

“Everyone has a plan until they get punched in the mouth”* *Mike Tyson

Executive Summary

The sentiment regarding U.S. assets, particularly U.S. Treasuries, has turned bearish.

- Despite the prevailing pessimism among analysts, we remain confident in U.S. Treasuries' resilience amid market volatility. Although the yield curve may steepen, U.S. assets could not be sold off, supported by the government's fiscal flexibility and a robust central bank with capacity to intervene if needed.
- In synthetic credit, some interesting dislocations have materialized since "Liberation Day."

Who Dares to Dictate Trump's Policy ? The Treasury Market Did!

Following "Liberation Day," the partial rollback of global tariffs to "just" 10% on April 9th marked a pivotal moment. Initially, the reintroduction of tariffs on April 2nd triggered widespread sell-offs not only in risk assets but also in traditionally safer havens such as U.S. Treasuries and the U.S. dollar. The market shock was largely alleviated when President Donald Trump announced a return to the 10% tariff level, citing progress in trade negotiations.

However, the decision to reduce tariffs appeared abrupt and was, in all likelihood, more directly influenced by the weak pricing action of the U.S. 10-year Treasury auction (T 4 5/8 15-Feb-2035) held on the same day.

On April 2nd, when tariffs were announced, U.S. 10-year yields initially tightened, dropping from 4.20% to as low as 3.85% over the following two days. At that point, U.S. Treasuries were still perceived as safe-haven assets. However, sentiment began to shift ahead of the April 8th auction. The fiscal trajectory of the U.S. deficit and its debt could be unsustainable if tariffs send the U.S. into a recession. At this time, some analysts increased the probability of a recession to [50%-65%] within a year. Market chatter intensified around potential retaliatory measures, particularly from China, including the sale of Treasuries held within their foreign exchange reserves.

It is worth highlighting that the U.S. dollar currently accounts for 58% of global FX reserves (totaling \$12.4 trillion), mostly invested in U.S. assets, primarily Treasuries. In the run-up to the auction (T 4 5/8 15-Feb-2035), the yield increased from its lowest point on the 4th to 4.5% just a few hours before the 10-year auction; an increase of +66 basis points over three days. This is the biggest move of the century!

Fig.1: 3 Hours – Candlestick Chart of UST 4.625% Feb-2025 (auctioned on 9th of April)



Source : Bloomberg, Selwood AM France

For Professional / Institutional / Accredited Investors Only

Selwood AM views and opinions are subject to change without notice

Selwood AM view and opinions are for illustrative purpose and not to be construed as investment advice

Significant pressure had clearly been mounting, prompting the U.S. administration to underscore the issue to President Donald Trump. This led to his decision to reduce the reciprocal tariff rate to 10% for a period of 90 days. Later that day, during a press conference, President Trump added the following: *"I was watching the bond market. That bond market is very tricky. I was watching it. But if you look at it now, it's beautiful. The bond market right now is beautiful. But yeah, I saw last night where people were getting a little queasy."*

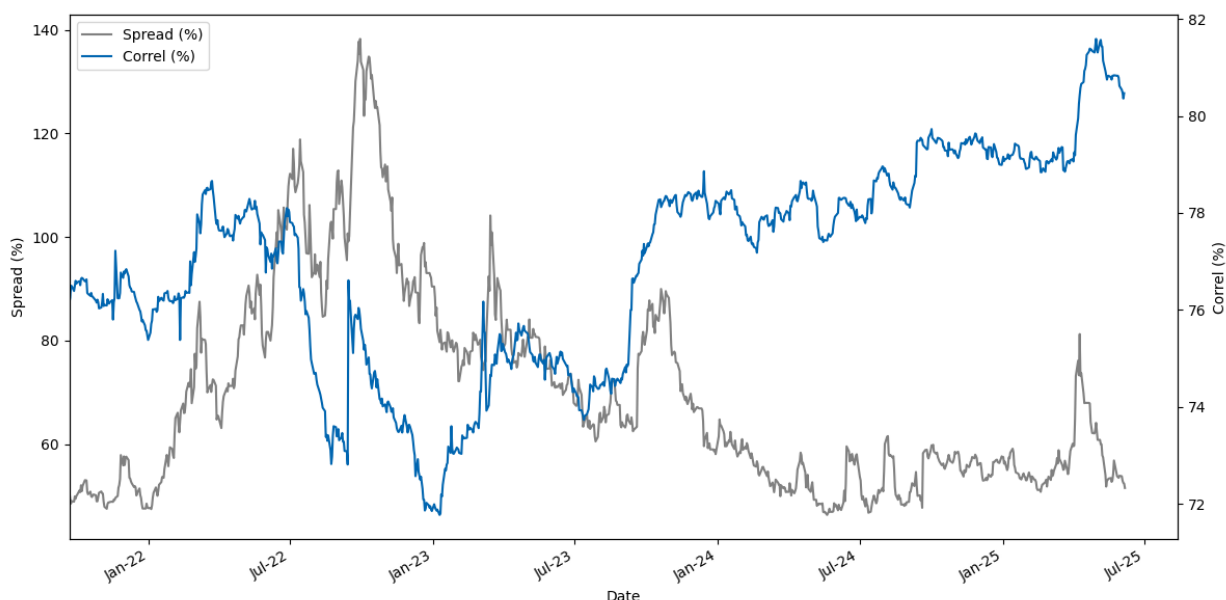
While this decision triggered a rally in equity markets and credit spreads, the bond market faced headwinds as it had to absorb a 20-year Treasury auction on the 10th. On the following day, the 10-year yield peaked at 4.58%. Both the U.S. dollar and bond markets remained under pressure, particularly due to concerns surrounding the proposed "Beautiful Bill," which could potentially add trillions to the national debt.

Patience often pays where momentum fades.

Since "Liberation Day," market behavior has been marked by elevated cross-asset correlations. On the synthetic side, iTraxx tranches have come under significant pressure, with implied correlations rising back to levels observed in 2020.

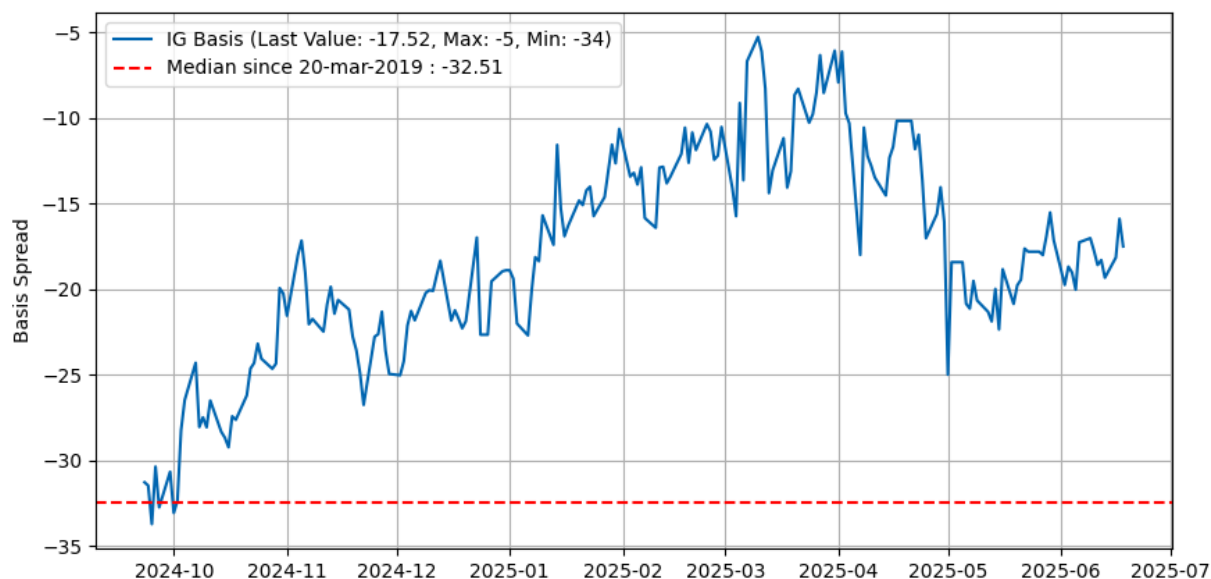
Beyond individual name spreads, correlation is a key driver of tranche pricing. An increase in correlation implies that defaults are more likely to occur together, shifting value toward senior tranches. Conversely, a decline in correlation indicates greater idiosyncratic risk, increasing the relative value of junior tranches, which are particularly exposed to the widest names.

Fig.2: iTraxx Tranche Spreads and Implied Correlation (2022-2025)



Source : Bloomberg, Selwood AM France

This time was no different, and this behavior was particularly pronounced in iTraxx indices, which are more volatile than their cash equivalents (see Fig. 3) due to their strong liquidity. In the early stages of such shocks, such as the announcement of tariffs, markets often struggle to assess issuer-specific impacts, leading to synchronized widening across CDS names and, consequently, a rise in implied correlation. Correlation increased from ~79% to ~82% between February and May.

Fig.3: Synthetic / Cash Index Spread Basis Over Time


Source : Bloomberg, Selwood AM France

With the iTraxx peaking at approximately 85 on April 9, 2025, flows were directed towards junior tranches, which offered very attractive returns at that time. However, with the iTraxx now returning to the mid-50s, the risk-reward profile has become less compelling, reducing the rationale for holding junior credit risk.

In May, the market largely reversed the previous widening, and the basis (Fig. 3) began to normalize. However, this is not entirely true for super senior tranches, as correlations remained elevated, above 80% (see Fig. 2). We observe a degree of asymmetry in market behavior. In a truly “systemic risk” environment, currently priced on the correlation side, financials and particularly banks, would be expected to lag during a recovery phase, yet they are currently leading. In this context, we believe correlations might return to their “pre-Liberation Day” levels in the high 70s. If certain sectors, such as the automotive sector, or issuers begin to suffer from the impact of tariffs, correlations could decline much further. In our view, this presents a particularly asymmetric risk for consideration, as the correlations appear ‘mispriced’ while banks demonstrate fundamental systemic robustness, bolstered by responsive central banks.

On Financials, May confirmed that European banks are navigating the rate cut cycle from a position of strength: profitability is solid, capital robust, and credit quality resilient. The market rallied after April’s volatility, supported by stable fundamentals and strong demand for bank paper. Regulatory tailwinds (e.g., potential FRTB delay) are credit-positive, though emerging risks like U.S. Section 899 withholding tax proposals may introduce new uncertainty for cross-border structures and funding. Ongoing M&A activity across Spain, Portugal, and Italy added a new layer of complexity and opportunity to the investment landscape. For now, the backdrop remains constructive on European Banks, with fundamentals and technicals both supportive.

Selwood AM France Investment Team - 19.06.2025

This material is not intended to be relied upon as a forecast, research, or investment advice and is not a recommendation offer or solicitation to buy or sell any securities or to adopt any investment strategy.

If you wish to know more about our **#ESG Credit (Article 8)**, **#Tail Hedge**, **#Long Only**; **#Solvency II Solutions** and **#Financials & AT1**. Please feel free to contact us for any further information at paris@selwoodam.com

Disclaimer

Monthly Letter. Selwood Asset Management France SAS ("Selwood") is providing this monthly commentary solely at the request of and for the exclusive use of the recipient (the "Recipient") in its capacity as the investment manager.

Purpose and Non-Reliance. The monthly letter is provided to the Recipients who are sophisticated investors, being professional clients, eligible counterparties, accredited investors or qualified purchasers. The monthly letter is provided to the Recipient for the limited purpose of providing the Recipient with information relating to the performance and the risk profile of the Fund as at the date specified therein and/or for the purposes of discussion with Selwood only. The monthly letter is not intended to provide and should not be relied upon as any form of accounting, legal or tax advice or investment recommendations. The Recipient should consult its own tax, legal, accounting or other advisors about the issues contained herein. The Recipient should refer to the risk factors set out in the Fund's prospectus and supplement.

Carry. Any references to "carry" are intended to refer to a specific performance computation. Carry and theta would correspond to expected performance in a 12 months' period. Certain assumptions are used to calculate "carry", such as no trading and all market parameters staying intact, which may have inherent limitations. Accordingly, the estimated carry and performance is not reliable, is not exhaustive and represents subjective views of Selwood. Please also refer to the Risk Factors listed in the Fund's prospectus and the supplement. Note also that any estimates are gross and do not include the deduction of fees and trading costs.

Accuracy of Information. The figures, estimated figures, projections, views, charts, calculations and other information (the "Information") contained in the monthly letter is indicative only and are provided as at the date specified therein.

Information related to any net estimated returns is based on unaudited, internally prepared assessments of the performance of the Fund's portfolio by Selwood and have not been independently verified or confirmed. The net estimated returns are subject to adjustment as a result of items such as changes or delays in Selwood's or the Fund's administrator's calculation of the profit and loss of the portfolio in whole or in part and/or Selwood's assessment of the month-end value of any one or more of the financial instruments in the Fund's portfolio. Any such adjustments could have a material impact on the estimated net returns, including a change from a positive monthly net return or year to date performance estimate to a negative monthly net return or year to date performance estimate.

Market views presented herein, including any forward-looking statements, are reasonably held by Selwood as at the date hereof but are subjective and have not been independently verified. Market pricings assume. These are not intended to and do not constitute financial or investment advice.

Selwood is not under any obligation to update or revise this monthly letter or any specific Information (including, without limitation, the estimated net returns or carry) contained therein or to correct any inaccuracies, whether as a result of new information, future events or otherwise.

No representation, warranty or undertaking, express or implied, is given as to the fairness, correctness, accuracy or completeness of the Information or the models used in preparing such, opinions or any forward-looking statements contained in the monthly letter by any of Selwood, or its respective members, employees or affiliates (together "Selwood Parties") and no liability is accepted by such persons for the accuracy or completeness of any such information or opinions, and nothing contained herein shall be relied upon as a promise or representation whether as to past or future performance.

Use of Models and Simulations. Certain information contained herein is derived from simulations or models. Methodologies and models used by Selwood are just some among alternative other methodologies that could be used, and such can produce different results. Neither the simulations, nor the models have been independently verified. The derived information is therefore based on certain assumptions which may be subjective and may not necessarily be reflective of reality.

Distribution and Non-Solicitation. The monthly letter is not intended, and must not be construed, as an offer of, or a solicitation of an offer to purchase, any investments in any jurisdiction where such offer or solicitation would be unlawful. The distribution of the monthly letter may be restricted in certain jurisdictions. It is the responsibility of any person or persons in possession of this monthly letter to inform themselves of, and to observe, all applicable laws and regulations of any relevant jurisdiction. Please refer to the country-specific disclaimers in the prospectus and the supplements of the Fund.

External Market Conditions. The current global market conditions are exceedingly impacted by the Russia/Ukraine conflict and the continuing uncertainty around COVID-19 which creates unprecedented volatility and could last for an extended period thus adversely affecting the Fund's performance and liquidity.

Solvency II (SCR). No representations or guarantees as to compliance with Solvency II are being made by Selwood. Prospective and existing investors need to complete their own analysis of Solvency II requirements.

Confidentiality. Selwood is distributing this monthly letter to the Recipient only. The monthly letter is strictly confidential and may contain proprietary information of Selwood. It may not be reproduced, distributed or published by any Recipient for any purpose without the prior written consent of Selwood.

Selwood. Nothing contained herein shall be deemed to create any obligations or commitment on the part of Selwood or any of the Selwood Parties. Selwood is acting solely as an arm's length contractual counterparty to the Fund and not as the Recipient's financial advisor or fiduciary. To the maximum extent permitted by law, none of the Selwood Parties shall be liable (including in negligence) for any direct, indirect or consequential losses, damages, costs or expenses arising out of or in connection with the use of or reliance on the monthly letter. By accepting a copy of the monthly letter, the Recipient agrees to be bound by the foregoing limitations and conditions.

Selwood Asset Management (France) SAS is registered in France (884 339 839 RCS) with its registered office at 40 rue du Colisée – 75008 – Paris; and is authorised and regulated by the Autorité des Marchés Financiers (AMF) (GP-21000006).