



**Investment
Managers**

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BNP PARIBAS
GROUP

Investment Institute *Asset Class Views*

Monthly Investment Viewpoint

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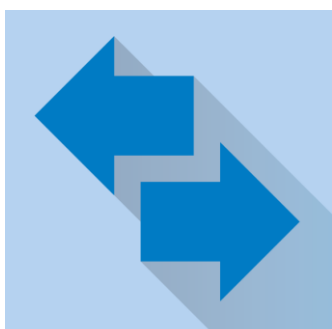
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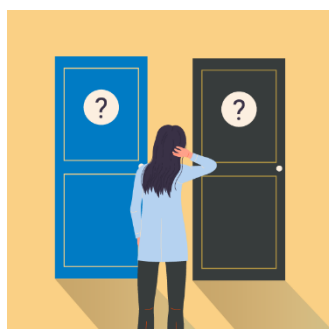
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KEY INVESTMENT THEMES



**Rise of the credit
default swap**



**The Fed's
policy challenge**



**China's anti-
involution play**

The CDS trade



Credit default swaps (CDS) are derivative instruments which enable investors to hedge the credit spread component of a corporate bond. Buying a single CDS, or CDS basket, is seen as buying protection against credit spreads widening. With increased liquidity, they also allow for expressing speculative views on the direction of credit spreads and achieving leveraged exposure to corporate credit, in investment grade, high yield and emerging market credit sectors. With being overweight credit a consensus view, using CDS to gain leveraged exposure has become a popular trade. Credit fundamentals are positive: ongoing growth, stable rates and strong corporate earnings. Momentum is positive, with credit spreads generally moving tighter in 2025. We remain positive on the asset class. However, spreads are at their narrowest for some time and speculative short CDS positions are considerable. Any macroeconomic shock could presage a rapid unwind and a reversal in spreads. Credit is attractive but negative returns are a clear risk given current market levels and positions.

The Fed's dilemma



Following the Federal Reserve's (Fed) decision to keep rates unchanged in July, the market is anticipating another 35 basis points (bp) of cuts by year end - in contrast with more than 100bp when the Liberation Day tariffs were announced. At the same time, the consensus still expects the US economy to slow from 2.8% in 2024 to around 1.5% in 2025, while inflation should accelerate to 3.0% and 3.1% in the third and fourth quarter of this year. The Fed is clearly facing a dilemma: cut rates as the economy is expected to slow or hike rates/keep them unchanged as the risk of faster inflation materialises. It has clearly identified and adopted the optimum policy stance to tackle this dilemma. A strictly data-dependent, neutral-guidance approach is best suited to deal with binary uncertainty about the future state of the economy, as it minimises the potential negative impact in the worst-case macroeconomic scenario.

Anti-involution evolution



As China's deflationary backdrop persisted into its 33rd month in June, policymakers acknowledged the underlying problem, driven by a growth model tilted toward investment and supply. Anti-involution actions - i.e. a pushback against intense and non-productive competition - have been mobilised by authorities across e-commerce, the auto sector, solar panels, electric vehicle batteries, and select upstream commodity sectors. The intention is to reduce capacity and/or promote investment favouring efficiency over output. That has driven renewed interest in policy-induced investment opportunities, with earnings multiples expanding in targeted sectors, albeit without indications of earnings recovery. Sustained earnings recovery requires deeper reforms to China's growth model - the internal demand shortage is a key challenge and remains an economic barrier. Excess capacity in the non-metallic minerals industry is largely a result of the property downturn. Past episodes of supply-side reforms were focused on aggressive capacity cuts - a path more challenging to take now, with much of the overcapacity sitting with private industries.



Asset Class Summary Views

Views expressed reflect CIO team expectations on asset class returns and risks. Traffic lights indicate expected return over a three-to-six-month period relative to long-term observed trends.

Positive	Neutral	Negative
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CIO team opinions draw on AXA IM investment team views and are not intended as asset allocation advice.

Rates		Yields remain in tight ranges, curve steepening still likely
US Treasuries		Interest rate cuts still expected, foreign demand holding up
Euro – Core Govt.		Lower inflation is supportive for European Central Bank easing interest rates
Euro – Govt Spreads		Still offering potentially attractive returns
UK Gilts		Cheap valuations but looking for better news on fiscal policy
JGBs		Higher yields seem likely given current inflation and fiscal risks
Inflation		Continue to like short-duration inflation-linked bonds

Credit		Narrow spreads and long positions create potential risks
USD Investment Grade		Positive fundamentals and momentum but valuations are rich
Euro Investment Grade		Demand continues to be strong but excess returns more modest
GBP Investment Grade		Potentially attractive returns for sterling- based investors
USD High Yield		Risks to cyclical sectors from global trade situation, with spreads tight
Euro High Yield		US tariffs on European Union exports could impact some more leveraged names
EM Hard Currency		Carry remains attractive but strong flows into local currency bonds

Equities		Earnings resilient despite macroeconomic uncertainties
US		Artificial intelligence-driven capital expenditure boom is sustaining large-cap earnings
Europe		US tariffs and expected German demand boost create opposing forces
UK		Market displays defensive qualities; domestic firms should benefit from continued rate cuts
Japan		Artificial intelligence and robotics are supportive themes for Japan
China		Technology and positive policy catalysts; broader earnings challenged by deflation
Investment Themes*		Long-term positive on artificial intelligence and carbon transition strategies

*AXA Investment Managers has identified several themes, supported by megatrends, that companies are tapping into which we believe are best placed to navigate the evolving global economy: Automation & Digitalisation, Consumer Trends & Longevity, the Energy Transition as well as Biodiversity & Natural Capital

Data source: Bloomberg

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