Perspectives
Financial Markets

May 2025

Interest rates & bonds
"Liberation Day" led to a jump in credit spreads

Overview of bond yields and investment-grade credit spreads

	10-year government bond yield			Investment-grade credit spread		
	Current	Apr. 2025*	Year-to-date*	Current	Apr. 2025*	Year-to-date*
US	4.2%	-4 bps	-41 bps	106 bps	12 bps	26 bps
Eurozone	2.4%	-29 bps	8 bps	112 bps	14 bps	10 bps
UK	4.4%	-23 bps	-13 bps	122 bps	11 bps	26 bps
CH	0.3%	-27 bps	0 bps	82 bps	13 bps	13 bps

10-year government bond yield eurozone = DE, bps = basis points.
* Change as at 30 April. Source: Bloomberg

USA

– After "Liberation Day" tariff announcements on 2 April, high yield (HY) and investment grade (IG) credit spreads increased because of increasing recession risks. Hard data holds up well for the time being, but we see a risk that this can turn quickly.
– Although the US Federal Reserve signalled patience, we still expect four policy cuts in 2025, starting in June. This is mainly due to rising trade policy uncertainty and its negative economic impact.

Eurozone

– Credit spreads in both EUR HY and IG widened, and 10-year yields declined in April on lowered global growth expectations given the trade war. European data remains robust in relative terms with surveys and hard data pointing to some stabilisation.
– The ECB cut its policy rate by 25 basis points (bps) in April, and we expect another three cuts this year.

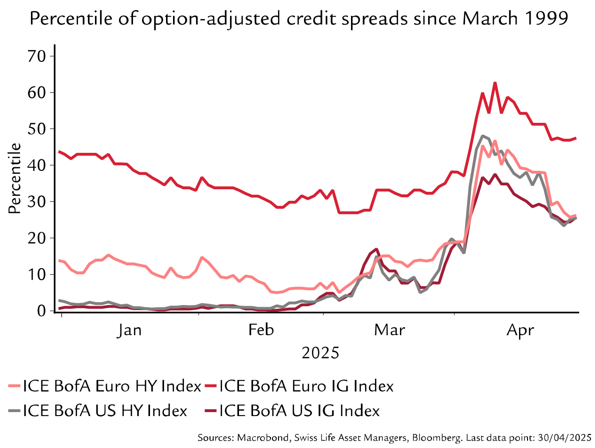
UK

– In April, IG credit spreads widened because of lower growth expectations. 10-year rates also declined.
– Given the outlook for weaker growth and a higher unemployment rate, we expect the Bank of England to cut its policy rate four times in 2025.

Switzerland

– Following the tariff announcements, expectations for GDP growth declined. This has led to an increase in IG spreads and lower 10-year rates in April.
– We expect one further SNB rate cut in June 2025, which brings the policy rate to 0%.

Volatile credit spreads in April



Credit spreads widened after US President Trump's "Liberation Day" announcement on 2 April, which introduced a package of "reciprocal" tariffs. This led to an increase in US inflation expectations, a downward revision of GDP growth forecasts across many markets and a higher recession probability for the US. As a result, credit spreads widened at the beginning of April (both in EUR and USD). In terms of percentiles (data back to 31 March 1999), the spread widening has led to a normalisation of US credit spreads both in IG and HY from historically very tight levels of below 5% to around 25%. Although spreads tightened in the second half of April, we are neutral on spreads in investment grade and high yield credit in EUR and in USD for May. Despite the risk of a US recession in the second half of 2025, the recent increase of spreads already discounts a certain fundamental weakening. Moreover, the market seems to expect only a short and shallow recession, supported by a calming of trade tensions (e.g. due to tariff pauses, more exemptions or trade deals) and rate cuts by the US Fed. Regarding duration, we expect lower yields in the US for 2-year and 10-year sovereign bonds. In the eurozone, we expect lower yields for the 2-year rate horizon but are neutral for the 10-year rate. For Switzerland, we have a neutral view on government bond yields across the curve.

Equities

Rollercoaster — US politics dominate stock markets

Overview of equity market performance

	Apr. 2025*	Year-to-date*
USA	-0.5%	-5.1%
Eurozone	0.2%	7.7%
UK	-0.8%	5.6%
Switzerland	-2.7%	5.8%
Emerging markets	1.3%	4.3%

MSCI net total return indices in local currency.
* Performance as at 30 April. Source: Bloomberg

US

- After a sharp correction in the first half of April (-10%), the market recovered in the second half and ended the month almost flat.
- Unpredictable political developments, including tariff announcements on "Liberation Day," were key drivers of the market correction. In addition, the potential firing of central bank chief Powell made markets very nervous. Trump backtracked after the market reaction, and markets recovered.
- Despite the correction, the US market is still expensive.

Eurozone

- The European and UK markets are the best performers this year. In local currency, the European market outperformed the US by around 13 percentage points.
- European stock inflows have been strong this year.
- European market valuation remains broadly neutral and much more attractive than US equities.

UK

- The defensive UK market has, so far, the same performance as the eurozone stock market.
- The UK market still benefits from a low valuation.

Switzerland

- April was a weak month for Swiss stocks. After three weak months, small caps outperformed large caps by around 3%.
- The Swiss equity market valuation is at the upper end of the neutral range.

Emerging markets

- In April, emerging markets outperformed all developed markets.
- Especially India, the second-largest weight in the index, performed well. After a 10% increase in March, the April performance was +3.6%.

What happens after periods of high volatility?

Market volatility has been exceptionally high recently. The VIX, an index that measures the short-term (expected) volatility of the US stock market based on option prices, spiked to more than 50. In "normal" times the VIX is usually around 20. Such spikes are not unusual in bear markets and during times with abnormally high uncertainty such as now or during the Covid crisis in 2020. For example, in 2020, the VIX went as high as 80. Historically, there is a strong relationship between spikes in volatility and subsequent equity market performance.

Volatility spikes (VIX > 50) and market performance

S&P 500: Subsequent performance after VIX closes > 50

	+1M	+3M	+6M	+12M	+24M
% of Positive Returns	55.4	35.1	68.9	98.7	100
Median	1.6	-7.3	5.8	26.6	39.4
Max	22.8	38.3	46.8	71	94.8
Min	-22.9	-24.9	-21.1	-0.4	9.8

Source: Swiss Life Asset Managers, Bloomberg. Data from 1990 to 2025

Historical data shows that equity market returns following VIX spikes above 50 tend to be strongly positive. The longer the time period, the better the performance and the share of positive outcomes. For a one-year horizon, almost 100% of the returns are positive and the worst outcome is very close to 0% performance. How can this positive development be explained? There are two main reasons for this pattern: 1. Volatility spikes typically occur during bear markets or sharp corrections. These phases are usually short-lived, lasting from a few days to several months. After such episodes, valuations tend to be more attractive, central banks have often reduced interest rates, and the economic outlook begins to improve. Markets tend to overreact to negative news in the short term. As uncertainty fades, markets start repricing risks and typically recover.

What will happen this time? We think that there is a decent chance that equity markets will confirm the historical pattern over the next 12 months. The reasons are: 1. It appears likely that trade negotiations lead to positive results, 2. Central banks will lower rates, 3. Fiscal stimulus in Europe and tax cuts in the US support markets. There are, however, two main risks: 1. We are too optimistic about trade negotiations, 2. Even after the correction, the valuation of the US equity market is rich.

Currencies

USD: more of the same

Overview of major currencies

	Apr. 2025*	Year-to-date*	1-month view
EUR/USD	4.7%	9.4%	→
EUR/CHF	-2.1%	-0.4%	↘
GBP/USD	3.2%	6.5%	→
USD/JPY	-4.6%	-9.0%	→

* Performance as at 30 April. Source: Bloomberg

USA

- The USD continued to weaken in April. All major currencies appreciated against the USD. The extent of the tariff announcement on 2 April was underpriced in FX markets and confidence in US assets was damaged.
- The sentiment towards the USD remains weak and positioning in both USD shorts and EUR longs is elevated. As this entails some risk of a reversal, we prefer to hold a neutral view on EUR/USD.

Eurozone

- EUR outperformed in April as the currency was seen as a liquid safe haven by the market in the aftermath of the tariff announcements.
- From a monetary policy perspective, there is no impulse for FX to be expected. For both the ECB and the Fed, our monetary policy expectations match the current market pricing.

UK

- In April, GBP again appreciated strongly against the USD, moving temporarily above 1.34. GBP lost some ground against the EUR, however.
- We maintain a neutral view on both GBP/USD and EUR/GBP for May.

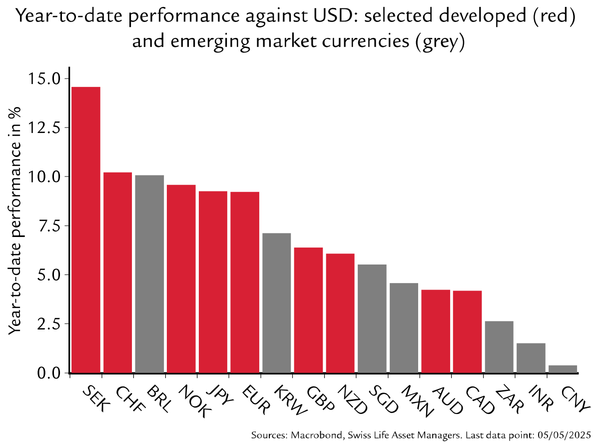
Switzerland

- CHF weakness against the EUR seen in March reversed in April in line with our expectations. EUR/CHF moved back below 0.93 mid-month.
- High trade policy uncertainty should keep the safe-haven properties of the CHF well supported. We expect further weakness of EUR/CHF in May.

Japan

- After failing to profit from the broader USD-weakness in March, JPY gained 4.8% against the USD in April, making it the second-strongest performer.
- We are taking a neutral view on USD/JPY for May.

The USD and the confidence crisis



The USD did not find any relief in April. The various announcements on US trade policy and comments from President Trump challenging the Fed's independence intensified the confidence crisis in US assets, which led to a further broad-based USD selloff. Also, the fundamental outlook remained challenging for the USD as the US recession probability rose further. Economic data released for the US remained quite robust, indicating that the US economy has entered this challenging period with good momentum. However, in contrast to the confidence loss, the negative effects of the trade war will likely be visible in the hard data with a lag and start to be a drag on economic activity in the second half of the year. Our economists have lowered their US GDP growth forecast for 2025 to 1.4% from 1.8%. At the same time, they also slightly lowered their growth expectations for the eurozone. In addition to reduced global demand, the high level of global uncertainty should have a particularly negative impact on corporate investment and private consumption in the eurozone. Nevertheless, the continued move up in EUR/USD in April was as much a reflection of relative EUR strength as it was of poor sentiment towards the USD. Five-year real rate differentials continued to move in favour of EUR, which explains most of the EUR strengthening. At the same time, market action in EUR/USD disconnected from the two-year nominal interest rate differential. The poor sentiment towards the US dollar is also visible in market positioning, as investors are heavily positioned in US shorts as well as EUR longs. This brings a latent risk of a lower EUR/USD in case of a sudden unwinding of these positions. Overall, we prefer to keep a neutral view on EUR/USD for the month of May.

Asset allocation

A month of confusion

Review

- The April 2 announcement of punitive US tariffs caused a significant global market correction, impacting all asset classes and regions.
- It also reinforced concerns about US Treasury bills and the USD as safe-haven assets, leading to USD depreciation and elevated yield volatility.
- Markets recovered losses after the US administration introduced exceptions and a 90-day pause to the trade tariffs.

Current asset allocation views

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

Source: Swiss Life Asset Managers

- We have reduced our equity exposure to neutral, while keeping the overweight in government bonds and the underweight in credits.
- Uncertainty has decreased, but the situation remains confusing with substantial risks. Equity markets remain volatile and have not fully priced in growth and earnings risks. Therefore, we have reduced our exposure to neutral.
- Government yields did not react entirely as expected during the recent market turmoil. Levels in the US and Europe remain elevated in the current environment. We therefore expect lower yields as weaker economic data starts to pour in.
- The recovery after the initial spike leaves spreads below the long-term average and the levels we would expect given the significant macroeconomic risks.

Elevated market volatility despite de-escalation

The tariffs announced by Donald Trump on 2 April shocked financial markets due to their size and calculation method. Subsequent actions by the US administration revealed the plan's infeasibility and risk of significant economic harm to both US and global economies. Financial markets have since recovered due to adjustments, concessions, pauses, and ongoing "negotiations", but uncertainty remains high, creating volatility. Industries cannot realistically adjust global supply chains by the end of June, making further concessions and a focus on domestic issues likely. This uncertainty will delay investment decisions and reduce consumer spending, negatively impacting US and global growth.

Equity markets, in the meantime, have returned to 2 April levels but haven't fully accounted for the longer-term macro effects of US policy. Consequently, we expect equity markets to stay nervous. We maintain a neutral overall equity weight, preferring to be tactical and overweight markets that may benefit from a moderation of US trade policy.

The strong depreciation of the USD and the behaviour of US government bonds in April suggest their status as a safe haven and reserve asset is being questioned. Investors are diversifying, putting pressure on exchange rates and bond yields. The full impact on US yields will not be immediate due to the lack of effective alternatives. And the currently elevated yields conflict with the expected economic slowdown in the US and most other countries, prompting us to overweight government bonds for the time being.

Credit spreads initially widened but have since decreased and remain below historical averages. These tight spreads are inconsistent with the increasing risk of a substantial growth slowdown. Consequently, we continue to be underweighted in this asset class.

Swiss Life Asset Managers

Sven Kreitmair
Portfolio Manager Fixed Income
sven.kreitmair@swisslife-am.com

Andreas Homberger
Head Quantitative Equities
andreas.homberger@swisslife-am.com
@Homberger_A

Damian Künzi
Head Macroeconomic Research
damian.kuenzi@swisslife-am.com
@kunzi_damian

Florence Hartmann
Economist Developed Markets
florence.hartmann@swisslife-am.com

José Antonio Blanco
CIO Third Party Asset Management
Head Multi Asset
joseantonio.blanco@swisslife-am.com

If you have any questions or if you would like to subscribe to this publication,
please send an e-mail to: info@swisslife-am.com.
For more information visit our website at: www.swisslife-am.com/research