



# iFlow

**QUARTERLY INVESTOR TRENDS**  
**Q1 2025**

Staying Home?

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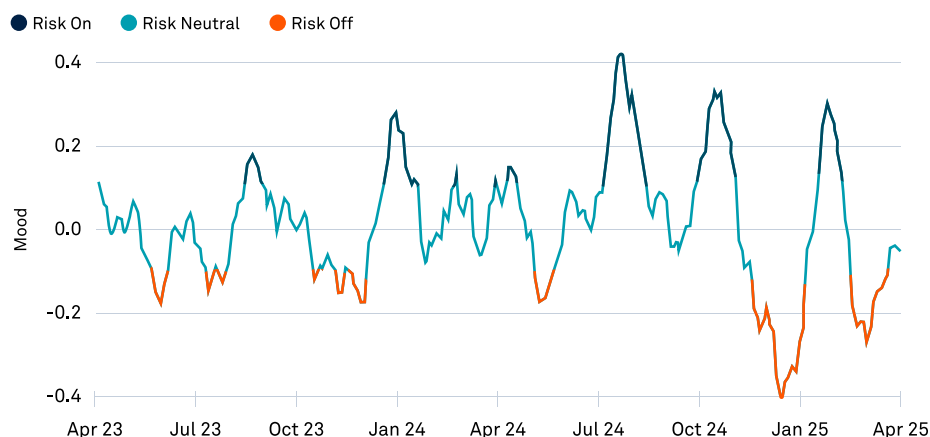
# 01

# Q1 INVESTOR TRENDS

Q1 uncertainty and unpredictability left many investors on the sidelines, confused and concerned. This led to a return to cash holdings in March. iFlow showed selling out of long positions in U.S. tech and fewer carry trades in emerging markets. Key events in the quarter include:

- Fiscal stimulus plans in APAC and EMEA countries resulted in steeper yield curves, particularly in Germany.
- Mood has reversed, with our iFlow Mood index dropping from extremely positive in January, at 0.5%, to extremely negative in March, at -0.3%.
- The biggest movers were in the U.S., with USD, U.S. shares and U.S. yields all reflecting doubts about U.S. exceptionalism.
- U.S. equities, particularly the “Magnificent Seven” technology shares, fell into correction territory, down over 12%, while Hong Kong’s Hang Seng index rose 23%.
- The biggest macro surprise came from Germany, where a new coalition government led by Chancellor Merz of the CDU changed its stance on the debt brake, favoring an increase in spending on defense and infrastructure. This seismic change, coupled with the shift by President Trump on Ukraine and plans for a ceasefire with Russia, led EU nations to move to increase defense spending.
- Euro Stoxx 600 rose by 12.5% and EUR rallied from 1.03 to 1.09.
- China’s “Two Sessions,” the country’s annual planning meeting, and the surprise success of the DeepSeek AI engine led China tech shares higher, raising hopes that the region and Chinese consumers had seen bottom.
- Emerging markets have varied in their response to Trump’s tariff plans, with the risk of economic stagflation pushed to Q2 and beyond.

## EXHIBIT #1: iFLOW MOOD



Source: BNY, WM/Refinitiv, MSCI

## Our Take

BNY's iFlow data highlighted significant rotational forces at play in portfolios. U.S. equity holdings fell back to near average, while Europe bounced back from 5% below average to 5% above. The 10% swing in the EU's mood was driven by the improved political situation following the German election and Trump's policy shift on Ukraine. Notably, the change in sentiment was not based on hard data, and that puts the burden on Q2 economic data to justify the new pricing of the EUR and EU equities. Asia was bought back to flat but continues to show regional bias, with money flows into China coming at the expense of India and other countries in the region. We can see that Indian shares linked to healthcare and infrastructure fell with small and medium-sized companies staging a rally back in March with foreign buying, while bigger tech names in China, like Alibaba and Tencent, gained with cross-border flows. The shift in mood reflected in U.S. flows and the bounce back in Asia and Europe can be seen in the iFlow Mood index, which is based on \$52tn that BNY touches through assets under custody or management.

JPY remains one place where investors have been less clearly involved, with the Japanese currency slightly overhyped as BoJ hikes are expected in June, but the role of politics in the quarter ahead looks to be significant. Similarly, GBP shifted from leader to laggard as growth and debt worries continue to plague the new British government. The U.S. dollar reversal can also be seen in the EUR, which saw positions go from significantly oversold and underhyped to overhyped.

## Forward Look

The quarter ahead will see a transition from de-risking to money being put to work.

**Looking ahead to Q2, we see a period of consolidation.** The quarter ahead will see a transition from de-risking to money being put to work. We see U.S. home bias and the risk of a return to U.S. exceptionalism until the data confirm significant slowdowns and faster Fed cuts. Markets are likely to see the actual implementation of tariffs as a relief even if they hit global growth and lead to one-off price hikes around the world. The rejiggering of the global supply chain and the focus of the rest of the world on sustainable growth without U.S. help will leave many focused on rates. Investors will be stuck balancing higher yields with hopes of higher growth in Europe, making asset allocation increasingly important. Actual inflation, whether from fiscally induced service demand or supply shocks from tariffs, will make curve steepening in Europe, China and the U.S. a key driver of risk. Volatility in both equities and bonds will be a critical tool for investors to use in determining allocation. The role of the USD will pivot on how U.S. policies on tariffs, taxes, deregulation and ongoing efforts to cut government spending affect the real economy.

# 02

# U.S. ECONOMIC OUTLOOK: UNCERTAINTY LEADS TO DISDAIN

At the end of 2024, we were expecting two rate cuts from the Fed this year, and we maintain that view. The deep decline in sentiment indicators – both business and consumer – has not (yet) been matched by similar weakness in the “hard” data. The Fed itself recently lowered its projection for growth this year from 2.1% to 1.7%, while the inflation outlook has deteriorated slightly, and two rate cuts remain the central bank’s rate scenario.

## Our Take

We continue to see an unprecedented level of uncertainty, and confidence in the economy has fallen sharply. The decline in equity markets so far this year reflects this reassessment of the outlook. We don’t expect uncertainty to ebb quickly. After tariff policy is finalized, the new administration will turn to fiscal policy and deregulation.

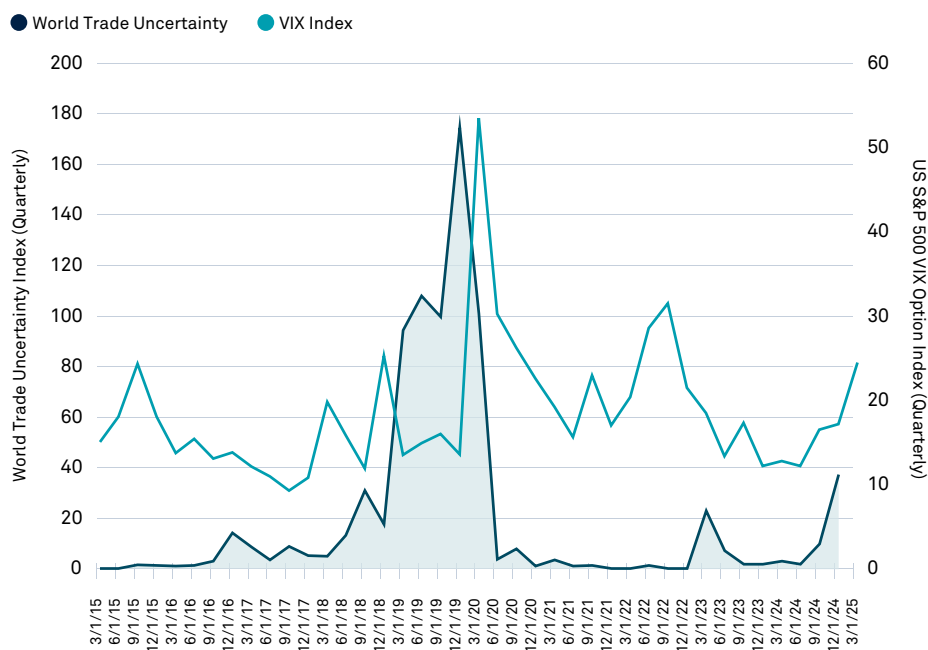
We remain concerned that tariffs will be disruptive to various sectors in the U.S. economy that depend on imports and act as a strain on consumers, who will face higher prices, at least in the short term. At its March meeting, the Fed acknowledged this likelihood. Nevertheless, the lower GDP projection of 1.7% would put U.S. growth only slightly below trend and represent a deceleration from the 2.5% y/y pace in 2024.

## Forward Look

Inflation remains elevated, and the Fed's forecast (with which we agree) calls for it to be above target for the year thanks in part to tariff-induced price increases. For now, however, the general view is that these price rises will be a one-time shock and not part of a persistent inflationary process. Nevertheless, there is a chance that if tariffs remain in effect for an extended period, higher intermediate and raw goods prices could lead to more sustained inflation. The question is, will the Fed prioritize what we expect to be tariff-induced weakness in the economy as a result of the trade war?

Benchmark bond yields have rallied from 4.80% to 4.20% since touching their highs in mid-January, and given the outlook we describe above we don't expect them to rise much beyond 4.5% in the medium term, given the marginally dovish Fed outlook and the rising risks to growth. Bear steepening was our call in December, and we did get quite a bit of that occurring across the yield curve through the first few weeks of the year. This yield curve steepening has shifted from bear to bull drivers as economic uncertainty puts the Fed rate cut path back into play in Q2.

## EXHIBIT #2: WORLD TRADE UNCERTAINTY AND THE S&P 500 VIX INDEX



Source: Bloomberg, BNY

# 03

## THE GREAT ROTATION

There will be even stronger home bias going forward. Our data show there is now a clear divergence between U.S. and international demand for longer-dated U.S. Treasuries. Foreign participation has been minimal in recent equity market moves in China and Germany relative to aggregate holdings. Our cross-border holdings of China equities are up 4.5%. This underperforms the Hang Seng China Enterprises Index, which rose nearly 19% in Q1. Outside of China, buying of shares was to get to benchmark rather than to overstretch long positions. The rally in the euro is best described as a removal of hedges, but this is due to prior extremities and the prospect of softer U.S. interest rates rather than any secular shift in valuations. Higher local yields will keep more savings onshore. Meanwhile, large public-sector investors in Canada, Europe and Asia-Pacific may declare their strategic intent to diversify away from longstanding U.S. exposures, and national governments will heavily incentivize their own private-sector investments to continue.

The ability of President Trump to forge new alliances around the world will be a new theme in Q2, and focusing on money flows due to Trump's policy shifts will be critical in the quarter ahead. There is a risk that money will stay at home and stop flowing to U.S. asset markets, as illustrated by our data and the headlines:

- Mark Carney, in his first speech as Canada's prime minister, spoke French and flew across the Atlantic to meet with EU leaders rather than visit the U.S. for his first overseas trip. Canada and the EU share two of the same concerns: re-arming within NATO and ongoing excess capacity in automotive manufacturing.
- Germany is directly engaged with China – as electric vehicles contribute to automotive capacity issues in Europe, too. The two countries are looking to cooperate on manufacturing electric vehicles for the European market.
- Despite material differences in strategic priorities and the baggage of history, China, South Korea and Japan held a trilateral foreign ministers' meeting in March, while Beijing and Tokyo decided to re-engage in their high-level Strategic Economic Dialogue for the first time in six years – all while South Korea, China and Japan work on closer economic ties.



The Bretton Woods system continues to break down and a new system looks impossible to achieve without the active participation of the world's largest economies. Smaller economies, therefore, have little choice but to pursue strategic autonomy. As Europe and China have shown, strengthening domestic fiscal impulse is the best way to offset the damage of overdependence on the U.S. For markets, financial realignment will prove more difficult than trade and strategic realignment: while the immediate response is to strengthen home bias by using savings to fund domestic investment, redirecting flows to new strategic partners will prove more difficult, especially while the dollar remains the world's reserve currency and the U.S. possesses the world's deepest pool of assets.

## Our Take

Even stronger home bias looms. The rally in the euro is best described as a removal of hedges, but this is due to prior extremities and the prospect of softer U.S. interest rates rather than any secular shift in valuations. Higher local yields will keep more savings onshore. Meanwhile, large public-sector investors in Canada, Europe and the Asia-Pacific may declare their strategic intent to diversify away from longstanding U.S. exposures, and national governments will heavily incentivize their own private-sector investments to continue.

## Forward Look

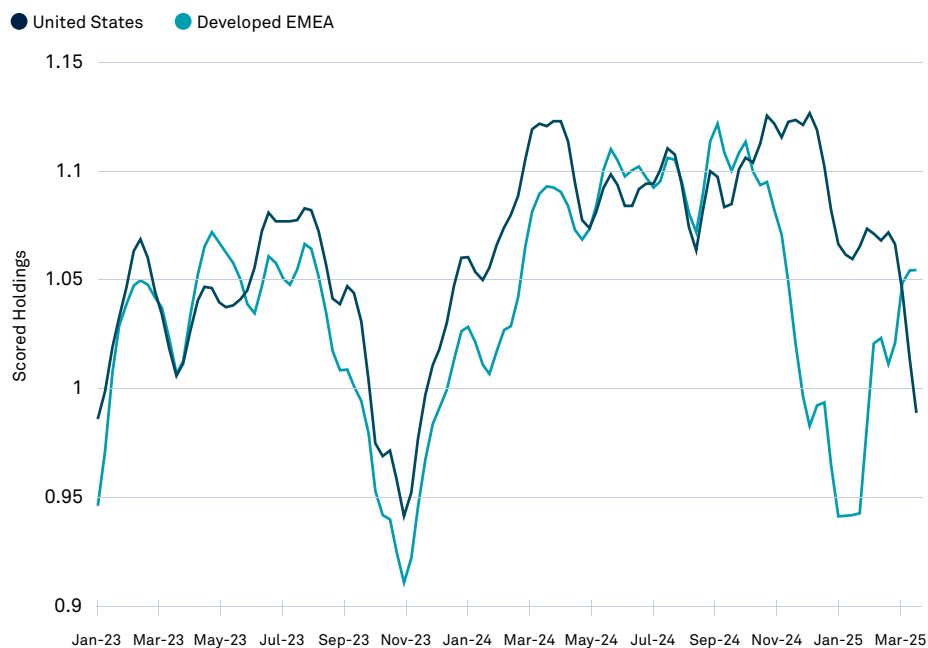
In March, Bank of England policymaker Swati Dhingra said the world is undergoing "orderly fragmentation...[but] serious price pressures [will materialize] in disorderly fragmentation." We believe that the world economy is heading toward increasingly less orderly fragmentation, but this is barely priced in markets. Simply put, cross-asset volatility can rise sharply. We see government bond yields of savings-heavy economies, especially China and Japan, moving into new and higher ranges. Equity markets will become increasingly volatile, leaving hitherto concentrated positions in U.S. technology heavily exposed, but non-U.S. markets can benefit from subsequent rotation. Foreign exchange volatility will also pick up due to central banks' inability to provide any guidance. However, in the worst-case scenario, full fragmentation may also cause a collapse in cross-border capital flows. France is already pushing for the EU's Anti-Coercion Instrument to be adopted, which will give the EU the legal authority to restrict financial market access to U.S. entities. Nothing is unthinkable in the new world order.

Simply put, cross-asset volatility can rise sharply.

Europe and APAC are going to see a re-rating by investors, both of their credit due to their borrowing needs and in their equity values as their potential growth shifts higher. The re-rating is likely permanent: Bund,

CGB and JGB yields will move to new ranges with higher yields – possible with the 10y Bund at 3% or the 10y JGB at 2% – and that shock and pain will be offset with higher equities as we no longer expect U.S. equities to have holdings spread over Europe (Exhibit #3). We also do not expect a comprehensive new currency and balance of payments accord between the U.S. and its key trading partners, referred to by some as a Mar-a-Lago Accord. Europe's surpluses will fall organically due to much higher levels of public investment, backed by Germany's fiscal resources and greater fiscal flexibility from the European Union. APAC economies will continue to take a skeptical view of any agreement that strengthens their own currencies, keeping in mind the experience of Japan after the Plaza and Louvre accords of the 1980s. Individual countries will accelerate plans to strengthen financial resilience and exposures to the dollar and the reach of the U.S., but the dollar will remain the primary reserve currency as it continues to suit all parties, including the U.S.

### EXHIBIT #3: EQUITY SCORED HOLDINGS, U.S. VS. DEVELOPED EMEA



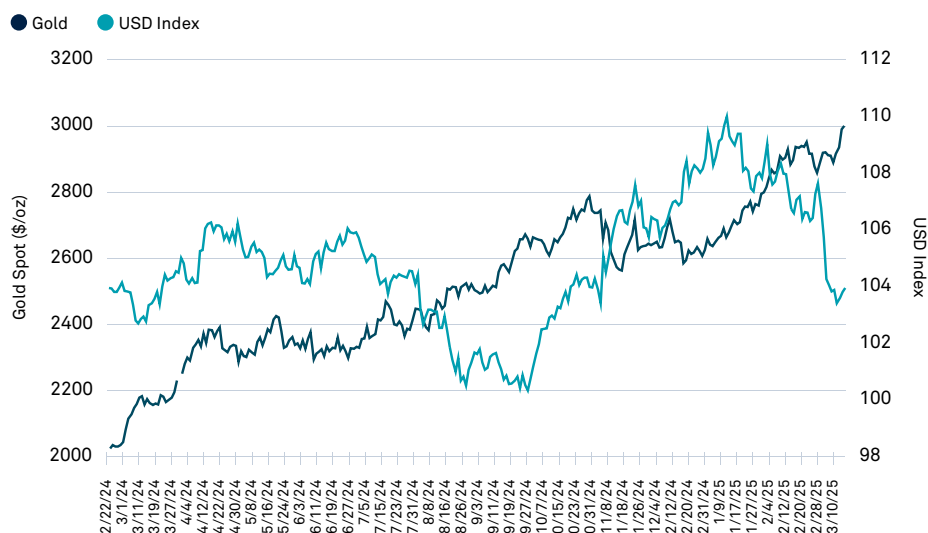
Source: BNY, MSCI, WM/Refinitiv

# 04

## ASSET ALLOCATION

iFlow showed the importance of safe havens in the first quarter, as seen in the spread between German and French government bonds. The search for safe, less volatile assets will drive Q2 allocation decisions, with USD alternatives, bonds vs. stocks and the role of credit all shifting. This puts asset allocation decisions at odds with the home bias proclivities of the first quarter. **The risk for Q2 is that cash gets put to work and that safe havens could lose their luster.** However, gold's rally to new highs suggests that doubts about fiat currencies will linger into Q2 and beyond. While gold has traditionally served as a reserve holding alternative for sovereign wealth funds and central bankers, Q1 buying included significant retail demand in the U.S. Gold ETF flows and physical gold deliveries in the U.S. bear this out. Other alternatives like Bitcoin (-10%) lost ground. U.S. bonds remain clearly less favored as the yield curve has positive – and as our flows show – significantly less bias to own duration everywhere. Nor did the focus on JPY and CHF as traditional alternatives to the USD work entirely. All of this suggests FX hedging isn't working, leading many investors to buy EU assets without hedging EUR in Q1. The role of U.S. bonds will also be called into question in Q2, as the level of yields has to reflect the ongoing doubts about debt sustainability, geopolitical risks from tariffs and the FOMC reaction to stagflation risks.

### EXHIBIT #4: GOLD AND THE USD



Source: Bloomberg, BNY

The risk parity performance in Q1 has stood out compared to trends, as neither bulls nor bears have done well overall.

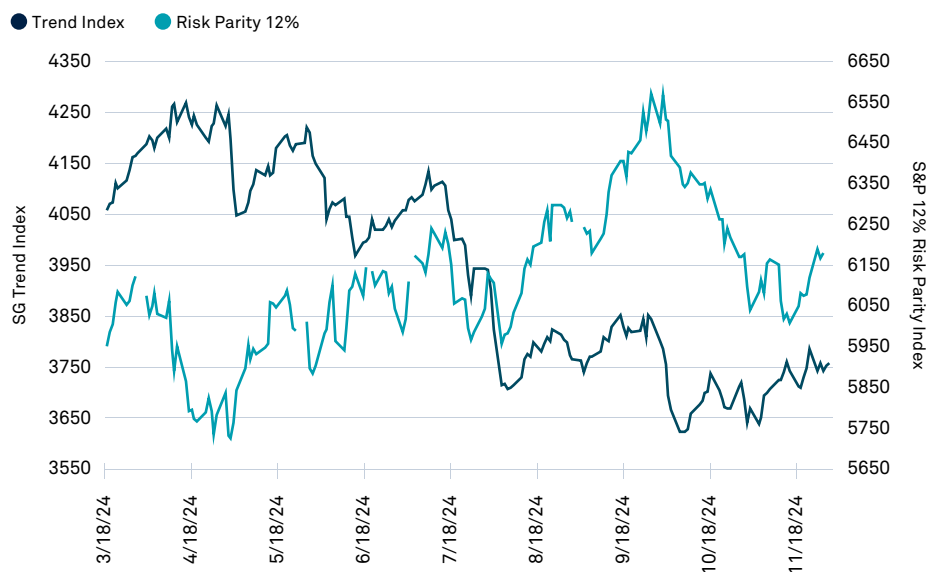
## Our Take

The role of cash and gold in portfolios is tactical not strategic. The level of volatility across markets is important for risk allocation. The risk parity performance in Q1 has stood out compared to trends, as neither bulls nor bears have done well overall. Risk parity allocates risk according to volatility, but that too has hit a limit. The rotational plays in equities have been uneven and global, leaving bonds more pinned to monetary policy despite ongoing fiscal worries. This shows up in iFlow, with equities volumes lower in Q1 and less interest in cross-border fixed income.

## Forward Look

The actual implementation of U.S. tariffs on April 2 will matter to all markets, particularly in how much surprise there is at the event. The size, scope and reach of reciprocal and other tariffs from the U.S. on global imports is going to link to expectations of future price shocks, growth and corporate earnings. The ability of the U.S. to negotiate lower tariffs bilaterally, increase U.S. reindustrialization and replace tax receipts will be critical to the response across markets via bond yields, the USD and equities. Most see the carry trade of U.S. exceptionalism cracking over the next quarter, depending on how the rest of the world responds. In the worst case, there will be trade wars and a race to the bottom in fiat currencies. In the best-case scenario, global trade becomes fairer and less costly, with more growth after a period of uncertainty and delayed investments. The lack of trends in 2025 makes volatility the first barometer for risk-takers, with safe havens requiring large liquidity to work.

### EXHIBIT #5: RISK PARITY AND TREND INDEX



Source: Bloomberg, BNY

## Bottom Line

The lesson of Q1 for investors was to stay close to home for risk.

The lesson of Q1 for investors was to stay close to home for risk. The problem is that opportunities are global, and the dislocation of value knows no national boundaries. We are most concerned that the real economy will catch up with the drop in sentiment in the U.S., while the rest of the world loses steam in the storm of tariffs. On the other hand, we are hopeful that tariffs will become clear enough for investors to put money to work and that other policies will support global growth. **The money on the sidelines and the mostly neutral positioning across markets set Q2 up for more volatility and more rotational trades.**

### BNY MARKETS FORWARD LOOK 2025 Q4

	GDP GROWTH (%)	POLICY RATES (%)	UNEMPLOYMENT (%)	CPI (%)
U.S.	0.9	4.0	4.9	4.4
U.K.	0.9	3.5	4.5	2.5
GERMANY	0.5	2.0	6.8	2.2
FRANCE	0.5	2.0	7.0	2.0
JAPAN	1.1	1.1	2.5	3.0
CHINA	4.4	0.8	5.0	1.5

# 05

## THE “FAB FIVE” MARKED- TO-MARKET:

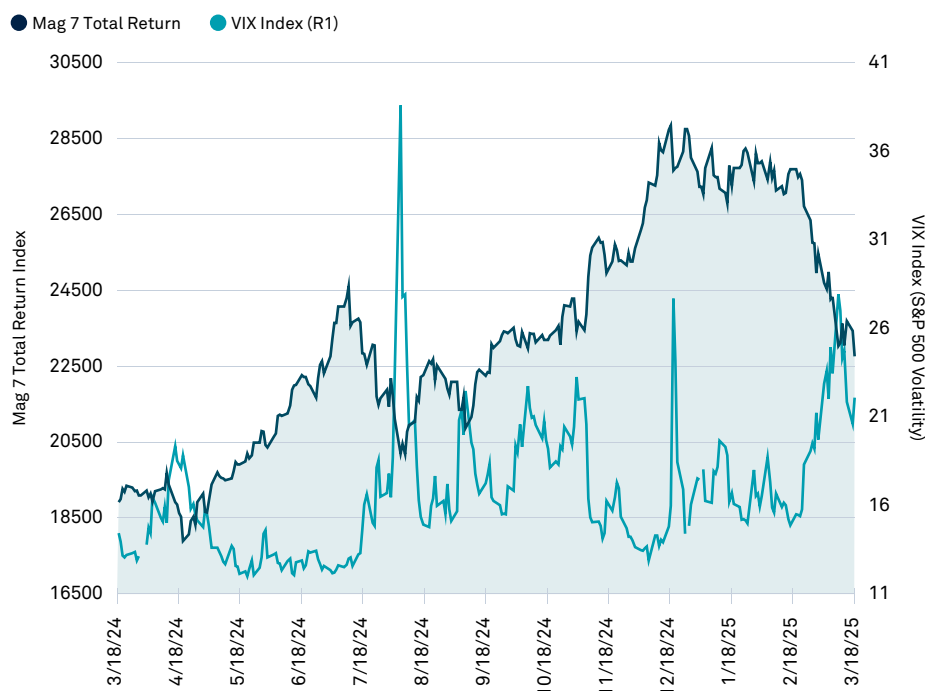
1. **The paradigm of U.S. exceptionalism has broken**, but the U.S. yield curve has not been a leading indicator of this shift. DeepSeek, the AI engine developed in China, the EUR bounce and the EU's spending plans combined to put a dent in the narrative of a superior U.S. It is not clear how long U.S. stocks will continue to underperform.

Now on a weaker bias than at the start of the year, USD will likely remain under pressure in the medium term. Potential stagflation is not a recipe for a stronger currency, and that's precisely the risk in the U.S. going forward.

2. **U.S. equities have corrected**, with both the NASDAQ and the S&P 500 in correction territory in Q1. The market correction was one of the five fastest ever, happening faster than we expected, and highlights the pace of change and role of volatility across markets linked to U.S. trade policy uncertainty. The key question for investors is: Will U.S. shares bounce back or continue to limp along?

iFlow Shorts, which aggregates short interest metrics that capture borrowing and lending behavior, shows less short positioning than in previous periods, and the rotational shifts are more about domestic vs. international plays than upside growth surprises. There is now a relationship between U.S. equity volatility and the ongoing unwinding of positions linked to IT, particularly the Magnificent Seven stocks. We expect this relationship to change and normalize in Q2. **Investors will return to trading a market of stocks rather than just a U.S. stock market.** The share performance of the other 493 companies in the S&P 500 will converge and micro factors like earnings and value will become more important for US equities.

## EXHIBIT #6: VIX VS. THE MAGNIFICENT SEVEN



Source: Bloomberg, BNY

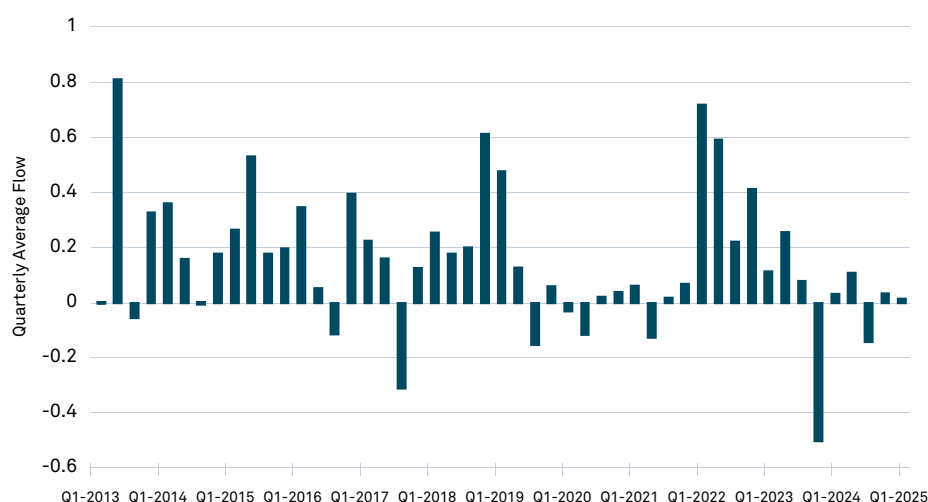
3. **USD peaked but will remain volatile.** One of our key calls for 2025 is that dollar valuations will peak, especially against DXY components, and by all accounts this already occurred in Q1. EURUSD and USDJPY should settle into new ranges, though tactically some recovery flow in the greenback is viable as current U.S. data do not yet warrant a serious downward adjustment of Fed expectations. Meanwhile, the rest of the world still faces the risk of stagflation, and the prospect of export losses to the U.S. will also negatively impact growth, despite the re-rating of the Eurozone and Chinese economies based on domestic factors. Even for some well-funded commodity-based economies with lower debt ratios, such as Norway and Australia, inflation expectations are being revised higher amid weaker growth outturns. In comparison, the dollar's growth-based fundamentals remain favorable and limit downside pressure on the dollar from asset rotation.

However, **the lack of outflows is very different from renewed inflows.** The dollar could stabilize at lower levels but is unlikely to reach its previous peaks. Policy execution risk and geopolitical realignment are already having a negative impact on external demand for Treasuries, especially in the longer dates (Exhibit #6), and the lack of yield support in the U.S. economy will deter new investment. Furthermore, greater fiscal impulse focused on domestic demand in Europe and the Asia-Pacific will lower

Home bias in these economies will rise naturally, especially as bond yields in Europe, Japan and China rise to far more favorable levels on a risk-adjusted basis.

surpluses, which normally would be supportive of the U.S. financial account. The greater risk now with global realignment is that U.S. creditors will slowly but surely engage in liquidation of U.S.-based holdings, both official and otherwise, to help fund domestic investment. Home bias in these economies will rise naturally, especially as bond yields in Europe, Japan and China rise to far more favorable levels on a risk-adjusted basis. We would not rule out a situation this year where 10-year Bund, CGB and JGB yields are collectively above 2% or higher, thereby supercharging surplus economies with a natural home bias. In equity markets, the lack of U.S. participation moves in Europe and Asia could also encourage greater outbound flows, and hedge ratios may even stay low if Fed rates are not high enough to compensate at the front end.

## EXHIBIT #7: CROSS-BORDER SCORED FLOWS INTO TREASURYS, 10Y+ MATURITIES



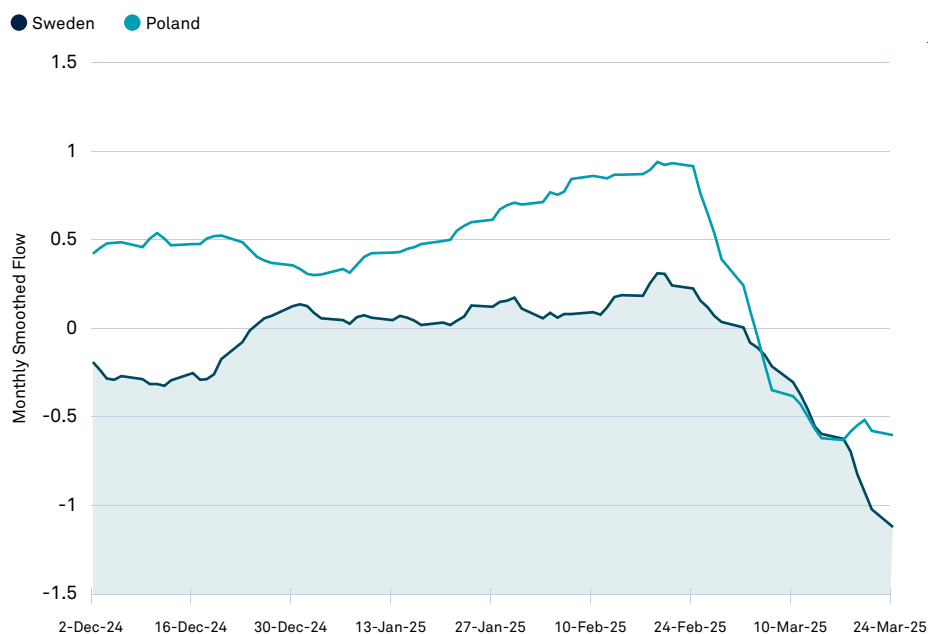
Source: BNY, WM/Refinitiv

4. **Germany has abandoned fiscal restraint, comprehensively re-rating European growth.** Domestic and foreign investors closing their equity holdings gap in developed EMEA markets relative to the U.S. was well within our expectations. Germany was fully on course, heading toward stronger fiscal impulse following the federal election in February. However, the seismic shift in Germany's assessment of the European security architecture has led to a comprehensive rethinking of national priorities. **The spending push is well above any prior expectations and as the funds are designed to stay in Europe, every economy linked to Germany's industrial chain will benefit.** For example, our data showed sharp inflows into Poland and Sweden, both of which are highly dependent on German demand. These changes will impact Germany's and Europe's potential growth for years to come. Europe now realizes this is the only way to build resilience against pressure from the U.S., Russia and China.



Europe's re-rating and higher potential growth, on top of supply challenges, mean that the ECB is comfortable with higher terminal rates. As such, we acknowledge that our prior expectations for quarterly ECB easing, which would keep euro valuations depressed, is not as viable. Our data show that hedges against euro weakness accumulated last year have fallen sharply, driving recent euro strength. However, we would not chase these gains in the currency further into Q2. Execution of fiscal plans will take time while growth challenges remain in much of Western Europe. Consequently, currencies and assets with a high beta to German fiscal and European defense impulse that have received surge flows of late, such as the SEK, PLN and defense stocks, could face holdings challenges. The sharp reversal in Swedish and Polish equities toward end-Q1 (Exhibit #8) is already a warning signal that re-rating in Europe has run its course in some areas.

## EXHIBIT #8: SCORED FLOWS INTO SWEDISH AND POLISH EQUITIES



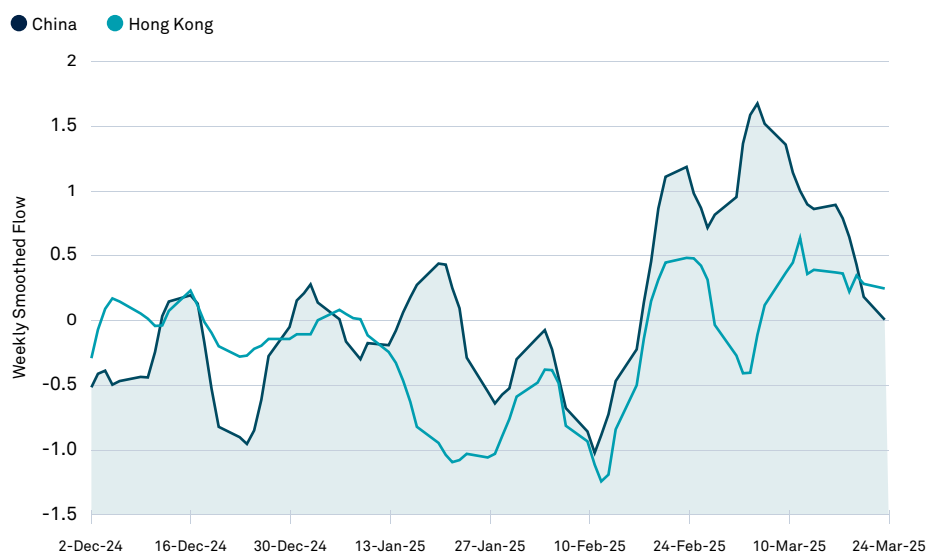
Source: BNY, WM/Refinitiv

5. **China: a fiscal arrow and an AI bazooka.** The hype around AI has helped to stabilize industrial doubts about EV, but the future play in China still requires consistent consumer stability – with a focus on jobs and wages. This was the clear emphasis at the National People's Congress and the additional 1 percentage point of GDP in fiscal impulse announced during the sessions is intended as a “downpayment” for the economy to achieve escape velocity. AI holds promise for productivity, but compared to much of the developed world, China's labor market is loose and there are fears that AI proliferation will add to household income pressure, in both in the public and private sectors. Much of China's industrial policy is seen as prioritizing

supply chain resilience and market share rather than earnings and margin expansion. Beijing's renewed embrace of private enterprise is welcome, but the government is very clearly focusing on the challenges surrounding domestic demand and price growth. We remain confident in our view that China can hit 5% GDP growth and further gains in the 10-year government bond yield toward a 2.75%-3.00% range are achievable, but equity markets could struggle up ahead if earnings growth and profits continue to disappoint in both industrial and consumer-driven sectors. Combined with less attractive valuations, China may also continue to struggle to attract external flows of a significant size. This will disappoint investors looking for an extension of the current rally and renminbi strength. **iFlow continues to point to hesitation in cross-border equity flows into the greater China region:** surge flows only commenced in the second half of February, after President Xi's meeting with key private-sector executives (Exhibit #9). However, cautious external demand would support our view that USDCNY will retain an upward bias due to policy differentials and reflation necessity.

Meanwhile, one of the standout features of re-rating in China is the failure of other "high China beta" asset markets to respond in kind. Perhaps due to the clear lack of emphasis on investment growth and bolstering (rather than simply stabilizing) the real estate market, APAC currencies have not rallied in kind, while AUD and NZD have struggled with their performance. On the other hand, for APAC economies to assert independence in their financial accounts rather than rely on Chinese, U.S. and Japanese growth is healthy over the longer term. While these economies need to brace for greater two-way volatility, such as we have seen in South Korea and Indonesia, the lack of cross-border spillovers signals a maturity in asset allocation, which should also comprise part of the new global investment order.

## EXHIBIT #9: SCORED FLOWS INTO CHINESE AND HONG KONG EQUITIES



Source: WM/Refinitiv, BNY



# iFlow

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