MACRO GROUP

Q4 EMD OUTLOOK
RETHINK THE NARRATIVE

Oct. 2025

GlobalEvolution

Part of GENERALI INVESTMENTS

Q4 EMD OUTLOOK – IN A NUTSHELL
RETHINK THE NARRATIVE

- **MACRO: Taking stock on three key themes for 2025**

  I. **Peak US exceptionalism: Pausing.** Reduced policy uncertainty, resilient growth, reduced fiscal concerns due to tariff revenues and an AI investment boom means US growth estimates are being lifted. Chinese momentum disappoints as fiscal stimulus remains measured → EM-DM (ex. US) growth gap should widen, EM – US more sideways (RHS).

  II. **Peak policy uncertainty: On track.** Trade uncertainty is high, but falling. US effective tariff rate most likely settles below its recession threshold. Trump's pressure on Fed should be about to peak as he's underperforming on inflation in the eyes of voters (no.1 concern).

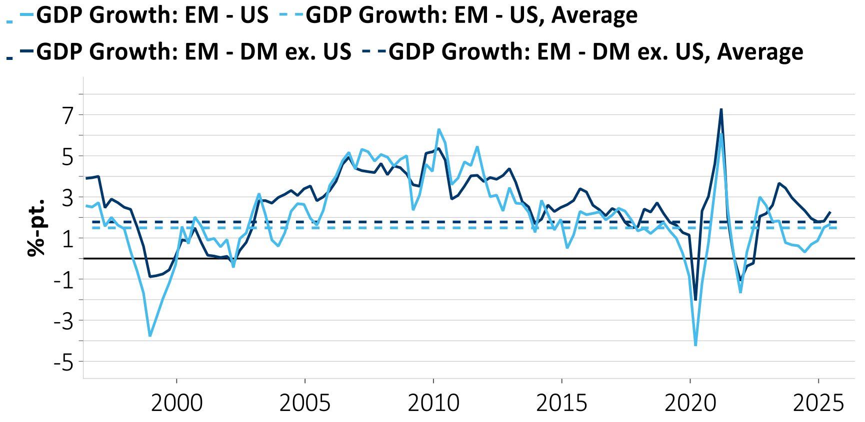
  III. **Peak growth pessimism: For now, mostly a DM story as China's stimulus cycle slows.** US recession probability falls as monetary conditions ease, oil price is low and labour lags.

  - **Two-sided RISKS:** Overheating/stagflation & recessionary reflexivity (US job market).

- **MARKETS: Solid 12M returns - shifting down into year-end**

  - **Don't extrapolate:** Monetary easing and peak policy uncertainty supports EMD, but growth rebalancing takes a breather → positive, but lower EMD returns towards year-end.
  - **Rethink the narrative (I):** Tactically moving hard currency to overweight form neutral as support for EM FX from peak US exceptionalism fades and USD weakness is consensus.
  - **Rethink the narrative (II):** Structural shifts (higher inflation, level-shift higher in geopolitical uncertainty, higher fiscal leverage) create a more uncertain investment environment. **These shifts are driven out of DM, not EM → EMD performed *because* of elevated uncertainty, not *despite* of it.** Longer-term, these shifts should benefit local currency debt, in particular.

EM- DM: Growth Differentials

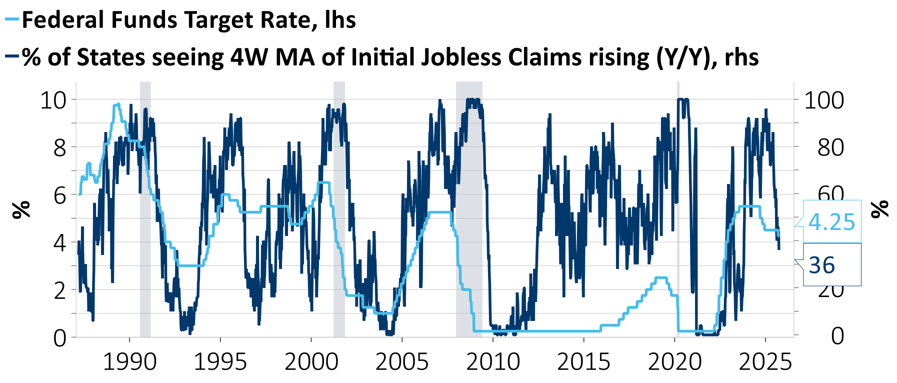


Source: Global Evolution, Macrobond and Bloomberg

Q4 EMD OUTLOOK
THE MACRO PLAYBOOK
"PEAK US EXCEPTIONALISM" PAUSING

Q4 EMD OUTLOOK - MACRO PLAYBOOK
WHERE ARE WE IN THE BUSINESS CYCLE?

US: Job Market & Monetary Policy
Grey Bars Marking US Recessions (NBER*)



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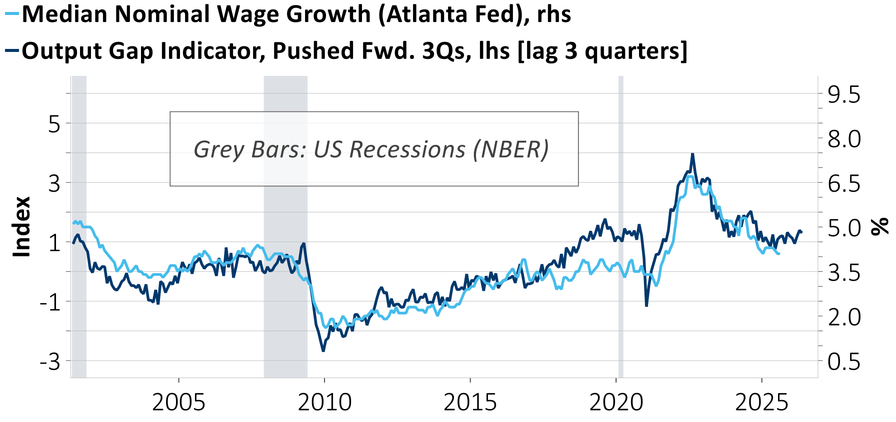
Source: Global Evolution, Macrobond and Bloomberg

US: Output Gap and Wages



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Source: Global Evolution, Macrobond and Bloomberg

- **It's the supply side, stupid:** Normally, gauging the business cycle is all about the demand side – not so much this time around → assessing the business cycle is much more two-dimensional than usual – **uncertainties abound!**
- **Mid-cycle upturn:** Rather than extrapolating US labour market weakness into "recessionary reflexivity", the latter might be as weak as it gets (LHS) as the economy exits a mid-cycle soft-patch. This rhymes with a stabilization of the outputgap (RHS).
- Implications: **Growth concerns are overblown…and monetary easing momentum is approaching a peak.**

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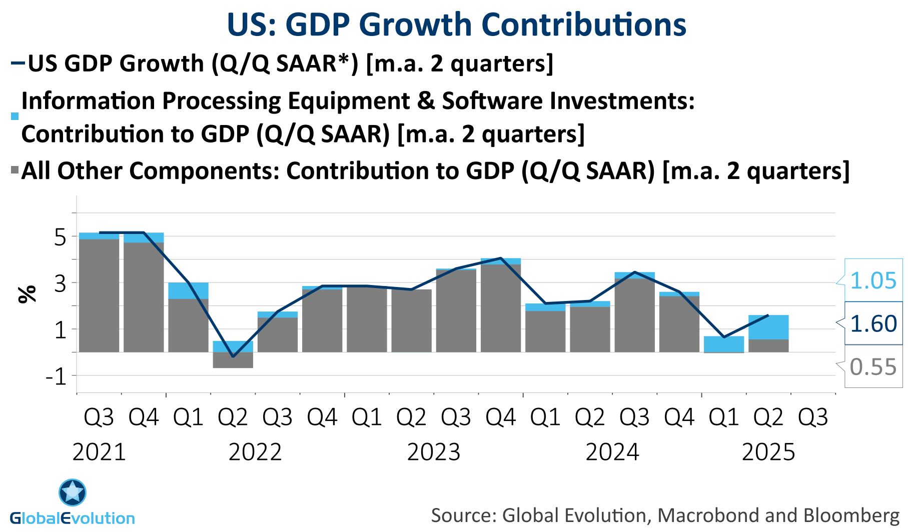
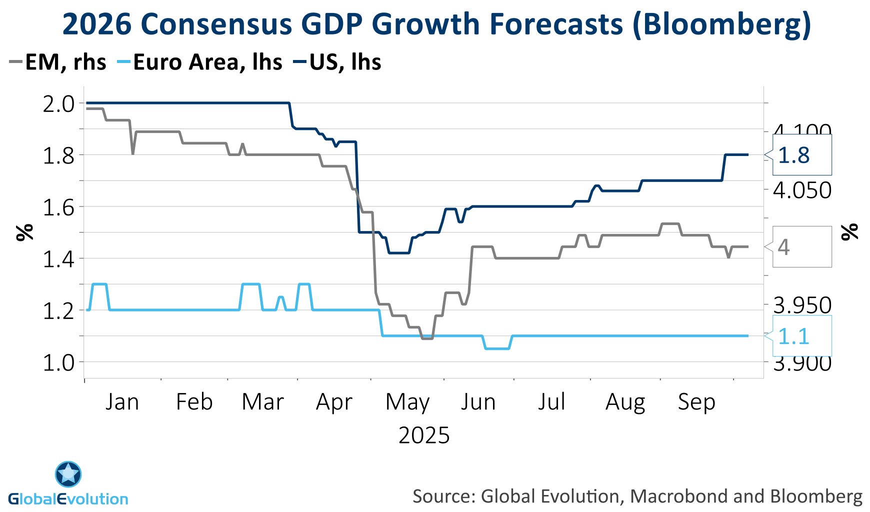
Prepared by Global Evolution as of Oct. 04, 2025. *) NBER: National Bureau of Economic Research.

Q4 EMD OUTLOOK - MACRO PLAYBOOK
GROWTH: "PEAK US EXCEPTIONALISM" PAUSING

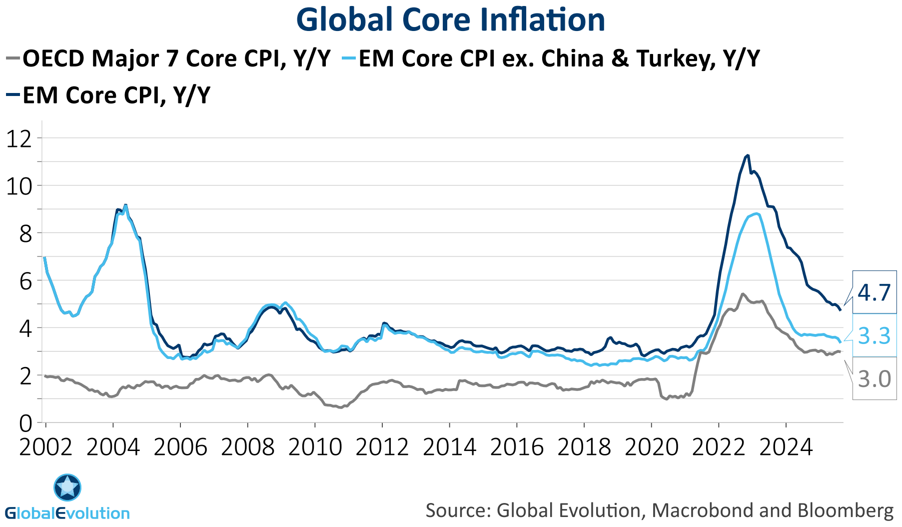




- **A little bit of US exceptionalism repeating:** An AI investment boom has contributed significantly to H1 growth (RHS), US consumers are so far unimpressed by tariffs and US GDP estimates are being revised higher (RHS).
- Atlanta Fed's Nowcast model indicates 3-4% GDP growth (AR**).

Prepared by Global Evolution as of Oct. 04, 2025. *) Q/Q SAAR: Quarter over quarter change at an annual rate, seasonally adjusted. **) AR: Annual rate.

Q4 EMD OUTLOOK - MACRO PLAYBOOK
INFLATION: BIFURCATION



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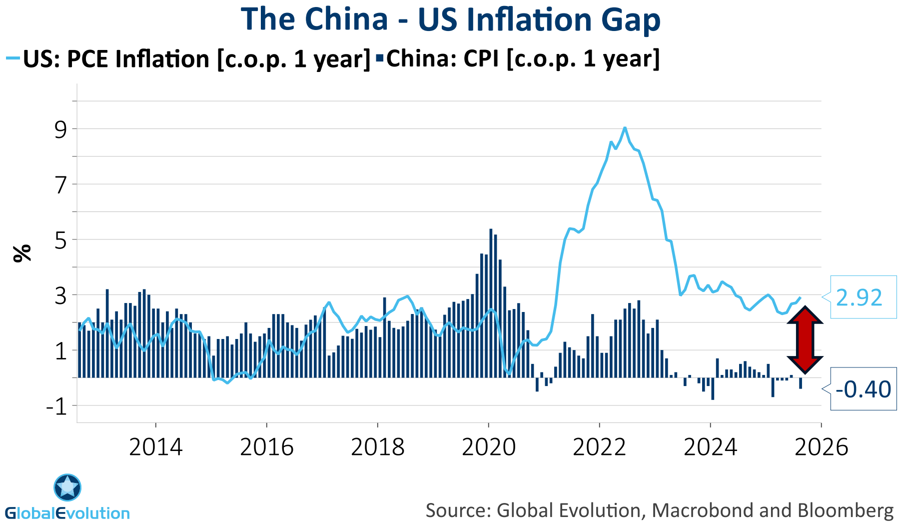


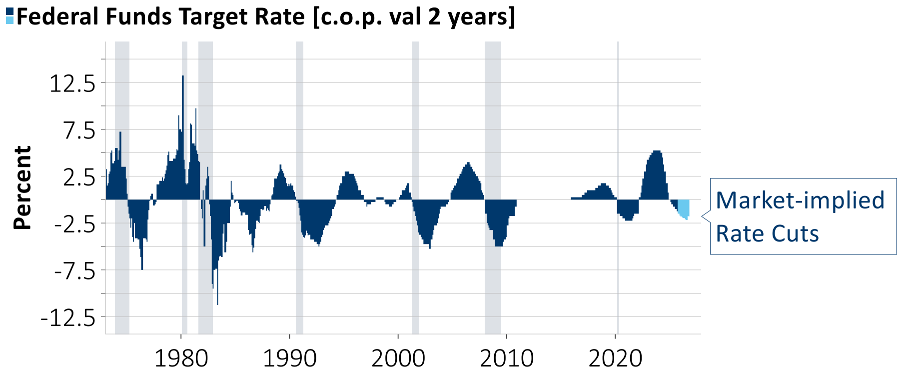
Source: Global Evolution, Macrobond and Bloomberg

- EM inflation continues to drift lower, while DM inflation is stagnating (EA) and accelerating in the US (LHS).
- **Disruptive divergence:** Re-flation in the US, deflation in China (RHS)
- → As long as China is in deflation, it will be **difficult to get consumption going**.
- → China's size relative to the US economy in current USD/market exchange rate terms (63%) is the same as it was in 2015.

Q4 EMD OUTLOOK - MACRO PLAYBOOK
MONETARY CONDITIONS: APPROACHING "PEAK EASY"

US: Market-Implied Fed Fund Change

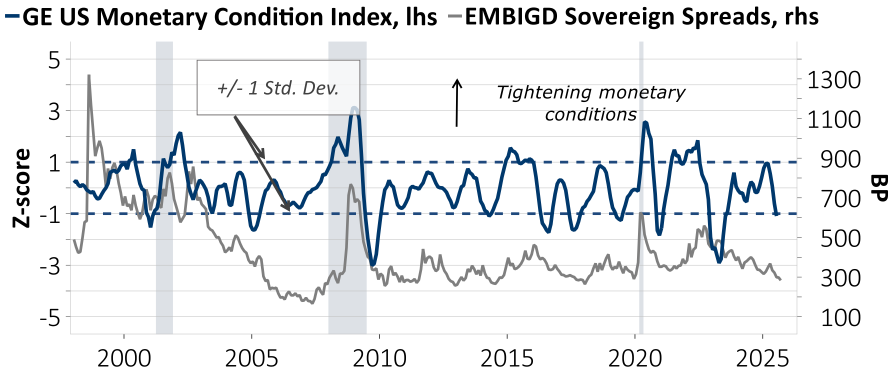
Grey Band: US Recession



Source: Global Evolution, Macrobond and Bloomberg

Global Monetary Conditions

Grey Bands: US Recession (NBER)

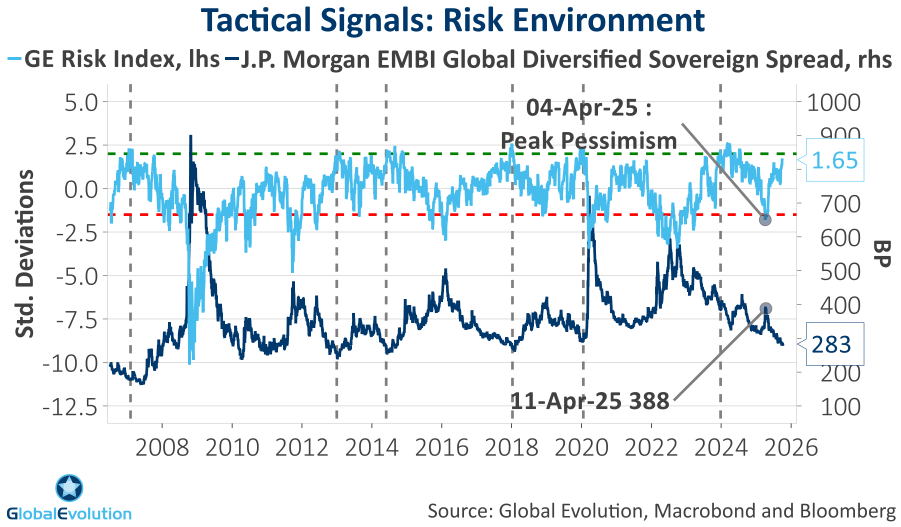


Source: Global Evolution, Macrobond and Bloomberg

- Amid US labour market weakness, Fed's not done with its "insurance cuts".
- However, the market seems to have priced too many cuts. Current pricing is more reflective of a recessionary backdrop (LHS), which we don't see. **Monetary conditions are easing** (RHS), but the pace of easing (impulse) is peaking.
- **Fed independence under threat:** Acc. to YouGov Sep. survey*, inflation is the single biggest issue for US voters. Trump scores the poorest on inflation ahead of Mid-terms → beyond pure rhetoric we believe, **White House pressure on the Fed should subside in 2026**.

Q4 EMD OUTLOOK
ASSET ALLOCATION
RETHINK THE NARRATIVE

Q4 EMD OUTLOOK – ASSET ALLOCATION
EMFX: A PAUSE TO REFRESH – O/W CREDIT IN Q4



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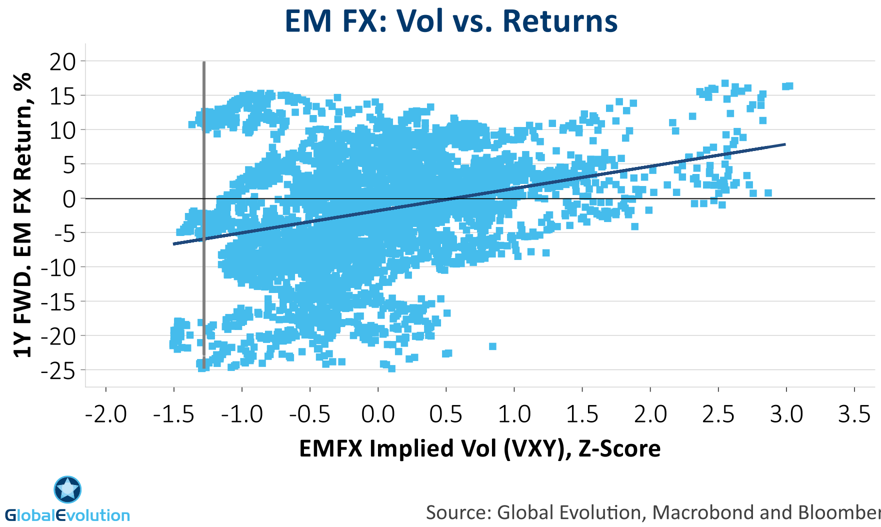
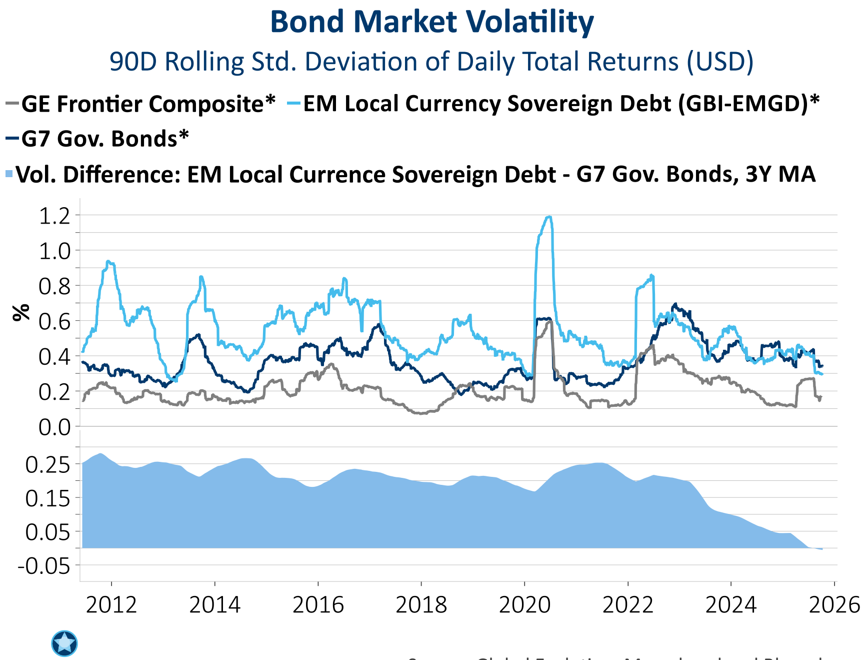


Source: Global Evolution, Macrobond and Bloomberg

- **In April, our contrarian GE Risk Index triggered a positive signal for risk assets and for credit risk, in particular (peak pessimism, LHS).**
- Tactical signals point to **limited risk of spread widening overshadowing carry** as the main return driver for hard currency debt.
- “Peak US exceptionalism” pausing, implied vol is historically low (RHS) → tactical downside risks to EM FX.
- **Rethink the narrative (I):** While we believe local currency EMD will outperform longer term, we **prefer hard currency EMD into year-end.**
- **What to watch out for:** Should the GE Risk Index surpass +2 std. dev., some spread widening in subsequent months has to be expected.

Q4 EMD OUTLOOK – ASSET ALLOCATION
NAVIGATING STRUCTURAL SHIFTS: RISK/REWARD



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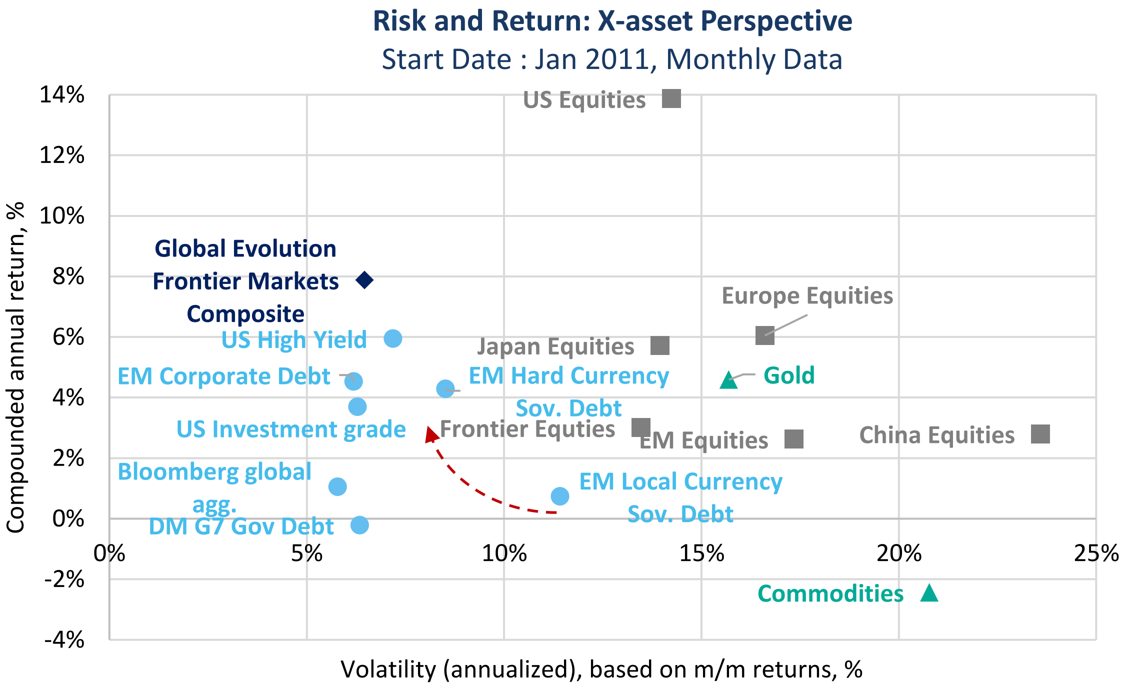

- **Rethink the narrative (II):** Structural regime shifts (higher inflation, higher geopolitical uncertainty, fiscal largesse) are EM- driven
- → Impacting DM vol more than EM vol (LHS), improving the relative risk/reward of EM debt.
- **Upside potential:** In particular, we expected **EM Local Currency Debt** to move north-west in the RHS diagram on the coming years.

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