

June 2025

## Interest rates & bonds

Tariff headlines and fiscal deficit concerns

### Overview of bond yields and investment-grade credit spreads

|          | 10-year government bond yield |           |               | Investment-grade credit spread |           |               |
|----------|-------------------------------|-----------|---------------|--------------------------------|-----------|---------------|
|          | Current                       | May 2025* | Year-to-date* | Current                        | May 2025* | Year-to-date* |
| US       | 4.5%                          | 32 bps    | -9 bps        | 88 bps                         | -18 bps   | 8 bps         |
| Eurozone | 2.6%                          | 11 bps    | 19 bps        | 101 bps                        | -11 bps   | -1 bps        |
| UK       | 4.7%                          | 29 bps    | 16 bps        | 111 bps                        | -11 bps   | 15 bps        |
| CH       | 0.3%                          | -1 bps    | -1 bps        | 77 bps                         | -4 bps    | 8 bps         |

10-year government bond yield eurozone = DE, bps = basis points.  
\* Change as at 28 May. Source: Bloomberg

### USA

- In May, US credit spreads and government bond yields were volatile due to tariff headlines and concerns over the US fiscal deficit. As a result, both 2-year and 10-year yields rose over the month.
- As expected, the US Federal Reserve kept its policy rate unchanged in May. We still expect four policy rate cuts in 2025 starting from July as high tariffs start to slow the economy in H2 2025.

### Eurozone

- Credit spreads in both EUR high yield (HY) and EUR investment grade (IG) tightened, with government bond yields rising to a lesser extent than in the US.
- As disinflation continues, we expect the ECB to cut rates another three times this year, starting in June.

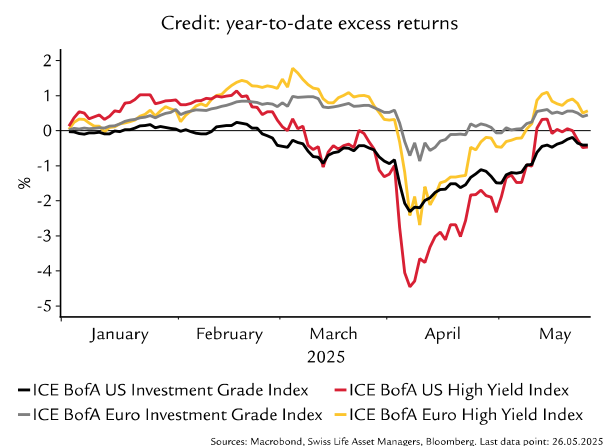
### UK

- IG credit spreads tightened from the wider levels in April and bond yields increased across the curve.
- The Bank of England cut its policy rate to 4.25% on 8 May, and we still expect another three rate cuts this year, the next one being delivered in August.

### Switzerland

- In line with other developed credit markets, IG spreads tightened. The government bond yield curve steepened due to a larger decline at the short end of the curve.
- To weaken the CHF and slow disinflation, we expect the SNB to cut its rate by 50 bps in June and by 25 bps in September to bring the policy rate to -0.5%.

### Credit excess return recovery continued in May



Excess return is the return of credit above government bonds. Year-to-date (YTD) excess return for investment grade (IG) and high yield (HY) credit relative to government bonds continued to recover in May. This was driven by a significant credit spread tightening across all credit asset classes in May, which outweighed the increase in government bond yields. Due to the greater spread sensitivity of HY compared to IG, excess returns in May were stronger in HY compared to IG. The highest increase in excess return in May was seen in USD HY, supported by strong spread tightening on the back of the rollback of US-China tariffs. Notably, YTD excess returns are positive in EUR credit but negative in USD credit. After spreads tightened in May, the risk for wider spreads because of US tariffs and the resulting negative economic impact has again increased. Therefore, we expect wider spreads in HY given its higher spread sensitivity, and we are neutral for credit spreads in IG in both EUR and in USD for June. Regarding duration, we expect lower 2-year and 10-year government bond yields in June in the US and the eurozone.

## Equities

Sell in May and go away?

### Overview of equity market performance

|                  | May 2025* | Year-to-date* |
|------------------|-----------|---------------|
| USA              | 6.0%      | 0.6%          |
| Eurozone         | 5.7%      | 13.8%         |
| UK               | 2.7%      | 8.5%          |
| Switzerland      | 1.4%      | 7.2%          |
| Emerging markets | 4.8%      | 9.3%          |

MSCI net total return indices in local currency.

\* Performance as at 28 May. Source: Bloomberg

### US

- May was a very positive month for US equities. The key drivers were tariff rollbacks for Chinese imports and the delay of higher tariffs against the EU.
- From its lows in April, the market has now recovered almost 20% – one of the fastest and strongest recoveries in history.
- With the sharp recovery, the US market has become very expensive once again. Only small caps are trading in the normal valuation range.

### Eurozone

- Eurozone equities performed similarly to US equities in May. It is the only major market that is up more than 10% year-to-date.
- Fears about increasing tariffs led to a very short-lived correction. After the US President announced a delay from June to July, the market recovered and outperformed the US once more.
- The valuation of the European market has increased and is now above historical averages. The valuation discount to the US is, however, still significant.

### UK

- The UK market underperformed other markets in May due to its very defensive character.
- The UK market still benefits from a low valuation.

### Switzerland

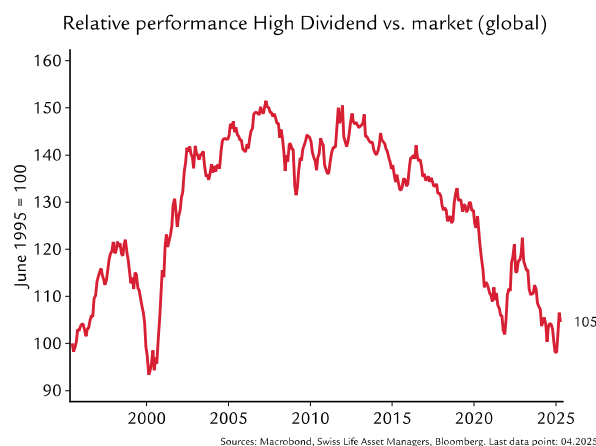
- May was another month of underperformance for the Swiss equity market. Small caps outperformed large caps again in May and are now slightly ahead since the start of the year
- The Swiss equity market valuation is now also above the neutral range.

### Emerging markets

- In May, Emerging Markets had a positive performance.
- Valuations in Emerging Markets remain fair and are significantly lower than those in developed markets.

### High-dividend investing

Investing in high-dividend stocks has been popular for approximately 30 years. Over the long-term, high-dividend stocks have similar returns to the broad market. However, for about 15 years and in particular in the past two years, there has been a significant underperformance of the global high-dividend universe due to significantly lower exposure to IT stocks and the Magnificent 7. Historically, dividends have played a crucial role in equity returns – in the US, nearly 50% of total returns since 1871 have come from dividends. In recent years the share has been lower, as companies have engaged in buybacks.



The high-dividend investment style has five main properties: 1. Over the long-term, the performance is similar to the broad market indices. 2. Dividends are significantly higher (MSCI high dividend indices have a 50% higher dividend yield than the broad market indices) and this higher dividend yield serves as a risk buffer. 3. It is less risky in dimensions such as volatility, share of cyclical sectors and concentration. 4. Their valuation is lower; companies have less debt but similar profitability. 5. Earnings growth is less than for the broad market. Essentially, the high-dividend style delivers market-like performance with several additional attractive features. The price for these attractive features is that in strong bull markets, the performance is weaker. For successful high-dividend investing, it is very important to use quality indicators in order to assess the sustainability of the high-dividend yield. We think that high-dividend investing is currently very attractive: relative valuation is low, the 15-year period of underperformance appears to have ended, and the global low-interest-rate environment that supported the previous bull market is no longer in place.

## Currencies

USD, victim of a confidence crisis

### Overview of major currencies

|         | May 2025* | Year-to-date* | 1-month view |
|---------|-----------|---------------|--------------|
| EUR/USD | -0.3%     | 9.1%          | ↗            |
| EUR/CHF | -0.2%     | -0.6%         | →            |
| GBP/USD | 1.1%      | 7.6%          | ↗            |
| USD/JPY | 1.2%      | -7.9%         | ↘            |

\* Performance as at 28 May. Source: Bloomberg

### USA

- After the selloff in April, the USD gained some ground in the first half of May before weakening again. On a trade-weighted basis, the USD performance was close to zero in May.
- The sentiment towards the USD remains weak and positioning in both USD shorts and EUR longs is elevated. We expect the confidence crisis to continue and to lead to a weaker USD in June.

### Eurozone

- Even though the interest rate differentials between the eurozone and the US widened to the disadvantage of the EUR, EUR/USD finished the month of May at 1.13, roughly the level it started off the month.
- We think that the Fed will deliver two more cuts and the ECB only one more cut than markets currently expect until the end of 2025. This is an additional reason why we expect EUR/USD to strengthen.

### UK

- In May, GBP appreciated against USD and EUR. Stronger-than-expected inflation numbers and a reduction in rate cut expectations might have contributed to the result.
- We maintain a neutral view on EUR/GBP but expect the GBP to appreciate against USD in June.

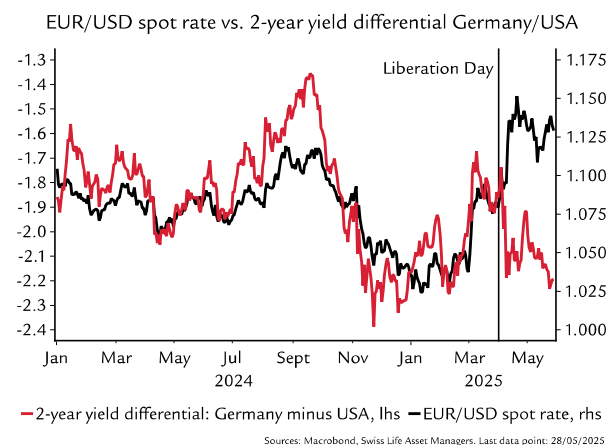
### Switzerland

- CHF was almost unchanged against EUR and USD in May.
- We are neutral on EUR/CHF despite the expected move to negative interest rates by the SNB in June.

### Japan

- The JPY had a rather weak performance in May, losing more than 1% on a trade-weighted basis.
- In line with our view of a weaker USD, we are negative on USD/JPY for June.

### EUR/USD: the confidence crisis outweighs carry



The USD remains under pressure. Even though the US President's reciprocal tariffs were swiftly put on hold for 90 days, the 2 April "Liberation Day" marked the point when the correlation between USD performance and carry broke down. For the most heavily traded currency pair EUR/USD, the interest rate differential ("carry") had been by far the most important performance driver (see chart). Not anymore. Among the financial market instruments, the USD is the most important victim of the confidence crisis that the US administration unleashed with its erratic economic policies, attacks on institutions and subtle threats against foreign investors, notably in US Treasuries. While we think that "Liberation Day" might have marked the peak of the trade war, it is unlikely that the confidence crisis will be solved anytime soon. With the focus now shifting to US fiscal policy and the proposed "big beautiful bill", another potential source of worry has been sparked among foreign investors. The current proposal of the House of Representatives implies a virtually unchanged budget deficit in the order of 7% of GDP for the next years, which is reduced to 6% if tariff revenues are taken into account (see our *Perspectives Economics* for more details). The US debt trajectory therefore remains unsustainable, notably if the economic policy uncertainty, lower immigration and the economically inefficient tariffs start to weigh on the country's growth potential. The confidence crisis and the fiscal concerns imply that we expect the USD to weaken further despite its carry advantage.

## Asset allocation

Back to square one

### Review

- In May, equity markets recovered further from the correction that was triggered by the 2 April “Liberation Day” tariff announcements. The recovery was supported by various adjustments and postponements of tariffs as well as ongoing trade negotiations.
- The positive sentiment in equities also benefited credit markets: credit spreads tightened, though higher government bond yields, particularly in the US, have detracted from returns.
- Government bonds generally posted negative returns in May, with Swiss bonds once again standing out as a positive exception.

### 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 leave our asset allocation unchanged. Now that the losses triggered by the 2 April announcement have been recovered, attention is turning back to economic fundamentals. However, we should remain mindful of potential volatility flare-ups as the July tariff negotiation deadline approaches.
- Improved market sentiment supports our neutral equity allocation, even though the underlying fundamentals are relatively weak. We still see room for some markets to catch up, but risks are clearly rising.
- The recent increase in US government bond yields, though understandable, appears difficult to reconcile with our base case of slowing growth and only temporarily higher inflation as a result of tariffs. Therefore, we continue to overweight government bonds and underweight credit. Credit spreads remain very tight and do not adequately reflect current risks.

### Go back to start!

In Monopoly, the board game, drawing a “go back to start” card sends you back to the beginning, skipping the “salary” you would normally collect. A similar pattern has played out in financial markets. Following Donald Trump’s 2 April “reciprocal” tariff announcements, global equity and credit markets corrected sharply, then rebounded to levels seen at the start of the year. So, what’s next? Let’s lay the cards on the table.

Our base case scenario anticipates an economic slowdown in the second half of 2025, but no outright global recession. Inflation should continue to ease in Europe, whereas it will temporarily rise in the US as a result of tariffs. Equity fundamentals have changed little since January. Analysts now forecast 7% to 11% annual earnings growth for large developed-market companies over the next two years – a historically strong pace. These optimistic projections may be tested, especially as US equity market valuations are still elevated and Europe’s equity market valuations are now within a neutral range. Earnings disappointments could trigger a correction. However, if trade negotiations progress, equity markets could catch up in the coming weeks. Overall, we maintain a neutral stance on equities.

Interest rates remain high in the US and, to a lesser extent, in Europe. Switzerland, still seen as a safe haven, continues to offer very low rates. While concerns about US debt sustainability and declining confidence in US Treasuries and the USD may justify higher government bond yields, current levels seem inconsistent with a slowing economy and are likely to fall.

Credit spreads, historically low at the end of last year, have returned to similar levels again in May after a modest widening in April. Some analysts argue that this is justified as government bonds are increasingly seen as risky. Still, the actual risk of a US Treasury default remains very low. And as seen after 2 April, market turbulence still tends to widen credit spreads and lead to lower yields – though less dramatically than in previous episodes of turbulence. We therefore view credit as expensive and thus underweight the asset class, while we maintain an overweight in government bonds.

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