Optimal Income Strategies
Equity markets near all-time highs.

- Resilient US market supported by robust corporate earnings drives confidence
- Market relief follows Japan and Europe trade deals seal, set at 15%
- European inflation rate is easing but fiscal and geopolitics add uncertainty

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What's happening?

As we move into the second half of the year, the landscape suggests a period of unwinding following the surge in US import demand earlier, which has now been pulled forward. This reversal poses a potential headwind for global growth and adds to the ongoing uncertainty surrounding trade tariffs for most US trading partners. The US government, under President Trump, has viewed tariffs as a crucial source of revenue, and some recent measures appear unrelated to trade disputes, indicating that higher tariffs may persist despite implementation uncertainties.

In the US, the surge in imports during the first half of the year, driven by looming tariff deadlines, raises concerns of a potential payback in the latter half. Consequently, GDP growth is now forecasted to fall below trend at 1.2% next year and just 0.5% in 2026.

In the Eurozone, forward-looking port data from the IMF reveal a clear message: economic weakness is on the horizon, with port activity down 7% at the start of July compared to the previous year. This aligns with our cautious outlook for the region, which may flirt with recession in the coming months.

China's exports have been buoyed by front-loading demand from the US since late 2024, supported also by transshipment to ASEAN regions and the EU. However, with Trump increasingly targeting transshipment routes with heightened tariffs, China's export prospects face mounting headwinds in the months ahead.

Lastly, shifts in US trade policy are prompting most developed central banks to adopt a more easing-oriented stance. We anticipate the Federal Reserve will implement two rate cuts this year—one in October and another in December—bringing the policy rate down to 4.0%. The ECB is expected to cut once in December, lowering rates to 1.75%, while the Bank of England is projected to reduce its rate to 3.75% by year-end, broadly in line with market expectations.

Portfolio positioning and performance

	GLOBAL OPTIMAL STRATEGY			OPTIMAL STRATEGY			DEFENSIVE OPTIMAL STRATEGY		
	Dec-24	Jun-25	Jul-25	Dec-24	Jun-25	Jul-25	Dec-24	Jun-25	Jul-25
Net Equity	87,9%	93,8%	85,2%	76,3%	77,8%	78,0%	34,6%	42,1%	41,0%
Equities	79,7%	73,7%	73,9%	72,9%	69,2%	68,8%	37,0%	24,8%	29,3%
Equities derivatives	13,9%	26,6%	13,4%	5,2%	14,1%	11,0%	-2,4%	17,3%	11,7%
Risk Mitigation Strategies	-5,7%	-6,5%	-2,1%	-1,8%	-5,5%	-1,8%	0,0%	0,0%	0,0%
Fixed Income	5,0%	12,8%	12,9%	23,6%	25,9%	25,8%	62,9%	47,4%	18,8%
Govies	0,0%	0,0%	0,0%	0,0%	0,0%	0,0%	0,2%	0,3%	0,3%
Bond Derivatives	45,0%	19,6%	18,4%	27,4%	15,9%	14,9%	10,4%	18,8%	19,3%
High Yield Credit	1,0%	2,2%	2,2%	5,6%	5,1%	4,8%	16,3%	19,0%	19,6%
Investment Grade	3,9%	10,3%	10,5%	17,6%	20,8%	21,0%	46,0%	27,5%	-1,5%
Emerging Debt	0,1%	0,3%	0,2%	0,3%	0,0%	0,0%	0,5%	0,6%	0,4%
Diversification	11,6%	8,6%	8,4%	2,2%	2,0%	2,0%	5,9%	8,2%	6,6%
Cash & Money Market	-4,4%	-15,3%	-6,4%	-1,9%	-5,7%	-5,8%	-3,4%	2,3%	33,6%

In July, we maintained a positive outlook on global equities. Although President Trump has increased pressure on trading partners to secure bilateral agreements, our patience was rewarded as Japan and Europe finalized trade deals with the US by month-end. The US earnings season has begun strongly, supported by a resilient economy and a weaker dollar. We favour US technology companies over small-cap stocks, as the former continue to demonstrate superior earnings quality.

Renewed optimism and the rebuilding of positioning in July have begun to moderate an otherwise favourable market environment. Looking ahead, the US labour market will be closely monitored, as it is a critical factor influencing the Federal Reserve’s decision on whether to lower interest rates in the fall.

In Europe, we prefer small- and medium-cap stocks, which are less exposed to the negative effects of euro strength. German mid-caps are particularly attractive, as Germany's private sector appears ready to complement public spending efforts to revive the country’s competitiveness.

On the interest rate front, break-even inflation rates have shown little sign of de-anchoring despite fiscal largesse and high effective tariff rates, suggesting that market participants still trust central bank credibility. Our portfolios are now broadly neutral regarding interest-rate sensitivity, with a preference for shorter durations.

We continue to adopt a bearish stance on the dollar over the medium term, viewing any short-term rebound as an opportunity to reinforce our positioning. The deceleration of US economic growth relative to other major economies, combined with political uncertainty and growing scepticism about Washington’s policy direction, should continue to weigh on investor confidence in the greenback.

Outlook

US exceptionalism is back as US equities continue to grind higher and outpace other major equity markets in July. This momentum stems from a supportive market framework and a remarkably resilient US economy. Markets seem to have become somewhat immune to trade risks, banking on incremental deal-making even amid tough rhetoric. US corporate earnings have been strong overall, further boosting confidence. In contrast, Europe’s earnings season started on a more mixed note. Despite heightened trade tensions and tariff increases under Trump’s administration, the expected damage to corporate earnings has yet to materialize.

After falling from its Rose Garden high, trade policy uncertainty—measured, for example, by the Bloomberg Economics Trade Policy Uncertainty Index—increased again in July as Trump ramped up pressure on major trading partners to secure favourable deals before the August 1 tariff cliff. Unlike previous episodes of rising uncertainty that triggered market sell-offs, US equities remained resilient, with both the S&P 500 and Nasdaq reaching new record highs—raising concerns about investor complacency. Late July brought relief as Japan and Europe sealed trade agreements, with tariffs set at 15%, a considerable hike but significantly lower than the previously threatened rates ranging from 25% to 50%. Equities responded swiftly, with US stock indices rallying to fresh highs and sentiment indicators reaching extreme optimism levels.

However, a deeper look raises questions about the durability of this optimism. While these new trade deals—less draconian than feared—represent a substantive increase in the effective tariff rate, they still impose significant headwinds. For instance, tariffs on automobiles in Japan and Europe have dropped from potential levels above 25% to 15%, and countries have committed to substantial spending plans in the US. Nevertheless, the real-world impact of punitive tariffs on imports from key trading partners remains a significant obstacle for global trade and corporate margins. What initially appeared as market relief may, in fact, be investors clinging to the lesser of two evils rather than signalling a genuine improvement in trade fundamentals.

On the fixed income front, recent weeks have seen a notable reconstitution of the term premium across major bond markets, with the long end of sovereign yield curves rising. This dynamic has been most evident in Japan, where upward pressure on long-term yields signals a fundamental reshaping of market expectations. Rising term premiums reflect governments' need to compensate investors for holding increased long-term debt issued to finance growing deficits. Contributing factors include policy uncertainty, geopolitical instability, and diminished central bank intervention, which have all heightened market sensitivity. Interestingly, these movements in term premia are unfolding even as inflation expectations remain anchored; break-evens have shown little sign of de-anchoring despite fiscal largesse and high effective tariffs, suggesting that market participants still trust central bank credibility and view current price pressures as transitory.

Meanwhile, the market consensus remains decidedly bearish on the US dollar, expecting further weakening against the euro and other major currencies. The deceleration of US economic growth relative to other large economies, along with ongoing political uncertainty and growing scepticism about Washington's policy direction, continue to weigh on investor confidence in the greenback. Although we believe the market is overestimating the number of interest rate cuts in the short term, the Federal Reserve is likely to reduce rates over the medium term.

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