

13th edition – 2024-2028 Expected Returns
Triple Power Play

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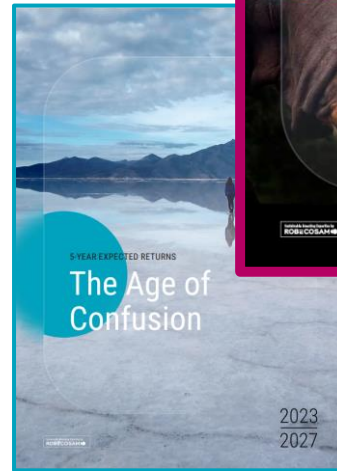
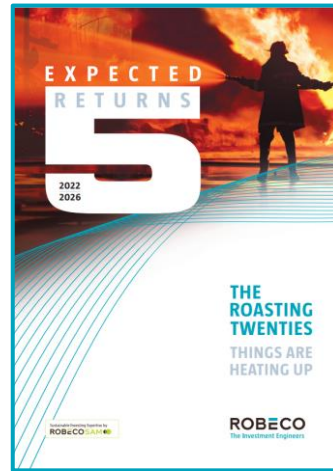
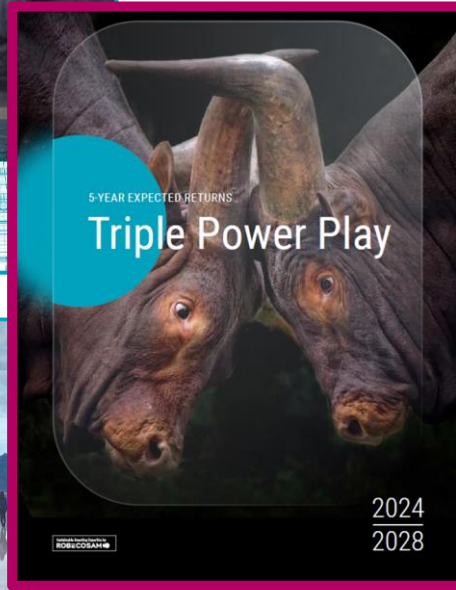
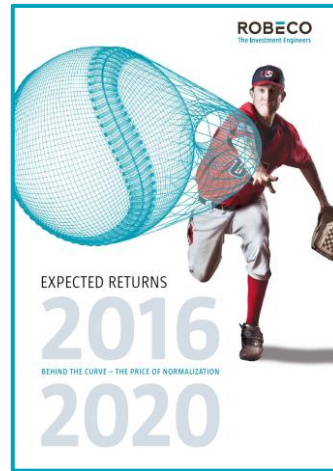
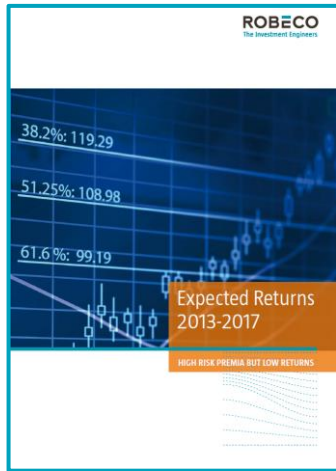
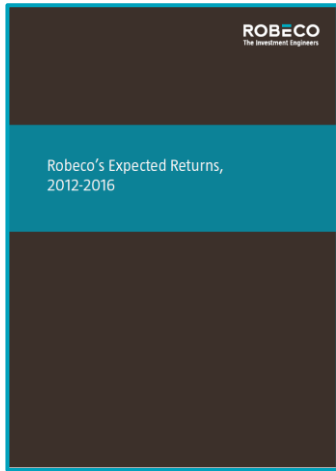
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Press webinar
12 September 2023

Agenda Press Webinar

- > Introduction
- > First presentation by Laurens Swinkels, Head of Quant Strategy, Sustainable Multi Asset Solutions at Robeco
- > Q&A
- > Second presentation by Peter van der Welle, Multi Asset Strategist, Sustainable Multi Asset Solutions at Robeco
- > Q&A

Thirteenth edition of the Expected Returns report



This year's four special topics



SPECIAL TOPIC | EMERGING MARKETS

Capitalizing on the AI advantage in emerging markets

Using Artificial Intelligence and Machine Learning techniques can help to better forecast stock returns in emerging markets



SPECIAL TOPIC | R-STAR

The invisible hand that guides bond markets

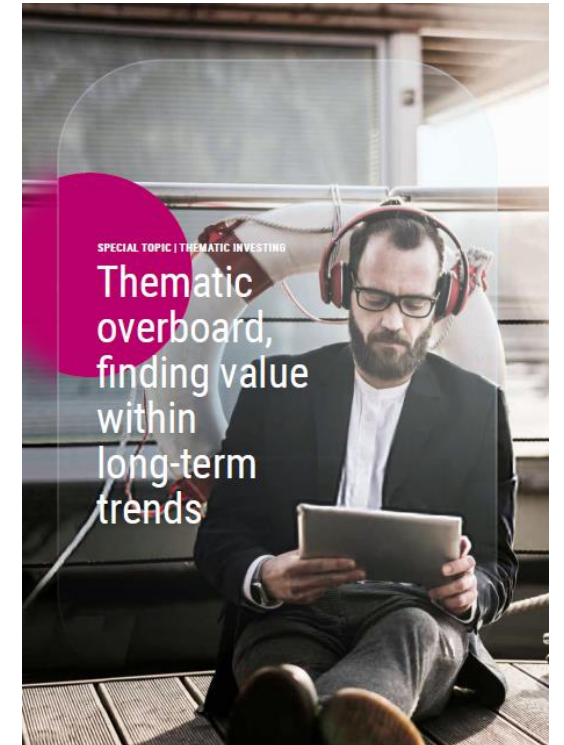
What is the natural interest rate R^ ? Practical estimates and implications for investment decisions*



SPECIAL TOPIC | SUSTAINABLE DEVELOPMENT GOALS

A roadmap for SDG integration in government bond portfolios

How to finance the Sustainable Development Goals in a way that the progress is largest per invested dollar? A practical framework and examples of how to use the scores in investment portfolios

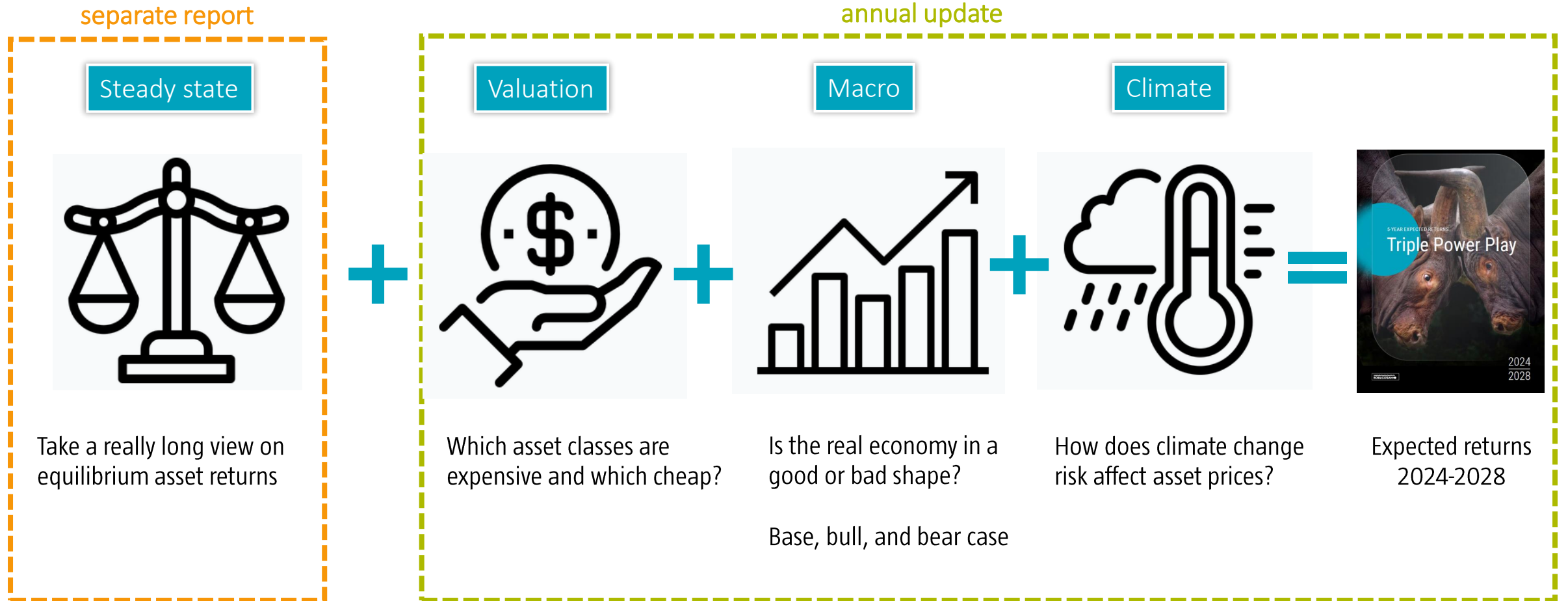


SPECIAL TOPIC | THEMATIC INVESTING

Thematic overboard, finding value within long-term trends

The fundamentals for broad structural themes across digital innovations, shifting demographics, and sustainable solutions remain buoyant

Our approach to estimating five-year expected returns



Final results

- > Returns higher than last year
- > Returns in EUR not at steady-state levels
- > Extra return for equity risk relatively low
- > Remainder of the presentation we discuss highlights of valuation, macro, and climate pillars

Table 5.1: Five-year return forecast for the main asset classes

	Long-term	Medium-term influences				Forecast in EUR			USD	JPY	GBP
	Returns	Valuation	Macro	Climate		2024-28	2023-27		2024-28	2024-28	2024-28
Fixed income											
Domestic cash	3.50%		-1.00%		↑	2.50%	1.00%		3.25%	0.25%	3.00%
Domestic bonds	4.00%	-2.00%	0.50%	0.00%	↑	2.50%	-0.50%		5.25%	-1.00%	5.50%
Developed	4.25%	-1.25%	0.50%	0.00%	↑	3.50%	1.00%		4.25%	1.25%	4.00%
Emerging debt	5.75%	-0.50%	-0.25%	-0.25%	↑	4.75%	2.75%		5.75%	3.25%	5.25%
Corporate inv grade	5.00%	-0.25%	-0.25%	0.00%	↑	4.50%	1.75%		5.25%	2.25%	5.00%
Corporate high yield	6.00%	-0.25%	0.00%	-0.25%	↑	5.50%	2.75%		6.25%	3.25%	6.00%
Equity											
Developed	7.00%	-1.50%	0.50%	-0.25%	↑	5.75%	4.00%		6.75%	4.25%	6.25%
Emerging	7.50%	0.00%	0.25%	-0.50%	↑	7.25%	5.25%		8.25%	5.75%	7.75%
Real estate	6.00%	0.00%	-0.25%	-0.25%	↑	5.50%	3.75%		6.50%	4.00%	6.00%
Commodities	4.00%	-0.25%	0.50%	0.50%	↑	4.75%	4.00%		5.75%	3.25%	5.25%
CPI											
Inflation	3.00%				↑	2.50%	2.25%		2.75%	1.75%	3.00%

Source: Robeco. September 2023. The medium-term influences correspond with our qualitative assessment of the valuation, climate and macro influences described in Chapters 2, 3 and 4. For equity-like classes, our medium-term influences are assessed relative to developed equities. The expected returns are geometric and annualized. Bond returns are euro-hedged except for emerging market debt (local currency). The value of your investments may fluctuate, and estimated performance is no guarantee of future results.

Valuation

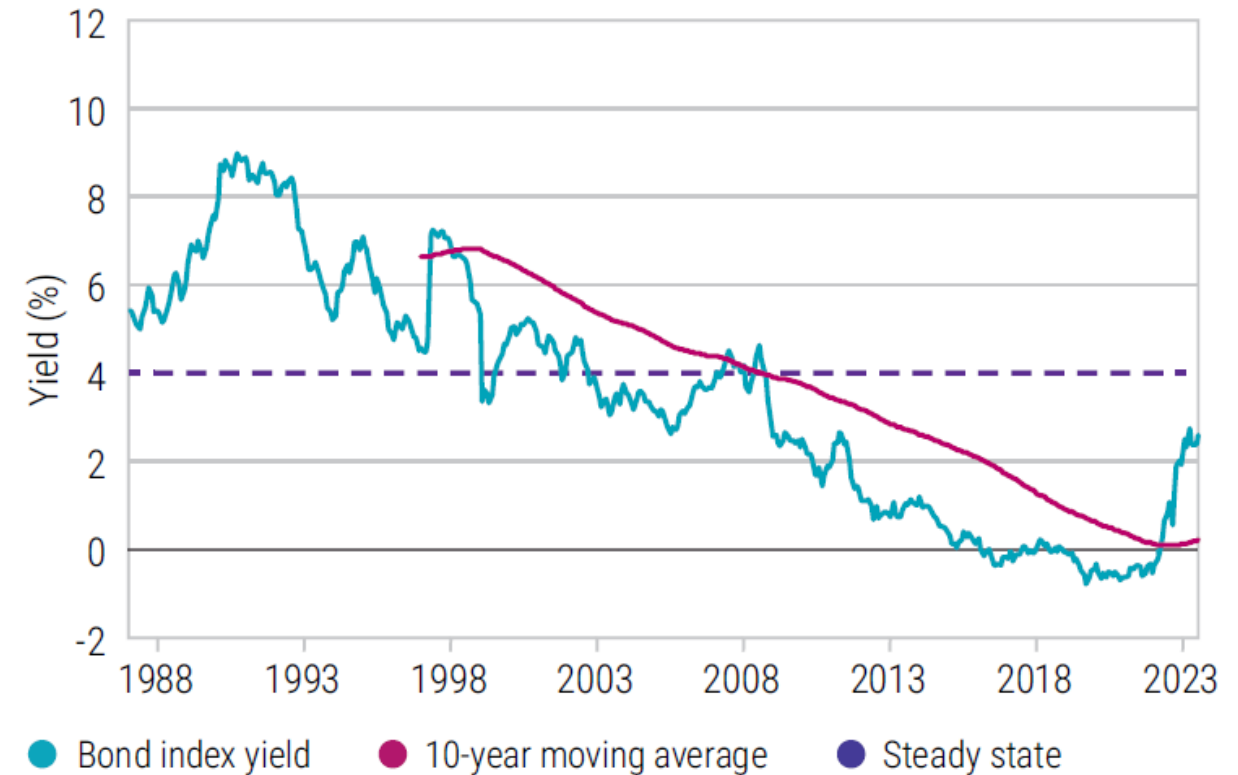
Triple Power Play

Government bonds no longer very expensive

- > We compare multiple valuation measures, present one – mean-reversion – here
- > Interest rate of EU below 4% equilibrium but above 10-year average
- > In combination with inverted yield curves and negative term premium estimates: government bonds are cheaper, not cheap

Figure 2.4: Mean reversion of government bond yields

Germany

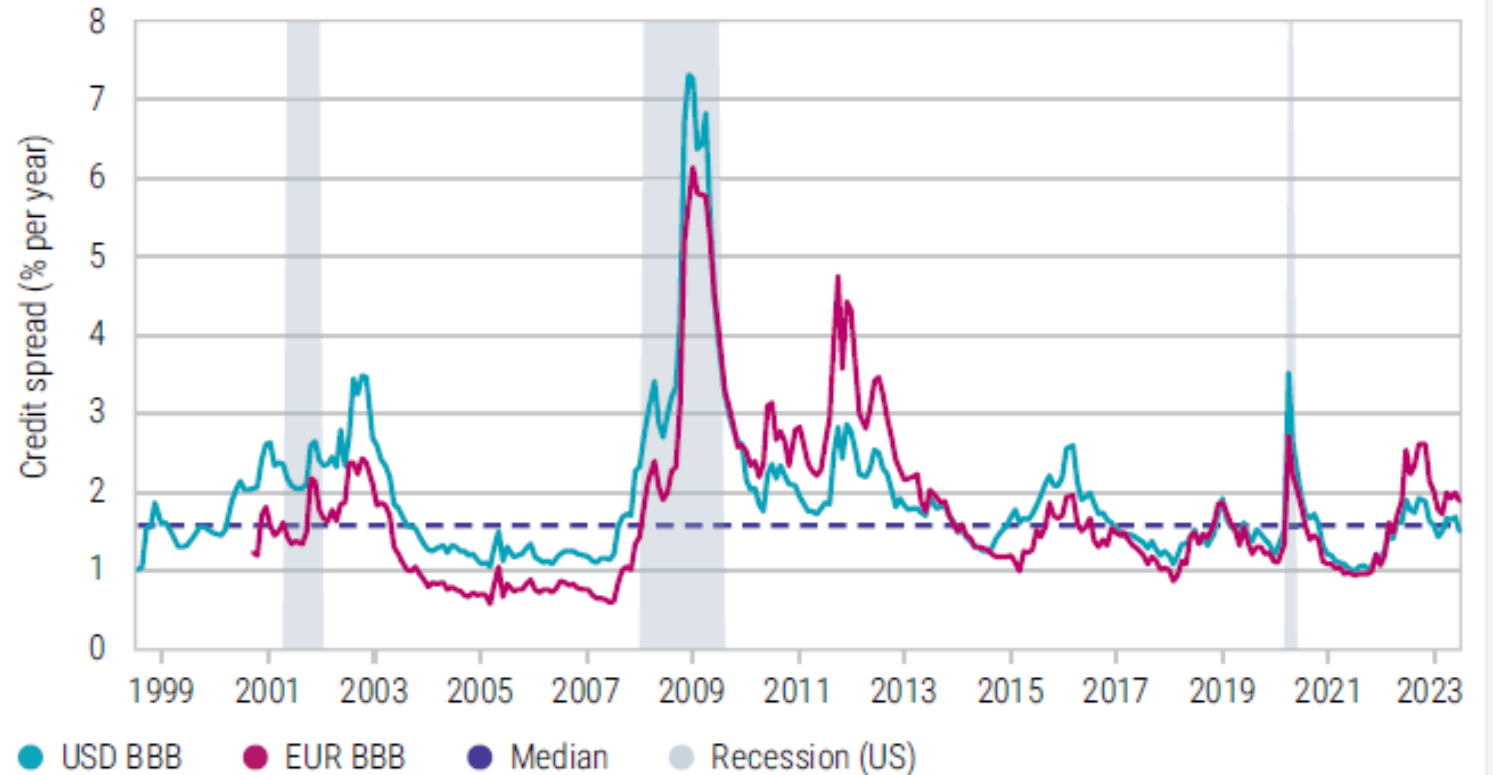


Corporate credit spreads in line with historical average

- > Corporate credit spreads are in line with the historical median/average
- > This does not point to a deep recession

Figure 2.6: Credit spreads

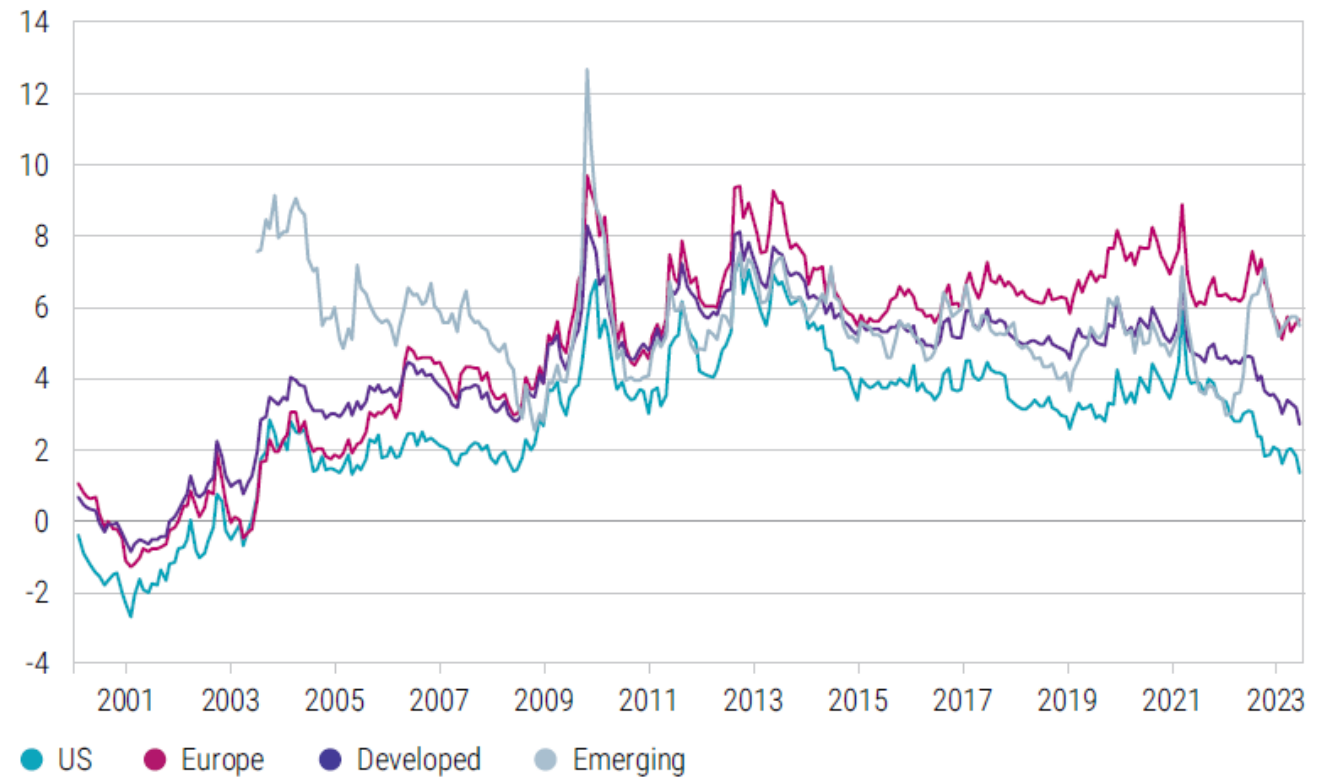
BBB credit spreads



Equity valuation relative to bonds has deteriorated since last year

- > Equity valuations decreased slightly, while bond yields increased substantially
- > The implied equity premium, or the earnings yield of stocks versus the bond yield, is low for developed markets
- > Developed markets is driven by ~70% US

Figure 2.11: Implied equity risk premiums

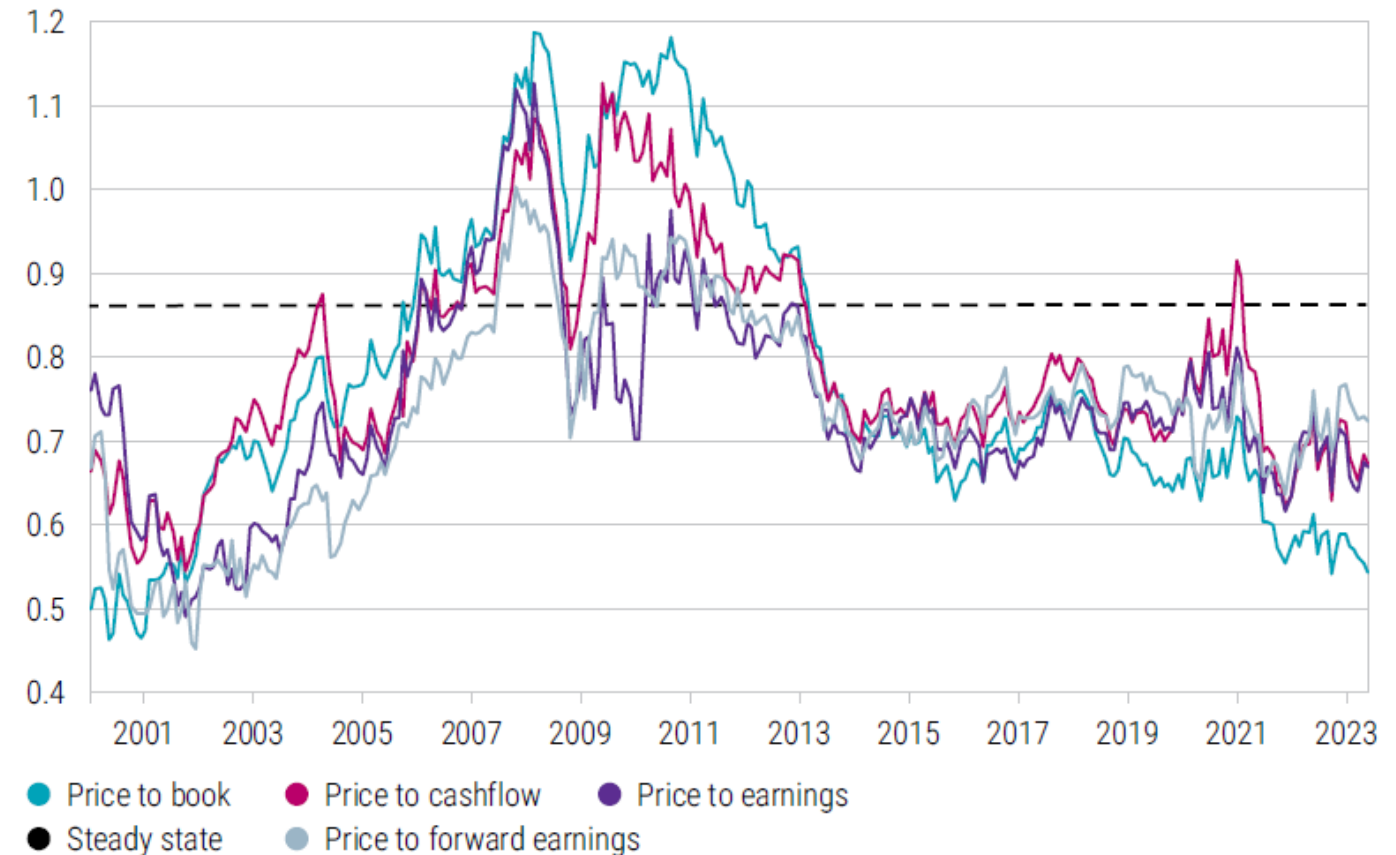


Source: Refinitiv Datastream, I/B/E/S, Robeco. Forward earnings (12 months) to price minus the government bond yield. For emerging markets, Chinese government bond yields are used as a proxy.

Emerging markets equities remain attractively valued

- > Since the 'taper tantrum' in 2013, emerging equity markets have been cheaper
- > Discount versus developed market 30%

Figure 2.12: Emerging equity valuations relative to global equity valuations



Source: Refinitiv Datastream, MSCI, Robeco. Each month we divide the bottom-up-derived valuation ratio of the MSCI Emerging Markets Index by the same valuation ratio for the MSCI World Index. The MSCI World only contains developed markets.

Climate Triple Power Play

Green innovation and investment is urgently needed to reduce greenhouse gas emissions

> GHG emissions increased a lot

> Because

> Population growth

> Economic growth

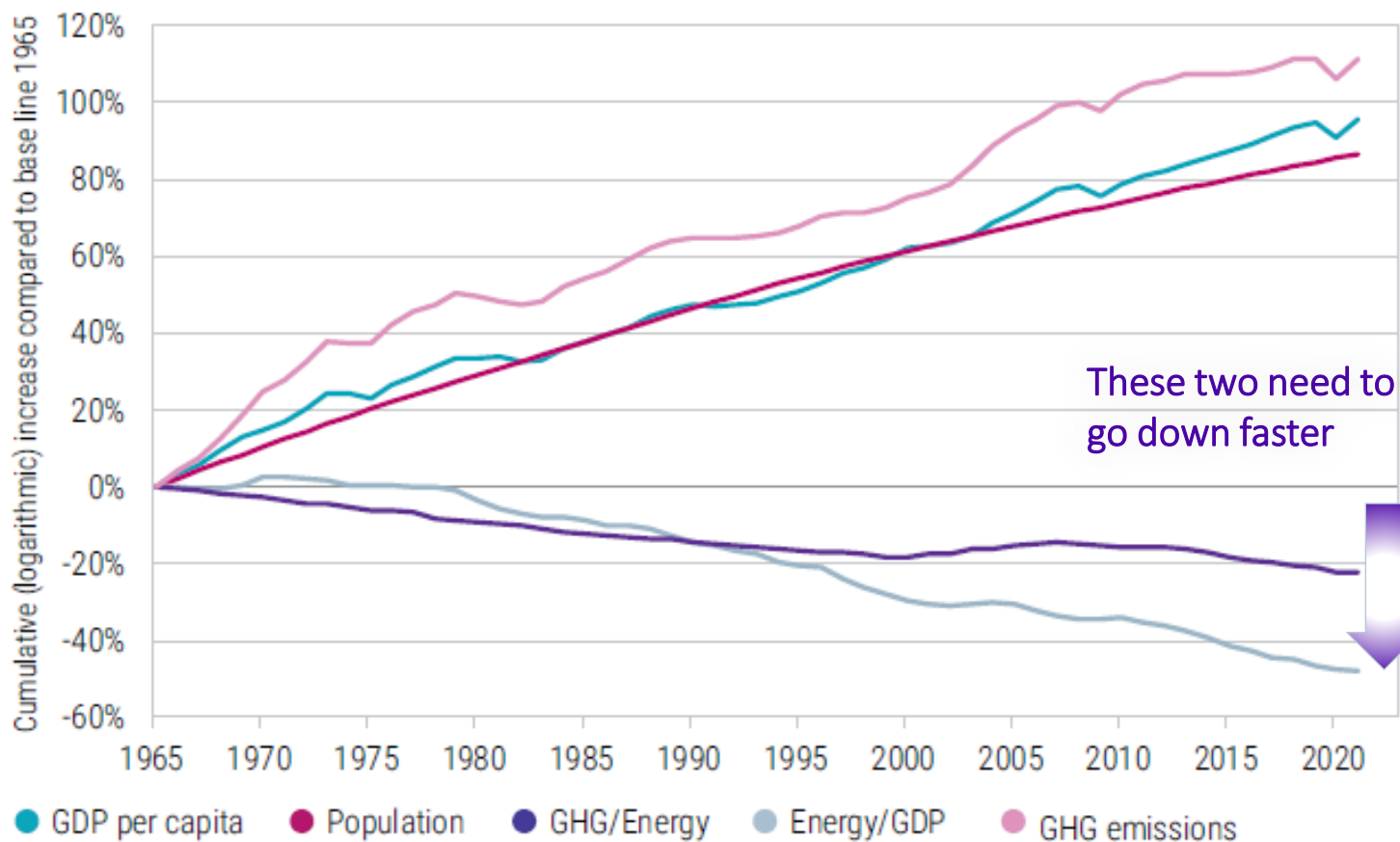
But: Not feasible to decrease these

> Therefore

Need to bring GHG from energy and energy use down fast

Requires innovation and investment

Figure 3.1: Cumulative change in carbon emissions over time and their main drivers



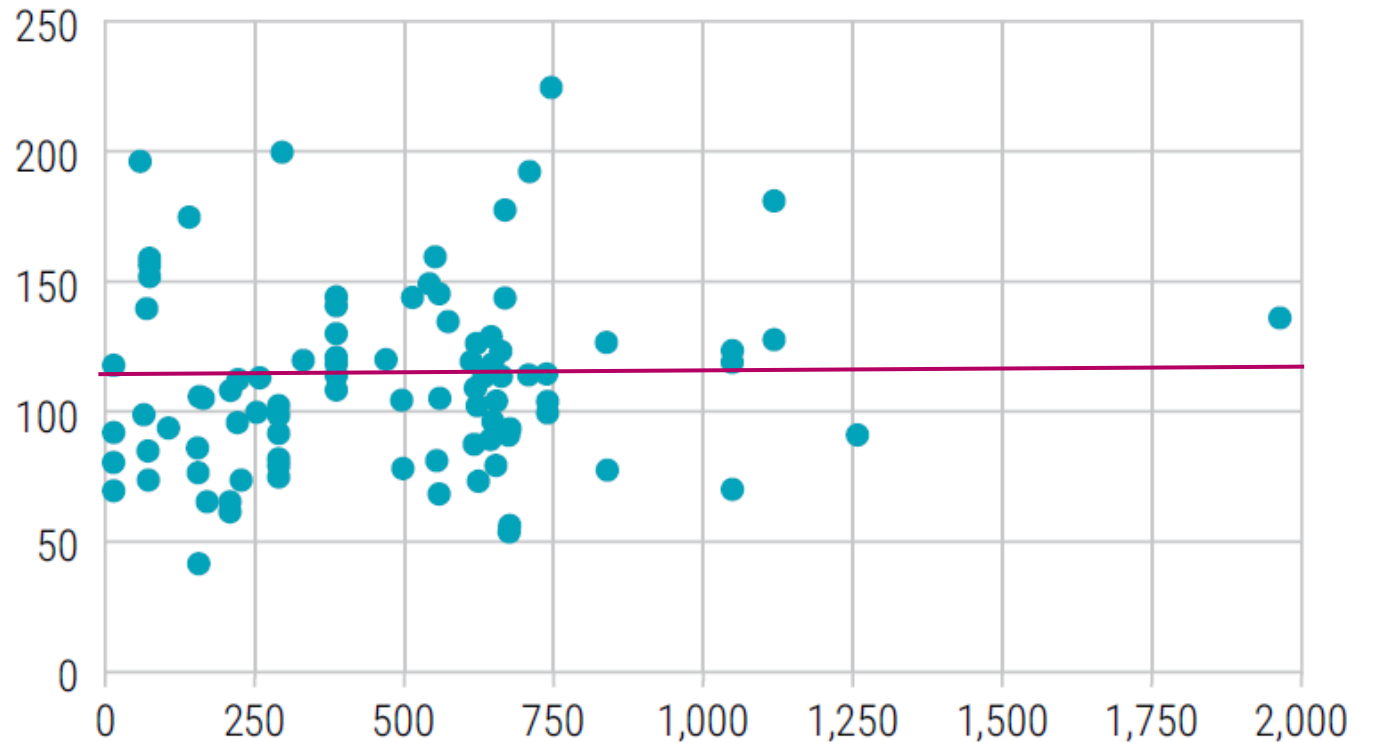
Source: Refinitiv, World Bank. Population, GDP per capita, Energy efficiency of GDP, Carbon efficiency of energy, Total emissions.

Is climate risk priced in? It doesn't seem to be the case

- > Credit spreads on the vertical axis do not seem to be related to carbon emissions
- > Also no relation with other climate risks
- > Climate risk not important, or climate risk not yet priced in yet?

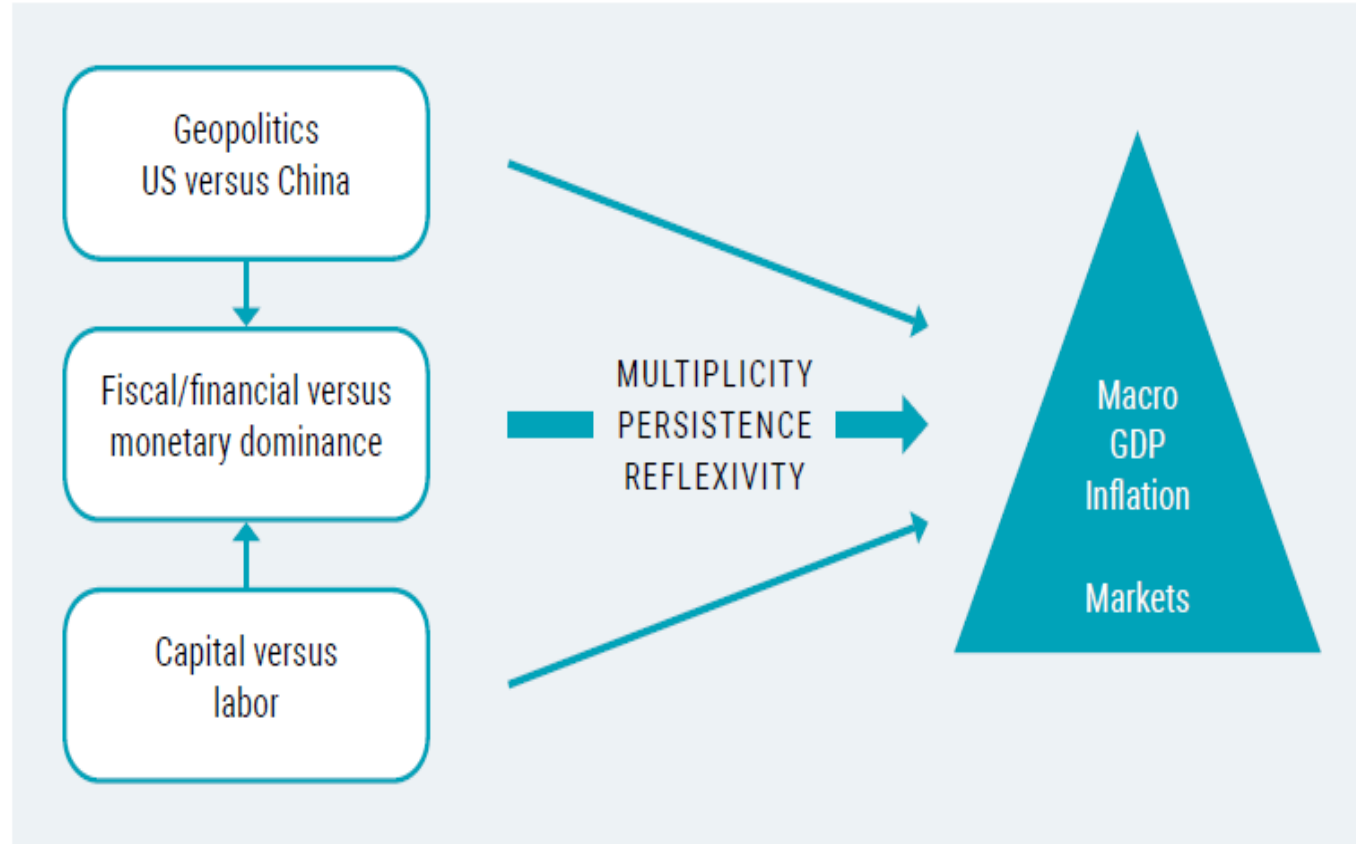
Figure 3.4: Climate change risk and corporate bond spreads of US electric utilities

Carbon footprint



Macro Triple Power Play

This year's theme: Triple Power Play Scenario building blocks



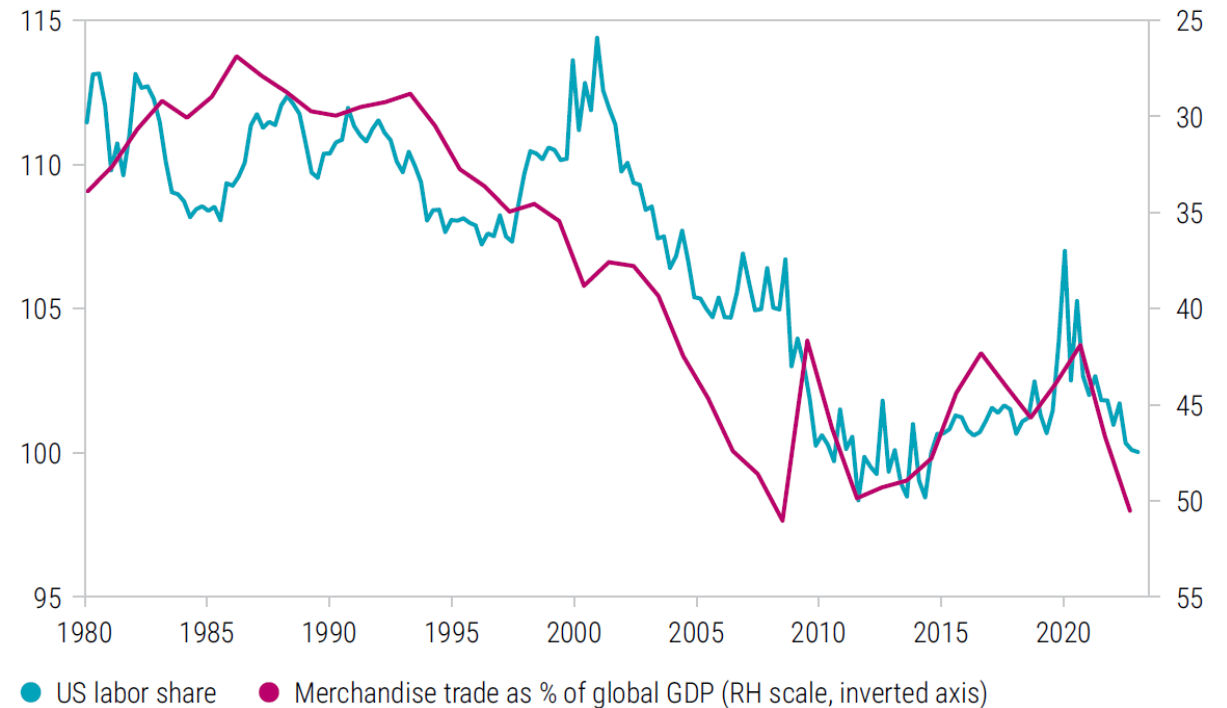
Source: Robeco, August 2023

Power play one: The rise of labor

- > Record high profit shares, falling labor share
- > Secular as well as cyclical headwinds for corporate profitability
- > The single-minded pursuit of maximizing profitability is increasingly being challenged by stakeholders
- > Race to the bottom in corporate tax competition has ended
- > Multipolarity could boost bargaining power of DM labor

- > Steep policy tightening cycle will raise cost of capital
- > Tight labor market > wage Phillips curve has steepened

Figure 4.9: Globalization and the share of labor in the US economy

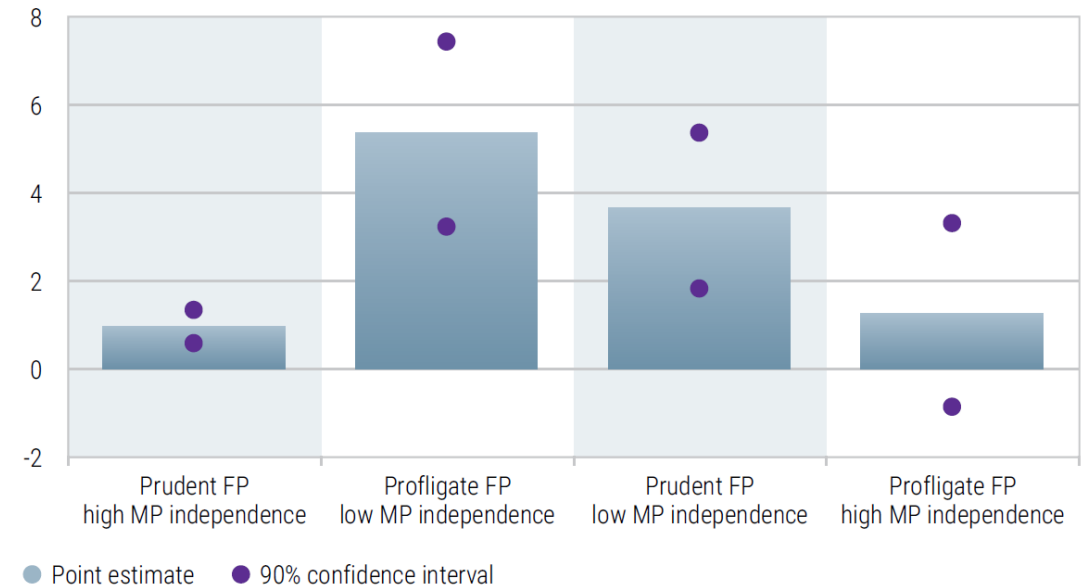


Source: Refinitiv Datastream

Power play two: The end of monetary lenience

- > Monetary-fiscal interactions key for inflation outcomes
- > Post pandemic shift from monetary led to fiscally-led regime (BIS)
- > Watch out for profligate fiscal authority in conjunction with weak central bank > inflationary
- > Variance in government debt largely driven by discount rates (Cochrane)
- > Profligate governments need monetary lenience

Figure 4.13: Fiscal-monetary interactions determine inflationary impulse



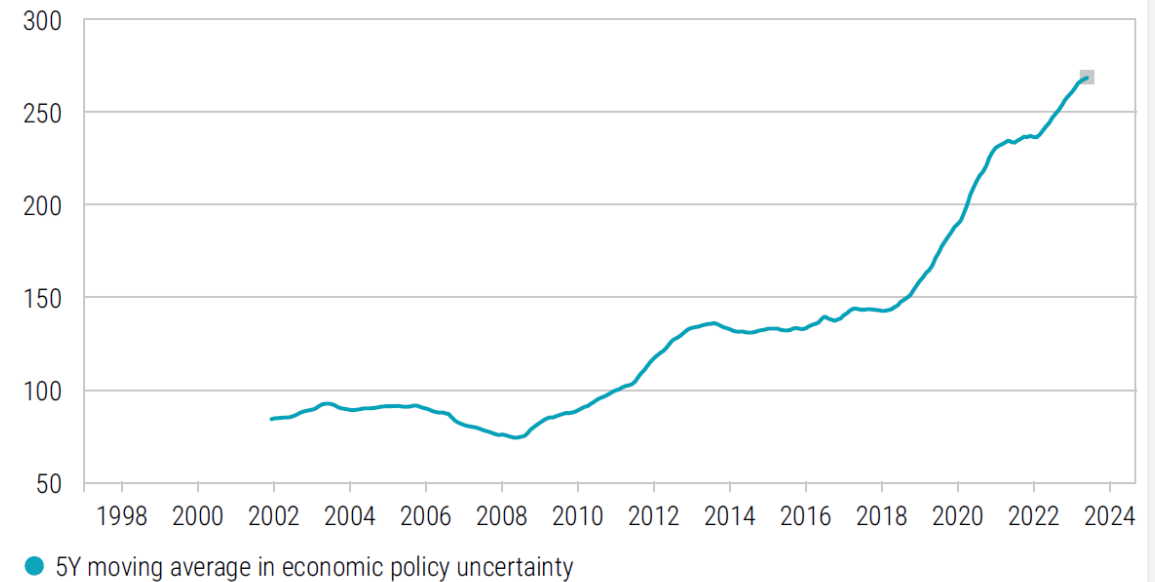
The inflationary impact of fiscal stimulus across fiscal and monetary regimes

The figure shows the estimated average impact of a one percentage point increase in the fiscal deficit on inflation over the next two years across different combinations of fiscal and monetary regimes. Fiscal regimes are classified as prudent or profligate based on Mauro et al. (2015). Monetary regimes are defined as being high or low independence based on legal limitations on central bank lending to the public sector in Romelli (2022). Source: BIS

Power play three: The dawn of multipolarity

- > China and US should step back from “top of a precipice” (Kissinger)
- > Global trust deficit (Edelman Trust barometer)
- > Deregulation, cuts to government spending and free market forces are on the retreat
- > Shifting global economic architecture raises macro volatility
- > For investors, level of policy uncertainty matters not outcomes

Figure 4.5: Hard to ignore: the steadily rising trend in global policy uncertainty



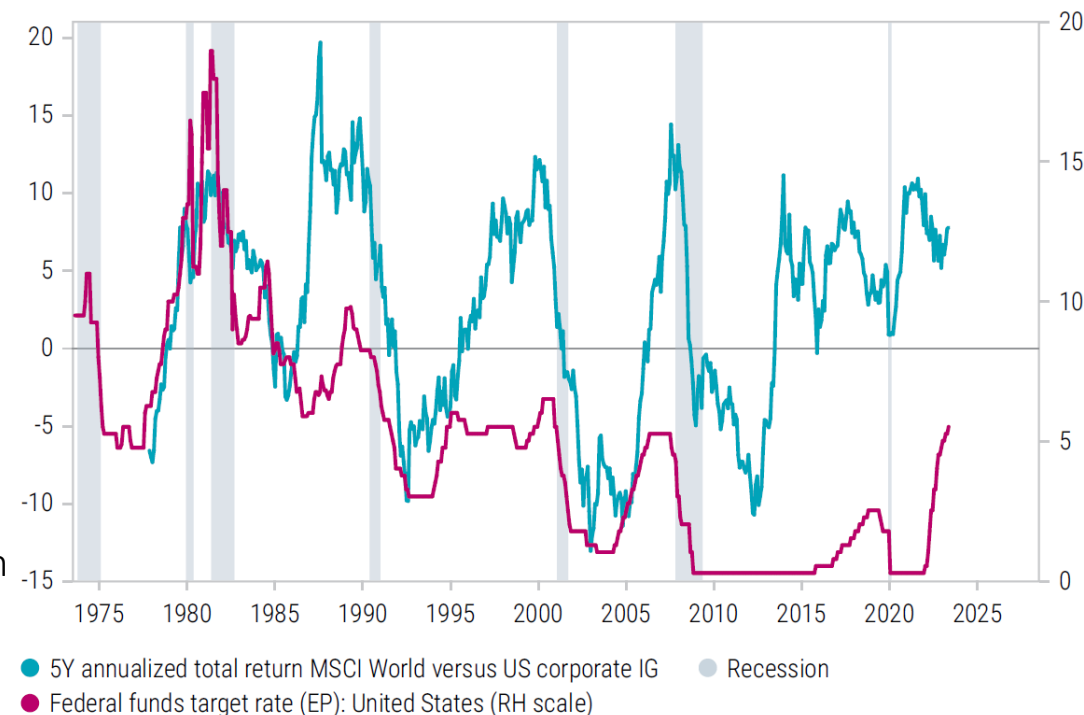
Source: Refinitiv Datastream, Robeco

Base case: 'Stalemate'

Rising tensions, but nothing boiling over

- > Growth around trend in DM (1.8%), mild recession in 2024
- > China's growth slows to 3% by 2028, but no balance sheet recession
- > Global consumption growth more volatile versus pre-pandemic
- > Inflation above CB targets but below 3% on average
- > After peak policy rate, expected decline in realized equity risk premium

Figure 5.13: Realized 5y annualized excess equity return tends to trend lower whenever rate cuts are recession induced



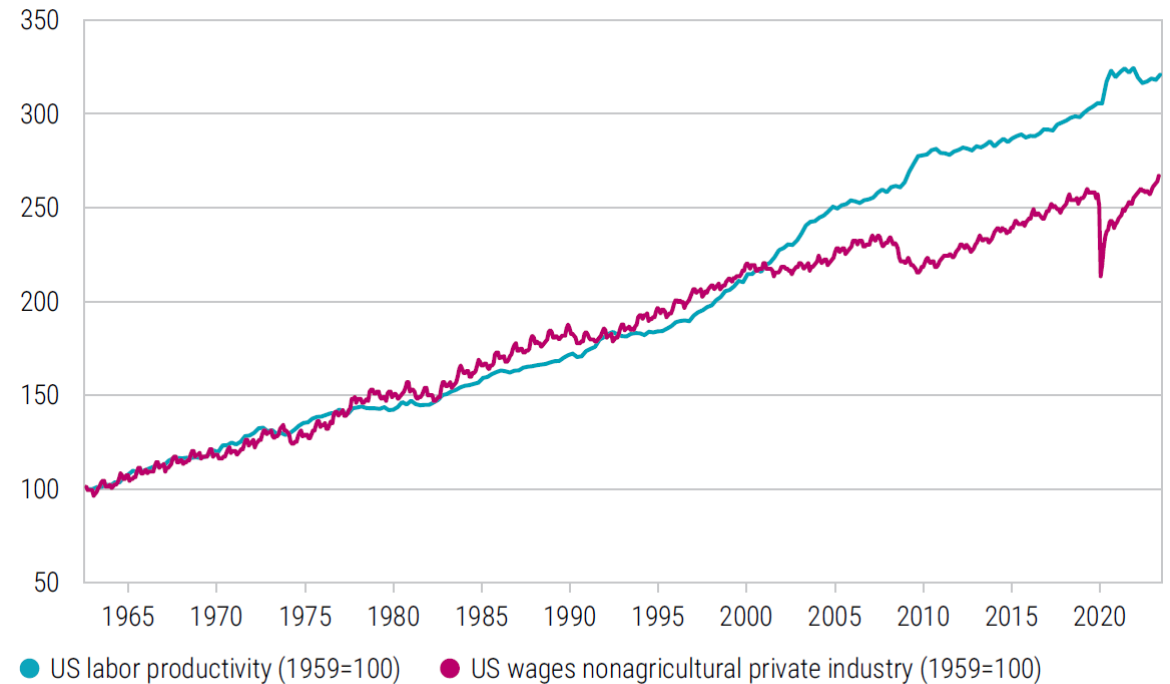
Source: Refinitiv Datastream

Bull case: 'AI gets wings'

Goldilocks endures as geopolitical tensions ease amidst a positive supply shock

- > GDP growth above trend (2.5%)
- > Headline inflation back to target
- > Fading labor bargaining power, further gains in profit share
- > Double digit equity returns, EM equity returns around 15%
- > Yield curve bull steepens > lower sovereign bond returns vs base case

Figure 4.10: Marginal wage = marginal productivity? Not anymore for the average US worker



Source: Refinitiv Datastream, Robeco

Bear case: 'De-risking'

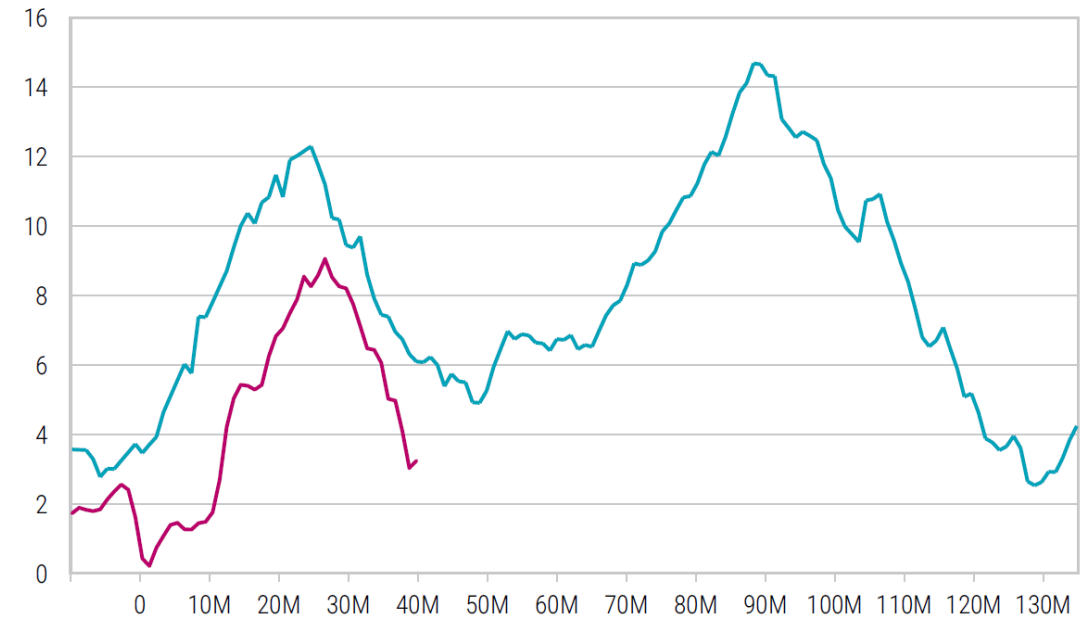
Face-off between superpowers, melee in labor market

- > Subdued GDP growth (0.5%)
- > A second inflation wave develops > CPI above 3% on average
- > Reshoring and militarization boost domestic labor
- > Moderate to deep recession around 2026/2027
- > Stagflation prevails echoing 1970s

- > Yield curves bear steepen, lowering sov bond returns vs base case
- > Real yields become deeply negative again, zero lower bound reached

- > Challenging environment for risky assets

Figure 5.4: Inflation comes in waves



● Slice for CPI - 01/01/1972 to 01/01/1984 ● Slice for CPI - 01/05/2019 to 01/01/2030

Source: Refinitiv Datastream, Robeco

Expected Returns

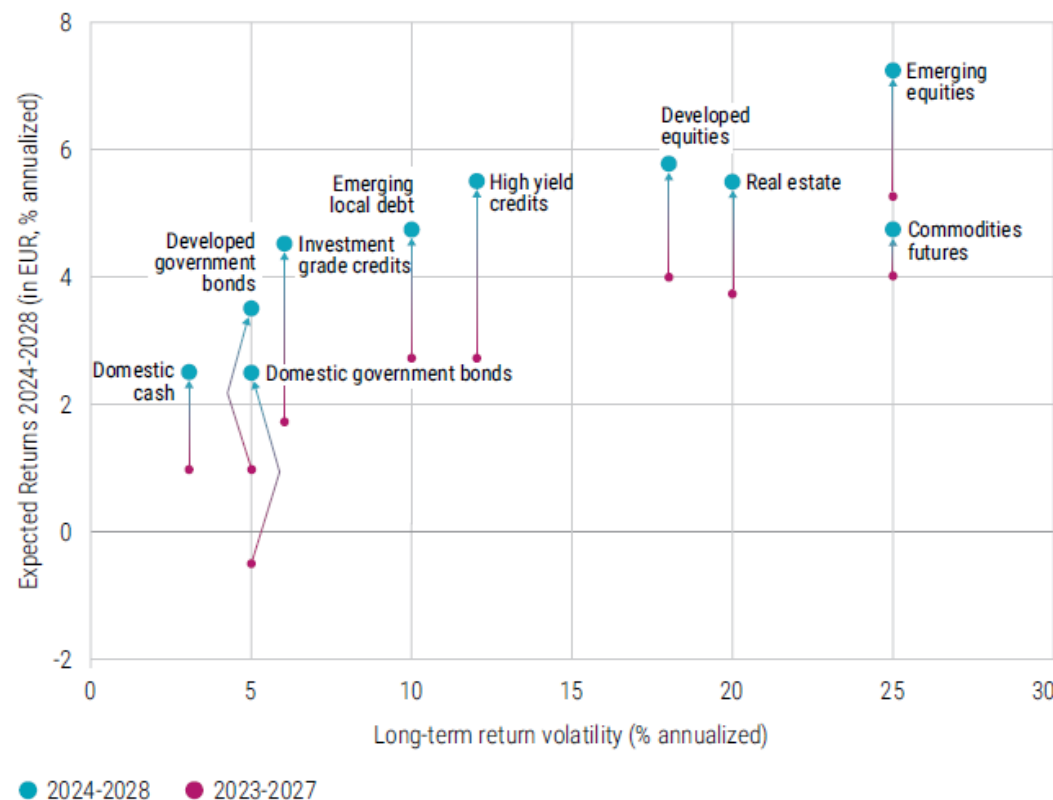
Triple Power Play

Summary Triple Power Play

The TINA narrative has collapsed

- > Upgrade in expected return vs last year as risk-free rate has surged
- > Moving away from a low risk-free rate, high risk premium world
- > Shifting further out on the risk curve is less rewarded vs past decade
 - > Starting valuations for DM equities less attractive
 - > End of open-ended QE
 - > Headwinds for corporate profitability
 - > Higher discount rates
- > Risky fixed income has better Sharpe vs equities
- > More room for diversification as bond-equity correlation shifts
- > Beware of the tail that wags the dog

Figure 5.2: Five-year return forecast versus long-term volatility



Source: Robeco. September 2023. Vertical axis contains the geometric annualized returns for a euro investor over the period 2023-2027 and 2024-2028. The horizontal axis is a proxy for the long-term return volatility of each asset class.

Summary Triple Power Play

Navigating a changing landscape of risk premiums and risk-free returns

- > Three separate powerplays likely to emerge in next five years which will shape macro-economic outcomes
- > We see the rise of labor, the end of monetary lenience and the strategic competition between China and the US as key pivot points
- > Our outlook base case is for a stalemate between capital versus labor, US versus China on trade and hawkish central banks countervailing profligate fiscal authorities
- > We foresee a mild US recession 2024 with inflation in developed economies averaging close but below 3% in the next five years
- > Overall, we expect below steady state returns
- > We are slowly shifting from a world with low interest rates and high equity risk premiums, to a period with higher interest rates and lower equity risk premiums, as US equities are still expensive
- > Risky fixed income is relatively attractive in risk-adjusted returns as given favorable relative starting valuations versus equities and expected phase of the monetary policy cycle
- > Mind the tail that wags the dog; the convergence of powerful forces heightens the likelihood of extreme outcomes
- > More room for cross-asset diversification as bond-equity correlation turns negative
- > Asset classes with attractive risk-adjusted returns: investment grade credits, high yield bonds, and emerging equity markets

Robeco Media Relations

Any further questions...

- > Femke Bruggeman, Manager PR & External Communications
- > Maurice Piek, Senior Manager External Communications



APPENDIX

Table 5.3: Five-year return forecast for three macroeconomic scenarios

	Expected Returns 2024-2028 (EUR)			Expected Returns 2024-2028 (USD)		
	Bull	Base	Bear	Bull	Base	Bear
Bonds						
Domestic cash	2.75%	2.50%	2.25%	3.50%	3.25%	2.50%
Domestic bonds	1.25%	2.50%	4.25%	4.00%	5.25%	4.75%
Developed	3.25%	3.50%	4.25%	4.00%	4.25%	4.50%
Emerging debt	5.50%	4.75%	2.50%	7.25%	5.75%	2.00%
Corporate inv grade	4.25%	4.50%	6.00%	5.00%	5.25%	6.25%
Corporate high yield	5.25%	5.50%	2.00%	6.00%	6.25%	2.25%
Equity						
Developed	11.00%	5.75%	2.75%	12.75%	6.75%	2.25%
Emerging	15.25%	7.25%	5.00%	17.00%	8.25%	4.50%
Real estate	6.00%	5.50%	3.00%	7.75%	6.50%	2.50%
Commodities	5.50%	4.75%	2.50%	7.25%	5.75%	2.00%
CPI						
Inflation	2.00%	2.50%	3.75%	2.00%	2.75%	3.25%

Source: Robeco. September 2023. Returns are geometric and annualized.

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