

Core Matters

5-year returns forecasts:

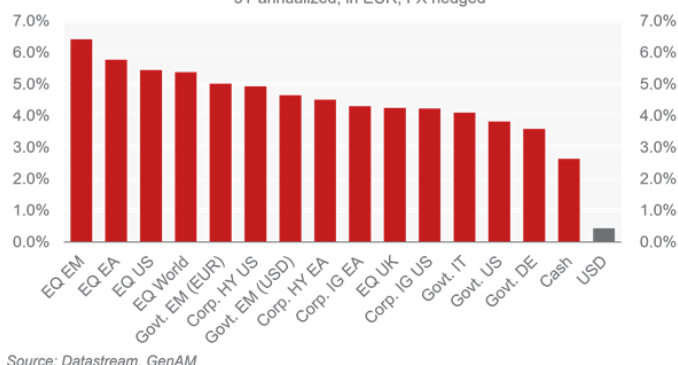
The return of carry

GenAM Macro & Market Research
 20 October, 2026

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

- Global equities remain on course for a fourth consecutive double-digit gain in 2026, while government bonds have struggled as yields climbed to multi-year highs. Those higher yields, however, now offer a much stronger starting point for fixed-income returns over the next five years – marking the return of carry.
- Equities still offer the highest absolute returns in our updated five-year outlook. Earnings growth should moderate as the AI investment cycle matures, but amid reasonable valuations should still prove enough to support annual returns of 5.8% for EUR equities and 6.4% for EM, after FX hedging costs. These returns are below historical norms but remain attractive.

Total Return Projections
 5Y annualized, in EUR, FX hedged



- The expected return gap between equities and bonds has narrowed sharply, though. Fixed-income performance should be driven primarily by carry rather than large capital gains or losses, with annual returns in euro terms ranging from 3.6% for Bunds to 4.1% for BTPs. Credit should fare even closer to Equities. Despite tight spreads, carry and subdued corporate default rates should support annual returns of about 4.3% or more for EUR IG and HY Credit. EM sovereign debt may deliver slightly higher returns.
- On a risk-adjusted basis, EUR credit and EM debt look especially attractive, with implied Sharpe ratios exceeding those of EMU equities. This strengthens the case for more balanced portfolios, a gradual rebuilding of duration and broader regional diversification.
- We expect the US dollar to weaken (EUR/USD at 1.20 in five years), though this is a slightly smaller move than forwards imply. Because unhedged USD exposure adds substantial volatility, FX hedging may still improve risk-adjusted returns.
- In all, the overall liquid asset return outlook is decent, not stellar. With dispersion rising within selected asset classes, alpha becomes more important. Also, at (currently) elevated level of real yields, the stock-bond correlation tends to be positive, which reduces diversification benefits: hedging matters. Four scenarios could materially shift returns from our baseline: renewed stagflation; escalating fiscal concerns; an AI-led earnings bust and recession; or a Goldilocks outcome in which broad AI adoption lifts productivity and growth without reigniting inflation.

CONTENT

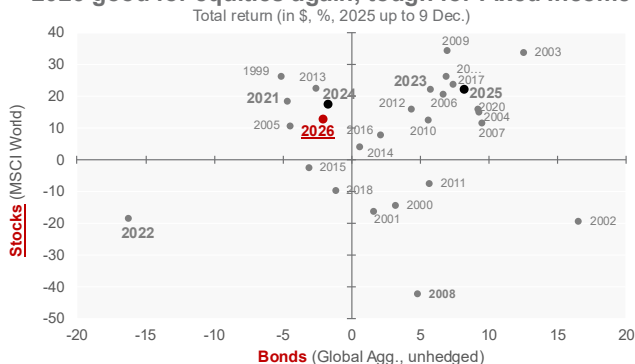
1. Introduction	2
2. Macro backdrop	6
3. Financial return expectations	9
3.1 Fixed income assets	9
3.1.1 Government bonds	10
3.1.2 Credit	11
3.1.3 EM Sovereign bonds	11
3.2. Equities	13
3.2.1 Earnings growth next 5 years: a slightly brightening outlook ex-US	13
3.2.2 Long-term equity returns: the framework	14
3.2.3. Expect high mid-single digit equity TR with EMs to outperform	16
3.3 FX: Weaker dollar, hedging pays only on a risk-adjusted basis	17
4. Conclusions: a new dawn for bond investors	19
IMPRINT	22

Looking back: a great decade for stocks; a lost one for bonds

1. Introduction

Global stocks look like they will enjoy another above-10% gain in 2026, for the fourth year in a row; at +13% year-to-date, the MSCI World has been less brilliant than in the past three years (respectively +22%, +18% and +22%), but that still caps an exceptional decade that will have seen the total return index more than triple. Meanwhile, Fixed Income returns have continued to struggle: the Global Aggregate is on course to deliver another negative total return this year (-2.1% YTD as we go to press), for the fourth time in just six years. Still, the small loss does not change the view, expressed last year, that global Fixed Income is now on the mend: the sharp rise in yields from the 2020 lows has bolstered carry, making large drawdowns ever less likely – unless the default cycle takes an aggressive turn for the worse. Despite lacklustre FI performances, a global 60-40 stock-bond portfolio has delivered some 64% (13% p.a.) in the four years to October 2026.

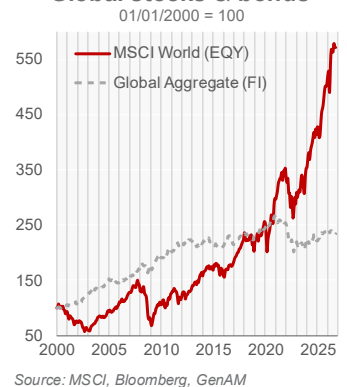
2026 good for equities again, tough for Fixed Income



60-40 global stock-bond

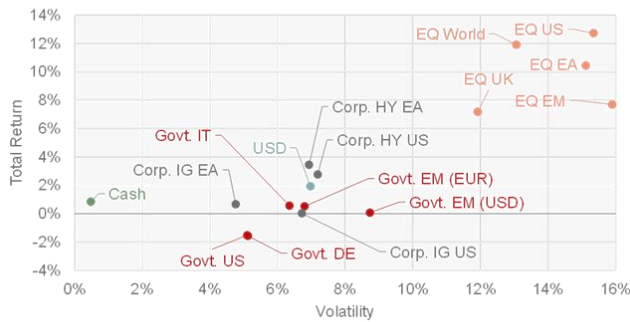


Global stocks & bonds



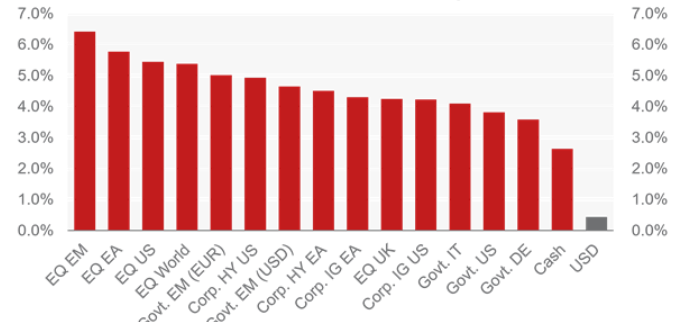
Looking back further to the past decade, the left-hand chart below summarises performance across liquid assets – this time in EUR, after FX hedging. Developed Market government bonds stand out, as the sharp drawdown of 2022 has caused a negative 10-year total return over 10 years – a rather rare occurrence. Investment Grade (IG) Credit has done better, thanks to carry and spread narrowing, but not even as well as Cash. High Yield Credit sits in the middle of the pack, both in terms of return (about

Historical Risk-Return Characteristics
in EUR, FX hedged, annualized



*based on monthly returns from 10/16 to 09/26
Source: Datastream, GenAM

Total Return Projections
5Y annualized, in EUR, FX hedged



Source: Datastream, GenAM

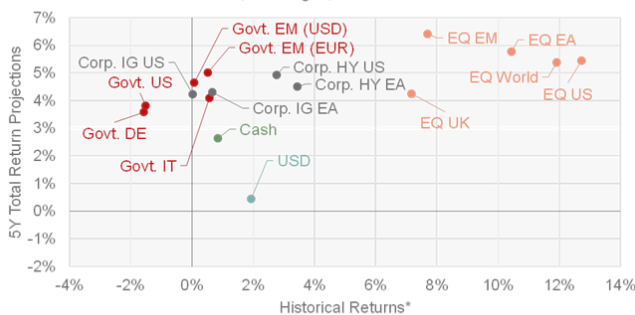
We expect equities to dominate again over the coming 5 years, but by a much lower margin

Equity dispersion has increased and is likely to stay elevated as AI creates win-ners and losers: Alpha matters

3% p.a.) and volatility. Equities have easily topped the rankings, with the US yet again winning the total return gold medal, around 13% p.a. (for an annualised volatility of ~15%). Looking forward, the right-hand chart above summarises our forecasts for the next five years, which are explained in detail in this report. We expect equities to dominate again, but by a much lower margin, as Fixed Income will do much better, largely thanks to carry rather than substantial capital gains: we expect bond yields to stay higher for longer. Emerging Markets should rank at the top, both in Equities (above 6% p.a.) and in Fixed Income (expected TR in Hard Currency Government Debt above 5%). We expect the USD to end up slightly stronger than the 5-year forward EUR/USD rate is suggesting. The left-hand chart below compares expected returns for the next five years to realised returns over the past ten. FI assets will do much better than they have, but the reverse is true for equities.

The equity miracle is likely tired. The middle chart shows that US stocks have massively outperformed what earnings yields suggested 10 years ago. This reflects both a sharp improvement in corporate profitability, and an expansion of equity multiples (the S&P NTM Price Earnings Ratio, around 19, is ~2.5 points above where it was 10 years

History vs. Projections
in EUR, FX hedged, annualized



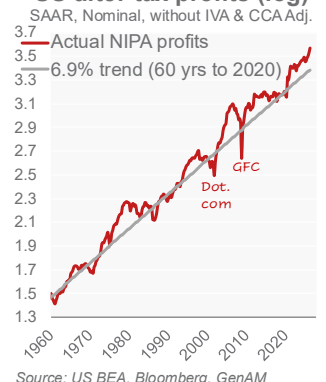
*based on monthly returns from 10/16 to 09/26
Source: Datastream, GenAM

Valuation leads S&P return



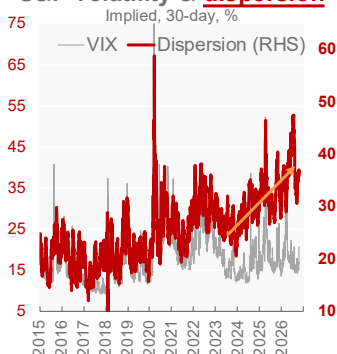
* Based on 12m fwd earnings, smoothed (6m)
Source: S&P, Bloomberg, GenAM

US after-tax profits (log)



Source: US BEA, Bloomberg, GenAM

S&P volatility & dispersion
Implied, 30-day, %



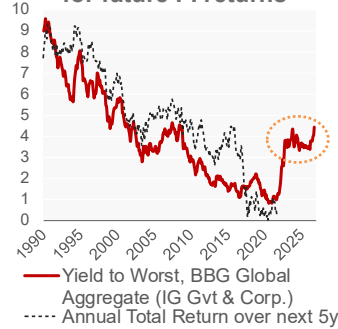
Source: CBOE, Bloomberg, GenAM

Global Agg. Treasuries



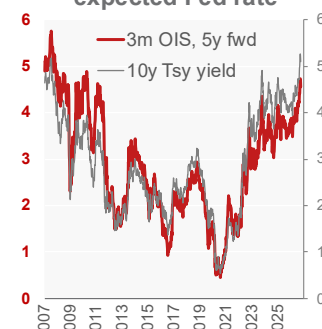
Source: Bloomberg, GenAM

Yield at t0 matters much for future FI returns



Source: Bloomberg, GenAM calculations

10yT vs. mid-term expected Fed rate



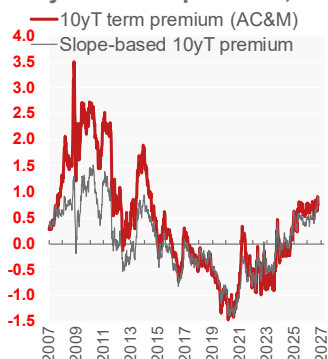
Source: Bloomberg, GenAM

ago). While we do not find valuation stretched, the key question is whether profits can continue to surprise to the upside. They have outperformed long-term trends, and such deviation has often not ended well – e.g. with the dotcom bust or the Great Financial Crisis (right-hand chart). We do not foresee a repeat of such an accident, as the AI revolution will help profits continue to take a bigger share of the added value (at the expense of employee compensation). Under the hood, equity dispersion has increased and is likely to stay elevated as AI creates winners and losers: Alpha matters.

The return of carry. The second chart above shows the average global government bond yield (DM and EM, IG, in local currencies), now at a new high for this century. As the next chart shows, yields at inception (Global Aggregate at 4.32% by mid-October 2026) largely define what FI returns will be over the following 5 years, plus capital gains (falling yields) or minus capital losses (rising yields and/or default). Reassuringly, with markets already pricing a hawkish path for central banks – too hawkish we think, e.g. the Fed is priced above 4.50% in 5 years, over 75bp above what we consider as neutral – the risk of a further sharp increase in yields is low. Arguably, we expect term premia to rise further (first chart below), which will limit capital gains. In line with our structural view, Corporate Credit has outperformed Government Bonds – sometimes in a spectacular fashion (2nd chart below: France vs. EurAgg). We continue to like Credit, where leverage remains low and carry substantial.

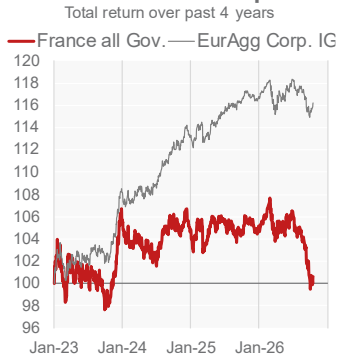
Average global government bond yield at a new high for this century

10y UST term premium, %



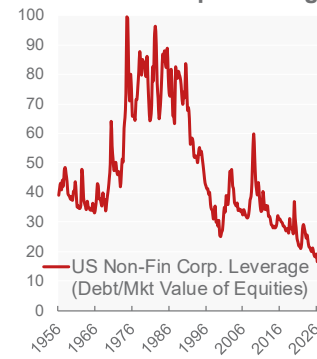
Source: Adrian Crump & Moench, BBG, GenAM

France Gov. vs Corp. IG



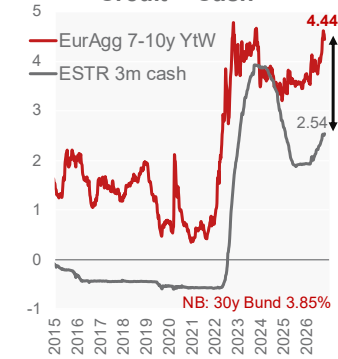
Source: Bloomberg, GenAM

US Non-Fin Corp. Leverage



Source: FRED, GenAM

Credit > Cash

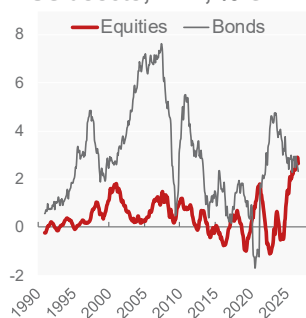


Source: Bloomberg, GenAM

Safe-haven status of US dollar damaged; lower stock-bond diversification benefit

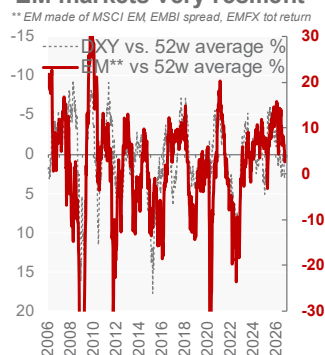
About long-term portfolio diversification and hedging. The US trade deficit has increasingly been funded by foreign flows into US equities, rather than Treasuries. This may well damage the safe-haven status of the USD, in future risk-off episodes, especially if they hit the dominant US Tech equity sector. Prefer the CHF and Gold as safe havens. Energy prices and the Fed repricing have supported the dollar in 2026, but EM assets have been very resilient – vindicating our view of converging EM-DM standards. Finally, let us remember that at elevated levels of real yields, the stock-bond price correlation tends to be positive. While our 5-year projections are positive – if somewhat muted – hedging at cheap levels of equity volatility makes sense.

Net foreign purchases of US assets, 12m, % GDP



Source: US TICSDATA, Bloomberg, GenAM

EM markets very resilient



Source: Bloomberg, GenAM calculations

US stock-bond price correlation



Source: Bloomberg, GenAM calculation

2. Macro backdrop

In 2026, global economic activity has remained resilient but lost momentum as the year progressed. Strong investment in artificial intelligence (AI), private-sector adaptation and still-supportive demand have cushioned the impact of major shocks, particularly in the US. However, US job creations have cooled, and the growth outlook has become more uneven. The euro area entered the year with improving underlying momentum, but its recovery has remained modest and held back by higher energy costs and its exposure to global trade. China continues to face weak domestic demand and persistent property-sector strains despite robust exports and technology investment. The trade conflict initiated by the Trump administration in 2025 has meanwhile become a more permanent feature of the global economy, even though some of the initial uncertainty has faded.

Growth outlook: resilient globally, diverging across the Atlantic. Over the next five years we expect global growth to hold up reasonably well, but the drivers are shifting. The biggest structural tailwind is the investment cycle around artificial intelligence. Spending on data centres, semiconductors, power grids and software is likely to support capital formation well into the second half of the decade, and broader adoption should gradually lift productivity. Global trade, by contrast, is no longer the growth engine it once was. Tariffs, geopolitical fragmentation and the reshoring of strategic supply chains point to trade expanding roughly in line with, or below, global output. Those forces also raise costs and weigh on efficiency, especially for open, export-oriented economies.

The US and the euro area look set to diverge further. We see US potential growth edging up from 1.9% in 2026 to 2.1% in 2031. The US benefits from leading the AI value chain, deep and risk-tolerant capital markets, faster diffusion of new technology, relatively favourable demographics and energy self-sufficiency. Lower immigration and high public deficits are the main risks. In the euro area, we expect potential growth to fall from 1.2% to 0.8% over the same period. The working-age population is starting to shrink, productivity growth is structurally weak, and the region relies less on AI production and more on adopting it, with a lag. Higher energy costs, an industrial base exposed to Chinese competition and fragmented capital markets add to the drag. Defence and infrastructure spending, notably in Germany, should provide a temporary demand boost. But without decisive progress on the capital markets union, the single market and labour supply, it is unlikely to reverse the downward trend. The transatlantic growth gap is thus set to widen from around 0.7 to 1.3 percentage points.

Inflation will cool down, but repeated supply shocks leave risks tilted to the upside. We expect inflation in both the US and the euro area to return gradually to 2%, although it is likely to remain above target for another couple of years. Long-term (5y5y forward) inflation-linked swaps currently embed a risk premium of around 20 basis points for both the US and the Euro area. This is consistent with our view that inflation risks over the next five years are skewed materially to the upside, not least because the geopolitical backdrop is unlikely to improve significantly. Adverse supply shocks could take the form of sudden and potentially long-lasting disruptions to commodity supplies, as occurred after Russia's invasion of Ukraine and the US-Israel attacks on Iran. They could also emerge more gradually: the re-configuration of trade and supply chains may reduce the efficiency gains from international trade, raising production costs. Many trade restrictions imposed by the US administration

Surprisingly resilient
global economy in
2026

Transatlantic potential
growth differential to
widen due to AI and
demographics

Geopolitics, the AI-
buildup and trade pol-
icy create upside risks
to inflation in the short
term

are likely to remain in place, as happened when the Democrats returned to power in 2021 after President Trump's first term. Outside the US, the EU is also likely to respond to a new "China shock", driven by Chinese overcapacity and stronger competition in key sectors such as automotive, by introducing additional trade restrictions. Climate change will also become an increasingly important source of adverse supply shocks, as higher temperatures and more frequent disruptive natural events affect agricultural output and commodity prices. Meanwhile, the build-up of AI capacity is currently adding to inflationary pressure on goods. Over time, wider AI adoption should lift productivity and help contain inflation, but the timing and scale of that transition remain highly uncertain.

Fiscal policy: little room, rising pressure. Over the next five years, public finances on both sides of the Atlantic are more likely to deteriorate than improve. The pressure is structural rather than cyclical. Ageing populations will push up spending on pensions, health and long-term care. The green transition requires substantial public investment and subsidies. And a more dangerous geopolitical environment has made higher defence spending a lasting commitment rather than a temporary one, as NATO's higher spending targets underline. At the same time, debt service will keep rising as low-coupon debt from the zero-rate era is refinanced at higher yields. In the euro area, falling potential growth will also make the gap between interest rates and growth less favourable, so stabilising debt will require larger primary surpluses that few governments are willing to deliver. The EU fiscal framework now gives more room for defence spending, and Germany has loosened its debt brake, so fiscal policy is set to stay loose rather than to tighten. Country-specific risks add to the uncertainty, with France the main concern. With a deficit north of 5%, a current debt ratio of 119% of GDP and a fragmented parliament, France has little room for error. Unless the 2027 presidential and general elections deliver a stable majority willing to tackle chronic deficits, further rating downgrades, wider spreads and spillovers to other highly indebted members may be in the offing. The ECB's Transmission Protection Instrument (TPI) is a backstop, but the hurdles for its use are high, especially as it is designed only for countries that comply with EU fiscal rules. In the US, the fiscal position is also very stretched. Deficits remain unusually high for an economy near full employment, and debt is on a steadily rising path. Interest costs are surging, and political polarisation leaves little prospect of consolidation. For bond markets, this points to persistent upward pressure on term premia and greater sensitivity to fiscal news over the forecast horizon.

Monetary tightening should be partly unwound, but a higher neutral rate will limit the decline in policy rates. Central banks may still need to raise rates in the near term to prevent higher energy prices from feeding through to core inflation. However, we expect part of this tightening to be reversed over the forecast horizon as inflation moves back towards target. The reversal is unlikely to be complete because we expect the neutral interest rate – the long-term anchor for policy rates – to rise. More specifically, we project the (real) neutral rate to increase from 0.3% to 0.6% in the euro area and from 1.3% to 1.6% in the US. Several forces underpin this rise. First, higher public debt will shift the global saving-investment balance: greater government financing needs will require higher interest rates to attract sufficient savings to clear bond markets. Second, AI-driven productivity gains should raise the expected return on capital and stimulate investment. A higher neutral rate will therefore be needed to balance stronger investment demand with available savings. Third, greater inflation uncertainty may lead central banks to maintain an upward bias in policy rates to limit the risk that supply shocks generate second-round effects on core inflation. Monetary-policy frameworks may also change over the next five years. A comprehensive review of Federal Reserve practices and targets under the new Chair Warsh could lead to changes with

Public finances generally deteriorate

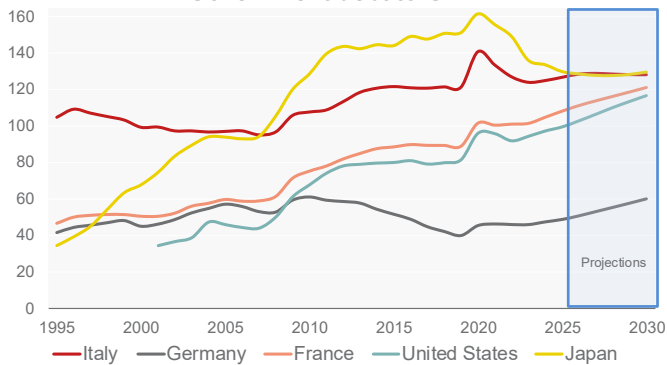
Rising r-star due to higher public debt, AI productivity gains and higher inflation uncertainty

implications beyond the US. The most consequential one would be a faster reduction in the Federal Reserve's bond holdings, which would return a substantial amount of duration to the market and put upward pressure on longer-term yields. We currently view this as a risk rather than our base case, though, as a sharper balance-sheet reduction would also drain bank reserves and could weaken credit supply. The next ECB strategy review is scheduled for 2030 only and we do not look for substantial adjustments in the meantime.

Fed and ECB policy rates to peak at 4.5% and 3.0%

Key rate normalization after near-term spike. The current energy-led inflation spike and the risk of second-round effects from wages will trigger higher policy rates near term. The Fed is expected to raise its key rate to 4.5%, the ECB to 3.0%, both in slightly restrictive territory. Depending on the evolution of geopolitical risks and energy prices, the risks around this base assumption are two-sided. While higher-than-expected inflation would demand higher policy rates, strongly deteriorating financing conditions could make central banks more hesitant. Looking beyond the current hiking needs, a shift towards shorter-duration debt over the coming years would cause borrowing costs to reset more quickly when policy

Government debt to GDP



2031 macro and central bank scenario

Item	Euro area		US	
	current	2031 proj	current	2031 proj
Equilibrium real short term rate (r^*)	0.3	0.6	1.3	1.6
Inflation (HICP, core PCE for US)	3.2	2.0	3.4	2.0
Potential growth	1.2	0.8	2.1	2.1
Neutral Central Bank policy rate	2.3	2.6	3.3	3.6
Current real short term rate (r)	-0.8	0.4	0.5	1.6
Current nominal short term rate (ESTR, SOFRE)	2.4	2.4	3.85	3.8

Source: Datastream, GenAM calculations

rates change, strengthening the transmission of monetary policy to government finances. Because rate increases would then have a faster and more pronounced effect on the economy, central banks may raise policy rates more cautiously. In any case, with the inflation spike fading more meaningfully in 2028, central banks are set to bring policy rates back down with timing and magnitude strongly depending on the materialization of geopolitical risks.

3. Financial return expectations

3.1 Fixed income assets

Attractive returns supported by high carry

Attractive fixed-income returns. We expect decent returns on fixed-income products, both sovereign and credit, over the next five years, reaching the upper end of the range seen over the past decade, following a further rise in global yields over the past quarters. As a result, several parts of the fixed-income spectrum, such as EUR and US HY and even EM USD external debt, should deliver returns close to their equity-market equivalents, with lower volatility.

Higher underlying yields make fixed income more appealing. We have raised our global yield forecasts, with the largest revisions in the US, underpinned by structural forces such as stronger investment, along with ageing populations and higher defence spending. The positive point is that these higher starting yields restore the appeal of fixed-income products and make carry the main driver of returns, while we do not expect a sustained yield increase from here. Despite tight spread valuations, high all-in yields make EM sovereign debt and DM credit compelling.

Continue to favour credit over sovereigns. The recent pressure on DM sovereign yields has vindicated our long-held preference for credit. Corporates continue to exhibit sound balance sheets, while the fiscal position of DM sovereigns has deteriorated.

Improving long-term valuations. EM sovereign and corporate financial fundamentals have improved. The resilience of spreads to the latest tensions in the Middle East provides a good illustration and so we have pencilled in lower long-term spread forecasts compared to last year.

Asset Class	FV Approaches					5Y Forecast	
	Currency	Current*	Regression	Forward	LT average	FV **	Applied
German Government 3-year	EUR	3.27%	2.50%	3.65%	0.64%	2.77%	2.70%
German Government 10-year	EUR	3.59%	3.71%	4.01%	1.08%	3.57%	3.55%
Italy Government 3-year	EUR	3.70%	2.97%	5.13%	1.45%	3.68%	3.40%
Italy Government 10-year	EUR	4.61%	4.70%	5.49%	2.64%	4.81%	4.75%
US Treasury 3-year	USD	5.00%	3.75%	5.52%	2.57%	4.34%	4.20%
US Treasury 10-year	USD	5.28%	5.35%	5.90%	2.90%	5.32%	5.25%
EM Ext. Gov. (spread in bps)	USD	184	250		278	262	225
EM Ext. Gov. (spread in bps)	EUR	178	220		241	230	185
Euro IG Corp. (spread in bps)	EUR	93	75		121	65	75
Euro HY (spread in bps)	EUR	331	300		376	285	300
US IG Corp. (spread in bps)	USD	85	80		106	75	80
US HY (spread in bps)	USD	331	320		354	290	320

*as of 30/09/2026

**weighted average (Govies: 50% regression, 40% forward, 10% LT average, EM: 50% regression, 50% LT av., Corps: 80% regression, 20% LT average)

Asset Class	Coupon	Mark to Market*	Valuation adj.**	Credit migration	Credit default	Overall***
German Government Bonds	2.5	0.8	0.2			3.6
Italy Government Bonds	3.7	0.6	-0.2			4.1
US Treasury Bonds	4.2	0.9	0.3			5.4
Euro IG Corporate Bonds	3.5	0.5	0.5	-0.1	-0.1	4.3
Euro HY Corporate Bonds	5.8	0.4	0.2	-0.2	-1.6	4.5
US IG Corporate Bonds	5.3	0.6	0.2	-0.2	-0.2	5.8
US HY Corporate Bonds	7.5	0.6	0.4	-0.2	-1.8	6.5
US EM USD Exter. Sov. Bonds	6.3	0.7	-0.3		-0.4	6.2
US EM EUR Exter. Sov. Bonds	4.2	0.8	0.3		-0.3	5.0

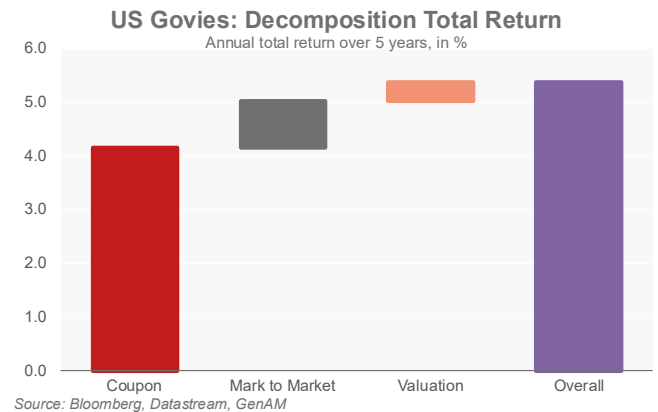
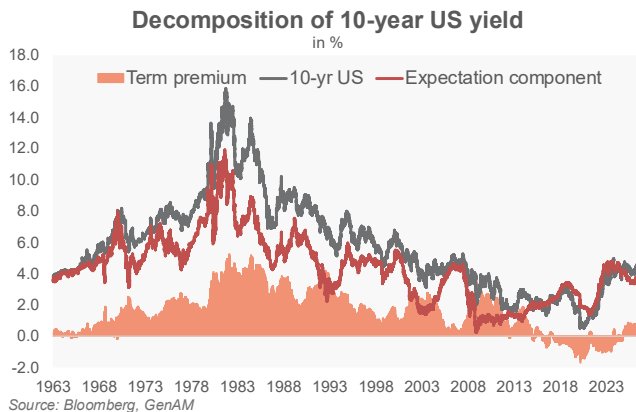
*roll and pull-to-par effect

**changing yield level at a certain time

***annualized returns over 5 years in local currency and in %

3.1.1 Government bonds

Government bonds delivered negative total returns over the past 12 months as yields climbed to multi-year highs across global markets. Markets have priced policy rates at levels that we consider difficult to sustain, pushing short-dated yields sharply higher and flattening curves. At the long end, the sell-off also reflected a broader reassessment of inflation, fiscal and term-premium risks. Higher inflation compensation and real yields both lifted 10-year Bund yields. In the US, by contrast, real yields accounted for almost the entire increase and now stand above 2.75% (10-year), up ~400bp in 5 years.



We have therefore raised our yield forecasts across maturities versus last year, with the largest revisions at the long end and in the US. This reflects our conviction that the forces behind the rise in yields are structural and likely to persist. Ageing populations and higher spending on defence, infrastructure and the energy transition will keep fiscal deficits and government financing needs elevated. Political fragmentation will meanwhile make credible and lasting consolidation harder to achieve. Heavy sovereign issuance will coincide with continued central bank balance-sheet reduction, shifting more supply towards price-sensitive private investors. In our baseline, they will demand higher term premia as compensation for greater fiscal, inflation and political uncertainty.

Strong private investment in AI, digitalisation, energy infrastructure and reshoring will intensify competition for savings and support a higher equilibrium interest rate. Higher domestic yields in Japan may also curb Japanese demand for foreign bonds, while mounting fiscal risks could erode part of the safety and liquidity premium traditionally attached to sovereign debt. Nevertheless, after the rapid rise in yields, particularly since the end of June, we do not envisage a further sustained increase over the five-year horizon. Instead, overly restrictive policy rate expectations should unwind, pulling short-dated yields lower and steepening curves.

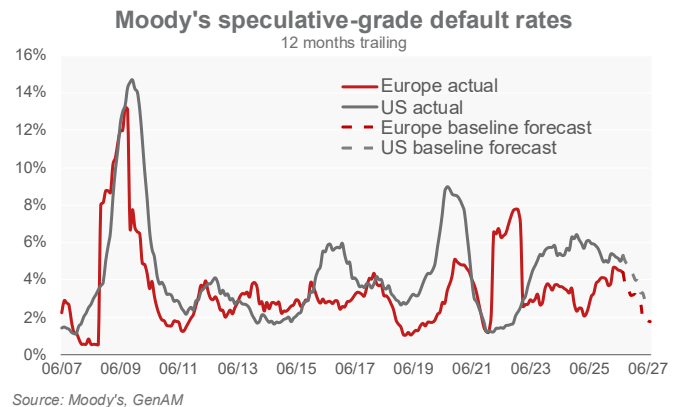
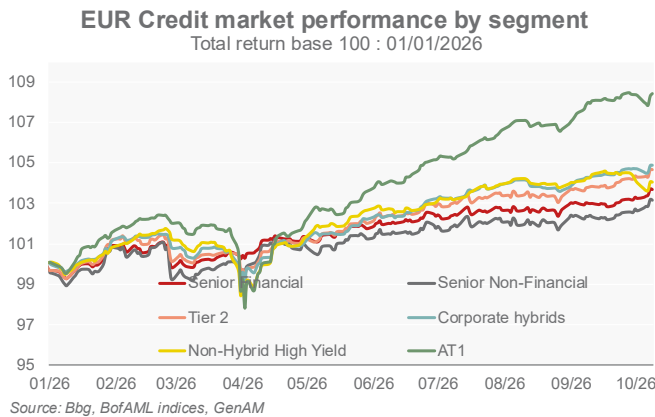
Higher starting yields materially lift our five-year total return forecasts compared with last year, with carry rather than capital gains providing the main contribution. In local currency terms, US Treasuries should return well above 5% per year. Italian BTPs rank second at more than 4%, even as we expect moderate spread widening versus Bunds. Bunds should still deliver around 3.6%, a marked improvement on previous years. Government bonds therefore offer a much narrower return gap versus riskier asset classes than they have for many years, significantly strengthening their relative appeal.

Higher starting yields restore government bonds' appeal, with carry driving attractive returns over the next five years.

Returns should also remain clearly positive after inflation. Over five years, government bonds should outperform euro area money market investments as the ECB is likely to resume rate cuts towards the end of the forecast period. Higher income, positive real returns and more attractive relative valuations now make sovereign bonds a considerably stronger portfolio proposition than a year ago. We therefore see greater scope for investors to rebuild strategic duration exposure.

3.1.2 Credit

Both fundamentals and technicals remain supportive for credit. Corporate balance sheets have generally proven resilient despite the higher-for-longer rate environment, while refinancing risks have remained contained. From a technical perspective, investor demand continues to be underpinned by attractive all-in yields, which remain elevated by historical standards. In a world where policy rates are expected to stay relatively high, credit continues to offer a compelling combination of carry and income, supporting strong demand across the asset class. While spread valuations appear rich, carry should remain the dominant driver of returns going forward.



Compared to last year, we are largely increasing our return assumptions for all credit market segments. The contribution of return components is different compared to 2025:

- Underlying yield contribution is the major positive, as mentioned in the previous section.
- Valuation is slightly more positive this year as both our fair value models and the 10Y moving average indicate slightly tighter spreads.
- Finally, carry is much higher compared to previous years, as underlying (government bond) yields have surged.

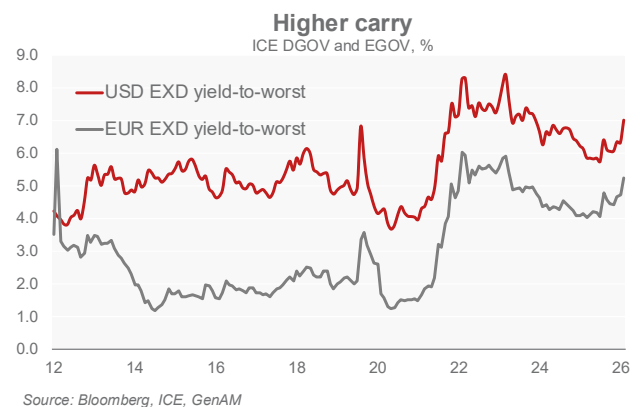
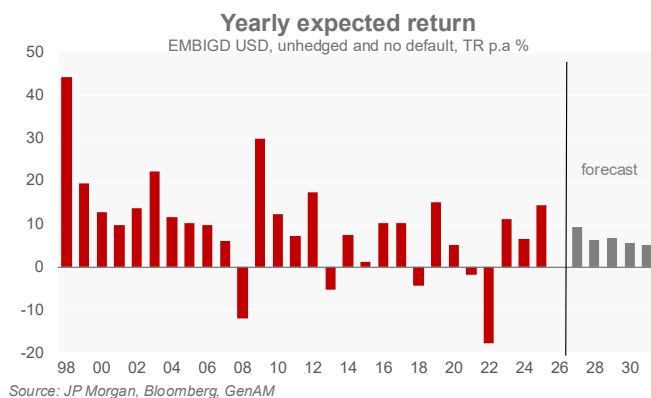
Following the sharp improvement in default rates over the past two years, we are keeping our default adjustments broadly unchanged this year. Default rates have largely normalised and are now close to long-term averages, while corporate fundamentals remain resilient despite a higher-for-longer interest-rate environment. Although pockets of stress persist among more leveraged issuers and in selected sectors, access to capital markets remains broadly open and refinancing risks appear manageable. As a result, we assume average annual default rates of 2.5% in Europe and 3% in the US. These assumptions remain prudent and reflect the structurally higher default propensity of the US market relative to Europe.

Although spreads are close to historical tight, net returns will still be very attractive relative to equities.

Therefore, our 5Y TR expectations for credit are much higher than last year's forecasts, with IG in the region of 4% in both Europe and the US, while we expect HY to deliver a total return of around 5% over the next 5 years in both regions.

3.1.3 EM Sovereign bonds

High returns highlighting continued structural improvement. The EM fixed-income environment has continued to improve, and we now expect five-year returns of 5.1% p.a. for USD external debt and 5.0% p.a. for EUR external debt (hedged). This represents a substantial upgrade from last year, especially for EUR debt, reflecting both a structural long-term improvement in macroeconomic fundamentals and higher underlying yields. Indeed, EM external debt spreads have remained broadly flat so far in 2026, close to their all-time lows, despite a combination of negative factors (US dollar strengthening, rising global yields and tensions in the Middle East). We expect the positive factors underpinning EM resilience to remain in place over the longer run. In addition, EM fixed income remains an under-owned asset class, and even a slight shift in crossover fund AUM towards EM would provide a significant boost to the asset class, ultimately supporting returns.



EM resilience to lead
to stronger return

Higher carry. Carry remains the main contributor to total returns. It has become even more attractive following the rise in global yields, with yields-to-worst close to 7% for USD debt and 5% for EUR debt. In relative terms, the increase in carry is greatest for EUR debt and IG names. This means there is no need to move too far down the rating scale to secure a compelling yield. Our preferred buckets are BBBs and BBs, where we see the most significant fundamental improvement combined with high carry. Finally, both HY and IG still offer a carry pick-up over US credit, which should support inflows into the asset class from large crossover bond funds looking for diversification.

Better long-term valuations. EM sovereign credit risk is structurally declining, given the improvement on both the fiscal front and external metrics. Sovereign credit ratings have been on an upward trajectory. We have therefore revised down our long-term spread estimates compared with our previous assumptions. However, despite this structural improvement, we expect spreads to widen slightly over the next few years. They are currently close to their all-time lows, especially for distressed countries. These countries account for 80% of the latest spread tightening episode, and we would expect some normalisation.

Over the long term, we expect more rating upgrades than downgrades, which could lead to spread tightening in selected countries. In the BB bucket, countries such as Morocco, Serbia and Ivory Coast could be upgraded to IG, while South Africa and Uzbekistan should also be close. The convergence of the Western Balkans towards the European Union and the prospect of Hungary joining the euro area should also lead to significant spread compression.

Stable default rate. We have assumed default rates in line with their historical averages for both EUR- and USD-denominated debt. This stability reflects two conflicting drivers. We expect lower credit risk across EM, which should help keep default rates low. The growing sophistication of EM issuers and improvements in the global debt-restructuring framework should also help. However, higher global yields will be punitive for the weakest countries, as current bond issuance at high yields will make refinancing more difficult in the future.

3.2. Equities

Over the past 12 months, equity markets have demonstrated remarkable resilience. While bond yields rose by more than 100bp, 12-month forward earnings (EPS) soared – by 40% in the US, driven by a 92% surge in US Tech earnings, and by 15% in the Euro Area (EA). Robust EPS growth has largely absorbed the valuation headwind from higher discount rates. As a result, the price-to-fair-value gap remains broadly unchanged despite strong equity returns (+16% TR US, +13% EMU), particularly in the US where earnings growth has been stronger. Profit margins also improved materially, expanding by 270bp in the US and 110bp in the EA.

EM EPS increased by 82% – on the back of the AI boom notably in South Korea and Taiwan – and profit margins by 470 bps over the past year, making the EM index theoretically cheaper by more than 10% despite a TR of +30% over the same period. That said, the MSCI EM index became more dependent on a few technology and semiconductor stocks.

Strong earnings growth has more than offset the drag from higher bond yields

3.2.1 Earnings growth next 5 years: a slightly brightening outlook ex-US

We have revised our earnings expectations for 2026-27 by approximately +27% in both the US and EA over the past year, reflecting resilient nominal GDP, stronger-than-expected EPS delivery, especially in the US – particularly in technology – and a broader EA recovery supported by financials, industrials, semiconductors along with ongoing buybacks.

Beyond 2027, we forecast a much more gradual 5% EPS growth in the EA, up from last year's estimate of 4.5%, broadly in line with historical norm since 1982 but below the current 5-year average annual EPS growth of 10%. German fiscal expansion further strengthens the medium-term growth narrative, particularly for infrastructure and defence, together with tailwinds for financials due to structurally higher yields.

The US outlook remains finely balanced. On the one hand, the exceptional EPS growth of recent years will prove difficult to sustain. On the other, productivity gains from technology and AI-related investment could extend the earnings cycle for longer than typically expected. We therefore continue to project an average nominal EPS

The medium-term earnings outlook is brightening outside the US, while US growth remains solid

growth of around 7% in the US over the next five years, unchanged from our estimates a year ago, and lower than the historical growth of 9% since 1997.

For EMs, we have slightly increased our EPS growth expectations to 4.5% (by 50 bps). The increase is warranted by the robust upturn in the Asian AI hardware cycle and structurally higher shareholder returns. However, we kept the upgrade limited, as the EPS momentum is concentrated in Korea and Taiwan, while China's earnings outlook remains weak and higher oil prices could pose a headwind to EM importers for longer.

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 return forecast for the MSCI EMU has edged down from 4.3% to 4.1% as lower GDP growth expectations and a 60bp increase in the 10-year Bund yield more than offset the fall in HY spreads (-23 bps compared to last year) and the slightly lower EURUSD forecast (1.2 vs 1.28 from the last year). By contrast, projected returns for the S&P 500 have risen from 6.3% to 6.9%, supported by GDP growth expectations that are, on average, 30bp higher than last time and a more pronounced 85bp fall in HY spreads, despite a 130bp rise in US 10-year yield expectations.

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 forecast TR via modelled fair PEs. In the end, long-term returns are decomposed into three 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 appreciation. 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 real yields and inflation trends, using also mean reversion properties and qualitative judgement.

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: 25.5x for the U.S. (down by 0.5p), 16.1x for the EA (down by 0.3p), and 14.6x for EMs (down by 0.3p).

Our analysis of nominal CAPE levels across different real yield environments indicates that a CAPE of around 26x for the U.S. aligns with historical norms observed since 1987, when real yields ranged between 2.5% and 3.5%—which is also our current forecast range. In the past, periods characterized by US inflation between 2% and 3% have been also associated with CAPE multiples close to 26x, broadly consistent with the assumptions underpinning our forecasts. Applying the CAPE targets and the EPS

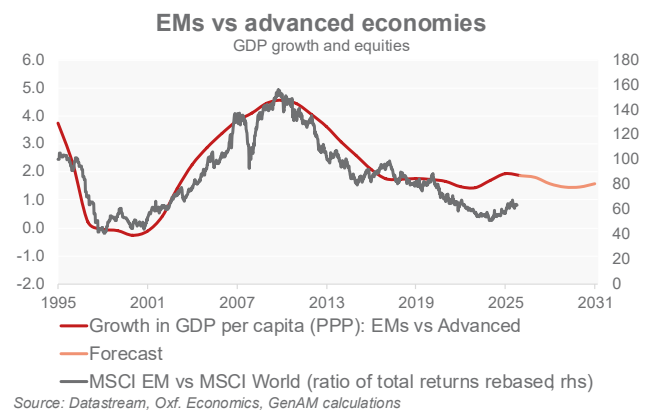
Three complementary approaches anchor our five-year equity return forecasts

growth expectations outlined above results in projected total returns of 8.1% for the U.S. (+2.4pp), 7.6% for the EMU (+0.2pp), and 9.3% for EMs (+2.5pp). A key pillar of the framework is the five-year target P/E multiple which we use as a control check of the previously described CAPE method. US PE target has remained broadly stable at 17.6x, while the EA one has risen to the historical average of 14.3x from 13.2x (+8%). The adjustment reflects a weaker euro, higher long-term rates and, most importantly, a surge in expected long-term EPS growth. Together, these changes increased our expected five-year annualized total returns by 0.5pp in the US and 0.8pp in the EA.

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 extends (e.g. from 5 to 10 years). For this reason, we regard a ten-year window as a more reliable basis for estimation. From this, we derive a TR projection, incorporating both a dividend yield and a buyback yield (at 1.5% for both the US and EA, and 1% for EMs). The resulting projected TRs are 5.6% for the MSCI EMU (-0.2% vs. last year), 2.1% for the S&P500 (-1.1%), and 8.0% for the MSCI EM (+1.4%). The higher projected return for EMs reflects an upward normalisation of CAPE from historically depressed levels, following a prolonged period of negative EPS growth, together with a structurally improving EPS growth trend and increased investor positioning.

In the final step, we assess the degree of current under-/overvaluation, along with specific positive and negative risks for each market. The resulting adjustment is then distributed evenly across the forecast years. This year, we set the adjustment factor for the EA at zero (vs. -0.25pp p.a. from last year): multiples premium relative to history declined slightly, from 22% last year to 19%, while both the five-year PE target and the current PE adjusted for long-term EPS growth (PEG) improved more significantly, with PEG falling to 1.5x from 2.1x. For the US, the positive adjustment was broadly unchanged (+1.3%). This remains justified by the AI and defence supremacy, productivity growth, greater policy flexibility, higher R&D and education spending, energy independence and stronger population growth (albeit reduced recently under Trump). For EMs, we reduced the adjustment to zero from +0.8pp last year, mainly because this year's forecast already recognises higher prospective EPS growth, albeit alongside the risks associated with a higher technology weight and greater concentration.

Expected returns (p.a.)	EA	US	EM (in \$)
Regression models (macro- and financial variables)	4.1	6.9	6.6
CAPE-based model	7.6	8.1	9.3
Historical returns coherent to current CAPE levels	5.6	2.1	8.0
<i>Average</i>	5.8	5.7	8.0
Adjustment due to pos./neg. risks & current over-/undervaluation (p.a.)	0.00	1.3	0.0
Final projection	5.8	7.0	8.0



That said, in addition to stronger earnings growth ahead, higher prospective EM returns are supported by attractive valuations relative to growth (PEG), solid

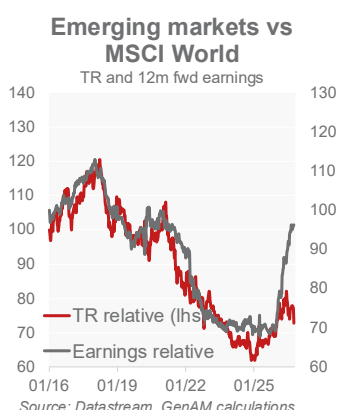
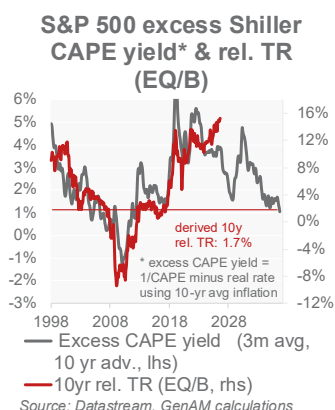
Rich US valuations constrain prospective returns, while ex-US earnings yield gaps remain more supportive

macroeconomic conditions and relative deficit trajectories, higher shareholder returns, still-cautious positioning and potential support from a weaker US dollar, which we forecast to depreciate by 1.1% per annum against the euro.

3.2.3. Expect high mid-single digit equity TR with EMs to outperform

Our final expected five-year annualized total returns stand at 7.0% for US equities, up 0.7pp from a year ago, and 5.8% for the EA, up 0.2pp. We remain more constructive on EMs, where annualized returns are expected to reach roughly 8%, supported by more attractive valuations and stronger long-term growth prospects. That said, we recognize increased risks to our forecast due to higher tech sector weight and concentration in the MSCI EM index.

The EPS outlook has improved slightly for both the EA and EMs, justifying modest increases in our EPS growth forecasts for these regions. US EPS remain sustained; however, elevated valuations should dampen future TR relative to history. We forecast a conservative 1.7% excess TR for US equities over US Treasuries – modest compared to historical averages, especially during periods when headline inflation was between 2% and 3% (and excess TR resulted in more than 5%). This reflects the currently less attractive gap between the CAPE yield, the inverse of CAPE, and real 10-year yields.



Market	Hist. avg 5-year total return since 1998 (p.a.)	5-year total return projection (p.a.)
World (in \$)*	7.9	7.0
US	9.7	7.0
EA	7.1	5.8
UK**	6.3	5.8
EM (in \$)	6.4	8.0

*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 in line with the EA

At 1.5%, the gap is almost 2.5pp below its historical norm of at least 3.9%, whether measured since 1970 or since 1928. For both the MSCI EMU and MSCI EM, the CAPE yield gap is much higher, at 4.6% and 4.2%, respectively, and is closer to its historical average, with a shortfall of 2.0pp.

Equity risk premia too low? Not in the EU, Ems, nor Japan. Even for the US, our [models show](#) that fundamentals justify US risk premia that are currently lower than in the post-global financial crisis period. That said, we assume that returns will be below the long-term norm because of rich US equity valuations, earnings approaching peak cycle, the risk of higher taxation and labour costs, a structurally higher cost of debt and geopolitical risks. Country diversification, also through thematics, should help: baskets covering different phases of AI, an ageing population, and capex supercycle (defense, electrification, digitalization, R&D-Tech-AI, green transition etc.). Compared with historical rolling five-year averages since 1998, our five-year equity TR expectations are ca. 25% lower for DM (9.7% US and 7.1% for EMU) and somewhat above for Ems (6.4%), see table above.

Country and thematic diversification can help navigate lower risk premia and greater concentration

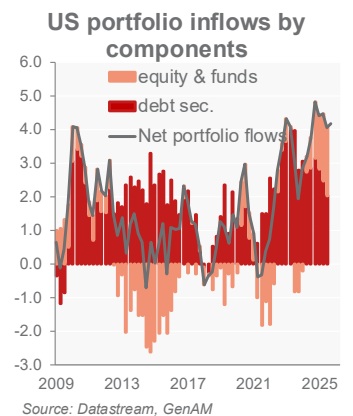
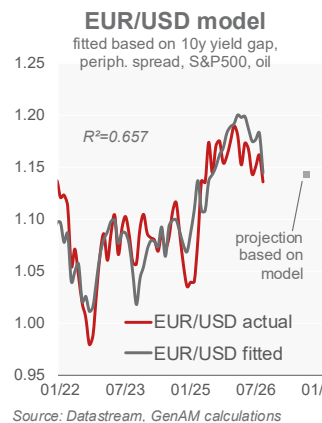
3.3 FX: Weaker dollar, hedging pays only on a risk-adjusted basis

For investments outside the EUR universe, investors need to decide whether to bear or hedge exchange rate risk. Notably for fixed income exposure, FX swings can easily dominate risk and returns. However, hedging is not free: its cost largely reflects the interest-rate differential between the USD and the EUR (plus the cross-currency basis). Based on forward contracts, hedging USD exposure for five years costs 1.5% p.a. In our summary tables, we therefore show our final return projections in the conclusions for all three dimensions: expected local, hedged and unhedged returns in EUR.

5y projections EUR/USD

	Forecast	Weight
Fair value projection (regression)	1.150	50%
PPP model	1.276	50%
Weighted avg	1.213	
Projection after qual. adj.	1.200	
Current (30/9/2026)	1.136	
Spot return USD p.a.	-1.09%	
Forwards	1.225	
Implied carry p.a.	1.53%	
Total return p.a.*	0.44%	

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



Over previous years, hedging USD exposure was the right decision, in line with our recommendation. Not so over the past year, during which EUR/USD declined by 3%. Looking ahead, we still see the USD weakening over the next five years, but the expected losses (5.3%, based on a 1.20 target) would still be somewhat lower than the cumulative hedging costs of around 7.7%. That said, this benefit over five years comes at the cost of higher volatility (7.4% p.a. historically).

As in previous updates, we derive our EUR/USD forecast in three steps. First, we use 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**. Second, we apply a qualitative adjustment to the average of these two approaches. Finally, we add the forward-implied carry (the reverse of the hedging costs) to arrive at the expected benefit (+) or disadvantage (–) of open vs. hedged USD exposure.

For (a), we use the most recent OECD PPP values and approximate their further evolution using actual and forecast inflation rates for the US and the euro area. This exercise projects PPP to rise from an estimated 1.408 currently to 1.422 by 2031. Assuming annual mean reversion towards PPP with a half-life of five years (gap reduction of ~13% p.a.), this implies a spot rate of 1.276 by 2031.

For (b), we use a model based on 10y US and Bund yields, EMU risk/spreads, risk sentiment (proxied by the S&P 500) and the oil price as inputs. It explains around two-thirds of EUR/USD variation since 2020 (middle chart above). The model indicates a slight EUR/USD undervaluation of 0.8%. We assume ¾ of this gap to close by 2031. In contrast to previous years, the model-based projections point to an only marginally higher EUR/USD at 1.15, mostly because we now expect the US yield gap to remain around its current high level of 170 bp. The average of the two approaches yields a

Purchasing power parity (PPP) points to a rising EUR/USD while our financial market model is more moderate.

High US growth and a persistent yield gap will keep depreciation pressures on the USD more limited than priced by forwards

target of 1.213. The fundamental USD richness suggested by PPP is confirmed by IMF analysis: this year's [IMF External Sector Report](#) suggests a 20% overvaluation of the USD and a minor ~2.5% undervaluation of the EUR.

Our **qualitative overlay** weighs several offsetting forces. The structural case against the USD remains strong. The dollar is fundamentally expensive, and the large US twin deficit requires continuous capital inflows. Increasingly, these come from AI-driven equity inflows, while more reliable bond inflows have faded (right chart). Moreover, US policy uncertainty, attacks on Fed independence and the administration's recent flirtation with [financial repression](#) may prompt foreign investors to demand a currency discount and reserve managers to further diversify away from the USD.

That said, several forces still support the dollar. First, the USD benefits greatly from US economic strength. US productivity growth is set to outpace the euro area's for longer, and we also expect the Fed funds rate to exceed the ECB's deposit rate by a wider margin than we did a year ago. Second, we also expect energy prices to remain high amid a prolonged US/Iran conflict, weighing on the EUR via higher import bills (in contrast to the US as a net energy exporter). Third, higher global yield levels also make markets more prone to pricing fiscal worries via wider EGB spreads, which weighs on the EUR. Finally, Europe still struggles to achieve stronger integration amid lost international competitiveness and rising global fragmentation.

On balance, we see the USD-supportive factors dominating slightly and apply a moderate discount to the average of the two models and pencil in 1.20 as our updated 5y forecast. This implies annual dollar depreciation of 1.1%, which is less than the cost of hedging USD exposure via forwards (1.5% p.a.). Given historical FX volatility of 7.4%, however, the resulting additional return of around 0.4% p.a. is not compelling on a risk-adjusted basis. It implies an expected annual Sharpe ratio (SR) of just 0.06 for open USD exposure (excess return over FX volatility), a small fraction of the roughly 0.3 we expect for EUR IG credit, for example. Hedging may therefore still be the preferred option.

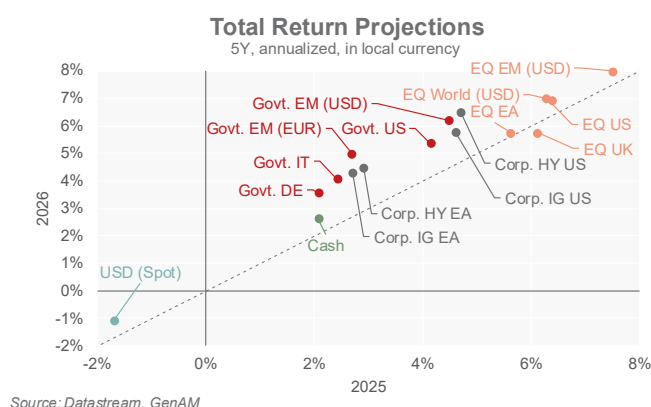
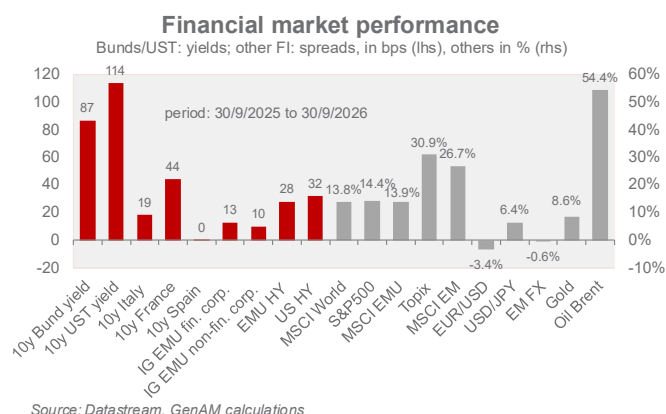
4. Conclusions: a new dawn for bond investors

Risen yield levels have increased the absolute and relative attractiveness of fixed income

Higher starting yields have markedly improved the 5-year return outlook for fixed income. Yields on most US and EUR government bonds have risen by more than 100bp since our update last year. While this made for challenging past quarters for bond investors, it now lifts prospective returns: in the right-hand graph below, all fixed income asset classes sit above the 45° line, i.e. today's expected returns exceed those of a year ago. Two factors drive this. First, as discussed in this paper, the starting level of yields largely determines future bond returns. Second, we expect core yields to move broadly sideways over the coming five years, with risks to this outlook more balanced than a year ago. Spreads on selected EGBs may widen somewhat, yet with more than 100bp of additional carry, Italian BTPs are still likely to slightly outperform Bunds.

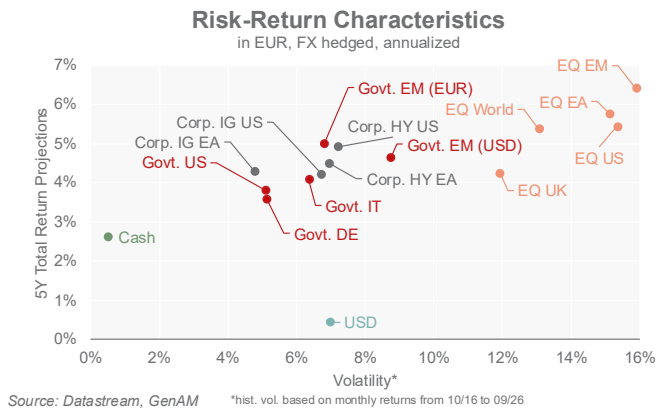
Higher underlying yields also brighten the outlook for Credit and EM sovereign debt. Much of the upgrade for both reflects the rise in Bund and Treasury yields, which has lifted fixed income return prospects across the board. Credit spreads remain tight, however, despite a slight widening over the past year. Yet with corporate balance sheets healthy and sovereign debt levels deteriorating, tight spreads look justified as the safe-haven status of sovereign bonds erode – and they may even re-tighten a bit for high-quality corporate issuers. Combined with higher underlying yields, this makes Credit attractive: we expect IG Credit to return more than 4% p.a. We have also upgraded the outlook for EM sovereign debt, whose fiscal dynamics are generally better than those of key advanced economies and which has proven resilient to US tariffs, soaring energy prices and higher US yields.

US fixed income offers particularly high local returns of 5.4% p.a. for US Treasuries and 5.8% for US IG Credit. EUR-based investors, however, need to adjust these numbers for exchange rates. Hedging costs of around 1.5% p.a. or an expected small loss on open USD exposure (-1.1% p.a.) need to be subtracted respectively, as detailed in the chart and table overleaf. On our forecasts, open USD exposure costs less than hedging, albeit at the price of additional currency volatility and risk.



We have raised our expected returns for equities slightly, to 5.8% p.a. for EMU (+0.2pp vs last year) and 7.0% for the US (+0.7pp). This may come as a surprise after the sizeable stock market gains since last year. Yet stellar earnings growth has more

than backed this rally, leaving valuations more attractive. Hyperscaler valuations do not look excessive. However, very high earnings growth expectations remain a key wild-card, notably for US markets, where tech stocks account for a large share of indices.



Asset Class	Currency	Local	EUR (FX hedged)	EUR (unhedged)
Cash	EUR	2.6%	2.6%	2.6%
Govt. DE	EUR	3.6%	3.6%	3.6%
Govt. IT	EUR	4.1%	4.1%	4.1%
Govt. US	USD	5.4%	3.8%	4.2%
Govt. EM (EUR)	EUR	5.0%	5.0%	5.0%
Govt. EM (USD)	USD	6.2%	4.6%	5.1%
Corp. IG EA	EUR	4.3%	4.3%	4.3%
Corp. HY EA	EUR	4.5%	4.5%	4.5%
Corp. IG US	USD	5.8%	4.2%	4.6%
Corp. HY US	USD	6.5%	4.9%	5.3%
EQ World	USD	7.0%	5.4%	5.8%
EQ US	USD	7.0%	5.4%	5.9%
EQ EA	EUR	5.8%	5.8%	5.8%
EQ UK	GBP	5.8%	4.2%	4.7%
EQ EM	USD	8.0%	6.4%	6.8%
		Spot	Carry	Total
USD		-1.1%	1.5%	0.4%
GBP		-1.0%	1.5%	0.5%

On a risk-adjusted basis, fixed income now looks particularly attractive, led by Credit and EM debt. Implied Sharpe ratios for EUR fixed income (expected excess returns over cash relative to volatility) stand at around 0.3 for IG Credit, HY Credit and EM sovereign debt, well above the 0.22 for EMU equities. BTPs roughly match equities at 0.23. For bond investors, this marks a new dawn.

Four main risks surround our base-case return assumptions. Three are adverse: a stagflationary shock amid rising geopolitical and trade conflicts and supply-chain disruptions; soaring fiscal worries that push government bond yields higher and raise fears of fiscal dominance; and a sharp global slowdown, e.g. triggered by an AI earnings bust and an equity sell-off. The fourth is benign: a Goldilocks scenario in which the fast diffusion of AI delivers a broad productivity boost.

Key risks arise from a fresh stagflationary push, soaring fiscal worries or a tech-led earnings bust – while an AI-based economic boom could provide for a Goldilocks scenario.

1. **A fresh stagflationary push.** As the world order erodes fast, with the US severing ties with long-standing partners and China taking a more assertive stance, trade conflicts and military confrontations may rise sharply. This would severely stress energy supplies and international supply chains, driving prices sharply higher and denting economic activity. Central banks would hike rates sharply to prevent supply-driven price shocks from morphing into broader inflation pressures. Bonds and Equities would suffer, while inflation linkers and (less so) Cash would outperform.
2. **Soaring fiscal worries.** In this scenario, sharply higher public debt levels leave several governments highly exposed to rising yields. Growing spending needs for demographic pressure, defence, social cohesion and climate change make fiscal consolidation ever harder – all the more so amid rising political polarisation. Fiscal dominance would loom, with monetary policy increasingly constrained by governments' need to sustain and finance their debt. Government bonds would suffer severely. Equities would come under pressure from rising recession risks and a hit to risk sentiment. Highly rated Credit may prove resilient but would still suffer from inflation worries. In the worst version of this scenario, investors start to fret about default risks within the Euro sovereign space, as the Treaty bars the ECB from monetising debt.

3. **AI earnings bust triggers a recession.** The AI boom has recently been the backbone of strong US growth and a resilient global economy. Soaring hyperscaler stocks have done the heavy lifting in global equity markets, easing financial conditions and supporting US consumption via wealth effects. US earnings have recently diverged from their long-term trend – any disappointment and mean reversion could trigger a sharp setback and a (likely moderate) recession. Central banks would cut rates, helping bonds outperform battered equities and HY Credit. IG Credit spreads would likely widen modestly.
4. **Goldilocks amid an unfolding AI boom.** In this positive scenario, the fast spread of AI as a *General Purpose Technology* spurs widespread productivity gains far beyond the tech sector. Lower costs and competition keep price pressures low while economic growth accelerates. Equities and HY would benefit most. Government bonds would gain from improving debt metrics on stronger tax revenues. However, a mild rise in the equilibrium level of policy rates may leave total returns on core government bonds similar to the base scenario.

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Head of Research	Vincent Chaigneau
Head of Macro & Market Research	Dr. Thomas Hempell, CFA
Team	Elisabeth Assmuth Research Operations Elisa Belgacem Head of Cross-Asset Quant & Dev, Senior Credit Strategist Jakub Krátký GI CEE Financial Analyst Michele Morganti Head of Insurance & AM Research, Senior Equity Strategist Vladimir Oleinikov Senior Quantitative Analyst Dr. Thorsten Runde Senior Quantitative Analyst Dr. Florian Späte, CIIA Senior Bond Strategist Guillaume Tresca Senior Emerging Market Strategist Dr. Martin Wolburg, CIIA Senior Economist Paolo Zanghieri, PhD Senior Economist
Head of Insurance and AM Research Team	Michele Morganti Carlotta de Maria Insurance Research Analyst Mattia Mammarella Research Analyst Antonio Salera, PhD Economist, Pension Expert Federica Tartara, CFA Senior Economist
Head of Cross-Asset Quant&Development Team	Elisa Belgacem Alexandre Boistard Quantitative Research Analyst Marc Jeulin Quantitative Research Analyst Mattia Mammarella Research Analyst
Head of Credit Research	Vivek Tawadey

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