Knowns and Unknowns

- US LEI still points to stable but below-trend growth, GDPNow an outlier for now
- Macro Risk Indicator remains neutral, implies sticking to benchmark allocations
- Backdrop of stable growth and sticky inflation likely to keep bond yields range-bound and present trade opportunities in bonds and the USD as 10-year yields near 4%

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This monthly Macro Snapshot report blends the output from VP's key Tactical (1-3m), Cyclical (6-12m) and Structural (2-3y+) models.

Please visit the Asset Allocation summary for all our views across asset classes and time horizons and our Desert Island Chart Collection for our top asset allocation charts.

LEI still points to stable but below-trend growth, GDPNow an outlier

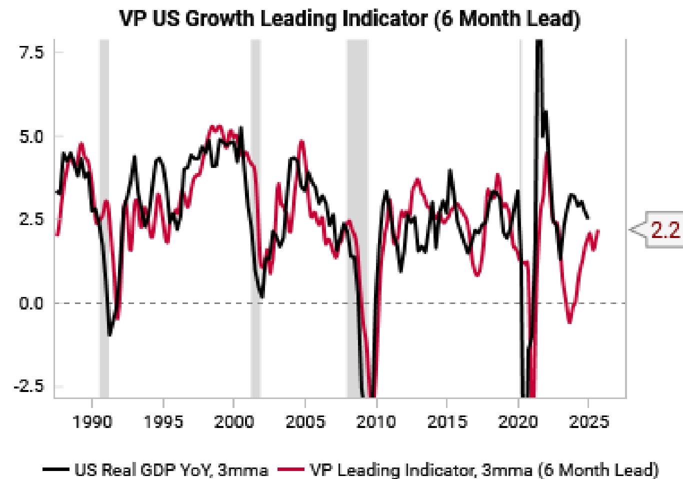
Our leading and high-frequency growth indicators for the US remain stable despite the recent negative data surprises. In fact, our growth LEI ticked higher in February, implying a 6-month forward point estimate of 2.2% YoY real GDP growth (top left chart).

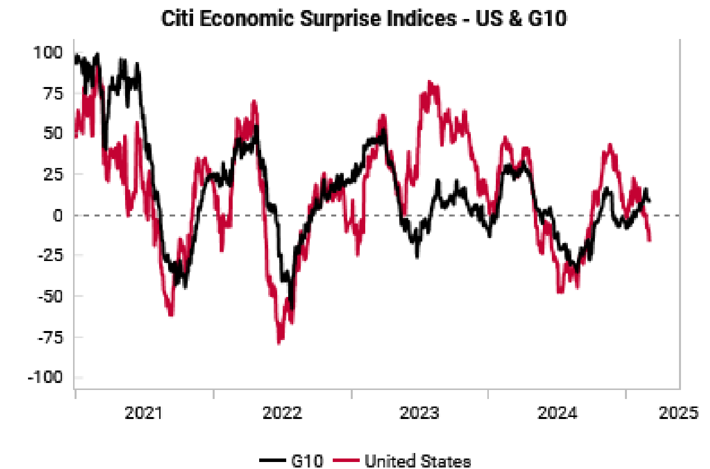
It is true that recent US economic data have started to disappoint lofty expectations, with the surprise index turning negative for the first time since mid-2024 (top right chart). Notably, the Atlanta Fed GDPNow estimate plunged to -1.5% last Friday.

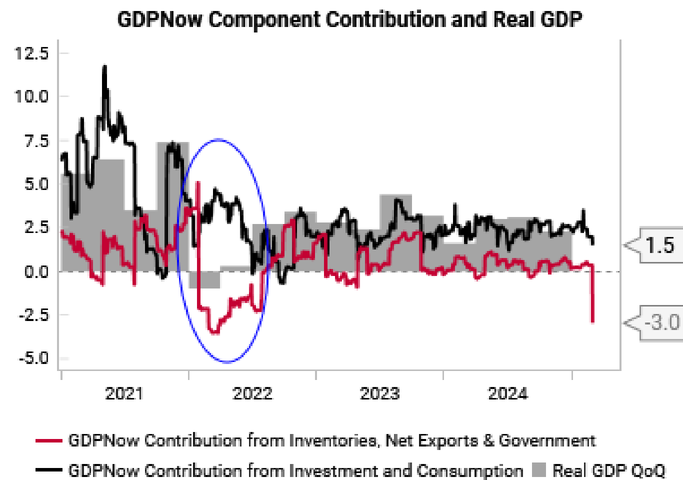
But this almost entirely reflects the recent surge in imports (probably tariff front-running) rather than underlying economic weakness. The same thing happened when supply chain relief led to a flood of imports in March 2022: consumption and investment remained steady while volatility in inventories and net trade dragged down the GDPNow estimate and headline real GDP (bottom left chart).

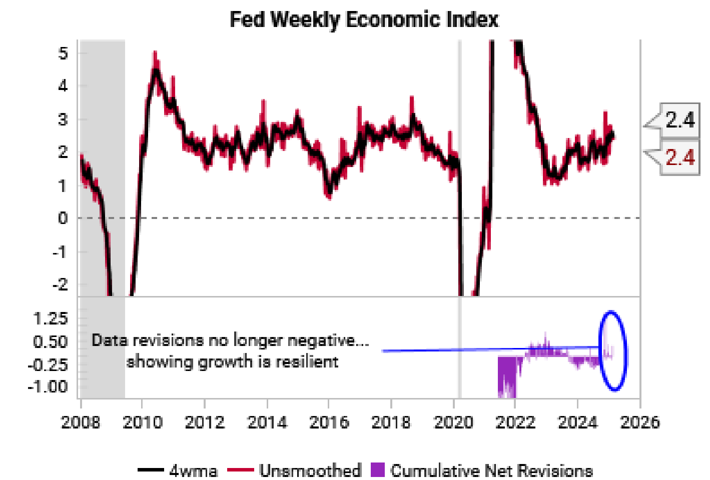
The vast majority of indicators continue to point to resilient growth and a manufacturing upturn. For example, the Fed weekly economic index is edging higher (bottom right chart).

Like 2022, we think this may present a tradable opportunity if yields fall closer to 4% and our growth LEI remains intact.









Source: S&P Global, Refinitiv, Macrobond, and Variant Perception

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What If: Known and unknown downside growth risks

Rather than the volatile components of GDP, **we are monitoring downside growth risks stemming from policy uncertainty and elevated interest rates**.

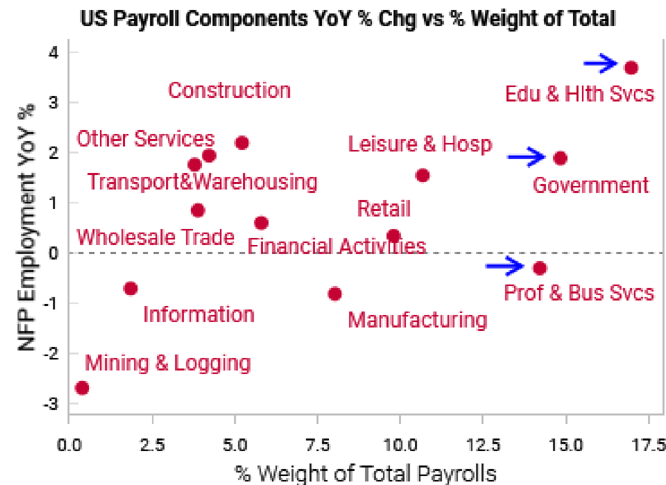
We see four potential downside risks:

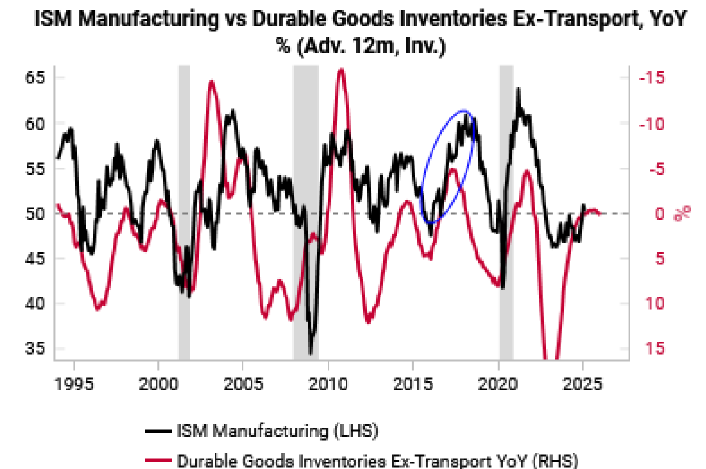
Risk #1: DOGE and other spending cuts could be larger than expected and push the fiscal impulse negative, reducing incomes via **job losses in the government, health, education, and consulting sectors**. Crucially, these are the largest payroll sectors in the economy (top left chart).

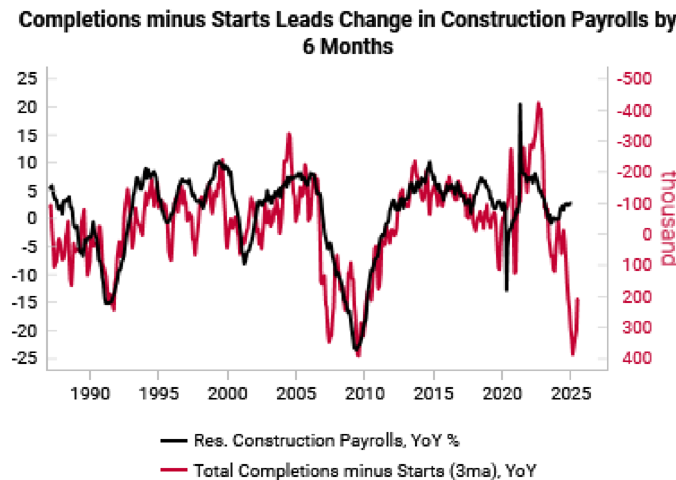
Risk #2: Tariff uncertainty amid a weaker backdrop than the first Trump administration could mean **the manufacturing rebound is short-lived**. Part of this weaker backdrop is that US inventories have not fallen much, reducing the need to rebuild inventories (top right chart).

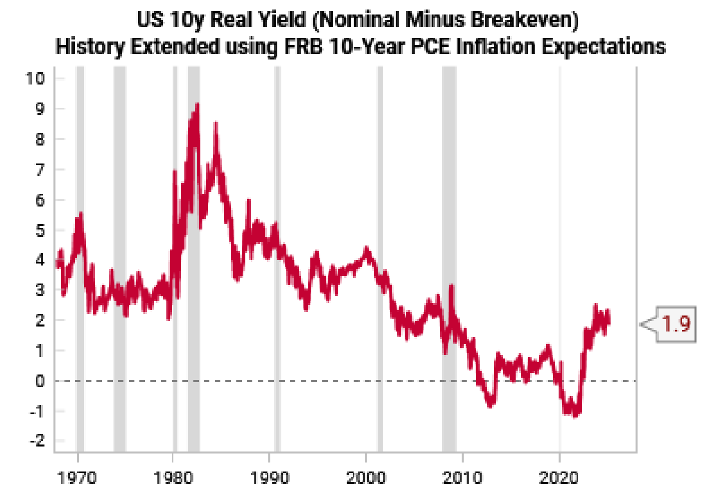
Risk #3: New home inventories continue to rise relative to sales and could finally cause **a decline in construction payrolls**. Notably, total completions remain high relative to starts, implying excess labor and downward pressure on construction payrolls from here. (bottom left chart).

Risk #4: Real interest rates are near multi-decade highs and could **pressure margins for private credit borrowers and small businesses** if rates stay elevated (bottom right chart).









Source: S&P Global, Refinitiv, Macrobond, and Variant Perception

Macro Risk Indicator remains neutral, stick to benchmark allocations

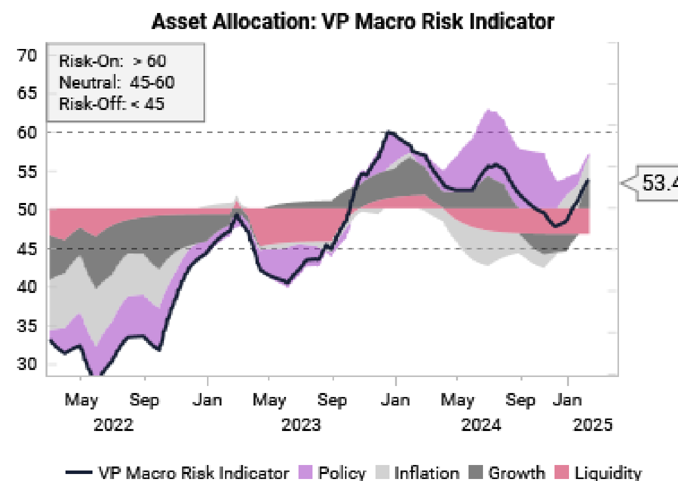
Our Macro Risk Indicator model is still "**neutral**" on the **risk asset outlook**, implying a **benchmark allocation to equities vs bonds** on a 6-month forward basis (top two charts).

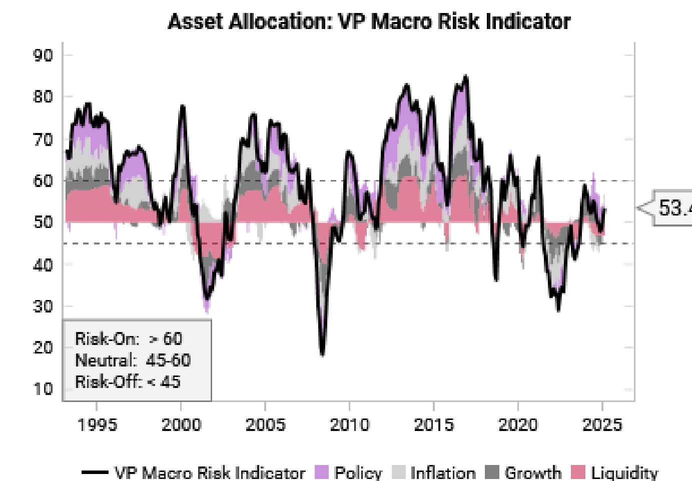
Bond exposure in this benchmark allocation has helped to provide some downside protection for portfolios. As we previously noted, inflation should remain sticky but not high enough to cause a renewed hiking cycle and losses in bonds.

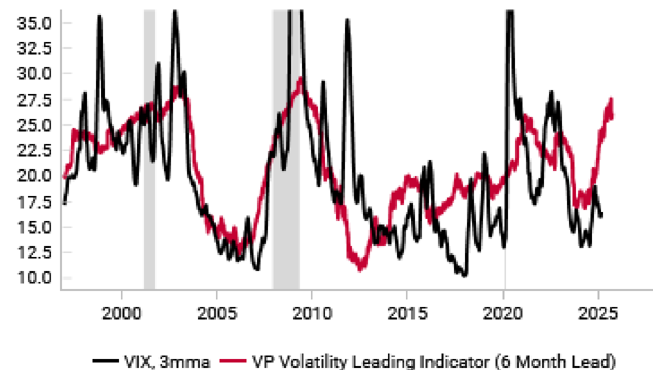
Growing uncertainties around policy and growth are consistent with our leading indicator pointing to higher volatility this year (bottom left chart). Adding to this, liquidity remains a headwind for risk assets.

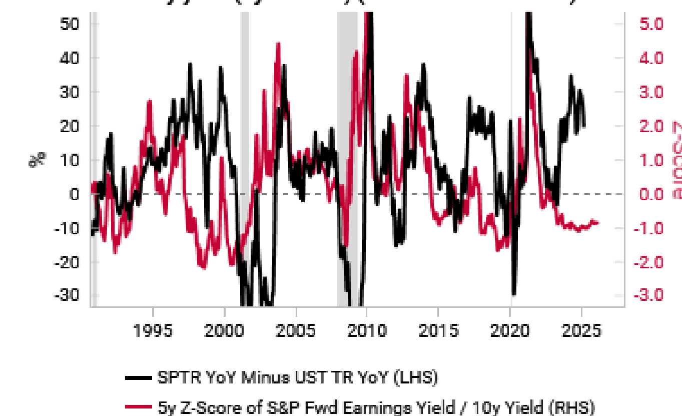
We think bonds are still likely to provide downside protection in a backdrop of elevated volatility.

Sticky inflation may limit further downside in yields and absolute returns in bonds (see our Fixed Income page). That said, **we expect bonds can still deliver strong returns relative to equities**. After all, equities have already outperformed bonds by a much wider margin than their relative valuations would imply (bottom right chart).









Source: S&P Global, Refinitiv, Macrobond, and Variant Perception

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High bar for EPS growth expectations, still underweight small caps

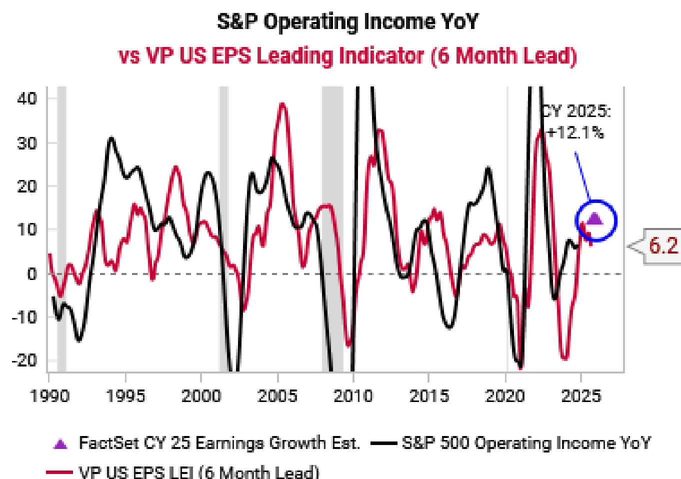
Ultimately, we think **US growth will hold up and support continued earnings growth.** But our US earnings LEI has edged lower the past few months and now implies growth of 6.2% YoY, well below the FactSet CY 2025 EPS growth estimate of 12.1% (top left chart). Stretched valuations set a high bar for this optimistic consensus earnings growth to be realized.

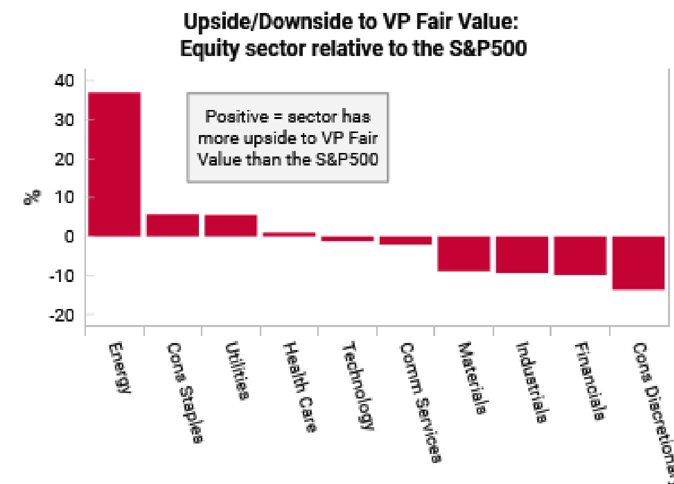
High valuation and our outlook for elevated volatility leave us staying selective in our exposure to US equities.

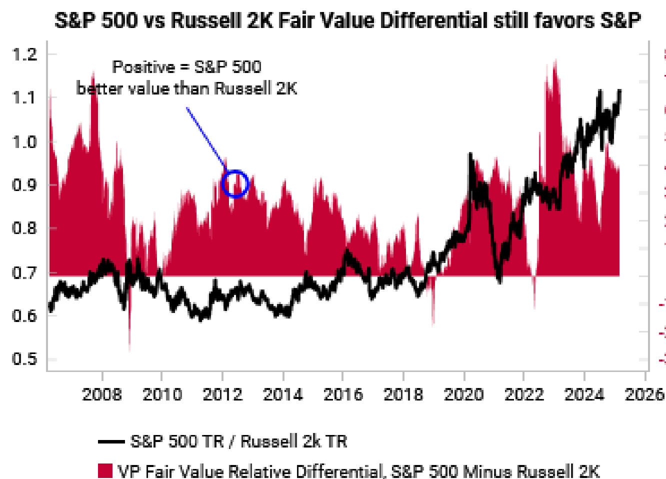
Within sectors, **we still see upside among energy stocks**. The sector continues to trade at the largest discount based on our Fair Value models (top right chart). On top of this, they are uncrowded and capital scarce. By contrast, **other cyclical sectors trade above our fair value models and could continue to struggle given the ongoing growth scare.**

Similarly, our Fair Value methodology continues to favor large caps over small caps (bottom left chart). Like after the first Trump election, small caps have reversed their initial outperformance (as we flagged in our 2025 Themes).

We expect small caps will continue to underperform as they face headwinds from elevated rates, higher volatility, and ongoing tariff uncertainty, as was the case in the 2018 trade war (bottom right chart).







Source: S&P Global, Refinitiv, Macrobond, and Variant Perception

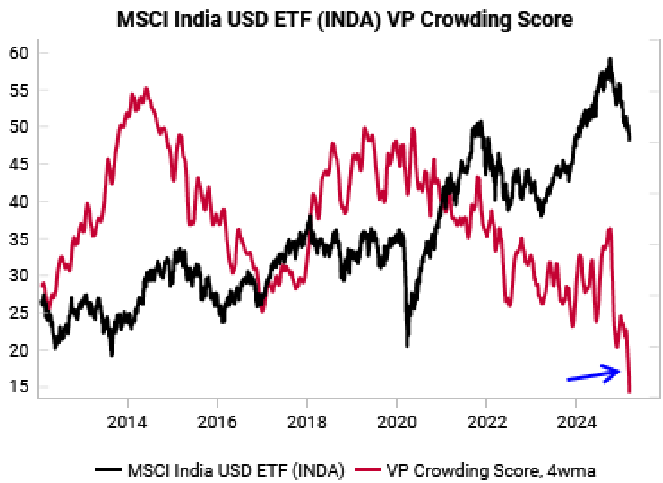
Staying selective among non-US equities, shifting tactical buy from China to India

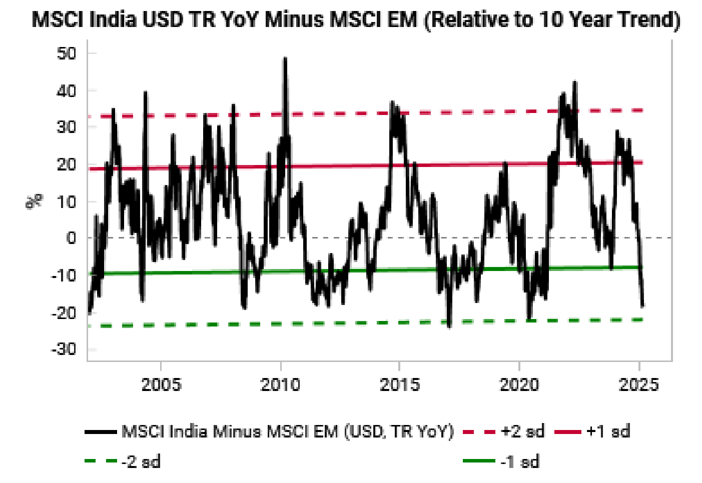
Our Asset Allocation Engine still implies limited exposure to non-US equities. Given the recent price action, we see opportunities in rotating from long Chinese equities to long Indian equities.

Global liquidity remains a key headwind for EM assets, which tend to thrive in strong liquidity backdrops. For example, global excess liquidity has shown a renewed fall after nearly turning positive a few months ago (top left chart). This leaves us selective in our exposure to EM equities.

Our bullish stance on China equities since September has been playing out well. **But the macro data out of China is deteriorating again and the tactical price action is looking stretched**. For example, the USD total return for MSCI China relative to the MSCI Emerging Market index is now above the historical two standard deviation range (top right chart). This led us to recommend taking profits in late February.

Instead, we like adding exposure to Indian equities given the alignment of tactical and cyclical buy signals. The cyclical growth outlook in India is positive while inflationary pressures remain tame. Meanwhile, tactical indicators look favorable: its Crowding Score has fallen to a decade low and its relative underperformance versus EM equities is at historically extreme levels (bottom right chart).





Source: S&P Global, Refinitiv, Macrobond, and Variant Perception

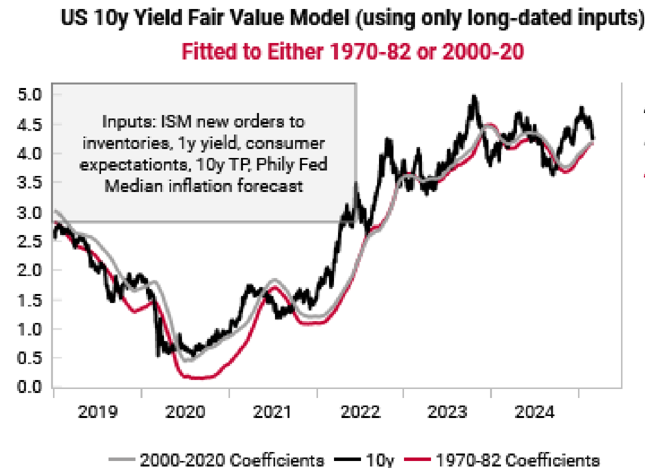
10y Treasury yields near fair value, sticky inflation a hurdle for faster cuts

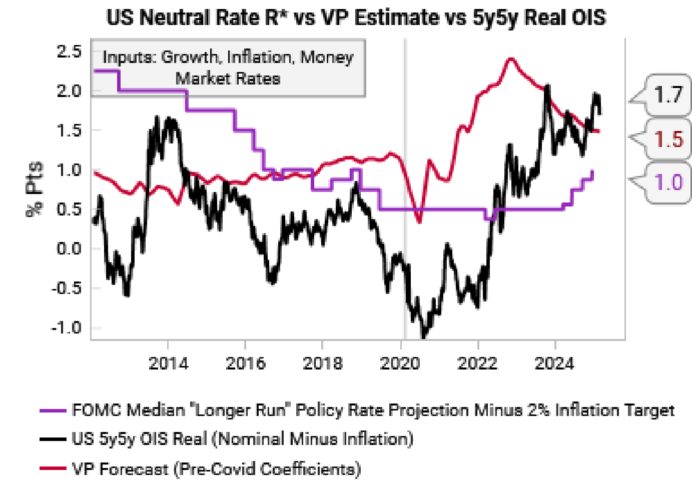
The latest fall in bond yields leaves the outlook for bonds more balanced than earlier this year when we thought they were biased lower. **If our outlook for sticky inflation and resilient growth remains intact, we would look to fade a further fall in bond yields** (likely around the 4% level on the 10-year UST).

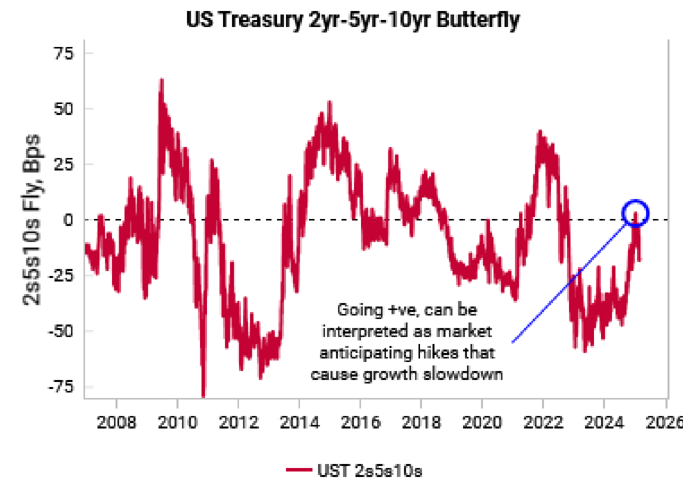
Long-term bond yields look close to our estimates of fair value. As of today, yields are in line with our fundamentals-based fair value of 4.2% (top left chart). Similarly, the fall in 5y5y real yields leaves it just 20bp above our measure of the "neutral rate" (top right chart).

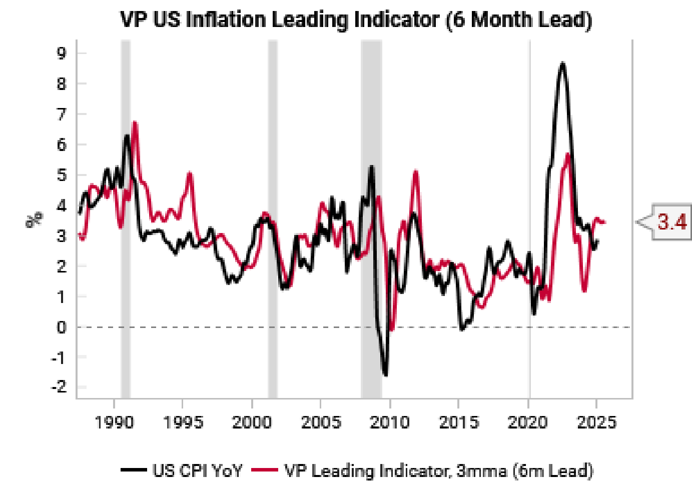
From here, stable but below-trend growth is likely to act as a ceiling for yields. When yields were rising towards 5% earlier this year, we flagged the 2s5s10s butterfly turning positive as a sign that elevated rates would start to weigh on growth (bottom left chart).

At the same time, our outlook for sticky inflation is likely to act as a floor for yields and prevent them from falling much below 4%. After all, inflation remains above target and our LEI shows no signs of inflation coming down over the next six months (bottom right chart).









Source: S&P Global, Refinitiv, Macrobond, and Variant Perception

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Risk/reward to tactically buy USD appealing as 10y UST yield nears 4%

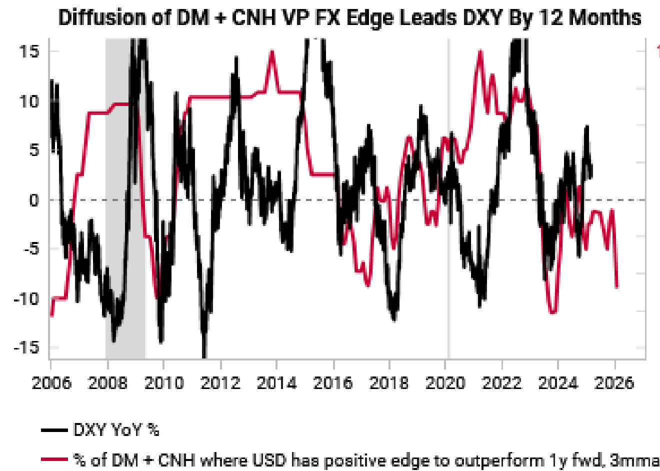
Our cyclical indicators for the US dollar imply more weakness ahead, but **we still maintain a medium-term bullish dollar bias given Trump's "strong dollar" policy mix** (tariffs, deregulation, etc). We are looking for bullish tactical indicators and a further fall in US yields to enter a long USD position.

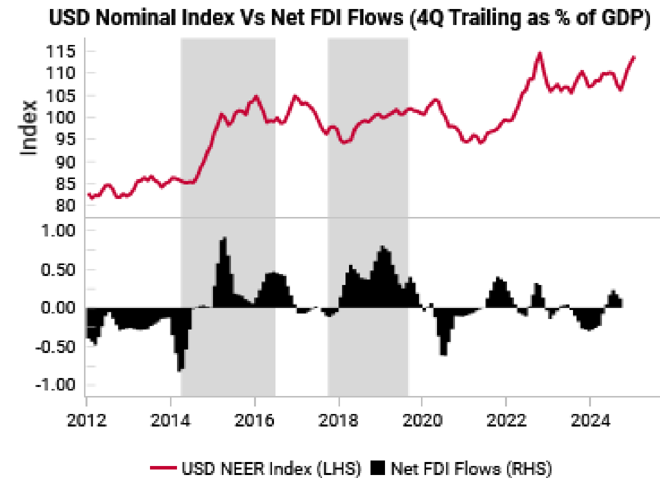
Our key indicators show the cyclical outlook for the dollar remains mixed.

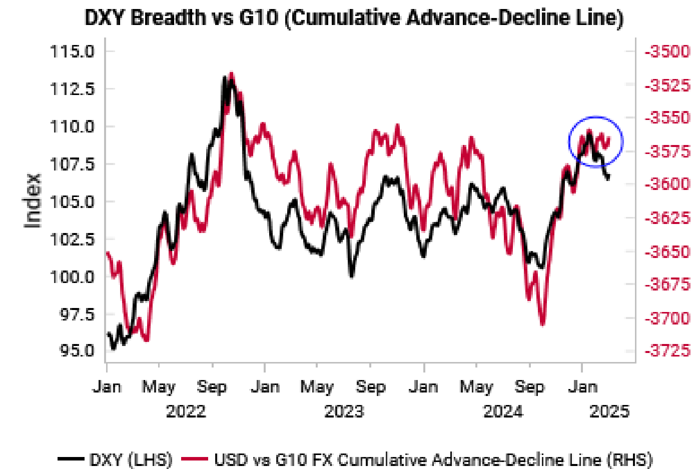
Carry remains positive for the dollar among G10 FX. But **the dollar's strength has pushed its inflation-adjusted exchange rate (i.e., REER, an input to our FX Edge model) to extremes**. This reduced the USD's expected returns against most G10 FX, according to our FX Edge models (top left chart).

On the other hand, the difference between the LEIs for the US vs the Eurozone and China – **a proxy for the "dollar smile" theory – implies positive returns for the USD this year** (top right chart). And the dollar should benefit from higher FDI flows, as long as those flows materialize (bottom left chart).

On a tactical basis, the dollar's breadth relative to other G10 currencies has actually held up well in the latest pullback (bottom right chart). Meanwhile, some key USD pairs have already triggered [tactical buy signals](). **We expect a buying opportunity to emerge in USDJPY in the coming weeks.**







Source: S&P Global, Refinitiv, Macrobond, and Variant Perception

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Mixed outlook for commodities, gold valuation still elevated

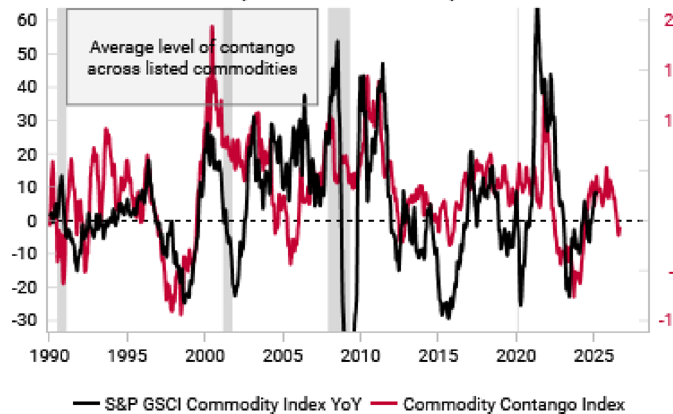
We still see upside in industrial commodities and a consolidation period for gold amid a relatively benign global growth backdrop.

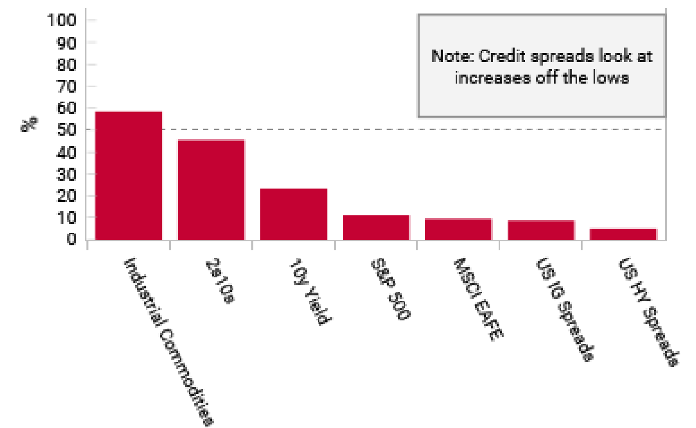
Our Commodity Contango Index model implies positive returns for commodities over the next six months (top left chart). The same is true based on our Commodity Supply-Demand model and the diffusion index of the inputs to our growth LEIs.

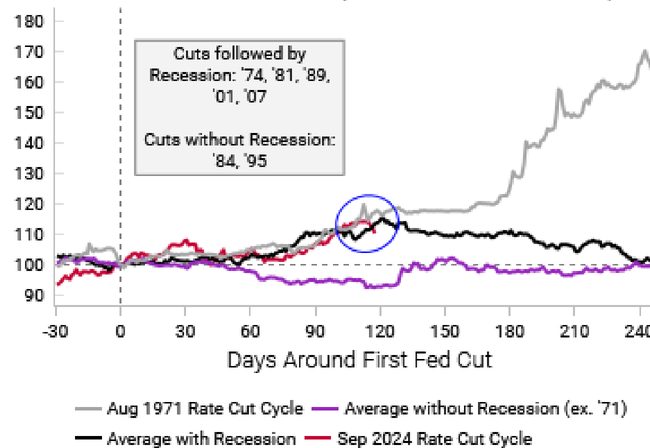
In light of these bullish indicators, **the sharp drawdown in industrial commodity prices remains an outlier.** After all, drawdowns of this extent have historically coincided with recessions, but this recessionary pricing isn't corroborated by other key assets (top rightchart).

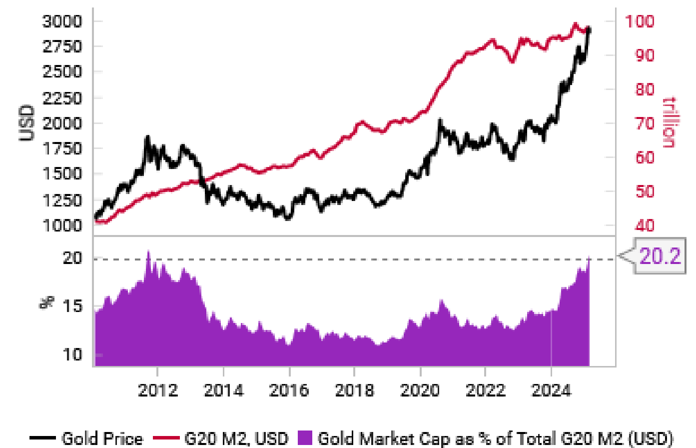
By contrast, gold's rally looks overdone. It's surge since the Fed kicked off its easing cycle matches past recessionary periods as well as the 1971 rate cut cycle, which coincided with the end of Bretton Woods (bottom left chart). We don't expect a recession or an imminent monetary regime change to support this latest price rally.

What's more, its valuation is as high as its last major cyclical top in 2011 (bottom right chart). **Our base case is that gold is likely to remain rangebound over the next few years.**









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