FUNDAMENTAL EQUITIES

Targeting alpha in a global trade revolution

ROBECO
The Investment Engineers

- US exceptionalism is in question, even if Trump's trade war is contained
- Long-term alpha generation will demand a more global footprint
- Rebalancing away from US assets and USD weakness will bolster EM

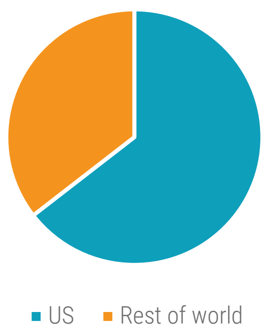
The trade war started by the new US government has prompted a severe stock market sell-off as economic confidence recedes amid uncertainty over the re-organization of complex global supply chains. This paradigm shift in trading conditions requires a more balanced global equity allocation to both developed and emerging markets.

Rebalancing away from the US will accelerate

'Liberation day' on 2 April has had two impacts which will be enduring. First, US exceptionalism took a serious blow, with the imposition of sweeping global tariffs certain to drive US inflation, weaken the US economy and make it more difficult for leading US multinationals to operate globally. Second, the impact on the global economy ex-US will be deflationary, with lower demand and overcapacity in some sectors likely to manifest itself rapidly, with negative short-to-medium-term macroeconomic aftershocks.

At the time of President Trump's inauguration, US equity market dominance had reached its zenith with the US accounting for 64% of the MSCI All World Index while the country accounts for 15.5% of global GDP in 2024.[1]

Figure 1: MSCI World is dominated by US companies



Source: MSCI. The MSCI ACWI captures large- and mid-cap representation across 23 developed markets (DM) and 24 emerging markets (EM) countries. With 2,558 constituents, the index covers approximately 85% of the global investable equity opportunity set.

[1] Source: Statista based on a Purchasing Power Parity measure of estimated 2024 GDP

ARTICLE MAY 2025

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Valuations also reflected this dominance, with the US CAPE ratio on 31 March 2025 at 32.8, compared to an average of 19 for developed markets (DM) and an average of 14 for emerging markets (EM).[2] This US valuation premium seems certain to narrow as the US rewrites the rules of global competition.

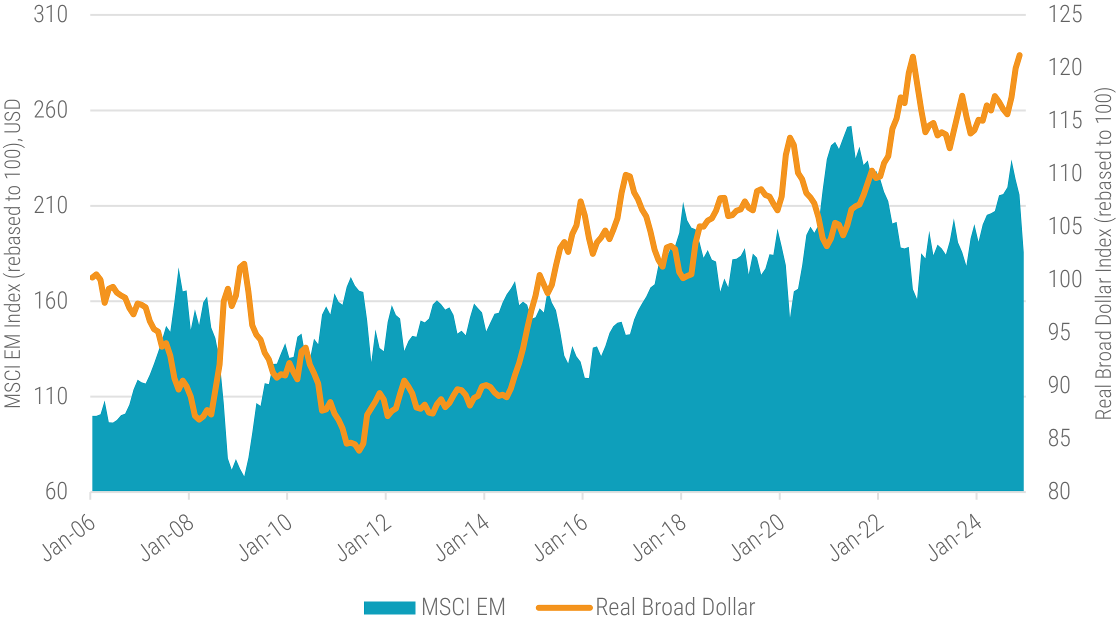
US economic retreat will manifest in USD weakness

The equity market response to the 'Liberation day' tariffs has been rapid as the prospects of whole swathes of the global economy are cast into ongoing uncertainty. In addition, the US Treasury market and USD have both weakened, an unusual combination in times of equity market stress, indicating that a rotation from US assets is underway. Despite the 9 April 'pause' in the tariff application ex-China (beyond the flat rate of 10%), this is confirmed as a new landscape for equity investors. Passive exposure to US large-cap stocks will no longer serve as a proxy for the global economy, and we believe it is certain that geographic exposure for global investors will become more balanced.

> *"Passive exposure to US large-cap stocks will no longer serve as a proxy for the global economy*

For emerging markets , the end of US exceptionalism and the potential decline of the US dollar's status as a reserve currency will be a long-term tailwind. In the past two decades EM equities' performance has been negatively correlated with USD strength so a reversal should boost the relative attractiveness of EM.

Figure 2: A persistent historical inverse relationship between the USD and EM equities



Source: Robeco, Federal Reserve Economic Data, as of 31 March 2025.

Our long-term case is that global trade can continue to expand even as the US share declines, with regional trade agreements becoming the norm. Existing free trade agreements like Mercosur and the Comprehensive and Progressive Trans-Pacific Partnership (CPTPP) could also be upgraded in importance as counterweights to the US and China, with some interest in the EU joining CPTPP,[3] following the UK, which joined in December 2024. In February 2025, China also reaffirmed its strategic partnership with ASEAN, which forms the basis for cooperation.

[2] 1Q25 Global Valuations – The Idea Farm - 8 April 2025. The CAPE ratio (cyclically adjusted price-to-earnings ratio), assesses whether the market is overvalued or undervalued by comparing current prices to average earnings over a 10-year period, adjusted for inflation.

[3] Why the EU should join the CPTPP – Singapore Straits Times – 13 March 2025

China's reaction to the newly protectionist and isolationist US is absolutely key. It must avoid the temptation to dump output intended for the US on Europe or its Asia-Pacific neighbors. We believe China is unlikely to miss this opportunity to extend its regional influence, and that may involve opening China's consumers to more imports from the region. On 30 March, trade ministers from China, South Korea and Japan met in Seoul[4] for discussions on trilateral trade cooperation, the first such meeting since 2019. While no free trade agreement is likely in the short term, the framework for regional cooperation in Asia-Pacific via APEC and ASEAN already exists, and now there is a clear incentive to cooperate more formally.

The new trading world of opportunity

Market uncertainty inevitably shakes investor confidence but needs to be balanced against equities demonstrated track record of strong long-term investment returns. Moving forward, we expect equity returns to show a wide dispersion, and we believe that the disciplined process, experience and decision-making skills of Robeco's active managers offer our clients a significant advantage over time.

US: Still the pre-eminent global equity market

Given the current policy revolution in Washington, the short-term outlook for the US economy and corporate earnings is very uncertain. Nevertheless, after the current trade impasse with China is at least partially resolved, global investors will still maintain high levels of exposure to the US.

US equity markets remain deep, diverse and resilient with a track record of recovering from economic disruptions, including trade wars and tariffs, in the past century. We will continue to focus on leading companies with strong return potential through the innovation and unmatched entrepreneurship that is central to US business culture. The choice of sectors, including technology, healthcare, basic materials and consumer goods is unparalleled, and provides ample opportunity for diversification. The AI revolution is still largely being driven by US companies and huge investments are still mapped out for the next decade. The broader adoption of AI in research, manufacturing and distribution could also go some way to compensating for lower immigration and productivity gaps as the country rebuilds some manufacturing behind its tariff barrier.

> *"Huge investments in AI are mapped out in the next decade*

Assuming there are no measures taken by the US government to constrain or limit capital flows, the US will stay the pre-eminent global equity market. Identifying the best investment prospects will require an active approach focused on the companies that retain strong competitive moats, move fast to mitigate tariff effects, address a significant domestic consumer base, or provide unique services with a global footprint. Robeco's global equity strategies focus on finding quality companies with high free cashflow and a healthy return on invested capital, and the US economy should remain a fruitful destination for that.

Europe: Shock-driven stimulus is renewing confidence

The breadth and speed of Trump 2.0 policy direction and application caught Europe by surprise, but the reaction has also been swift with a renewed commitment to invest in defense and infrastructure across the EU. This is being led by Germany whose new government is determined to rebuild its battered economy, helped by its strong fiscal position with government debt-to-GDP at only 65%. European equity markets have long lived in the shadow of US peers since the Global Financial Crisis in 2008 and still trade at a large valuation discount.[5] Europe's markets enjoyed a strong start to 2025 before being derailed by the imposition of tariffs by the US. Valuations in Europe in both developed and emerging markets remain moderate in our view, and we expect Europe's industrials and technology sectors to be underpinned by the expected fiscal stimulus.

[4] Talks with Japan, China discuss trilateral free trade agreement – South Korea government website, 31 March 2025
[5] The stars align for European equities – Robeco - 14 August 2024

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The isolationist stance of the US and apparent removal of its security umbrella has also made regulatory reform and enhanced European integration more likely. We believe there are substantial opportunities that could boost Europe's economy over the long term, especially the long-considered European Capital Markets Union[6] which would enable the EU to compete more effectively as a trading region by lowering costs, increasing efficiency of capital allocation and improving liquidity. In addition, given the antagonistic and capricious approach of the new US government to its traditional allies, Europe's prospects of economic and trade cooperation with the UK, and allied countries like Canada and Japan now seem vastly improved. Even trade relations with China have the potential to ease, given the demand shock both the EU and China are set to experience through US tariffs, and the consequent incentive to cooperate.[7]

On the negative side, a strengthening euro could be a headwind for exporters already impacted by the US tariffs, while Europe's own political situation is not stable. On balance though, Europe is well-placed to regain economic momentum and is likely to increase its share of global market capitalization in the next decade.

Asia-Pacific: Industrial powerhouses and dynamic emerging economies

Like Europe, the long period of US outperformance and the 2025 market turmoil has left Asia-Pacific equities very reasonably valued. In the short-term, it's crucial that China and the US find and maintain a new trading equilibrium given a weakening CNY and stimulus cannot replace US demand for goods. Despite the region being hit particularly hard by the tariffs, many Asian countries are likely to negotiate deals to mitigate some of the impacts or at least minimize the level to 10%, and they can use monetary and fiscal stimulus to offset short-term macroeconomic effects. A shift toward a more balanced global economy, with growth driven by multiple regions rather than relying heavily on the US consumer, is expected if the current US policy initiatives will be implemented. To enable that, both China and India will need to open their economies further, fulfilling their promise as consuming nations.

> *"Exposure to the North Asian industrial economies is essential*

For global equity investors, exposure to the North Asian industrial economies in China, South Korea and Japan is essential with world-class companies and plenty of value being unlocked through an increased focus on shareholder value. Confidence in China's international competitiveness and continued ability to innovate was boosted in January 2025 by the release of the DeepSeek Large Language Model (LLM), which was developed at lower cost than similar LLMs from the US. China can achieve more technological breakthroughs in the coming years despite sanctions and restrictions from the US. China is already capitalizing on advantages like rapid adoption of new technologies, a vast domestic market, and an unrivaled manufacturing base, to lead in key industries including electric vehicles and renewable energy.

Emerging markets in Southeast Asia have been hit hard by the threat of US tariffs, the short-term outlook is clouded, but long-term the fundamentals remain positive. Increasing technology and mass consumption in Asia can create significant growth opportunities for companies with exposure to these markets, driving revenue and profitability. Last but not least, to complement its vibrant domestic economy, India is becoming a haven of production relocated from China, highlighted by Taiwanese contract manufacturing giant Foxconn's ongoing investment in manufacturing in the country. In addition, trade deals with both the US and UK could be finalized in 2025, emphasizing India will be a central rather than peripheral player in the global economy in the years ahead.

LatAm and Middle East: Set to thrive in a multi-polar world

Asia has dominated emerging markets investing in the past 20 years, accounting for more than 80% of the MSCI EM index by geographic weight at the end of 2024, led by China, India and South Korea. We believe the new global trading landscape will help both Latin America and Africa attract more equity investors. Latin America has performed relatively better than other regions since 2 April reflecting different export exposure to the US than

[6] EU revives capital markets union plan to unlock trillions in savings – Financial Times - 19 March 2025
[7] EU leaders plan trip to Beijing in July for summit with Xi Jinping – South China Morning Post - 11 April 2025

Asia's economies and thus generally lower proposed US tariff levels than in Asia. The region is already producing globally competitive companies in sectors like fintech, ecommerce, aerospace and basic materials. Given deep cultural ties with both the US and Europe, and growing trade ties with Asia through the CPTPP, we are confident about the prospects of the region for the long term.

In the Middle East, the Gulf Cooperation Council countries are offering increasing opportunities for global equity investors as they strive to diversify their economies. While GCC markets have been dominated by financials and energy, we are researching companies in sectors like real estate, healthcare and technology, and we expect to increase our exposure to GCC equities in the next decade.

" GCC countries are offering increasing opportunities as they strive to diversify

Africa: FDI and technology adoption are positive signs

Africa remains the last frontier for equity investors with, at the moment, a limited set of investable opportunities. However, the continent is benefiting from technology adoption and growing foreign direct investment. In Africa, FDI surged 84% to USD 94 billion in 2024,[8] largely due to investment by Abu Dhabi in a new city on Egypt's Ras El-Hekma peninsula. Without this project, the continent's inflows rose by 23% to USD 50 billion. South Africa remains the dominant equity market on the continent, and with its maturing democracy and efforts to re-invest in infrastructure and deregulate, Robeco's EM strategies are positive on its long-term prospects.

High-conviction strategies for volatile times

The current turbulence and volatility will yield numerous entry points for long-term investors, making it an ideal time to rebalance your global equity exposure. We believe the best way to target alpha in this more complex global trading landscape is through active, focused strategies with a high active share, offering diverse sector exposure but with the agility to react rapidly to changing conditions and event risk.

Robeco's Fundamental Equity team takes a data-driven approach to finding a select group of companies to invest in, from over 59,000 companies listed in 60 global markets. Our high-conviction strategies are managed by some of the most experienced teams in the industry and can enable you to achieve a truly global and balanced equity investment footprint.

For more information on Robeco's Global Focused Equity strategy and Emerging Markets Focused Equities strategy please visit robeco.com/en-us/

[8] UN Trade and Development (UNCTAD) - Foreign investment in developing economies fell 2% in 2024, marking second year of decline – 25 January 2025

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