ROBECO
The Investment Engineers

Global markets outlook

Emerging markets debt: Coming of age

April 2025

General overview

Gold and black gold glisten through the storm clouds

MULTI ASSET	1mo	3mo	YTD	1YR	3YR	5YR
Gold (USD)	9.9%	18.2%	18.2%	39.4%	16.3%	13.2%
Oil Index (USD)	3.3%	2.8%	2.8%	-0.6%	0.8%	22.9%
Emerging Markets (LC)	0.3%	2.7%	2.7%	11.1%	4.7%	9.6%
Cash (EUR)	0.2%	0.7%	0.7%	3.6%	2.7%	1.4%
Global investment grade bonds (H, EUR)	-0.5%	1.4%	1.4%	3.6%	-0.3%	0.3%
Global Gov Bonds (H, EUR)	-0.6%	0.7%	0.7%	1.4%	-2.0%	-2.6%
Global inflation-linked bonds (H, EUR)	-0.6%	1.2%	1.2%	-0.2%	-5.6%	-1.6%
GSCI Commodities (USD)	-0.9%	0.5%	0.5%	3.8%	2.3%	21.1%
Global high yield (H, EUR)	-1.0%	0.8%	0.8%	7.4%	3.8%	5.6%
EMD local currency (UH, EUR)	-2.9%	-0.5%	-0.5%	3.6%	3.1%	2.4%
Emerging Markets (UH, EUR)	-3.1%	-1.3%	-1.3%	8.1%	2.4%	8.3%
EMD hard currency (UH, EUR)	-3.7%	-1.7%	-1.7%	7.1%	4.3%	3.1%
MSCI World (H, EUR)	-5.0%	-2.8%	-2.8%	6.0%	6.7%	14.9%
MSCI World local currency	-5.0%	-2.7%	-2.7%	7.0%	8.5%	16.5%
Global real estate (UH, EUR)	-6.4%	-2.0%	-2.0%	6.7%	-0.5%	7.8%
MSCI World (UH, EUR)	-8.0%	-5.9%	-5.9%	7.0%	8.6%	16.5%

Source: Robeco, Bloomberg. Note Returns in Euros

March saw US recession odds rise

March brought the curtain down on a tumultuous first quarter, as the S&P 500 delivered the worst returns since Q1 2022, while the German Dax index outperformed its US counterpart by 16% in euros.

The watershed moment in Germany's approach to increasing defense spending effectively pushed to one side the Maastricht Treaty, in which the EU acts as one homogenous body on raising debt levels. This was a catalyst for a rising German stock market and higher bond yields. In an historical context, the rise in 10-year German Bund yields following the announcement was the largest one-day jump since reunification in 1990.

The drawn-out process of US tariff announcements caused a derisking in investors' portfolios and a downgrading of the US economic outlook. In this period of uncertainty, one asset that everyone agreed on was to hold more gold, metals and oil.

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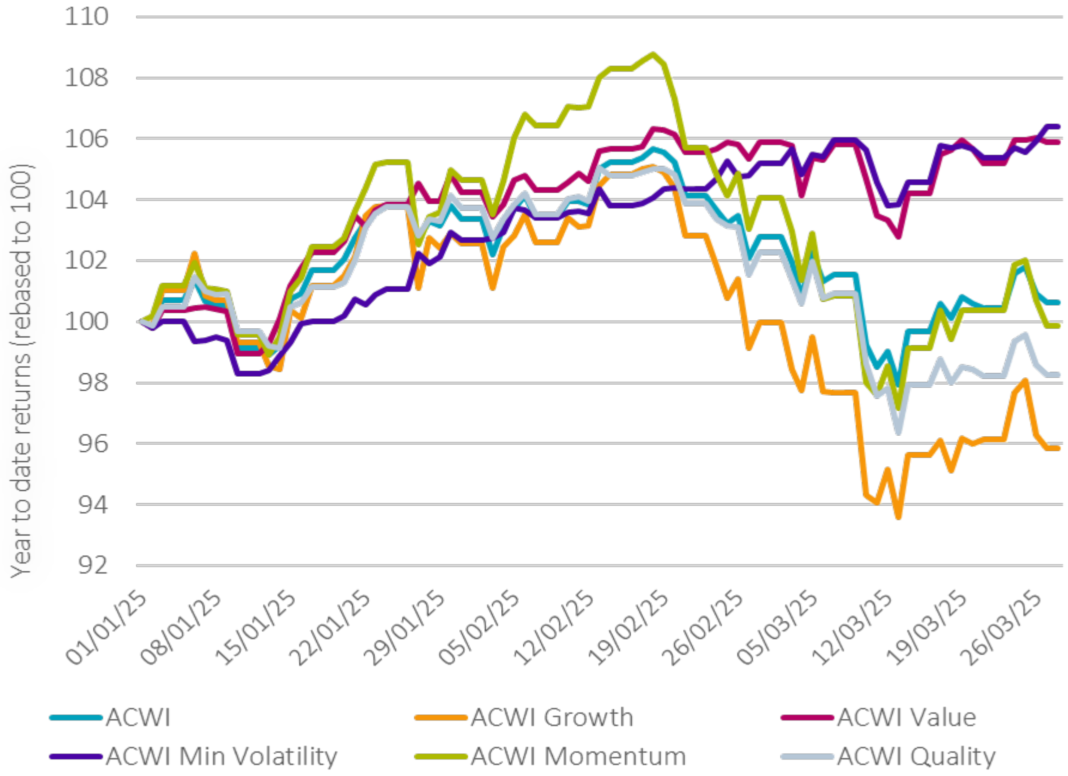
General overview

Value and low-volatility stocks have taken the spotlight



Source: Robeco, as @ March 2025

A rotation, or just closing out positions (derisking)?

Investors continued to close out their large risk positions in portfolio, namely selling Magnificent Seven tech stocks and closing underweights in European equities. The style rotation within equities has been the largest since 2008.

Value and low-volatility stocks have delivered positive absolute performance over Q1.

We observe that CTA, hedge funds and risk parity funds have reduced their leverage ratios i.e. they have derisked portfolios, which involves closing overweights (Mag7, US dollar) and underweights (China, value, Europe, the euro).

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Theme of the month: Emerging markets debt

EMD: Coming of Age

Chart 1: US traded weighted dollar from 1990 to Q12025
Source: Bloomberg, Robeco

Headwinds are staring to fade

The key headwind for emerging market debt has been the strength of the US dollar, as this tightens financial conditions outside the US. Despite the better fiscal and deficit management in an asset class previously ravaged by sovereign defaults, this has not translated into better performance, despite the obvious cheap valuations in compared to spreads in other credit markets like high yield (See Robeco 5-year Expected Return publications).

US exceptionalism has sucked in investors and capital

This has prevented rate cuts in Latin America, as fear of currency devaluation against the US dollar still haunts local central banks. The conflict in Ukraine has instilled an additional risk premium in several local bond markets (see Chart 2), while the manufacturing hubs in Asia have been able to lower rates as they are natural recipients of US dollars through traded goods.

Theme of the month: Emerging markets debt

Happy hunting ground for yield hunters

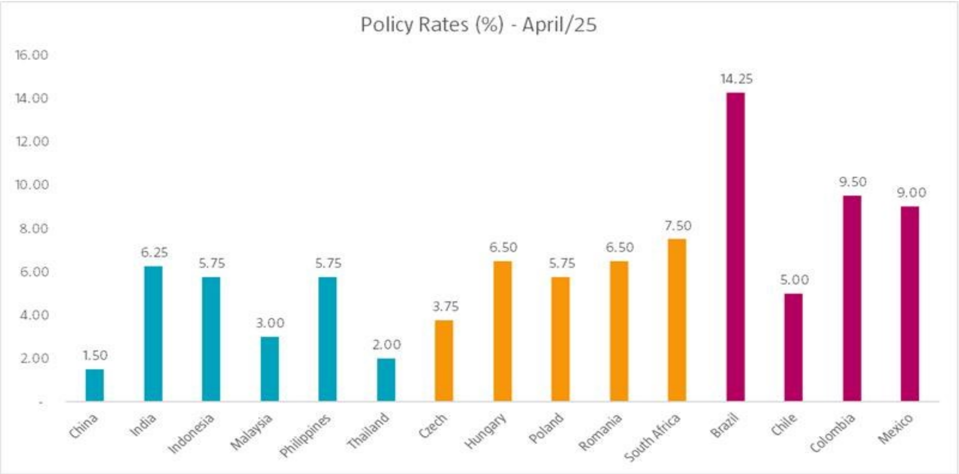

Chart 2: Yields provide attractive hunting ground in LatAm and parts of EMEA
Source: Bloomberg, Robeco

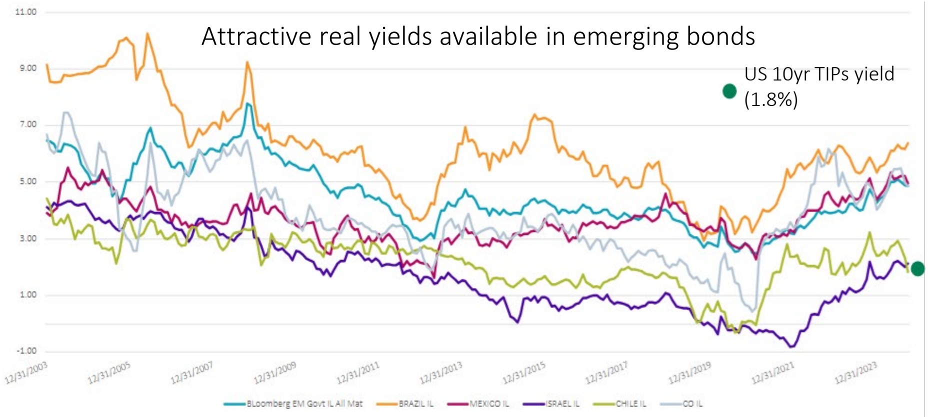

Chart 3: EMD local currency yields
Source: Bloomberg,Robeco

Opportunity has been knocking

The valuation signals for emerging markets debt have flashing cheap for a few years, but not enough to attract investors' attention. However, the catalysts are aligning with the crack in US exceptionalism and countries that are more willing to trade in non-dollar currencies. With EMD, investors take on a different credit risk to investment grade and high yield bonds, though our research suggests that allocating to a basket of the asset classes gives a better risk return profile.

Headwinds remain for investors

The Trump administration's first order of priority is to impose tariffs on everyone. Asian yields remain low, particularly in China where the property bust is continues to negatively impact economic growth. In conclusion, investors should expect a choppy ride and use market sell-offs to diversify from other credit holdings.

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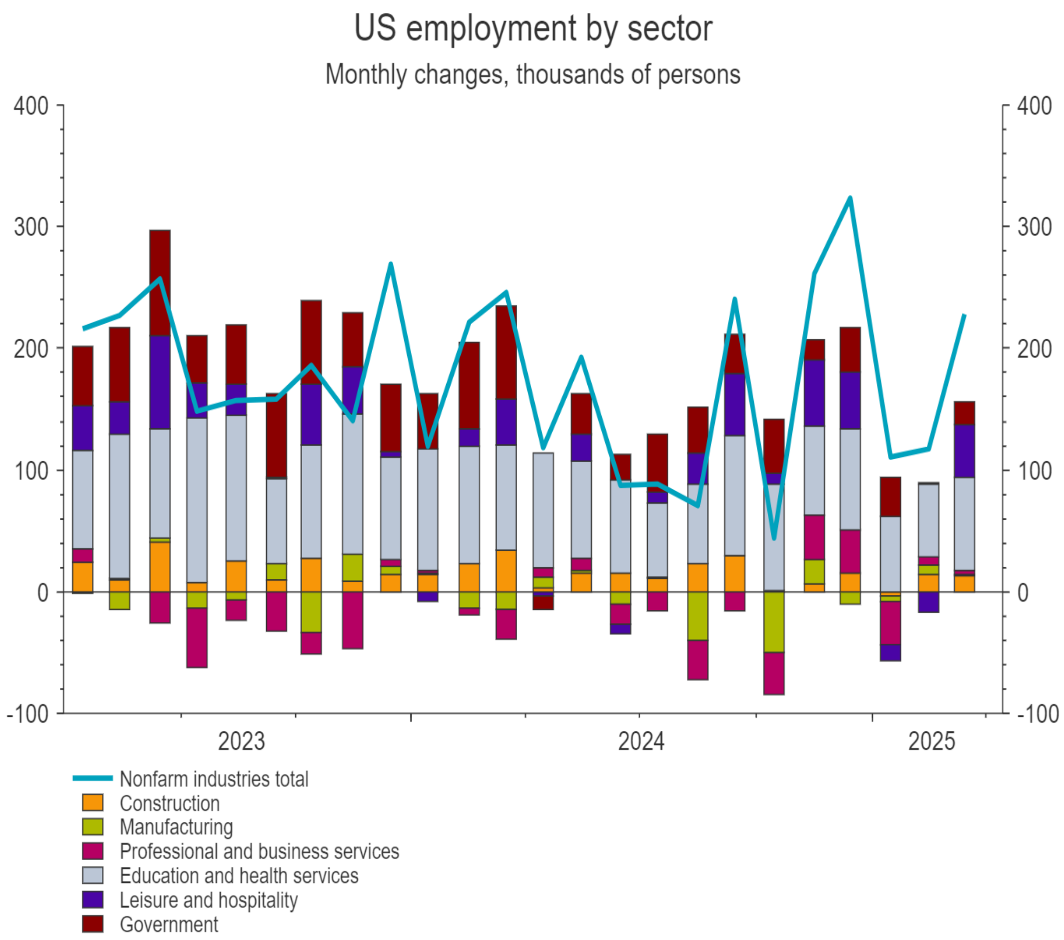
Economy

Payrolls; a good number but manufacturing is going nowhere



Source: LSEG Datastream, Robeco

Upgrade of bear case: US policy has moved in the wrong direction

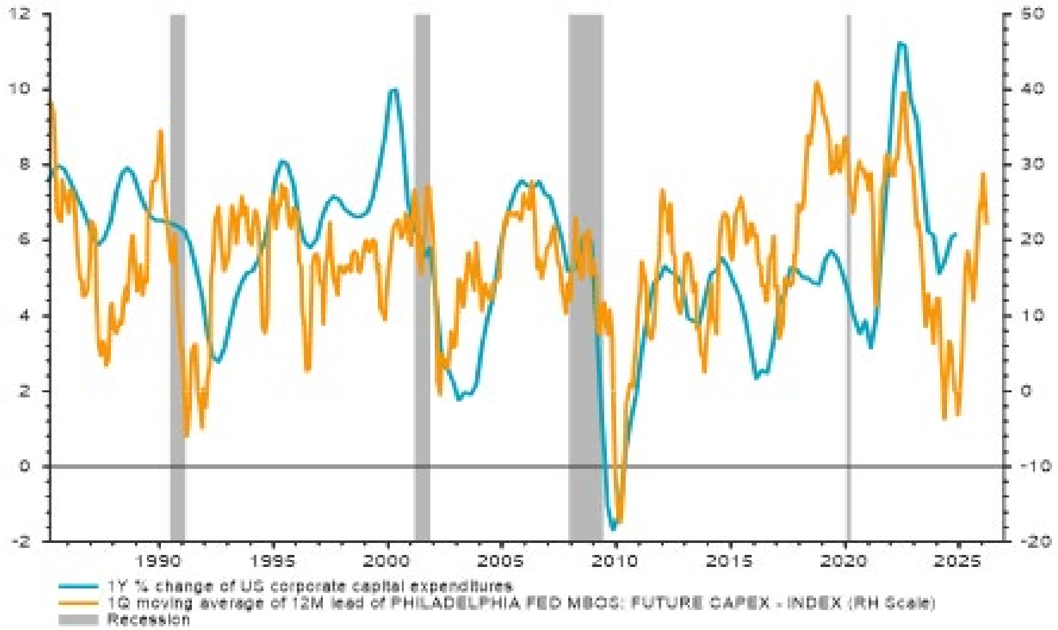
Whereas last month we wrote that there was "so much short-term noise and so much long-term signal", we increasingly see long-term signals for the US economy moving in the wrong direction. Yes, hard data is holding up relatively well for the US economy – for now. The non-farm payroll number of 228,000 new jobs added last month was above expectations, but the composition showed that manufacturing jobs were not bouncing back. This will only reinvigorate Trump's 2 April tariff shock where he announced universal tariffs of 10% and reciprocal tariffs which in some cases were as high as 46%.

Tariff formula is flawed

Tariffs are seen as the vehicle to bring manufacturing jobs back to the US. Tariffs on China are now at 54%, close to Trump's campaign promise of 60%. The formula that the White House applied, charging a country a tariff rate which was proportional to the net export surplus that country runs relative to its total exports to the US, had nothing to do with pure reciprocity. Instead, it amounted to a tariff rate that is clearly in excess of what other countries levied on the US prior to 2 April. This is a game changer which endangers the resiliency of the US economy.

Economy

Capex intentions have rolled over in the US



Source: LSEG Datastream,Robeco

'Waking up from a pipe dream'

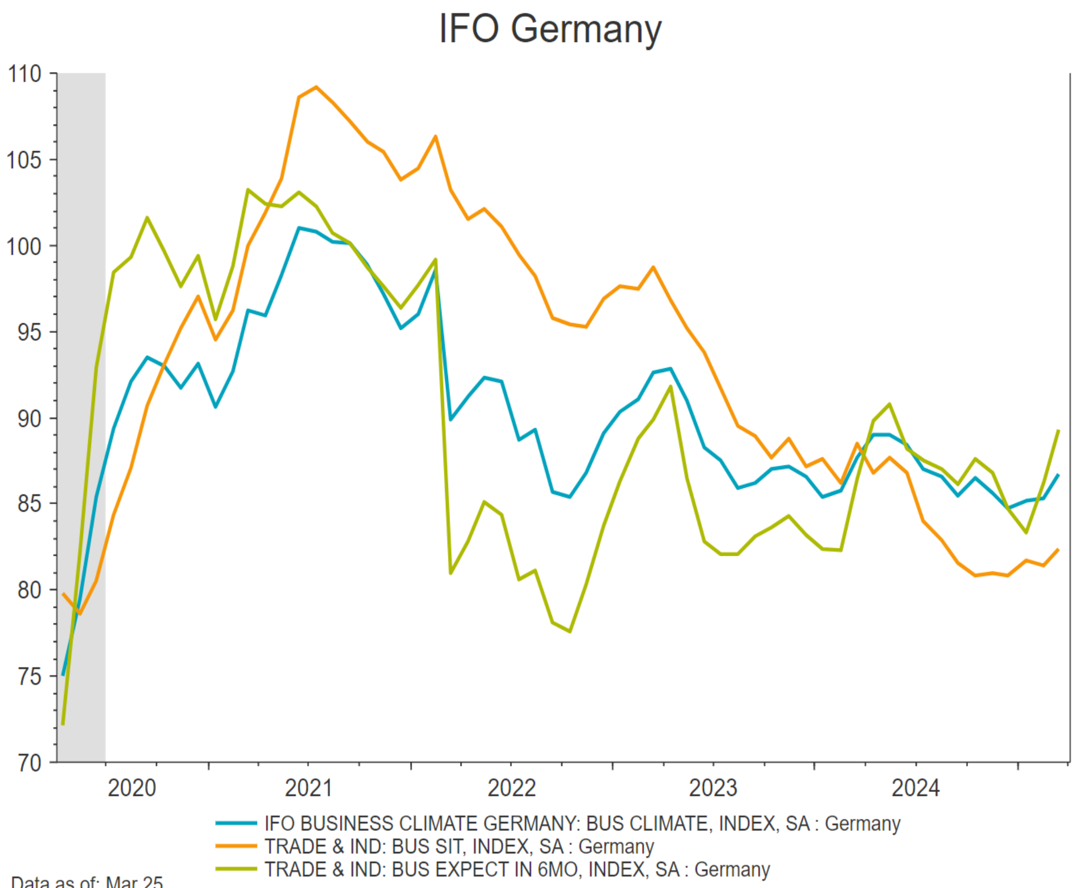
In addition to confidence being hurt by tariffs threats, the execution and determined stance to pursue a bilateral trade balance of at least 'break-even' will add more pressure to the US economy, frustrating supply chains and posing an initial negative supply shock that put the Fed in a bind. We now foresee something more ominous than a powerful stagflationary cross-current and have raised the chance of our bear case 'Waking up from a pipe dream' coming to pass to 45%.

A crude reality check

Markets have been waking up to a crude reality check as Trump does not seem to back down, taking the initial 10%+ market sell-off that it caused in his stride. Next to the erosion of purchasing power on the back of tariffs, the negative wealth effect from stock market losses could make US households – the allocation to equities among US households is at an historic high – even more cautious in the near term, creating the risk of a self-fulfilling drop in aggregate demand.

Economy

Germany's producers were becoming more upbeat in March



Data as of: Mar 25

Source: LSEG Datastream, Robeco

Germany takes its foot off the brake

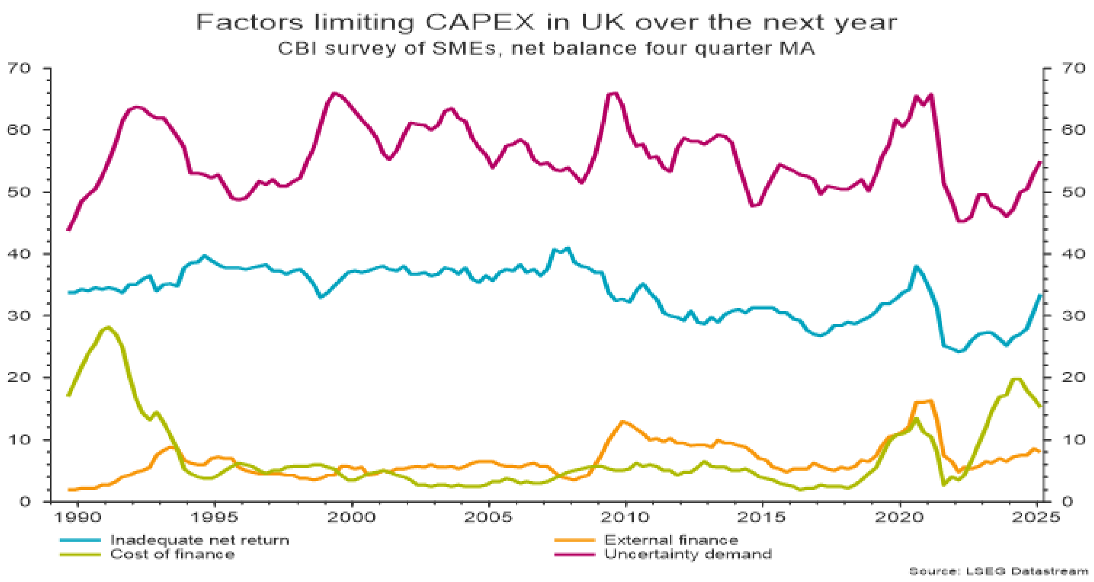
In Europe, Germany achieved a real 'Zeitenwende' when the old parliament agreed to a last-minute change in the Constitution to relax the debt brake rules, creating more leeway for fiscal stimulus. A EUR 500 billion infrastructure fund was announced, with the federal government now able to spend more in defence if expenditures run in excess of 1% of German GDP.

Uptick in industrial confidence

In reaction, leading producer indicators from the IFO survey showed a notable uptick in confidence among German industry. However, this survey was held prior to the 2 April tariff announcement which saw a 20% reciprocal tariff on Germany in addition to the 10% universal tariff. This will likely dent nascent optimism among German exporters in the coming months.

Economy

Negative earnings guidance ahead on rising demand uncertainty



Improving consumer optimism

Consumer optimism also improved in Germany, though it remained subdued at the broader European level. The European commission consumer sentiment indicator did not improve further in March, even though European unemployment dropped to 6.1%, remaining at historic lows. While consumer resilience on the back of a tight labor market and more expansionary fiscal policy could weather any incoming tariff shock, retaliatory tariffs could also create a headwind for the European consumer.

Opening the door for talks

While the European Commission has opened the door for negotiations, the Trump administration is still assessing whether any opening gestures are ''believable''. Retaliatory measures from Europe loom, while China already has retaliated by raising tariffs on US imports by 34%. After benefitting for decades from the gains of comparative advantage, current policy settings are partially reversing those efficiency gains, denting the global growth outlook.

All market data to 31 March 2025 unless mentioned otherwise

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