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ECONOMIC RESEARCH – DECEMBER 2025

INVESTMENT INSIGHT USA

- ✓ Less clear outlook for bond market
- ✓ New paradigm for the dollar
- ✓ Risk/return ratio unfavorable for US equities

2026 START VERY UNCERTAIN IN THE UNITED STATES

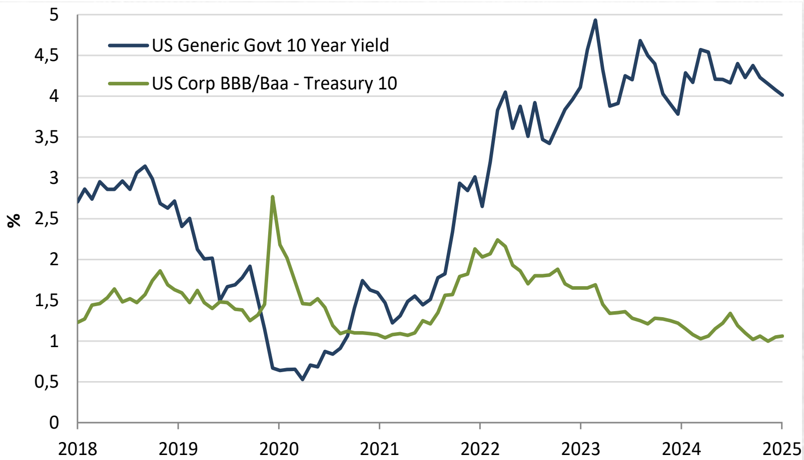
US treasury yield dynamics and term premium risks

The US bond market has entered a phase of preventive adjustment, with 10-year yields stabilizing near 4.10%. While the real yield of 140 basis points remains attractive, capital gains must contend with a projected $1.8 trillion deficit for fiscal year 2025. This massive supply imposes a significant term premium that leaves the market structurally vulnerable to any inflationary rebound in early 2026.

Yield curve recovery and institutional rotation

Current market dynamics confirm a meaningful recovery in the yield curve, with the short end falling rapidly as markets price in the conclusion of the Federal Reserve's easing cycle. This shift is prompting institutional investors to gradually rotate out of equities, where the risk premium is increasingly viewed as insufficient compared to the relatively safe returns offered by the bond market. While our short-term outlook for Treasuries remains positive with a 10-year target potentially below 4%, we advise extreme caution in Q1 2026 to avoid potential trend reversals driven by supply-side pressures and deficit-related volatility.

US Treasury yields and BBB bonds (spread)



Sources : Bloomberg, BBGI Group

A new paradigm for the US Dollar

The dollar is entering a more complex phase as it loses the support of extreme uncertainty and favorable yield differentials. With the government shutdown resolved and PCE inflation at 2.9%, a real interest rate of roughly 0.7% may no longer be adequate to offset the dual pressures of political risk and twin deficits. International investors appear to have reached a saturation point regarding Washington's political turmoil, making a sustained technical rebound difficult in the immediate term. The Federal Reserve's move away from a "restrictive" stance means the dollar no longer enjoys a clear advantage over other major currencies in the short-run.

Dollar consolidation and potential momentum shift

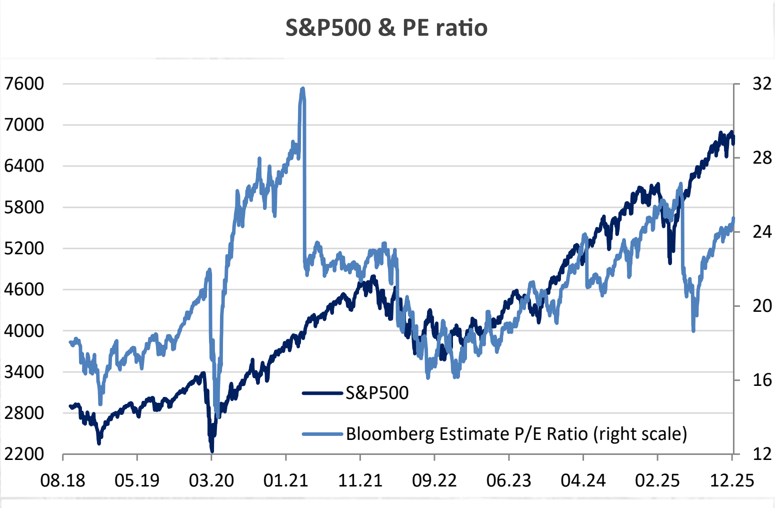
From a technical perspective, the greenback is nearing the end of an eight-month period of horizontal consolidation. While the immediate outlook is clouded by domestic fiscal concerns, the dollar could still find unexpected momentum if US growth continues to outperform international peers on a relative basis. However, until there is greater clarity on the trajectory of trade policy and the final impact of tariffs on the global growth mix, the currency is likely to remain in a range-bound environment, sensitive to shifts in the Fed's rhetoric and global risk appetite.

Equity market fragility and valuation extremes

US equity markets are concluding the year with significant volatility, ending only slightly above September levels. The risk/return ratio for the S&P 500 appears increasingly unfavorable as economic indicators "flash orange" and the tailwind from rate cuts is fully exhausted. With P/E ratios stretched above 25x, valuations leave no margin for error or disappointment in corporate earnings. The current market pricing appears to ignore the likely headwinds of 2026, including the potential for tariff-driven margin compression and a pivot toward tougher Federal Reserve rhetoric if inflation proves stickier than anticipated.

Strategic outlook for Q1 2026 and risk reassessment

As we transition into 2026, the potential for a "hawkish pause" by the Fed remains a significant tail risk that could trigger a sharp reassessment of equity valuations. Corporate margins are under threat from rising input costs and a plateauing consumer demand. Given these factors, we maintain a defensive posture, favoring capital preservation in high-quality fixed income over stretched equity multiples. The first quarter of 2026 will be the definitive test of US economic resilience, requiring investors to navigate the delicate balance between decelerating growth and the persistent threat of a supply-side inflationary shock.



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