



Global Fixed Income Macro Outlook Coming to America

- An energetic new administration and big fiscal easing already here
- Job gains, growth and Fed tapering comments should arrive from Q2
- The latter should bring value after H1's cyclical bear trade in rates

Summary

Well, what a start to the year! Several things are coming to America. A new Democrat administration keen to sprint out of the blocks, outsized fiscal easing, and wider breakevens (already at well above pre-pandemic levels) are already here. From now, should no mutation hitches stymie reopening plans, outsized job gains, inflation base effects, consumer spending and growth should follow. Then, contingent on the job gains, we should expect the first Fed comments on tapering, probably in May. While value has already begun to build in US Treasuries, with 5y5y forwards already above the Fed's median longer-run dot, the coast may not be clear – particularly for real yields – until the market has fully priced in tapering. Beyond the USD 13 trillion US Treasury market, the USD 34 trillion global government complex remains a

source of active differentiation – and therefore alpha (both long and short) – within the USD 66 trillion global aggregate universe opportunity set. Correlations, too, are as dynamic as ever, with Bunds and JGBs seeing less than a third and an eighth of the volatility of Treasuries over the year to date. And Italy, China and even the 2yr US Treasury have delivered positive returns for material

Outlook

For professional investors
March 2021

Robeco Global Macro team

Jamie Stuttard, Michiel de Bruin, Bob Stoutjesdijk, Rikkert Scholten, Martin van Vliet, Regina Borromeo, Stephan van IJzendoorn

All examples mentioned are for information purposes only and not intended as investment advice in any way. The value of your investments may fluctuate. Results obtained in the past are no guarantee for the future.

periods, offering comparative respite. Even in Q1 2021, amid sharply rising yields, you needed to have picked your shorts carefully, by geography and maturity.

For Q2 portfolio strategy, we expect to rotate shorts from the US to Bunds in due course, anticipating that the EU's vaccination programs will eventually get in order and that the ECB will shake off its current timidity over the mighty heights of -0.25% Bund yields. Gilts should continue to bear steepen, albeit to a lesser extent than the US, given greater proposed fiscal restraint. The JGB long end should steepen, too. We think an opportunity on the overweight side will emerge in China as extraordinary economic stimulus from 2020 rolls over first in that market, given that China's economic hit predated that of the west. Markets are focused on base effects of growth and inflation, but don't forget the base effects of policy and credit creation.

'Whereas the underweight in duration is cyclical, we view our underweight in credit as tactical'

In credit, IG spreads offer little value in our view – with year-to-date returns in credit heavily dominated by duration rather than the OAS component. The only difference in investment proposition is that credit carries a bit better than rates, at the cost of considerable latent illiquidity risk. But whereas the underweight in duration is cyclical, we view our underweight in credit as tactical. We expect a much narrower range in IG in 2021 than last year's drama (see: "[Just another range trade](#)", the previous edition of the Global Macro Quarterly Outlook).

High yield may offer opportunities too as the quarter progresses, though the big gains were in Q2 last year and cannot mathematically be repeated this year. On EM, while we do not expect volatility to the same degree as 2013, caution is warranted. The sell-side consensus has been surprisingly accurate on its call in 2021 for higher yields, wider breakevens and steeper curves; however, the call for a weaker dollar looks more suspect: EM would see the most fallout if the dollar consensus slips on a summer tapering banana skin, so a 'basket case basket' may be in order on the short side.

Both duration and credit will need to be carefully and actively managed this summer. The Q2 market movie may not be a PG-rated one: real yields tend not to fall when the Fed begins the multi-year process of communicating its intentions and then withdrawing stimulus. And, because markets anticipate, volatility

should be frontloaded. At the same time, should monetary policy become less reflationary, breakevens could get crushed, thereby turbocharging real yields – with both components thus reversing the standard pattern on the 'announcement effect' of QE (see: "[How did quantitative easing really work?](#)"). A real yield rise, if combined with a stronger surprise on the dollar, would upend several of the more expensive asset classes (particularly the raciest ones outside of fixed income). Beyond tapering concerns, it is quite possible that a separate dual policy mistake is unfolding before our eyes, with excess and poorly targeted fiscal spending together (see Larry Summers on the debate on whether 'go big' is too big, [here](#) and [here](#)) with the monetary experiment of FAIT.

Still, after any 2013-type summer market drama, we expect underlying economic fundamentals to stay intact. After all, 2021 is still on track to be the strongest year for US growth in at least 36 years and, for Chinese industrial production, the best ever in year-on-year volume terms. So much for deglobalization. In contrast to 2020, volatility is more likely to come from market (and possibly social and political) factors than economic ones. And once the market has priced in the economic outlook – 5y5y forwards tend to peak in the calendar year after recessions – active fixed income can be played from the long side once again, rather than the short. After Democrats and fiscal easing, we expect that jobs, reopening, recovery, tapering – and finally fixed income value – is coming to America.

Macroeconomic and policy outlook

Growth outlook: unsynchronized re-openings?

As we move into Q2 2021, the prospect of full economic reopening and hence a recovery in services activity seems firmly tied to the evolution of new infections, Covid hospitalization rates and vaccination progress. Countries as diverse as the US, UK, Chile, the UAE and Israel are quickly moving in the desired direction, almost the best that could have been hoped, which unfortunately cannot yet be said for the Eurozone or EM. Still, we expect the arrival of spring across the Northern Hemisphere and a pick-up in vaccination pace in Q2 – as some recently approved vaccines become available – to prompt a noticeable brightening of the (near-term) economic outlook. Moreover, base effects will still imply spectacular year-on-year GDP growth in Q2 2021, also in Europe, with some of the Chinese macro data for the first two months of this year already providing a glimpse of what could be in store.

The obvious wildcard remains the threat of virus mutations, and as yet undiscovered new strains potentially derailing the recovery (we remain humble as to our ability to assess the likelihood of such a scenario).

Looking ahead to 2H 2021, two other points received prominent attention in the discussion at our *Quarterly Outlook*.

First, ongoing fiscal support, and its future prospects, as we explore below.

Second, the strength of the upcoming consumer recovery. Three areas were explored here – each of which could have important ramifications for the inflation trajectory.

Firstly, the impact from expectations for future fiscal consolidation, or the lack thereof – given plans for substantial infrastructure spending in the US, and the extension of the suspension of current Eurozone budget rules to 2023.

Secondly, the scope for normalization in still-elevated household saving rates, given that savings dollars are concentrated among higher income groups less affected by the pandemic with a lower marginal propensity to consume, and in view of the pandemic scarring effect on precautionary saving as well as the actual multiplier on some of the fiscal support.

Thirdly, the composition of consumer spending, to the extent any relapse in consumer goods spending – which actually rose above its long-term trend in the US during the pandemic – could offset the pent-up surge in spending on services.

‘While consumption figures in many DM economies will likely be impressive, saving rates are unlikely to return to pre-Covid levels soon’

All in all, we conclude that while the consumption figures in many DM economies will likely be impressive, certainly the year-on-year ones, saving rates are unlikely to fully return to pre-Covid levels soon.

Inflation outlook: going with the flow...for now

The inflation outlook received more than prominent attention in the run up to this Quarterly. Indeed, the Global Macro team organized a dedicated Inflation Day on 5 March, during which three external speakers gave

their opinion on the forces shaping the outlook for consumer inflation over the coming years.

After discussing the various key cyclical drivers (including fiscal stimulus and monetary growth, pent-up demand, labor market conditions, and supply bottlenecks) and secular ones (including (de-)globalization, de-unionisation, demographics, automation and technology, inequality, and sustainability), we concluded it was premature to believe that a durable secular shift above target in the inflation trend is unfolding across developed markets. It is clear there are three distinct horizons for the inflation outlook: tactical, cyclical and secular.

On the tactical, there was widespread agreement that commodity price base effects and supply chain disruptions (such as those in semiconductors and shipping containers) would help prompt a sharp rise in headline inflation rates in coming months, to above 3% and 2% in, respectively, the US and Eurozone – which might reinforce the beliefs of those subscribing to the view that inflation has indeed entered a new regime.

On the cyclical, the risk of ‘go big’ being ‘too big’ in US fiscal policy, and the potential for the outsized nature of this year’s forecast cyclical upswing, coupled with a Fed who have determined to stay behind the curve under the FAIT framework, may also lead to temporarily over-dramatized concerns.

But on the secular, we find many of the arguments unpersuasive. The thesis of the end of global goods disinflation due to an end to developing-world labor trends, looks to be one billion people and a decade too early, given UN projections for rural-urban migration. As for DM demographics, a gradually ageing society incrementally spending a slightly higher share each year on healthcare hardly strikes us as a cataclysmic inflationary shock. Deglobalization is plainly not in evidence, with supply chain security limited to specific strategic goods where governments may step in to control logistics, while global cost arbitrage remains the key driver for the corporate sector. The profit motive hasn’t gone away. These secular views may become more important in late summer and H2 in defining the limits of curve steepness.

Consequently, even though we are aware of the strong correlation between DM inflation breakeven rates and equity prices since 2020 (and a consequent risk of an equity risk-off-induced tightening), we do think that such confirmation (bias) could push breakeven rates somewhat wider near term. Globally, there is room in our view for

some catch-up outside the US, where in contrast, breakevens are still below pre-pandemic levels.

Policy outlook: some leaning more than others

Fiscal policy is still the main game in town and, with the large net borrowing associated with hefty fiscal deficits, central banks will remain an important source of funding via their asset purchase programs.

'In the US, the electoral blue ripple result has already become a blue tsunami of fiscal spending'

In the US, the electoral blue ripple result has already become a blue tsunami of fiscal spending. The Democrats have adopted a 'carpe diem' approach ahead of the 2022 mid-terms. The latest USD 1.9 trillion Covid relief bill should manage to keep the fiscal *impulse* (i.e. the change in the fiscal stance compared to last year) in positive territory in 2021. Avoiding fiscal regret over 2009-2010 seems a high policy priority, although there appears to be some rewriting of history going on too: US government debt grew by 21% in 2008, 20% in 2009, 18% in 2010 and by double digits in each of 2011 and 2012 – five years after the start of the crisis. Still, go even bigger this time is the US message.

In the Eurozone, despite being less aggressive than the US, overall fiscal support should remain significant, thanks to the large(r) automatic stabilizers and upcoming support via the 'Next Generation EU' recovery fund. Notably, the fiscal impulse in China is likely to relapse into negative territory, with the government and budget reports released in early March hinting at a 2.5-3ppt of GDP reduction in the augmented fiscal deficit.

On the monetary side, with the prospect of full economic reopening drawing closer, especially in the US, talk about a future tapering of sovereign bond purchases is likely to gain traction. Chair Powell recently mentioned that the FOMC would want to see confirmation of employment growth in "actual data" before deciding on tapering. Looking at the expected pace of economic reopening, we would expect a taper discussion among FOMC participants might well have taken place by the June meeting. The official announcement might be timed for September-October. To be sure, given the experience of 2013, we expect the Fed to tread carefully. Tapering itself will probably start only in Q1 2022 and take the whole year to be completed. In addition, if yields continue to rise

the Fed could decide to involve a 'twist' operation as well, in which (remaining) purchases are shifted towards the longer end of the yield curve. Given the 2013 episode, markets will be acutely sensitive: real yields will not react when the Fed completes its last purchase; they should move at the very first sniff of tapering plans.

In the Eurozone, the ECB looks set to keep leaning against a rise in (long-term) bond yields, certainly as long as economic reopening lags, with the recent pledge to conduct purchases under PEPP in Q2 "at a significantly higher pace" than during the first months of this year. Having in 2020 avoided the real economic market forces of job reallocation and deaths and births of firms, by sidestepping a more dynamic reorganization in the economy, 2021 now sees Eurozone policy averse to financial market forces. All of this comes at a cost to long-run economic trends but, at least for bond investors, it puts downward pressure on long-run R^* assumptions.

Meanwhile in China, where PBoC balance sheet expansion has been limited in the past two years, the central bank is already more advanced in heading for the exit. As macroprudential concerns about high leverage have come back to the fore, and a cap has been imposed on banks' property exposures, authorities want to steer overall social financing growth back in line with nominal GDP growth. Mechanically, this should translate into a relapse of the closely-watched credit impulse – which measures the change in the net flow of credit-to-GDP ratio – back into negative territory. This, in turn, could raise concerns about a downturn in the global manufacturing cycle into 2022. Any fresh infrastructure-led wave in US fiscal support could obviously sustain the industrial (and perhaps commodity) cycle, as long as the size is impressive. The tension between these two policy outcomes will probably shape the timing and peak steepness of fixed income curves this year.

Policy rates: first things first

If we follow the blueprint of Fed normalization in 2013-2015, the onset of interest rate increases comes after balance sheet expansion has ended. Rate hikes in the next 12 months therefore seem premature. Still, there are global exceptions: Norges bank – which is not engaged in net QE – seems to be heading for lift-off within this horizon. That said, the debate about some other central banks possibly joining the ranks of the BoJ, ECB and SNB in adopting a negative interest rate policy (NIRP) has pretty much died down – as consistent with our central scenario.

Looking further out, markets seem to be challenging the guidance from many G10 central banks. In the US, a full

25bps hike is priced in for early 2023 despite the median 'dot' of FOMC participants' interest rate projections seeing rates on hold through 2023. Moreover, in Australia, where the RBA is engaged in 3-year yield curve control – given the expectation not to hike the 0.10% policy rate during that timeframe – the swap market is second guessing this.

In the Eurozone, the ECB is still trying to keep the possibility of a further rate cut alive, although markets assign only a small probability to such an outcome – and rightly so in our view. On the other side, the last time the ECB managed to hike rates was over a decade ago.

Meanwhile, in EM, while some recently delivered their last rate cuts (i.e. Mexico), others, such as the central banks of Brazil and Turkey, have started to deliver some FX-related rate tightening. In China, despite the PBoC's modestly hawkish bias, actual policy rate hikes do not seem imminent, given subdued underlying inflation pressures.

Rates strategy

Fundamentals point to continued underweight

Our portfolios have an underweight duration position, implemented across several markets and maturities. There are three main drivers:

1. Fiscal easing
2. Central bank stance
3. Pace of economic recovery

US yields have been highly responsive to fiscal easing headlines and this theme is not yet done: an infrastructure plan looms, potentially generating fresh headlines for Treasury yields of multi-trillion-dollar plans. Beyond the US, further fiscal support may continue, but it is less noisy and smaller in size. Given the fiscal backdrop, the US will likely have made up for all lost *trend growth* by end Q3 of this year – an impressive achievement. For most European countries as well as Japan, this will take several years longer.

bears, with tapering then to follow. Contrast the ECB. The PBoC, in turn, may be forced to transition away from its current moderately restrictive policy stance. All this means different levels of 'control' in the global rates environment, altering correlations, volatility and rates trajectories, particularly in the transatlantic divergence. Post-Brexit, we note the correlation divide is, perhaps appropriately, now more in the English Channel than mid-Atlantic.

With prospects for vaccination-led reopening also varying dramatically by country, we should see the most eye-catching pick-up in US employment, especially given the flex was taken in 2020 by outright American job losses compared to the furlough schemes of Europe. This may mean some >1mn payrolls prints in the near-term – another fundamental/cyclical argument for higher US yields.

Still, the fiscal and cyclical recovery-led fundamental drivers should be placed alongside market technicals and valuations.

Market positioning indicators show shorts at historic extremes and our own analysis of US investor positioning highlights consistent shorts too, both suggesting the pain trade is actually for lower yields. Still, this has been the case all year, and yields have ignored positioning. On the bearish side, auction tests seem to come around with remarkable frequency these days and remain a potent threat given what happened with the 7-year in late February. Fixed income ownership has increased dramatically over the last decade, suggesting some unwind risk. But so too have growth-stock valuations and there are complex interactions between real yields and growth stocks (depending on the market's mood, either positive feedback loops based on flight to quality, or negative ones, should tapering concerns dominate).

Value is building, but how much is enough?

Post-2000 US Treasury sell-offs point to a median rise in 10-year yields of circa 120bps, or a yield level of 1.8% from the 0.6% base in August (see our [Central Bank Watcher](#)), not far from here.

A second approach is to look at what the market could be expected to price in for official rates 2 to 3 years out and derive a conclusion on the curve from there. There are currently circa 75bps in rate hikes for September 2023. This would suggest a yield range for the 10-year point of 1.4-1.8%. If we assume that markets would be willing to price in 100bps for December 2023, the upper bound of the range would shift to circa 2.1%.

'The contrast in central bank stances towards the rise in yields has been remarkable'

The contrast in central bank stances towards the rise in yields has been remarkable. In the FOMC press conference of 16 March, Fed chair Powell confirmed the Fed's *laissez faire* attitude towards the rise in yields: a green light for

Similar levels for the 10-year yield occur if we plot the US 5y5y forward yield against its 30-year trend channel, assume it will move to the upper end of that channel and link this to 10-year spot yields. Five-year US yields have not yet reached the levels that could be expected based on what is priced in for the Fed.

The forwards can only be an approximate guide in current circumstances, where the Fed intentionally wants to be behind the curve: one could argue that the 5y spot yield is artificially depressed relative to the 10y, and that the 10y term premium is or should be bigger than in 5s. One could also question whether policy from 5 years ahead should always be assumed to return to neutral. Given FAIT, the process of allowing inflation to rise and then containing it back down to long-run acceptable levels may or may not take longer than five years – it is an experiment after all. Still, if history is any guide, the bearish move in forward space should be done this year, given that 5y/5y forwards peaked in the first year of the economic recovery after each of the last two US NBER recessions. So, while a cyclically bearish move in front-end rates and in the belly may last longer, that in curve steepness should be done in 2021.

‘The only challenge here is that these are not known ex ante and the Fed’s own forecasts were hopelessly wrong last cycle’

All in, we have to be somewhat humble on valuation numbers. It has been one hundred years since bond markets have been faced with reopening from a pandemic. This time around, the multi-trillion fiscal stimulus and Fed experiment on FAIT on the one hand are very different to globalized capital, ageing demographics and debt overhangs on the other. Long-term R* assumptions for the upcoming economic expansion will be key. The only challenge here is that these are not known ex ante and the Fed’s own forecasts were hopelessly wrong last cycle. If we are right that there is a bigger cyclical upswing than this time last cycle, but that the secular inflation (and therefore R*) fears are overdone, then we are in for further bearish price action in Q2 (particularly during forthcoming taper communication). To figure out how far that goes, the basis points of yield rise already delivered must be taken into account, and we believe a secular breakout beyond last cycle’s parameters remains unlikely.

For Bunds, should the 10-year yield rise above -0.25%, the market would probably have to start pricing in up to 20bps of ECB rate hikes by Q2 2023. ECB forward guidance would weigh against this, but the experience since the introduction of QE suggests that the market could still price this scenario. However, pricing in much more than this would probably be a stretch. We would therefore become more constructive on Bunds again at levels of -0.20% (corresponding to 10bps of rate hikes being priced in) and -0.05% (20bps of hikes). On the German, curve we think 2-5 year steepener positions offer an attractive risk-reward profile at around the current level of 5bps. Signs of vaccination program success to help the reopening, after the disappointing third wave, will be the key to timing.

Globally, we currently see the best opportunities in rates markets where either yields have moved significantly away from fundamental guidance (New Zealand), or where we see more attractive valuation and potential global flows in combination with a supportive transition in monetary policy (China).

We are mindful the US may be seeing the first dual policy mistake perhaps since the Vietnam War and a laissez faire Fed in the early 1970s, and then there is the tapering. The US arguably experienced a dual policy mistake in 2017-2018, with the timing of the tax cuts and the Fed messing up its communication with markets. Those, however, are mere foothills in the mountain range of potential policy excess brought on by the extraordinary events of the last twelve months and the significant US political shifts on spending in 2021.

Fixed income sector allocation

Fundamental-technical cycle tension

We are in the very first year of a new economic expansion but the ninth year of all-time highs in the S&P500. That is longer than the bull run in the pre-GFC excess or even the 1920s. Only the late 1990s saw a longer period of calendar year all-time highs. Economic and market cycles are usually more aligned as, in recent history, new economic expansions have begun after a 6-8 quarter equity bear market, which has been a cathartic experience, transforming positioning, valuations and resulting in a complete psychological mindset shift. That has been notably absent in the frothy growth-stock conditions of recent quarters.

It speaks to the speed of events last year – recall that the high yield bear market lasted just 5 weeks – and the extraordinary monetary and fiscal liquidity, particularly in

the US, received since then. Credit valuations meanwhile lurk unappetizingly in the background following the tremendous rally in 2020.

Credit bearishness more tactical in horizon

The good news is that whereas the bearish outlook for rates is largely cyclical, that for credit is tactical. While forward rate curves may steepen out by year-end, any back-up in IG credit in particular should be even shorter, given that, for credit, the risk is posed by market factors rather than fundamentals. On the latter, the spread required to compensate for defaults and downgrade risk should be on the lower side, if superlative consensus growth forecasts prove correct. The bad news is that the cheapening in both rates and credit appears still to have legs, with that in credit having barely begun, and with Fed taper events still ahead of us. In sum, the focus for credit for the next few months is on exogenous shocks from other markets – rates and equities – or more specifically, from a potential real-yield shock and/or a bursting of growth-equity valuations.

‘A couple of strong payrolls reports would require a Fed response, potentially leading to the first hints this summer of future tapering’

The timing of the real-yield risk is more immediate, given a couple of strong payrolls reports would require a Fed response, potentially leading to the first hints this summer of future tapering. That suggests an intra-year tactical backup in spreads, modest in overall magnitude but potentially quite fierce for a few weeks. Given the duration implications for total returns, it suggests IG outflows for a few months. US investment grade, with its duration having lengthened by 2.5 years since 2000, is obviously vulnerable to the Fed and US Treasury ructions, without the lower duration of EUR IG, the lower level of Bund volatility and the support of CSPP. Similarly, EM borrowers are more sensitive to real yields and external financing than elsewhere, even if current accounts have improved versus 2013. For the longer-term strategic view, the growth outlook is key. So long as that is not materially thrown off course – which may require some sort of cap to mortgage rates, possibly by eventual Fed jawboning and/or maturity extensions – the period of volatility should be fairly temporary.

The elusive timing of equity bubbles

The challenge with the second shock, that of a growth-equity downturn, is much harder to time. The 1920s saw

five years of all-time highs, currently we are in the ninth consecutive year, but in the 1990s there were twelve. Our analysis shows that credit is more sensitive to falls in value stocks than growth stocks, but the sting in the tail is that it is relatively unusual (there are just a few examples in the last one hundred years) for value stocks to hold up, either in real terms or versus T-Bills, when growth stocks tank. The declines in the Nasdaq in February may be a harbinger of things to come this year; but, equally, we respect that irrational exuberance can last for a while – as was the case in the late 1990s. Given uncertainty over timing, so long as credit spread valuations are expensive, we think it pays to lean conservative.

An unusual default cycle – risks for 2022 and beyond

In high yield, the risks are a little more fundamental in nature. The duration of US high yield has actually fallen by 0.5 year since 2000. And while an analysis of the 2013 period shows high yield is nevertheless still sensitive to any generalized rise in risk aversion amid rising real yields and rate volatility, given its higher beta, we need to check in on default risk too. The brevity of the spread cycle in 2020 was in part matched by the brevity of the default cycle. With defaults rising and peaking in a matter of just nine months, the period of default stress in the pandemic was far shorter than the cumulative default experience of 1998-2002 or 2008-09. While default rates rose several percentage points in 2020, towards double digits, a more granular analysis shows that single B and BB default rates remained remarkably low by historical recessionary standards.

This brevity of time and lack of depth in default stress across the quality spectrum, while helpful to last year’s spread recovery, poses a lingering problem going forward, because the expansion from 2009-2019 was the largest in US economic history. While year-on-year corporate re-leveraging never quite got as hot as the late 80s, late 90s or mid-2000s, we nevertheless witnessed a sustained credit creation cycle, with record weakening in covenants, clear capital misallocation in shale gas and several sectors with either excess debt (telecoms, energy) or dramatic sectoral shifts due either to prevailing trends, or pandemic-driven uncertainty (bricks and mortar retail, airlines, international travel, office property etc.). That suggests there is substantial unfinished business to come in terms of future defaults relating to past excess. The good news is that strong growth could delay that process into 2022 or beyond, such that the forecasts of some (S&P have a 7% base case speculative grade default rate forecast for end-2021) looks several percentage points too high. The bad news is that market spreads sub-400 already lean more towards the optimistic default scenario in any case, so the larger skew for any major

market surprise would be on future economic disappointment rather than anything else.

Still, as in investment grade, should spreads back up amid volatility in real yields or growth equities, we view a scenario of cheaper valuations later this summer as an opportunity. Unless US policymakers drop the ball or unless the US-China relationship sours dramatically further, it's possible we'll enjoy a period of growth for the next half decade – and that is tough to fight from the short side in credit. Our analysis suggests credit underperforms for around 40% of the time in the short term, falling to 30% and lower for much longer periods.

Eurozone periphery: Still constructive

We are mindful that in the past, a sharp increase in rates volatility has coincided with peripheral spread widening. Nonetheless, even as rate volatility has picked up, we remain relatively constructive on peripheral spreads, particularly Italian BTPs, as they can outperform other spread products, such as EM, in these periods. We carefully look at valuations and whilst Italian yield spreads over Germany have tightened to fresh six-year lows across most of the curve, they remain above previous lows, especially in the long end. We therefore continue to favor longer-dated BTPs given the steepness of the curve. In addition, growth in Europe should improve significantly from some time in Q2. Growth in the periphery should receive an additional boost from H2 onwards, as NGEU funds will start flowing from North to South. With Mr. Draghi now at the helm in Italy, the EU funds should be wisely spent. Further, the ECB have determined to maintain favorable financial conditions, and are set to “significantly” increase PEPP purchases during Q2. This increase, combined with lower expected supply, leads to a significant improvement in net supply dynamics, at least for April, and should initially help contain EUR rates volatility. How that pans out for the following quarters, remains to be seen, as Ms. Lagarde has not yet mentioned anything on increasing the total amount of the PEPP envelope.

wave of virus spikes will weigh on the near-term outlook, offset by longer-term vaccine and re-opening optimism. Asia remains an exception, given its superior pandemic management. The rise in commodity prices has understandably supported risk sentiment in the commodity-exporting EMs. The escalation in political instability such as in Brazil will dampen domestic demand and foreign investment in parts of Latin America, but intra-regional contrasts may be opening up given the comparative success in, for example, Chile. In CEE, the latest developments on the virus front have not been encouraging, suggesting delayed reopening, albeit at least industrial supply chains have not been impacted by the ongoing travails in the EU. Market technicals started on solid footing for the year, but this has begun to wane in the past several weeks, considering the rise in US real yields and the US dollar.

As summer Fed taper discussion looms, focus on EM vulnerabilities has rightly increased. Still, the current account dynamics are in general now quite different from 2013. Most EMs have seen sizeable improvements in their current account through their trade balance channel, which limits them from external funding fragility. But this doesn't apply to all EMs. Some countries have accumulated sizeable public debt, while their growth profile has been lagging. More vulnerable examples are South Africa and Brazil. Given the steady performance in EM spreads both in corporate and sovereigns, valuations for the asset class remain unattractive. There are still positive real yields available in countries such as Indonesia and Mexico, but these provide only modest compensation for potential FX depreciation and increasing volatility. We maintain our OW duration position in Chinese government bonds whilst hedging the currency risk.

FX: USD turning the corner

It is hard to argue that current US yields and market pricing for the Fed are inconsistent with fundamentals. Powell himself has acknowledged in recent speeches that the outlook for the US economy has brightened, especially with the recent fiscal stimulus. The date for completing the vaccination of the US population keeps coming forward, with most of the US states already starting to re-open. While Powell comes across as dovish, we believe it will be increasingly difficult for the Fed to suppress market sentiment around future policy normalization in the months ahead. The Fed could well be forced to update their growth and inflation forecasts upwards. This sets the base for higher nominal and real yields in the US versus the rest of the world. Any such move might be difficult to stomach for the consensus short USD view, as this already feels the pressure from the relative growth angle favoring a higher USD. Given the

‘Whilst EM countries have weathered the pandemic better than the worst fears, another wave of virus spikes will weigh on the outlook’

EM debt: expensive still

We continue to be underweight EM risk both in sovereigns and credit. Whilst EM countries have weathered the pandemic better than the worst fears last year, another

All examples mentioned are for information purposes only and not intended as investment advice in any way. The value of your investments may fluctuate. Results obtained in the past are no guarantee for the future.

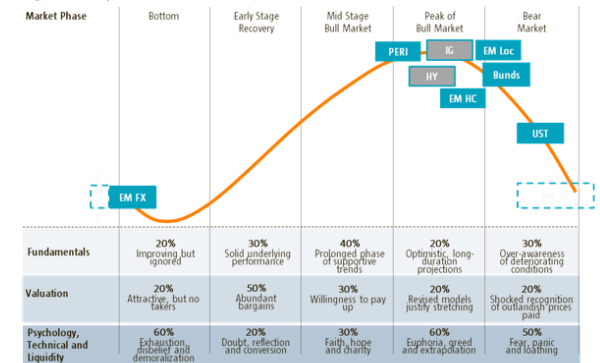
sizable consensus dollar short, we would not rule out a stronger USD in the next quarter.

Beyond the USD rollercoaster, we note some interesting trends in the rest of G10 and emerging markets. The currencies that have done well, regardless of the USD strength, include GBP, NOK, CAD and AUD. Currencies that have done badly include CHF and JPY. This is consistent with our view that the rates market volatility is primarily driven by good news, namely the global recovery from the pandemic. This positive sentiment is spilling over into FX and outweighs the impact of the market pricing in Fed policy normalization. We expect this risk sentiment to remain supportive for these currencies.

EM currencies have been in a trading range, with some notable exceptions due to domestic political wobbles like BRL. In our baseline, the global economy is recovering, with the US doing exceptionally well and Europe is lagging behind. Japan continues to struggle with deflation risks and EM markets face a negative mix of delayed re-openings/slow vaccinations/political troubles and potential Fed tapering risks. In this environment, we expect the USD to do well against EUR, JPY and emerging currencies as a group. Within EM, we favor shorts in ZAR, BRL, potentially IDR and MYR, while being cautiously optimistic on MXN.

Asset class positioning

Figure 1 | The market cycle



Source: Robeco, March 2021, Morgan Stanley cycle characterization

Source: Robeco, March 2021

We wish to thank Michael Feroli (JP Morgan), David Lubin (Citi) and Ben Emons and Daniel Sternoff (Medley) for contributing to a productive and insightful quarterly outlook session.

Important Information

Robeco Institutional Asset Management B.V. has a license as manager of Undertakings for Collective Investment in Transferable Securities (UCITS) and Alternative Investment Funds (AIFs) ("Fund(s)") from The Netherlands Authority for the Financial Markets in Amsterdam. This marketing document is solely intended for professional investors, defined as investors qualifying as professional clients, have requested to be treated as professional clients or are authorized to receive such information under any applicable laws. Robeco Institutional Asset Management B.V. and/or its related, affiliated and subsidiary companies, ("Robeco"), will not be liable for any damages arising out of the use of this document. Users of this information who provide investment services in the European Union have their own responsibility to assess whether they are allowed to receive the information in accordance with MiFID II regulations. To the extent this information qualifies as a reasonable and appropriate minor non-monetary benefit under MiFID II, users that provide investment services in the European Union are responsible to comply with applicable recordkeeping and disclosure requirements. The content of this document is based upon sources of information believed to be reliable and comes without warranties of any kind. Without further explanation this document cannot be considered complete. Any opinions, estimates or forecasts may be changed at any time without prior warning. If in doubt, please seek independent advice. It is intended to provide the professional investor with general information on Robeco's specific capabilities, but has not been prepared by Robeco as investment research and does not constitute an investment recommendation or advice to buy or sell certain securities or investment products and/or to adopt any investment strategy and/or legal, accounting or tax advice. All rights relating to the information in this document are and will remain the property of Robeco. This material may not be copied or used with the public. No part of this document may be reproduced, or published in any form or by any means without Robeco's prior written permission. Investment involves risks. Before investing, please note the initial capital is not guaranteed. Investors should ensure that they fully understand the risk associated with any Robeco product or service offered in their country of domicile. Investors should also consider their own investment objective and risk tolerance level. Historical returns are provided for illustrative purposes only. The price of units may go down as well as up and the past performance is not indicative of future performance. If the currency in which the past performance is displayed differs from the currency of the country in which you reside, then you should be aware that due to exchange rate fluctuations the performance shown may increase or decrease if converted into your local currency. The performance data do not take account of the commissions and costs incurred on trading securities in client portfolios or on the issue and redemption of units. Unless otherwise stated, the prices used for the performance figures of the Luxembourg-based Funds are the end-of-month transaction prices net of fees up to 4 August 2010. From 4 August 2010, the transaction prices net of fees will be those of the first business day of the month. Return figures versus the benchmark show the investment management result before management and/or performance fees; the Fund returns are with dividends reinvested and based on net asset values with prices and exchange rates of the valuation moment of the benchmark. Please refer to the prospectus of the Funds for further details. Performance is quoted net of investment management fees. The ongoing charges mentioned in this document are the ones stated in the Fund's latest annual report at closing date of the last calendar year. This document is not directed to, or intended for distribution to or use by any person or entity who is a citizen or resident of or located in any locality, state, country or other jurisdiction where such distribution, document, availability or use would be contrary to law or regulation or which would subject any Fund or Robeco Institutional Asset Management B.V. to any registration or licensing requirement within such jurisdiction. Any decision to subscribe for interests in a Fund offered in a particular jurisdiction must be made solely on the basis of information contained in the prospectus, which information may be different from the information contained in this document. Prospective applicants for shares should inform themselves as to legal requirements also applying and any applicable exchange control regulations and applicable taxes in the countries of their respective citizenship, residence or domicile. The Fund information, if any, contained in this document is qualified in its entirety by reference to the prospectus, and this document should, at all times, be read in conjunction with the prospectus. Detailed information on the Fund and associated risks is contained in the prospectus. The prospectus and the Key Investor Information Document for the Robeco Funds can all be obtained free of charge at www.robeco.com.

Additional Information for US investors

Robeco is considered "participating affiliated" and some of their employees are "associated persons" of Robeco Institutional Asset Management US Inc. ("RIAM US") as per relevant SEC no-action guidance. Employees identified as associated persons of RIAM US perform activities directly or indirectly related to the investment advisory services provided by RIAM US. In those situations, these individuals are deemed to be acting on behalf of RIAM US, a US SEC registered investment adviser. SEC regulations are applicable only to clients, prospects and investors of RIAM US. RIAM US is wholly owned subsidiary of ORIX Corporation Europe N.V. and offers investment advisory services to institutional clients in the US.

Additional Information for investors with residence or seat in Australia and New Zealand

This document is distributed in Australia by Robeco Hong Kong Limited (ARBN 156 512 659) ("Robeco"), which is exempt from the requirement to hold an Australian financial services license under the Corporations Act 2001 (Cth) pursuant to ASIC Class Order 03/1103. Robeco is regulated by the Securities and Futures Commission under the laws of Hong Kong and those laws may differ from Australian laws. This document is distributed only to "wholesale clients" as that term is defined under the Corporations Act 2001 (Cth). This document is not for distribution or dissemination, directly or indirectly, to any other class of persons. In New Zealand, this document is only available to wholesale investors within the meaning of clause 3(2) of Schedule 1 of the Financial Markets Conduct Act 2013 ("FMCA"). This document is not for public distribution in Australia and New Zealand.

Additional Information for investors with residence or seat in Austria

This information is solely intended for professional investors or eligible counterparties in the meaning of the Austrian Securities Oversight Act.

Additional Information for investors with residence or seat in Brazil

The Fund may not be offered or sold to the public in Brazil. Accordingly, the Fund has not been nor will be registered with the Brazilian Securities Commission – CVM, nor has it been submitted to the foregoing agency for approval. Documents relating to the Fund, as well as the information contained therein, may not be supplied to the public in Brazil, as the offering of the Fund is not a public offering of securities in Brazil, nor may they be used in connection with any offer for subscription or sale of securities to the public in Brazil.

Additional Information for investors with residence or seat in Canada

No securities commission or similar authority in Canada has reviewed or in any way passed upon this document or the merits of the securities described herein, and any representation to the contrary is an offence. Robeco Institutional Asset Management B.V. is relying on the international dealer and international adviser exemption in Quebec and has appointed McCarthy Tétrault LLP as its agent for service in Quebec.

Additional Information for investors with residence or seat in the Republic of Chile

Neither Robeco nor the Robecofunds have been registered with the Comisión para el Mercado Financiero pursuant to law no. 18.045, the Ley de Mercado de Valores and regulations thereunder. This document does not constitute an offer of, or an invitation to subscribe for or purchase, shares of the Funds in the Republic of Chile, other than to the specific person who individually requested this information on his own initiative. This may therefore be treated as a "private offering" within the meaning of article 4 of the Ley de Mercado de Valores (an offer that is not addressed to the public at large or to a certain sector or specific group of the public).

Additional Information for investors with residence or seat in Colombia

This document does not constitute a public offer in the Republic of Colombia. The offer of the Fund is addressed to less than one hundred specifically identified investors. The Fund may not be promoted or marketed in Colombia or to Colombian residents, unless such promotion and marketing is made in compliance with Decree 2555 of 2010 and other applicable rules and regulations related to the promotion of foreign Funds in Colombia.

Additional Information for investors with residence or seat in the Dubai International Financial Centre (DIFC), United Arab Emirates

This material is being distributed by Robeco Institutional Asset Management B.V. (DIFC Branch) located at Office 209, Level 2, Gate Village Building 7, Dubai International Financial Centre, Dubai, PO Box 482060, UAE. Robeco Institutional Asset Management B.V. (DIFC Branch) is regulated by the Dubai Financial Services Authority ("DFSA") and only deals with Professional Clients or Market Counterparties and does not deal with Retail Clients as defined by the DFSA.

Additional Information for investors with residence or seat in France

Robeco Institutional Asset Management B.V. is at liberty to provide services in France. Robeco France is a subsidiary of Robeco whose business is based on the promotion and distribution of the group's funds to professional investors in France.

Additional Information for investors with residence or seat in Germany

This information is solely intended for professional investors or eligible counterparties in the meaning of the German Securities Trading Act.

Additional Information for investors with residence or seat in Hong Kong

The contents of this document have not been reviewed by the Securities and Futures Commission ("SFC") in Hong Kong. If you are in any doubt about any of the contents of this document, you should obtain independent professional advice. This document has been distributed by Robeco Hong Kong Limited ("Robeco"). Robeco is regulated by the SFC in Hong Kong.

Additional Information for investors with residence or seat in Italy

This document is considered for use solely by qualified investors and private professional clients (as defined in Article 26 (1) (b) and (d) of Consob Regulation No. 16190 dated 29 October 2007). If made available to Distributors and individuals authorized by Distributors to conduct promotion and marketing activity, it may only be used for the purpose for which it was conceived. The data and information contained in this document may not be used for communications with Supervisory Authorities. This document does not include any information to determine, in concrete terms, the investment inclination and, therefore, this document cannot and should not be the basis for making any investment decisions.

Additional Information for investors with residence or seat in Japan

This document is considered for use solely by qualified investors and are being distributed by Robeco Japan Company Limited, registered in Japan as a Financial Instruments Business Operator, [registered No. the Director of Kanto Local Financial Bureau (Financial Instruments Business Operator), No. 2780, Member of Japan Investment Advisors Association].

Additional Information for investors with residence or seat in Mexico

The funds have not been and will not be registered with the National Registry of Securities, maintained by the Mexican National Banking and Securities Commission and, as a result, may not be offered or sold publicly in Mexico. Robeco and any underwriter or purchaser may offer and sell the funds in Mexico on a private placement basis to Institutional and Accredited Investors, pursuant to Article 8 of the Mexican Securities Market Law.

Additional Information for investors with residence or seat in Peru

The Fund has not been registered with the Superintendencia del Mercado de Valores (SMV) and is being placed by means of a private offer. SMV has not reviewed the information provided to the investor. This document is only for the exclusive use of institutional investors in Peru and is not for public distribution.

Additional Information for investors with residence or seat in Shanghai

This material is prepared by Robeco Overseas Investment Fund Management (Shanghai) Limited Company ("Robeco Shanghai") and is only provided to the specific objects under the premise of confidentiality. Robeco Shanghai was registered as a private fund manager with the Asset Management Association of China in September 2018. Robeco Shanghai is a wholly foreign-owned enterprise established in accordance with the PRC laws, which enjoys independent civil rights and civil obligations. The statements of the shareholders or affiliates in the material shall not be deemed to a promise or guarantee of the shareholders or affiliates of Robeco Shanghai, or be deemed to any obligations or liabilities imposed to the shareholders or affiliates of Robeco Shanghai.

Additional Information for investors with residence or seat in Singapore

This document has not been registered with the Monetary Authority of Singapore ("MAS"). Accordingly, this document may not be circulated or distributed directly or indirectly to persons in Singapore other than (i) to an institutional investor under Section 304 of the SFA, (ii) to a relevant person pursuant to Section 305(1), or any person pursuant to Section 305(2), and in accordance with the conditions specified in Section 305, of the SFA, or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA. The contents of this document have not been reviewed by the MAS. Any decision to participate in the Fund should be made only after reviewing the sections regarding investment considerations, conflicts of interest, risk factors and the relevant Singapore selling restrictions (as described in the section entitled "Important Information for Singapore Investors") contained in the prospectus. You should consult your professional adviser if you are in doubt about the stringent restrictions applicable to the use of this document, regulatory status of the Fund, applicable regulatory protection, associated risks and suitability of the Fund to your objectives. Investors should note that only the sub-funds listed in the appendix to the section entitled "Important Information for Singapore Investors" of the prospectus ("Sub-Funds") are available to Singapore investors. The Sub-Funds are notified as restricted foreign schemes under the Securities and Futures Act, Chapter 289 of Singapore ("SFA") and are invoking the exemptions from compliance with prospectus registration requirements pursuant to the exemptions under Section 304 and Section 305 of the SFA. The Sub-Funds are not authorized or recognized by the MAS and shares in the Sub-Funds are not allowed to be offered to the retail public in Singapore. The prospectus of the Fund is not a prospectus as defined in the SFA. Accordingly, statutory liability under the SFA in relation to the content of prospectuses would not apply. The Sub-Funds may only be promoted exclusively to persons who are sufficiently experienced and sophisticated to understand the risks involved in investing in such schemes, and who satisfy certain other criteria provided under Section 304, Section 305 or any other applicable provision of the SFA and the subsidiary legislation enacted thereunder. You should consider carefully whether the investment is suitable for you. Robeco Singapore Private Limited holds a capital markets services license for fund management issued by the MAS and is subject to certain clientele restrictions under such license.

Additional Information for investors with residence or seat in Spain

Robeco Institutional Asset Management BV, Sucursal en España with identification number W0032687F and having its registered office in Madrid at Calle Serrano 47-14º, is registered with the Spanish Commercial Registry in Madrid, in volume 19.957, page 190, section 8, sheet M-351927 and with the National Securities Market Commission (CNMV) in the Official Register of branches of European investment services companies, under number 24. The investment funds or SICAV mentioned in this document are regulated by the corresponding authorities of their country of origin and are registered in the Special Registry of the CNMV of Foreign Collective Investment Institutions marketed in Spain.

Additional Information for investors with residence or seat in South Africa

Robeco Institutional Asset Management B.V. is registered and regulated by the Financial Sector Conduct Authority in South Africa.

Additional Information for investors with residence or seat in Switzerland

The Fund(s) are domiciled in Luxembourg. This document is exclusively distributed in Switzerland to qualified investors as defined in the Swiss Collective Investment Schemes Act (CISA). This material is distributed by Robeco Switzerland Ltd, postal address: Josefstrasse 218, 8005 Zurich. ACOLIN Fund Services AG, postal address: Affolternstrasse 56, 8050 Zurich, acts as the Swiss representative of the Fund(s). UBS Switzerland AG, Bahnhofstrasse 45, 8001 Zurich, postal address: Europastrasse 2, P.O. Box, CH-8152 Opfikon, acts as the Swiss paying agent. The prospectus, the Key Investor Information Documents (KIIDs), the articles of association, the annual and semi-annual reports of the Fund(s), as well as the list of the purchases and sales which the Fund(s) has undertaken during the financial year, may be obtained, on simple request and free of charge, at the office of the Swiss representative ACOLIN Fund Services AG. The prospectuses are also available via the website www.robeco.ch.

Additional Information relating to RobecoSAM-branded funds/Services

Robeco Switzerland Ltd, postal address Josefstrasse 218, 8005 Zurich, Switzerland has a license as asset manager of collective assets from the Swiss Financial Market Supervisory Authority FINMA. RobecoSAM-branded financial instruments and investment strategies referring to such financial instruments are generally managed by Robeco Switzerland Ltd. The RobecoSAM brand is a registered trademark of Robeco Holding B.V. The brand RobecoSAM is used to market services and products which do entail Robeco's expertise on Sustainable Investing (SI). The brand RobecoSAM is not to be considered as a separate legal entity.

Additional Information for investors with residence or seat in Liechtenstein

This document is exclusively distributed to Liechtenstein-based duly licensed financial intermediaries (such as e.g. banks, discretionary portfolio managers, insurance companies, fund of funds, etc.) which do not intend to invest on their own account into Fund(s) displayed in the document. This material is distributed by Robeco Switzerland Ltd, postal address: Josefstrasse 218, 8005 Zurich, Switzerland. LGT Bank Ltd., Herrengasse 12, FL-9490 Vaduz, Liechtenstein acts as the representative and paying agent in Liechtenstein. The prospectus, the Key Investor Information Documents (KIIDs), the articles of association, the annual and semi-annual reports of the Fund(s) may be obtained from the representative or via the website www.robeco.ch.

Additional Information for investors with residence or seat in the United Arab Emirates

Some Funds referred to in this marketing material have been registered with the UAE Securities and Commodities Authority (the Authority). Details of all Registered Funds can be found on the Authority's website. The Authority assumes no liability for the accuracy of the information set out in this material/document, nor for the failure of any persons engaged in the investment Fund in performing their duties and responsibilities.

Additional Information for investors with residence or seat in the United Kingdom

Robeco is subject to limited regulation in the UK by the Financial Conduct Authority. Details about the extent of our regulation by the Financial Conduct Authority are available from us on request.

Additional Information for investors with residence or seat in Uruguay

The sale of the Fund qualifies as a private placement pursuant to section 2 of Uruguayan law 18,627. The Fund must not be offered or sold to the public in Uruguay, except in circumstances which do not constitute a public offering or distribution under Uruguayan laws and regulations. The Fund is not and will not be registered with the Financial Services Superintendency of the Central Bank of Uruguay. The Fund corresponds to investment funds that are not investment funds regulated by Uruguayan law 16,774 dated September 27, 1996, as amended.