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Investment Institute *Asset Class Views*

Monthly Investment Viewpoint

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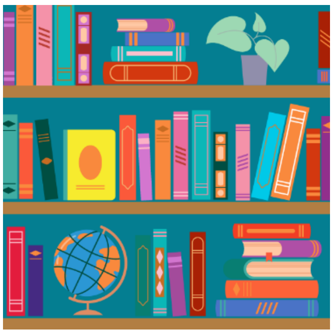

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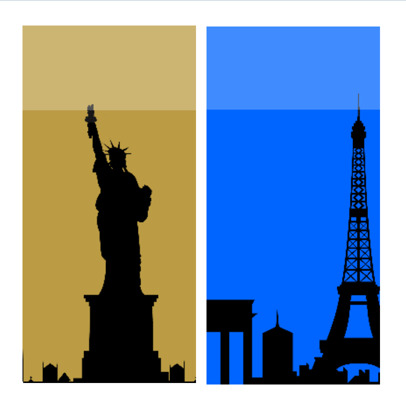
KEY INVESTMENT THEMES

Rethinking balanced portfolios

US inflationary pressures persist

China's economic and market divergence

A more balanced approach required



The historic relationship between valuations and future returns suggests equity and bond index performance being more similar going forward. This could prove to be important in how investors construct balanced portfolios, such as target retirement funds which reduce their equity allocation and increase their bond weighting over time, so returns become more bond-driven the closer the investor gets to retirement. However, bond returns over the last decade undermined this approach and simulations suggest investors would have benefited from maintaining a higher equity weighting. However, current equity valuations suggest lower long-term returns while increased yields point to higher bond returns. Forward looking analysis suggests potential annualised equity returns of between 3% and 5% for the US market, with returns from US corporate bonds of around 5%. For Europe, the analysis shows a modest preference for equities. Globally, equities have outperformed bonds hugely over the last decade, but a more balanced allocation may potentially serve long-term investors better going forward.

Higher inflation into year end

US inflation is likely to accelerate in the coming months. While many US firms front-loaded imports because of incoming tariffs, and we're still uncertain about China's exporting policies, we cannot dismiss inflation's stickiness. Based on Atlanta Federal Reserve data, underlying inflation – i.e. the persistent, longer-term trend of price increases – has stabilised above 3%, and even accelerated by about 0.4 percentage points since April. Tariffs might add further pressure to goods inflation, albeit as a one-off factor. Furthermore, base effects should have a slightly positive impact on both headline and core inflation into year-end, assuming the month-on-month profile is consistent with the last three months (i.e. +0.3% average monthly variation). Financial markets do not seem to be too worried by an acceleration of inflation, as suggested by the CPI fixings until year end. Ultimately, what matters for Federal Reserve rate setters is the medium-term outlook, but how quickly markets deal with incoming information is always debatable.

China's macro and markets divergence

Despite macroeconomic weakness, China equity markets have achieved double-digit year-to-date returns. Markets can diverge from macro trends, and in China's case, the narrative has shifted. Sectors such as information technology - driven by breakthroughs in artificial intelligence - and biotechnology, as well as recent anti-involution efforts, have led the earnings recovery, offering significant growth opportunities. Available liquidity has also contributed to the market's re-rating. As of June, households had accumulated approximately $24trn in savings, while dividend yields have become more attractive relative to deposit rates. Meanwhile, fixed income returns have declined, volatility has increased, and with the property market remaining weak, investors have sought alternative investment avenues. This rally has driven index valuations to align with long-term averages. Top-performing stocks share attributes such as significant consensus upgrades in earnings per share, revenue, and elevated price-to-earnings multiples. Looking ahead, the key question is whether a wider range of companies can generate enough earnings and dividend growth, despite deflationary pressures, to attract more inflows, and sustain the market recovery.

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

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

Rates	Fiscal and inflation concerns underpin curve steepening
US Treasuries	Potential Federal Reserve easing supports short end of curve but may push long yields higher
Euro – Core Govt.	Core rates steepening reflects policy rate probably being below neutral
Euro – Govt Spreads	French political and budget risks suggest preference for Spain and Italy
UK Gilts	Markets await budget proposals on tax, but total returns remain mildly positive
JGBs	Steady increase in long yields adds to global concerns on bonds
Inflation	US inflation risks are tilted to the upside; short duration strategy preferred

Credit	Spread volatility remains low but depends on macroeconomic and equity risk
USD Investment Grade	Income returns on track to make 4%-5% this year with stable credit backdrop
Euro Investment Grade	Strong demand for credit with stable European Central Bank interest rates
GBP Investment Grade	Total returns healthy but vulnerable to gilt curve volatility
USD High Yield	Attractive income return, with less drawdown risk than the equity market
Euro High Yield	Healthy income returns to potentially continue above Eurozone inflation
EM Hard Currency	Attractive diversifier to US credit with higher yields

Equities	Positive momentum continues to drive new highs but macro and valuation risks remain
US	Earnings growth expectations continue to defy potential slowdown risks; AI theme still strong
Europe	Price/earning multiples have increased; dividend income and valuations more attractive vs. US
UK	Better performance despite macro risks, with large-cap companies less exposed to tariffs
Japan	Steady performance since April, with rates on hold and signs of improved global capex cycle
China	Technology and policy are positive catalysts; broader earnings challenged by deflation
Investment Themes*	Long-term positive on AI 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