

July 2025

Interest rates & bonds

Tight credit spread valuation despite elevated risks

Overview of bond yields and investment-grade credit spreads

| | 10-year government bond yield | | | Investment-grade credit spread | | |
|----------|-------------------------------|------------|---------------|--------------------------------|------------|---------------|
| | Current | June 2025* | Year-to-date* | Current | June 2025* | Year-to-date* |
| US | 4.2% | -16 bps | -33 bps | 86 bps | -2 bps | 6 bps |
| Eurozone | 2.6% | 7 bps | 20 bps | 94 bps | -6 bps | -8 bps |
| UK | 4.5% | -17 bps | -9 bps | 101 bps | -9 bps | 5 bps |
| CH | 0.4% | 14 bps | 11 bps | 73 bps | -4 bps | 4 bps |

10-year government bond yield eurozone = DE, bps = basis points.
* Change as at 26 June. Source: Bloomberg

USA

- In June, US credit spreads tightened as the “risk-on” mood among investors and the market recovery from the April tariff announcements continued. Yields fell during the month across the curve.
- We expect three policy rate cuts by the Fed in H2, bringing the lower bound to 3.50% by year-end.

Eurozone

- EUR credit spreads tightened (except in CCCs) given good technical support. Two-year government bond yields increased more than 10-year yields.
- As expected, the ECB cut its policy rate by 25 bps in June. Instead of two, we now only expect one additional rate cut in 2025. The rate cut cycle is thus likely to bottom out at a still accommodative 1.75%.

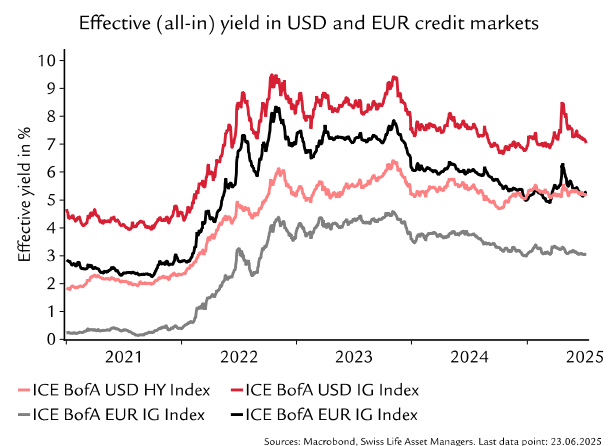
UK

- Investment Grade (IG) credit spreads tightened back from the wider levels in April and yields increased.
- Given expectations for higher inflation and a higher unemployment rate in 2025 compared to 2024, we expect the Bank of England to cut its policy rate three times in 2025 starting from August.

Switzerland

- IG spreads remained stable in June, but yields went up across the curve. However, the yield curve steepness between 2 and 10 years was fairly unchanged.
- The SNB cut its policy rate by 25 bps in June. Given the low inflation rate and to avoid further appreciation of the CHF, we expect another 25 bps policy rate cut at its September meeting.

Spreads are tight, but all-in yield still looks decent



Credit spreads again tightened in June due to less negative news on the tariffs front, a stable (although elevated) recession probability for the US plus attractive all-in yields and subsequent good demand for credit. As a result, option-adjusted credit spreads (OAS vs. government) are trading in historically low percentiles, in particular in USD credits which therefore remain highly valued. However, as shown in the chart above, all-in yields (in local currency) for credit asset classes are roughly 300 bps higher compared to mid-2021, before the period of rate increases. In addition, the current all-in yield is also higher than the average over the past ten years. In terms of percentiles (using data going back to Mar-1999), all-in yields for high yield (HY) and EUR IG trade in the decent 35-40% range and in USD IG in the 60% range. Given uncertainty regarding US economic policy, increased risks regarding the macroeconomic outlook and (geo-)politics as well as high valuations, the risk for spread widening remains elevated. Because of its stronger credit quality, we expect fundamental resilience and spread volatility to remain lower in IG credit compared to lower-rated HY credits. As a result, we maintain our expectation for wider spreads in HY and we are neutral for spreads in IG in both EUR and in USD for July. Regarding duration over the next month, we expect lower rates in the US, the eurozone and in Switzerland.

Equities

Wars do not derail markets

Overview of equity market performance

| | June 2025* | Year-to-date* |
|------------------|------------|---------------|
| USA | 4.0% | 5.0% |
| Eurozone | -1.8% | 11.6% |
| UK | -0.5% | 8.7% |
| Switzerland | -2.6% | 4.8% |
| Emerging markets | 6.3% | 15.6% |

MSCI net total return indices in local currency.
* Performance as at 26 June. Source: Bloomberg

USA

- After an exceptionally strong May, US stocks advanced slightly in June. The Iran war and rising oil prices had only a minor impact on the performance.
- The US market clearly outperformed European markets in June. However, the year-to-date US underperformance is still more than 8%.
- With the sharp recovery, the US market has become quite expensive again. Only small caps are trading in the normal valuation range.

Eurozone

- Eurozone equities underperformed in June. Germany and France in particular lost ground and dragged the market lower.
- In styles, Value and Momentum have done very well this year and small caps outperformed large caps.
- The valuation of the European market has increased and is now above historical averages. The valuation discount to the US is, however, still very large.

UK

- The UK market did better than eurozone stocks but also underperformed the US market.
- The UK market still benefits from a low valuation.

Switzerland

- The Swiss market continued to underperform in June. In the last two months it underperformed the US market by more than 8%.
- Like in the eurozone, small caps outperformed large caps. The gap increased in June.
- Valuation is still within the fair range, but higher than other non-US equity markets.

Emerging markets

- Emerging markets outperformed in June, with Korea and Brazil advancing the most.
- Valuations remain fair and are significantly lower than those in developed markets.

Mid-year update

Our annual outlook in January projected a 5–10% total return for global equities. The broadest index, MSCI All Country World, is so far up 5.5% in local currency terms, just above the lower bound of that target. The first six months saw significant events such as the release of DeepSeek, “Liberation Day” tariffs and more recently the war between Israel and Iran. Considering this backdrop, the high starting valuation and the strong performance of the previous two years, we think that this is a satisfactory result. A key difference to previous years is that European and emerging market equities have outperformed the US market this year.

| Event | Time to bottom* | Time to recover* | Selloff (%) | Equity market return from trough (%) | | | |
|-------------------------|-----------------|------------------|-------------|--------------------------------------|------------|-------------|-------------|
| | | | | 1M | 3M | 6M | 12M |
| Cuban missile crisis | 7 | 9 | -6.6 | 15.0 | 22.7 | 30.0 | 36.5 |
| Vietnam war (1964) | 15 | 36 | -3.2 | 1.7 | 4.8 | 7.3 | 29.3 |
| Six day Israel Arab war | 20 | 40 | -6.5 | 3.3 | 6.5 | 7.7 | 13.0 |
| Israel arab oil embargo | 27 | 1475 | -17.1 | 7.3 | 5.6 | -2.0 | -28.2 |
| First Gulf war | 50 | 87 | -15.9 | 6.2 | 6.7 | 27.8 | 29.1 |
| 9/11 attacks | 6 | 15 | -11.6 | 11.1 | 18.5 | 19.4 | -12.5 |
| Iraq war (2003) | 7 | 16 | -5.3 | 8.0 | 15.8 | 20.0 | 32.8 |
| Russia/Ukraine 2014 | 6 | 13 | -2.0 | -0.6 | 5.2 | 7.8 | 11.5 |
| Russia/Ukraine 2022 | 20 | 16 | -9.1 | 7.6 | -1.3 | -3.9 | -4.3 |
| Israel Hamas war | 13 | 8 | -5.9 | 10.5 | 18.8 | 23.9 | 42.4 |
| Median | 14 | 16 | -6.6 | 7.5 | 6.6 | 13.6 | 21.1 |

*in trading days. Source: Deutsche Bank, Swiss Life Asset Managers

What now are the prospects for the second half and how do recent events affect the view? Historically, war events have rarely had a lasting negative effect on stock markets and in most cases, subsequent returns were positive. We think that these historical patterns will be confirmed in the current episode. Positives for equity markets include likely further policy rate cuts, less negative tariff headlines, decent earnings growth and earnings revisions that do not indicate major problems. The valuation of non-US equities has increased, but is still within the fair value range. Negatives are high US valuations, the new war between Israel and Iran and the uncertainty around tariffs and US politics. Our view is that in the very short term there is a correction risk as tariff deadlines approach, but between now and year-end we see further upside potential for global equities. Therefore, we retain our view of a total return for global equities in the range of 5-10%. We would revise down this target if a broader Middle East war with a severe disruption of oil supply emerged. In the current environment, we think that investment styles like minimum volatility, high dividends or protection are very interesting.

Currencies

USD: when it rains, it pours

Overview of major currencies

| | June 2025* | Year-to-date* | 1-month view |
|---------|------------|---------------|--------------|
| EUR/USD | 3.1% | 13.0% | ↗ |
| EUR/CHF | 0.3% | -0.4% | → |
| GBP/USD | 2.0% | 9.7% | ↗ |
| USD/JPY | 0.3% | -8.1% | ↘ |

* Performance as at 26 June. Source: Bloomberg

USA

- The USD weakness continued in June with the USD depreciating against all major currencies except the JPY.
- The USD continues to act as a pressure valve in the US confidence crisis. The end of the 90-day tariff pause on 9 July will bring trade uncertainty back to the fore, potentially increasing volatility further. We therefore expect USD weakness to continue over the next three months.

Eurozone

- EUR strength returned in June, with EUR/USD moving higher and reaching levels above 1.17.
- We currently expect one Fed cut more than the market, while our ECB expectation is aligned with market pricing, supporting our view for a higher EUR/USD over the next three months.

UK

- In June, GBP appreciated against USD, but lost against EUR. The Bank of England paused its rate cutting cycle in June as expected, as inflation pressures remain higher compared to the eurozone.
- We maintain a neutral view on EUR/GBP but expect the GBP to appreciate against USD during the third quarter.

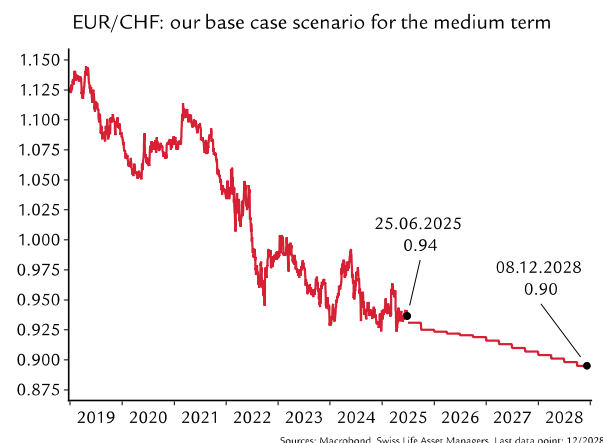
Switzerland

- CHF was almost unchanged against EUR in June, while USD/CHF temporarily fell below 0.80.
- We remain neutral on EUR/CHF despite the expected move to negative interest rates by the SNB in September.

Japan

- The weak performance of JPY continued in June, losing 1.6% on a trade-weighted basis.
- In line with our view of a weaker USD, we are negative on USD/JPY for the next three months.

Looking ahead: CHF appreciation to continue



The safe-haven properties of the CHF are still intact. CHF continued to strengthen against the USD in June, with USD/CHF falling below 0.80 for the first time. While we expect the SNB to continue its proactive stance in limiting fast CHF appreciation through negative rates and, if needed, FX interventions, we see the CHF appreciating further over the next three years. In our yearly medium-term planning process, we formulate most likely scenarios for the next three years. For FX markets, one basic assumption is that the purchasing power parity (PPP) plays an important role for the trajectory of exchange rates. PPP is based on the idea that a basket of goods should cost roughly the same in every country when prices are converted into the same currency. The exchange rate at which this equality holds is the “fair value”. As we assume the structural differential between lower Swiss and higher eurozone inflation will persist, the fair value of EUR/CHF is set to go lower by around 1% every year. Therefore, our expected path for EUR/CHF (see chart) and the expected CHF appreciation against other currencies should keep the real trade-weighted Swiss franc stable. Generally, we expect USD weakness to persist, at least for the next 12 months. For EUR/USD, we forecast a peak of 1.25 in mid-2026 based on the expectation that short-term real yield differentials will turn negative, before EUR/USD will trend lower again to 1.19 by the end of 2028.

Asset allocation

US markets recover amid USD weakness

Review

- Equity markets extended their recovery in June, briefly disrupted by the Iran conflict. Emerging markets led gains, followed by the US, while Europe lagged.
- Global bond yields were stable in June, although US yields declined due to rising rate-cut expectations, while Swiss yields rose after the SNB's surprisingly hawkish communication at their June meeting.
- Credit spreads narrowed early in June and remained low and stable thereafter.
- The US dollar continued to weaken, with only a brief rebound during the Iran flare-up.

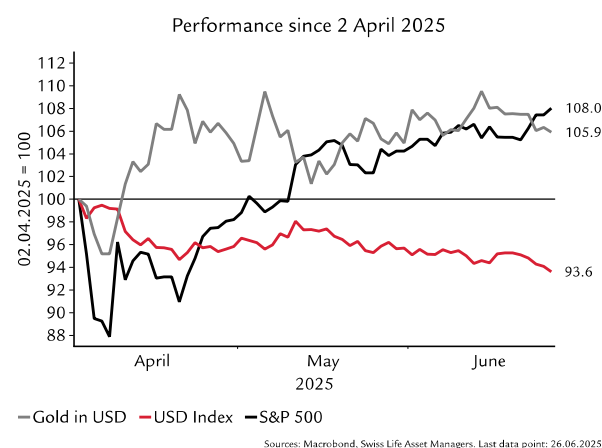
Current asset allocation views

| 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

- Our asset allocation remains unchanged, as both fundamentals and market indicators have shown little movement since last month.
- While equity markets may continue their recovery, our optimism is tempered not only by geopolitical risks, but also trade-war related risks: the 9 July tariff deadline is approaching quickly, and political tensions in the US remain elevated. The current calm could therefore reverse swiftly.
- US yields are likely to trend lower, albeit with high volatility. US Treasuries should therefore continue to offer some protection in the event of significant market correction, as seen in June. In contrast, the potential for lower EUR yields is more limited.
- Credit spreads remain very tight and offer limited value.
- The USD remains weak, suggesting that a higher currency hedge ratio is appropriate for now, despite the significant interest rate differential versus the EUR and especially the CHF.

Where is the risk?



The recent muted market reaction to various unsettling economic and geopolitical developments seems to be at odds with the current global situation. While the surge in gold prices, weakening USD, and the volatile decline in US yields partly reflect rising uncertainty, in our view credit spreads and equity valuations do not adequately price in the significant risks posed by the ongoing trade war, geopolitical instability, and more structural issues such as demographic shifts in the developed world. In previous years, concerns about elevated valuations across most financial markets were offset, initially by a highly accommodative global monetary policy, and later by surprisingly robust economic growth, particularly in the US. These supportive factors have now disappeared or are much weaker. Meanwhile, the global trend towards reduced free trade and increasingly unsustainable public deficits is creating mounting economic headwinds. Most financial markets seem to reflect a strong optimism based on the expectation that technological progress (e.g. advances in AI) and a more supportive monetary policy will eventually resolve these challenges. However, a rational assessment of both suggests that such hopes may be overly optimistic in the near term. We therefore conclude that it is now more important than ever to focus on risk management and adopt a tactical approach to investing. This entails broader portfolio diversification than usual and, crucially, a willingness to be tactical by dynamically adjusting risk exposure in the short term in response to relevant developments. Accordingly, our current slightly defensive asset allocation reflects the strategy we are comfortable with at the time of writing.

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