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June’s topic:
„US fiscal policy back in the spotlight“

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US fiscal policy back in the spotlight

– Global economic activity remains resilient for the time being, supported by ample liquidity – although rising fiscal and trade policy risks are creating increasing headwinds.
– US fiscal policy remains procyclical and largely unsustainable – rising term premia and a forthcoming wave of Treasury issuance following the lifting of the debt ceiling are are placing structural strain on the bond market.
– We are maintaining a broadly neutral stance in terms of overall risk exposure, but remain cautious with regard to US Treasuries.

Overall economic situation

Several coincident indicators – including nowcasting models for the US and Europe – continue to reflect resilience, with consumers and corporates frontloading purchases in anticipation of tariffs. Global liquidity remains ample, and rebounding equity markets are providing additional support for economic growth. Nonetheless, ongoing uncertainty around US tariff policy and rising global interest rates are weighing on sentiment and economic prospects.

Recent developments: Tariff squall and debt storm

— In May, US trade policy once again followed President Trump's established pattern – Wall Street has dubbed it the "TACO Trade": Trump Always Chickens Out. The planned tariff hike on EU imports announced on 23 May was rescinded just two days later, prompting only a brief sell-off in equity markets.
— Focus has returned to long-dated bond yields. Markets are becoming reacquainted with the structural fiscal risks posed by the US federal budget, particularly in light of the proposed "One Big Beautiful Bill Act". This legislation would increase the federal deficit by an estimated USD 4–5 trillion over the next decade.
— In Japan, persistently high inflation, debate around VAT reductions, and the gradual quantitative tightening by the Bank of Japan (BoJ) have led to a sell-off in long-dated JGBs. Stability only returned after the BoJ signalled further potential rate hikes and authorities suggested a reduction in long-term bond issuance.

➲ **On the radar: Toxic cocktail in the US Treasury market** (page 6)

Overview & outlook: Fiscal power with side effects?

— Resistance to the Trump administration's tariff policy is not only coming from the markets, but also from the judiciary: the US Court of International Trade declared the reciprocal tariffs unconstitutional. However, President Trump successfully appealed this ruling at the Federal Court of Appeals, and the case is now likely to reach the Supreme Court. For the time being, the 10% reciprocal tariffs on virtually all trading partners therefore remain in place. In addition, the U.S. government can still impose punitive tariffs on individual countries through other legal channels. Nonetheless, the situation adds further uncertainty, which could slow down negotiations on trade agreements.

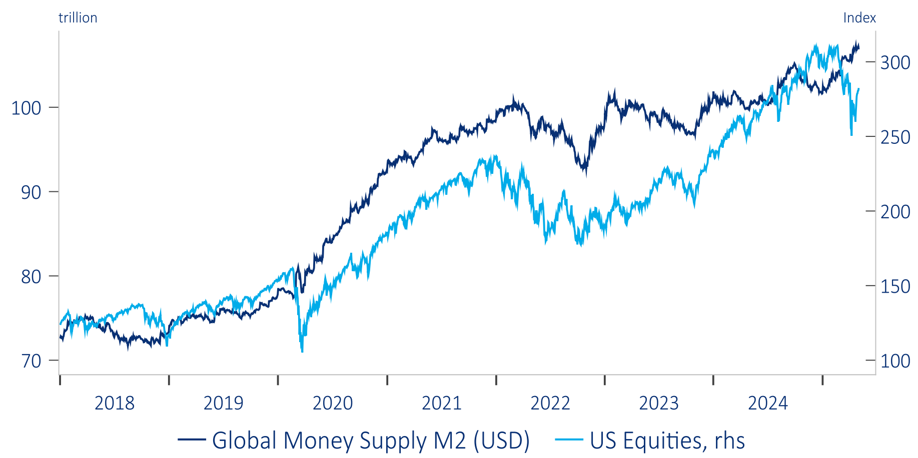
» Bond markets are increasingly demanding higher term premia.

— A key issue in US fiscal policy is its increasing procyclicality – despite full employment, the US budget deficit is an incredible 7% of GDP. This trend began in President Trump's first term, when tax cuts and higher deficits were implemented despite strong economic conditions – a trend that could continue under the new tax legislation. Accordingly, bond markets are beginning to demand higher term premia, which is pushing up long-term Treasury yields. Another risk factor is the lifting of the debt ceiling in August 2025, which is expected to result in a massive surge in T-bond issuance (see page 6).

— Section 899 of the proposed tax legislation has attracted particular attention: the clause would allow significantly higher withholding taxes on interest or dividends in the US for foreign investors who apply "unfair tax practices" against America. This would reduce returns on US assets and could lead to capital outflows, a weaker US dollar, and higher long-term interest rates.

— The Fed finds itself in a difficult situation, as US tariff policy has stagflationary effects. While procyclical fiscal policy cushions downside risks to the economy, it simultaneously increases inflationary pressure. Markets are currently pricing in four further rate cuts by the end of 2026. If these expectations are scaled back, this could mean further upward pressure on interest rates.

Chart: Upward pressure on long-term government bond yields



Sources: Macrobond, Fisch Asset Management

Positioning: Stability on thin ice

- Thanks to ample liquidity, the global economy continues to demonstrate resilience. In the short term, however, erratic US trade policy, higher interest rates, and fiscal risks are increasingly acting as a drag – the global economic environment remains fragile and characterised by high uncertainty.

» Limited short-term upside potential in equity and credit markets.

- After the strong rebound in global equity and credit markets, we see only limited upside potential in the short term. Valuations have quickly recovered from multi-year lows in April, while US Treasury yields have risen. As a result, the equity risk premium has dropped back to 0%, and US equities are again pricing in near-perfect conditions. Against the backdrop of still supportive liquidity but fiscal and economic risks in the US, we recommend positioning within a neutral range.
- We remain cautious with regard to US Treasuries due to several structural burdens: continued expansive US fiscal policy is increasing term premia – investors are demanding higher compensation for long-term risks. At the same time, concerns over growth meet persistent inflationary pressures, which further reduce the attractiveness of nominal government bonds. In addition, a massive supply wave is looming due to the expected lifting of the US debt ceiling from August 2025 (see page 6).
- The US dollar remains a central risk for long-term foreign investors in US assets. For over a decade, they benefitted from the dollar carry trade – comparatively high US interest rates and a steadily appreciating dollar – as well as the outperformance of US equity markets. However, the greenback is now significantly overvalued. The massive current account deficit, an unpredictable trade policy, an unsustainable fiscal trajectory, and declining foreign demand are likely to weigh on the US dollar in the long run.

	US	Europe	Japan	Asia ex-Japan	LatAm	CEEMEA
Return drivers						
Equities	o	+	o	o	o	o
Gov. Bonds	- ↓	o	-			
Credit IG *(Spreads)*	o	o		o	o	o
Credit HY *(Spreads)*	o	o		o	o	o
Total return						
Convertibles	o	+ ↑	-	+		
Credit IG	o	o		o	o	o
Credit HY	o ↓	o ↓		o ↓	o ↓	o ↓

	PrecMet	InduMet	Energy
Commodities	+ ↓	o	o

Key:

++	Strong positive marke
+	Positive market
o	Neutral
-	Negative market
--	Strong negative marke

Notes regarding the table: The table summarises the model results for the total return of convertible bonds and credit investment grade and high yield, which are a function of the listed return drivers. Changes from prior month are indicated with ↓ or ↑, i.e. "O ↓" means that the output has weakened from a prior value of + or ++. The methodology for calculating model outputs, and how the various pieces fit together to form the big picture, is explained here.
Within government bonds, we take German Bunds into account for Europe.

Cross asset class preferences

This table combines top-down views with bottom-up analysis at the portfolio level.

	Most preferred	**Least preferred**
Convertible Bonds	– Software (Cybersecurity) – Semiconductor (AI-related) – Healthcare – CBs with high convexity – Bond-like CBs with quality credits and attractive yields – Balanced deep investment grade Chinese tech with high convexity	– Consumer discretionary – Unprofitable, early stage, expensively valued IT and biotech – Weak credit quality and/or liquidity – Cryptocurrency-related names
Global IG Corporates	– Financials, healthcare, TMT sector – EUR-denominated issues – BBB-rated bonds	– Transportation, energy, utilities – GBP- and CAD-denominated issues – AA-rated bonds
Global Corporates	– Healthcare, financials – Investment grade – Developed markets	– Transportation, energy, chemicals – High yield – Emerging markets
Global High Yield	– Capital goods – Health care – Telecommunications	– Transportation – Financial services – Insurance
Emerging Markets - Defensive	– LatAm (Chile, Peru), Africa – Defensive sectors, oil & gas – Maturities 7-10 years	– High beta Asia (India, Indonesia) – Industrials – Maturities < 3 years
Emerging Markets - Dynamic / Opportunistic	– LatAm (Brazil, Chile, Colombia) – BBB & BB-rated bonds – Defensive sectors, oil & gas	– Asia, Middle East – Investment grade maturities < 3 years – C-rated bonds

Note: Preferred sectors/regions may differ between asset classes owing to respective performance drivers. In particular, equity exposure is the key performance driver for convertible bonds and is not relevant for corporate bonds.

On the radar: Toxic cocktail in the US Treasury market

Yields on 10-year US Treasuries have been rising for over six weeks – even though, given signs of a cooling economy, the activated debt ceiling, and geopolitical uncertainty, they should actually be falling. But in the US, a toxic cocktail of interest-rate drivers is at play, which in the medium term can only be countered – if at all – by central bank intervention.

Since January, no new US Treasuries may be issued due to the USD 36 trillion debt ceiling. The reduced supply should, in theory, support prices and therefore depress yields. Furthermore, maturing bonds are being mostly refinanced with T-Bills. These cash-like instruments increase liquidity in the financial system and put downward pressure on the long end of the yield curve. Estimates suggest that increased T-Bill issuance has lowered 10-year yields by up to 100 basis points.

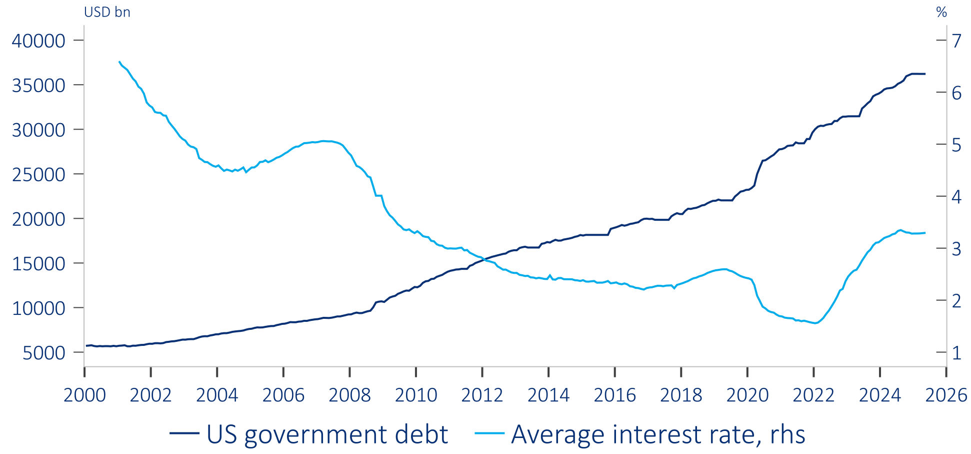
Nevertheless, yields recently traded above 4.5%. The reason is a mix of rising US budget deficits (currently 6.5% of GDP), persistent inflation, and sharply rising inflation expectations – up to 7.3% over the next 12 months.

New yield drivers are likely to emerge soon: the lifting of the debt ceiling in August is expected to trigger a wave of issuance of up to USD 1 trillion. At the same time, global refinancing needs are increasing – the so-called "Debt Maturity Wall" is drawing nearer. This fragile equilibrium in the bond market is therefore coming under further pressure.

» Only the Fed can provide lasting support.

Only the Fed could counteract sustainably through a new round of quantitative easing – but doing so in an inflationary environment would be playing with fire. Investors should therefore closely monitor warning signs such as jumps in SOFR/Fed Funds spreads and a depreciation of the US dollar below 140 against the yen.

Chart: No end in sight for US government debt



Sources: U.S. Treasury, Fisch Asset Management

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