ODDO BHF

MONTHLY INVESTMENT *Brief*

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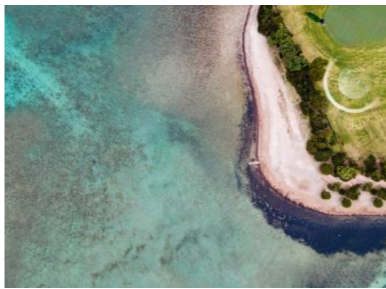
Out of the office, not out of danger



> *Therefore, the prudent investor should enjoy the summer break but also remain vigilant, staying prepared to act swiftly.*

While it hasn't been fully explained, many periods of market turmoil have begun in the summer period, when liquidity is low. Remember 2024 when a weak US jobs report in August was followed by other poor data prints, fueling fears of a US economic slowdown. In addition, the Bank of Japan raised interest rates at the end of July, causing the yen carry trade to unwind and the Topix to fall by more than 12% in a single day. Another recent example is 2022 when Jerome Powell delivered a hawkish speech at the annual Jackson Hole Economic Symposium in late August. This was followed by the US central bank delivering another 75 basis-point interest rate hike in September. That August, the S&P 500 fell more than 4%, followed by a 10% loss in September. Whether it's a self-fulfilling prophecy or not, we need to stay alert on our deck chair (between swims) with our checklist to tick the ten boxes of what could derail the financial markets in the summer.

☑ Tariffs roulette

As trade letters from the US continue to be mailed out, the deadline has been pushed from April 2nd to July 9th and then to August 1st for an ever-increasing list of countries. Who is next? To what extent? Nobody knows. What is certain is that uncertainty is far from over, as evidenced in the continuing mixed headlines, and the impact on the economy likewise might not yet have been fully digested. Specifically for the European Union, the proposed 30% "reciprocal tariff" rate together with the existing sectoral duties (steel, aluminum, autos) could lower Euro area GDP by a cumulative 1.2% through end-2026. The key here is to monitor the outcome of various trade negotiations … and stay connected to X and Truth Social.

☑ Earnings season

The Q2 earnings season has kicked off and Europe must be scrutinized particularly closely. Consensus expects earnings per share (EPS) to decline by 2% year-on-year in Q2, a five-quarter low. This is due to weaker sales and the strength of the euro. There are two things to consider here: one is to have a close look at sectors with high US sales exposure (consumer services, pharma, media, software, construction) and the forex impact on those sectors. The second is to monitor the earnings revision trend for 2025e. Expectations for EPS growth in 2025e have halved since April, and we anticipate further EPS cuts over the coming months. It will not be surprising to see negative EPS growth in Europe in 2025 (the consensus is still at +2%), which would jeopardize the diversification from international investors towards Europe.

☑ Soft and hard data in the US

The resilience of the US economy is surprising. The Citi Economic Surprise Index shows that “hard” data, which reflects past activity, is better than expected. However, “soft” data, which looks ahead, suggests that economic confidence is deteriorating further. Economic data releases expected over the summer may help to narrow this gap. Inflation poses the main risk to markets as soft data suggests that US companies intend to pass on some of the cost increases linked to the tariffs to their customers. If the inflationary impact of tariffs becomes apparent, it could cause markets to price out interest rate cuts (an additional 48 basis points priced in by the consensus for 2025). This would send a negative signal to financial markets.

☑ US bond market and Chair Powell’s future

Donald Trump's ‘One Big Beautiful Bill’ has been passed and will increase the US deficit by USD 3-5 trillion over ten years. Now that the US debt ceiling has been raised, the Treasury can issue debt once again. Large volumes of short-term securities could therefore flood the markets in the coming weeks. The key is to monitor how different auctions are received as long-duration bonds are increasingly vulnerable to inflation surprises, Fed recalibration, and shifts in capital flows. It cannot be ruled out that fiscal fears might flare up again in a world where bond markets remain fragile. Sources of vulnerability have multiplied in recent months, including an uncontrolled budgetary trajectory in the US, investor disengagement from US assets, erosion of the safe-haven status of Treasuries, and Trump’s push to fire Chair Powell challenging the Fed’s independence.

☑ German Bazooka

With regard to Germany's fiscal uplift, investors should monitor the execution of the stimulus, management commentary, and the concrete actions of policymakers. In the first half of July, Germany’s largest corporations pledged a landmark EUR 300 billion in domestic investments by 2028 (7% of GDP). This pledge is conditional on structural reforms. A summit on July 21 with Friedrich Merz aims to formalize this public-private reset. Backed by an EUR 46 billion tax relief package, this initiative could mark a strategic pivot from stagnation to renewal. However, any disappointment on that front could lead to the sentiment that “no one really believes it will happen (fast)”.

☑ Investors positioning

In contrast to the growing narrative of surging equity exposure, especially for retail investors, investors on both sides of the Atlantic have a neutral positioning on equities. It means that it is still vulnerable to negative catalysts. As was very predictable, the market has not treated the tariffs escalation as a negative catalyst at all… However, the absence of an equity selloff also suggests that other forms of negative feedback will see equities react. The backdrop of equities reaching record highs reinforces our cautious stance. Specifically in the US, there is a very high level of crowding in Mag-7 stocks and AI-related themes (semi-conductors mostly). Although this is justified by relatively resilient EPS growth, investors should stay vigilant on that front.

☑ Artificial intelligence developments

AI is an arms race in terms of capital expenditure (capex). Thus, the key story underlying AI is capex and monetization of those capex. Amazon, Microsoft, Google and Meta have announced plans to invest USD 300bn in AI capital expenditure in 2025. Investors should monitor two things during the summer break. One is management comments about AI Capex during the earnings season. A reduction in investment efforts would be viewed as a negative signal. The second is comments about the impact of AI on company margins. Morgan Stanley estimates that AI-driven productivity could increase net margins for constituents of the S&P 500 by 30 basis points in 2025.

☑ Oil price rollercoaster

A potential trigger for summer turmoil would be a significant rise in oil prices caused by a geopolitical shock. Even if the immediate risk of a major oil shock is averted, it still represents a potential headwind for markets. A new surge in oil prices would exacerbate inflation and could force central banks to reconsider additional rate cuts. Fundamentally, we see no reason for an oil price spike. Similarly, we see no good reason for prices to fall below $60/bbl as the current breakeven price for US shale producers is $65/bbl.

☑ EUR/USD

We believe that the dollar bear market is only just beginning. However, the 15% USD depreciation versus the euro since January 10th is starting to put pressure on European exporters. Therefore, a consolidation phase is likely during the coming months. This sideways movement will be a launching pad for another major leg up toward year-end. In the meantime, the growing profit pressure on European exporters must be monitored. The current earnings season should provide investors with valuable hints. The impact of a weaker USD on imported inflation in the US is also a topic to keep an eye on during the summer break.

☑ Chinese stimulus

While economic growth is largely on track, the gradual softening of domestic demand means that policymakers will likely introduce incremental stimulus measures in the coming months. These measures will probably include higher government bond-issuance quotas, bank loans for infrastructure projects, interest-rate cuts, and childcare subsidies. There are also substantial risks remaining in the property sector. A renewed downturn in the property sector would almost certainly deal substantial damage to economic growth. The absence of clear stimulus in the property sector could be a drag for Chinese equities.

How to position?

- **Equities**: We maintain a slightly overweight position on equities but recommend reducing the tracking error and moving closer to neutral. Given somewhat stretched valuations and high uncertainty, we refrain from taking on large active risks. As higher US tariffs and related uncertainties could lead to a slowdown in US growth, we prefer holding a slightly underweight position in US equities. In Europe, balancing factors such as potentially limited retaliation measures and a strong fiscal stimulus might be a relative advantage. Therefore, we favor European equities and increase our exposure to small caps to slightly overweight. We have moved our exposure to UK equities to slightly underweight due to increased political uncertainty.

- **Rates**: We move to a slightly long-duration position. For core Europe, the continued disinflation process and a supportive ECB favor this view. Fundamentals and sentiment for peripheral Europe have improved. Therefore, we maintain a slightly overweight position in peripheral Europe. The slightly long duration position in US treasuries acts as a tactical hedge against equity positioning given the anticipation of softer macroeconomic data in the second half of 2025. Nevertheless, we are fully aware that fiscal deficits and higher inflation pose long-term risks to the US.

- **Credit**: We are constructive on credit risk as global recession risks have faded. While spreads are relatively tight, overall yield levels still offer good carry investment opportunities. From a risk-return perspective we continue to favor short-duration investment-grade and high-yield as the potential for drawdown is low.

- **Currencies**: We maintain our view that the euro will strengthen against the US dollar as long-term indicators such as purchasing power parity and current account balances point to an appreciation of the euro. In addition, a slowdown in US growth might weaken the USD.

Conclusion: Take a rest, but keep one eye open

Summer may be synonymous with low liquidity and lazy afternoons, but history has shown that markets can quickly turn turbulent when least expected. The list of potential catalysts for volatility is long, ranging from trade uncertainties and earnings disappointments to bond-market fragility and geopolitical risks. While none of these factors alone may trigger a major correction, the combination of softening economic data, policy surprises, and investor positioning could amplify market reactions. Therefore, the prudent investor should enjoy the summer break but also remain vigilant by monitoring key indicators, reassessing risk exposure, and staying prepared to act swiftly. After all, summer calm has often proven to be the calm before the storm.

READ THE PRESENTATION

Past performance is not a reliable indicator of future returns and is subject to fluctuation over time. Performance may rise or fall for investments with foreign currency exposure due to exchange rate fluctuations. Emerging markets may be subject to more political, economic or structural challenges than developed markets, which may result in a higher risk

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