Investment Institute *Asset Class Views*

Monthly Investment Viewpoint

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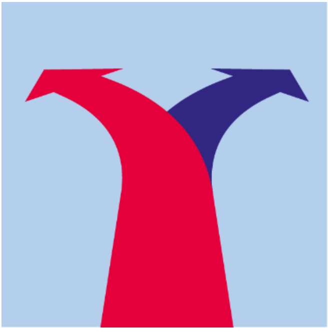
KEY INVESTMENT THEMES

US policy dictates outlook



Central bank policy divergence

Foreign US credit inflows

Investors await clarity on US policy

US policy uncertainty and its outlook implications remain front and centre. In the case of adverse outcomes, US assets remain most at risk, given the threats to growth, inflation and interest rates. Markets reflect this with US equities and long-duration bonds underperforming in 2025. Over the summer there could be more policy clarity. Investors should be prepared for a meaningful level of import tariffs and a budget that underscores medium-term fiscal sustainability risks. In fixed income, short-duration strategies have endured less drawdown and delivered positive year-to-date returns. Resilient fundamentals should help sustain credit assets' performance with limited interest rate risk. Being at the centre of the trade war; US and greater China equity indices have performed poorly. Few countries are exempt from trade risks but equity markets with the lowest valuation multiples should fare better as uncertainty persists. The UK, Canada, Australia and Eurozone have the lowest drawdown risks given current valuations.

Central bank policy: Same shock, different answer

The pandemic reminded us that monetary policy is not well equipped to face economic asymmetries. For decades, the standard model has somewhat dodged the supply side issues in the economy, prioritising demand stabilisation instead. While the European Central Bank's (ECB) Strategy Review will supposedly address this key issue, responses may vary. The Federal Reserve (Fed) is confronted with a US trade policy asymmetric shock, although the consensus was already expecting higher inflation and slower US GDP growth even before Liberation Day. In contrast, the ECB is facing a symmetric shock, i.e. slightly lower growth and inflation, which is easily manageable with standard tools. Therefore, the Fed's reaction should differ from the ECB's, at least in theory: Fed policymakers should carefully weigh costs and benefits of targeting price stability rather than full employment and vice versa. Against this background, markets believe that both the Fed and the ECB are likely to continue cutting rates during 2025.

Foreign flows into US credit: A pause rather than reverse

Concerns over foreign investment in US dollar credit have recently emerged, driven by the deflation of US exceptionalism narrative and the substantial appreciation of Taiwan's dollar. A flood in US dollar supply, alongside limited demand drove the move, as investors returned to home equity markets and exporters repatriated deposits. Data shows that historically there has been no structural relationship between the US dollar and foreign investors holdings of US corporate bonds. Instead, other factors play an important role in driving foreign demand, such as global savings supply and limited competing domestic investment alternatives. For Asian investors, challenging foreign exchange (FX) hedging costs are not new, however US dollar credit purchases from life insurers could ease if they're faced with headwinds to sell US dollar-denominated policies. Increasingly so if local investors think the dollar is overvalued, and more losses could be ahead. Equally, an FX hit to earnings could constrain insurers' ability to continue to deploy capital into US dollar credit.

Asset Class Summary Views

Views expressed reflect CIO team expectations on asset class returns and risks. Traffic lights indicate expected return over a three-to-six-month period relative to long-term observed trends.

Positive	Neutral	Negative

CIO team opinions draw on AXA IM Macro Research and AXA IM investment team views and are not intended as asset allocation advice.

Rates		Lower interest rates but steeper yield curves reflect longer-term risk
US Treasuries		Concerns over US budget deficit should prevent decline in yields
Euro – Core Govt.		European Central Bank to ease monetary policy further
Euro – Govt Spreads		Limited fiscal concerns support continued income
UK Gilts		Attractive valuations surpass fiscal and monetary policy concerns
JGBs		Ministry of Finance has suggested less longer-dated JGB issuance to restrain the rise in yields
Inflation		Continue to like short-duration inflation linked bonds

Credit		Modest excess returns expected with risks of spread widening
USD Investment Grade		Strong demand despite Treasury volatility
Euro Investment Grade		Yields are more attractive than government bonds
GBP Investment Grade		Spreads seem unlikely to narrow further
USD High Yield		Attractive yields and strong support from technical factors
Euro High Yield		Yields around 6% or higher are attractive given outlook for lower interest rates
EM Hard Currency		Market unlikely to achieve new highs given US Treasury uncertainties

Equities		Global trade uncertainty will hit profit margins
US		Valuations are once again elevated while earnings momentum is fading
Europe		Short-term uncertainty over US trade deal but valuations remain attractive
UK		Sentiment towards UK remains poor but boasts low volatility relative to global trade concerns
Japan		Valuations fair; decline in trade uncertainty would be positive
China		Tech a positive catalyst; broader earnings are challenged by deflation and structural imbalances
Investment Themes*		Long-term, still positive on artificial intelligence and carbon transition strategies

*AXA Investment Managers has identified several themes, supported by megatrends, that companies are tapping into which we believe are best placed to navigate the evolving global economy: Automation & Digitalisation, Consumer Trends & Longevity, the Energy Transition as well as Biodiversity & Natural Capital

Data source: Bloomberg