Perspectives
Financial Markets

SwissLife Asset Managers

March 2025

Interest rates & bonds
Eurozone: 10-year yields up and credit spreads down

Overview of bond yields and investment-grade credit spreads

	10-year government bond yield			Investment grade credit spread		
	Current	Feb. 2025*	Year-to-date*	Current	Feb. 2025*	Year-to-date*
US	4.3%	-24 bps	-27 bps	83 bps	4 bps	3 bps
Eurozone	2.4%	-1 bps	8 bps	89 bps	-2 bps	-13 bps
UK	4.5%	-2 bps	-5 bps	93 bps	2 bps	-3 bps
CH	0.5%	8 bps	19 bps	65 bps	-3 bps	-4 bps

10-year government bond yield eurozone = DE, bps = basis points.
* Change as at 27 February. Source: Bloomberg

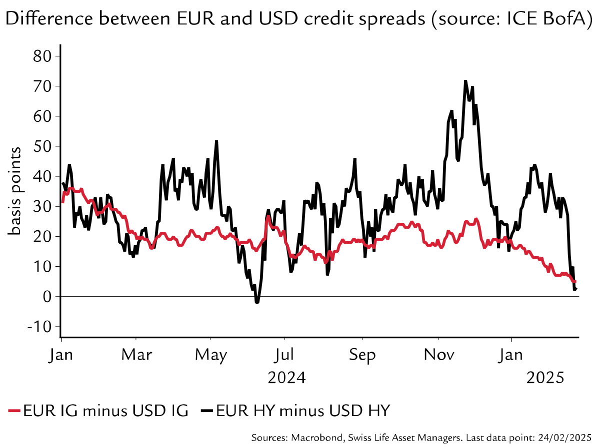
USA
- Investment-grade credit spreads stayed at historically tight levels in February. Since mid-February, however, economic surprise indicators have weakened, leading to wider high-yield spreads and lower yields for both 2-year and 10-year Treasuries.
- Due to tariff policy uncertainty, the US Federal Reserve remains in "wait-and-see" mode. However, we still expect policy rate cuts later this year.

Eurozone
- European credit spreads tightened in February, supported by expectations of increased defence spending by European governments. The yield curve steepened as 2-year rates declined and 10-year rates stayed quite stable over the whole month.
- The ECB cut its policy rate by 25 basis points (bps) in January, and we expect five more cuts this year.

UK
- IG credit spread trading was quite range-bound. Rates were volatile through the month but remained stable across the whole of February.
- Economic surprises in the UK have been positive since mid-February, and the yield curve steepened slightly in February.

Switzerland
- Core inflation for January increased more than expected, leading to higher rates and a steeper yield curve in February
- However, we expect inflation to soften further and one more 25 bps rate cut by the SNB.

European credit spreads tightened despite tariff risks



Last month, EUR credits outperformed USD credits, especially in high yield (HY). EUR credit profited from expectations regarding increased defence spending, with European defence and industrial companies seen as major beneficiaries. This is supported by the German election result, which is likely to bring a stable government, the expectation of several rate cuts by the ECB in 2025 and a weaker EUR. Investor confidence in Europe was also supported by hopes of a ceasefire in the Ukraine war, which could potentially lead to lower energy prices and reconstruction efforts in Ukraine. At the same time, however, rates at the longer end rose slightly as the market expects increased sovereign bond issuance to fund the anticipated defence spending. In addition, the outcome of the Ukraine peace talks remains uncertain, and tariff headlines are starting to weigh on corporate sentiment and have increased inflation expectations, particularly in the US. For March, we expect wider spreads in HY in EUR and in USD. We also expect wider spreads in EUR investment-grade (IG) as the market has priced in a bit too much optimism regarding Ukraine peace talks and Eurozone growth, while remaining somewhat complacent regarding US tariff risks. We take a neutral view with regard to USD IG credit. Regarding duration, we are neutral on the US. For the EU and Switzerland, we have a neutral view on 2-year yields but expect higher 10-year government bond yields.

Equities

Trump so far not positive for stock markets

Overview of equity market performance

	Feb. 2025*	Year-to-date*
USA	-1.6%	1.4%
Eurozone	4.5%	12.1%
UK	1.1%	7.2%
Switzerland	3.1%	11.8%
Emerging markets	3.9%	5.8%

MSCI net total return indices in local currency.
* Performance as at 27 February. Source: Bloomberg

US

- The US market continued to lag global markets in February. The Magnificent 7 stocks lost almost 8%.
- Since the inauguration of President Trump (and the release of the latest version of Deepseek), the US market has lagged other markets by several percentage points.
- The US market is still expensive and the valuation much higher than all the other markets.

Eurozone

- The outperformance continued in February, which is surprising to us, given the crisis in major European countries, tariff announcements by President Trump and an unclear situation in Ukraine.
- The valuation of the European market is still neutral relative to its history and attractive relative to the US. The fact that the ECB will deliver more cuts than the US Fed in 2025 is another relatively positive factor for European stocks.

UK

- Like the other European markets, the UK got off to a –very good start to the year.
- The UK market still benefits from a low valuation.

Switzerland

- The market continued its good performance in February. Pharmaceuticals and especially Nestlé have performed very well this year.
- The Swiss equity market valuation is at the upper end of the neutral range.

Emerging markets

- Emerging markets have caught up due to the strong performance of the Chinese market and despite a very weak Indian market.
- The valuation discount of emerging market stocks is big, and an extended rally in Chinese stocks could lead to an outperformance.

Deepseek and the implications

On 20 January (inauguration day of President Trump), the small Chinese company Deepseek launched a new large language model as a competitor to established players like ChatGPT, LLAMA or Copilot. The model contains several innovations including a much more efficient training process and an innovative use of reasoning, resulting in much lower energy usage, lower hardware requirements, much lower training costs and much lower prices for the user (40x cheaper). The quality of the model is on par with ChatGPT and is open source so that the code can be evaluated and used by everybody for free. As a result, the model poses a formidable challenge for US AI companies. Put simply, the US AI landscape is in jeopardy and so is its exceptionalism and dominance in the stock market. Going forward, China may play a much more important role. China "produces" 5x more graduates in science than the next 5 countries combined and dominates in AI patents and number of AI researchers. The market understood the significance of the development quickly and major hardware producers (Nvidia), energy producers (e.g. Vistra) or companies providing supporting technology (e.g. Schneider) suffered double digit losses, which so far have only been partially recovered. The Chinese stock market in general and technology stocks in particular (e.g. Alibaba) have strongly outperformed the US market. Even European markets, which would benefit from an end of the US AI monopoly, clearly outperformed the US market.

Market performance since 20 January 2025

USA	EU	China	China Tech	Magnificent 7
-0.8%	5.5%	15.4%	31.1%	-7.1%

Data as at 26 February 2025. Source: Bloomberg, Swiss Life Asset Managers

Is this trend likely to continue and is Deepseek the long-awaited trigger for the end of US AI and tech stock dominance? We think that Deepseek indeed shows that the US monopoly with its extraordinary margins (Nvidia has a margin of 50%) will not persist forever and therefore expectations currently priced into US stocks (in particular in AI and tech stocks) are too high. This also calls into question the high valuation. On the other hand, the US has stronger economic and productivity growth and less regulation. Net net, we think that the US market is fully priced, and other markets are currently more attractive.

Currencies

Further USD weakness in February

Overview of major currencies

	Feb. 2025*	Year-to-date*	1-month view
EUR/USD	1.1%	1.2%	↘
EUR/CHF	-0.4%	0.1%	→
GBP/USD	2.3%	1.3%	↘
USD/JPY	-3.5%	-4.8%	↗

* Performance as at 27 February. Source: Bloomberg

USA

– The USD continued to weaken in February. All major currencies appreciated against the USD, with SEK being the biggest winner.

– We expect renewed appreciation of the USD as the tariff discussion gains traction over the next weeks and as interest rate differentials, the so-called "carry", remain favourable for the USD.

Eurozone

– In February, the rise in the EUR against the USD was driven by rising optimism for a peace deal between the Ukraine and Russia. Nevertheless, the EUR depreciated against all other major currencies.

– Eurozone business surveys continued to improve in February. Yet, Eurozone economies are still underperforming the US structurally and are likely to suffer from the trade uncertainty. Together with continued monetary policy easing by the ECB, we expect the EUR to weaken against the USD in March.

UK

– GBP recovered from its January weakness as higher-than-expected January inflation data led to a repricing of rate cut expectations for the Bank of England by the market.

– For March, we expect stabilisation in EUR/GBP and a decrease in GBP/USD.

Switzerland

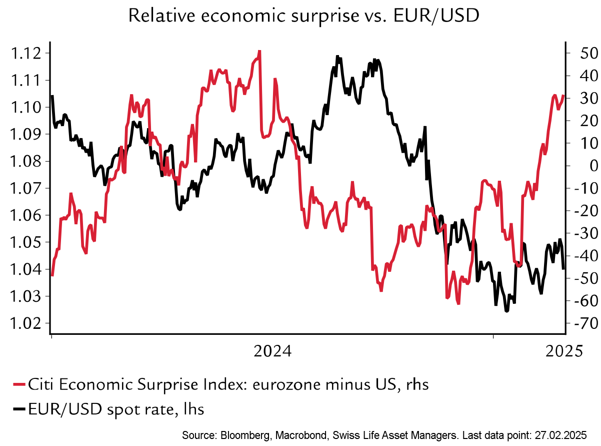
– EUR/CHF remained range-bound in February, despite the market pricing out negative interest rates in Switzerland this year after the higher-than-expected January inflation print.

– We maintain a neutral view on EUR/CHF as risks over one month are balanced.

Japan

– USD/JPY continued its decline in February, but in line with our view of a stronger USD, we expect this move to be reversed over the next few weeks.

The Euro's fragile comeback looks overdone



Trade uncertainty has been one of the main drivers for FX markets this year. Geopolitics have now also come back into focus as President Trump made headlines with his efforts to broker a peace deal between Ukraine and Russia. While the outcome and the timeline of such a potential deal are still highly uncertain, the FX market has started to price in some positive effects for European growth (we have detailed the potential effects of such an agreement on the Eurozone economy in our Economics Perspectives). Furthermore, the market is looking for an additional boost from the fiscal side due to higher defence spending as well as from the new German government in the form of a reform to the debt break. Apart from that, the EUR has also been supported by improving economic momentum (see chart), with Purchasing Manager Indices (PMI) continuing to bottom out. We see the EUR optimism as overdone and look for a reversal in EUR/USD in March. Further tariff announcements over the next weeks should put pressure on the currency. Fiscal stimulus from increased defence spending has adverse side effects such as higher government debt ratios. Even though there seems to be light at the end of the tunnel with regards to economic sentiment in the Eurozone, the Eurozone economy is still underperforming the US structurally. Finally, we expect the USD to remain well supported by the interest rate differential ("carry"), as inflation risks in the US are skewed to the upside, leaving our view of general USD strength intact.

Asset allocation

News flow induced volatility

Review

– Market performance in February aligned with our expectations, with equities outperforming corporate bonds.
– Although bond yields were volatile, they remained relatively stable. Corporate bonds outperformed government bonds due to tightening spreads.
– Market developments were significantly influenced by the news flow from the US, leading to increased volatility.

Current asset allocation views

Asset class	Active weight
Global government bonds	neutral
Global investment grade credit	underweight
Emerging market bonds	underweight
Global equities	overweight

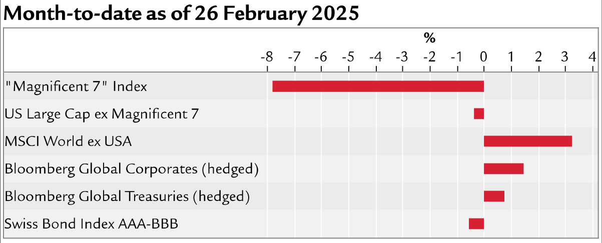
Source: Swiss Life Asset Managers

– We maintain our asset allocation view, continuing to see greater potential in equities compared to corporate bonds, particularly after the recent tightening in credit spreads. However, our conviction has diminished somewhat, as the more attractive markets are gradually exhausting their potential.
– The year-to-date weakness in the US equity market is primarily due to the underperformance of the "Magnificent 7". This has been offset by the ongoing recovery in the European and Chinese markets. We expect this trend to continue in the short term, supported by more favorable economic data, a more accommodating monetary policy, and government interventions in China start to bolster the economy.
– Credit spreads have continued to tighten, further deteriorating their risk/return profile.
– Government yields were volatile. US yields decreased, German yields remained stable, while CHF yields increased. Interestingly, yields fell during equity market corrections, supporting our view that high USD yields and, to a lesser extent, EUR yields could mitigate the impact of corrections, justifying our neutral stance despite the limited potential for significant capital gains.

Time to review our strategy?

Our current allocation strategy hinges on equities outperforming corporate bonds alongside a shift from the expensive US equity market to more attractive regions and market segments. Year-to-date, this thesis holds. The constant flow of surprising and sometimes confusing news from the US creates uncertainty for investors, but equities have had a solid return and have outpaced corporate bonds, despite credit spreads tightening again. And the expensive US equity market has so far underperformed the cheaper rest of the world (see the chart below).

Gross total return in USD of selected asset classes
Month-to-date as of 26 February 2025



Sources: Macrobond, Bloomberg, Swiss Life Asset Managers

Is it now the time to revise our view? We are unwilling to do it for the following reasons:

1. European economic indicators have improved a little, supporting its financial markets.
2. The US equity market has underperformed because of the "Magnificent 7" but continues to be resilient.
3. The Chinese government has increased efforts to buoy the weak economy, while DeepSeek has created tailwinds lifting the Chinese tech sector and the equity market.
4. The recent diplomatic developments on Ukraine might have a temporarily positive impact on financial markets' sentiment.

However, we should not ignore risks such as tariffs, geopolitical tensions, and high valuations. Therefore, investments should prioritize more defensive strategies and ensure the broadest possible diversification.

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