Rates Strategy
CHECKING ALTERNATIVES

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We remain tactically MODERATELY LONG, but we are now considering turning NEUTRAL if there is a further rally towards the 4.20% area.

For the following reasons:

1. Markets remain relative dovish on the Fed in 2025, pricing in more than 80bp in rate cuts in 2025, along with an additional cut in 2026 (compared to our baseline, which anticipates two rate cuts in 2025).

2. The supply/demand balance in USTs remains unfavourable and continues to deteriorate, even if President Trump fails to push through an aggressive budget.

3. USTs may progressively lose some of their safe haven status as investors' preferred risk-off hedge.

Meanwhile, **we continue to extend duration at 4.50-4.60%.**

For the following reasons:

1. We have received confirmation that the Trump administration is sensitive to bond market performance and aims to keep the cost of debt under control, potentially setting a ceiling for USTs.

2. While Fed's actions on rates remain constrained by the contrasting effects that tariffs may have on growth and inflation, we believe their hands are free when it comes to market liquidity issues, particularly post-Lehman. In the event of an adverse technical adjustment due to excessive volatility in the bond market, the Fed can (and in our view will) respond with ad-hoc liquidity instruments to restore financial stability, with no impact on monetary policy stance (as seen in the aftermath of the SVB crisis in March 2023).

Strategically, we remain CONSTRUCTIVE with a NEGATIVE outlook, as the support for USTs from expectations of a growth slowdown may be offset by a temporary increase in inflation due to tariffs, by a more accommodative-than-expected fiscal stance and by the diversion of some foreign investor flows away from USTs and into other bond markets.

That said, **we believe the strategic outlook remains highly uncertain and may evolve in various directions, depending on how trade and fiscal policies develop over the coming months**.

1 - Tactically, moderately LONG on USTs, looking to turn NEUTRAL

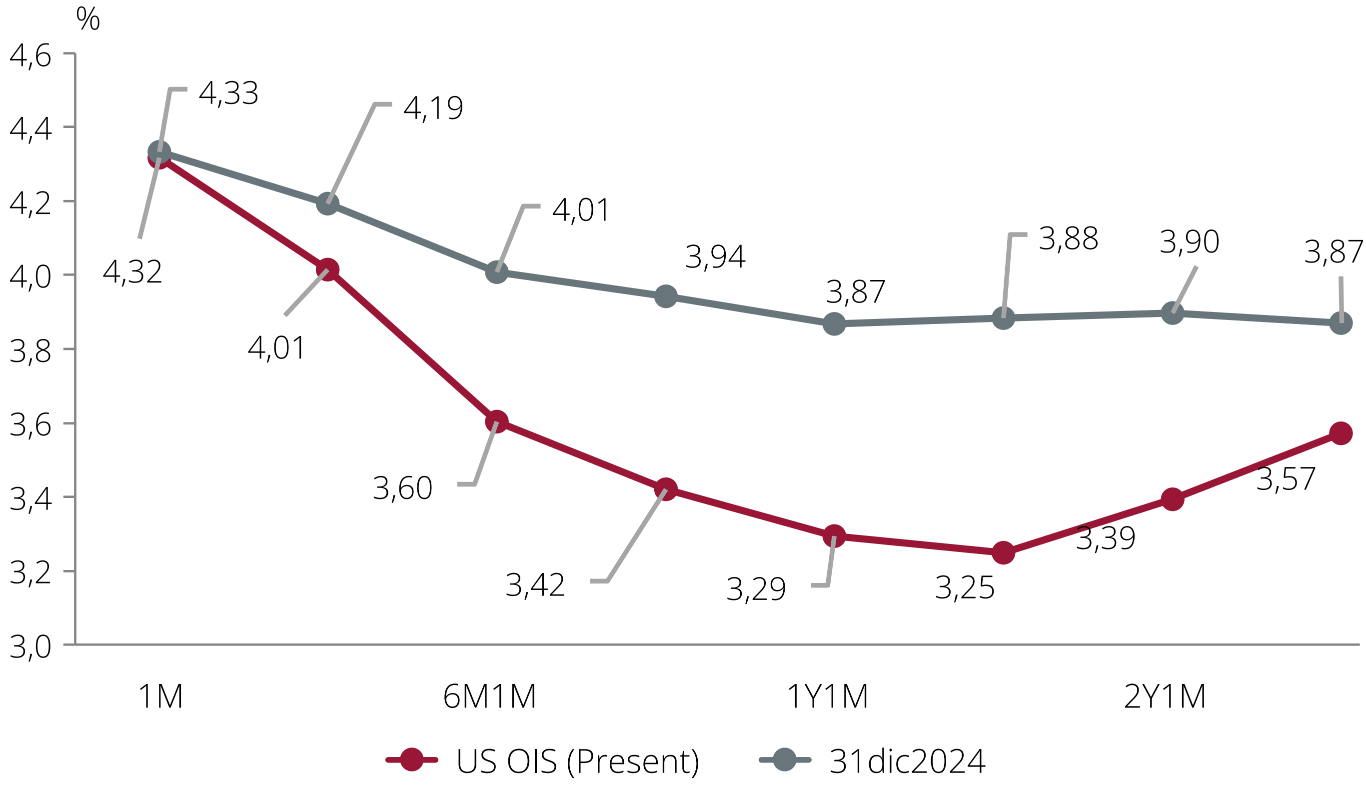
Following the revision of our macroeconomic outlook, **we remain tactically MODERATELY LONG on USTs, but we are prepared to turn neutral should there be a further rally towards the 4.20% area.**

This view is driven by the following considerations:

1. Despite recent hawkish rhetoric from FOMC members and the announcement of a 90-day delay in the implementation of additional universal tariffs, **markets remain highly dovish on the Fed's 2025** trajectory. Currently, more than 80 basis points of rate cuts are priced in for 2025, with a further cut expected in 2026. If market sentiment improves even modestly, there is a strong likelihood that one or two rate cuts will be priced out for 2025/2026 (**Figure 1**).

FIGURE 1

Monetary policy expectations on the Fed have become very dovish



Source: Bloomberg, ANIMA Research

2. **The supply-demand balance in USTs remains unfavorable and will continue to deteriorate**, even if Trump is unable to implement a full extension of tax cuts. While the slowdown in quantitative tightening (QT) may offer temporary relief, we anticipate that QT will eventually resume at full pace.

3. USTs may be gradually losing some of their safe-haven appeal as the preferred risk-off hedge for investors.

- **Figure 2** illustrates that during the most recent risk-off episode, the USTs delivered mixed results as a hedge against falling equities. Furthermore, unlike previous risk-off periods, the USD did not appreciate; instead, it experienced a notable depreciation.

- Following President Trump's announcement of a 90-day delay in the implementation of additional tariffs, the UST curve continued to steepen. USTs remained significantly cheap relative to Swaps, and the term premium stayed elevated – well above 60bps– even after softer-than-expected March inflation data. We interpret this as a sign that President Trump's policies have already begun to erode investor confidence, particularly among foreign investors. As a result, we expect the term premium to remain structurally higher than in the past.

At present, we lack -real-time official data to confirm whether non-resident investors are reducing their holdings of USTs. The Fed weekly report on foreign official holdings of USTs held in custody—often a reliable proxy for central bank activity—, indicates that foreign official holdings have so far remained stable. However, this will be a critical factor to monitor going forward, given the importance of foreign investors to the stability of the UST market.

Indeed, non-resident investors currently hold 33% of outstanding USTs, equivalent to USD 8.6tn out of over USD 26tn in marketable debt (**Figure 3**). Among foreign UST's holders, the eurozone, Japan, China and the UK are the most significant (**Figure 4**).

Chinese investors alone (most of which are represented by central bank holdings) hold USD 760bn in USTs (around 3% of US marketable government debt, based on official statistics). However, the actual figure may be higher, as a portion of China's holdings is likely channelled through other jurisdictions such as Belgium and Ireland.

FIGURE 2

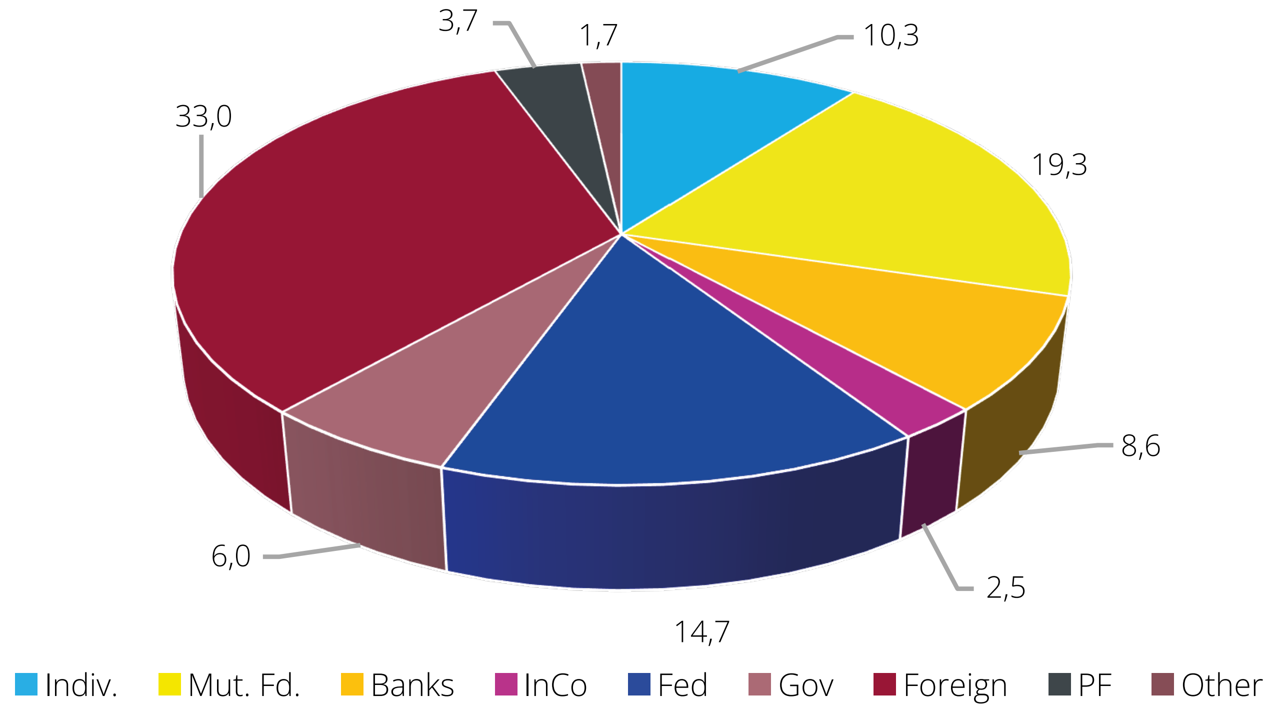
USTs are increasingly losing their status as a reliable safe-haven asset

	Equity (%)	10Y UST (Bp)	Correl bond-equity(%)	DXY (%)
Ott07-Mar09	-56	-181	51,89	13
Sep18-Dec18	-18	-27	38,19	3
Feb20-Mar20	-32	-74	68,59	4
Dec21-Sep22	-22	243	-8,87	16
Feb25-Now	-12	-17	21,61	-7
Since Liberation day	-5	24	20,77	-4

Source: Bloomberg, ANIMA Research

FIGURE 3

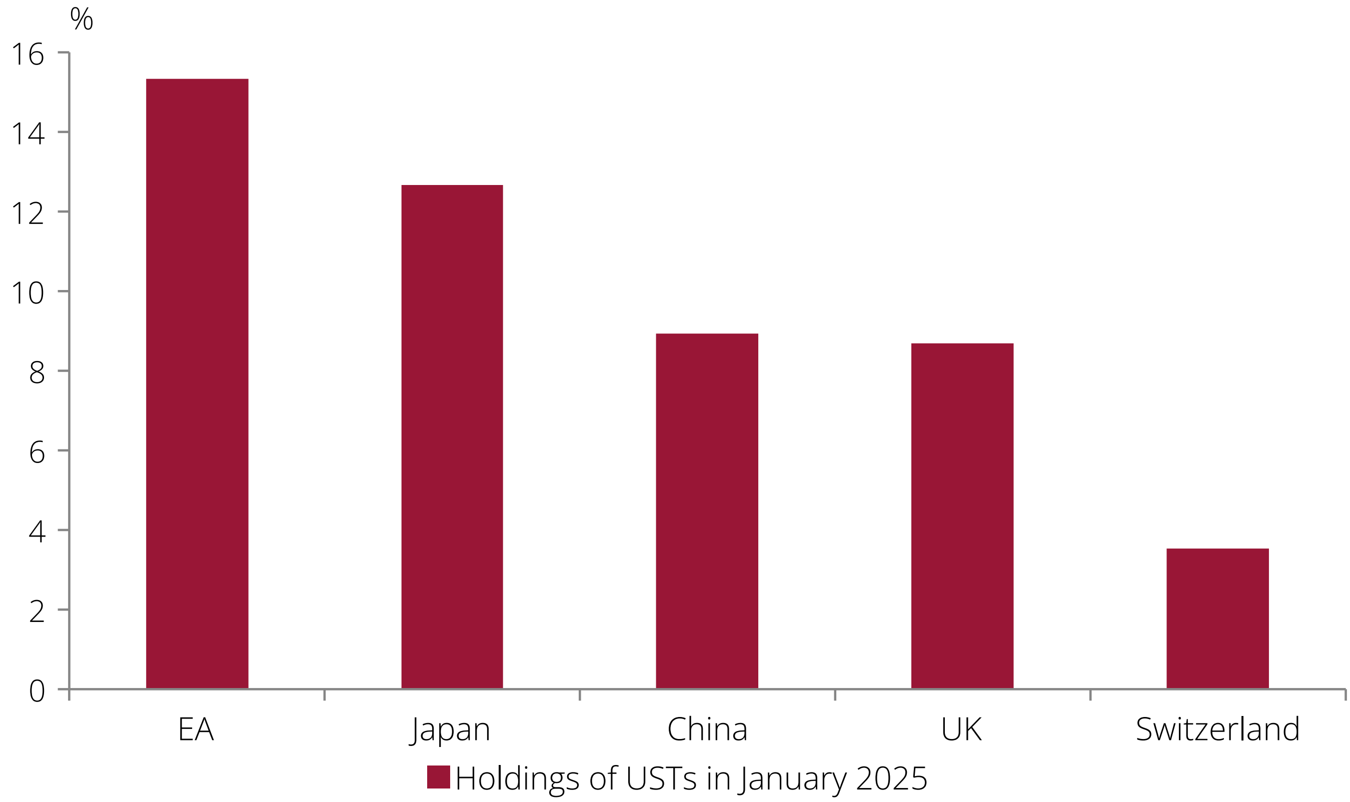
Foreign investors hold 33% of marketable US government debt



Source: SIFMA, ANIMA Research

FIGURE 4

EA, Japan, China and UK are the largest foreign holders of USTs



The chart illustrates the share of USTs held by selected foreign investors as a percentage of total foreign holdings.
Source: Bloomberg, ANIMA Research

What factors could push the 10Y UST yield below 4.20% in the short-term?

1. **The resurfacing of recession fears.** Since October 2025, the 4% level has proven to be a strong support for 10Y USTs. Our model suggests that the fair value for the 10Y UST is around 4.30%. However, in the event of a moderate recession, 10Y UST yields could fall as low as to 3%. Should sign of economic weakness emerge in hard data, markets could price in a higher likelihood of recession and an expectation that the Fed will cut rates below neutral in 2026. This would likely result in the 10Y UST yield dropping well below the 4.20% mark.

2. **Fiscal tightening.** If the 2017 tax cuts are only partially extended and expenditure cuts are implemented, this could lead to a decline in 10Y yields, pushing them below 4.20%.

Meanwhile, we have maintained our threshold for gradually beginning to extend duration at 4.50-4.60%.

From the recent episode of heightened tensions in the bond market, we drew two key considerations that lead us to conclude that the **4.50-4.60% range could be an opportune level to re-extend duration in the near term**:

1. We have received confirmation that the Trump administration is attuned to bond market performance and is keen to keep the cost of debt under control. After three days of substantial sell-offs in USTs, combined with negative USD and stock performance (which typically signals significant capital outflows from foreign investors), President Trump reversed some of his Liberation Day tariff measures, helping to break the negative cycle of rising UST yields.

2. In the event of an adverse technical adjustment caused by excessive volatility in the bond market, such as unwinding of basis trades or swap spread trades, the Fed can respond with ad-hoc liquidity measures aimed at restoring financial stability. These measures would have no impact on the overall monetary policy stance (e.g. as seen in the aftermath of the SVB crisis in March 2023).

What factors could push 10Y UST yields above the 4.50–4.60% range?

1. **Fiscal easing.** If the Trump administration successfully implements an extension of the 2017 tax cuts (estimated to cost around USD 4–4.5 trillion over 10 years), with only minor reductions in expenditure, the deficit could exceed 7%. This would likely result in a rise in the term premium and a further steepening of the UST yield curve.

2. **Un-anchoring inflation expectations.** So far, investors have viewed the rise in inflation due to tariffs as temporary. This is reflected in breakeven rates and inflation swaps, which have risen at the short maturities but remained stable at the long end, resulting in a sharp

inversion of the breakeven curve. However, if inflation expectations begin to rise at the long end, this could push 10Y UST yields above the 4.50–4.60% threshold.

3. **A fully-fledged crisis of confidence in the US.** In the event of significant selling of USTs by foreign investors, UST yields would need to adjust to a new, higher equilibrium, particularly at the long end of the curve.

2 – Strategically CONSTRUCTIVE with a negative outlook

We remain strategically CONSTRUCTIVE with a NEGATIVE outlook, as the support for USTs from expectations of a growth slowdown may be offset by a more accommodative-than-expected fiscal stance and by the diversion of some foreign investor flows away from USTs and into other bond markets. **That said, we believe the strategic outlook remains highly uncertain and could evolve in different directions, depending on how trade policy and fiscal policies develop over the coming months.**

3 – We remain tactically LONG and strategically NEUTRAL on Bunds

On Bunds, **we remain TACTICALLY LONG and have lowered our trading ranges: we recommend extending exposure at 2.70-2.80%** (vs. 3.00-3.10% previously) **and taking profit at 2.30-2.40%** (vs. 2.50-2.60% previously).

We believe that, in the near term, markets are likely to focus on the negative impact of tariffs on EA growth, while suspending concerns over the effects of the German fiscal package and the EU defence plan.

That said, **we remain STRATEGICALLY NEUTRAL** because the US tariff policy has increased the likelihood that the EU will make further institutional progress and deliver on common defence, as well as a European Union for Savings and Investment. Additionally, the rise in fiscal spending in Germany will help offset the downward pressure on yields caused by tariffs.

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