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AIP

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Inching towards a stalemate

US President Trump's plan to end military operations in the Middle East within 2-3 weeks has eased fears of a drawn-out conflict. However, uncertainty remains about a near-term escalation in the conflict and when normal shipping through the Hormuz Strait will resume. Trump stated the responsibility for reopening the strait now falls to Asian and European governments, whose economies depend heavily on Gulf energy supplies. This signals tough negotiations ahead. In this environment, it is preferable to invest in quality stocks with robust profit margins and earnings moats, especially within technology and utilities sectors. There are opportunities to secure elevated yields in US government and high-grade corporate bonds. As focus shifts from short-term inflation driven by higher oil prices to medium-term risks for growth and employment, these strategies are expected to outperform.

Equities

The VIX closing above 30 signals market stress, but such episodes have historically been short-lived, preceding strong recoveries. For instance, when the VIX closed above 30, the S&P500 index has historically delivered an average 12-month forward return of 29%, far above the 14% long-term average. Recent declines in the US aerospace and defence sector stem from expectations of an end to US' Iran operations, an expected slump in airline revenue and impact on airline profit margins from higher oil prices. However, an expected de-escalation of the conflict is likely to boost commercial aerospace and ease oil prices. Additionally, US President Trump's proposal to boost military spending by 50% to USD 1.5trn in 2027 is positive for the sector. Against this backdrop, 12-month forward earnings growth of over 40% provides a strong tailwind for a sustained recovery.

FX

Recent data has not altered expectations that the BoJ is likely to hike rates to 1.25% by 2026 year-end. Hence, bearish on USD/JPY. USD/JPY is forming a significant resistance zone at 160-161. The pair is facing downside risk, with support at 155.9 in the coming weeks.

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