



Global Markets Outlook

Half-time report

July 2023

General overview

Emerging market equities and commodities join risk rally and outperform bonds and gold

MULTI ASSET	1mo	3mo	YTD	1YR	3YR	5YR
MSCI World local currency	5.7%	7.1%	15.1%	18.2%	12.9%	9.7%
MSCI World (H, EUR)	5.5%	6.7%	14.1%	15.9%	11.1%	7.8%
Oil Index (USD)	4.0%	-5.5%	-10.5%	-26.3%	30.0%	-8.9%
MSCI World (UH, EUR)	3.6%	6.4%	12.6%	13.6%	13.3%	10.6%
Emerging Markets (LC)	3.4%	1.7%	5.6%	3.3%	3.9%	3.0%
GSCI Commodities (USD)	2.0%	-3.1%	-9.5%	-17.8%	26.3%	4.2%
Global high yield (H, EUR)	1.9%	1.4%	3.6%	7.0%	0.0%	0.3%
Global real estate (UH, EUR)	1.7%	1.7%	1.8%	-7.2%	4.8%	2.3%
Emerging Markets (UH, EUR)	1.4%	0.5%	2.6%	-2.5%	3.3%	2.3%
Global inflation-linked bonds (H, EUR)	0.4%	-2.6%	0.3%	-6.8%	-4.7%	-1.1%
Cash (EUR)	0.3%	0.8%	1.4%	1.7%	0.2%	0.0%
Global investment grade bonds (H, EUR)	0.0%	-0.6%	1.8%	-1.1%	-4.5%	-0.6%
EMD local currency (UH, EUR)	-0.3%	0.7%	3.7%	5.1%	-0.3%	2.3%
Global Gov Bonds (H, EUR)	-0.4%	-1.1%	1.4%	-3.8%	-5.4%	-1.4%
EMD hard currency (UH, EUR)	-0.6%	0.8%	1.3%	1.5%	-2.2%	1.8%
Gold (USD)	-2.2%	-2.5%	5.4%	6.2%	1.1%	7.8%

Source: Robeco

2 All market data to 30 June unless mentioned otherwise

Global equities have delivered one of their best half year performances ever, especially adjusted for the valuation starting point. Investor concerns about rising interest rates, global recession, earnings collapse have been misplaced, so far. Replacing this narrative has been AI and technology promises of future productivity and earnings potential. Unfortunately, these returns have not been shared across the equity indices and the S&P 500 equally weighted index has lagged the market cap weight S&P 500 index (usual index quoted) the most since the TMT bubble leading up to the 2000 crash and recession. In other words, the Magnificent 7 have ridden off with most, if not all, of the returns.

High yield has held up well, despite rate rises. The spread cushion and continued low defaults have given investors a better return than sovereigns, investment grade and inflation-linked parts of the bond market.

Emerging markets disappointed as the China reopening boost and consumer 'revenge' spending failed to materialize, probably due to the lack of fiscal hand outs to consumers & corporates, compared to those given by western governments (Covid, Inflation Reduction Act and Energy subsidies). As with other countries industrial activity fell in China, but given the structure of the economy this is seen as more important than elsewhere.

Commodities bounced back after the second round of OPEC cuts to oil supply. However, copper prices have fallen, reflecting China growth concerns, and it's been a volatile month for agricultural prices.

Events that could derail 2023 consensus outlook – half-time report

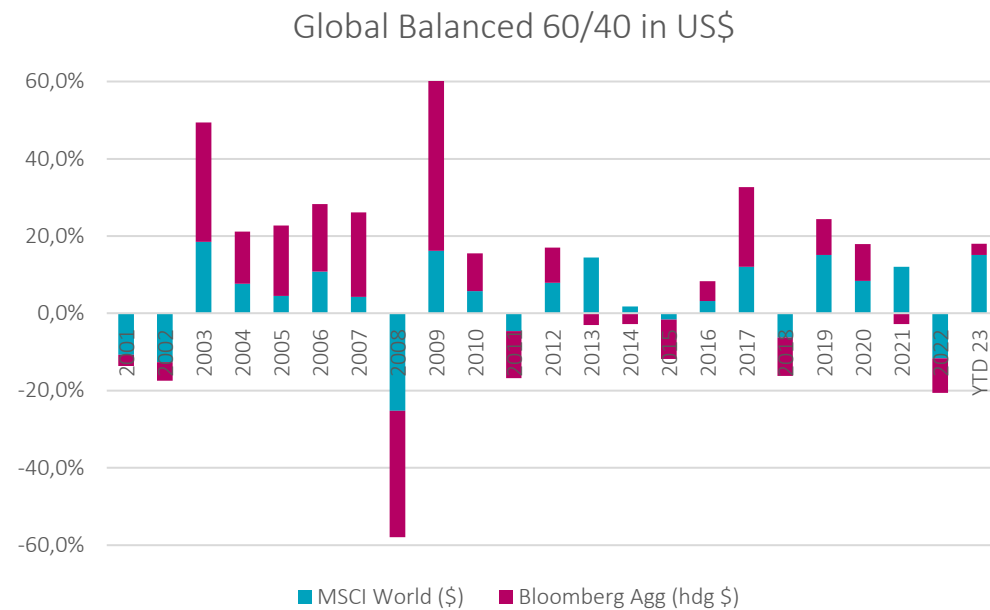
At the start of the year, we highlighted some of the tail-risk events that could significantly affect the consensus outlook. While risks may dominate the market psyche for short periods without changing our fundamental outlook, when priced-in, they provide investment opportunities. We are keeping score, and if these risks have been observed then we score a point, if not observed then no need to trouble the scorers, and we get half a point if an outcome is partially observed. Here is how the possible scenarios we identified at the start of 2023 are playing out:

1. Goldilocks' Revenge: US inflation peaks without the interest rate hikes causing a recession. This becomes the consensus view in the market. **Result:** US equities and high yield performed well. The AI 'disinflationary' gold rush began, with a narrow market (top 2-3% of S&P500 index generating all the performance so far this year). **Robeco's view:** we are still cautious and now anti-consensus.

2. The US Federal Reserve tires of low long-term rates and reviews the inflation target, citing a structural break with previous regime: Central banks begin to start adapting inflation targets to ranges or write apologetic letters to policy makers about missing targets. **Result:** So far, inflation's delayed return to 2% targets has been accepted by bond vigilantes as has the fiscal largesse. Sovereign bonds delivered positive returns in H12023 and central banks have signalled the rate hiking cycle continues. **Robeco's view:** The rate cutting cycle will be a 2024 investment debate unless there's a financial/economic accident.

3. Deflation has a higher number of hits than inflation according to news flow data scrapers from Wall street and Main street: **Result:** No evidence that economies have cracked yet with labor and aggregate demand remaining strong. **Robeco's view:** Inflation will be stickier than economist models are predicting. Thus interest rates will need to be higher for longer and there is an increased chance of an inflation target undershoot.

Mixed Asset portfolios are alive and.....

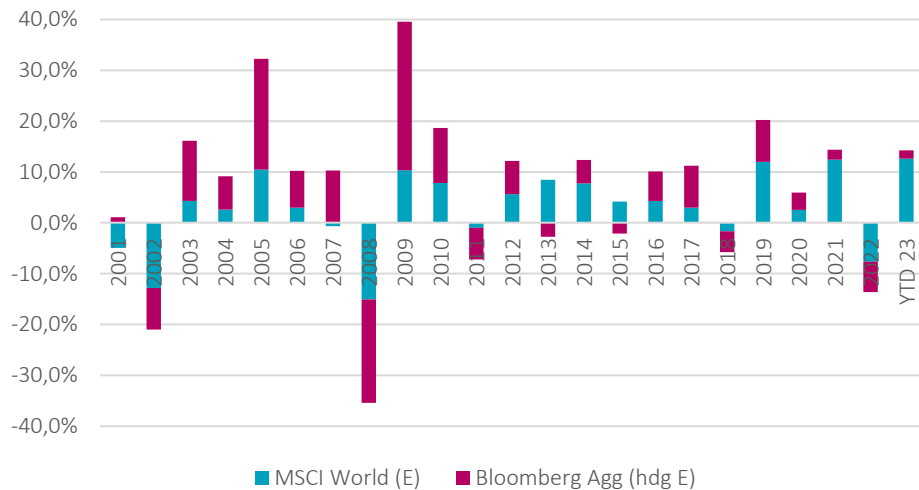


Source: Robeco, Bloomberg

Theme of the month

.... correlations are falling

Global Balanced 60/40 in euro



Source, Robeco, Bloomberg

Events that could derail the 2023 consensus outlook – Half time report

4. Sustainability claims are questioned by regulators, media and investors: Large 'jack of all trades' financial institutions struggle to evidence their sustainability credentials across their businesses. **Result:** We observe a split in US clients' requirements on sustainability issues, downgrading of SFDR Art 9 funds to Art 8, and firms quitting the Net Zero Asset Management Initiative or stepping back from sustainability claims e.g. delisting themselves from UN PRI. **Robeco's view:** The regulatory environment continues to evolve, with marginally increased clarity in some areas. We have made it our mission to embrace the sustainability framework, and our SDG framework is available with open access for clients and academics.
5. In 2022, risk profile funds (cautious, balanced and aggressive) deliver similar returns to each other despite different levels of equity and bond allocations, 60/40 is dead! 2022 these profiles performed within 50 bps of each other. **Result:** equities and bonds are providing positive returns and correlations have fallen. **Robeco's view:** 60/40 is alive and kicking and we continue to expect correlations to be lower than 2022.

6. End of bottlenecks: commodity prices have fallen in the first half of 2023 and the surveys are suggesting that demand and wages are more concerning than the cost of input goods. PPIs around the world continue to deflate, indicating input cost inflation is disinflationary again. China reopening has disappointed as minimal stimulus has been unleashed. **Result:** There's been an energy windfall for global economies as Chinese demand disappointed, especially for Europe with recession averted and producer prices falling. **Robeco's view:** China's consumers did not have the helicopter money benefit seen in US and Europe, hence are taking longer to recover, and this bad news is priced-in to Chinese equity prices.
7. Social media backlash & regulation of large technology and social media platforms as data protection issues come to the fore again. **Result:** No change in equity market leadership, but the regulatory environment is increasing pressure on big tech business models. **Robeco's view:** The stocks that led the last bull market will not lead the recovery, so not a new bull market. We also expect big tech will look quite different in years to come.

Theme of the month

Half time scorecard 7/10

Event		Event	
1. Goldilocks	1	6. Bottlenecks ease	1
2. Higher Inflation targets	½	7. Big tech regulations	1
3. Deflation	0	8. Shock regime change	½
4. Sustainability	½	9. Private assets	½
5. 60/40 Alive	1	10. Climate commitment	1

Score: 1 – observed, ½ partially seen of the outcome been observed, 0 not observed

Source, Robeco,

Events that could derail the 2023 consensus outlook – Half time report

8. Shock regime change: First year this century without an election in G7, however we could see a major shift in policy as a ‘major’ regime topples. **Result:** Major volatility spikes, which have been observed fixed-income, LDI switch to physical assets and US Regional banks liquidity mismatch, but no major political shock so far. **Robeco’s view:** We have seen a major volatility spike in bonds, we expect more change, and we can’t predict these tail risks, but whatever the event happens to be, we will continue to uncover opportunities.
9. Private assets see liquidity drain, LDI structures questioned, and scrutiny of banks. **Result:** Slow discovery of investments that were only funded because cash was ‘free’, and a few real estate structures have collapsed. **Robeco’s view:** Buyer beware as private assets have been a major beneficiary of cheap money.
10. No backtracking on climate: The evidence about climate change continues to mount and COP27 highlighted that political will is key. In the long run, achieving energy security means investing more in green technologies and climate solutions to close the gap between ambition and implementation. **Result:** We are experiencing continued commitment from governments, backed with actual cash, to fund the clean energy transition, more through necessity and FOMO rather than politicians having a vision. We also believe this additional spending will add to short term inflationary pressures. **Robeco’s view:** This trend will continue to intensify

In conclusion, we do not have perfect foresight on events that affect market returns, but a score of 7/10 is very high given the tail risk nature of these predicted events and the inherent contradictions. When we observe market pricing or volatility incorporating tail risks, we view this as opportunity to generate returns for clients. At Robeco, we are prepared for turbulent second half of 2023.

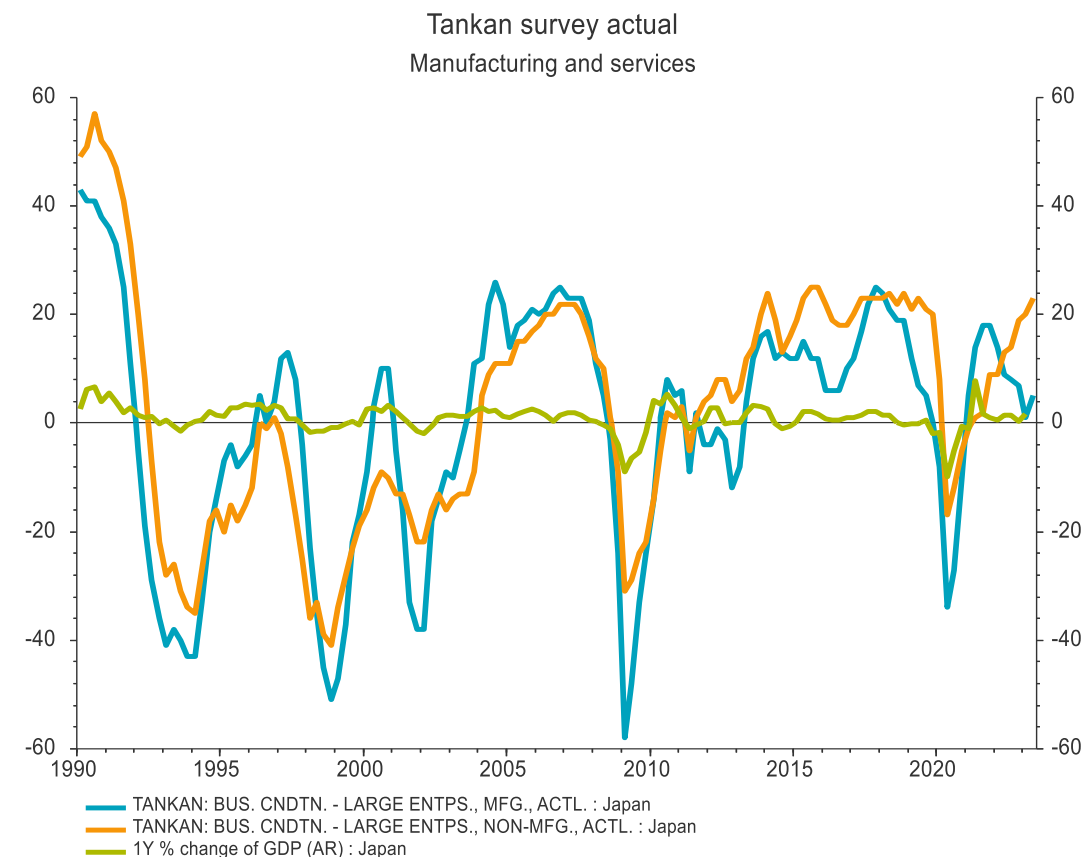
Economy (I)

The narrative unfolding year-to-date has been mostly about surprising economic resilience from the US and the comeback of Japan, while core inflation in developed economies is proving to be sticky.

While US Q1 GDP was revised upwards and consumer personal income rose in May by 0.4% (m-o-m), forward looking soft data as well as an even deeper inversion of the US yield curve last month suggests that clouds are gathering on the horizon. The core PCE increased by 0.3% (m-o-m) in May, up 4.6% (y-o-y). In the Eurozone, macro surprises have become increasingly negative, while core inflation is proving sticky as well at 6.7%, defying the gravity pull of the steep 5% drop in overall HICP since it's October 2022 peak. Most notable has been the weakening in services where the expansion is decelerating. The drop of the S&P Global French services PMI last month into contractionary territory is notable as it took place well before the riots in Paris erupted.

In Japan, the latest Tankan survey for corporates in the services sector increased to 23 in Q2 from 20 in Q1, showing the reopening boost after removal of Covid restrictions still has vigor with tourism flows increasing. China's economic performance has been underwhelming with the jump in the credit impulse failing to get a domestic consumer recovery firmly on track. The Caixin PMI eased to 50.5 in June from 50.9 in May. It shows the leading manufacturing sector is not yet able to offset an entrenched property downturn, high youth unemployment and deflationary pressures.

Bright services activity outlook in the land of the rising sun



Source: Refinitiv Datastream, Robeco

Source: Refinitiv Datastream & Robeco

Economy (II)

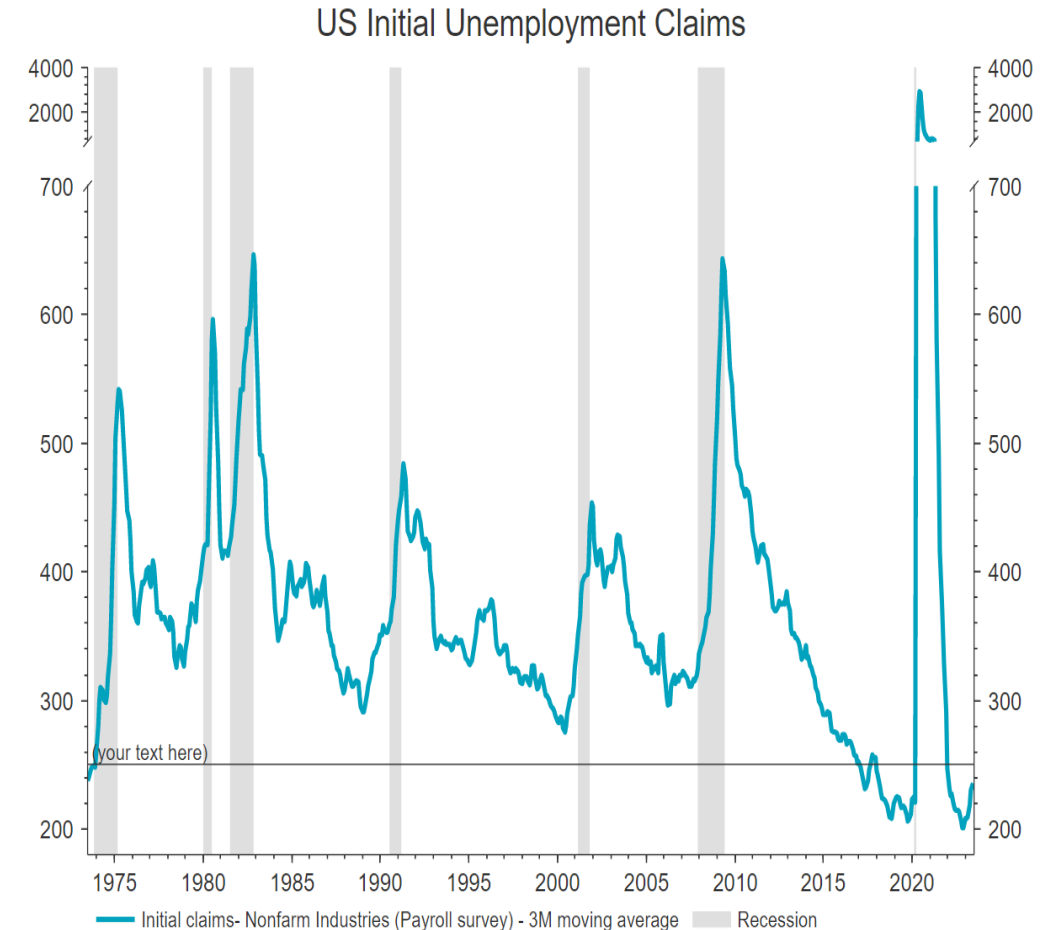
Looking ahead, we continue to expect central banks to achieve a Pyrrhic victory by bringing core inflation below 3% by early 2024 at the cost of a mild recession (i.e. US unemployment rate to peak in 5-7% range). We observe four signposts to detect a more imminent turn in the business cycle. First, changes in the employment situation are key as central banks judge sticky core inflation to be a function of wage dynamics. In the US, increases > 150K in the 3M moving average unemployment claims after a cycle trough have always coincided with a recession.

Second, while recent hard macro data still looks solid and seemingly signals that DM economies are resilient to the recent policy tightening, the soft data on average continues to weaken, both in manufacturing as in services. Third, although major commodity prices did recover somewhat in June, they are still in a bear market (and trading contango), signaling the odds for a soft landing for the global economy seem modest. Fourth, loan standards continue to tighten with worsening household debt service ability starting to squeeze household spending, especially in more interest rate sensitive countries like Australia and Scandinavia. Lastly, we are closely watching any signs of a firming Chinese housing market as pivotal for a sustained domestic consumer recovery. More targeted easing measures for the property market are needed.

Source: Refinitiv Datastream & Robeco

7 All market data to 30th June unless mentioned otherwise

Close eye on US jobless claims



Source: Refinitiv Datastream & Robeco

Source: Refinitiv Datastream

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