Investment Institute Asset Class Views

The view from the Core CIO Office

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KEY INVESTMENT THEMES

Tariffs, trade deficits and inflows	Interest rates and risk	China needs more than AI

CIO Office: Opinions

Chris Iggo, CIO AXA IM Core

Tariffs vs. investment returns

US President Donald Trump doesn't like much about the global economic and political order. He feels the system has not treated the US well. This is exemplified by his frustration over the US's net indebtedness position which, as of the third quarter (Q3) of 2024, stood at around $24trn. Years of large US trade deficits means the rest of the world has owned increased amounts of dollar assets. His tariff focus is seen as one way of addressing what is perceived as an unfair global trade system.

Capital flows into the US, as the counterpart to trade deficits, have gone into US Treasuries, real estate, direct investment in US companies and listed equities, exchange-traded funds and mutual funds. The bigger the trade deficit, the larger the capital flows with foreign investors taking comfort in the reserve currency status of the dollar. What if tariffs do cut the trade deficit? Capital inflows should ease too. In recent years flows into US equities have been significant (foreigners bought $230bn in Q3 2024 alone). There is a circularity here – inflows boost stock returns; high returns attract inflows. The US has outperformed as a result. If the flows diminish, the valuation gap between US markets and the rest of the world could be reduced. As the old saying goes, be careful what you wish for.

Alessandro Tentori, CIO Europe

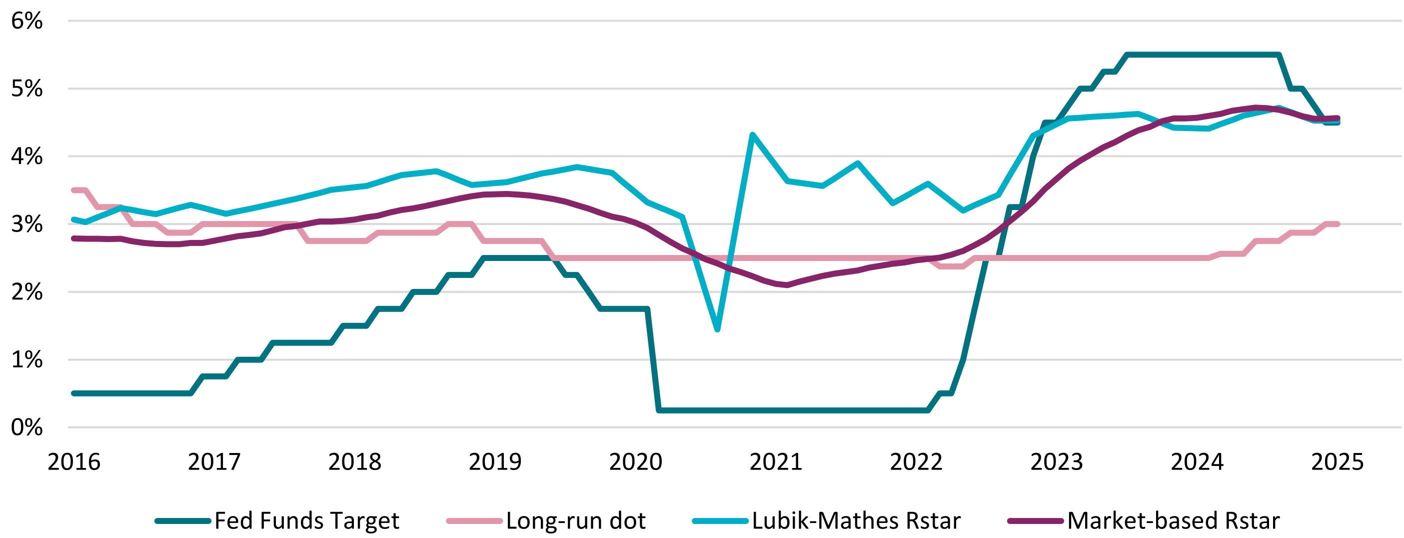
Neutral interest rates and the allocation of risk

The European Central Bank (ECB) recently estimated that the nominal r* – the short-term interest rate which would prevail when the economy is at full strength and inflation is stable – spans a range of between 1.75% and 3%. While it admits these estimates are subject to uncertainty, they are not inconsistent with the simple approach of deriving the neutral interest rate from structural variables. Currently, the sum of the Eurozone's potential growth and the ECB's 2% inflation target matches the ECB's main deposit rate of 2.75%.

In the US, both market and (some) model-based estimates of r* provide us with information about the Federal Reserve's (Fed) policy stance. The chart shows these estimates together with the Fed Funds Rate target as well as US policymakers' own assessments of the long-run interest rate (i.e. the "dot"). At 4.50%, the Fed might be close to a neutral level – though this view is not yet shared by all of its members. The long-run dot lags significantly behind the recent, steep increase in policy rates and both estimates of r*. Furthermore, the simple approach mentioned earlier results in a neutral rate around 3.50%, about 50 basis points higher than the long-run dot.

The art of monetary policy making cannot, and should not, be reduced to a single equation - but there is value in factoring in this approach into our view on future interest rates and the allocation of bond market risk.

| The Fed's monetary policy stance



Source: Bloomberg, ECB, February 2025

Ecaterina Bigos, CIO Asia ex-Japan

China's economy needs more than AI

The emergence of DeepSeek - a rival to the popular ChatGPT - has been a gamechanger in terms of China's position in the artificial intelligence (AI) race. It has bolstered investors' optimism about the potential growth and economic benefits of AI – it's widely believed AI adoption has the scope to boost earnings over the long term, via productivity gains, cost savings and likely new revenue opportunities. However, it's early days in terms of real-world applications. For now, AI model training remains the primary focus. But risks are vast, such as those around AI data usage, industry regulation, national security, technology export controls, and the transferability of open-source models to existing ecosystems. The language in which models are trained is another key consideration, with Chinese companies naturally preferring domestic models.

The DeepSeek breakthrough indicates that innovation is likely to come from a broader group of players. And it is not unprecedented given that China has created tech giants that replicate global success stories in areas like e-commerce, search and social media. But China's recent market rally is narrowly focused and narrowly driven; policy support is still required to address deflation, to drive a broader, sustainable earnings recovery. Demand-side policy support and signs of a more market-friendly policy shift towards technology companies are encouraging, but much more is needed to shore up confidence in consumers and investors, as well as in the private sector.

Investment Managers

Asset Class Summary Views

Views expressed reflect CIO team expectations on asset class returns and risks. Traffic lights indicate expected return over a three-to-six-month period relative to long-term observed trends.

Positive	Neutral	Negative

CIO team opinions draw on AXA IM Macro Research and AXA IM investment team views and are not intended as asset allocation advice.

Rates		Medium-term rate expectations are stable but subject to policy triggered volatility
US Treasuries		Fed on hold until more clarity on inflation and Trump policy; bonds in range
Euro – Core Govt.		Range trading while markets wait for any new policy initiatives on the fiscal side
Euro – Govt Spreads		Spreads to remain narrow; focus on what eventual new German government will do
UK Gilts		Investors unsure about path of inflation and fiscal policy; gilts range bound for now
JGBs		Markets still expect further interest rate hikes
Inflation		Scope for breakeven rates to move higher as inflation continues to be sticky

Credit		Credit remains strong with spreads stable and positive returns
USD Investment Grade		Strong earnings backdrop supportive for US corporate debt
Euro Investment Grade		Demand for fixed income remains strong; fundamentals are solid
GBP Investment Grade		Spreads have narrowed in 2025, but demand remains strong
USD High Yield		Solid economic data, strong cash-flows and technical factors continue to support high yield
Euro High Yield		Resilient fundamentals, technical factors and ECB cuts support total returns
EM Hard Currency		Spreads over US Treasuries are attractive but Trump agenda could be disruptive

Equities		Signs of broadening of performance away from narrow US technology sector leadership
US		Earnings momentum starting to flatten; valuations are still expensive
Europe		Modest pick-up in earnings forecasts and possible beneficiary of global move away from US
UK		Markets need to see how government can improve growth prospects; lower rates will help
Japan		Solid combination of valuations and expected earnings growth
China		Tech sector bolsters investor optimism, with scope to broaden out on policy support
Investment Themes*		Competition in AI to create more opportunities for technology beneficiaries

*AXA Investment Managers has identified six themes, supported by megatrends, that companies are tapping into which we believe are best placed to navigate the evolving global economy: Technology & Automation, Connected Consumer, Ageing & Lifestyle, Social Prosperity, Energy Transition, Biodiversity.

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