LONG (from NEUTRAL), supported by its quality characteristics, strong cash generation and improving earnings momentum. We also move Food & Staples Retailing to LONG (from SHORT), adding defensiveness through a sector with relatively stable demand and resilient earnings profiles.

Strategically, we maintain our rolling 12-month OVERWEIGHT stance. Earnings delivery, cash generation and disciplined capital allocation remain central to the returns outlook. Buybacks can support per-share fundamentals, although investment requirements and net dilution also matter. AI investment continues to absorb financial capacity unevenly, but improving free-cash-flow conversion through 2028 could gradually create greater scope for shareholder distributions.

The main risks are further earnings disappointment, additional credit-spread widening and persistent geopolitical tensions. We expect markets to remain range-bound through the election period and will look for clearer evidence of stabilising earnings and credit conditions before adopting a more constructive tactical stance.

FX

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

The main drivers of the EUR/USD over the past month have been the widening UST–Bund yield spread (particularly its real yield component) and selling pressure on French government debt, which has at times triggered flight-to-quality flows. We believe that the depreciation of the EUR has been overdone, for the following reasons:

1) Speculative positioning data indicate that investors' net short positions in the EUR are close to record highs.
2) Unless there is a sudden deterioration in EA economic growth, a dovish shift in the ECB's policy stance, or a further wave of selling pressure on OATs spilling over into the broader EGB, we expect Bund outperformance vs. USTs to lose momentum in the near term.
3) Over the past month, the rise in US real yields has been driven mainly by an increase in the term premium, suggesting that investors are demanding greater compensation for risk at the long end of the yield curve. While selling pressure on French government debt has largely offset this factor, a higher term premium typically exerts downward pressure on the currency.

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

1) We believe that the macroeconomic and monetary policy outlook, together with policy and fiscal uncertainty, will once again weigh on the USD over the medium term, once the effects of the Fed's rate hikes and the midterm elections have subsided.
2) At the same time, we believe that the EUR has already priced in all the positive macroeconomic developments. If the Middle East conflict persists, we believe that elevated energy prices will increasingly weigh on consumers, leading to a slowdown in economic growth.
3) Moreover, over the coming months, the EUR could come under renewed pressure from political uncertainty surrounding the 2027 general elections.

Against this backdrop, while the DXY could weaken, adverse developments in both the US and the EA could offset each other over the medium term.

ANIMA INVESTMENT RESEARCH

FABIO FOIS
Head of Investment Research & Advisory
fabio.fois@animasgr.it

CHIARA CREMONESI
Senior Rates Strategist
chiara.cremonesi@animasgr.it

COSIMO RECCHIA
Senior Equity Strategist
cosimo.recchia@animasgr.it

MATTEO GALLONE
Macroeconomist
matteo.gallone@animasgr.it

FRANCESCO PONZANO
Junior Equity Strategist
francesco.ponzano@animasgr.it

MATTIA BANIN
Junior Macro Analyst
mattia.banin@animasgr.it

IMPORTANT DISCLOSURES

Marketing material for professional clients or qualified investors only. This material does not constitute an advice, an offer to sell, a solicitation of an offer to buy, or a recommendation to buy, sell, or hold any investment or security or to engage in any investment strategy or transaction. ANIMA can in no way be held responsible for any decision or investment made based on information contained in this document. The data and information contained in this document are deemed reliable, but ANIMA assumes no liability for their accuracy and completeness. ANIMA accepts no liability whatsoever, whether direct or indirect, that may arise from the use of information contained in this material in violation of this disclaimer and the relevant provisions of the Supervisory Authorities.

This is a marketing communication. Please refer to the Prospectus, the KID, the Application Form and the Governing Rules ("Regolamento di Gestione") before making any final investment decisions. These documents, which also describe the investor rights, can be obtained at any time free of charge on ANIMA website (www.animasgr.it). Hard copies of these documents can also be obtained from ANIMA upon request. The KIDs are available in the local official language of the country of distribution. The Prospectus is available in Italian/English. Past performances are not an indicator of future returns. The distribution of the product is subject to the assessment of suitability or adequacy required by current regulations. ANIMA reserves the right to amend the provided information at any time. The value of the investment and the resulting return may increase or decrease and, upon redemption, the investor may receive an amount lower than the one originally invested. In case of collective investment undertakings distributed cross-border, ANIMA is entitled to terminate the provisions set for their marketing pursuant to Article 93 Bis of Directive 2009/65/EC.