Core Matters

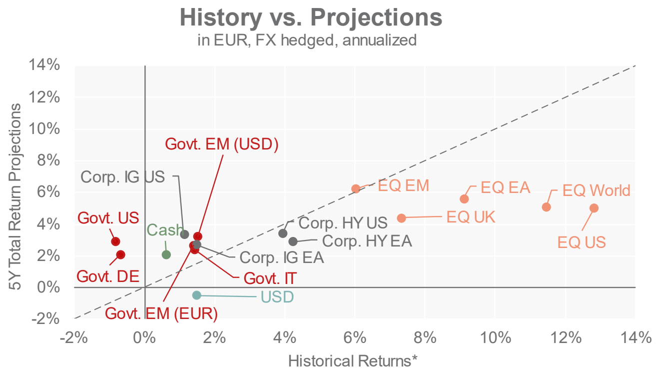
5-year returns forecasts: the draught of risk premia

GenAM Macro & Market Research

23 October 2025

Our Core Matters series provides thematic research on macro, investment, and insurance topics

- 2025 has been a good vintage, with global equities pursuing their phenomenal run since autumn 2023, government bonds showing signs of life after a lost decade and credit spreads reaching new cycle lows.
- This paper updates our capital market assumptions (CMAs) for the next 5 years, among many 'known unknowns'. Will nascent credit stress in the private debt sector prove to be the canary in the coalmine, or will US deregulation, competition between lenders and an acceleration in the EU Capital Market Union support a new credit wave and global economic growth? Will rising public debt push neutral rates and term premia higher? Will AI prolong the roaring 2020s that have seen a remarkable corporate profit acceleration (especially in the US)? Will the rise of the new world order and attacks on the Fed independence undermine the US dollar and feed the revival of EM markets?



*based on monthly returns from 10/15 to 09/25

Source: Datastream, GenAM

- Our 5-year expected returns are little changed from last year. We have trimmed our return expectations for Credit (both IG and HY), as the strong further compression of spreads has eaten into carry. The most striking upgrade is for EM equities (+1pp), owing to higher higher valuation targets (CAPE), a weaker US dollar and stronger Chinese IT earnings amid still cautious investor positioning in the asset class.
- The risk premia for both corporate credit and equities have continued to compress over the past year. This not only depresses the current yield on those assets but also implies a greater risk asymmetry. Our long-standing thesis that risk premia will be "lower for longer", in the context of rising 'fiscal dominance' risks, holds.
- Still, low risk premia imply a low dispersion among our expectations of 5-year returns. In our projections, the difference amounts to just some 4pp (EM equities +6.2% vs. Cash 2.1%).
- We see four key risk scenarios shifting returns from our baseline assumptions. First, a resuming trade war denting risk sentiment and reigniting stagflationary pressures. Second, rising debt sustainability worries, with the risk of fiscal dominance unleashing inflation. Third, a sharp global slowdown or recession. Fourth, a Goldilocks scenario with the AI boom unfolding a broader productivity boost.

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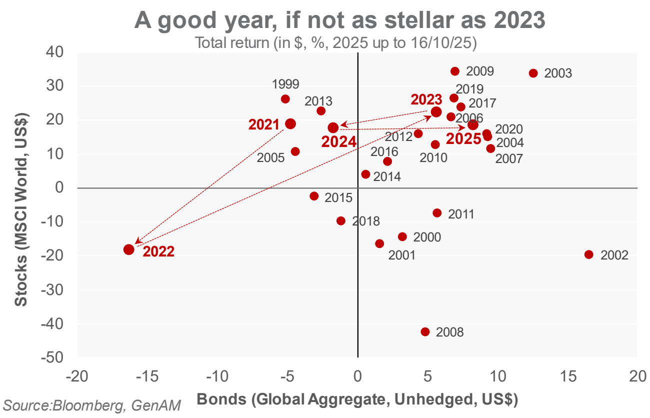
1. Introduction

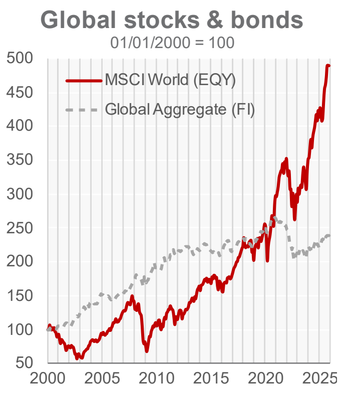
> Equities again delivering stunning returns in dollars, with the 3-year average close to 20% p.a.

2025, a good vintage. Global equities are on a roll. What a run in the two years to fall 2025! The first chart below shows annual returns in global stocks and bonds, in US dollars (unhedged), since 2000. The year-to-date returns, respectively above 18% and 8%, have been inflated by the pullback in the US dollar. This means a third consecutive year with stunning equity returns (nearly 20% p.a. over the past three years), and this year a sharp improvement in Fixed Income returns, following a poor 2024. After a lost decade (2014-2024), bonds have started to show signs of life again – thanks to carry, but also to a pullback in US Treasury yields. Hundred dollars invested in a 60-40 global equity-bond portfolio in early 2000, rebalanced monthly, are now worth nearly 400 dollars. This owes largely to equities, which have delivered nearly x5, vs. less than x2.5 for bonds (chart 3). An opportunity

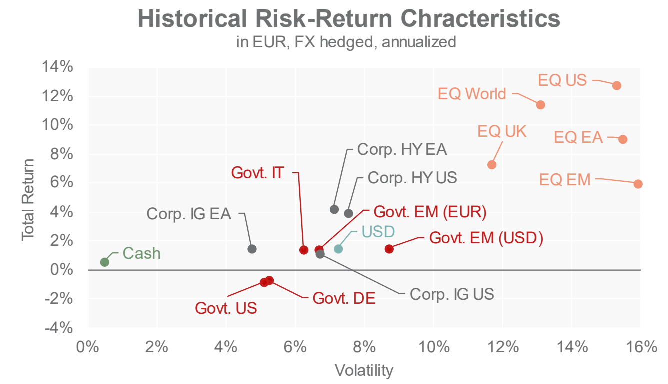


Source:Bloomberg, GenAM

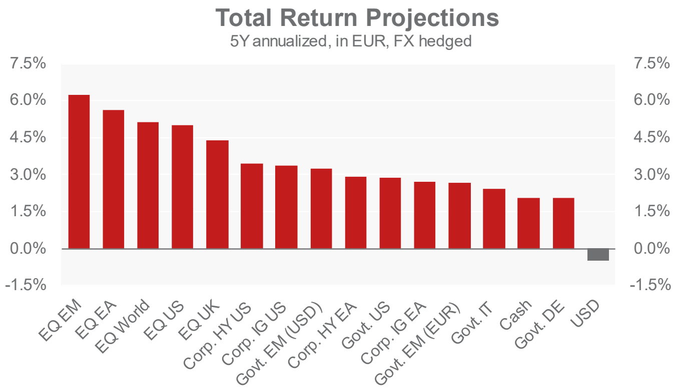
Source: MSCI, Bloomberg, GenAM calculations



Source: MSCI, Bloomberg, GenAM



*based on monthly returns from 10/15 to 09/25
Source: Datastream, GenAM



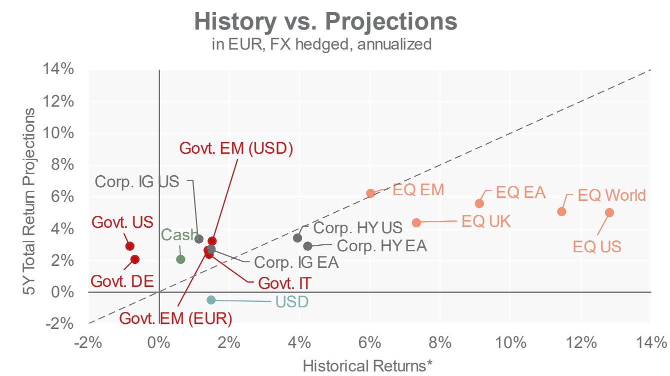
Source: Datastream, GenAM

to remind that *5.70% compounded over 25 years deliver a 4-time increase* in value. The secret of investment is not just about stellar returns, but more importantly, steady ones.

Not the same story in EUR (hedged). The left chart above shows annualised risk-returns over the past decade, this time hedged in euros. Strikingly, Treasuries and Bunds are in negative territory – still a lost decade. Our long-standing preference for Corporate Credit over Govies has largely paid off. Performances in equities have been diverse, with the US delivering over 12% saar, more than twice EM equities (Euro area in the middle, near 9%).

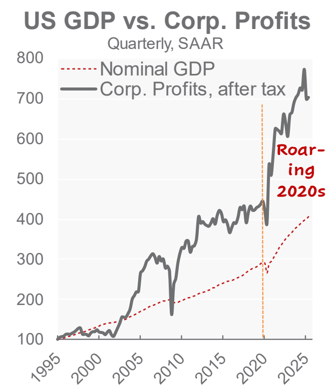
FI assets to deliver low single-digit returns. Equities will keep outperforming, but with much lower returns

EM equities top our 5-year ranking. EM equities have started to reverse that underperformance over the past year and still offer attractive returns for the coming years, in our opinion, and more so in an environment of declining US dollar valuation. The right-hand chart above indeed shows EM equities topping our ranking for the next 5 years, with about 6% p.a., hedged in EUR. We expect government bonds to deliver positive returns, but rather meagre ones as we assume slightly higher yields, which would prevent capital gains. As the left chart below indicates, we expect FI assets to do much better in the next 5 years than they have done over the past 10 – the bar is extremely low – but still in the low single-digit area. We expect equities to keep outperforming, but to deliver much lower returns going forward than they have done in the past 10 years.



*based on monthly returns from 10/15 to 09/25
Source: Datastream, GenAM

Source: S&P, Bloomberg, GenAM



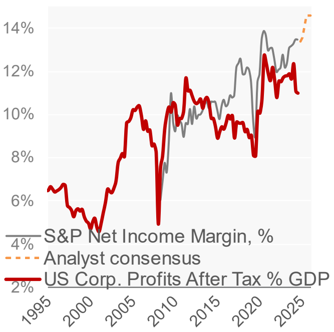
Source: BEA, Bloomberg, GenAM

Sharp acceleration of US corporate profit over the past 5 years have led to stunning equity returns

The roaring 2020s. The middle chat above shows something very unusual. US equities have delivered 15% p.a. (in local currency) over the past decade, about twice what the S&P earnings yield suggested 10 years ago! This owes to booming profits, and a large multiple expansion (S&P 12-month forward PE up 7 points to over 22). The third chart above shows the astonishing US profit acceleration since the Covid drawdown. A continuation of the equity feast would require the forces behind this profit boom to persist. We think three forces have dominated.

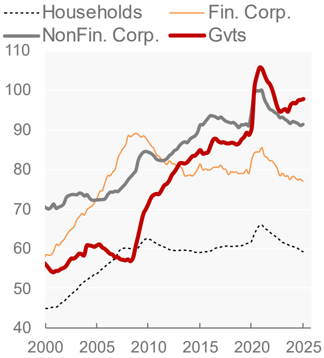
Corp. margins and profits

(Profits After Tax without IVA and CCAdj)



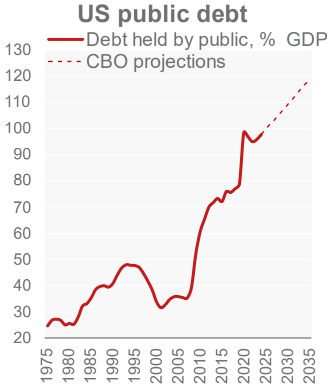
Source: US BEA, BBG, GenAM

Global debt, % GDP



Source: IIF, GenAM

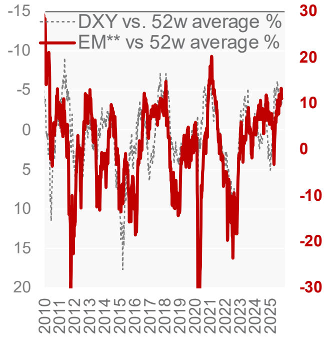
US public debt



Source: CBO, Bloomberg, GenAM

Weak DXY good for EM

*** EM made of MSCI EM, EMBI spread, EMFX tot return*

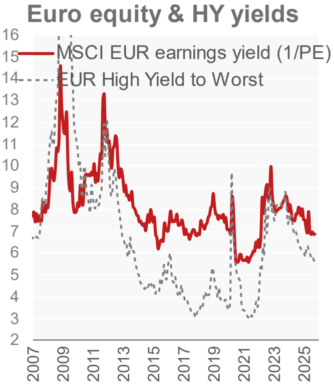


Source: Bloomberg, GenAM calculations

> We assume some moderation in US profit growth. A fast and deep diffusion of AI creates some upside risk.

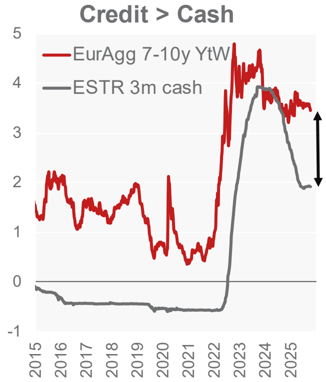
1/ **Greedflation**, through the inflation crisis, that has seen a surge in nominal GDP. We note that NIPA profits (at GDP level) have started to flatten out – a warning flag – though S&P have been much more resilient (first chart above). 2/ That decoupling largely owes to the impressive profitability of the **Tech sector**. 3/ We showed in previous issues of this annual edition how rising **fiscal deficits** tend to fall into corporate pockets (profits). Government debt around the world has surged over the past quarter century, with the US a key contributor (middle charts above). US public debt has increased by nearly 70 points of GDP over the past 25 years, vs "just" 25 points for the Euro Area. While the CBO sees an extension of that public debt trend, we still assume some moderation in US profit growth over the coming 5 years. A fast and deep diffusion of AI however creates some upside risk, i.e. margin expansion across sectors could again create upside surprises for equities. We also assume that the rising new world order, concerns about the rising US public debt and Fed independence will lead to a further decline of both the USD dollar share in global reserves and its valuation. This tends to benefit EM markets across markets (top-right chart above).

Euro equity & HY yields



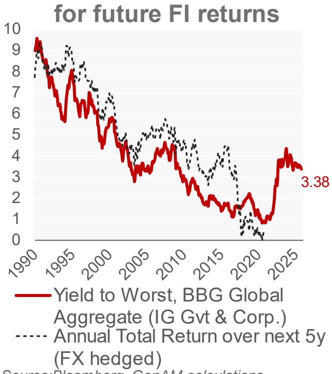
Source: Sentix, MSCI, Bloomberg, GenAM

Credit > Cash



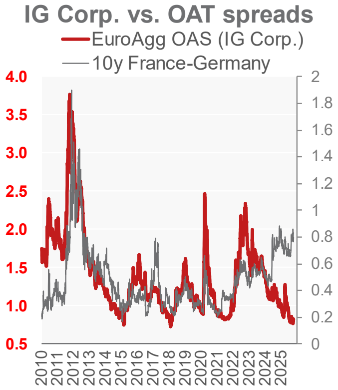
Source: Bloomberg, GenAM

Yield at t0 matters much for future FI returns



Source:Bloomberg, GenAM calculations

IG Corp. vs. OAT spreads

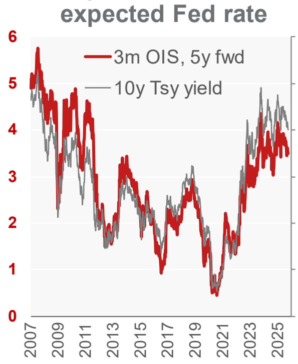


Source: Bloomberg, GenAM

The risk of fiscal dominance implies an inflation risk that will keep ERP below historical standards.

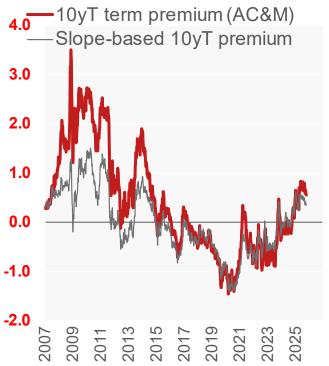
Tight risk premia, but still pockets of risk opportunities. The first two charts above suggest that risk assets, in this case in EUR, still have some juice. EA equities offer an earnings yield of about 7% (and a cash yield, dividends and buybacks, of 5%). EUR IG Credit offers yields that are still far superior to Cash. Chart 4 above shows the decoupling between French OAT and Corporate bond spreads vs. Bunds – for the right reasons. Government bonds are no longer the safe havens that they used to be; the risk of fiscal dominance across the DM world implies an inflation risk that will keep risk premia (especially the ERP) below historical standards. Fortunately, bond valuation has improved (moderately), through the rise of term premia (two charts below, in the case of the US), and should support positive (if low) returns over the next five years. The 1-month stock-bond correlation has been very unstable, but as the Fed stance will become more accommodative, we also expect greater diversification opportunities (more negative correlation).

10yT vs. mid-term expected Fed rate



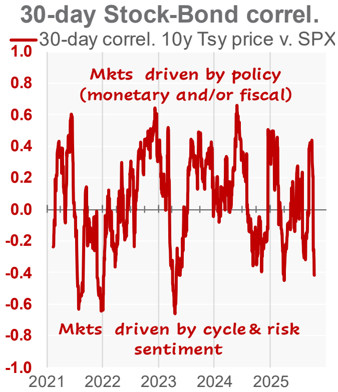
Source: Bloomberg, GenAM

10y UST term premium, %



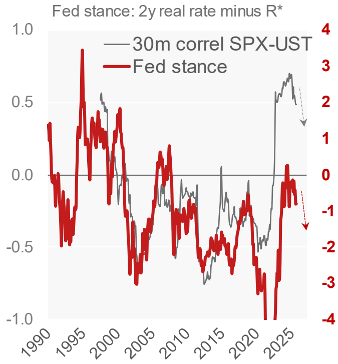
Source: Adrian Crump & Moench, BBG, GenAM

30-day Stock-Bond correl.



Source: Bloomberg, GenAM

Fed vs stock-bond correl.



Source:Bloomberg, GenAM calculations

2. Macro backdrop

In 2025 **global economic activity** likely lost momentum with a long-lasting period of strong US growth coming to an end. The euro area remained stuck in stagnation after a Q1 sugar rush from firms front-running US tariffs. Thanks to the lack of any severe retaliation, the global economy however has weathered the stiff headwinds from policy uncertainty and sharply raised US tariffs notably well thus far. We expect the US and the euro area expanding with roughly unchanged average growth rates in 2026 compared to 2025. In the US tax cuts and further monetary policy easing should help to stabilize activity. In the euro area, the cyclical upswing will be supported by bold German fiscal spending and passthrough of past rate cuts. In China, a non-recovering housing sector and the effects from the yet not settled trade war with the US will lead to slower growth.

Disinflation towards targets, though tariffs will delay normalisation in the US

Euro area **inflation** has come down over the course of 2025. Slowing wage growth and the recent EUR appreciation will help core inflation to recede further. Annual headline inflation will likely even undershoot the 2% target next year. Thereafter, however, we see inflation staying close to target again. In the US, disinflation has been disrupted by the price impact of tariffs, which will still show up in full by early 2026, and the disruption in trade flows will be a more persistent upside risk to inflation. The harsh anti-immigration policies are leading to a contraction in labour force, tightening the labour market, which may slow wage disinflation especially in labour intensive services sectors. This may limit the downside for ex-housing services inflation, which is still running at 3% year on year More generally these policies will lead to a stickier, more inflationist labour market. We confirm our view of US inflation back to 2% by 2030, but upside risks from adverse supply shocks have increased from last year.

Euro area market inflation expectations over the medium and long term have stabilised at levels consistent with the ECB's inflation target (15 to 30y EUR break-evens, which include an inflation risk premium, are in the 2.10% to 2.25% range). Likewise, the ECB Survey of Professional Forecasters anticipates average inflation at 2.0% over five years. In the US, professional forecasters see core inflation still at 2.4% in 2027.

We see two major upside risks to our baseline inflation outlook. The tariff might re-escalate, e.g. the EU could impose tariffs on imports. Alternatively, geopolitical tensions, especially around Taiwan, could disrupt supply chains. Extreme weather events and the effects from increased defence and infrastructure spending, especially in the EU, are additional upside risks. In contrast, tariffs may aggravate overcapacity, leading China to export deflation to the rest of the world.

US trade policy carries stagflationary risks

The **changes in US trade policy** have thus far been less disruptive than initially anticipated. However, these tariffs are likely to remain a permanent fixture, primarily due to their contribution to addressing the widening fiscal deficit in the United States. Persistent trade tensions and the strategic repositioning away from the US will accelerate the reorganisation of international trade patterns. Additional frictions, such as those between the EU and China regarding electric vehicles, further complicate the process. This restructuring of supply chains is unlikely to be seamless. The risk of adverse supply shocks impacting goods trade flows remains elevated, potentially causing temporary surges in inflation as a significant challenge for central banks.

Size of AI productivity boost a major source of uncertainty

The anticipation of a produc**tivity boost from the fast development and adoption of Artificial Intelligence (AI)** is currently fuelling substantial investment across sectors. Forecasting the extent of AI's impact on productivity and economic growth remains uncertain, with estimates of the benefit to GDP over a ten-year horizon ranging from 1.5% to 7%. This wide range underscores the dual nature of risks associated with AI.

In a positive scenario AI-induced productivity gains could result in a marked increase in economic growth, though this is unlikely to be accompanied by significant growth in employment. In addition, AI-driven efficiency could exert downward pressure on inflation, dampening the effect of tariffs. Conversely, should the anticipated boost from AI fall short of expectations, a rapid reduction in investment could ensue. This would have a notably adverse impact on growth, with the US being particularly vulnerable to such a downturn.

Soaring public debt an increasing challenge

Public debt and questions about its sustainability will continue to impact markets. According to the latest IMF projections net debt in the euro area is expected to increase from 73.9% of GDP in 2024 to 81% in 2030. The US should see a much sharper increase, from 97.4 to 116.8%. Debt is trending higher as most countries do not have a structurally balanced budget. Moreover, additional fiscal spending will be required due to ageing populations, the need to address climate change, and increased military expenditure. The new target by NATO members to spend at least 3.5% of GDP for defence, up from 2% before will strain budgets further. This is even more challenging as most euro area economies (as well as the US) exhibit a structurally negative primary balance pushing debt ratios further up. Debt servicing costs will rise, too, with past interest rate increases gradually phasing in. And unlike to the past, debt ratios are also set to increase for traditional safe havens like the US and Germany. The US tax plans will keep the deficit at around -6% of GDP despite the extra revenues from tariffs. In Germany, the scrapping of the debt brake for bold infrastructure and defence spending will push annual deficits towards -4% of GDP over the coming years. We doubt that these measures will spur growth sufficiently to stop debt ratios from rising. Fiscal consolidation measures may fall short of what is needed and government will be tempted to finance increasing social security contributions via debt so that unpopular reforms can be avoided. As result debt sustainability is likely to be increasingly questioned. Risk of instability risks may put at least some indirect pressure on central banks to contribute to favourable financing conditions.

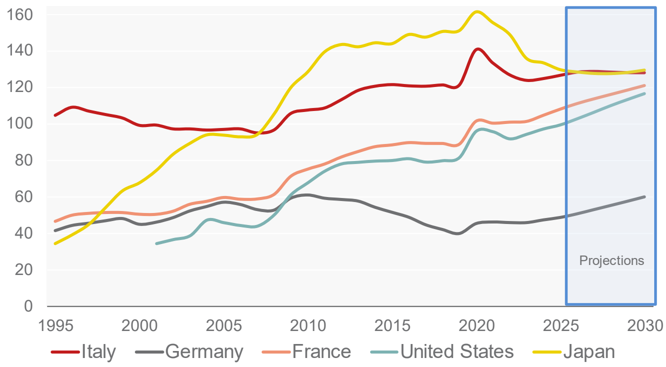
We assume as small pullback in US and EA potential growth…

Potential growth in the US is projected to decrease from 2.1% to approximately 1.9%, while in the euro area it is expected to decline from 1.2% to 0.8% over the next five years, reflecting demographic trends and a cautious perspective on the impact of AI adoption (potential growth estimates remain unchanged compared to the previous five-year outlook). Yet we assume that the equilibrium interest rate will increase by 0.3 percentage points in the euro area and 0.4 percentage points in the US during this period, in line with normalised inflation expectations and higher government debt issuance, which may influence capital costs. Since the last five-year return report, the US neutral rate has been adjusted upward by 0.1 per centage points to consider further deterioration in public finances. In the euro area, the projected increase is also greater than last year; yet the current rate assessment is lower, leading to a reduction in the five-year expectation by 0.2 percentage points.

… but expect neutral rates to increase slightly over 5 years

Central banks reacted to the easing inflation pressure by cutting key rates. The **ECB** has reached the centre of the communicated neutral policy range between 1.75% to 2.25%. The mentioned spending needs raise the neutral policy rate range by 50 bps to 2.5% (0.5% in real terms, see table) towards the end of the projection horizon. However, we look for some mild form of fiscal dominance and expect the ECB to keep its short-term rate below this reference rate by 2030 (see table).

Government debt to GDP



Source: IMF, World Economic Outlook, Oct. 2025, GenAM

2030 macro and central bank scenario

Item	*Euro area*		*US*	
	current	*2030 proj*	*current*	*2030 proj*
Equilibrium real short term rate (r*)	0.2	0.5	0.8	1.2
Inflation (HICP, core PCE for US)	2.2	2.0	2.9	2.0
Potential growth	1.2	0.8	2.1	1.9
Neutral Central Bank policy rate	2.4	2.5	4.0	3.2
Current real short term rate (r)	-0.3	0.2	1.3	1.3
Current nominal short term rate (ESTR, SOFRE)	1.9	2.2	4.2	3.3

Source: Datastream, GenAM calculations

For the **Fed**, markets anticipate a steep path of further monetary easing from current levels of 4.25% (upper bound), projecting the policy rate to fall below 3% by the end of next year, before rising again to around 3.3% by 2028. Market-based estimates suggest the neutral rate could range between 3% and 4%. We see monetary easing ending in early 2026 with the policy rate in the 3.25%-3.5% range. However, a key risk to this outlook is the possibility that the administration's efforts to exert greater control over the Federal Reserve could succeed. While most current members of the Federal Open Market Committee (FOMC) are set to remain until 2028, there is growing evidence that the government may seek to replace them earlier. If fiscal dominance takes hold, the policy rate could be kept below what is needed to contain inflation, and in the worst case the return of large-scale QE may be used to manage the impact of rising federal debt on borrowing costs. This approach would significantly increase money supply, which could drive up inflation and undermine confidence in the US dollar.

3. Financial return expectations

As in our exercises from previous years, our 5-year total return are the result of a top-down approach. Using growth, inflation, and central bank forecasts as inputs, we derive point forecasts for yield levels, spreads, exchange rates and equity performance in different approaches and models. We focus on key liquid asset classes for euro-based investors, including Government Bonds (EA, US, EM), Credit (US and EA), Equities (various markets) and FX (focus: USD). We do not hereby cover unlisted assets and/or alternative assets. A more detailed description of the underlying methodologies is provided in our original 5-year return report.

3.1 Fixed income assets

Lower but attractive returns. Following a solid 1H25 for fixed income assets, the outlook has become mildly less favourable in some buckets. We expect positive returns over the next five years at the upper end of the historical distribution. However, the significant spread compression seen across riskier fixed income assets leads us to forecast lower returns than last year.

Carry will be the main driver of positive returns

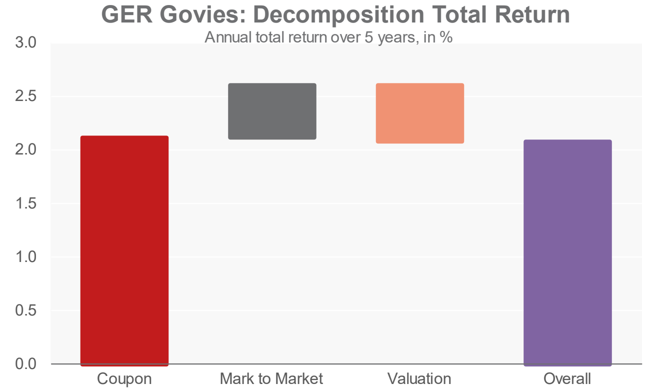
Bund yields up, Treasury yields down. One of the reasons is our upward revision of yield forecasts for German Bunds and US Treasuries, due to expansionary fiscal policies and rising debt ratios. We now expect a modest decline in Treasury rates, but a more pronounced rise in German rates.

Lower credit risk but demanding valuations. In the long term, credit fundamentals have improved for corporates relative to Sovereigns, so we have revised our long-term spread forecasts lower. However, valuations have reached levels close to decade lows. We assume a moderate spread widening over the next five years, curbing total returns.

Carry and lower default to support return. Despite the tight valuation metrics, all-in yields remain at a relatively attractive level, especially relative to EUR cash. Carry will continue to be the most important driver of fixed income returns. We also assume that defaults will have less of a negative impact on returns, particularly for EM sovereigns where fiscal adjustments have been initiated.

3.1.1 Government bonds

Following volatile years since 2020, DM government bonds have enjoyed **relatively calm conditions over the past twelve months**. As expected, US Treasuries have performed best, supported by a moderate yield decline. In Europe, Italian BTPs have benefited from a further significant spread narrowing. In line with our forecasts, German government bonds are at the bottom of the table, once again, with the lower coupon and fiscal shift of the new government pushing Bund yields to a permanently higher level.



Source: Bloomberg, Datastream, GenAM

No significant changes to the outlook for the performance of DM government bonds compared to last year

Compared to last year, we are **raising our yield forecast for German Bunds and US Treasuries moderately**. This primarily reflects the trend towards sustained expansionary fiscal policy and a further increase in government debt ratios. Despite the rise in term premia since 2023, they remain at a historically moderate level. In an environment of more volatile inflation and rising government debt, we see leeway for a further increase and a slight steepening of the yield curves. In the euro area, ongoing Quantitative Tightening (QT) is also contributing to the increase, while in the US, concerns about the Fed's independence exert an upward pressure on the term premium. The fact that the forecast adjustment in the US is still quite moderate at 50 bps for 10-year Treasuries, despite a higher terminal key rate, is mainly due to expected regulatory measures that will boost demand for US Treasuries to keep the government's financing costs low. This also means that the transatlantic yield spread will narrow further. The **outlook for Italian BTPs has noticeably improved.** We now expect a more modest rise to 105 bps in the 10-year BTP/Bund spread (3-year: 40 bps). This is primarily due to Italy's improved fiscal situation, as also reflected in upgrades by rating agencies.

Consequently, we are only making minor adjustments to our performance forecasts for the next five years compared to last year, with the income component still driving the total return. **US Treasuries remain the preferred option in local currency**, although the upward revision of yields across all maturities has an impact on the valuation component of the expected performance. The higher coupon means that Italian BTPs have a better total return outlook than German Bunds. While the components of the total return for Bunds and BTPs are changing, the overall performance forecast for Italian and German government bonds on a 5-year horizon remains the same as last year.

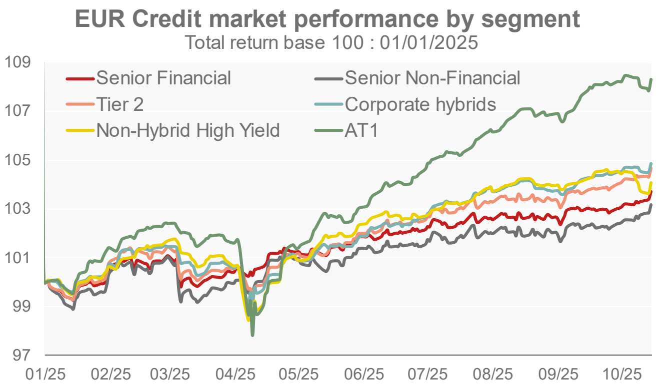
Taking inflation into account, **euro area government bonds are therefore expected to generate only a low real total return**. Due to the further decline in key rates, the same applies to investments in the euro area money market.

3.1.2 Credit

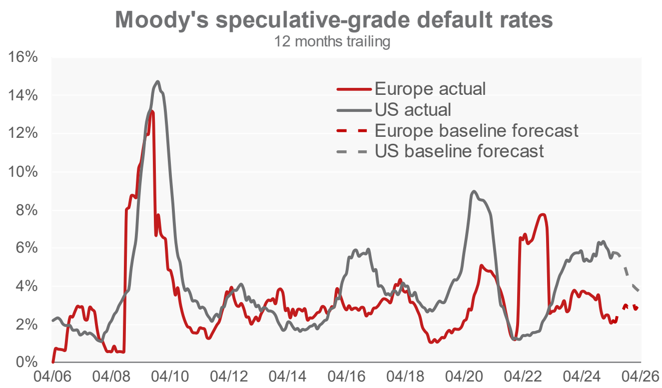
In 2024 and 2025 alike, the tightening of credit spreads has been impressive, supported by the strong demand induced by the perspective of potentially decreasing interest rates. Both technicals and fundamentals remain supportive. Lower interest rates mean that companies' profitability improves, via lower financing costs. However, the most powerful effect has been the demand from investors attracted by the elevated all-in yield in a context where monetary products are expected to gradually offer lower returns.

Compared to last year, we are modestly decreasing our return assumptions for all credit market segments. The contribution of return components is different compared to 2024:

- Underlying yield contribution is positive, though a rise in Bund yields is a mild headwind, as mentioned in the previous section.



Source: Bbg, BofAML indices, GenAM



Source: Moody's, GenAM

- Valuation: both our fair value models and the 10Y moving average indicate moderately wider spreads over 5 years.
- Finally, carry is much lower compared to 2023 and 2024, as credit spreads have declined.

Following an initial downward adjustment in 2024, we are decreasing further our default adjustments. According to Moody's, the current figures are just over 3% in Europe and over 4% in the US, well past the peak and close to the long-term averages. We expect these figures to continue to decline. Over the past decade, US defaults have been higher than European defaults due to a different bankruptcy regime and because support during the pandemic was directed at individuals rather than companies. We are decreasing our default adjustments, which reflect an average annual default rate of 2% in Europe and 3.5% in the US.

> We further decrease our corporate credit default adjustment

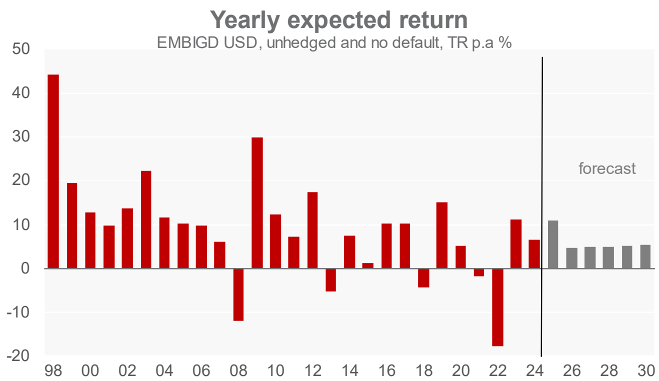
With defaults falling below the long-term averages, net returns will still be attractive relative to equities when adjusted for volatility. In all, our 5Y TR expectations for credit are lower than last year's forecasts, with US HY delivering a total return of nearly 5% in local currency (above 3% in EUR hedged), marginally above US IG, while EU credit is seen to deliver returns just short of 3% p.a.

> Credit expected to deliver around 3% in EUR hedged.

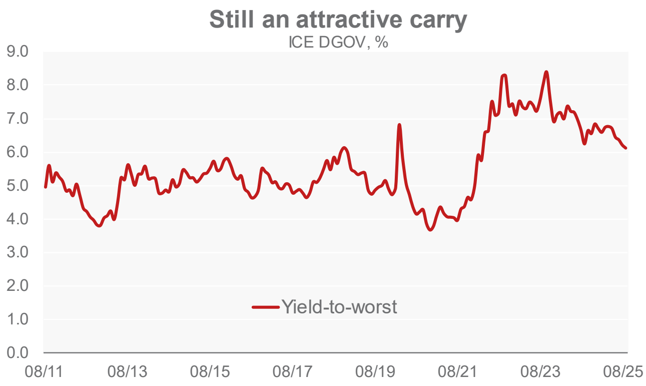
3.1.3 EM sovereign bonds

> Expected returns in EM Hard Currency revised down following stellar 2025 performance. Some upside risk.

Less brilliant prospects after strong rally. EM sovereign bonds have recently benefited from renewed global appetite, global economic resilience, a weaker USD and sound fiscal and external metrics among EMs. We now expect a 5-year return of close to 4.5% p.a. for US external debt (in USD) and 2.7% p.a. for EUR external debt. This is a 1.3pp downgrade compared to last year's return projections, as EM external debt has performed strongly over the past year. Spreads have reached new all-time lows, and US rates have declined; the ultimate consequence is that there is less room for outperformance. Nevertheless, returns still exceed the average of the past decade, and we see some upside risks given the low investor positioning, positive technicals, a further USD weakening and fading US exceptionalism.



Source: JP Morgan, Bloomberg, GenAM



Source: Bloomberg, ICE, GenAM

Carry is the main contributor of EM debt performance

Still a carry trade. As in previous years, carry will be the main contributor to performance, with a yield-to-worst still close to 6% (USD). Although this yield has declined from the 2022 highs, as the number of distressed countries offering very high yields has fallen, the carry remains at the top end of the decade's distribution. Furthermore, EM external debt continues to offer a significant yield pickup over US credit in both the IG and HY spaces.

No help from Treasury rates. Last year, the expected large Treasury rates decline provided a significant lift to returns. This is no longer the case (see above).

Tight valuations but long-term EM credit risk to diminish. Current valuations are demanding in both the IG and HY sectors, and our short-term econometric model confirm this richness. Our long-term fundamental valuation model projects a 5-year spread forecast of 300 bp. This implies a gradual widening from current levels, but this long-term forecast is lower than our previous estimates. Indeed, fiscal metrics have improved since the deterioration caused by the pandemic, and external accounts are in better shape too. In other words, the long-term EM credit risk has decreased.

Lower default rate. Similarly, we have applied lower default rates than in the past, and a lower one for EUR than for USD debt. Primary market access has improved, the average issuance yield has declined, and significant progress has been made in the debt restructuring framework. A few countries are still under threat, but progress has been made in dealing with complicated situations using new IMF instruments and the risk of contagion is limited.

3.2 Equities

EMU posted good TRs despite negative EPS revisions, which we expect to recover

Since last year's report, the MSCI World Index has risen by about 18% (total return, TR), while 12-month forward earnings (EPS) have been revised upward by 8%, and U.S. 10-year yields have declined by 10 basis points. Based on our value indicator— earnings per share (EPS) divided by the 10-year rate plus an equity risk premium—the US market is currently "only" 2% more expensive than a year ago, and the MSCI EMU 12% (following a 17% TR). The EMU has been impacted by significant negative EPS revisions in the energy and automotive sectors, but we anticipate a recovery in the coming quarters. Emerging market (EM) equities have even gained 22%, supported by a weaker US dollar (-3.5%), lower EM yields, and tighter EMBI spreads (-46 basis points).

The strength in equities reflects the resilience of macroeconomic and confidence indicators. Solid GDP growth in the U.S., China, and parts of Europe has bolstered investor confidence. The prospect of declining central bank interest rates has also served as a catalyst. Tech-heavy indices like the Nasdaq experienced robust EPS growth, driven by advances in AI, cloud computing, and semiconductors. The MSCI China outperformed thanks to favourable policy support and attractive valuations, including the tech sector.

Our EPS forecasts and ex-US valuations back decent equity returns over the next 12 months

In our base scenario, we see solid 12-month TR driven by Fed's rate cuts and positive EPS momentum. Sentiment will also be supported by solid financial conditions, lower political uncertainty and tight IG credit spreads. Our EPS forecasts and ex-US valuations back decent returns over the next 12 months (+6.4% for the MSCI World, in USD), with high cash yields (EU = 5%) and the SPX at 6,500-7,200 in one year. Compared to our Autumn 2024 5-year projections, our updated TRs have not changed much, still remaining below historical norm (s. section 3.2.3). However, we upgraded the prospects for EM equities.

3.2.1 Earnings: less muted for EMU and EM, but US still leads

We have slightly raised our earnings (EPS) growth forecasts over the next five years for both the Euro Area (EA) and Emerging Markets (EM), even though TRs are seen to remain below the historic norm. For the EA, we incorporated German fiscal expansion and the positive im-pact of higher yields on the financial sector. For EMs, we accounted for the benefits of a weaker US dollar and continued fiscal support in China.

For the EA, we incorporated German fiscal expansion and the positive impact of higher yields on the financial sector

The EA now shows projected EPS growth of 4.5%, up from 3.5% last year, aligning more closely with an average real GDP growth of 1%—consistent with the historical EPS-to-GDP multiplier of 4x. This compares to an average of 4.7% since 1987 and 5.2% since 2009. In this context, 4.5% appears relatively conservative, especially when factoring in an additional 1.5% contribution from share buybacks.

Meanwhile, we raised EM EPS growth from 3.5% to 4%, which remains well below the long-term 5-year average of 6.7% since 1992. US EPS growth remains unchanged at 7%, in line with our model projections. This is close to the historical average of 7.1% since 1987, though below the 9.5% average since 2009. Still, 7% appears realistic—if not conservative—given the anticipated productivity boost from AI advancements.

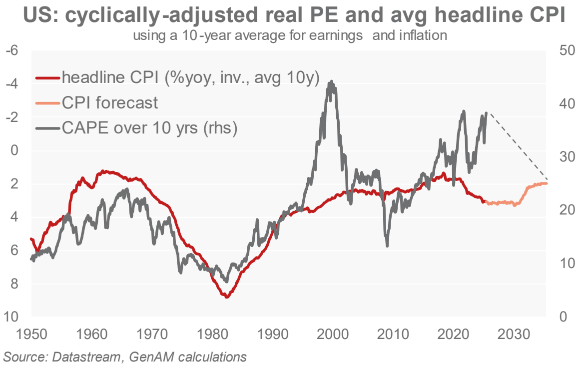
3.2.2 Long-term equity returns: the framework

Long-term equity returns are driven by trend in fundamentals and valuations but remain highly volatile in the short term. To estimate future returns, we use a three-part quantitative framework: (1) regression models based on macro and financial forecasts, (2) a CAPE-based model using targeted yearly PE ratios and earnings growth, and (3) historical returns at comparable CAPE levels. We then adjust the average output for current valuation gaps and probable risk factors. For details, please refer to our first publication on 5-year returns projections.

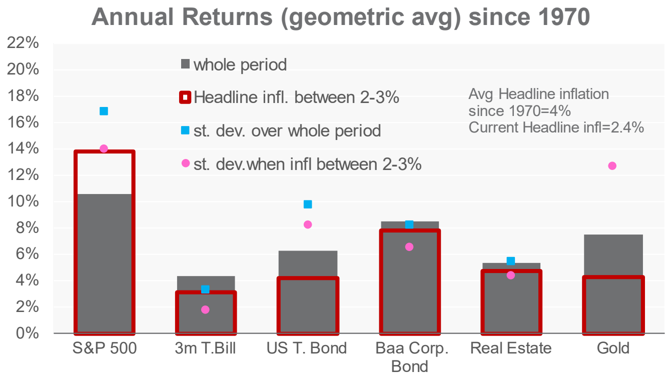
1. Our **regression-based approach uses projections of macroeconomic and fixed income variables** to estimate prospective equity returns. Key inputs include GDP growth, 10-year government bond yields, the EUR/USD exchange rate, and high-yield (HY) credit spreads. The model's forecast for the MSCI EMU has slightly increased from 4% to 4.3%, driven by lower inflation and a 60bp decline in HY spreads—more than offsetting the rise in EA yield forecasts (+65 bps compared to last year). Also for the S&P 500, projected returns

have risen from 5.5% to 6.3%, supported by a more pronounced drop in HY spreads (-85 bps), despite a modest in-crease in US 10-year yield expectations (+40 bps).

2. Our proprietary **CAPE-based model** projects 5-year returns using expected earnings growth, payout ratios, dividend and buyback yields, and target CAPEs. We also adjust fore-cast TR via modelled fair PEs. In the end, long-term returns are decomposed into three



Source: Datastream, GenAM calculations



Source:NYU, GenAM

factors: income (dividend and buyback yields), growth (EPS growth), and valuation (target CAPE). Indeed, an equity investor gets the stream of cash yields plus the annual price ap-preciation. We use the US target CAPE expected at the end of 2030 as an anchor for other markets, to which we apply historical gaps relative to the US. The target for the US CAPE is based on its observed coherence to inflation trend, using also mean reversion properties and qualitative judgement.

> We increased the EM CAPE target based on expectations of policy support in China and stronger growth prospects in Chinese Tech sector

For the Euro Area (EA) and Emerging Markets (EMs), we apply the average valuation gap of approximately 40% relative to the U.S., based on data since 2009. The resulting CAPE targets are: 26x for the U.S. (unchanged), 16.4x for the EA (up 1.2p, reflecting higher expec-tations for fiscal expansion and structural reforms), and 14.6x for EMs (up 0.4p, driven by continued expectations of fiscal support in China and stronger growth prospects in Chinese tech).

Our analysis of CAPE levels across different real yield environments indicates that a 26x CAPE for the U.S. aligns with historical norms observed since 1987, when real yields ranged between 2% and 2.5%—which is also our current forecast range. Applying the CAPE targets and the earnings growth expectations outlined above results in projected total returns of 5.7% for the U.S. (+0.3pp), 7.4% for the EMU (-0.1pp), and 6.8% for EMs (-0.3pp).

3. **Historical** assessment. We derive future return perspectives from the historical returns observed during periods when CAPE levels were similar to current levels. Across all markets considered, the dispersion of 5-year returns is wide, but it narrows as the time window ex-tends (e.g. from 5 to 10 years). For this reason, we deem a 10-year window to be a more reliable estimate. From this, we derive a TR projection, incorporating both a dividend yield and a buyback yield (higher by 50 bps vs last year due to sustained strong firms' cash-flow growth perspectives and persistently high levels of free cash on corporate balance sheets). The result is a projected TR of 5.8% for the MSCI EMU (+0.2% vs. last year), 3.2% for the S&P500 (-0.9%), and 6.4% for the MSCI EM (+2.5%).

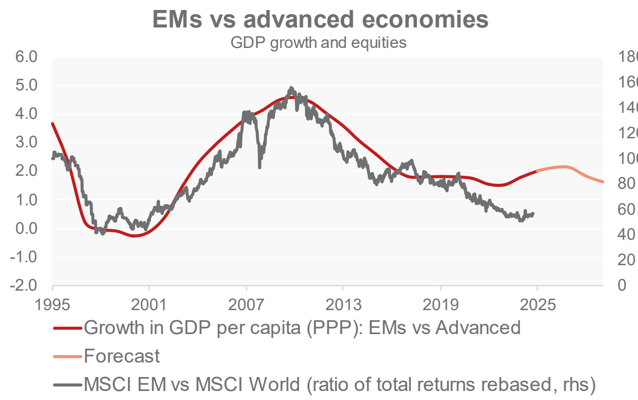
In the final step, we assess the degree of current under-/overvaluation, along with specific positive/negative risks for each market. The resulting positive or negative adjustment is then distributed evenly across the forecast years. We apply a negative factor to EA (-0.25pp p.a.) reflecting high energy costs, lagging innovation and geopolitical risks in the EA. For the US, we apply a positive adjustment (+1.2% vs prior 1.7% due to decreasing exceptionalism). This is justified by the AI and defence supremacy, productivity growth, greater policy flexibility, higher R&D and education spending, energy independence, and stronger population growth. The adjustment factor for EMs is modest (+0.8% vs 0.5% before), balancing undervaluation and improved fiscal health vs China's structural economic challenges.

For EMs, TR forecasts are also supported by higher GDP growth and expectations of a weaker US dollar (-1.7% vs. EUR p.a.).

3.2.3 Equities: better outlook vs. FI instruments

Current expected 5-year expected equity returns are not very different from those of last

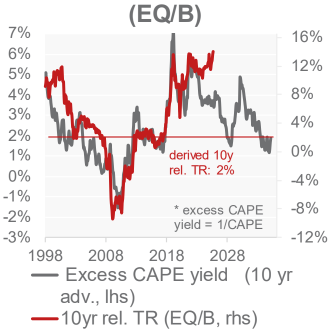
Expected returns (p.a.)	EA	US	EM (in $)
Regression models (macro- and financial variables)	4.3	6.4	6.9
CAPE-based model	7.4	5.7	6.8
Historical returns coherent to current CAPE levels	5.8	3.2	6.4
Average	*5.9*	*5.1*	*6.7*
Adjustment due to pos./neg. risks & current over-/undervaluation (p.a.)	-0.25	1.2	0.8
Final projection	**5.6**	**6.3**	**7.5**



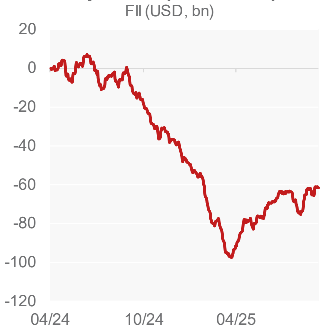
Source: Datastream, Oxf. Economics, GenAM calculations

year, except for EM upgrade. The EPS outlook has brightened a bit, especially for the laggard Europe and EMs. In the US, EPS remain sustained, however elevated valuations should dampen future TR relative to history. We forecast a conservative 2% excess TR in US equity over Treasury — modest compared to historical averages, especially during periods of headline inflation between 2% and 3%. This is explained by a currently less attractive CAPE yield (inverse of CAPE) gap vs real 10-year yields, which is almost 1.8pp below the historical norm: 2.2% vs. at least 4% since 1970 or 1928. The EMU (and ex-US countries) CAPE yield gap is better aligned with history. Notwithstanding the EMU performance achieved in the last year, resulting in higher valuation, we increased a bit the TR forecast due to expectations of higher EPS growth ahead (fiscal expansion and higher profitability for financials due to higher yields), and greater buyback yields (1.5% from 1% last year). Concerning final return expectations, we have decreased our projections for US equities (by 0.4pp), but increased other markets' ones (by 0.4pp for EMU and by 1.0pp for EM). Ex-US markets are characterized by higher volatility; both rising protectionism and trade tensions could also impact their supply chains and economies negatively. For EMs, our CAPE target and potential TR expectations, have increased vs. last year, driven by continued expectations of a weaker USD, fiscal support in China and stronger growth prospects for the Chinese Tech sector. The final adjustment factor for EMs is also modestly more positive, due to further increased negative positioning by institutional investors which may turn, thanks to undervaluation, lower US exceptionalism, better relative government efficiency as well as lower interest expenses relative to DMs (better relative fiscal metrics' trend, tighter spreads).

> We forecast a conservative 2% excess TR in US equity over Treasuries — modest compared to norm, especially during periods of inflation between 2% and 3%



Source: Datastream, GenAM calculations



Source: Bloomberg, GenAM calculations

Market	Hist. avg 5-year total return since 1998 (p.a.)	5-year total return projection (p.a.)
World (in $)*	7.7	6.4
US	9.6	6.3
EA	6.9	5.6
UK**	6.0	6.1
EM (in $)	6.4	7.5

*derived from the single returns in local currency, taking into consideration the expected FX moves

** On valuation grounds, we decided to put the UK projection 0.5% (p.a.) above that of the EA

Equity risk premia too low? Not in EU, nor in EM and Japan

Equity risk premia too low? Not in EU, nor in EM and Japan. Even for the US,our models show that current fundamentals justify currently lower-than post GFC US risk premia. That said, we assume that returns will be below the long-term norm due rich US equity valuation, the risk of higher taxation and labour costs, cost of debt etc. Diversification, also through thematics, should help: ageing population, capex supercycle (defense, electrification, digitalization, R&D-Tech-AI, green transition etc.). Compared to historical rolling 5-year averages (since 1998), our 5-year equity TR expectations are 25% lower for DM and in line for EMs. Equities should still beat most of Fixed Income, if at the cost of higher risk/volatility.

3.3 FX: a more protracted USD slide

When considering the prospects of asset classes outside the EUR universe, exchange rate risk can dominate expected risk and returns. This holds in particular for FX-dominated government bonds. The historical volatility of the EUR/USD, e.g., exceeds that of 10-year US Treasuries by a factor of about 1.5. If the outlook for USD is favourable, investors may decide to leave this FX exposure open. Alternatively, the FX risk can be hedged via forwards or cross-currency swaps. Hedging USD exposure, however, remains costly. Due to the higher interest rate environment in the US, these costs currently amount to around 1.2% p.a. (based on 5-year forward rates). In our summary tables, we therefore show the results for all three dimensions: expected local, hedged and unhedged returns.

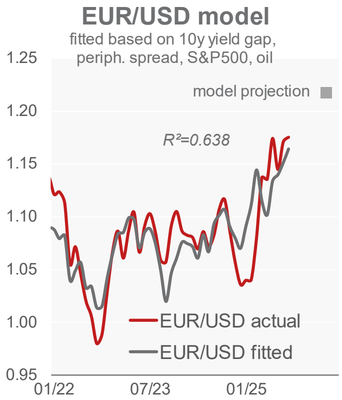
We recommended hedging USD exposure in our previous annual return updates. This has paid off. Keep it on

We recommended hedging USD exposure in our previous annual return updates. This has paid off. The USD's slide by 7% vs. the EUR since last year's update would have seriously dented returns on unhedged US assets. Looking ahead, we still see the benefits of FX hedging prevailing, even if by a tight margin. In fact, we have raised our EUR/USD 5-year target value markedly from 1.17 to 1.28. First, this reflects a significantly higher starting level (1.18 vs. 1.09 last year). Second, we see both fundamental valuations and financial market drivers still pointing towards some further USD weakness over the coming years. The implied

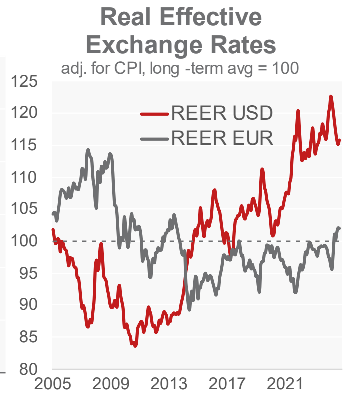
5y projections EUR/USD

	Forecast	Weight
Fair value projection (regression)	1.220	25%
PPP model	1.299	75%
Weighted avg	**1.280**	
Projection after qual. adj.	**1.280**	
Current (30/9/2025)	1.175	
Spot return USD p.a.	-1.70%	
Forwards	1.249	
Implied carry p.a.	1.22%	
Total return p.a.*	**-0.5%**	

*Source: Datastream, GenAM calculations; * spot return + carry*



Source: Datastream. GenAM calculations



Source: Datastream, GenAM calculations

expected annual spot depreciation (-1.7%) exceeds the hedging costs by 0.5pp. Hence, we expect FX hedging to both reduce the portfolio risk and protect effective returns on USD assets.

As in the previous updates, we use various steps to derive our EUR/USD forecast. We start with two quantitative approaches: (a) a **mean-reversion framework** based on purchasing power parity (PPP) and (b) projections based on a **financial market fair-value model**. We then add a qualitative adjustment to the weighted average of these approaches. Finally, we add the forward-implied carry (the reverse of the hedging costs) to arrive at the expected benefit (+) or disadvantage (-) of leaving USD open vs. a hedged exposure.

PPP points to higher much EUR/USD. Macro model more moderate. Combined approaches put fair value at 1.28 in 5 years

For (a), we employ most recent OECD PPP values and approximate the further evolution by using actual and forecasted inflation rates for the US and EA. This exercise projects PPP from estimated 1.40 currently to 1.44 by 2030. Assuming a mean-reversion towards PPP with a half-live of four years, this implies a spot rate of 1.30 by 2030. For (b), we use a model based on 10y US and Bund yields, EMU risk/spreads, risk sentiment (proxied by the S&P500), and the oil price as inputs. It explains around two thirds of EUR/USD variation since 2020 (mid chart above). The model indicates a slight EUR/USD overvaluation of ~1%. We assume three quarters of this gap to close over the next 5 years. Mostly driven by a tightening in the transatlantic spread, which is only partially offset by somewhat wider EGB spreads, these factors imply a projected fair value of 1.22 for 2040. The weighted average of the two approaches (75% PPP and 25% fair value model) renders a target of 1.28.[1]

The fundamental USD richness suggested by PPP models is confirmed by alternative fundamental approaches. Despite this year's fall in the USD, its real effective exchange rate is still dear, while the EUR is close to long-run average (right-hand chart). This year's IMF External Sector Report suggests a 12% overvaluation in the USD and a minor ~2% undervaluation in the EUR.

In our **qualitative overlay** to the model-implied values we see up- and down-side forces roughly in balance. On the USD-negative side, the USD may suffer from further diversification of global FX reserves, both by official and private investors. As shown by the declining share of the USD in official reserves and a massive increase in Central Bank gold purchases, the search for alternative holdings has increased, following stiff sanctions imposed on Russia

[1] We also provide forecast EUR/GBP for UK equity exposure. The PPP model (applying a 5-year half-life time to the gap vs current) renders 0.94 in 5 years, consistent with the ~6-7% overvaluation of GBP REER identified by the IMF. This target implies a 1.5% annual GBP spot depreciation. This is slightly less than hedging GBP exposure at annual cost of 1.7%.

and lingering frictions with trade partners. Furthermore, intensifying attacks by President Trump on the Fed's independence has unsettled investors. US institutions remain very solid, but the risk of fiscal dominance (artificially low interest rate alleviating debt servicing costs) pose upside risks to inflation and – in a worst case – the debasement of the US dollar. Given the US persistent C/A deficit which requires continuous capital inflows, even passive diversification via a drain in USD inflows would suffice to weaken the USD.

The risk of fiscal dominance is a headwind for the USD, though the EU faces its own challenges (primarily competitiveness)

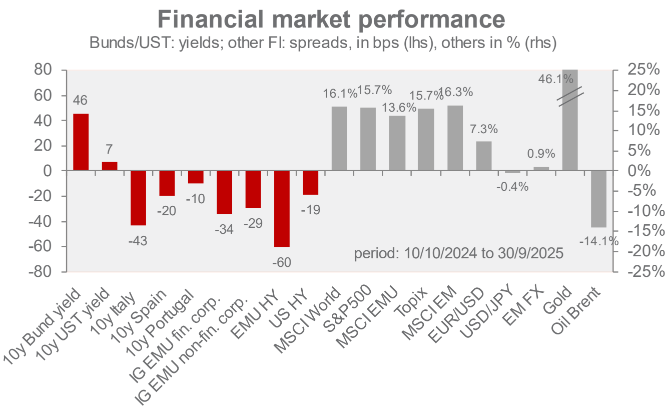
These downsides for the USD, however, are contrasted by risks to the EUR. This year's fall in energy prices has alleviated the euro area's terms of trade and its acute competitiveness problems arising from relative energy prices. Yet with most EU countries still hesitant to deliver on deeper reforms and the EU as a whole lagging far behind in implementing key recommendations by last year's Draghi report, the euro area keeps struggling to regain international competitiveness. Given its strong international integration, it is also vulnerable to a further fragmentation of global trade links amid deepening US/China rivalry. While net FDI inflows may recover, they are likely to remain lukewarm on a structural basis.

Given the rather balanced qualitative considerations, we apply the models' weighted average of 1.28 as our 5y forecast. This implies an annual spot depreciation of -1.7%, which is inferior to the costs of hedging via forwards (-1.2%) by a margin of 0.5% p.a.

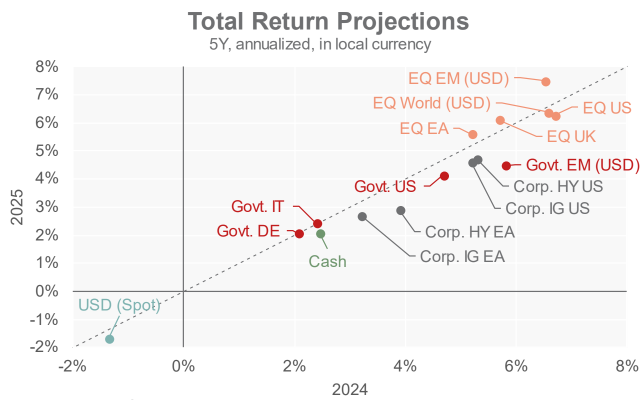
4. Conclusions

Tighter risk premiums keep a lid on returns and induce a higher risk asymmetry

The period of ultra-low yields, which dominated much of the 2010s, is over. Both cash and safe government bonds offer prospective returns over the next years that can at least compensate for inflation which we expect to largely match central bank targets again. That said, the expected compensation for higher-risk asset classes is historically subdued. The risk premium for both corporate credit risk and equities has compressed further over the past year. This not only depresses the current yield on those asset classes but also entails a higher risk asymmetry: risk premia are unlikely to significantly compress further from here while the risk of a re-widening has grown. Also, low risk premia imply that the range of expected returns remains tight. Over the past ten years, the performance difference between the best and worst performing asset classes under consideration was 13.6pp (US equities 12.8% vs. USTs -0.8%). In our projections for the coming 5 years, the difference amounts to just some 4pp (EM equities +6.2% vs. Cash 2.1%).



Source: Datastream, GenAM calcuations



Source: Datastream, GenAM

Limited changes in the return expectations vs. last year…

That said, compared to last year's projections the dispersion is slightly higher due to decreased returns on Cash (2.1% from 2.5%) following central banks' rate cuts and slight upgrades to returns in EM equities (6.2% from 5.2%, EUR hedged). Overall, however, this year's changes to our (2024) projections are limited. This is illustrated in the right chart above, which compares the local currency return projections between last year (horizontal axis) and this year (vertical line), with points above the dotted line implying higher expected returns this year (and reversely for those below the line). The most striking upgrade is the expectations for EM equities (+1pp) owing to anticipated higher valuations (CAPE), a weaker US dollar and stronger Chinese IT earnings growth amid still cautious investor positioning in this asset class. By contrast, we have trimmed our return expectations for Credit (both IG and HY). This is the result of the strong further compression of spreads (left chart above) which both lowers the current income and – notably for EUR Credit – the returns prospects from spread moves. The expected returns on government bonds are little changed in EUR, and slightly lower in USD. EUR yields have risen slightly (so better entry levels), while US yields have dropped a bit. We have increased our long-term target yields amid a slightly higher assumed neutral rate in the US and a stronger increase in the term premium amid rising public debt levels (10y Bunds target up from 2.4% last year to 3.05% now, 10y UST from 3.5% to 4.0%). We lowered our return expectations for hard-currency USD EM debt by 1.3pp owing to compressed spread levels and lowered prospects for US Treasuries. We also raised our EUR/USD target by more than its past year's 7% bounce (from 1.17 to 1.28) which implies a (continued) recommendation to FX hedge USD exposure.

… with an upgrade of EM equities return contrasting a downgrade for EM bonds

We see key risks to the baseline forecasts from a resuming trade war, debt sustainability worries, a global recession and – on the upside – from fast materializing AI benefits

We see four key risk scenarios shifting returns from our baseline assumptions. First, a resuming trade war denting risk sentiment and reigniting stagflationary pressures. Second, rising debt sustainability worries, with the risk of fiscal dominance unleashing inflation. Third, a sharp global slowdown or recession. Fourth, a Goldilocks scenario with the AI boom unfolding a broader productivity boost.

1. **Stagflation risks from a resuming trade war.** The global economy has weathered the US tariffs with striking resilience thus far, thanks to the large absence of retaliation measures as well as lower energy prices and Fed rate expectations. Trade tensions may resume swiftly, however, amid lingering strategic US/China rivalries. Non-compliance on some hard-to-realize concession (e.g. the EU's pledge to buy U$750bn worth of US energy and unleash U$600bn in US investment by 2028) may also trigger new US action against the EU with risk of retaliation. A tit-for-tat trade war would be stagflationary, with adverse impacts on bond and equity return alike while inflation linkers offer protection.

2. Rising **debt sustainability worries**, with the risk of **fiscal dominance** unleashing inflation. Public debt in advanced economies has soared over the past 20 years, with G7 levels amounting to 126% of GDP in 2025. A sudden increase in market worries about debt sustainability may trigger surging government bond yields. Even the UST market no longer looks fully immune to such worries. Equities and HY Credit would suffer too on rising recession worries and a hit to risk sentiment. IG Credit would feel headwinds but may prove more resilient amid overall healthy balance sheets.

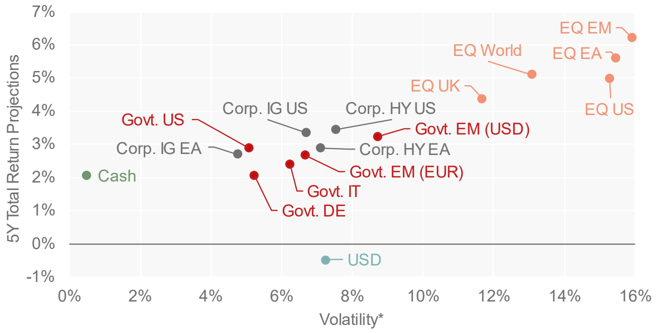
3. A **sharp global slowdown /recession**. Souring sentiment and credit events could end the protracted period of global economic resilience. Pockets of weakness may be exacerbated by high leverage and liquidity mismatches in the shadow banking sector. Central banks would lend support by cutting rates but high public debt levels and already elevated fiscal deficits in many legislations limit the scope of a forceful fiscal

response. Highly rated government bonds would benefit while risk assets may suffer strong drawdowns.

4. A **Goldilocks scenario** with the AI boom unfolding a productivity boost. Investment in AI and datacentres has been soaring, notably in the US. Other regions may soon follow suit. If deployed widely and effectively, broad based productivity gains can materialize faster and more strongly. Higher economic growth rates would benefit corporate earnings and thereby Equities and HY, Government bonds – more mildly so – from improving debt dynamics and easing inflation pressures even though this would be partially offset by a rise in the equilibrium levels of policy rates.

Risk-Return Characteristics

in EUR, FX hedged, annualized



*hist. vol. based on monthly returns from 10/15 to 09/25

Source: Datastream, GenAM

Total Return Projections

(5Y, annualized)

Asset Class	Currency	Local	EUR (FX hedged)	EUR (unhedged)
Cash	EUR	2.1%	2.1%	2.1%
Govt. DE	EUR	2.1%	2.1%	2.1%
Govt. IT	EUR	2.4%	2.4%	2.4%
Govt. US	USD	4.1%	2.9%	2.4%
Govt. EM (EUR)	EUR	2.7%	2.7%	2.7%
Govt. EM (USD)	USD	4.5%	3.2%	2.7%
Corp. IG EA	EUR	2.7%	2.7%	2.7%
Corp. HY EA	EUR	2.9%	2.9%	2.9%
Corp. IG US	USD	4.6%	3.4%	2.8%
Corp. HY US	USD	4.7%	3.5%	2.9%
EQ World	USD	6.4%	5.1%	4.6%
EQ US	USD	6.3%	5.0%	4.5%
EQ EA	EUR	5.6%	5.6%	5.6%
EQ UK	GBP	6.1%	4.4%	4.5%
EQ EM	USD	7.5%	6.2%	5.7%
		Spot	**Carry**	**Total**
USD		-1.7%	1.2%	-0.5%
GBP		-1.5%	1.7%	0.1%

IMPRINT

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