ROBECO
The Investment Engineers

Multi-asset market outlook

Asset classes and the elephant in the room

September 2024

Marketing materials for professional investors, not for onward distribution.

General overview

Emerging markets returns are showing signs of life

MULTI ASSET	1mo	3mo	YTD	1YR	3YR	5YR
Global real estate (UH, EUR)	4.1%	11.6%	11.5%	18.0%	1.9%	2.9%
Gold (USD)	2.6%	7.0%	20.4%	27.9%	10.7%	9.3%
MSCI World local currency	1.9%	5.5%	17.0%	23.8%	8.0%	13.4%
MSCI World (H, EUR)	1.7%	5.2%	16.2%	22.2%	6.2%	11.7%
Global high yield (H, EUR)	1.6%	3.8%	6.5%	12.7%	0.3%	2.1%
EMD local currency (UH, EUR)	1.1%	3.0%	1.2%	4.5%	0.9%	0.4%
Global investment grade bonds (H, EUR)	1.0%	3.6%	2.5%	7.4%	-3.4%	-1.0%
Global Gov Bonds (H, EUR)	0.9%	3.4%	1.0%	4.2%	-3.9%	-2.4%
Emerging Markets (LC)	0.4%	5.3%	12.1%	16.3%	0.1%	6.6%
MSCI World (UH, EUR)	0.3%	4.5%	16.5%	22.0%	9.2%	13.0%
Cash (EUR)	0.3%	1.0%	2.7%	4.1%	2.0%	1.0%
Global inflation-linked bonds (H, EUR)	0.1%	2.1%	0.1%	3.0%	-5.8%	-2.3%
EMD hard currency (UH, EUR)	0.0%	2.6%	5.9%	10.2%	0.3%	0.6%
Emerging Markets (UH, EUR)	-0.7%	3.9%	9.3%	12.8%	-1.0%	4.7%
Oil Index (USD)	-3.6%	0.2%	12.3%	0.2%	15.9%	-0.2%
GSCI Commodities (USD)	-3.9%	-5.7%	5.1%	-4.0%	13.4%	8.3%

Source: Robeco, Bloomberg

August got off to an incredibly rough start as the Bank of Japan (BoJ) raised rates with a hawkish tilt, and fears mounted about an economic slowdown in the US. The latter catalyst was the US jobs report where the unemployment rate rose to 4.3%, tiggering the Sahm rule indicating that a US recession is underway.

Lower growth and interest rate differentials led investors to reassess the carry trade (borrowing yen to buy dollars or the Mag7, etc.), culminating in Japanese equities falling over 12% in one trading session, the highest equity market volatility since March 2020.

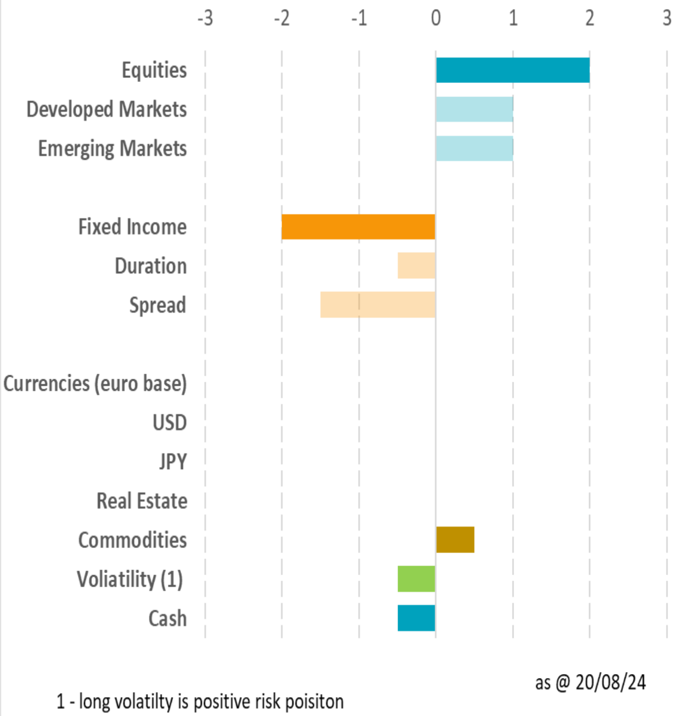
There were also gains for sovereign bonds as investors priced in more rate cuts. US Treasuries were up for a fourth consecutive month for the first time since July 2021, posting a 1.3% gain in total return terms, whilst Eurozone sovereigns were up 0.4%. Gold outperformed bonds, since it tends to do well in a lower-rate environment and economic recessions, and prices exceeded USD 2,500/oz for the first time.

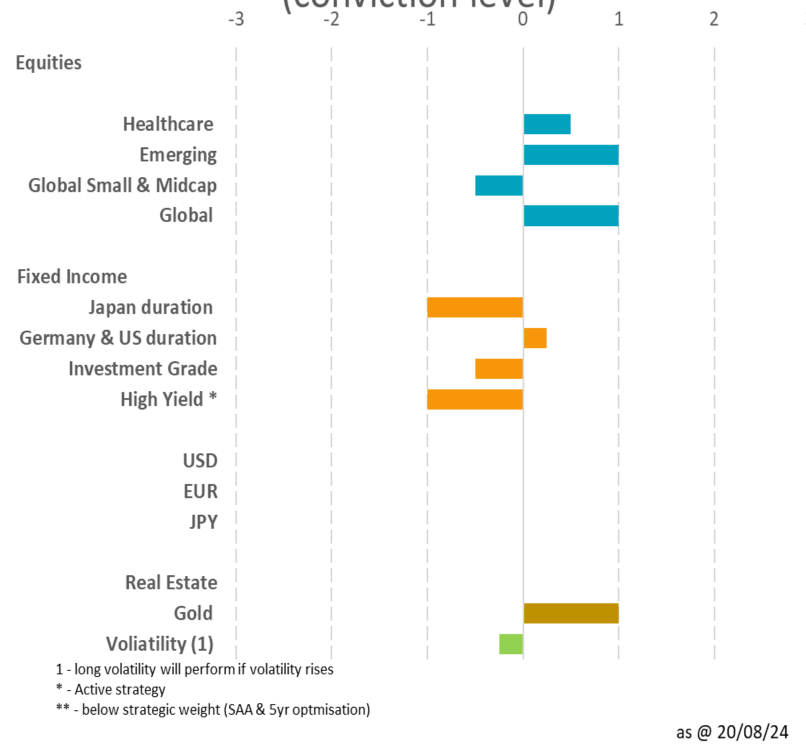
Calm returned to equities as corporates delivered a good earnings season, and so supporting a risk-on environment. Fed Chair Powell's speech at Jackson Hole convinced investors that US rates have room to be cut. Hence, bonds will return as a diversifier in portfolios, and not just as a one-off phenomenon seen in the August turmoil, as rate cuts will accelerate if growth disappoints.

Equities and in particular rate-sensitive sectors top the performance table in August

Robeco Multi Asset views

Sustainable Multi Asset Solutions positions





Source: Robeco

The multi-asset funds outperformed their respective benchmarks in August and are ahead in the year to date, although thematic equities struggled to add value.

The unwinding of the carry trade caused market volatility to jump. Several causes have been discussed for this; poor US employment data; massive short covering in US small-cap stocks; or the financial shockwave that hit Japanese markets. The team used this opportunity to rebalance the portfolio. We closed out UK stocks as the post-election honeymoon fades and added to global equities as we prefer stocks over high yield bonds. We traded commodities, sold the broad index and gained increasing exposure to physical gold, while we closed out all currency positions and added bond steepeners in the US and Germany.

We are of the opinion that the Fed rate-cutting cycle will not significantly impact small caps in our portfolios, especially with slower US growth. The recent violent reversal appears to be short covering but we continue to monitor for greenshoots if the US economy reaccelerates.

We are still convinced that the yen is too cheap and that Japanese interest rates will have to rise. The BoJ is the last bank standing funding the carry trade (borrow in yen and buy another asset). The next phase will be interesting to see if the GPIF, insurance companies and retail traders start to repatriate overseas assets back to Japan.

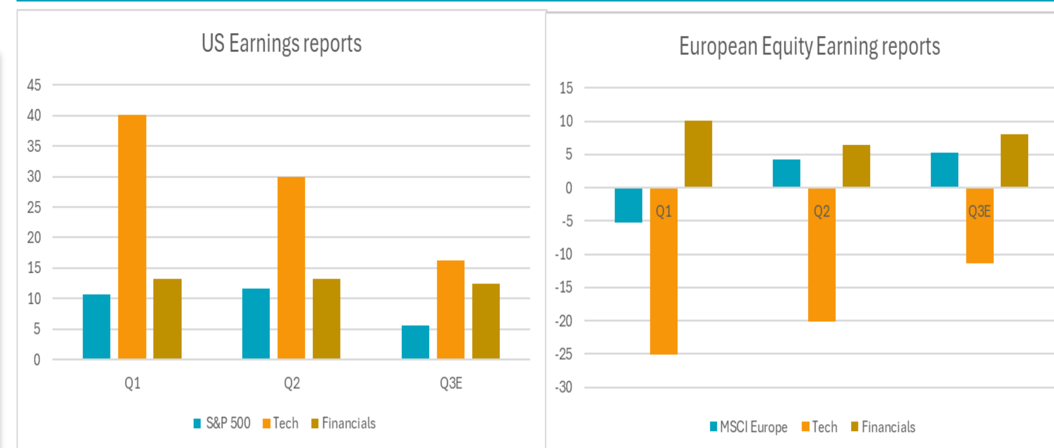
Theme of the month

The elephant in the room

The whole market has become data dependent trying to spot a change in trend that will cause central banks to lower rates, or do so faster than expectations. The recent US Bureau of Labor restatement of non-farm payrolls showed that statistical errors (within known confidence intervals) can influence the direction of markets. So, if we look within asset classes, there is an internal consistency in assumptions. But by taking a step back, we can see that assumptions across asset classes are inconsistent. An ancient Buddhist text, the Tittha Sutta, recounts a story of blind men asked to touch different parts of an elephant, an animal unknown to them. Each one describes what they were confronted with and could not understand the other men's 'truth' of what they were experiencing. Needless to say, their observations did not lead to the discovery of the elephant, nor to an understanding of what others were observing. We can see this in markets.

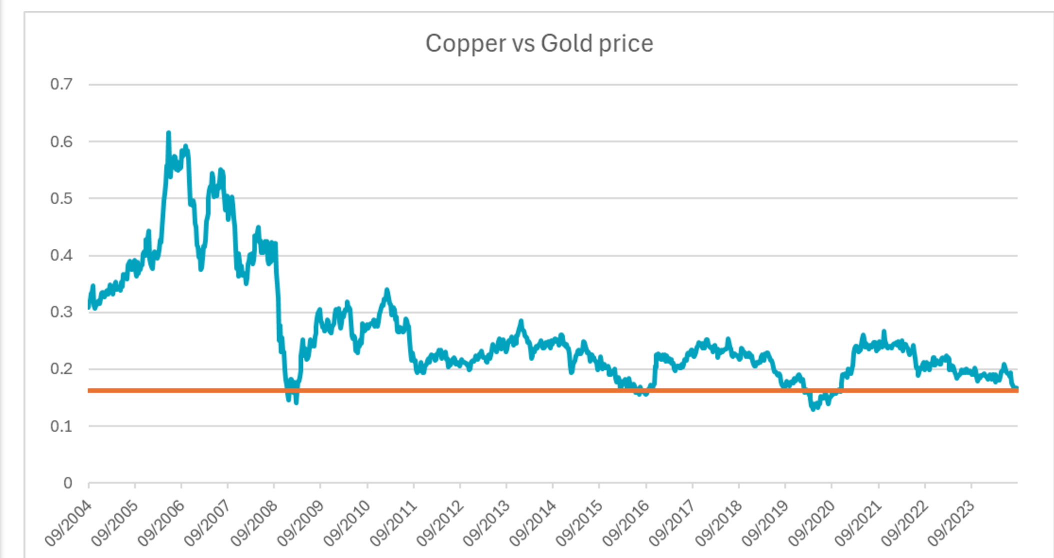
Looking across investible assets, let's start with the YTD winners. Gold has outperformed equities this year, despite a strong US economy and higher real interest rates (bank rates minus inflation), so now it is seen as a risk asset rather than a store of value. Gold demand from China has increased, as concerns about the domestic banking sector and falling house prices have seen locals looking for a safe haven. Next come equities, driven by the AI boom, with analysts expecting companies to continue to beat earnings growth expectations to justify the valuations, in US Tech earnings have been stellar while Europe technology has struggled due to semi-conductor stocks. Only financials outside AI-related companies have so far delivered across the global. So, equities could be pricing in an economic upswing, especially as the global rate-cutting cycle gathers steam. This has been verified by US small caps outperforming large caps by 10% in just a couple of days in July, a type of reversal that has been observed at the bottom of bear markets. If we look at the US equity index options market, then over the last 15 years, buying a put option to protect against a bear market (defined as a 20% fall in S&P 500 index) has made money over a 3-month window only about 25% of the time – a period that includes the Eurozone crisis and Covid. Comparing this with current S&P 500 put option pricing, there is a 37% chance of finishing in the money come December 24. It means equity investors are willing to pay up for insurance against a bear market and stay invested.

Financial earnings have surprised to the upside this year



Source: Robeco, UBS, Morgan Stanley

Economic outlook signals from commodities markets



Source: Robeco, Bloomberg, Refinitiv Eikon, .

Theme of the month

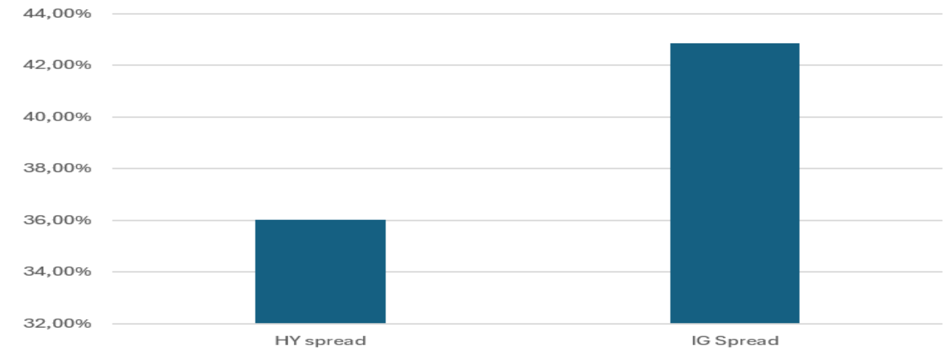
Acceleration of the rate-cutting cycle

Credits and high yield bonds have remained resilient in the face of rate rises and worries about companies having to refinance debt at higher interest rates. There has been little concern about a slowing economy; historical analysis suggests the high yield market is pricing in less chance of a recession than investment grade, or a rise in default rates, but then the tailwind of lower interest rates from the cutting cycle has boosted the outlook. This is aligned with the rally in rate-sensitive equity sectors like REITs, telecoms, utilities and US small caps. Global government bonds have struggled to outperform cash rates so far this year and their yield curves have front-run rate cuts, causing a collapse in the term premium (what investors demand for lending money over a longer period), the downward-sloping US yield curve has not been the usual harbinger of doom. For US short rates to fall below long rates (a disinverted curve) requires a significant rate-cutting cycle of around 200 bps. This implies a return to the post-GFC framework with historically low real rate levels, around 2% inflation and an average rate-cutting cycle, voila, justifying the current levels of long rates! Commodities continue to lag other markets, which is not surprising given the global manufacturing malaise, with the copper to gold price ratio hitting lows only seen during Covid, the GFC and in 2016, confirming a continuation of the weak outlook.

Commodities, gold and government bonds appear to point to a major slowdown, allowing rates to be cut in line with historical outcomes including recessions, whereas credit and equity are pricing a much rosier outlook of a pick-up in activity, better earnings and no credit cycle. Usually, our ingrained psyche would defer to the bond market being right... so is the inverted yield curve signal forewarning of a recession broken, or has it not played out yet? Overall, the consensus appears to be averaging out the extreme outcomes rather than reflecting cross-asset consistency, much like the observers in the elephant story.

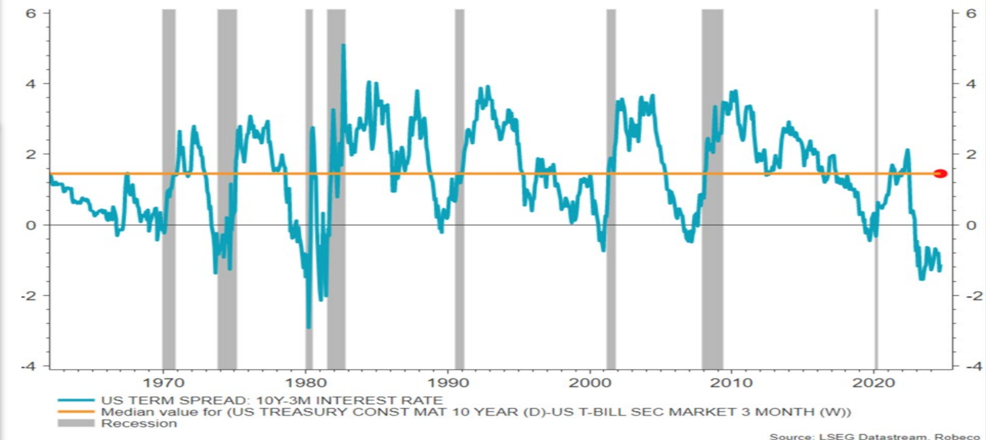
Taking a step back, we visualise the real elephant in the room as being liquidity. The cumulation of quantitative easing, a decade of emergency rate levels, and more recently, higher government spending means we have too much money chasing too few assets, and therefore allocation decisions do not need to be made. The Federal Reserve embarking on a deep rate-cutting cycle will keep the observes at odds, not agreeing on the big picture, and not discovering the elephant in the room.

Wide margin of recession risk priced into credit markets



Source: Robeco, Bloomberg, Refinitiv Eikon. Data to August 2024.

Inverted US yield curve has not predicted a recession….

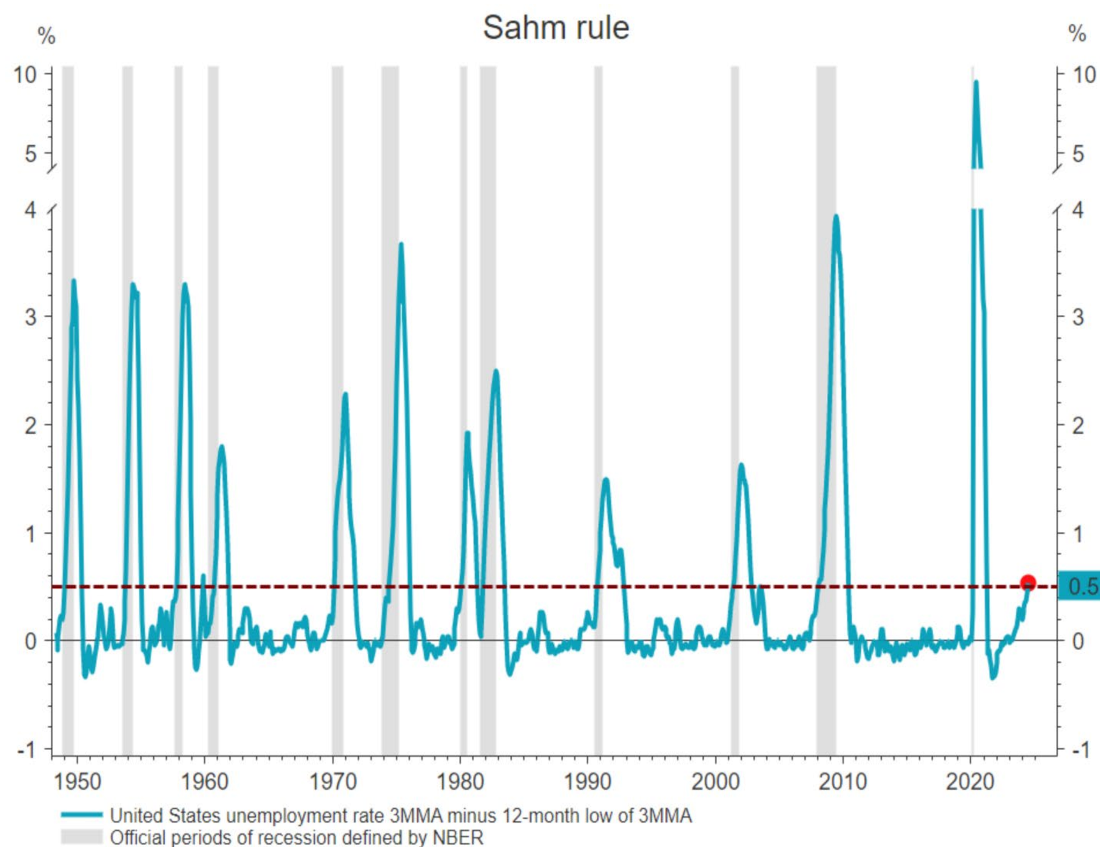


Source: Robeco, Bloomberg, Refinitiv Eikon. Data to August 2024.

Source: Robeco, Bloomberg. Data to 30 August 2024

Economy

August has turned all eyes on the Sahm rule



Source: Refinitiv Datastream, Robeco

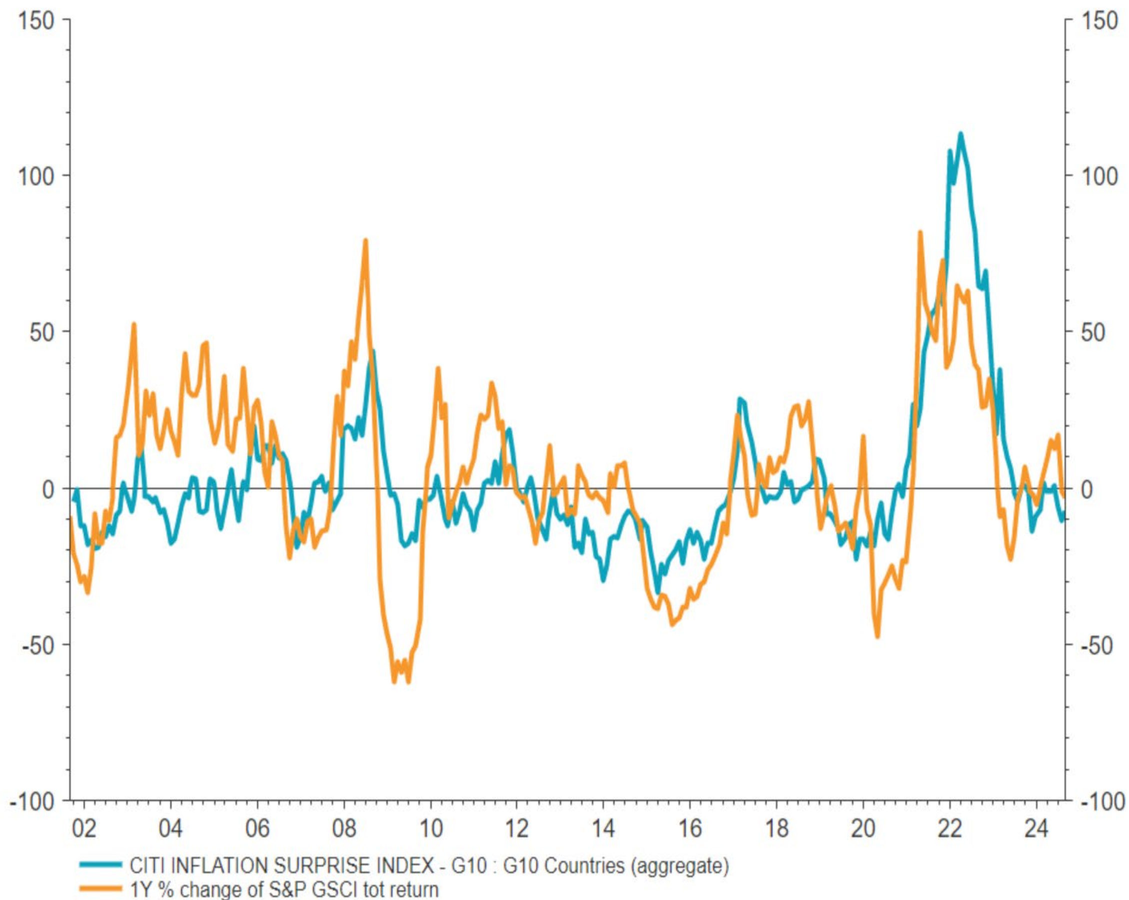
All market data to 31 August 2024 unless mentioned otherwise.

August started with a cracking noise as US unemployment surprised market expectations with a 0.2% rise to 4.3%. In doing so, the Sahm rule recession indicator was triggered. The Sahm rule metric shows the deviation of the 3-month moving average in unemployment from its 12-month low. When it exceeds 0.5, historically a recession has followed. A lot of commentators, including Sahm herself, have since nuanced the signal, pointing out that labor market weakness might be lower than it seems, as it could be caused by supply side factors due to the rise in (un)skilled immigration. August data broadly confirmed that aggregate demand is still on track; the Atlanta Fed Q3 GDP nowcast stands at 2.5%, significantly above US trend growth. Macro surprises, while remaining negative throughout August, appear to be bottoming out.

Regardless of a supply-side tilt in the recent weakness, the fact remains that the US labor market is cooling. Weakness may beget weakness as unpaid workers lower demand, putting more people out of work. Gradual increases in unemployment will gain momentum at some point in the cycle; the Sahm rule tries to capture that very aspect. And it's not only leading indicators that suggest further cooling; the non-farm payroll data benchmark revision showed that past-year job market gains (up to March 2024) were 818,000 lower than previously estimated. This aligns the data better with the household survey which has shown much flatter job gains recently. The Fed, which held its Jackson Hole symposium in August, by now has clearly become more vigilant and is now more concerned about a further cooling of the labor market than inflation risks. We are closely monitoring developments in the US labor market, especially if the quits rate, NFIB hiring intentions, hard-to-fill jobs and the ISM services employment indicators deteriorate next month, as this could signal a further decline in job openings.

Economy

G10 inflation surprises have been negative this quarter



Source: Refinitiv Datastream, Robeco

All market data to 31 August 2024 unless mentioned otherwise

G10 inflation has now been surprising to the downside in the past quarter, helped by declining commodity prices. This paves the way for a broadening easing cycle among G10 central banks. In Europe, the flash CPI for August saw a confirmation of disinflation, as it declined to 2.2% from the previous month's 2.6%. Yet, services inflation over July increased to 4.2%, despite negotiated wages coming down. As the correlation between services CPI and wages is still 0.8, a further decline would provide the ECB with more confidence to cut rates further. There are signals that the European consumer is getting a bit less downbeat and is willing to spend again after a period of underspending. While real wage growth stood at 3.7% at the end of Q2, real consumption spending only saw a 0.8% increase. A perking up of willingness to spend is confirmed by the European Commission's leading indicator, which shows that enthusiasm for major purchases has increased. Europe is still stuck in a low gear, but the outlook is improving. The HCOB manufacturing PMI for the Eurozone and Germany still shows contraction, but the pace of contraction is decelerating, with the August data surprising to the upside. The final manufacturing PMI rose from 45.6 to 45.8. Credit conditions for smaller firms have been easing and further ECB cuts next to recent declines in commodity prices will help to spur a more meaningful recovery in the coming quarters.

The Chinese economy showed signs of slowing, with the sub-components of the official PMI particularly concerning. In July, output fell significantly by 4.4 points to 50.2, and new orders fell into contractionary territory. Yet, the Caixin PMI over August saw some improvements, with the indicator rising to 50.4 from 49.8 in July. Chinese new home price increases weakened, showing that China's property woes are protracted, necessitating more stimulus. China's Third Plenum reiterated the 5% growth target, suggesting more policy thrust could be forthcoming to reinvigorate growth.

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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. Investors should consult their 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 invoke 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 does 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 B.V., 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: Leutschenbachstrasse 50, 8050 Zürich, 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 Information Documents (PRIIP), 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.

Additional information for investors with residence or seat in Taiwan

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Additional information for investors with residence or seat in Thailand

The Prospectus has not been approved by the Securities and Exchange Commission which takes no responsibility for its contents. No offer to the public to purchase the Shares will be made in Thailand and the Prospectus is intended to be read by the addressee only and must not be passed to, issued to, or shown to the public generally.

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 Institutional Asset Management B.V (FRN: 977582) is authorised and regulated by the Financial Conduct Authority.

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 under 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 27 September 1996, as amended.

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