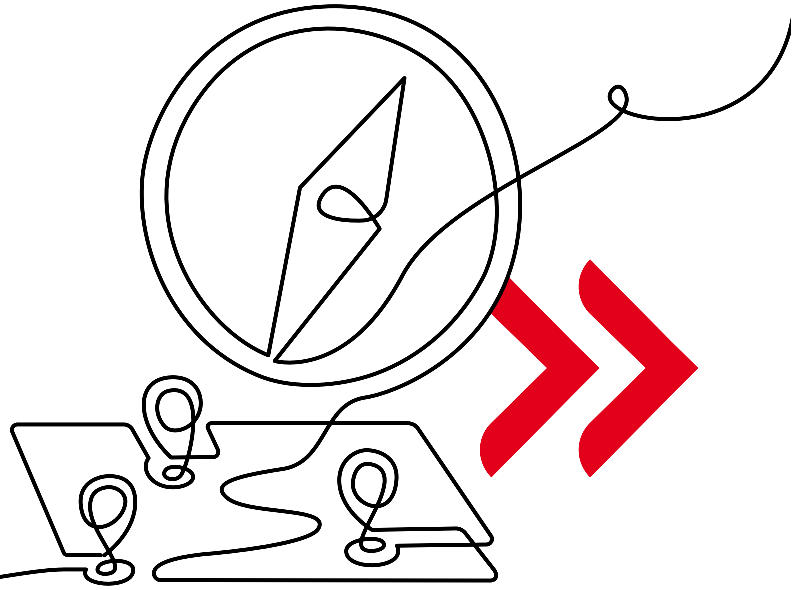
The Investment Institute
By UniCredit

The Compass Checkpoint

27 February 2025



Adapting to Trump 2.0

Financial markets had a remarkable start to 2025. Despite persistent economic weakness in core Europe, the threat of a trade war with the US and potentially massive changes to Europe's security architecture, European stock markets took off and, in some cases, posted double-digit gains after a few weeks of trading. European equities have thus clearly outperformed US equities. The driving factor behind this spectacular rally in the European stock market is the expectation that European large caps, which are still favourably valued, especially compared to US equities, will show noticeable earnings growth in the coming years after a long dry spell.

As pleasing as this development may be from a European perspective, it is based on the constructive baseline scenario that Trump 2.0 will not force any massively disruptive changes upon Western economic, trade and security architecture. Events so far support this expectation. The implementation of US President Donald Trump's tariff threats, which would have led to a massive disruption of global trade, was quickly mitigated or postponed after concessions from trading partners. The constructive market picture continues to depend on this negotiation pattern holding. If implemented, many of Trump's campaign promises would be disruptive – both for the US and for the rest of the world.

Meanwhile, Europe will be looking to Germany after that country's general election, the results of which could offer a ray of hope. The next government is likely to be a grand coalition. Given the recent policy rift between the US and Europe, markets will focus on whether the new German government will create the necessary financial leeway for urgently needed investments in security, energy, transport and digital infrastructure by modifying the country's debt brake. In any case, it will have to manage a tricky balancing act due to the narrow majorities in parliament. Implementing the necessary reforms to help end economic weakness in the eurozone will be a major challenge. Nevertheless, we see a good that chance progress will be made.

With regard to financial markets, policy uncertainty, be it in the US or in the eurozone, is likely to lead to ongoing volatility. While investors seem to expect a brighter outlook for the eurozone, fuelled by further policy easing and fiscal stimulus, US fundamentals remain strong and justify a relative preference for US equities, in our view. Overall, our asset allocation remains largely unchanged, while we continue to pursue a prudent investment strategy.

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Macro Stories

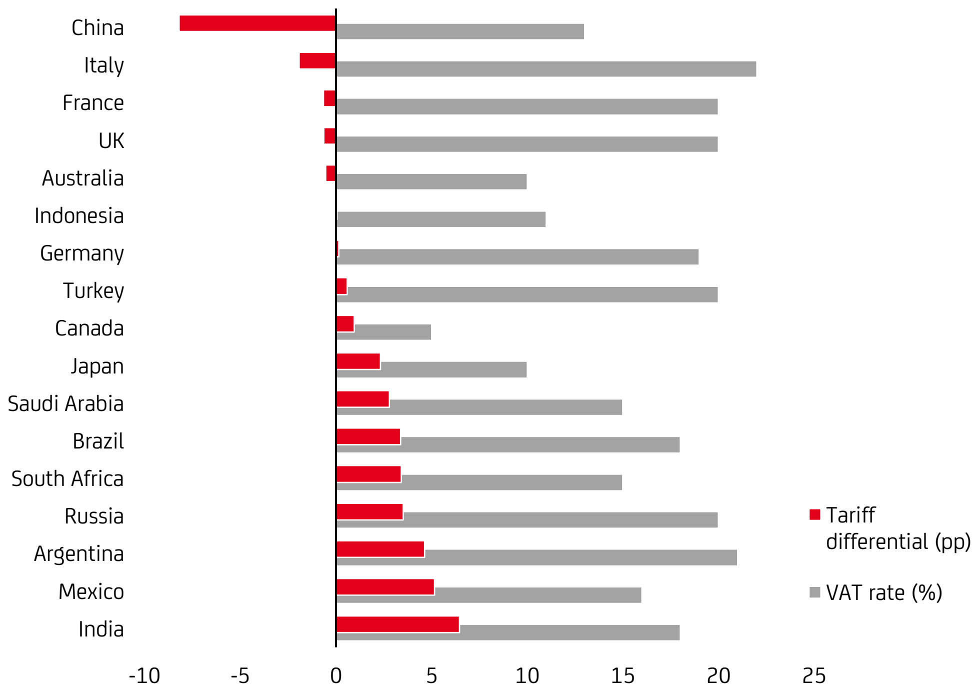
Authors: Marco Valli, Daniel Vernazza

Tit-for-tat tariffs to weigh on global growth

The global economy faces headwinds in the near term. The US administration has imposed new tariffs on China, announced tariffs on steel and aluminium, and indicated it may impose (reciprocal) tariffs on others (see chart 1.1). China responded with limited tariffs on US goods. Tariffs would be negative for global growth, but there is significant uncertainty surrounding their timing and form. This ongoing uncertainty may lead firms to delay investment and hiring. In our baseline scenario, US economic resilience continues, with GDP seen expanding by 2.2% in 2025 and by 2.3% in 2026 as a fiscal package later this year offsets the drag from tariffs and slower immigration. However, risks are skewed to the downside.

Growth in the eurozone remains stuck in low gear (2025: 0.9%; 2026: 1.2%), with limited prospects of an acceleration in the near term amid trade tensions, a weakening labour market and higher wholesale gas prices. An improvement in real wages, ECB rate cuts and NGEU-related investment should then support a modest pickup in growth. In China, domestic demand remains weak and US trade tensions will weigh on growth. We expect further monetary and fiscal easing, but this is unlikely to meaningfully boost consumption and rebalance growth to avoid a structural slowdown (2025: 4.5%; 2026: 4.2%).

CHART 1.1: MATCHING US TARIFFS TO THOSE ON US EXPORTS AND VAT BARRIERS
TARIFF DIFFERENTIAL WITH THE US AND VAT RATE



Source: National sources, Peterson Institute, World Integrated Trade Solution, The Investment Institute by UniCredit

Note: The tariff differential is the US-applied weighted average tariff on imports from the partner country minus the partner-country-applied weighted average tariff on imports from the US, expressed in percentage points. The tariff differential with China is estimated based on data from the Peterson Institute and includes the 10% additional tariff on US imports from China effective 4 February 2025.

Fed and ECB policies likely to decouple

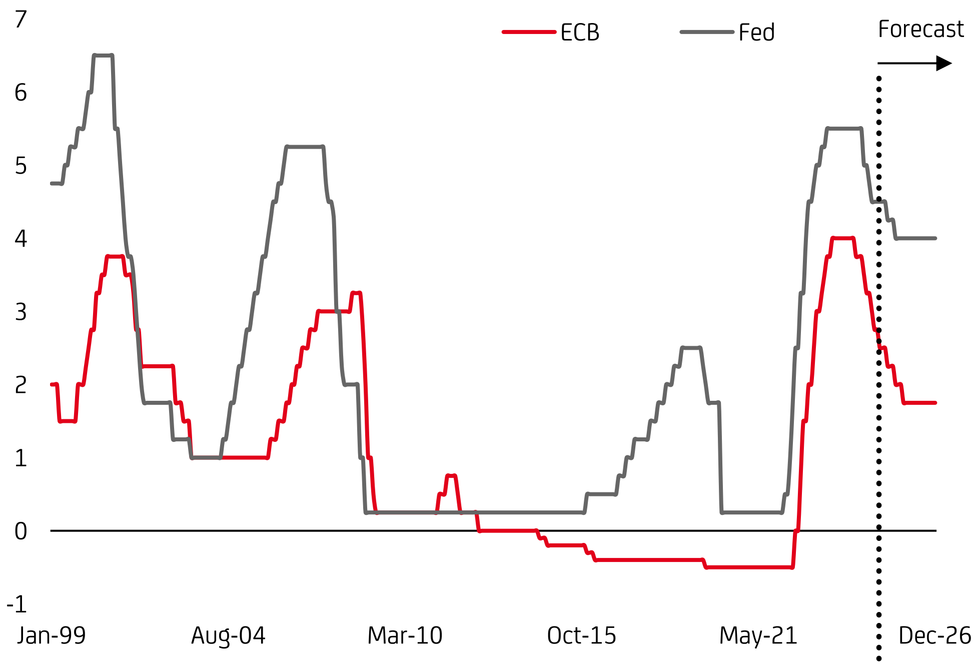
The Fed is in no hurry to adjust monetary policy after making 100bp of rate cuts in the final three meetings of 2024. We expect two 25bp rate cuts this year, in June and September, before the central bank enters a long holding pattern. However, we now consider it almost as likely that there will be no cuts. Resilient economic activity and above-target inflation (CPI 2025: 2.8%; 2026 2.5%) fuelled by higher tariffs, tax cuts and reduced immigration will limit how much the Fed can cut rates. The Fed could disregard tariffs, but recent developments in short-term inflation expectations are not particularly comforting.

> The Fed is in no hurry to adjust monetary policy.

In contrast, the ECB faces low growth and inflation is on track to stabilise at around the ECB's 2% goal this year, although higher gas prices might raise the near-term CPI path somewhat. We are confirming our view that the deposit rate will bottom out at 1.75% this year. While another 25bp cut in March appears to be a done deal, communication noise might increase as rates approach a neutral level. Our forecast for the terminal rate is at the low end of the neutral range recently provided by ECB staff (1.75-2.25%). We see the risks surrounding our depo rate forecast as broadly balanced.

CHART 1.2: TRANSATLANTIC RATE GAP LIKELY TO WIDEN

POLICY RATE, %



Source: ECB, Fed, The Investment Institute by UniCredit

EU defence challenges

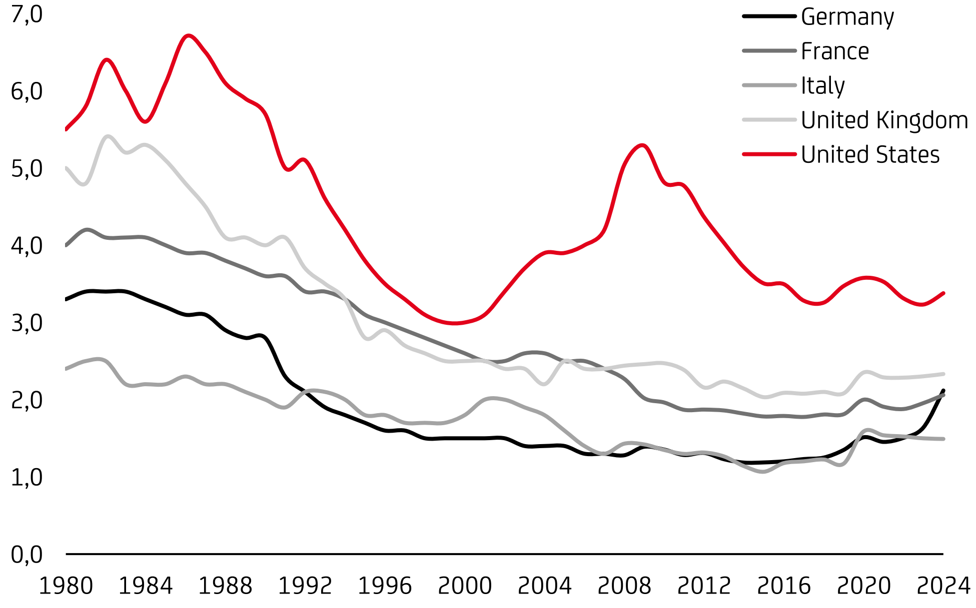
The confrontational approach to trade and foreign policy by the new US administration puts Europe at a crossroads. The acceleration in Ukraine ceasefire talks between the US and Russia with Europe being sidelined rings alarm bells because it might lead to a deal that does not provide sufficient security guarantees for war areas and might embolden Russia's aggressive expansionary stance. This would be troublesome for Europe, which might end up shouldering most of the cost of peacekeeping and reconstruction of Ukraine while no longer being able to count on the US's security umbrella.

The confrontational approach to trade and foreign policy by the new US administration puts Europe at a crossroads.

The good news is that this new challenge seems to have caused an immediate reaction in European capitals. European Commission President Ursula von der Leyen proposed to activate the escape clause for defence investment to make it possible for member states to temporarily increase their defence expenditure while remaining compliant with the fiscal rules. Joint financing of part of the additional defence investment is also likely to be an option. Such shared financing might occur through repurposing spending within the EU budget or the issuance of common debt, similar to that deployed during the pandemic with the SURE program, for which member countries provided guarantees based on the size of their economies. If issued through a new, ad-hoc special fund, common debt for defence spending would not necessarily require the involvement of all EU countries, and some non-EU countries (for example the UK) might join as well.

CHART 1.3: LARGE EUROPEAN COUNTRIES INVEST MUCH LESS IN DEFENCE THAN THE US

MILITARY SPENDING, % OF GDP



Source: NATO, The Investment Institute by UniCredit

FOCUS 1

European exporters to weather higher US tariffs

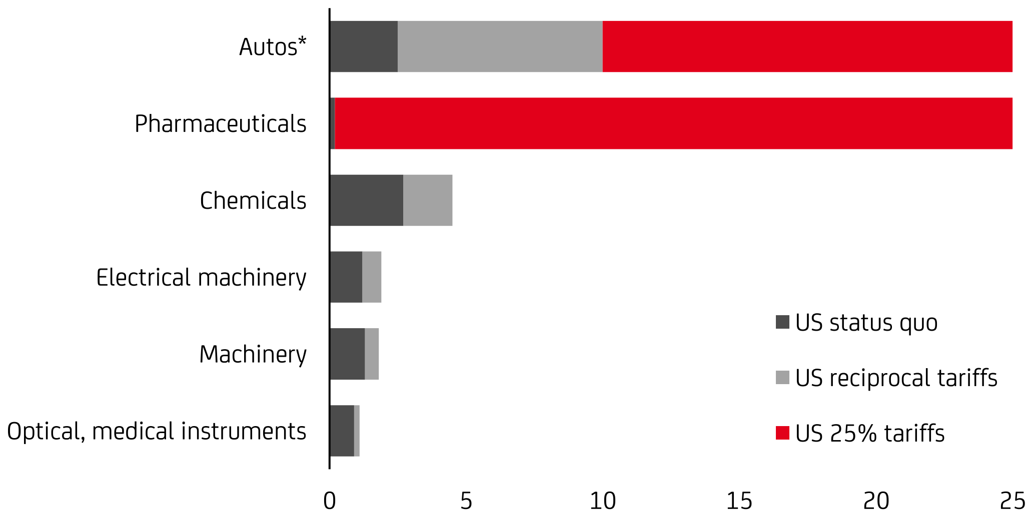
Author: Andreas Rees

At the time of writing, US President Donald Trump has still not announced any tariff hikes solely aimed at the EU, in contrast to his levying of tariffs against China, Mexico and Canada. However, he has pledged to impose so-called reciprocal tariffs, i.e. US tariffs would be lifted to the same level as other countries and regions. Furthermore, Trump threatened that the US would generally increase tariffs to 25% or higher on a few selected US imports, such as automobiles, pharmaceuticals, and semiconductors. Reciprocal and selectively higher tariffs would also directly impact European exporters and the EU economy.

How significant would the negative effects be?

In the following, we mainly focus on the direct effects of higher US tariffs on European exports, while indirect effects, such as higher uncertainty, might also play an important role. In a scenario in which only reciprocal tariffs were to be imposed, there is some relatively good news. Although EU tariffs are typically higher than US tariffs, the differences are comparatively small for the majority of sectors (see chart 1.4). This is especially true for those industries that form the backbone of European exports to the US, such as the machinery and pharmaceutical industries. Combined, they account for about 35% of total EU exports to the US. However, even in a reciprocal-tariffs scenario, there are also sectors for which markedly higher US tariffs would kick in. With an EU export share to the US of more than 11%, one important example is the auto industry, where US tariffs on passenger cars would be hiked by 7.5pp to 10%. Since German car manufacturers account for more than half of EU auto exports to the US, the auto industry in Germany would be hurt more than in any other European country. This negative effect would probably ripple through to some CEE countries, such as Poland, Hungary, Czechia and Slovakia, in whose economies the auto-supplier industry plays an important role.

CHART 1.4: AVERAGE US TARIFFS ON EU GOODS (%)



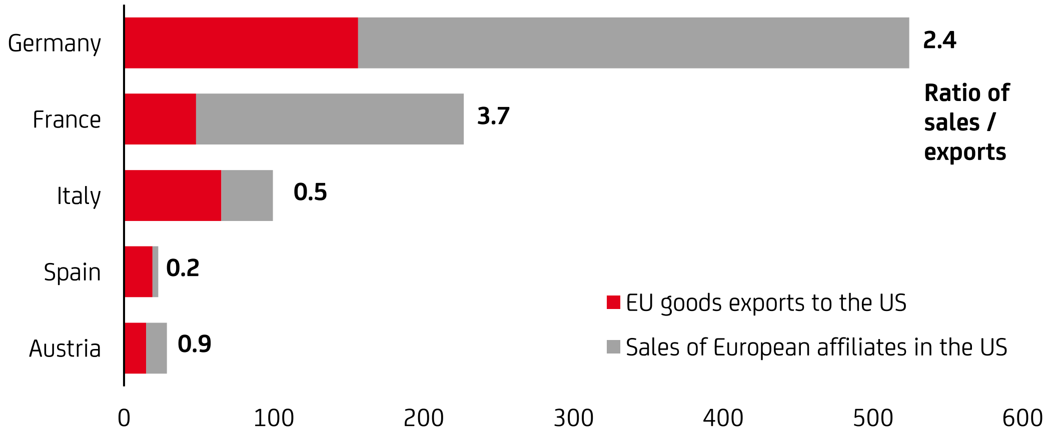
Source: WTO, Eurostat, The Investment Institute by UniCredit
* Passenger cars

What would happen if the US imposed additional higher tariffs of 25% or more?

Needless to say, the negative impact on sectors such as cars and pharmaceuticals would rise. The precise effect is difficult to estimate, as it would depend on unknown factors. For instance, much would depend on the ability of European companies to pass on the higher tariffs to US consumers. Looking at the earnings of European exporters, one also has to consider their US businesses, which would not be affected by higher US tariffs. Typically, larger companies with greater financial means have invested in local production facilities in the US and sell their goods directly there. Especially for German and French companies, the ratio of US sales through their affiliates to exports is impressive. In 2022 (latest available data), German manufacturers sold more than twice the amount through their US affiliates than they did by shipping goods from Germany to the US (see chart 1.5). This is especially true for the car and chemicals sectors, while the pharmaceutical industry would be more negatively affected due to few US production facilities (see our recent The Short View – German exporters: navigating challenges, 19 February). The sales-exports ratio for French companies was even more favourable than for German firms. In the case of Italian and Spanish corporates, exports outweighed US sales activity.

CHART 1.5: EU GOODS EXPORTS TO US AND US SALES

EUR BN, 2022



Source: WTO, Eurostat, The Investment Institute by UniCredit

Our bottom line

In the case of reciprocal US tariffs, the overall damage for European exports would be limited. If more aggressive tariff hikes were applied, the car industry, especially in Germany, and the pharmaceutical sector would be more negatively impacted. However, the strong build-up of US production facilities, at least in some industries, and a weak(er) euro exchange rate would markedly dampen the negative effect on earnings.

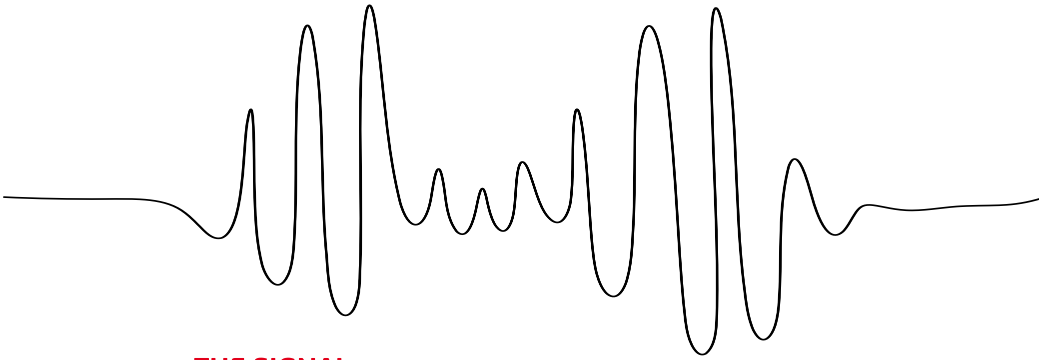
Market Stories

Authors: Edoardo Campanella, Stefan Kolek, Tobias Keller, Roberto Mialich, Michael Rottmann, Christian Stocker, Thomas Strobel, Michael Teig

What's going on in the market?

THE NOISE

As expected, Donald Trump's return to the White House and his "America First" agenda have shaped the start of 2025. The announcement of shifts in US policy, including, above all, the expansion of trade barriers, as well as the disruptive entry in the AI industry of Chinese company DeepSeek have led to elevated volatility in markets. DeepSeek, as well as a more-friendly approach towards the private sector by Chinese President Xi Jinping, has helped drive a rotation of funds back into China. In turn, January's widely anticipated rate moves by the Fed (on hold) and the ECB (25bp cut) did not catch market participants by surprise.



THE SIGNAL

While volatility could remain elevated in the short term given the uncertainty surrounding US tariff, immigration and fiscal policy, the latest developments have not changed our fundamentally constructive view for 2025. Our impression is that the Trump administration is using tariffs to tactically influence negotiations on non-trade related topics and not strategically to address trade deficits. Similarly, while DeepSeek is reshaping the tech landscape, our outlook for US megacaps remains positive. Nevertheless, given the market's unprecedented concentration, we believe the appeal of diversification, both within and beyond the US, has again become apparent.

Equities

POSITIVE SHIFT IN MOOD ON EUROPE, BUT WE CONTINUE TO PREFER THE US STOCK MARKET

Stock markets have started the year on a positive footing. European stocks have set the positive tone with a strong double-digit percentage increase YTD (see table). The strong performance of European companies is not based on a better economic-growth outlook, but rather on stronger-than-expected earnings growth, particularly of export-sensitive companies, in combination with low valuations compared to other regions. Chart 2.1 shows that the earnings trends of major regions have generally continued to be positive since the beginning of 2024.

Another trigger for the strong performance of European equities has been the weakness of US tech stocks since the end of last year, which is only temporary, in our view. The weakness has led to a rebalancing of international portfolios, which often have strong overweight positions on US equities, in favour of European stocks. We view these trends as positive as they indicate a broadening of the global stock-market rally and a reduction of concentration risk in the US. From a regional perspective, we continue to prefer the US stock market, given its strong fundamentals, while the Asia-Pacific region should benefit from a gradual improvement in the Chinese economy and government support measures.

Although we still have an underweight recommendation on European stocks, there is something brewing under the surface: the strongly negative sentiment towards Europe is gradually beginning to improve. Since December, the 12-month forward earnings momentum has been in favour of Europe, while US estimates have been losing momentum recently (see chart 2.1). Also, the prospect of a softening of the German debt brake after the election is supporting not only German stocks but also European equities more generally. The increasing likelihood of a ceasefire between Russia and Ukraine and the associated reduction in energy prices are also supporting European industrial stocks. However, aside from the current uncertainty regarding US tariff policy and possible trade conflicts, these trends have yet to prove sustainable.

The risk of trade tensions with the US is dampening earnings expectations, particularly for tariff-sensitive sectors such as basic resources, autos and chemicals. Although we believe that an increasingly cyclical allocation could be appropriate in Europe over the next few quarters, possible trade tensions with the US and continued uncertainty regarding the European and Chinese economies still argue against an immediate and significant increase in the share of cyclical companies. In fact, we prefer sectors such as financials, which would remain largely unaffected by potential US tariffs, and industrials and health care, as these should benefit from a gradual improvement of the economy and enjoy stable demand and high margins, respectively. Earnings estimates for these three sectors have developed significantly better than the European market as a whole in recent months (see chart 2.2), which we expect to continue.

In the US, we consider financial stocks to be attractive, along with the important technology sector. In the current robust economic environment, these sectors are shining with strong corporate profits. The consumer discretionary sector is also receiving significant positive impulses from the strong economy.

CHART 2.1: TREND IN COMPANY EARNINGS IS UP GLOBALLY

2024=100

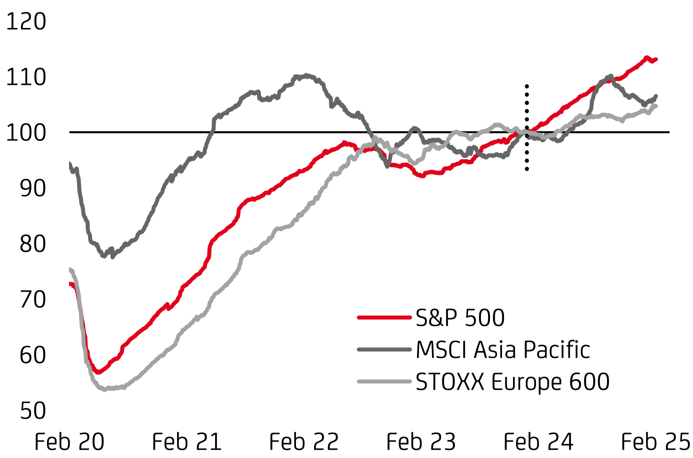
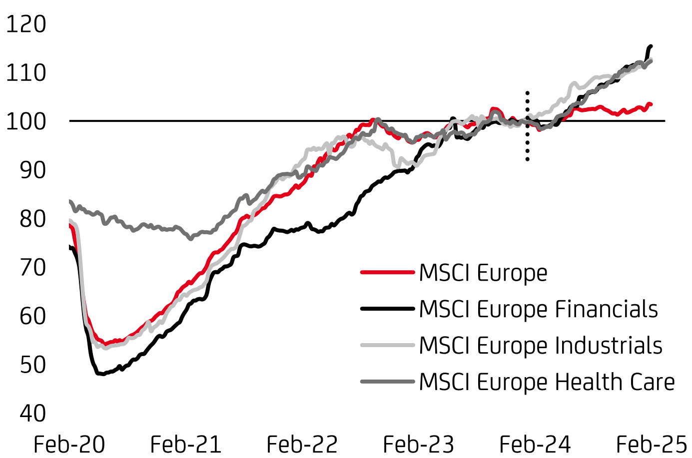


CHART 2.2: FINANCIALS, INDUSTRIALS AND HEALTH-CARE SECTORS SHINE WITH STRONG EARNINGS GROWTH

12M FWD EPS, 2024=100



Source: Bloomberg, The Investment Institute by UniCredit (observation period: 17 Feb 2020-17 Feb 2025)

Fixed Income

FLUID IMPULSES FROM US POLITICS AND INCOMING MACRO DATA DO NOT CHANGE OUR STANCE

GOVERNMENT BONDS

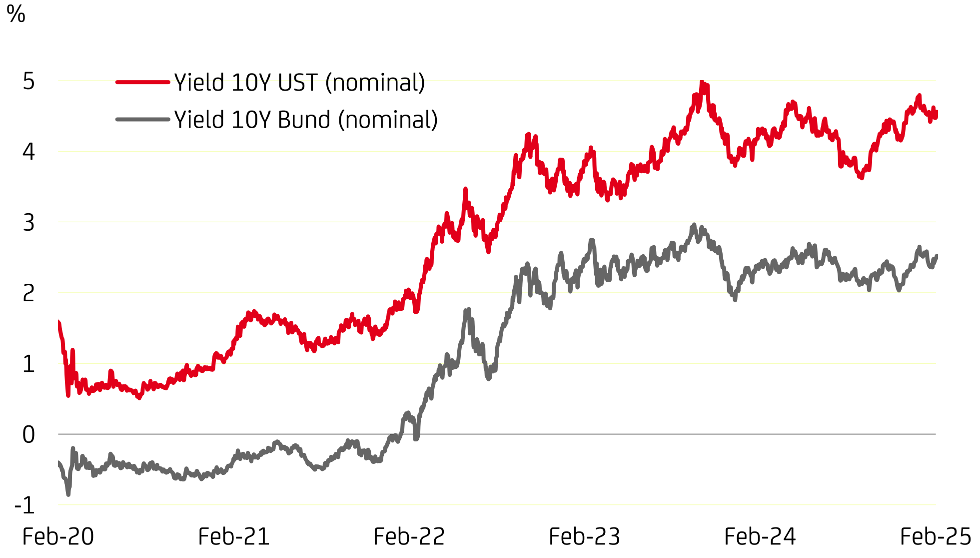
Major bond markets had a somewhat volatile start to the year, with a full agenda of data and market news following Trump's inauguration as US president. Ultimately, however, they did not move much, with both the 10Y US Treasury (UST) yield and the 10Y Bund yield rising only slightly (see chart 2.3 and table). There were no major surprises in US data, which included a solid labour market and sticky inflation, while in the eurozone business confidence remained sluggish and inflation, although above the ECB's 2% target, was moving in the right direction.

Looking ahead, long-term government bond yields (10Y USTs and Bunds) are virtually at the midpoint of our 2025 forecast ranges. For the 10Y Bund yield, we see a trading range of between 2% and 3%; for 10Y USTs, a reasonable range is between 4% and 5%, probably with a slight overshoot on either side. However, given that we are close to the middle of these ranges and that the impulses from US politics are fluid and extremely difficult to predict, we believe our broadly neutral stance on government bonds is appropriate.

Given the many unknowns, we feel comfortable maintaining a neutral stance on government bonds for the time being, both in terms of overall exposure to the US and European government bond markets and in terms of duration. On this basis, a level at which we would consider increasing our Bund exposure (and duration) would be if 10Y yields were to rise above 2.7%, while Bund holdings (and duration) could be reduced if yields were to fall to around 2.2-2.3%. UST exposure (and duration), where we are also currently neutral, could be increased at a level of 4.8% or above, while we would tend to reduce exposure (and duration) at a level of around 4.3% or below.

Regarding emerging market (EM) bonds, we believe that they are particularly vulnerable to the impact of potential tariffs on growth and, related to this, a deterioration in global risk sentiment. Nevertheless, EM bonds remain a potentially valuable addition to a diversified portfolio due to their attractive yield and projected carry-based returns.

CHART 2.3 VOLATILE START TO THE YEAR, BUT YIELDS NOW BACK CLOSE TO LEVELS AT THE START OF 2025



Source: Bloomberg, The Investment Institute by UniCredit
(observation period: 17 Feb 2020-17 Feb 2025)

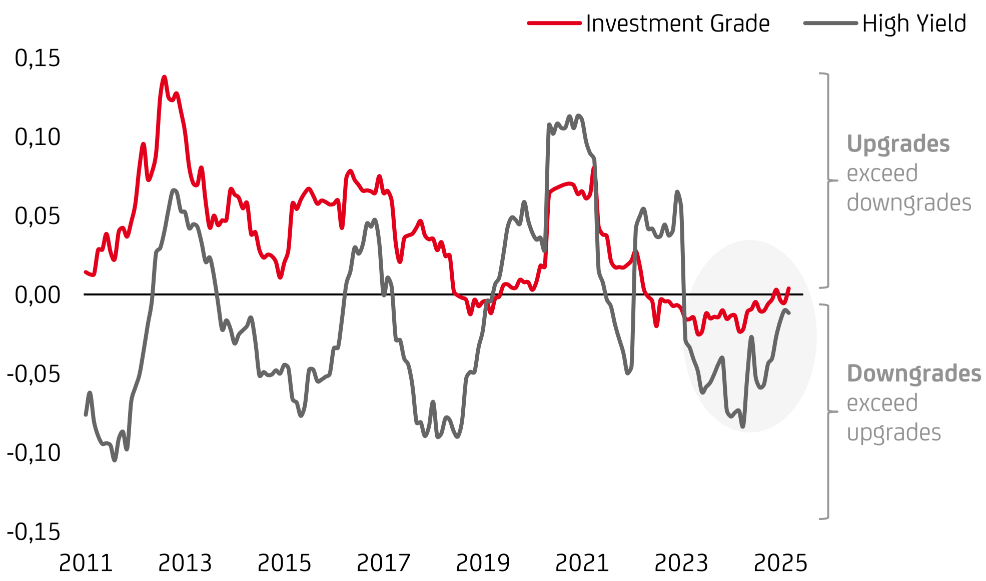
FLUID IMPULSES FROM US POLITICS AND INCOMING MACRO DATA DO NOT CHANGE OUR STANCE

CORPORATE CREDIT

Given supportive ECB monetary policy and weak growth but no elevated risk of sharply rising default rates in the eurozone, we see an overweight allocation to corporate exposure as justified due to the yield pickup and our expectation that spreads will stay broadly unchanged. We remain constructive on European corporate credit. Issuers' credit quality is stable to improving. This is supported by non-financials delivering positive results, on balance, during the latest earnings season. Amid low economic growth, these positive results are largely due to cost-saving measures and cash-preserving policies. Lower new-bond supply compared to the same period last year is also supportive for the secondary market. Going forward, amid a potential push for higher defence spending in the EU, a key source of volatility in European credit is the associated impact on the long end of EGB curves, which could potentially primarily affect the investment-grade senior space. From a performance perspective, however, in our base scenario, we continue to see carry being the key source of total return this year.

Bank credit will be supported by the ongoing strong performance of European banks. Despite moderating net interest income momentum, we see their profitability remaining high this year. Capitalisation remains solid (with an average fully loaded CET1 ratio of 15.9%) despite the high shareholder remuneration of recent years. We expect a slight increase in the cost of risk but see it remaining at a manageable level. The current bank credit-spread landscape reflects these strong credit fundamentals, with spread levels throughout the bank capital structure at historical lows.

CHART 2.4: CORPORATE CREDIT RATINGS IMPROVE IN EUROPE



Source: S&P Global, The Investment Institute by UniCredit
(observation period: 2011-2025)

Note: The 12M rating drift is calculated as the number of upgrades minus the number of downgrades over the past 12 months divided by the number of ratings in the respective iBoxx Non-Financials Index.

Commodities

GEOPOLITICS AND TRADE WAR KEY DRIVERS FOR PRICES

CRUDE OIL

By mid-February, crude oil was roughly flat on the year at around USD 70 per barrel (see table), amid concerns about the negative impact of tariffs on demand and Joe Biden's "farewell" sanctions on supply targeting Russia. Going forward, the oil market is at risk of being undersupplied in view of the latest US sanctions and Trump's strategy of exerting maximum pressure on Iran, while demand concerns in China and trade tensions are still clouding sentiment. An increase in monthly output by about 140kb/d by OPEC+, starting in April and lasting for the subsequent 18 months, as intended, could prove too small to absorb the potential shock from a drop in Russian and Iranian oil exports.

NATURAL GAS

TTF prices showed substantial volatility in first two months of 2025, fluctuating between EUR 44/MWh and EUR 58/MWh. The closing of the Ukraine transit for Russian gas, regulatory uncertainty about storage requirements for EU countries, weeks of unusually cold weather in Europe and low supply of renewable energy have pushed natural-gas prices up. For the rest of the year, we expect TTF prices to remain within a EUR 45-50/MWh trading range. The winter will likely end with storage levels substantially below where they were during the past two years, leading to strong demand during the summer period as governments seek to replenish them.

GOLD

Gold has had a very good start to the year, continuing its momentum from 2024, with the USD 3,000/oz mark now in sight (see table). While real interest rates have lost some of their explanatory power in recent quarters, we believe they remain a relevant driver, especially if the 10Y UST yield rises above 5% (not our baseline scenario). However, central-bank demand (especially from emerging markets such as China) remains strong and supportive. In addition, we see physical gold ETCs picking up a bit, or at least bottoming out, suggesting that retail investors are increasingly stepping in on the demand side. We expect gold to trade in a range of USD 2,500-3,000/oz this year, with risks to the upside.

Foreign Exchange

EUR-USD SHOULD HOLD ABOVE PARITY

In FX, EUR-USD has retested 1.05 after an initial fall below 1.02 (see table). The recovery has been helped by delayed US tariffs and Ukraine peace hopes, but it is too early to call the start of a bullish trend towards the upper bound of the 1.05-1.10 band. Indeed, the pair has already partly retreated from early peaks and sluggish economic activity in the eurozone is set to play against a sustained euro rally. Uncertainty prevails on many fronts, which might expose EUR-USD to further fluctuations rather than trends. On balance, we still expect a lower EUR-USD but see the pair probably remaining slightly above parity. Trump's policies remain favourable to the greenback, especially on the tariffs front, US inflation remains sticky, and the ECB is set to deliver more easing than the Fed. That said, a drop to parity and below – i.e. towards the low of close to 0.95 touched in September 2022 – remains challenging. The Fed remaining on hold this year or the ECB cutting to below the 1.75% we expect remain the two preconditions for such a decline, and even this might not be enough currently.

FOCUS 2

How DeepSeek is changing our AI story

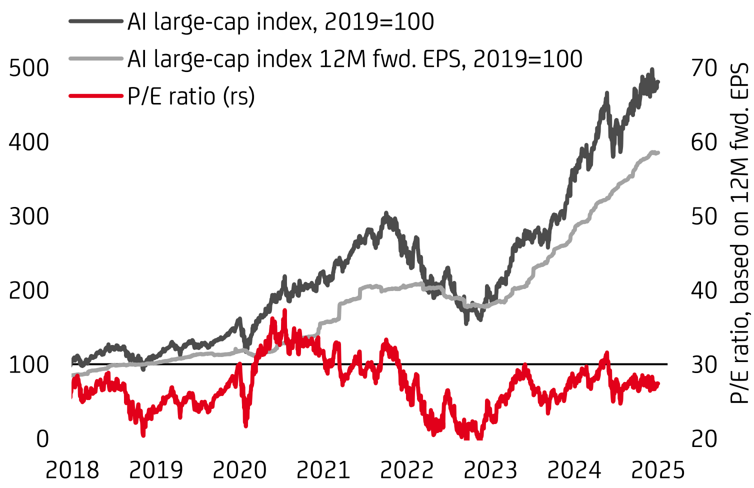
Author: Christian Stocker

DeepSeek has made a significant impact on the AI sector by developing efficient and cost-effective models that compete with leading models like OpenAI's Chat GPT while using fewer hardware resources and less energy, thus driving productivity improvements. This has democratised AI development, allowing smaller firms to compete in the area while potentially reducing the cost and environmental impact of doing so. The free availability of DeepSeek's models challenges the dominance of major US tech companies and can also be considered a positive supply shock. In principle, we view this as a favourable development as it suggests that countries or regions that have thus far been followers in generative AI, such as the EU, could potentially develop a homegrown AI platform. This had seemed impossible until now because of the sheer amount of investment considered necessary to develop AI models.

Recent developments have also had notable implications for large tech firms, such as Microsoft, Meta, Amazon and Alphabet, which could save significantly on AI-related costs. Some argue that DeepSeek's innovations reduce the importance of computational power and therefore have the potential to negatively affect semiconductor companies such as Nvidia and ASML. However, this perspective may be too simplistic, in our view. In fact, the increased efficiency of DeepSeek's models underscores the importance of computational power. Although the efficiency gains will enable companies to push AI capabilities further with the same computing resources, greater computational power will remain essential to advancing AI at scale, as companies will be able to achieve even greater results with more resources.

Despite all these advantages, one should not overestimate DeepSeek either. Apart from data-protection issues, technically, DeepSeek is not comparable with US AI platforms since it mainly optimizes existing models rather than creating new ones that could compete with those developed in the US. Model optimization is important and welcome, but it does not eliminate the need to create new models. DeepSeek has been able to reduce computing costs massively and has opened the door for efficient architecture to reduce performance gaps between smaller and larger models, but it does not fundamentally break the scaling law, according to which larger models deliver better results. Nevertheless, we think the efficiency gains introduced by DeepSeek will contribute to the evolution of AI technology, driving higher productivity and profitability for companies leveraging AI.

CHART 2.4: UPWARD TREND IN PROFITS OF AI COMPANIES MAY SLOW FOR A WHILE



Source: Bloomberg, The Investment Institute by UniCredit (observation period: 17 Feb 2018-17 Feb 2025)

A new chapter. DeepSeek's innovations are likely to mark the beginning of a new chapter in AI, and they also show the innovative power that prevails in China, attracting investors to the Chinese technology sector. DeepSeek arguably helps non-tech firms more than tech companies, as it is likely to drive productivity improvements. This also means that the traditional profit-drivers for tech companies could lose momentum, leading to slower profit growth, especially for hardware companies, which could experience a temporary decline in demand. However, we expect this to be a short-term effect. In the long run, the introduction of more-efficient AI solutions is part of the natural evolution of this technology and will ultimately drive higher productivity and profit growth for companies producing and using AI. The strong upward trend in AI companies' profits and share prices (as the chart shows) is likely to weaken for a while, but it is not going to stop.

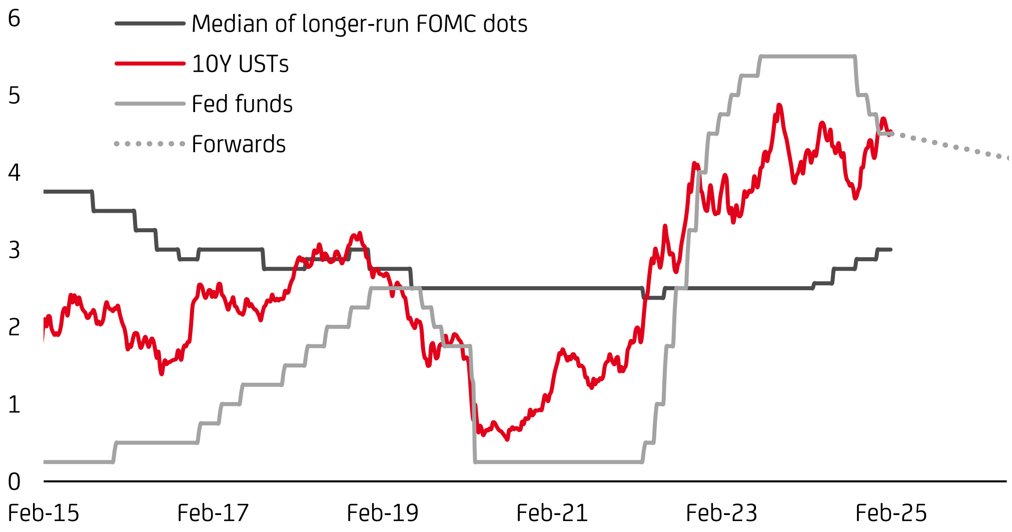
FOCUS 3

What could push the 10Y treasury yield above 5%?

Author: Luca Cazzulani

UST yields were highly volatile in January. We maintain our view that the Fed will cut rates further this year and that, as a result, the 10Y UST yield will hover at around 4.50% in the coming months.

CHART 2.6: OUR BASELINE: LOWER FED RATES SHOULD SUPPORT THE LONG END



Source: Bloomberg, The Investment Institute by UniCredit
(observation period: 17 Feb 2015-17 Feb 2025, forwards until 30 Jun 2026)

What are the risks surrounding this forecast?

With many details still unknown, particularly regarding economic policy, further yield volatility should be expected. Below, we discuss the scenarios that could justify UST yields at 5% or above and why we regard them as unlikely.

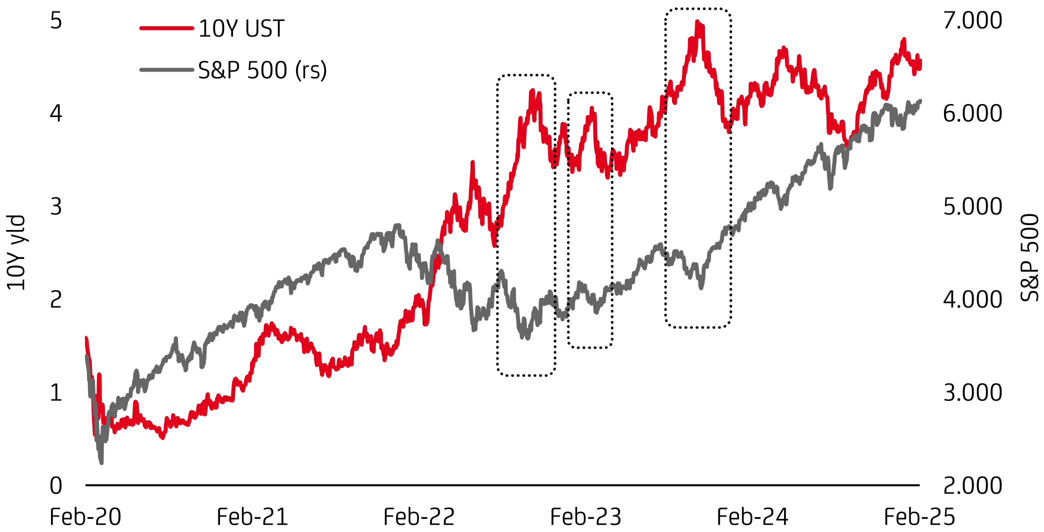
A first reason that could drive UST yields up is a significant increase in inflation expectations. Tariffs could trigger this but being a one-off measure, likely with negative medium-term effects on growth, their impact should be temporary. However, as long as the Fed remains independent and committed to keeping inflation expectations in check, deglobalisation, the green transition or geopolitics are unlikely to lead to persistently high inflation. In such a scenario, selling pressure is likely to occur mainly at the short end, with the UST curve likely to remain flat or even inverted.

A second reason is an increase in the risk premium resulting from strong supply at a time when demand from big players (e.g. China) is faltering. This should lead to significant curve steepening, as in Sep-Oct 2023, when the risk premium rose by almost 90bp. But several factors suggest that a large increase in the risk premium is not very likely:

1. US President Donald Trump's ability to pass meaningful deficit-widening measures may be limited due to the slim Republican majority in the House of Representatives and a general preference to avoid inflationary measures.

2. Abundant US supply is not new and should be priced in. Indeed, the (estimated) risk premium is close to its highest level in the last five years.
3. US Treasury Secretary Scott Bessent said the administration is interested in low yields at the long end rather than in low policy rates. This reduces the pressure on risk premiums related to the Fed's independence and suggests that the US Treasury would lean against higher 10Y yields rebalancing supply, at least temporarily, from the long end to bills, as happened in the past.
4. An increase in yields that is not justified by improving economic conditions would be negative for equities (see chart 2.7). Lower risk appetite could ultimately support USTs.

CHART 2.7: HIGHER YIELDS > LOWER EQUITIES > LOWER YIELDS



Source: Bloomberg, The Investment Institute by UniCredit
(observation period: 17 Feb 2020-17 Feb 2025)

A third reason is robust economic data, supporting the idea of a significant increase in R-star. This would require a massive increase in productivity, possibly driven by AI. For the time being, this would be a stretch. In such a scenario, current Fed rates would not be as restrictive, and investors might even start to debate rate hikes. This could lead to a prolonged repricing of UST yields (mostly real yields), with the whole yield curve shifting upward to take higher rates into account. As the increase in yields would be backed by a robust economy, equites should not suffer.

As a final remark, one factor that should support USTs is positioning: fast-money investors are already short/underweight USTs, limiting the scope for additional selling.

Asset Allocation

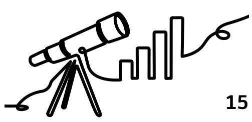
PRUDENT POSITIONING AMID PERSISTENT UNCERTAINTY

As we enter March, financial markets continue to navigate a landscape of elevated, multifaceted uncertainty. Global growth remains robust but faces headwinds, while the monetary-policy paths of the Fed and the ECB appear increasingly divergent. We still believe in our stance of cautious optimism. While our positioning remains broadly unchanged, prudent asset allocation remains paramount. As we endeavour to strike a balance between resilience and opportunity, we maintain adaptability, disciplined risk management and a strategic focus on long-term value creation. In the equity space, we continue to prefer US over European stocks, given still strong US fundamentals.

OUR INVESTMENT VIEW ON ASSET CLASSES

	UNDERWEIGHT	NEUTRAL	OVERWEIGHT
GLOBAL EQUITIES		●	
US EQUITIES		●	
EUROPE EQUITIES	●		
PACIFIC EQUITIES (DEVELOPED MARKETS[1])			●
EMERGING MARKET EQUITIES		●	
GLOBAL BONDS			●
EMU GOVERNMENT BONDS		●	
NON-EMU GOVERNMENT BONDS		●	
EURO INVESTMENT-GRADE CORPORATE BONDS			●
HIGH-YIELD CORPORATE BONDS	●		
EMERGING MARKET BONDS (HARD CURRENCY)			●
EMERGING MARKET BONDS (LOCAL CURRENCY)			●
MONEY MARKETS	●		
ALTERNATIVES		●	
COMMODITIES		●	
OIL		●	
GOLD		●	

1. Developed Markets (Australia, Japan, Hong Kong, New Zealand, Singapore)



Forecast Tables

Unicredit Forecasts

GDP, CPI AND BUDGET BALANCE FORECASTS

	Real GDP (% Y/Y)			Consumer prices (% Y/Y)			Budget balance (% of GDP)		
	2024	2025	2026	2024	2025	2026	2024	2025	2026
Global	**3.2**	**3.2**	**3.3**						
US	**2.8**	**2.2**	**2.3**	**2.9**	**2.8**	**2.5**	**-7.6**	**-8.0**	**-8.6**
Eurozone	**0.7**	**0.9**	**1.2**	**2.4**	**2.2**	**1.9**	**-3.6**	**-3.2**	**-2.8**
Germany	-0.2*	0.7*	1.2*	2.2	1.5	1.7	-2.6	-2.0	-2.0
France	1.1	0.7	1.2	2.0	0.9	1.1	-6.1	-5.4	-4.2
Italy	0.5	0.7	1.0	1.0	1.7	1.7	-3.9	-3.7	-3.0
Spain	3.2	1.8	1.9	2.9	2.5	2.4	-3.3	-3.1	-2.5
UK	0.9	1.0	1.4	2.5	3.0	1.9	-4.3	-4.0	-3.8
China	**5.0**	**4.5**	**4.2**	**0.6**	**0.9**	**1.8**	**-7.4**	**-7.6**	**-7.7**
Japan	**0.1**	**1.0**	**0.9**	**2.4**	**1.8**	**1.9**	**-6.9**	**-3.1**	**2.8**
India	**8.2**	**6.5**	**6.5**	**4.4**	**4.1**	**4.1**	**-2.4**	**-2.1**	**-2.2**

Source: The Investment Institute by UniCredit
*Non-WDA figures. Adjusted for working days: -0.2% (2024), 0.8% (2025) and 1.0% (2026)

CENTRAL BANKS WATCH

	Current	1Q25	2Q25	3Q25	4Q25	1Q26	2Q26	3Q26	4Q26
Fed	4.50	4.50	4.25	4.00	4.00	4.00	4.00	4.00	4.00
ECB	2.75	2.50	2.25	2.00	1.75	1.75	1.75	1.75	1.75
BOE	4.50	4.25	4.00	3.75	3.50	3.25	3.00	2.75	2.75
BoJ	0.50	0.50	0.75	1.00	1.00	1.00	1.00	1.00	1.00
Riksbank	2.25	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00
Norges Bank	4.50	4.25	4.00	3.75	3.50	3.25	3.25	3.25	3.25

Source: The Investment Institute by UniCredit
Note: Figures are end-of-period

INTEREST RATE AND YIELD FORECASTS

	25.02.25	1Q25	2Q25	3Q25	4Q25
Eurozone					
Depo rate	2.75	2.50	2.25	2.00	1.75
3M Euribor	2.50	2.43	2.20	1.95	1.75
2Y Schatz	2.07	2.10	2.00	1.90	1.80
10Y Bund	2.46	2.30	2.30	2.30	2.30
2Y EUR swap	2.20	2.20	2.10	2.05	1.95
10Y EUR swap	2.38	2.30	2.30	2.35	2.35
10Y Bund-swap spread	-7	0	0	5	5
2Y BTP	2.39	2.55	2.45	2.40	2.30
10Y BTP	3.59	3.60	3.60	3.60	3.60
10Y BTP-Bund spread	113	130	130	130	130
US					
Fed fund rate	4.50	4.50	4.25	4.00	4.00
3M OIS SOFR	4.32	4.36	4.11	3.90	3.90
2Y UST	4.09	4.25	4.20	4.10	4.00
10Y UST	4.29	4.50	4.50	4.50	4.50
10Y UST-Bund spread	184	220	220	220	220

FX FORECASTS

	25.02.25	1Q25	2Q25	3Q25	4Q25
EUR-USD	1.05	1.04	1.03	1.03	1.02
USD-JPY	150	152	150	149	148
EUR-JPY	157	158	155	153	151
GBP-USD	1.27	1.24	1.23	1.23	1.22
EUR-GBP	0.83	0.84	0.84	0.84	0.84
USD-CNY	7.26	7.33	7.40	7.35	7.30
EUR-CNY	7.62	7.62	7.62	7.57	7.45

Source: Bloomberg, The Investment Institute by UniCredit

RISKY ASSETS FORECASTS

	Closing 25.02.25	Mid-2025	End-2025
Oil			
Brent USD/bbl.	74	75	78
Equities			
Euro STOXX 50	5,437	5,200	5,400
STOXX Europe 600	553	540	555
DAX	22,351	21,000	22,500
MSCI Italy	100.2	94	100
S&P 500	5,948	6,400	6,800
Nasdaq 100	21,003	22,000	23,500
Credit			
iBoxx Non-Financials Senior	83	85	80
iBoxx Banks Senior	82	90	85
iBoxx High Yield NFI	269	280	270

Source: Bloomberg, S&P Global, The Investment Institute by UniCredit

For detailed forecast tables click the following links: Economics I FI I FX I Risky Assets

Development of selected financial market indices

From	**25.02.24**	25.02.20	25.02.21	25.02.22	25.02.23	25.02.24	25.02.20	**01.01.25**
To	**25.02.25**	25.02.21	25.02.22	25.02.23	25.02.24	25.02.25	25.02.25	**25.02.25**
STOCK MARKET INDICES (total return, in %)								
MSCI World (in USD)	**16.8**	24.8	10.0	-4.8	24.4	16.8	85.8	**3.1**
MSCI Emerging Markets (in USD)	**12.8**	36.0	-13.2	-13.0	7.3	12.8	22.4	**4.6**
MSCI US (in USD)	**19.2**	27.6	14.2	-6.6	29.1	19.2	105.3	**1.4**
MSCI Europe (in EUR)	**15.5**	3.5	14.3	8.0	11.2	15.5	60.1	**9.7**
MSCI AC Asia Pacific (in USD)	**11.5**	36.8	-13.4	-9.1	10.8	11.5	31.5	**3.5**
STOXX Europe 600 (in EUR)	**15.6**	4.5	13.1	7.6	11.1	15.6	59.1	**9.4**
DAX 40 (Germany, in EUR)	**28.6**	8.7	5.0	8.2	12.6	28.6	75.2	**12.6**
MSCI Italy (in EUR)	**26.7**	-2.3	15.5	12.7	28.3	26.7	103.6	**14.1**
ATX (Austria, in EUR)	**27.9**	6.1	18.1	6.5	2.6	27.9	67.7	**12.2**
SMI (Switzerland, in CHF)	**17.4**	5.0	15.7	-1.2	5.4	17.4	45.0	**12.3**
S&P 500 (US, in USD)	**19.1**	25.1	16.1	-5.9	28.9	19.1	105.8	**1.4**
Nikkei (Japan, in JPY)	**-0.8**	37.2	-10.8	8.1	47.3	-0.8	86.3	**-4.2**
CSI 300 (China, in Yuan)	**17.5**	37.1	-14.9	-8.3	-12.8	17.5	7.2	**0.0**
BOND MARKET INDICES (total return, in %)								
US government bonds 10Y (in USD)	**4.1**	1.4	-2.0	-13.4	0.5	4.1	-9.3	**2.7**
US government bonds (ICE BofA , in USD)	**4.6**	0.0	-2.1	-9.9	1.7	4.6	-5.6	**2.1**
US corporate bonds (ICE BofA A-BBB, in USD)	**6.7**	2.2	-3.5	-9.0	6.1	6.7	1.7	**2.1**
German Bunds 10Y (in EUR)	**2.6**	-2.3	-3.7	-17.4	3.6	2.6	-17.2	**-0.1**
EUR government bonds 1Y-10Y (iBOXX, in EUR)	**3.9**	-0.8	-4.0	-15.3	4.4	3.9	-12.3	**0.1**
EUR corporate bonds 1Y-10Y (iBOXX, in EUR)	**6.2**	0.6	-4.3	-9.4	6.0	6.2	-1.8	**0.9**
BOND YIELDS (change in basis points = 0.01 percentage points)								
US government bonds 10Y (in USD)	**0**	16	49	199	37	0	296	**-28**
US government bonds (ICE BofA , in USD)	**-27**	-37	94	255	17	-27	290	**-23**
US corporate bonds (ICE BofA A-BBB, in USD)	**-34**	-38	107	236	-7	-34	259	**-23**
German Bunds 10Y (in EUR)	**1**	23	46	235	-9	1	293	**6**
EUR government bonds 1Y-10Y (iBOXX, in EUR)	**-10**	12	52	243	-15	-10	281	**4**
EUR corporate bonds 1Y-10Y (iBOXX, in EUR)	**-55**	4	103	265	-40	-55	278	**-8**
SPREADS ON GOVERNMENT BONDS (credit spreads, change in basis points)								
US corporate bonds (ICE BofA US Corporate Master)	**-12**	-20	32	-4	-33	-12	-29	**2**
US corporate bonds (ICE BofA US High Yield)	**-39**	-85	20	35	-107	-39	-134	**-8**
Euro corporate bonds (ICE BofA Euro Corporate AAA-A)	**-24**	-10	47	-2	-18	-24	0	**-12**
Euro corporate bonds (ICE BofA Euro High Yield)	**-56**	-42	115	-23	-81	-56	-58	**-30**
EURO EXCHANGE RATES (change in %)								
US dollar (EUR-USD)	**-3.3**	12.4	-8.3	-5.3	2.1	-3.3	-3.2	**1.0**
British pound (EUR-GBP)	**-3.0**	2.7	-3.1	5.7	-3.2	-3.0	-0.9	**0.0**
Swiss franc (EUR-SFR)	**-1.7**	4.4	-6.1	-4.1	-3.7	-1.7	-11.5	**-0.3**
Japanese yen (EUR-JPY)	**-3.8**	8.0	-0.1	11.9	13.7	-3.8	31.1	**-3.6**
COMMODITIES (change in %)								
Commodity Index (GSCI, in USD)	**41.9**	5.0	5.6	-6.3	11.6	41.9	67.2	**10.1**
Industrial metals (GSCI, in USD)	**12.6**	47.9	23.4	-19.4	-9.7	12.6	52.3	**4.4**
Gold (in USD per fine ounce)	**43.0**	8.5	6.2	-6.0	11.7	43.0	75.2	**10.4**
Crude oil (Brent, in USD per barrel)	**-11.2**	22.2	46.5	-16.0	0.2	-11.2	31.0	**-2.2**

Source: Refinitiv Datastream, The Investment Institute by UniCredit (as of 25 February 2025)
Note: Past values and forecasts are not a reliable indicator of future performance. Indices cannot be purchased and therefore do not include costs. When investing in securities, costs are incurred which reduce the performance. The return on investments in foreign currencies may also rise or fall as a result of currency fluctuations. So-called synthetic bonds are calculated to reflect the performance of government bonds in a fixed maturity range. In each case, the most "suitable" real federal bond at the relevant time is used as a reference for the yield opportunity of the synthetic bond. The development of the expected yield to maturity is shown under the following conditions: servicing of interest payments and redemption in accordance with the terms and conditions and holding until maturity. In this respect, it is a yield opportunity. The yield opportunities reflect the different risk assessments of the investors for the respective products or countries (higher yield opportunity=higher risk assessment). The synthetic bonds cannot be purchased and therefore do not include any costs. In the case of currencies and commodities, acquisition and/or custody costs incurred are not included.

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Information and data contained in this document is updated as at 25 February 2025.