

Overview

Upgrading Equities

- We expect global equities to outperform fixed income, supported by fading tariff risks, easier monetary policy, and AI investment.
- Short-term headwinds remain, but a more supportive monetary backdrop should limit pullbacks and support risk assets.
- We upgrade equities to overweight, funded by reduced rate exposure (via a downgrade to JGBs). Within rates, we also reduce our US TIPS overweight and upgrade EM local bonds to neutral. We remain overweight precious and industrial metals and underweight high-yield credit.

Global equities were the strongest-performing asset class over the past three months (see chart 1) and have managed to recover from several shocks, including a sharp rise in US tariffs, a military conflict in the Middle East, and rising bond term premia. Some risks remain for global markets, and recent US labour market data indicate weakening job growth. However, if the US avoids a recession this year and the Fed cuts rates (our base case), equities have historically outperformed.

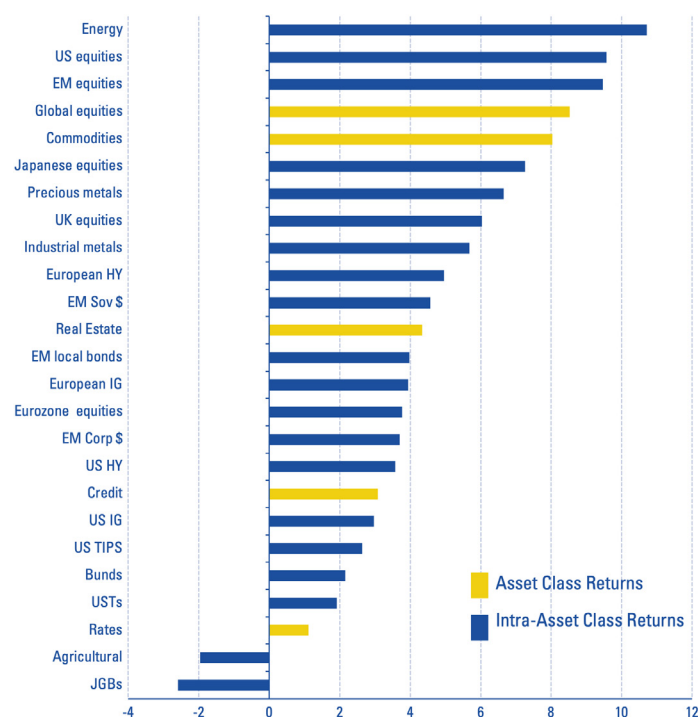
In our last Cross-Asset Quarterly, we outlined the crosscurrents that kept our equity stance as neutral, while emphasizing our conviction in trades benefiting from US dollar weakness. The latter view remains intact, and we continue to expect cyclical and structural forces to weigh on the dollar, favouring non-US equities and precious metals. Further details can be found in our July 2025 report *USD Weakness: A Crowded Idea, Uncrowded Trade*. For equities versus fixed income, our view has shifted in favour of equities. As tariff risks fade, monetary policy eases, and AI investment continues to drive growth, stocks will likely trend higher. We describe our new baseline scenario as ‘quasi-Goldilocks’.

‘Goldilocks’ is typically defined as steady economic growth that is neither too hot nor too cold – i.e., a recession is avoided and inflation remains stable. Stocks can perform well in this environment as financial conditions ease and earnings grow. US growth slowed in 1H25 and will likely remain below trend in the second half of the year as tariffs, immigration restrictions, and slowing consumption weigh on activity. Still, AI-related investment and potential positive impacts from deregulation and the One Big Beautiful Bill

(OBBS) provide some offset. Also, the upcoming 2026 US mid-terms will further incentivise the Trump administration to tailor policies to support the economy and avoid a recession. We use the term ‘quasi-Goldilocks’ because inflation is elevated and expected to rise in response to tariffs, but the ‘consumption tax’ should eventually have a deflationary effect after the initial price shock. A growing number of FOMC members share this view, potentially shifting the majority to prioritise the Fed’s maximum employment mandate at the upcoming meetings.

The market narrative is likely to centre around the Fed and other global central banks. At the current 4.50% policy rate, the Fed has room to react to weaker data. Furthermore, approximately \$7 trillion is parked in money market funds earning roughly 4%, which could be reallocated to duration, equities, or other assets (e.g., hard assets or alternatives) as short-term rates decline. Additionally, many non-US central banks are either cutting or expected to cut rates this year (see chart 2). Overall, the global monetary backdrop is becoming more supportive for financial assets.

Chart 1: Jun-Aug Performance (%)



Source: Bloomberg

*The publication reflects asset performance up to August 29, 2025, and macro events and data releases up to September 5, 2025, unless indicated otherwise.

Some headwinds remain, and there is scope for some short-term market pullbacks. However, elevated global policy uncertainty is declining following difficult trade negotiations (see chart 3). Also, the US dollar is weakening (-7% YTD, based on the Fed's nominal trade-weighted index), and financial conditions are easing (the Chicago Fed Financial Conditions index is around its lowest level since 2021, at -0.53). Finally, global earnings revisions bottomed and turned net positive in July (see chart 4). There is scope for some pessimism to capitulate as monetary policy eases (see chart 5).

Market Strategy:

Our asset allocation still reflects some caution around immediate risks (e.g., slowing US growth and rising 30y bond yields) and we remain underweight high-yield credit. Still, we see some macro risks starting to fade and monetary policy becoming more supportive for markets. The combination of these factors justifies an incremental upgrade to equities. This quarter, we make the following adjustments:

- Upgrade **equities** to a small *overweight*. AI remains supportive for companies with direct or indirect exposure. FX trends indicate relative outperformance of non-US equities versus the US. We add to existing overweights in Japan and EM. We remain underweight the UK and US.
- In **rates**, we stay *overweight* but reduce exposure. We downgrade JGBs (to underweight) and reduced our overweight to US TIPS. We also upgraded EM local bonds to neutral.
- Remain *underweight* **credit** via global high yield (HY) credit. We see limited value in HY spreads, while US HY default rates have started to inch higher in recent months.
- Our **real estate** allocation remains *neutral*. The asset class offers long-term value if rates fall and growth accelerates.
- We keep our *overweight* in **commodities** via precious and industrial metals. A weaker USD environment is historically positive for metals. We remain neutral on energy.

Justin Kariya**

September 9, 2025

**This document includes contributions from Tom Traill and Yasemin Engin.

Asset Allocation

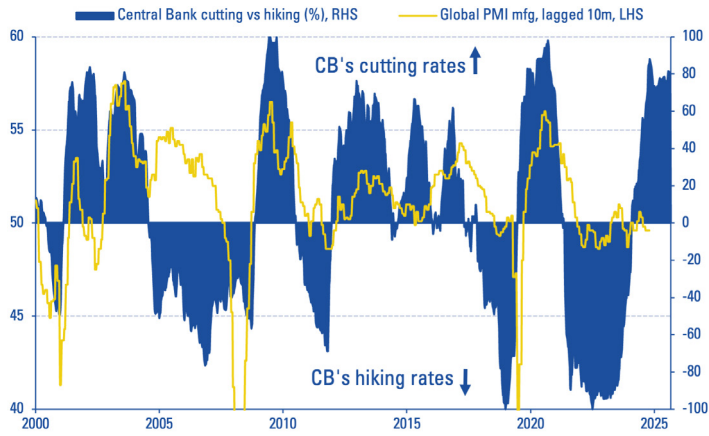
	Chg	-3	-2	-1	0	+1	+2	+3
EQUITIES	↑							
RATES	-							
CREDIT	-							
REAL ESTATE	-							
COMMODITIES	-							

	Chg	-3	-2	-1	0	+1	+2	+3
US equities	-							
Eurozone equities	-							
UK equities	-							
Japan equities	-							
EM equities	↑							
USTs	-							
TIPS	↓							
Bunds	-							
JGBs	↓							
EM local bonds	↑							
US IG credit	-							
US HY credit	-							
European IG credit	-							
European HY credit	-							
EM Sov \$ credit	-							
EM Corp \$ credit	-							
Energy	-							
Industrial metals	-							
Precious metals	-							
Agricultural	-							

Note: Up/down arrows indicate a positive or negative change in our asset allocation compared to the previous quarter. A dash indicates no change.

Source: CLIM

Chart 2: Global Central Banks Cutting vs. Hiking



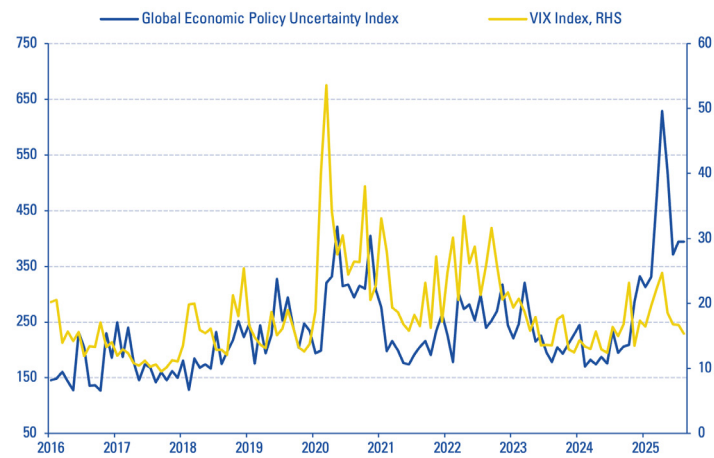
Source: Bloomberg

Chart 4: Global Earnings Revisions Index



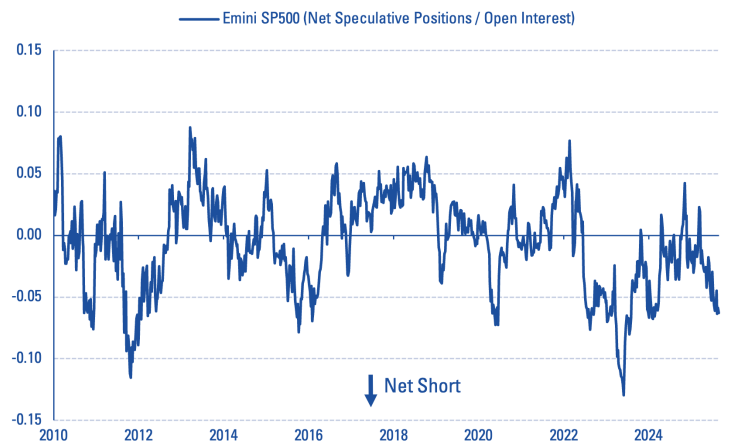
Source: Bloomberg, Citi

Chart 3: Global Economic Policy Uncertainty Index



Source: Bloomberg and Baker, Bloom, Davis

Chart 5: Equity Speculative Positioning Data (Ratio)



Source: Bloomberg, CFTC

Equities

Overweight ↑

> Monetary easing and USD weakness favour multiple expansion in non-US markets.

Global Equity Indicators

	3Y history	Latest
Global P/E		22.1 Aug
DM P/E		23.3 Aug
US P/E		27.4 Aug
Europe P/E		16.1 Aug
Japan P/E		17.3 Aug
EM P/E		15.3 Aug

Source: Bloomberg, MSCI

Chart 6: 12m Forward PE Ratio



Source: Bloomberg

Asset	View	Chg	Commentary
Global equities	+1	↑	We expect global equities to outperform, supported by fading tariff risks, easier monetary policy, and AI investment. Potential short-term headwinds remain, but a more supportive monetary backdrop should limit pullbacks and support risk assets.
US equities	-1	-	US profit expectations remain high, reflected in elevated valuations. Cyclical and structural forces should continue to weigh on the dollar, a trend that tends to favour non-US stocks. We remain <i>underweight</i> .
Eurozone equities	0	-	Economic data has been improving in the Eurozone, albeit from a low base, and the bloc may benefit from increased German investment following its vote to remove their 'debt brake'. The ECB's cuts should support activity. However, a strong Euro and below trend growth have historically been headwinds for the Eurozone. We remain <i>neutral</i> .
UK equities	-1	-	The UK economy lacks a clear driver for improvement. It also has a significant overweight to the energy sector which, with the US's stated ambition to keep prices down and excess global supply, seems unlikely to outperform in the near-term. We remain <i>underweight</i> .
Japan equities	+1	-	Japanese equities have strengthened recently, reaching all-time highs in local indices. This strength was driven by improving corporate governance, a significant uptick in share buybacks, and reduced trade uncertainty. The Trump administration's stated ambitions to lower oil prices would historically benefit Japan. We remain <i>overweight</i> .
EM equities	+2	↑	EM tend to benefit from a weaker dollar and remain the leaders in the production of advanced semiconductors and high-bandwidth memory. EM companies linked to AI are more attractively valued than those in the DM. US-China geopolitical risks have also eased. We add to our existing <i>overweight</i> .








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Rates

Overweight

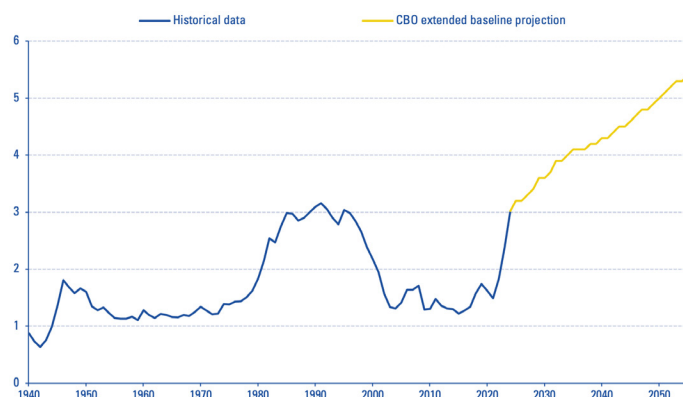
Debt sustainability concerns have pushed up term premia in several DM markets, while global monetary easing is providing some offset.

Global Rates Indicators

	3Y history	Latest	
Global Govt Yield		3.1	Aug
UST 10Y Yield		4.2	Aug
TIPS 10Y Real		1.9	Aug
Bund 10Y Yield		2.7	Aug
Italy 10Y Yield		3.6	Aug
JGB 10Y Yield		1.6	Aug
EM Local Yield		3.7	Aug

Source: Bloomberg Barclays Indices, US Federal Reserve. Yield in %pts

Chart 7: US Federal Outlays — Interest (% of GDP)



Source: FRED St Louis Federal Reserve, CBO

Asset	View	Chg	Commentary
USTs	0	-	USTs' safe haven appeal has been reduced due to a large ongoing US fiscal deficit and elevated inflation. The front-end of the curve is providing some support as the Fed appears close to resuming rate cuts. We remain <i>neutral</i> .
US TIPS	+1	↓	We see a slight upward bias to long-term inflation expectations given rising debt levels. Inflation-linked bonds provide some protection from stagflation. However, over a tactical horizon, breakevens typically track oil prices, which we believe are more likely to weaken than rise. We reduce our <i>overweight</i> .
Bunds	+1	-	Diversification from Treasuries should benefit AAA-rated assets such as bunds. The relaxation of the German 'fiscal brake' and additional issuance may be a risk to bunds, but euro exposure is attractive in a weaker USD environment. We remain <i>overweight</i> .
JGBs	-1	↓	Unlike other DM central banks, the BoJ is expected to raise rates rather than cut. Inflation remains above target, implying that a gradual tightening remains feasible. We reduce our exposure to <i>underweight</i> .
EM local bonds	0	↑	The yield spread to Treasuries is less attractive. However, the exchange rate volatility is often the major determinant of returns for EM local bonds. Further dollar weakness would historically be a support. We upgrade to a <i>neutral</i> position.








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Credit

Underweight

> Corporate margins may suffer under tariffs and spreads fail to offer attractive compensation.

Global Credit Indicators

	3Y history	Latest	
Global IG OAS		0.8	Aug
US IG OAS		0.8	Aug
US HY OAS		2.7	Aug
Euro IG OAS		0.8	Aug
Euro HY OAS		2.8	Aug
EM Sov \$ OAS		2.3	Aug
EM Corp \$ OAS		2.1	Aug

Source: Bloomberg Barclays Indices. Option-adjusted spreads in %pts

Chart 8: US Corporate Spreads



Source: Bloomberg

Asset	View	Chg	Commentary
US IG	0	-	Initial evidence suggests that US corporates are bearing a large proportion of the US tariffs, potentially reducing their margins. Spreads remain tight against US Treasuries, and there seems to be little space for spreads to fall further. However, below-trend growth and Fed cuts should still support duration assets. We remain <i>neutral</i> .
US HY	-3	-	High yield spreads remain tight, offering little protection against the risk of rising defaults. The possibility of mean reversion, and the potential for a slowing economy could all cause spreads to widen. Companies may still need to refinance at rates higher than before, and there is some evidence that corporate margins are being squeezed by tariffs. We remain <i>underweight</i> .
European IG	0	-	Despite the European economy remaining relatively weak, spreads remain low. The EU has, at times, been threatened by the Trump administration, though the tariffs imposed are not as punitive as may have been feared. We continue to prefer Bunds to European IG credit. We remain <i>neutral</i> .
European HY	-1	-	Spreads remain tight and do not provide adequate compensation for rising defaults. We maintain our <i>underweight</i> position.
EM Sov \$ credit	0	-	With the Fed looking likely to cut rates in the near future, lower rates should support hard currency debt. The dollar downtrend is also supportive. Spreads remain narrow, however. We remain <i>neutral</i> .
EM Corp \$ credit	0	-	EM spreads remain particularly tight, providing limited scope for further spread compression despite the dollar downtrend. We do not see an attractive entry point and maintain our <i>neutral</i> position.

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Real Estate

Neutral

> *Fed rate cuts could support real estate assets; however, a softer economic backdrop and the ongoing divergence between prime and secondary assets keeps us neutral.*

Asset	View	Chg	Commentary
Global Real Estate	0	-	Tariff-related uncertainty continues to weigh on investor sentiment, as evidenced by subdued transaction activity in the direct real estate market in Q2. The prospect of easier policy should benefit listed real estate valuations, which continue to appear expensive relative to government bonds. However, concerns over US fiscal excesses and the independence of the Fed could limit the fall in Treasury yields. Moreover, steady but slowing growth is not traditionally supportive for real estate. As such, we stay <i>neutral</i> .

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Commodities

Overweight

> *Gold prices are expected to benefit from structural drivers such as de-dollarisation, while copper prices should find support from energy infrastructure upgrades following tariff-related weakness.*

Asset	View	Chg	Commentary
Energy	0	-	A well-supplied oil market is likely to continue to put downward pressure on prices regardless of any possible geopolitical escalation. The EIA projects a surplus in the global oil market as OPEC+ reverses output cuts and non-OPEC supply continues to expand. Restrictions on buyers of Russian oil, such as India, pose an upside risk. However, any resulting price increase would likely be politically unpalatable in the US given President Trump's campaign pledge to lower energy prices. In the natural gas sector, higher inventories have weighed on prices but growing demand for US LNG exports should help tighten balances. This would support prices in 2026, as reflected in the futures market structure, which is in contango. We remain <i>neutral</i> .
Industrial Metals	+1	-	The Comex-LME premium narrowed significantly after the 50% copper tariff rate was applied to only semi-finished products. As inventory that was built up in anticipation of tariffs in the US unwinds, this could put downward pressure on prices outside the US. Also, the fading of H1 tariff front-loading suggests a softer manufacturing backdrop. Beyond the near term, prices should find support from 2026 due to a tightening market and structural demand linked to decarbonisation and AI's growing energy needs. As such, we maintain a small <i>overweight</i> .
Precious Metals	+2	-	In addition to near-term drivers of easier Fed policy, gold prices should continue to find support from medium-term factors such as concerns around US fiscal profligacy and the Fed's independence, and a bearish US dollar environment. Robust central bank purchases should keep a floor under prices. We remain <i>overweight</i> .
Agriculture	0	-	Agriculture prices have generally been soft despite low inventories, reflecting tariff-related uncertainty. Investor positioning is weak for corn and wheat, and in the absence of a clear catalyst, we maintain a <i>neutral</i> stance.

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KEY ASSET ALLOCATION INDICATORS (All data shown are as at end-Aug 2025 unless otherwise stated)

BENCHMARK INDEX & WEIGHTS

PERFORMANCE

ASSET ALLOCATION

	-3	-2	-1	0	+1	+2	+3	5Y	3Y	1Y	2024	Ytd	end May-end Aug		
EQUITIES								76.2	62.9	15.8	17.5	14.3	8.5	MSCI ACWI	50%
US								92.2	69.1	16.0	24.6	10.6	9.6	MSCI USA	25%
Eurozone								72.4	82.9	19.9	2.6	29.3	3.8	MSCI EMU	7%
UK								91.7	63.1	16.5	7.5	24.7	6.0	MSCI UK	3%
Japan								51.5	55.8	12.9	8.3	17.8	7.3	MSCI Japan	5%
EM								28.9	36.1	16.8	7.5	19.0	9.5	MSCI EM	10%
RATES								-14.8	6.6	2.3	-3.6	6.9	1.1	Bloomberg Barclays Global Treasury Total Return Index Unhedged	27%
USTs								-7.2	6.3	2.4	0.6	4.5	1.9	Bloomberg Barclays US Treasury Total Return Unhedged USD	10%
US TIPS								6.5	7.3	4.9	1.8	6.4	2.6	Bloomberg Barclays US Treasury Inflation-Linked Bond Index	3%
Bunds								-16.8	13.8	5.2	-5.7	11.6	2.2	Bloomberg Barclays Euro Aggregate Treasury Germany TR Index Unhedged USD	3%
JGBs								-36.2	-14.5	-5.9	-13.1	2.7	-2.6	Bloomberg Barclays Asian-Pacific Japan Treasury TR Index Unhedged USD	5%
EM Local								9.4	26.9	9.3	-2.2	13.3	4.0	Bloomberg Barclays EM Local Currency Liquid Govt TR Index Unhedged USD	6%
CREDIT								0.3	19.4	5.8	1.1	8.2	3.1	Bloomberg Barclays Global Aggregate Credit Total Return Index Unhedged USD	13%
US IG								0.0	14.6	3.9	2.1	5.3	3.0	Bloomberg Barclays US Corporate Statistics Index	4%
US HY								28.6	30.6	8.3	8.2	6.4	3.6	Bloomberg Barclays US Corporate High Yield Statistics Index	3%
European IG								-0.7	32.0	10.5	-1.8	15.7	3.9	Bloomberg Barclays EuroAgg Corporate Statistics Index USD	2%
European HY								19.5	48.0	13.2	1.4	17.7	5.0	Bloomberg Barclays Pan-European High Yield (Euro) Index Statistics USD	1%
EM Sov \$								6.4	29.7	8.4	7.0	7.9	4.6	Bloomberg Barclays Emerging Markets Sovereign TR Index Value Unhedged USD	2%
EM Corp \$								4.0	22.1	6.4	7.0	6.5	3.7	Bloomberg Barclays Emerging Markets Corporates TR Index Value Unhedged USD	1%
REAL ESTATE								20.9	12.9	2.5	0.6	9.7	4.3	FTSE EPRA/NAREIT Global Index Net TRI USD	5%
COMMODITIES								115.0	5.1	9.3	9.2	5.4	8.0	S&P GSCI Total Return Index	5%
Energy								156.5	-5.2	2.6	9.9	0.1	10.7	S&P GSCI Energy Total Return Index	2%
Industrial metals								41.7	14.3	6.4	2.8	8.3	5.7	S&P GSCI Industrial Metals Total Return Index	1%
Precious metals								66.1	101.0	37.8	26.1	31.5	6.7	S&P GSCI Precious Metals Index Total Return Index	1%
Agricultural								51.7	-13.3	3.5	0.4	-4.9	-2.0	S&P GSCI Agriculture Index Total Return Index	1%

Source: Bloomberg, CLIM



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