THE MONTHLY LETTER

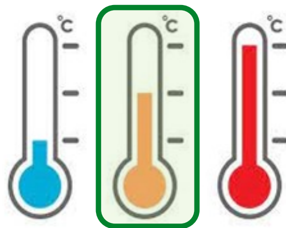
Tactical update

MARCH 2025

Reality check

Global landscape

Inflation in Next 6m



Stance: above central banks targets (ex-China)

Trend: widely dispersed

Economic growth in Next 6m

Stance: below LT potential

Trend: recovering from cyclical low (ex-China)

The long-term macroeconomic regime is characterised by irregular and volatile economic cycles

The following factors will negatively impact potential growth: Weakness in the main structural factors (demographics, excessive debt and productivity), Asymmetric risks of deflation or inflation, The uncertain pace of adoption of AI - Issues of deficit financing and debt reduction

Cyclical outlook. Early, hectic stage of global reflation

The US, along with China and Japan, is expected to be a key driver of the 2025 recovery. Europe is set to experience a more gradual recovery, while emerging markets will undergo hectic trajectories. The form of new US economic policies will establish the framework for a more uncertain S2. The formation of a new German coalition could have positive implications for the EU.

Geopolitics. The die has been cast

The new US administration is making bold changes. The likelihood of unexpected events has increased. There is a higher chance of de-escalation in the Ukraine/Middle East conflicts, but what are the implications?

Global liquidity momentum will gradually wane

Liquidity conditions are still favourable. But a deceleration is imminent

Negative equity-bond correlation still in place, for now

The expectation of US sub-3% CPI over next quarters remains valid, but fragile. More active reflation in China and the EU would not endanger it. Japan remains a dangerous case apart, to be monitored.

Highly volatile investors' sentiment and capital flows

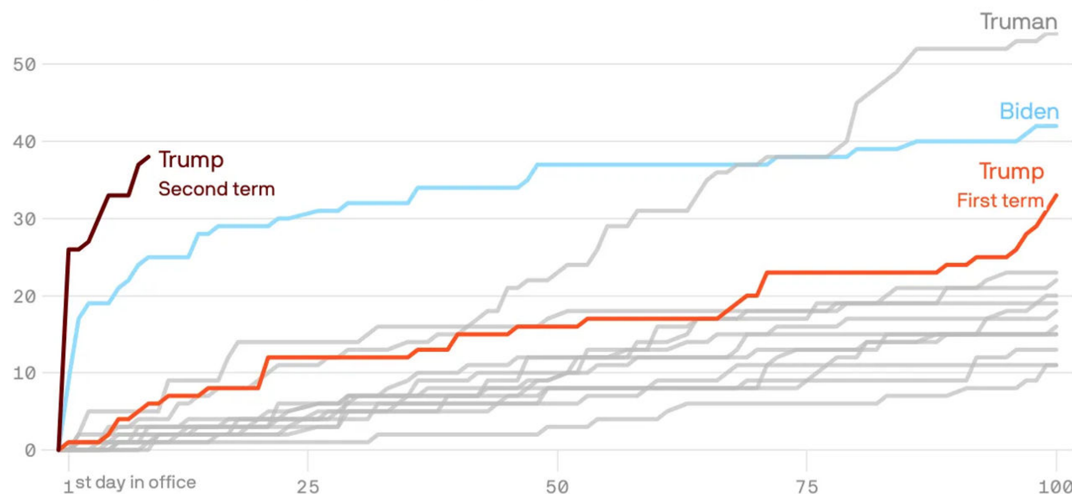
Retail investors' complacency finally vanished. Further deleveraging / downsizing is possible short-term.

No omelette without breaking eggs

A transition period of approximately 100 days occurs for a new government to settle in. With Trump, the honeymoon period was short. Recent market fluctuations and survey results suggest that the optimistic sentiment that characterised Q424 are coming to an end. This would mark the conclusion of the period of risk-taking associated with the new administration.

Thriving in Chaos, the best-selling management guide by T. Peters, theorises and promotes the virtues of adaptation and flexibility, especially in difficult/uncertain times. The guide is based on three postulates: A) Incremental change hinders true innovation, B) Excellent companies see continuous improvement as the way forward, not excellence as the goal, C) A constantly changing environment does not necessarily lead to chaos; it means that companies can manage change successfully.

Trump brutally imposes his law/vision

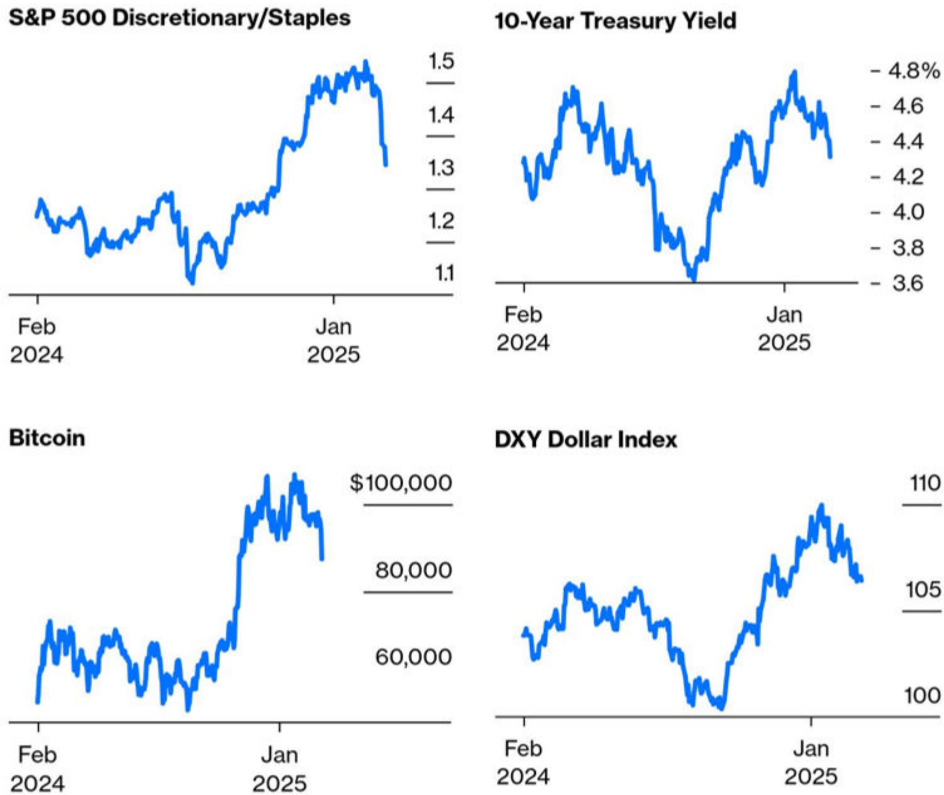


The policy is yet to be finalised, so it would be premature to reject it outright.
Still, this approach will worsen international relations.

US economy. From Goldilocks to growth scare?

The President and Musk's frequent appearances and statements have compounded the confusion. The launch of two crypto-memo coins by the President and First Lady represented the culmination of "outstanding" events. These actions proved overwhelming, overshadowing the reassuring impression created by Treasury Secretary Bessent and his articulate, coherent speech. Market participants are now being concerned about a slowdown in US growth and sticky inflation.

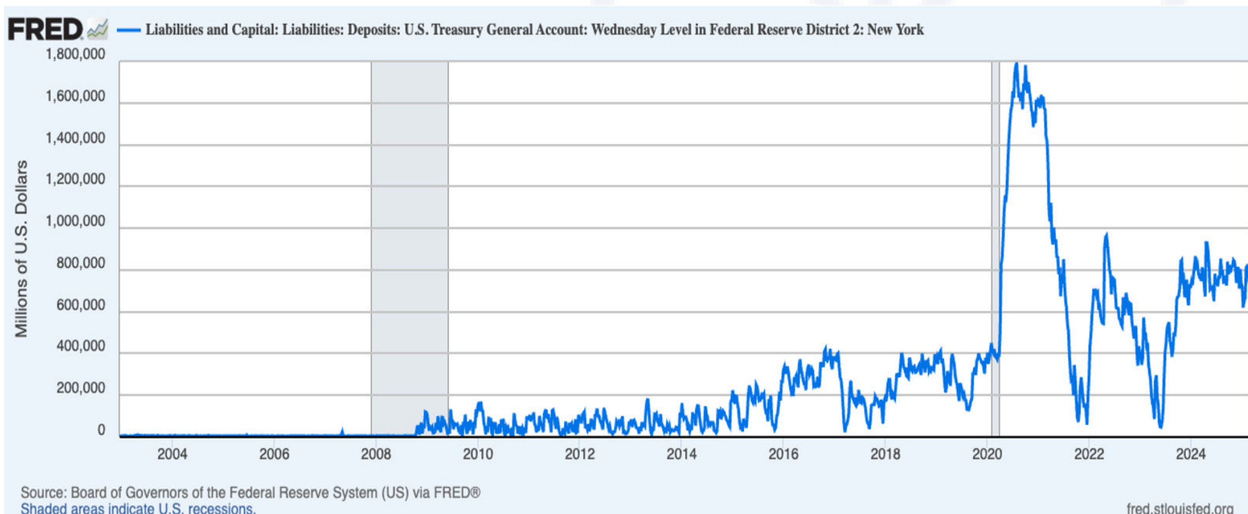
Brutal reversal of ¨Trump trades¨



Unreasonable expectations of US exceptionalism have been moderated.

The US Treasury's predictable schedule for future issuance and the substantial size of its (TGA) reserves are expected to maintain stability in interest rates. This is good news as an overheated economy in 2025 could have potentially disastrous consequences.

Like for the former administration, TGA will come to the rescue



Big – enigmatic – moves in the making

The United States is launching a new wave of protectionism, threatening to impose various forms of tariff barriers. The objectives are numerous and varied, including replenishing the public purse, reindustrialising, and pursuing strategic objectives (defence). However, it is unlikely that these objectives will be achieved, particularly considering the retaliatory measures that will be taken by their trading partners. Tariff barriers are often circumvented. Decentralised production chains are being phased out. Protectionism hinders trade, lowering volumes, distorting prices and discouraging investment. This is detrimental to the global economy.

A repeat of the 1985 Plaza Accord is unthinkable, given the uncooperative nature of international relations. Then there are rumours of a so-called Mar-a-Lago deal. It would basically consist of forcing foreign countries to either invest in the US or participate in a disadvantageous debt swap. The US would offer to swap foreign-held Treasuries for non-interest-bearing ultra-long-term Treasuries. Participants would either avoid tariffs and/or receive US defence protection. The US would reduce the supply of tradable Treasuries, tame interest rates and weaken the USD.
After a short introduction, the new administration has started to reveal its intentions, displaying a strong stance.
Its modus operandi, predicated on intimidation, the element of surprise and the raw balance of power, constitutes a grave source of destabilisation and political, economic and financial uncertainty.

Asset allocation recommendation

Undisputedly, uncertainty is rising in many areas. However, take care not to overreact! The positive first phase of the reflation cycle is still in effect around the world, liquidity is abundant and the risks of overheating in the US have dropped. More, speculative activity has decreased as the complacent retail investors become more cautious.

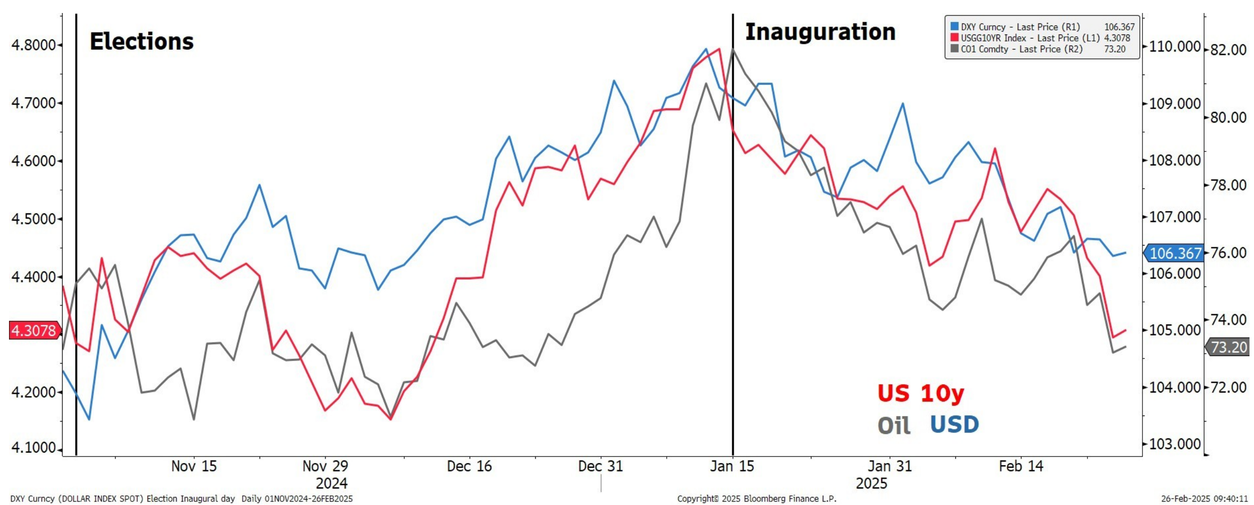
While a slightly more cautious approach to asset allocation is warranted, focus should be on active sector and country repositioning.

Currencies

Not just a weak USD

In 2024, the USD was without doubt the best-performing developed market currency, followed by the GBP, with the EUR in third place.The key to our constructive EUR outlook is the expectation that the USD will lose some of its 2024 gains, and the outlook for 2025 is clear: it will be like that of 2017, with Trump's policies impacting the USD performance. The trajectory of the EUR/USD in Q4 2024 and Q1 2025 mirrors that of late 2016 and 2017.

Trumps objectives include lower yields, cheaper oil and a weaker USD



Rates are a key driver.Reduced expectations for Fed rate cuts and the prospect of further ECB cuts have helped pull EUR/USD lower in 2024, with the correlation with the EU/US 2-year swap spread reaching 90% last year.The relationship clearly indicates that the pair was oversold at the start of the year, and we are certain the 2-year yield gap will pull EUR/USD higher. To reach parity, the 2-year spread would need to widen to -300bps, from the current -210bps.It is also noteworthy that the EUR is trading at 3 standard deviations below its purchasing power parity value.

The USD is likely to weaken with lower US rates

Trump was clear: a strong USD hides US manufacturers' ability to sell their goods. In response, Bessent restated the strong USD policy, emphasising that other countries should not adopt a weaker currency policy. In November 2024, the US Treasury added China, Japan, Singapore, South Korea, Taiwan, Vietnam and Germany to a watch list, indicating a strategic focus on FX policy. The US administration seeks to avoid a record-breaking year for the currency.

In Germany, the formation of a coalition took six months after the September 2017 elections, and the market is not expecting a clear and decisive result anytime soon. The speculative positioning data indicates that investors have maintained a net short EUR/USD position, which has remained relatively stable in recent months. Overall, speculators are heavily invested in the USD, with limited room/appetite to further boost their USD positions.
The EUR/USD has found a floor. We maintain our outlook for a gradual appreciation throughout the year.
Part of the catalyst is a correction in an expensive USD against a cheap EUR.

The GBP as high as in 2020 and 2022

Sterling reached this upper limit on both occasions, but corrected shortly thereafter. The reason for the subsequent pullback was an unusual external shock: the pandemic and the gas price shock. In these crises, the EUR acted as a safer haven. Assuming no black swan event occurs, the GBP will gradually rise. The Eurozone is experiencing greater political uncertainty than the UK, and FX markets are sensitive to uncertainties. This is not a vote of confidence in the UK government; it is just worse in Europe.

The GBP is testing key levels

The ECB will ease more than the BoE this year, with markets anticipating three ECB cuts versus two BoE cuts. Furthermore, if there is less fiscal stimulus in Germany after the elections, the ECB will have to go a bit further than current pricing suggests.

While neither the UK nor the Eurozone are likely to experience significant growth soon, the UK is expected to outperform. The tariffs imposed by the US government have not yet had a negative impact on the UK economy.
The combination of reduced uncertainty, a more stable rate environment, and a modest uptick in growth is likely to support the GBP against the EUR.

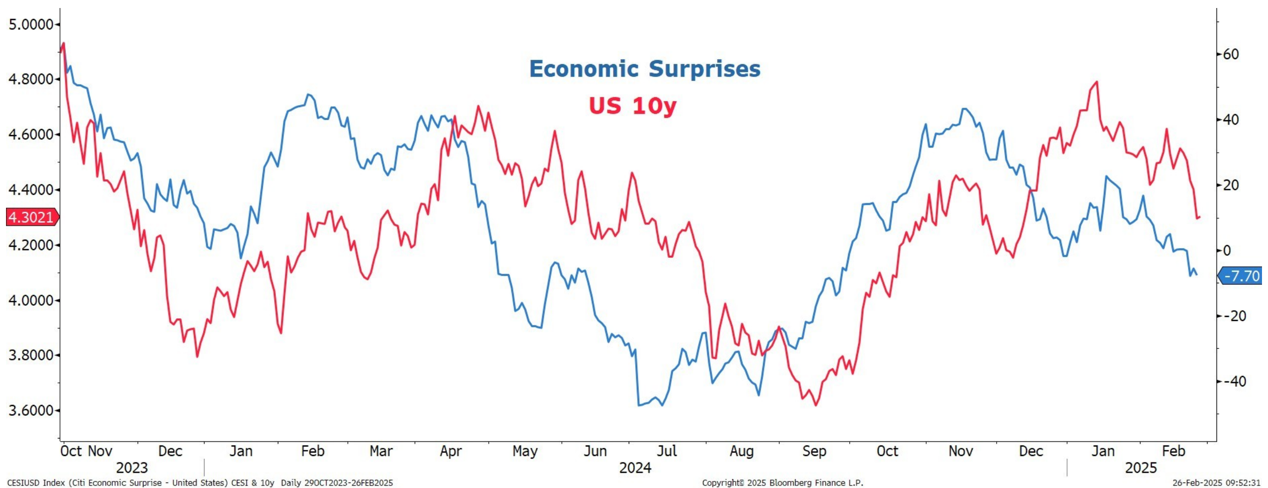
Bonds

Fed participants hold differing views

The Fed took a cautious approach, and for the first time since July 2024, it did not cut rates. There are several reasons for this decision. The job market remains robust, inflation has shown less softening, and there is significant uncertainty surrounding economic policy. President Trump has already issued a record number of executive orders, tariff threats have become a daily occurrence, and efforts to reduce the public sector (DOGE) have led to resignations.

This is causing heightened policy uncertainty, which is creeping into surveys of US economic activity. Consumers' long-term inflation expectations hit a 28-year high of 3.5%, while their confidence has plummeted, as shown by most leading activity indicators. The Fed is in a consensus to be patient, but some members have expressed disagreement. Given the anticipated decline in the Treasury General Account in the forthcoming weeks owing to the debt ceiling, it is prudent to consider a temporary halt or moderation in balance sheet runoff (QT). This stance contrasts with Powell's remarks during his testimony to Congress. Our forecast for the final Fed Funds rate (3.00/3.25%) remains well below the market-implied range of 3.50-3.75%.

Economic surprises index leads yields by 1 or 2 months



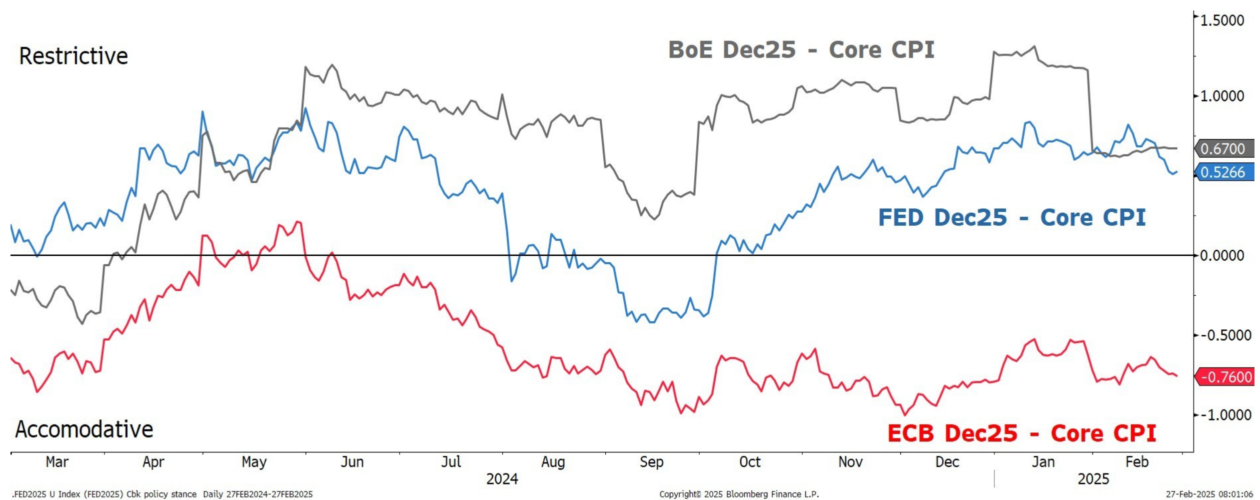
The most likely scenario is the Fed announcing in March meeting a slowdown of the monthly pace of UST runoffs. We maintain our call of 4 cuts this year.
Disappointing macro data will push long-end yields down.
An earlier end to QT together with the US Treasury Department's announcement that it will not increase issuance for several quarters, could halt the recent rise in the 10-year US Treasury term premium.

Relative value

At this stage of the economic cycle, it is vital to assess progress and identify areas for improvement by focusing on the central bank policy stance. The first approach to estimate a central bank policy rate stance is to compare year-

end key rate expectations with short-term inflation expectations. At present, all three are positive, indicating an accommodative monetary policy. However, if we compare central bank rates year-end expectations with the current core CPI, we see a different picture. The Fed and the BoE have maintained a restrictive stance for most of the past year, while the ECB has adopted an accommodative stance for over a year.

At this stage of the cycle, the ECB has been accommodative for some time



Germany has followed a distinct trend in bond supply compared to other countries over the past decade, with a net reduction in bond supply, while peers have shown a positive net supply. The US government yields significantly more than German Bunds, a notable shift from the situation a decade ago, primarily due to the implementation of the debt-brake rule in 2011.Since then, the US-Bund spread has been materially above zero, while prior to 2011 it was less pronounced.

In Europe, government ratings are clearly diverging between the core and the periphery. The core countries are experiencing a decrease in their ratings, while periphery nations are seeing an increase. This shift is a direct result of significant differences in the underlying economic factors. The improved performance of the periphery is a clear result of tighter fiscal discipline following the 2010 debt crisis, whereas core countries (France and Italy) have struggled to maintain their ratings, except Germany.
A significant policy shift in Germany may lead to a convergence in bond yields.
The Fed and the BoE have more room to ease than the ECB.
We favour US and UK government bond markets over Europe.

Credit spreads do not require central banks support

Contrary to 2021, when central banks purchased corporate debts, there is now a very strong market appetite for this asset class, despite heavy new issue volumes, ongoing uncertainties and a rise in risk aversion. It is clear that companies will not start a strong releveraging soon and IG credit fundamentals are set to remain solid and supportive for spreads, even if the economy growth slows.

The latest Fed senior loan officers survey revealed that banks have raised standards for medium-sized and larger companies, more than in the past 3 years, which will put pressure on borrowers who are already dealing with higher funding costs. Fridson's data, back to 1997, shows a correlation of 70% between lending standards and the level of distress in credit markets. The distress ratio — defined as the proportion of bonds trading at a spread of 1000bps or higher — reached 3.7% in January, well below its long-term average of 12.7%, and down from a peak of 10.4% in March 2023. Risky borrowers should face refinancing at higher rates as cheap debt from the pandemic starts to expire, despite the Fed easing. HY firms are more vulnerable to a downturn.The latest Fed survey data may just be a blip, but the most significant increase in lending standards since Q4 2022 will exert pressure on the weakest companies.

We do not anticipate a significant and lasting IG spread tightening.

An increasing distress ratio is a potential catalyst for wider spreads.

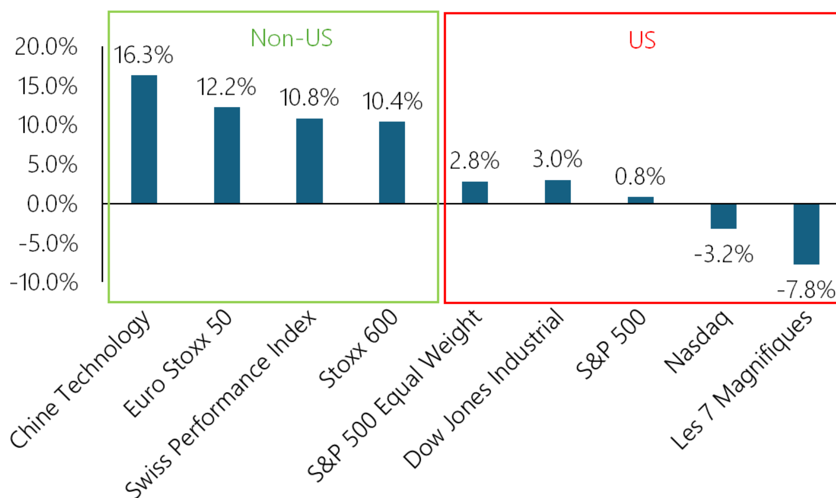
A tightening of credit standards poses a heightened risk for a greater number of companies and wider HY spreads.

Equities

The end of the Trump trade and AI momentum. Investors are turning to Europe and China

End of the honeymoon between Donald Trump and American financial markets, American households and US companies. In 2025, American stock indices significantly underperform the rest of the world, American household confidence indices fall and American companies slow down their investments in the face of Donald Trump's unpredictability and inconsistency.

Performances of indices in 2025



The polls for Donald Trump's first 30 days in office are the worst of any US president since 1950. 48% of respondents disapprove of his trade policy and the layoffs within the federal government. Polls show that Trump is not doing enough to lower retail prices. In 2017, the situation was the same with 45%, far ahead of Joe Biden with 37%, George W. Bush with 25% and Bill Clinton with 20%.

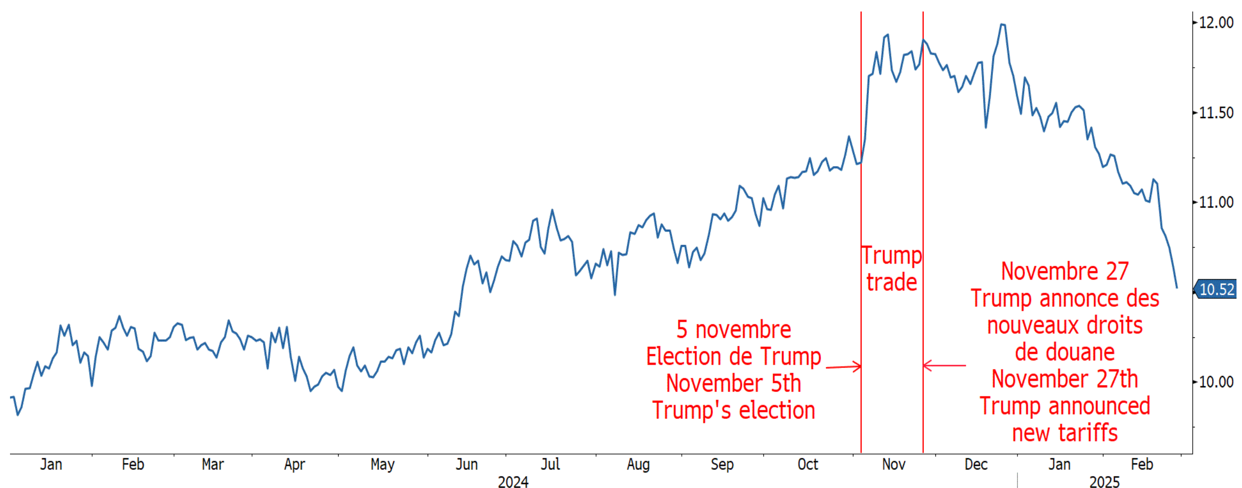
The beginning of the dismantling of the federal government is brutal with massive layoffs, affecting the Washington DC region with a drop in consumption and a housing sector under pressure, despite the injunction of judges to stop the layoffs, because this power rests with the agencies themselves and not with the management and budget office. Two important federal agencies are being shattered, the National Oceanic and Atmospheric Administration, NOAA, and the Consumer Financial Protection Bureau.

In the 4th quarter of 2024, S&P 500 profits grew by a healthy 16.9%, with 77% of companies reporting higher than expected profits. The four sectors supporting this strong performance were banks, communications, consumer discretionary and technology. However, the negative outlook has increased with Donald Trump's tariff hike and the likely counterattacks from the countries concerned, with a risk of inflation, recession and disruptions in supply and production chains.

On March 4, the new tariffs will amount to 25% for Mexican and Canadian imported products, steel and aluminum, and 20% for Chinese products. Donald Trump announced 25% tariffs for European products, without detailing for the moment which products will be affected and when they will be implemented. A "tit for tat" situation would obviously be damaging for the global economy and corporate profits. Europe, Canada and China have announced that they will retaliate. A recession in profits (2 consecutive quarters of profit decline) has always resulted in a correction of the stock markets; the Atlanta Fed's GDPNow announces a decline in US GDP of 1.5% in 1Q25.

The other factor explaining the underperformance of the US stock market, and the Nasdaq in particular, is the arrival of the Chinese company DeepSeek with R1, its open-source conversational AI application, presenting itself as a serious alternative to ChatGPT and other chatbots, challenging the American AI business model due to lower development costs, less data center infrastructure and reduced energy consumption. The Magnificent Seven will underperform in 2025. AI is becoming a commodity and therefore, their valuations no longer deserve a premium.

S&P 500 / Stoxx 600. The US stock market started its underperformance with the announcement of new import tariffs as soon as he arrives at the White house. Since January 27, DeepSeek has accelerated this movement.



In this chaotic environment, investors are returning to European and Chinese stocks due to their defensive and Value bias, as well as for their lower valuations. The Trump risk is also an argument for underweighting US stocks. The sharp rise in the stock prices of the Magnificent 7 had pushed their weight in the S&P 500 to historically high levels (32%). The weighting of the US stock market compared to the overall market had also reached record highs, out of step with the weight of US corporate profits. There is a need for a readjustment against the United States.

Source: Thomson Reuters, Goldman Sachs Global Investment Research

Stock markets will be volatile in 2025 and there will be a lot of dispersion within indices and sectors. We are not immune to a correction if economic and geopolitical conditions were to deteriorate; no bear market, but a potential decline of between 6% and 13% according to technical analysis. In terms of seasonality, after two unfavorable months, the

March-April period is historically more favorable, but the first quarter of a year following a US presidential election is generally weak, including March.

While many strategists recommend defensive sectors, there is no guarantee of outperformance. For example, the healthcare sector has been outperforming for a few weeks, but with a lot of internal dispersion; we remain cautious with the 25% tariffs announced on European products, not knowing which products will be affected (probably also pharmaceuticals) and with the new rather anti-drug US administration. A change in the FDA could penalize pharmaceutical companies. The United States accounts for 45% of global sales in the pharmaceutical sector. The consumer staples sector could be affected by inflation. However, it is true that these two sectors outperform during stock market corrections.

Our convictions focus on two sectors: European defense and Chinese technology. It is obvious that Europe must rearm. Before the Russian invasion, the major European powers had a military spending/GDP ratio between 1% and 1.5%. Today, it is around 2%, while the 5-year target is 3%-3.5%. We are overweighting European defense stocks. Chinese technology is becoming interesting again. The arrival of DeepSeek in the AI landscape and Huawei's good results demonstrate that the constraints on exports of technological products to China are not slowing down Chinese development. Xi Jinping is easing the pressure on private entrepreneurs to promote innovation.

Alternative Investments

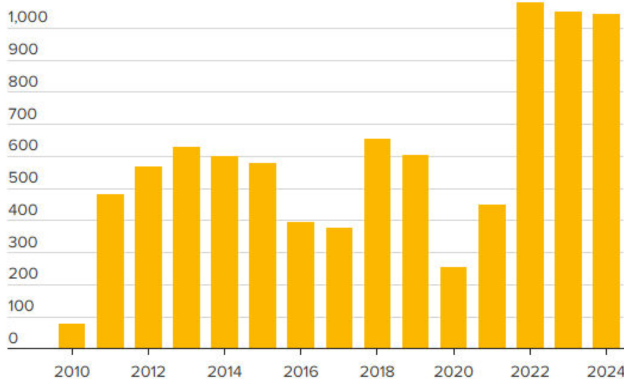
The Trump effect on industrial and precious metals. The end of the Trump trade weighs on cryptocurrencies

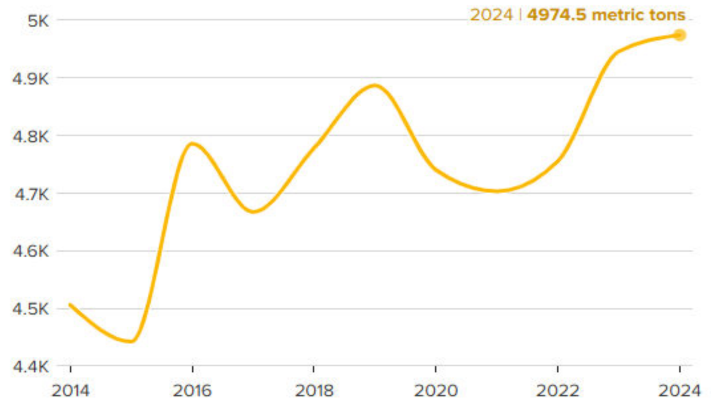
Industrial metals. The announcement of the 25% increase in customs duties on steel and aluminum on March 12 pushed traders to buy aluminum and copper massively in the United States before the price increase. Donald Trump has not ruled out putting new customs duties on other metals, including gold and silver. Prices have only risen in the United States. The premium for copper futures on the New York Comex is between $600-$1,000 per ton compared to futures on the London Mercantile Exchange; the same goes for aluminum, some of which comes from Canada. Copper inventories on the Comex are at their highest since 2019. But outside the US, industrial metal prices are weakening, as the market believes that Donald Trump's trade war will result in an economic slowdown, at best. For the moment, it is American buyers who are paying the price for Donald Trump's trade war. Donald Trump's idea with his tariff increases is the repatriation of metal production lines to the United States, but for experts it would take 4 to 5 years to have American domestic production. Despite the growing risk of an economic slowdown, we are maintaining our neutral tactical allocation on industrial metals, due to a likely decline in the US dollar and new Chinese measures to support its economy.

Spread of copper price between Comex and LME

Precious metals. After having reached nearly $3,000 per ounce, gold weakened with the bullish recovery of the dollar. But the trend is structurally bullish. Donald Trump does not rule out customs duties on gold and silver, but first he would like to check the gold stocks at Fort Knox. To be sure that Americans' gold has not been stolen. The total amount of American gold stocks should amount to $770 billion. Donald Trump's idea would be to revalue US gold, recorded at $42 per ounce, to reduce the debt or pay the bills by selling gold. Everything is still unclear and difficult to perceive the impacts. In the meantime, gold performs well when there are trade and geopolitical tensions in the world. Gold is a "Trump tariff trade". In 2024, central banks continued their purchases of gold.

Central banks' gold net purchases and gold global demand at record level in 2024





In the short term, the price of gold is hitting the psychological barrier of $3,000, but it should be easily crossed in 2025. Since the beginning of the year, we have observed an acceleration in gold purchases in financial products invested in gold by individual investors, which is not the case for products invested in silver. We buy gold.

Bitcoin fell to $78,500 on March 1, a 28% drop from its highs of $109,000 in mid-December and mid-January. Nothing exceptional for a highly volatile asset. The explanations are the end of the Trump trade, speculation on the eve of Donald Trump's inauguration with the Trump meme coin and Melania meme coin, relative disappointment with the expectation of new legislation on digital assets for the summer of 2025 and the hacking of $1.5 billion worth of bitcoins on the Bybit platform. Risky assets do not like uncertainty and cryptocurrencies follow the Nasdaq, which is in a bearish phase. This recent correction is considered a buying opportunity. The digital asset industry is becoming institutionalized and upcoming US legislation should result in less volatility. US banks are ready to buy bitcoins. Pending regulatory development, several US states and central banks want to create strategic reserves in bitcoins. In February, there was a record outflow of $3.3 billion in Crypto ETFs with a Fear & Greed indicator in the extreme fear zone, which is not a bad time to buy back bitcoin for contrarians. Donald Trump has just confirmed the creation of a strategic reserve invested in cryptocurrencies.

Record outflows of $3.3 billion from Crypto ETFs in February

Oil prices are on a downward trend. OPEC and non-OPEC producers are producing more. The US government wants to produce an additional 3 million barrels per day within 4 years thanks to a pro-fossil fuel policy. Demand is lower than expected. But the future of oil is darkened by the inevitable energy transition towards decarbonization. The clean energy revolution is driven by powerful economic and technological forces. The United States, or rather Donald Trump, is wrong to exit this revolution; they will fall behind China and Europe. A pause in the Ukraine war should push crude prices lower. While we underweight industrial metals for cyclical reasons, we are negative on oil for structural ones.

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