GENERALI ASSET MANAGEMENT

Market Perspectives

Tectonic Shifts

March 2025

GenAM Macro & Market Research

'Market Perspectives' provide our monthly macro & market outlook and investment recommendations

- **US-Russian peace talks on Ukraine and the erosion of US security guarantees for Europe are amplifying the global tectonic shifts from US tariff threats.**
- **President Trump's hawkish trade talk may be testing our assumption that he will want to avoid large negative supply shocks. So far markets have not lost faith (non-US stocks up, USD down). Political uncertainties in Germany are receding and a substantial fiscal boost to defence is in the offing.**
- **Yet US surveys are sending warning signals on growth and disinflation amid US policy turmoil. The risk of a wider trade war keeps a lid on sentiment.**
- **We maintain a prudent risk exposure, via IG Credit and a small overweight in Equities. We prefer US duration medium term but see two-sided risks for US yields short term. Higher fiscal spending in Europe has led us to trim the long duration in € fixed income.**

Content

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Global View – Tectonic Shifts

Thomas Hempell

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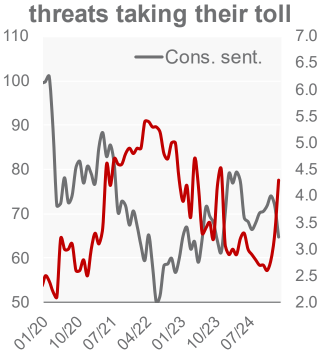
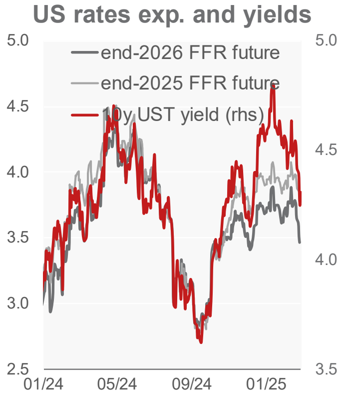
An unrelenting barrage of Trump's decrees and announcements continues to unsettle US institutions and the world order, with the start of direct peace talks with Russia causing consternation in Europe. Yet markets are looking at the bright side, hoping for lower energy prices, a boost to sentiment and reconstruction gains from a potential peace in Ukraine. We deem a quick solution to the conflict rather unlikely given Putin's upper hand on the battlefield and Europe's reluctance to ease sanctions. And even for Trump there will be limits on the pain of peace conditions he can impose on Ukraine and Europe. Nevertheless, hopes for a 'deal' will remain alive – with a 30% drop in European gas prices already a tangible benefit for European industry.

US cons. sentiment: tariffs threats taking their toll



Source: Univ. of Mich., Datastream, GenAM

US rates exp. and yields



Source: Datastream, GenAM

European markets also appreciate receding domestic political uncertainty. The French government has survived a 2025 budget vote. And German elections are set to result in a more stable two-party government. Prospective chancellor Merz seems keen to bring forward a heavy special fund to boost defence spending with the help of pre-election majorities in parliament. The fast erosion of US security guarantees for Europe may trigger swift EU action for raising military spending and cooperation, with even joint funding an option. This may partially offset the tailwinds to European Fixed Income from ECB rate cuts and easing inflation, but also bolster European risk sentiment and the EUR.

10-Year Gvt Bonds	Current*	3M	6M	12M
US Treasuries	4.31	4.30	4.20	4.00
Germany (Bunds)	2.45	2.40	2.30	2.20
Credit Spreads**				
EA IG Non-Financial	85	85	85	85
EA IG Financial	90	90	90	90
Forex				
EUR/USD	1.05	1.04	1.04	1.05
USD/JPY	149	148	146	145
Equities				
S&P500	5965	5995	6115	6350
MSCI EMU	181	179	183	192

**3-day avg. as of 26/02/25 **ICE BofA (OAS)*

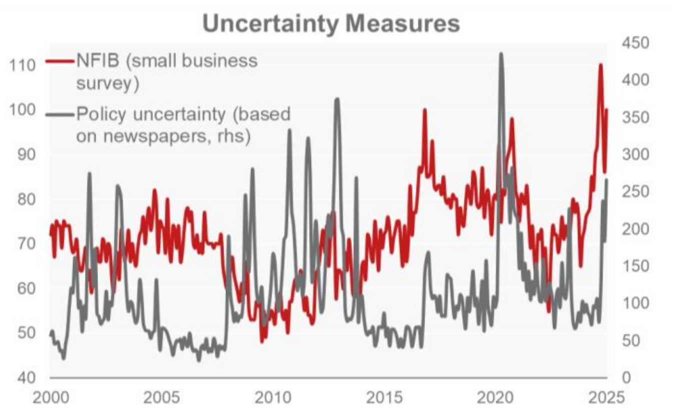
In the US, by contrast, slumping housing activity and contracting PMIs have questioned the sustainability of US exceptionalism. Stagflationary fears over US tariffs have left their mark on consumer sentiment (left chart). Markets have added a full Fed rate cut for 2025 to their expectations, sending US yields lower (right chart). We acknowledge downside risks to our 2.4% 2025 US growth forecast from Trump's tariffs but still think that robust labour markets will keep US growth solid and exceeding most European peers.

Trimmed long duration bias for Europe

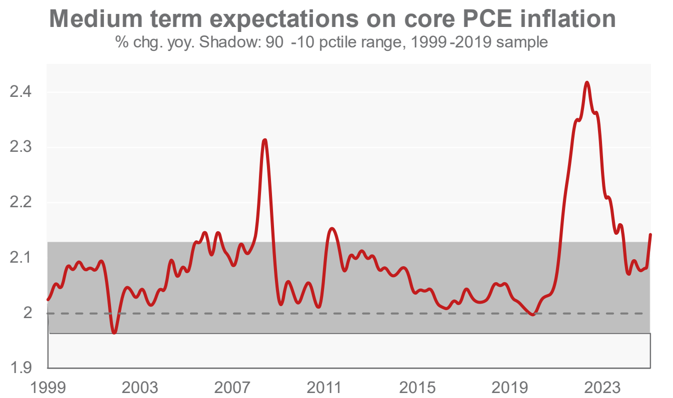
We maintain a moderate pro-risk stance in the portfolios amid a still favourable backdrop of solid global growth, further disinflation (especially in the euro area) and ECB and Fed rate cuts. We continue to expect Trump to proceed cautiously with the actual implementation of tariffs as soaring inflation may backfire in next year's mid-terms. Still, we keep our risk exposure notably to Equities prudent on lingering risks of a trade war. In Fixed Income, we stick to our old/structural preference for IG Credit, if only for carry. Admittedly, spreads are already tight. But to a large extent this also reflects the waning appeal of Govies amid stretched fiscal prospects, which is mirrored by even negative asset swap spreads ("tighter for longer"). We favour US duration over 6-12m but see US yields subject to two-sided risks short term. The prospect of higher fiscal spending in Europe makes us trim our long duration bias for EUR bonds.

United States

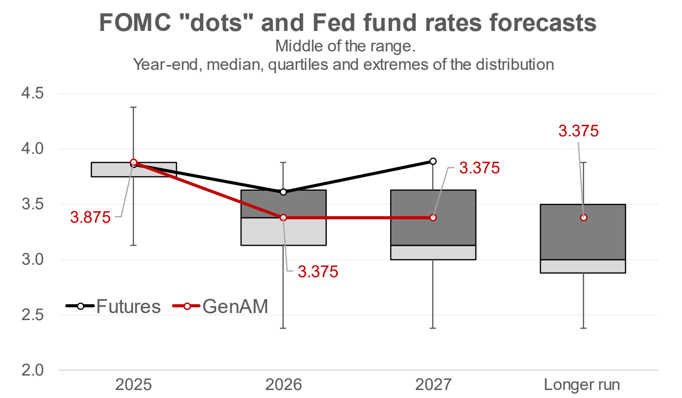
Paolo Zanghieri



Source: NFIB, policyuncertainty.com, GenAM



Source: Federal Reserve Board, GenAM



Source:Federal Reserve Board, Datastream,GenAM estimates

- **We expect GDP to grow by 2.2% ann. in Q1, as consumption remains strong. Our 2.4% forecast for 2025 carries downside risks as policy uncertainty could drag on domestic demand.**
- **December and January price data disappointed. Core PCE inflation should decrease more meaningfully in H2, to a still high 2.5% by year-end. Assuming sharp tariff increases can still be avoided, inflation may recede sluggishly further.**
- **The Fed is set to pause at least until June or July. We still see two rate cuts this year, but risks are tilted to a more limited action. We expect QT to end in June.**

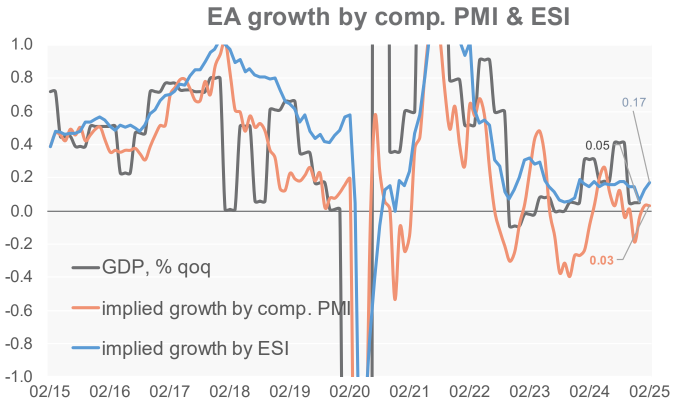
Bad weather and wildfire disrupted economic activities in several areas creating volatility in data. Yet, consumption remains strong, backed by solid labour income growth, and we expect it to lead annualised growth to above 2% in Q1. Our baseline forecasts has GDP up by 2.4% this year, but risks are increasingly tilted to the downside: the large downward revision in fixed investment in the second GDP release is a warning that still high borrowing costs are a threat to domestic demand. The sharp increase in uncertainty related to the announced policies on trade may dampen hiring and investment, and expectations on tax cuts later in the year may not be enough to full offset the negative impact on demand. Moreover, the consumers' fatigue signalled by surveys may materialise faster, also given the very low saving rate. Strong demand is preventing a fast disinflation, as wage growth remains sustained and pricing power strong. CPI data for January show that inflation in services remains very strong (4.2% yoy, ex housing). The weakening in consumer surveys observed in the last few months owes a lot to the upward revision in expected inflation. Our index shows expectations at the upper end of the pre-pandemic period range, with some concerning upward pressure. We expect core PCE inflation not to move much from the current 2.6%-2.7% range until the summer and it should end 2025 at 2.5%, with risks tilted to the upside even under our expectation of only mild tariffs.

Fed pauses rate cuts until H2

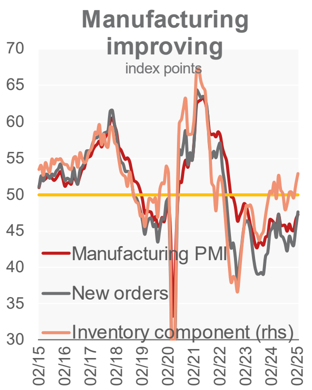
The minutes of the January meeting and the following statement by FOMC members showed a unanimous conviction that the Fed is in no rush to further cut rates. Our expectations of two rate cuts this year is broadly in line with market pricing, but risks are tilted to one or even none this year. We expect QT to end in June, as bank reserves remain abundant. However, balance sheet runoff could stop a bit earlier as by July/August the Congress must pass the debt ceiling increase. We do not expect surprises, but caution may lead to a pause.

Euro Area

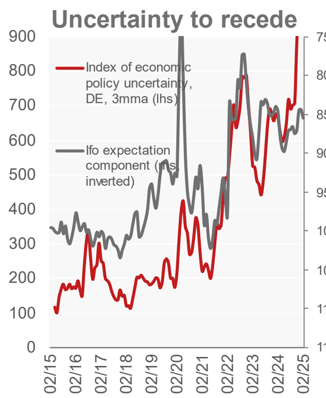
Martin Wolburg



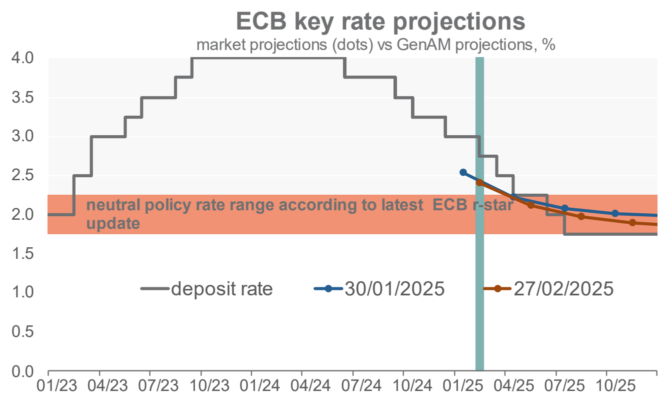
Source: Datastream, GenAM



Source: Datastream, GenAM



Source: Datastream, GenAM



Source: Datastream, ECB, GenAM calculations

- **February data back our view of a slowly recovering economy with manufacturing sentiment further improving from a cyclical low.**
- **Receding political uncertainty after the German election and the perspective of higher EU fiscal (military) spending should also lift expectations.**
- **The ECB will cut its key rate by another 25 bps to 2.5% in March as inflation appears on track towards target and we continue to see further cuts ahead.**

The data over the past month all in all back our view of a slowly recovering economy. In February, sentiment stabilized at levels consistent with moderate expansion (see top chart). Hard data for the first quarter are not yet available but it seems as if the recovery will be based on a sounder footing. Manufacturing sentiment (PMI) advanced further reaching the highest since May last year. With new orders up and a push from inventories (new orders minus stocks of purchases) ahead, we see good chances that the recession in the manufacturing sector finally comes to an end. Also, the German elections likely result in a more stable two-party coalition (of conservatives & socialists) thereby ending soon the political limbo following the government breakdown in November. The perspective of another big EU-wide military spending package should also help to lift the mood.

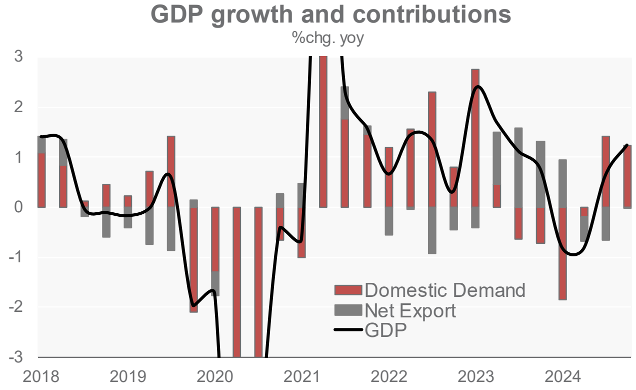
Huge uncertainties still surround our forecast. The emergence of a trade war (25% US tariffs on EU imports, EU retaliation) stands against a possible end of the war in Ukraine. For the time being we therefore stick to our view of a clearly sub-par growth rate of 0.8% in 2025, below the 1.0% consensus.

ECB heading well into neutral territory

There is overall agreement that at its March 6 meeting the ECB will cut its key rate by another 25 bps to 2.5%. That said, the discussion at markets and within the Governing Council (GC) is shifting towards where the landing rate of this easing cycle will be. Updated inflation projections will likely stay consistent with the view of inflation being on track to reach target again and we see potential for the growth outlook to be revised down. While this would support further rate cuts, various GC members have more recently hinted that the direction of travel at current key rates become less clear and warned about too much easing. We expect the ECB to stick to its data-driven, meeting-by-meeting approach with emphasize on prevailing uncertainties (e.g. tariffs). While leaving the door for further rate cuts open it will likely also communicate that the degree of policy restriction has significantly come down. We continue to look for further rate cuts but see the risk that our expected landing rate of 1.75% will not be reached by July already.

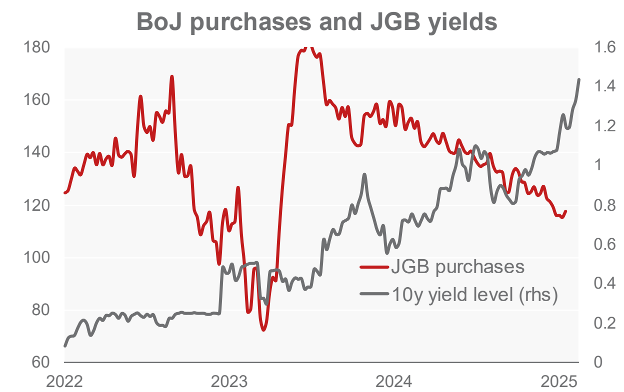
Japan

Paolo Zanghieri



Source: Cabinet Office, GenAM

Source: Bank of Japan, GenAM



Source: BoJ, GenAM

- **Domestic demand is leading to unusually strong GDP growth, backed by healthy real wage dynamics. We expect 1.1% growth for 2025.**
- **Food and energy prices have lifted inflation around the turn of the year. Risks are tilted to persistently high inflation.**
- **We expect the BoJ to raise rate once more this year, most likely in July. A further hike is possible should inflation risk materialize.**

The strong Q4 performance of the economy (1.2% yoy, 2.8% qoq. ann.) was mostly due to the pick-up in domestic demand. Despite gloomy surveys consumption continues to grow in line with the pre-pandemic trend. The additional boost to income from the latest round of wage negotiation will ensure support and the economy should continue to grow at around 1.1% this year (from 0.3% in 2024). The strength of the economy is for the moment offsetting the worries about US trade policy: in January, the composite PMI rose to 51.6, with a strong showing by the manufacturing sector

Food and energy prices (respectively +5.1% and +10.8% yoy in January) pushed up again inflation in January, but the core rate rose solidly too, to 2.3% yoy as the lagged effect of the Yen depreciation and increasing labour costs are increasingly be felt. If protracted, the latter could contribute to inflation stickiness.

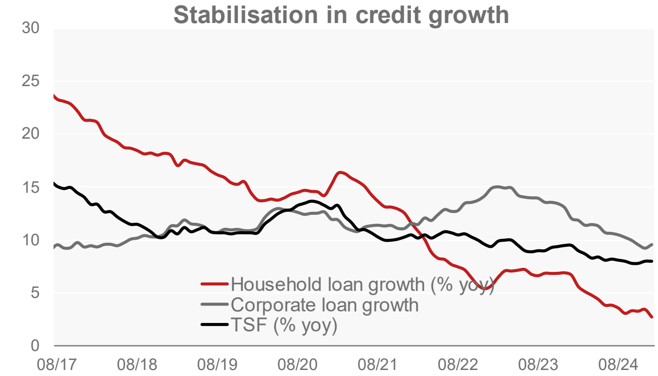
Small upward risk for policy rates

The risk of inflation getting entrenched amid solid activity data, would step up the pressure for the BoJ to raise rates. We still expect another hike in July, with a final one around mid 2026 bringing the policy rate to the estimated neutral 1% level. Risks are marginally tilted to a more frontloaded action. First, sticky inflation may require monetary policy to turn outright restrictive. Second, as emphasised by a board member, the economy has likely underwent a structural transformation and the fast pace of growth may be hinting at a higher neutral rate. However, the BoJ strategy of engineering a high-pressure economy, backed by solid wage dynamics, is bearing fruit on domestic demand, calling for moderation in rate increase.

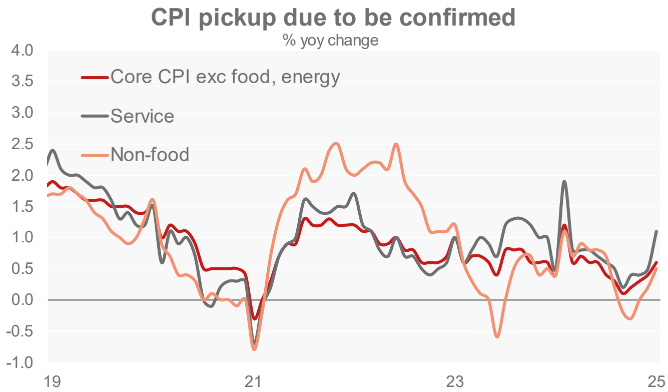
Higher estimates of the natural rate can be behind the upward grinding of long-term rates. Governor Ueda warned that the BoJ might step up bond purchases in case “abnormal” market moves lift sharply yields, but this does not seem the current situation as macro data and policy expectations are consistent with the yields behaviour.

China

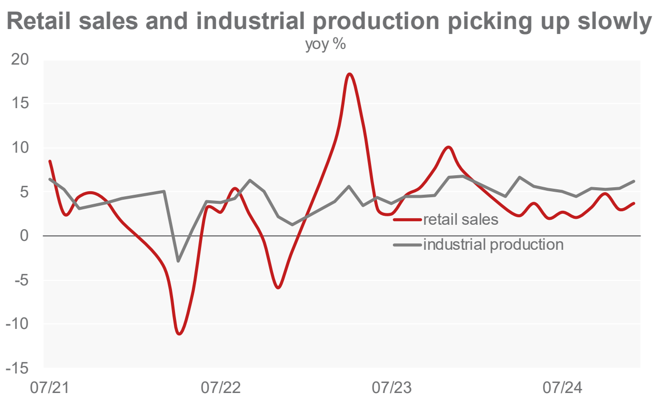
Guillaume Tresca



Source: Bloomberg, PBoC, GenAM



Source: Bloomberg, NBS, GenAM



Source: Bloomberg, NBC, GenAM

- **Improvements have been noticeable on several fronts but the recovery must be sustained and be confirmed. China is not out of the deflationary trap.**
- **The third annual session of the NPC on 5th March will be key, providing details on the awaited fiscal stimulus and other supportive measures.**
- **Retaliation to the tariff hike has been modest so far, but the risk is still for escalation, as the US may step up their tariffs on China further.**

There have been gradual improvements on several fronts, supporting hopes that the economy has probably bottomed out and fueling animal spirits in equity markets. The 2024 stimulus has so far been sufficient to stabilise the economy. The recovery is still fragile, China is not out of the deflationary trap and the property market is still in a difficult situation, but at least the situation is better than it was a few months ago. One unexpected change is the recent symposium on private enterprise hosted by President Xi, which sent a supportive message to the private sector, giving a boost to risky assets. Still, more stimulus is needed and the upcoming National People's Congress (NPC) on 5 March will be key. The growth forecast should remain stable at around 5% and the long-awaited new fiscal measures, amounting to 2-3% of GDP, should be announced. The risk is to the downside as policymakers may be slow in react to trade disruption triggered by a possible escalation in US tariffs. We also expect announcements on technology investment in strategic industries.

Better economic indicators to be confirmed

Economic indicators have continued to improve, and the Chinese New Year holiday has shown a further recovery: first, retail sales accelerated to 4.1% in January, supported by the government's short-term replacement scheme. Second, new home sales in major cities are stabilizing, as are prices in tier 1 cities. Downward pressure remains in second-tier cities. Third, total social financing surprised to the upside. Finally, core CPI rose more than expected but remained low. PPIs stabilized at -2.3%. Yet seasonality may have played a big role and further evidence on the improvement is needed

Tariffs: waiting for new announcements

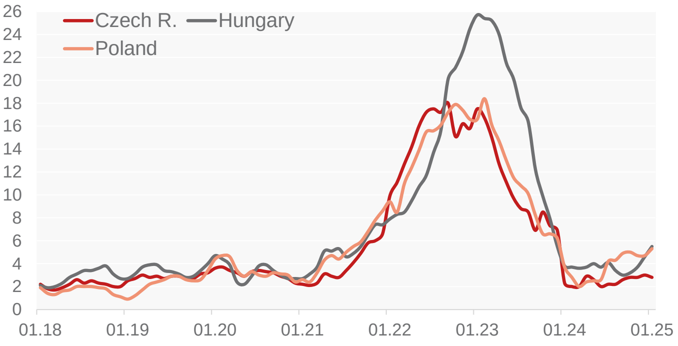
Retaliation to the 10% tariff was modest, targeting only USD 14bn or 8.5% of Chinese imports. China appears willing to engage in trade talks. However, the risk of escalation is real, as President Trump threatened another 10pp increase in tariffs.

Central and Eastern Europe

Radomír Jáč

Headline inflation

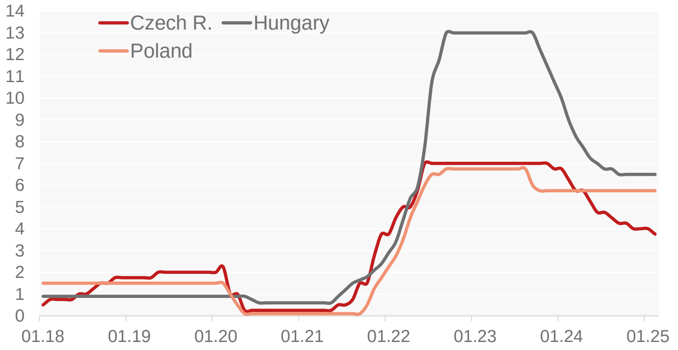
CE-3 countries (CPI yoy in %)



Source: www.czso.cz, www.ksh.hu, www.stat.gov.pl, GenAM

Monetary policy interest rates

CE-3 countries (end-of-month level, in %)



Source: www.cnb.cz, www.mnb.hu, www.nbp.pl, GenAM

Main Forecasts

Czech Republic	2023	2024e	2025f	2026f
GDP	0.1	1.0	2.0	2.4
Consumer prices	10.7	2.4	2.4	2.0
Central bank's key rate	6.75	4.00	3.00	3.00
Hungary	**2023**	**2024e**	**2025f**	**2026f**
GDP	-0.8	0.6	2.5	3.3
Consumer prices	17.6	3.7	4.8	3.6
Central bank's key rate	10.75	6.50	6.00	5.00
Poland	**2023**	**2024e**	**2025f**	**2026f**
GDP	0.1	2.8	3.5	3.3
Consumer prices	11.4	3.7	4.3	3.0
Central bank's key rate	5.75	5.75	5.00	4.00

Source: www.cnb.cz, www.mnb.hu, www.nbp.pl, GenAM

- **GDP growth was solid across the region in Q4, with Poland outperforming. The CE-3 GDP growth may accelerate in 2025, mainly due to fixed investment.**
- **Czech annual inflation eased slightly in January, while Hungarian and Polish CPI accelerated more than expected. Inflation should moderate in H1.**
- **The Czech CNB cut rates in February: we expect the next move in May, but the CNB forecast signals even faster easing. Higher CPI suggests that Hungary will hold rates steady in H1 and Poland is a similar case.**

The CE-3 countries recorded solid GDP growth at the end of 2024. Czech GDP rose by 0.5% qoq in Q4 and by 1% for the entire year 2024. Hungary also reported the Q4 GDP growth at 0.5% qoq, with full-year growth coming in at 0.6%. Poland was an outperformer with the Q4 growth at 1.3% qoq and a full-year growth at ca. 2.8% (our estimate for a seasonally adjusted figure). GDP growth in the region is likely to accelerate in 2025. The main driver of faster growth should be domestic demand, due to consumption and revival of gross fixed capital creation co-financed by EU funds.

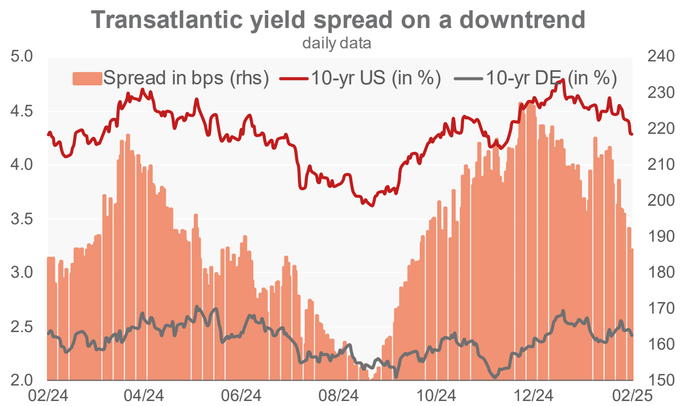
The inflation picture was mixed in January. The Czech CPI eased from 3.0% yoy to 2.8% yoy: energy prices were the key driver of the decline. While headline CPI came in above expectations, core inflation was lower than the CNB expected, and inflation should ease further in H1. Headline CPI in Hungary jumped from 4.6% yoy to 5.5% yoy, well above expectation. While the annual inflation is likely to ease in H1, the faster price growth is likely to stop the MNB from cutting rates before summer. Polish inflation rose from 4.7% yoy to 5.3% yoy and is likely to assure the MPC in its opinion that there is no need to rush the resumption of rate cuts.

In H1, only the Czech CNB will likely reduce rates

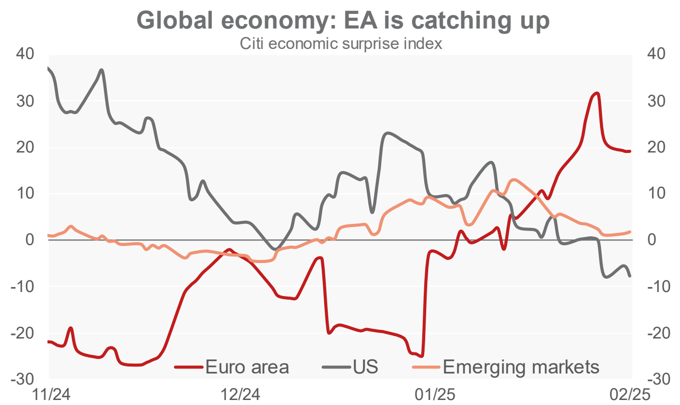
In early February, at its first monetary meeting of the year, the Czech CNB cut its key rate by 25 bps to 3.75%. The new forecast, presented by the CNB staff, expects the key rate to fall to 3% by Q3. However, the CNB Board indicated that its policy easing can be slower. We expect rate cuts by 25 bps per quarter in 2025, the next one in May. In Hungary, the MNB kept the base rate at 6.50% in February (the last rate cut by 25 bps came in September). The high January CPI suggests that the MNB may keep rates unchanged throughout H1. We expect rate cuts to resume in Q3, assuming that disinflation will prevail in H1. Poland left its key rate at 5.75% so far in Q1 after keeping it on hold through 2024. The NBP will present a new forecast at its March meeting, however, there are clear signs that policy easing could resume in July at the earliest.

Government Bonds

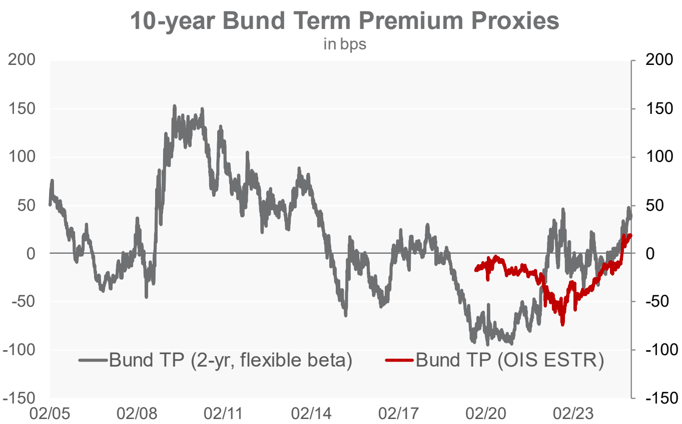
Florian Späte



Source: Bloomberg, GenAM



Source: Bloomberg, GenAM



Source: Bloomberg, GenAM

- **The transatlantic government bond yield spread continued to narrow in February. While Bund yields declined only slightly, US yields continued to fall markedly.**
- **Given the expected additional defence spending in Europe, we are adjusting our forecast for EA long-term core yields and expect only a moderate further decline in yields over the next 12 months. This implies that the transatlantic 10-year yield spread will move almost sideways over the course of the year.**
- **EA non-core government bond spreads moved sideways in a narrow trading range in February. The somewhat reduced political uncertainty in France following the adoption of the 2025 budget had little lasting impact. We expect spreads to widen only slightly in the coming weeks.**

The narrowing of the transatlantic spread that began in December continued in February. While Bund yields were little changed across all maturities, US yields continued to decline. The overall small movement in EA core yields was due to several opposing factors. The economic picture in the EA has brightened recently. Although still at a low level, momentum has improved somewhat, reinforcing our view that the EA economy has bottomed out and will gain some momentum in the coming months. Nevertheless, inflation expectations have declined moderately. We attribute this mainly to the recent decline in energy prices.

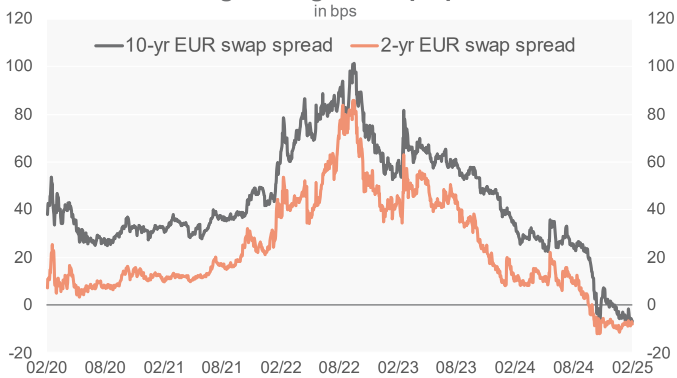
However, the main reason for the decoupling of European government bond markets from the US one has been recent political developments. First, hopes for a lasting peace in Ukraine and the associated positive economic stimulus and an early end of the ECB cutting cycle have supported yields. Second, there has been a growing recognition that European countries need to significantly increase their defence spending.

At this stage, it is still unclear how much additional spending will be required for each country. Nor is it clear to what extent the available, not yet utilised resources at European level will be used. Even the issuance of new joint bonds by European institutions - similar to the NGEU to dampen the economic and social burden of the Covid pandemic - seems possible at a later stage, alongside national borrowing. This is also the context in which the debate on reforming the German debt brake, which gained momentum after the German election, should be seen. While the forthcoming government does not have the necessary two-thirds majority in the parliament, at least another special fund (probably worth € 200bn) is a realistic alternative. All in all, we assume

Government Bonds

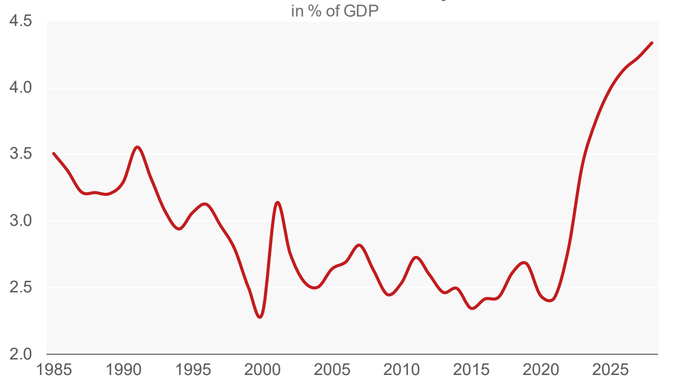
Florian Späte

EA: Tightening of swap spreads



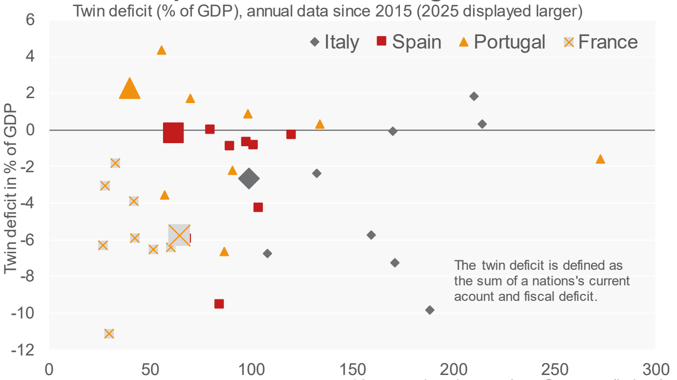
Source: Bloomberg, GenAM

US: Government interest expenditure



Source: Datastream, GenAM

Markets penalise France for high twin deficit



Source: Datastream, GenAM

that an additional 1% of increased defence spending will imply an additional annual supply of government bonds of at least € 150bn on an EA level.

This comes on top of the € 850bn net-net government bond issuance (including the ECB's QT) we estimate for 2025 and represents a significant additional burden on the EA bond markets. It will be reflected in a further increase of the term premium. It is also likely that government bonds will continue to become cheaper relative to swaps. Accordingly, we have raised our yield forecast and now expect a moderate decline of the 10-year Bund yield to 2.20% on a 1-year horizon.

This means that the 10-year transatlantic spread is likely to tighten only lightly over the course of the year. The sharp decline of almost 50 bps in 10-year US yields since mid-January is unlikely to continue in the short term. In fact, the Fed rate cuts priced in by the market for 2025 are now slightly higher than ours (62 bps versus 50 bps). Despite the recent softening of economic data, we still believe that the US economy is robust. Finally, inflation expectations have corrected to a reasonable level (5-year-5-year forward: 2.45%). Overall, we expect 10-year US yields to fall to 4.00% on a 12-month horizon.

Meanwhile, Japanese government bond yields continue to move independently. The yield on the 10-year JGB has risen by a further 15 bps month-on-month. Given the ongoing economic momentum and further BoJ key rate hikes, we expect Japanese bonds to continue to develop contrary to other global bond markets. Over the next 12 months we forecast the 10-year JGB yield to rise to 1.50% (currently: 1.40%).

EA non-core bonds unaffected by political turmoil

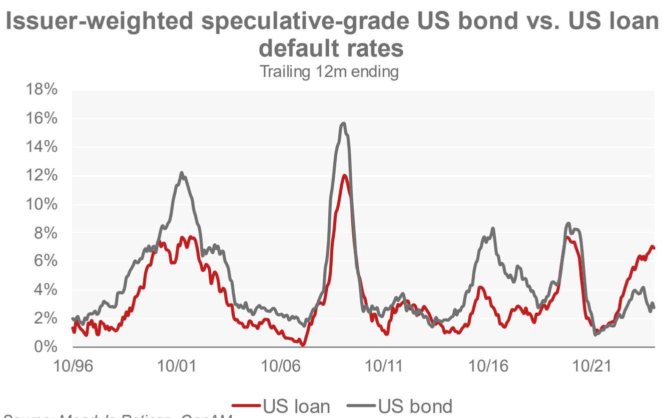
Spreads on EA non-core government bonds remained in calm waters in February. The slightly better economic news flow, the prospect of further ECB rate cuts and a smooth absorption of new supply (among others, the new Italian retail bond BTP Più collected € 14.9bn) have so far outweighed possible negative factors (e.g. US tariffs). Despite the recent slight improvement in the performance of French OATs following the adoption of the budget, we continue to advise caution due to the tense fundamental and the uncertain political situation.

Higher defence spending poses serious financing problems, especially for those countries that are in a particularly tight budgetary situation and/or have the greatest need to catch up in terms of defence spending. However, if debt were to be issued at the European level (see above), this would likely improve risk sentiment and even contribute to a further narrowing of spreads, affecting all EA non-core countries.

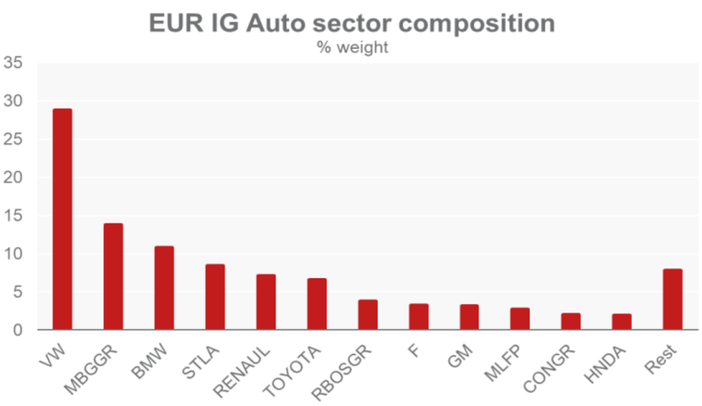
Credit

Elisa Belgacem

Source: Bloomberg, BofAML indices, GenAM own calculations



Source: Moody's Ratings, GenAM



Source: Bloomberg, BofAML indices, GenAM own calculations

- **The persistently strong demand for credit, coupled with anticipated further decreases in central bank rates, supports our long position in investment-grade (IG) securities.**
- **Despite high yield (HY) underperforming IG in spread terms since this summer, the carry remains elevated. We maintain a slight overweight in HY, bolstered by an improving default outlook.**
- **Cyclical sectors, particularly Autos, continue to face pressures. We recommend a defensive sector positioning through the end of the year.**
- **We remain neutral non-financials over financials.**

In recent weeks, credit spreads have tightened significantly due to lower supply during the reporting season. However, demand remains elevated as investors are drawn to the high all-in yield, particularly with the expected decline in yields on monetary products.

Still long Autos

Rating agencies have begun to adopt a cautious stance on the most cyclical European companies, either by downgrading ratings or revising outlooks downward. This is especially evident in the Automobile sector, where the transition to electric vehicles, intense competition from Chinese manufacturers, and sluggish demand from China are creating significant challenges. Yet investors have been chasing the market laggards and we expect it to continue, hence we remain overweight on the sector despite the challenges.

Spreads are less appealing but carry still is

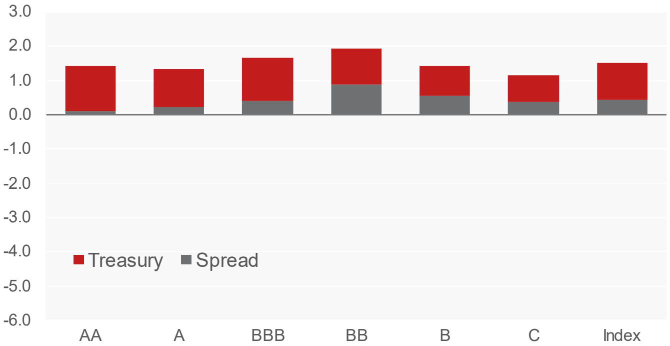
We expect stable credit spreads over the coming months, keeping carry elevated. Valuation considerations also lead to a preference for Europe over the US. We prefer long IG and subordination risk to pure HY, but keep a slight HY overweight. With HY defaults declining but fundamentals under slight pressure, we like leveraged IG to enhance credit returns. While extending duration may not be favorable from a spread perspective, our constructive duration view justifies a long position, especially in the 5-7 year bucket. AT1 has been the best-performing asset class within credit so far this year. Despite limited spread tightening potential going forward, we continue to favor AT1, particularly versus single-Bs.

EM sovereign bonds

Guillaume Tresca

External debt: positive monthly return

Return since 17/01, EMBIGD, %



Source: JP, Bloomberg, GenAM

Expected positive return despite spread widening

12M TR for different rate and spread scenarios, Dgov index

	OAS spread	US 8Y 4.13%	4.23%	4.33%	current 4.43%	4.53%	4.63%	4.73%	4.83%
	119	15.8%	15.1%	14.4%	13.7%	13.0%	12.3%	11.6%	10.9%
	139	14.4%	13.7%	13.0%	12.3%	11.6%	10.9%	10.2%	9.5%
	159	13.0%	12.3%	11.6%	10.9%	10.2%	9.5%	8.8%	8.1%
	179	11.6%	10.9%	10.2%	9.5%	8.8%	8.1%	7.4%	6.7%
	199	10.2%	9.5%	8.8%	8.1%	7.4%	6.7%	6.0%	5.3%
current	219	8.8%	8.1%	7.4%	6.7%	6.0%	5.3%	4.6%	3.9%
	239	7.4%	6.7%	6.0%	5.3%	4.6%	3.9%	3.2%	2.5%
	259	6.0%	5.3%	4.6%	3.9%	3.2%	2.5%	1.8%	1.1%
	279	4.6%	3.9%	3.2%	2.5%	1.8%	1.1%	0.4%	-0.3%
	299	3.2%	2.5%	1.8%	1.1%	0.4%	-0.3%	-1.0%	-1.7%
	319	1.8%	1.1%	0.4%	-0.3%	-1.0%	-1.7%	-2.4%	-3.1%

Source: Bloomberg, GenAM calculations

Ukraine: market based probability for a peace deal

probability in % based on Ukraine $ 2034 and 2035 bonds*

Source: Bloomberg, GenAM

** probability basedon the pricing of a full trigger of the embedded GDP option in Ukraine $ 2035 bond (98% prinicpal reinstatement and discount rate at 10.5%) vs the valuation of Ukraine $ 2034*

- **We maintain a cautious stance given the tariff related risk and geopolitical uncertainty. That said, the outlook has turned more constructive.**
- **EMs macro fundamentals have been resilient, and the China situation has stabilised.**
- **We still favour external debt over local debt and IG over HY. A Ukraine deal would be a game changer, supporting local debt and especially CEE FX.**

We maintain our cautious stance on our global allocation, given the risks ahead in terms of escalating tariff hikes and geopolitical uncertainty. The recent acceleration of peace talks in the Ukraine war shows that geopolitics is fluid and can have a significant impact on EM assets. Nevertheless, risks have diminished slightly, and the outlook is more constructive. EM assets have so far been resilient to new US policies, with even local debt outperforming and EM FX rebounding. Indeed, EM macroeconomic fundamentals are more solid than in 2018, with external vulnerabilities reduced and economic activity indicators barely declining. China has shown signs of stabilisation and fiscal support will be announced at the March NPC meeting. Against this backdrop, we continue to expect positive returns for EM fixed income, driven by high carry and positive duration effects.

External debt: positive return despite tight valuations

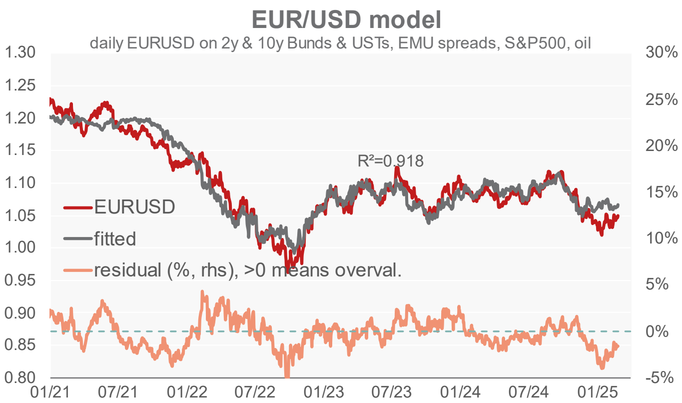
The return on external debt has been positive, largely driven by the fall in Treasury yields, but spreads have also continued to tighten. Valuations are extremely tight by historical standards and even low-rated buckets offer limited value. External debt remains our preferred asset in an uncertain environment. We also favour IG over HY globally. Indeed, EM IG continues to lag US IG and BBBs are cheap. We are neutral on Romania and move to neutral on Mexico. EM HY has become unattractive versus EM HY. There are still pockets of value and we like Morocco, Colombia and Serbia. Regionally, a Ukrainian deal could be very positive for CEE, especially Hungary and Kazakhstan. However, the market probability is already at a high level.

Local debt: preference for CEE rates

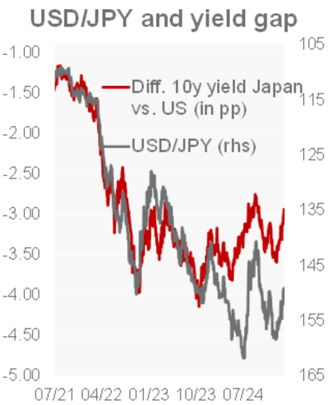
Light positioning and long USD unwinding positions have supported local bonds. We remain defensive, especially on FX given the tariff risks, and prefer EM rates, especially in CEE. A Ukraine deal can be a game changer, with EM FX being the most sensitive assets and then EM rates. CEE would benefit the most, but globally it would be positive for all EM assets via lower energy prices, more dovish central banks and a stronger EUR.

Currencies

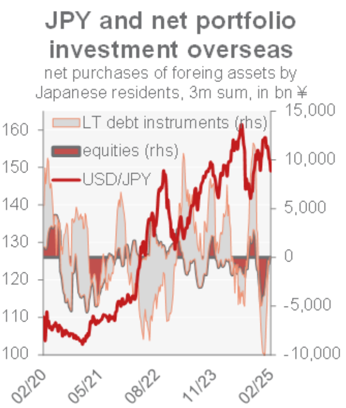
Thomas Hempell



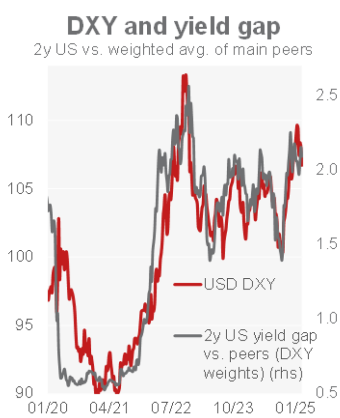
Source: Datastream, GenAM calculations



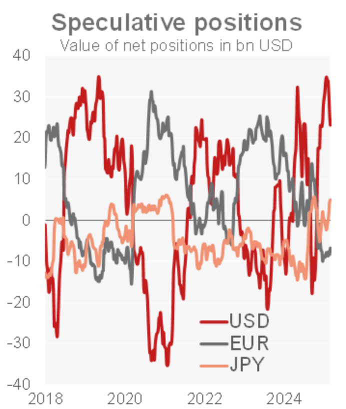
Source: Datastream, GenAM calculations



Source: Datastream, GenAM



Source: Datastream, GenAM



Source: CFTC, Datastream, GenAM

- **The sizeable US yield advantage and growth outperformance will keep the USD underpinned. Yet, we are turning more cautious on the greenback.**
- **Recent US data point to a potentially more visible growth deceleration, while falling UST yields have been a headwind too.**
- **Hopes of a peace deal for Ukraine and the scope of a boost to defence spending by Germany's new government and European partners may render some further support for the EUR.**
- **This support now largely outweighs the USD-bullish risk of an intensifying trade war, keeping the outlook for the EUR/USD roughly balanced for now.**
- **We anticipate some further JPY strength in the medium term, with risks of short-term pullbacks after the recent rally.**

The USD remained on the backfoot in February amid doubts about the duration of US growth exceptionalism, and falling US yields. Looking ahead, we still see the USD bolstered by solid US growth and its marked yield advantage vs peers. But our short-term outlook is turning from moderately bullish to fairly neutral. Trade worries keep lingering (incl. 25% levies on EU) but Trump has thus far refrained from a swift implementation of punitive tariffs, except a 10% levy on Chinese goods (threatened to be raised further). Several measures have been merely deferred, and reciprocal tariffs are looming for April. The delivery on these threats still ranks top among the USD-bullish risks we have in our books.

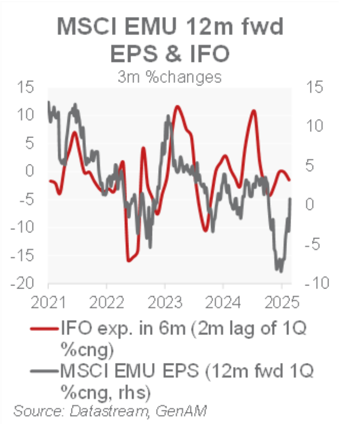
Lowered US yield forecasts (see Bond section) dent the USD's appeal. The JPY is a key beneficiary and further BoJ hawkishness and repatriation flows may add to the JPY's support (mid charts). The Japanese Government Pension Investment Fund (GPIF) is set to finalize its 5-year strategy review March and may further raise domestic allocation targets. We lower our USD/JPY 3m forecasts to 148 and see the risks to our 12m forecasts (145) tilted to the downside.

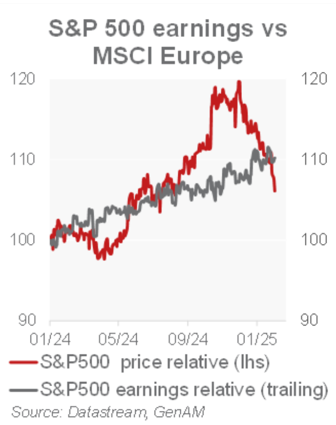
EUR bolstered by Ukraine peace hopes and fiscal plans

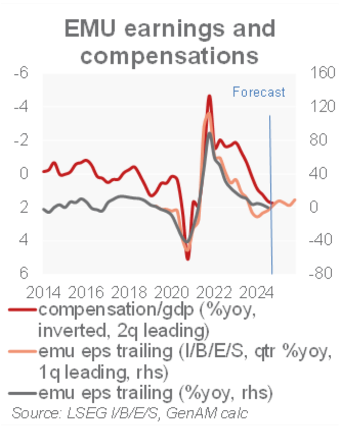
General market relief on Trump's thus far muted tariff implementation has helped the EUR. The Q4/24 rise in the EUR discount (measured as moves beyond levels implied by other key financial variables, see top chart) reflected tariff worries. Ukraine piece hopes and some tariff fear relief helped to cut the EUR discount. A likely stable two-party German government, the scope for a sizeable increase in defence outlays and potentially even jointly financed EU military expenses may also benefit mildly the EUR. Overall, we now see the EUR/USD roughly balanced for the coming months at levels around 1.04.

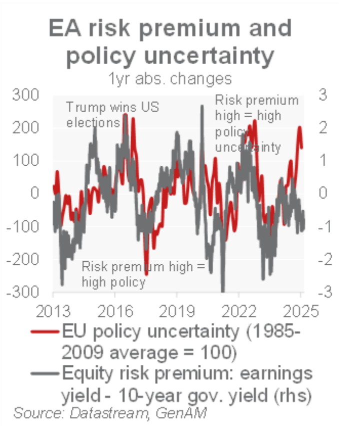
Equities

Michele Morganti and Vladimir Oleinikov









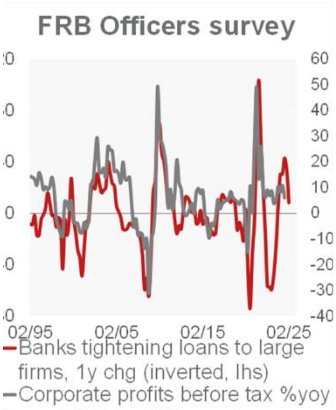
- **We remain constructive on equities and maintain a cautious OW position. Rotation is ongoing in line with our suggestion contained in our annual outlook, albeit still involving ex-US large caps and not smaller ones. SPX 403, EMU, China, China Tech, EMs are among the outperformers vs. the US M7, year-to-date.**
- **China in particular, enjoys better competition in AI and expectations of government's stimuli. Markets are increasingly discounting a new Chinese cycle, especially in the Tech sector.**
- **Decent confidence indicator, high free-cash flow, M&A and our ML models add to hopes of a ceasefire, China stimulus, and possible higher spending in the euro area (EA). While EMU earnings momentum could recover from a low base, US one is stronger, resilient, albeit showing some peaking signs.**
- **Tariffs and geopolitical risks plus the still fragile EA recovery induce us to maintain a contained OW on equities. We see 7%-11% TR for the US and 8%-12% for the EMU in 12 months.**
- **We stay neutral EMU vs USA and on US IT. OW SMI, EU small cap, Japan, slight China and India. Diversify US into equally weighted SPX & Russell 2000 (OW). OW cyclicals vs. defensive.**
- **EU sectors: OWs: Financials, A&D, Construction, Energy, Pharma, RE, Semis. UWs: Consumer and Comm. Prof. Services, Cap.Goods ex-A&D, Staples, Retailing, Media, Transportation, Utilities.**

We remain constructive on equities, maintaining a cautious OW position. Trump's induced uncertainty is having effects on volatility. In February the VIX increased by 10% to 19. Some signs of US macro weakness triggered an unexpected decline in 10-year yields by a sound 30 bps and the SPX lost 1.3%. The M7 declined by 4.5%. Nvidia results were ok, but the beat was not great and margin guidance soft.

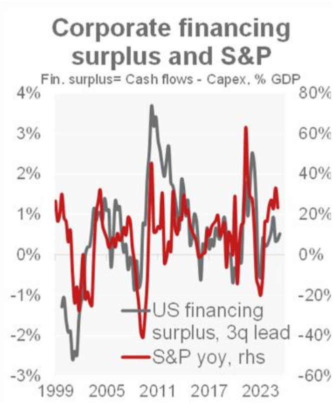
A rotation from US IT is in place (albeit still involving ex-US large caps and not smaller ones). This was our investment thesis contained in our annual outlook in December. The SPX 493 gained 1%, outperforming M7 by 6.5% in the month and 10% year-to-date (YTD). EMU is also outperforming the SPX, driven also by a better macro surprises. A peaking USD is backing good EM performance. China enjoys better competition in AI (DeepSeek) and government's stimuli to the economy. The market is increasingly discounting a new Chinese cycle, especially in the Tech sector.

The 3 positive legs remain at work: post-US election cycle,

Equities



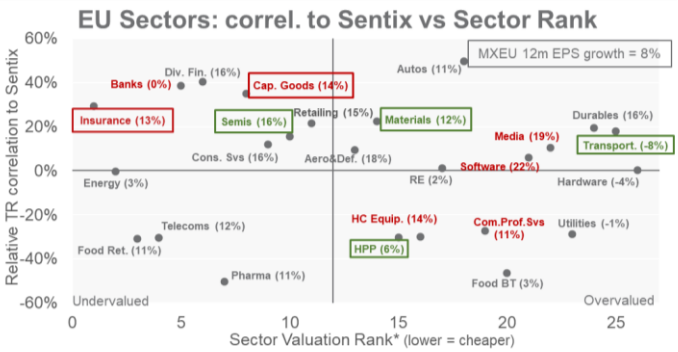
Source: LSEG, GenAM Research



Source: FRED eco data, GenAM calculations

Market Index	expected 1-yr TR: composite LT models (Shiller approach for US)	expected 1-yr TR: of which: PE-based valuation	PEG adj.*	CAPE yield gap vs real yield (1yr fwd), bps to avg since 2003	CAPE premium / discount vs history since 1993
S&P 500	6,000 - 7,000	5%	2.1	-203	44%
MSCI EMU	1%	9%	2.2	-55	13%
FTSE 100	8%	8%	2.3	13	-1%
SMI	9%	10%	1.9	14	12%
TOPIX	16%	14%	2.1	-24	5%
China	n.a.	n.a.	1.7	267	-24%

Source: Datastream, Bloomberg, GenAM calculations
Note: LT models: PE tgt (US 20.7x, EMU 14x, JP 14.5x), Fed model, EY-BY, DDM, and 3-stage eps growth model
PEG is PE divided by expected long-term EPS growth. PEG adj. (higher = expensive): PEG is modified by the ratio COE/ROE, which signals the ability to produce a return on equity (ROE) higher than the cost of it (COE).
excess CAPE yield = 1/CAPE - (10yr rate - avg inflation over 10yr)



*includes Fed Model gap, exp. TR, PEG adj. (for ROE and COE), Shiller PE, 3-stage EPS growth model, mkt multiples, PE vs hist. avg. excl. bubble years. 12m EPS growth = 12m fwd EPS vs 12m trailing EPS
Green/Red name = positive/negative machine learning (ML) models in (X%): 12m EPS growth
Source: Refinitiv, GenAM calculations as of 27/02/2025 ☐ = Best performing models

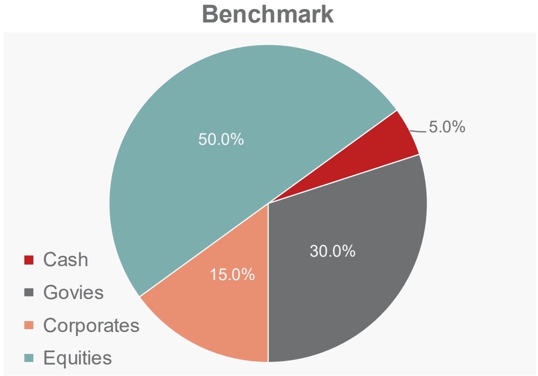
improved financial conditions and rotation out of US Tech via its lower relative EPS growth. Additional positives are better PMI & Sentix for EMU, high free cash flow gap vs. CAPEX, good trend in M2 and increased M&A activity. In addition to these factors, the outlook on credit remains good and our quant ML models stay positive on equity vs. bonds. There are also growing expectations of a higher European propensity to invest in defence, including for Germany. The European Commission is debating how to smooth the transition costs for the auto sector. The latter has started to restructure, cutting costs and production capacity. Political issues have also turned marginally positive, especially for Germany and less for France. Hopes for increased spending in the EA add to rolling hopes for ceasefire in Ukraine. That said, there are also risks in addition to the possible lingering soft macro surprises in the US. The VIX trend is less supportive recently, albeit neither representing a threat yet. Policy uncertainty is very high. Trump's announced tariffs continue to trigger a bumpy investor sentiment. Lastly, we see signs of peaking among some variables which remain positive for equities but slightly less so (no more improving). We refer to toppish bank loan survey, M2 impulse, Fed bank's reserves, higher TW USD, lower oil prices and peaking Free cash flow momentum. A nice surprise could instead come from a further recovery in the manufacturing sector. Thus, we are cautiously optimistic and maintain a contained OW position on equities. EMU reached already our lower band of the valuation range from early December (11% - 17%). We expect a further 9% in the next 12 months. The EA should benefit from lower CPI, four ECB cuts, a weaker euro and increased savings in addition to the above-mentioned positive triggers. Our updated models see an increase in US earnings in 2025-2026, a 20.7X tgt PE and still around 6,500 SPX tgt in 12 months. As for EMU, our 2025-2026 EPS forecasts are unchanged, but models see PE to remain stable at 14X – 14.5X in 12 months vs. our previous estimate of 13.5X. For both indices, our EPS forecasts are at consensus in 2025, lower by 5% in 2026 and by 9% in 2027. We see 7%-11% TR for the US and 8%-12% for the EMU in 12 months. We are neutral EMU vs USA. Neutral US IT. OW SMI, EU small cap, Japan, slight China and India (less vulnerable to tariffs). Diversify US into equally-weighted SPX & Russell 2000 (OW).

European sector allocation: maintain a cyclical bias

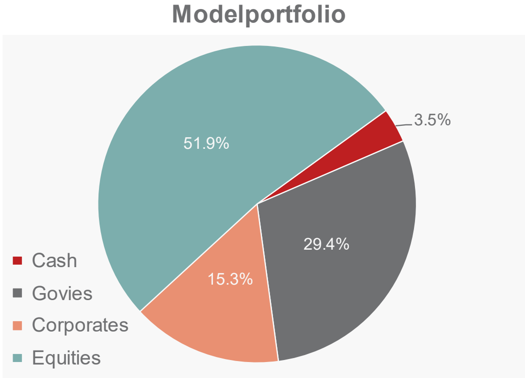
The trend in disinflation and global positive leading indicator trend (LDI) point at "goldilocks", supporting an allocation with a cyclical bias. We decreased Durables to neutral (on account of revisions and valuation), OW Small vs Large Cap, Financials, A&D, Construction, Pharma, RE, Semis, Energy. UWs: Cons. and Comm. Services, Cap. Goods ex-A&D, Staples, Retailing, Media, Transportation, Utilities.

Asset Allocation

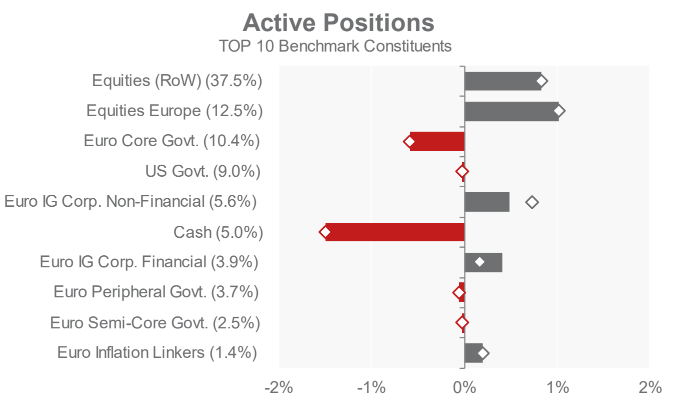
Thorsten Runde



Source: GenAM



Source: GenAM



Source: GenAM; Benchmark weights in parentheses, diamonds indicating prev. recommendations

- **The total return ranking In February 2025 (27.02.25) was quite mixed. MSCI EMU (+4.5%) are at the top closely followed by long-dated US Treasuries (+4.3%) and the MSCI EM (+3.7%).**
- **The bottom of the ranking is held by the MSCI Pacific and the MSCI North America revealing total returns of -1.9% and -1.5% respectively.**
- **On the Government Bond side, the long end of the curve outperformed the short end throughout all markets, most extreme for US-Treasuries +370 bps.**
- **On the Credit side, EA HY outperformed EA IG by more than 50 bps. Regarding IG non-Fin vs IG Fin, the gap was much closer with +16 bps.**
- **The global macro picture (resilient growth, receding inflation, more monetary easing) keeps favouring a small pro-risk bias in the portfolios. That said, the uncertainty induced by political imponderables across the world appear more massive than ever.**
- **Against this backdrop we just keep our moderate tilt towards risk assets and slightly trim our duration stance for the EA. Within EA IG Credit we neutralize our preferences between non-Fin and Fin.**

In February 2025 (27.02.25) our model portfolio outperformed its benchmark by +3.1 bps, with the first half of the months (+3.5 bps) clearly beating the second (-0.4 bps). All in, the OW in Equities proved most rewarding by contributing +2.2 bps to the result and being positive in both sub-periods. With respect to Cash, EA Core Govies, and Corporates, performance contributions changed signs between the subperiods drifting into negative territory in the second one.

The broad picture did not change that much over the past month. The global economy still appears quite robust with clear advantages for the US compared to the EA. Yet, given the imponderables imposed on markets by President Trump's measures at the economic and political fronts, the political situation in Germany and (still) in France, a cautious tactical stance appears advisable.

Stay moderately OW in risk assets

For the time being, we keep our Equity exposure untouched compared to January. We trim our duration for the EA leaving the duration for the US unchanged at a neutral level. We reallocate from EA IG non-Fin to Fin.

Forecasts

Macro Data

Growth[1]	2024	2025 forecast	2025 Δ vs. cons.	2026 forecast	2026 Δ vs. cons.	2027 forecast
US	2.8	2.4	0.2	2.2	0.2	2.0
Euro area	0.7	0.8	-0.2	1.3	0.1	1.3
Germany	-0.2	0.2	-0.2	1.1	0.1	1.1
France	1.0	0.5	-0.3	1.3	0.2	1.4
Italy	0.7	0.6	-0.2	0.5	-0.4	0.5
Non-EMU	1.0	1.3	0.0	1.9	0.4	1.5
UK	0.9	1.2	0.0	1.9	0.5	1.5
Switzerland	1.4	1.3	0.0	1.6	0.0	1.2
Japan	-0.1	1.1	-0.1	0.9	-0.0	0.6
Asia ex Japan	5.0	4.8	0.1	4.6	0.0	4.3
China	4.8	4.5	0.1	4.1	0.0	3.6
CEE	3.2	2.1	-0.0	2.3	-0.0	2.4
Latin America	1.8	2.2	0.0	2.2	0.0	2.6
World	**3.1**	**3.1**	**0.0**	**3.0**	**0.1**	**2.9**

1) Regional and world aggregates revised to 2024 IMF PPP weights

Inflation[1]	2024	2025 forecast	2025 Δ vs. cons.	2026 forecast	2026 Δ vs. cons.	2027 forecast
US	2.9	2.7	0.1	2.2	-0.4	2.2
Euro area	2.4	2.1	0.2	2.0	0.2	2.0
Germany	2.4	2.1	0.1	2.0	0.1	2.0
France	2.3	1.8	0.4	2.0	0.4	2.0
Italy	1.3	1.8	0.1	1.8	0.1	2.0
Non-EMU	2.3	2.1	0.0	1.9	-0.1	1.9
UK	2.5	2.6	0.0	2.1	-0.2	2.0
Switzerland	1.4	0.6	0.0	0.8	0.0	1.0
Japan	2.3	2.4	0.1	2.0	0.2	1.8
Asia ex Japan	2.0	2.4	0.5	2.7	0.5	2.5
China	0.4	1.3	0.6	2.0	0.9	2.0
CEE	19.4	12.5	0.9	7.8	0.1	6.5
Latin America[2]	4.7	4.3	0.0	3.7	0.0	3.0
World	**4.0**	**3.4**	**0.3**	**3.0**	**0.2**	**2.7**

1) Regional and world aggregates revised to 2024 IMF PPP weights ; 2) Ex Argentina and Venezuela

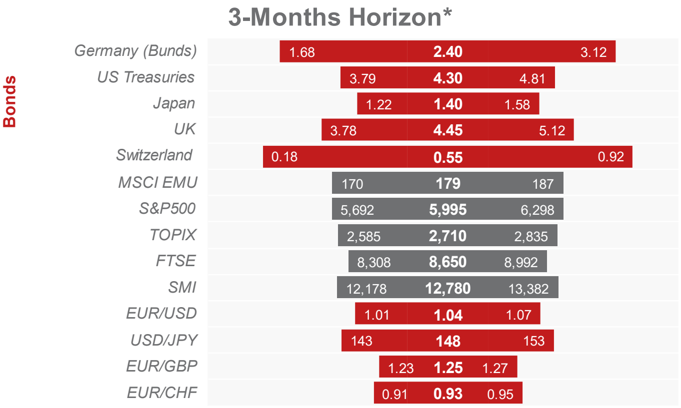
Financial Markets

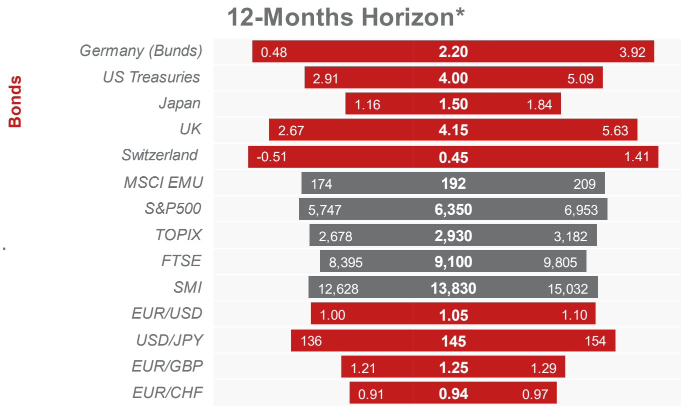
Key Rates	Current*	3M Forecast	3M Fwd	6M Forecast	6M Fwd	12M Forecast	12M Fwd
US (upper bound)	4.50	4.25	*4.23*	4.25	*3.94*	4.00	*3.70*
Euro area	2.75	2.00	*2.17*	1.75	*1.98*	1.75	*1.85*
Japan	0.50	0.50	*0.56*	0.75	*0.68*	0.75	*0.87*
UK	4.50	4.50	*4.24*	4.25	*4.04*	3.75	*3.85*
Switzerland	0.50	0.25	*0.19*	0.25	*0.11*	0.25	*0.14*
10-Year Gvt Bonds							
US Treasuries	4.31	4.30	*4.34*	4.20	*4.35*	4.00	*4.40*
Germany (Bunds)	2.45	2.40	*2.48*	2.30	*2.50*	2.20	*2.56*
Italy	3.53	3.50	*3.60*	3.45	*3.66*	3.40	*3.80*
Spread vs Bunds	*107*	*110*	*112*	*115*	*116*	*120*	*124*
France	3.19	3.15	*3.21*	3.10	*3.25*	3.10	*3.35*
Spread vs Bunds	*74*	*75*	*73*	*80*	*75*	*90*	*78*
Japan	1.38	1.40	*1.44*	1.45	*1.49*	1.50	*1.58*
UK	4.53	4.45	*4.58*	4.35	*4.60*	4.15	*4.66*
Switzerland	0.56	0.55	*0.51*	0.50	*0.53*	0.45	*0.57*

**3-day avg. as of 26/02/25*
***ICE BofA (OAS)*

Credit Spreads**	Current*	3M Forecast	3M Fwd	6M Forecast	6M Fwd	12M Forecast	12M Fwd
EA IG Non-Financial	85	85		85		85	
EA IG Financial	90	90		90		90	
EA HY	281	280		280		280	
EM Sov. (in USD)	231	230		240		245	
Forex							
EUR/USD	1.05	1.04	*1.05*	1.04	*1.06*	1.05	*1.07*
USD/JPY	149	148	*148*	146	*146*	145	*144*
EUR/JPY	157	154	*156*	152	*155*	152	*154*
GBP/USD	1.27	1.25	*1.27*	1.25	*1.27*	1.25	*1.27*
EUR/GBP	0.83	0.83	*0.83*	0.83	*0.84*	0.84	*0.85*
EUR/CHF	0.94	0.93	*0.93*	0.93	*0.93*	0.94	*0.92*
Equities							
S&P500	5,965	5,995		6,115		6,350	
MSCI EMU	181.0	178.5		182.5		191.5	
TOPIX	2,726	2,710		2,790		2,930	
FTSE	8,686	8,650		8,775		9,100	
SMI	13,007	12,780		13,130		13,830	

Forecast Intervals





**Forecast ranges of ±1 stdv. centred around point forecasts; based on historical volatilities; length of bars indicative only*

Imprint

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