ROBECO
The Investment Engineers

Multi-asset market outlook

The value winter is thawing

April 2022

For professional investors

Sustainable Investing Expertise by ROBECOSAM

General overview

Inflation hedges outperform

MULTI ASSET	1mo	3mo	YTD	1YR	3YR	5YR
GSCI Commodities (USD)	10.7%	36.1%	36.1%	73.8%	13.7%	9.1%
Oil Index (USD)	8.1%	40.8%	40.8%	86.8%	-2.4%	2.0%
Global real estate (UH, EUR)	5.6%	-2.5%	-2.5%	23.6%	6.1%	6.1%
MSCI World (UH, EUR)	3.7%	-3.1%	-3.1%	16.3%	15.3%	11.5%
MSCI World local currency	3.1%	-4.6%	-4.6%	11.6%	15.0%	12.3%
MSCI World (H, EUR)	3.0%	-4.8%	-4.8%	10.7%	13.4%	10.5%
Gold (USD)	2.7%	6.6%	6.6%	13.1%	13.0%	8.1%
Cash (EUR)	0.0%	-0.1%	-0.1%	-0.5%	-0.5%	-0.4%
Global high yield (H, EUR)	-0.8%	-5.5%	-5.5%	-3.6%	1.2%	1.4%
Emerging Markets (UH, EUR)	-1.3%	-4.9%	-4.9%	-6.4%	5.3%	5.1%
Global inflation-linked bonds (H, EUR)	-1.4%	-3.2%	-3.2%	4.1%	3.7%	2.5%
EMD local currency (UH, EUR)	-1.6%	-2.5%	-2.5%	-0.5%	0.5%	0.5%
EMD hard currency (UH, EUR)	-1.6%	-7.8%	-7.8%	-3.7%	0.5%	0.9%
Emerging Markets (LC)	-2.1%	-6.1%	-6.1%	-9.9%	6.3%	7.5%
Global investment grade bonds (H, EUR)	-2.3%	-7.1%	-7.1%	-5.3%	0.8%	1.1%
Global Gov Bonds (H, EUR)	-2.3%	-4.9%	-4.9%	-4.4%	-0.3%	0.3%

Source: Robeco

Commodity prices surged by 36.1% (In US dollars) in the first quarter on the back of widening geopolitical risk premiums and outright supply distortions as the world's third-largest oil producer, Russia, faced sanctions. As both the level and breadth of inflation deteriorated, central bank announcements to tighten policy turned even more hawkish.

As a result, sovereign bond yields skyrocketed, with the global government bond index ending the quarter 4.9% lower. The 2-year US Treasury yield rose 155 basis points, the largest increase since 1984. For US Treasuries it has been one of the worst quarters in decades as the index dropped 5.5% (hedged into euros).

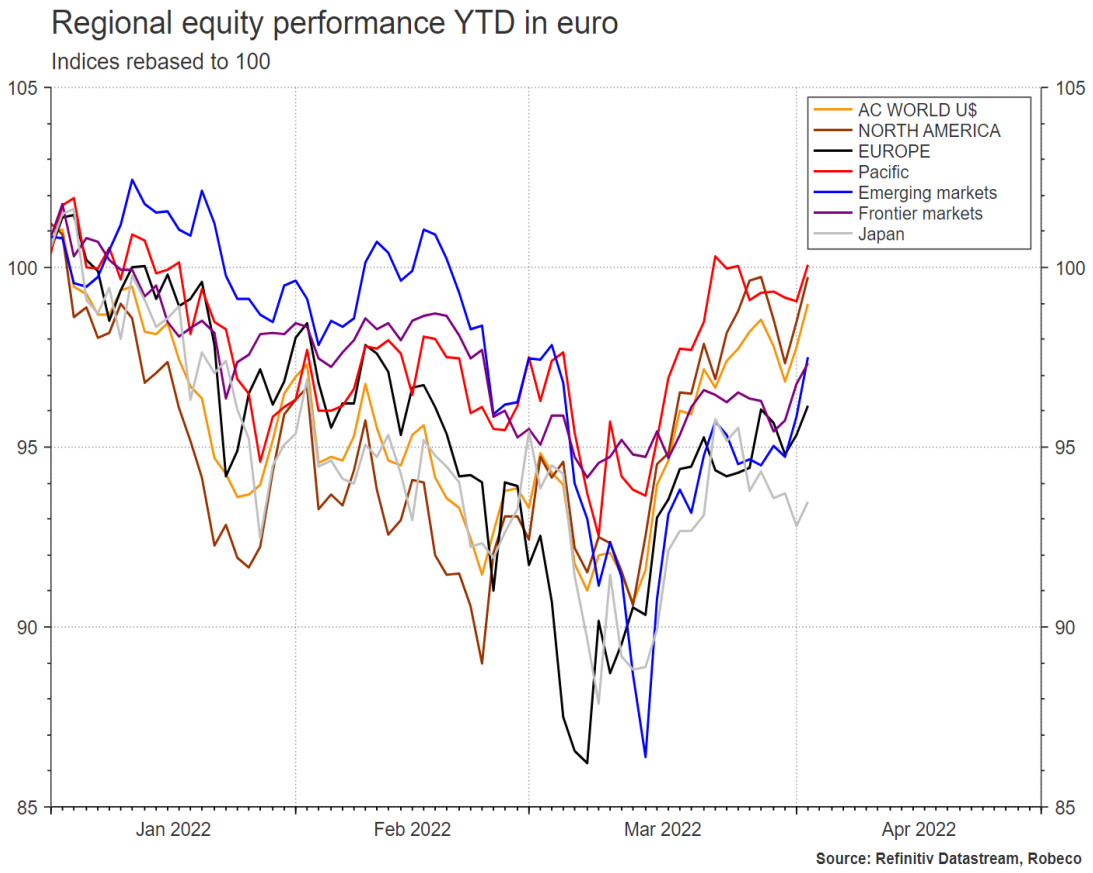
Overall, the fixed income asset classes lost ground, as spreads widened due to tightening liquidity conditions and worries about a deceleration in global expansion on mounting geopolitical concerns.

General overview

Equity markets bounce back from early March lows

Regional equity performance YTD in EUR

Indices rebased to 100



Source: Refinitiv Datastream , Robeco

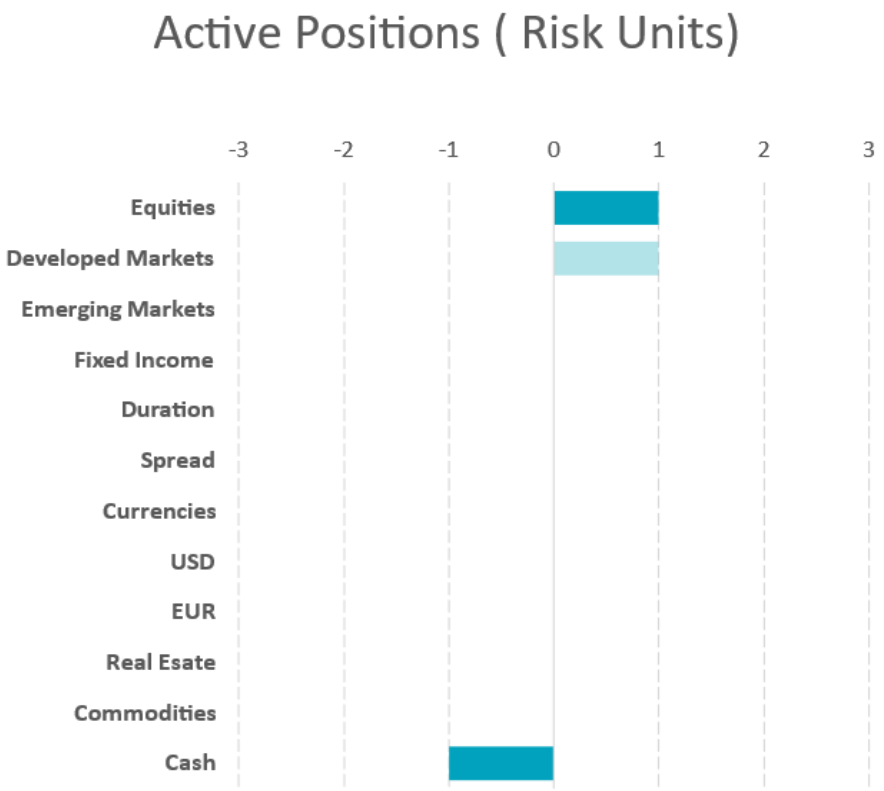
With a human tragedy unfolding in Ukraine, rampant inflation and geopolitical risks, the US yield curve inverting and the Fed starting a tightening cycle, it seems that the rally in broader equity markets since the second half of March is unhinged from fundamentals.

Yet, there are a few reasons why equities have been trending higher. First, even though the Fed is likely to embark on more aggressive tightening path to contain inflation, corporates still have a lot of pricing power, and consumers still have spending power (no signs of rationing yet), extending the earnings cycle. Second, this ability to raise prices also makes equities an attractive inflation hedge while nominal bonds suffer. Third, in contrast to what recent headlines about inversion and recession risk suggest, it is the extent to which the Fed tightens beyond the neutral rate of interest that really impacts the earnings cycle. This typically takes place well after inversion, which is why equities still tend to trend higher up to 6-12 months after it.

Fourth, from a relative valuation perspective, global equities are still attractive compared to bonds, despite the recent bond sell-off. Lastly, sentiment has become very bearish while positioning had been heavily reduced (Eurozone equities have seen record outflows). Excessively downbeat risk sentiment has paved the way for a rebound.

Multi Asset views

Sustainable Multi Asset Views



Source: Refinitiv Datastream, Robeco

We continue to hold a lightly procyclical stance as our base case is that US recession risk is not immediate. Two conditions for immediate recession risk are not in place; excess Fed tightening and corporates and household running out of cash to spend. Further out, risks are tilted to the downside, as there is only a narrow road for the Fed to engineer a soft landing.

We took profit on our long dollar versus the euro position, as we judged that the upside of this hedge against Russia-related risks had become limited, given a turn in market sentiment and the compression of risk premiums. We closed our overweight in European equities. Despite a record discount versus US equities, we judge that the trigger to unlock this value – a catch-up in profitability – has stalled against a worsening economic backdrop in the Eurozone. We remain neutral on emerging markets and continue to look for triggers to upgrade to an overweight. More Chinese stimulus, a depreciation of the dollar and a turn in the credit cycle are the signposts we are watching.

The current global macro landscape is complex, as evidenced by the diverging signals from the sovereign bond- and equity markets. We stick to a modest overweight in equities as we judge the earnings cycle could extend somewhat further, though the recession clock has started ticking. In fixed income we have a preference for carry and have upgraded our credit exposure from underweight to neutral. We remain neutral on sovereigns as we see two-way risk here. We judge rate hikes in developed economies as being fully priced, though we acknowledge that yields typically continue to rise once the Fed starts hiking, while the flattening of the yield curve has somewhat further to go.

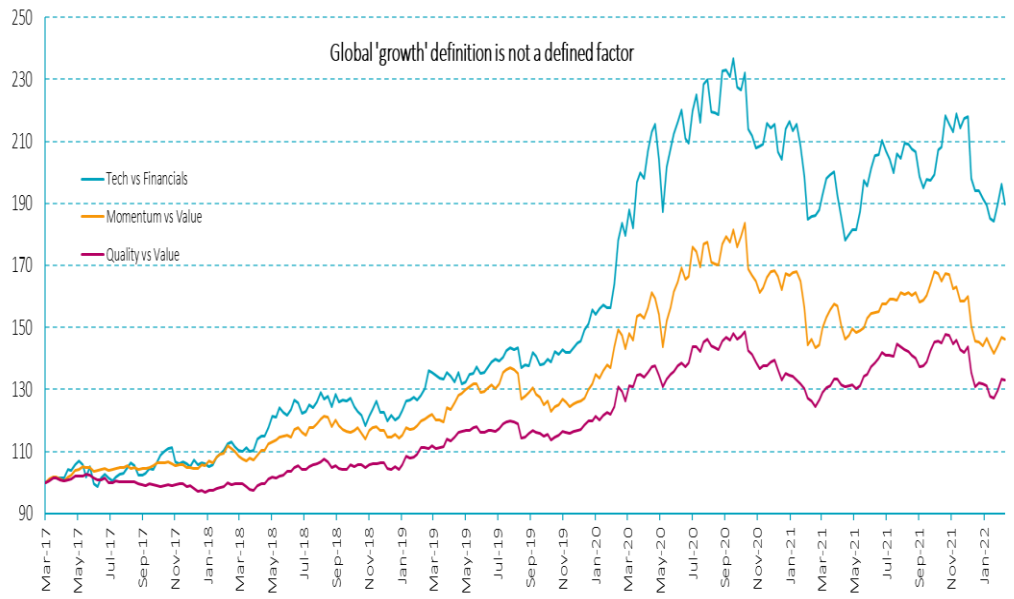
Theme of the month

Rotation away from 'growth' began in 2020

The growth style is undefined from a factor perspective, whereas value has a clear approach. The growth style is mixture of earnings quality/predictability and business model momentum for those companies with potentially super-high profits that are on their way to market dominance. Some companies will succeed; we know the household names. However, there are many that will fail as their business model is exposed, and the 'cheap money' runs out. Do you remember Napster, Boo, Broadcast, Netscape, Bear Stearns, Pebble, etc.?

Turning to the value style – let the buyer beware. The most obvious downside of value investing is the 'value trap' where companies don't innovate their way out of a 'dying' industry, or looking through a sustainable lens, those companies left with stranded assets. There are many historical and current examples of companies and industries we can refer to; coal, tobacco, camera film, etc. We can observe that the sectors and industries within the value style change – tech and health care make up 20% of many value funds today. We are strong believers in active management which can help avoid and mitigate these pitfalls.

'Value' winter is thawing

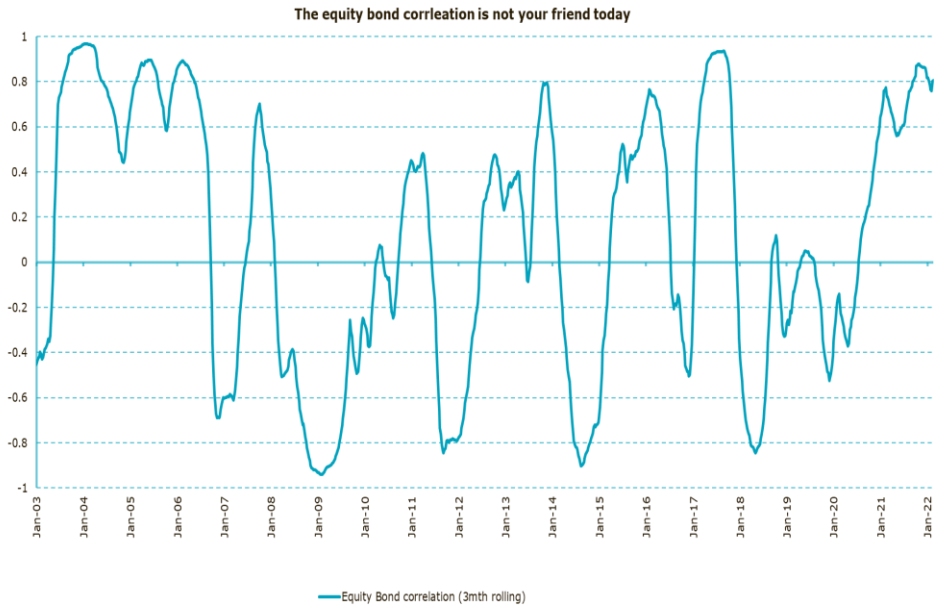


Source: Bloomberg, Refinitiv Datastream, Robeco

The data shows that the rotation away from growth began in Q3 2020, so these are not recent observations. Financials started to make a comeback once the US Federal Reserve stopped the post-Covid QE and investors realized that the fiscal stimulus would require higher rates as economies reopened and labor markets recovered towards full employment. In a nutshell, yield curves began to steepen and then flatten towards the end of 2021. This created a catch-up for part of the value universe, although by end of 2021, the growth and value styles were performing in line.

Theme of the month

Other rotations are not happening yet



Source: Bloomberg, Refinitiv Datastream, Robeco as @18 March 2021

Equity markets are not the only falling knife

Very rarely in bull markets does the leadership change. Sustained underperformance of the bull market champions could signal tougher times ahead for equity market performance. We note that the value leadership baton was passed to the mining and energy sectors as the economic recovery remained supercharged and supply constraints became tighter after Russia invaded Ukraine.

Multi-asset investors use 'safe haven' assets to dampen volatility in fund performance. However, from our vantage point in this episode, government bonds have failed to provide this diversification. The has meant that equity and bond prices have moved in the same direction – namely down.

The US dollar did not see flows from investors seeking safety; indeed the euro rallied as the ECB continued its hawkish tone and its alignment with Fed tightening. As the war in Ukraine escalated, the US dollar rallied, and investors questioned the alignment between central banks. The ECB and Bank of Japan are less able to raise rates, while the US has begun a tightening policy by raising rates and signaling that more is yet to come.

The value winter is thawing, and we are finding the stock-picking universe to be different to those of previous cycles, with investors finding IT and health care names eligible for investment within the value style. The recent leaders of the value style in the more conventional value sectors have environmental footprints that are 50% of their respective global equity benchmarks, and the style is still historically cheap. At Robeco, we are committed to climate transition, and this includes the value style. The decarbonization of value allows us to fully capture the risk premium while significantly lowering our carbon footprints.

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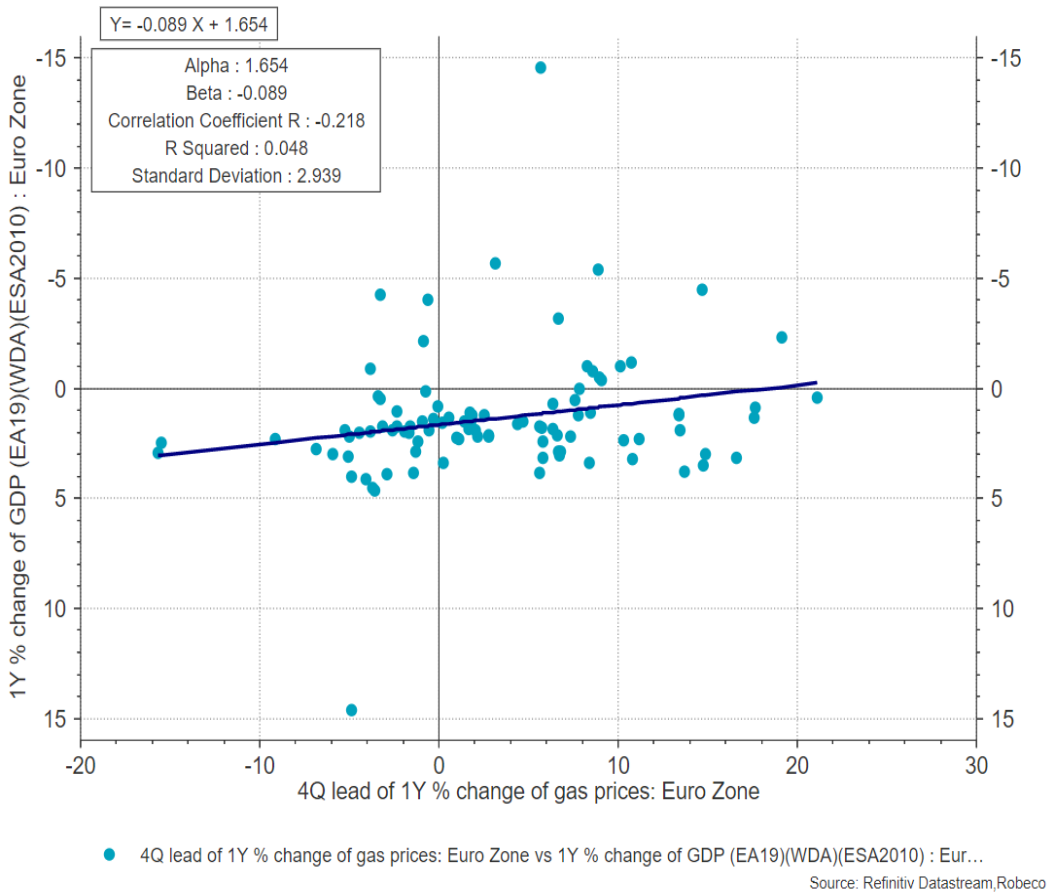
Economy (I)

The global economy expanded in March, though at a decelerating pace. The global PMI reading declined from 53.7 in February to 53.0 in March. Russia's invasion of Ukraine delivered a new headwind on top of Covid worries in China. With recession indicators like the inversion of the US yield curve flashing amber, we have now likely moved from a mature mid-cycle expansion phase to a late cycle expansion. We are playing in extra time as the recession clock has started ticking.

The inversion of the 2Y-10Y segment of the US Treasury yield curve has a strong track record in predicting recessions, with only two false flags in recent decades. A recession typically follows after 16 months, though the length of these lags varies. The signal shows that the bond market does not believe in the Fed's ability to engineer a soft landing of the US economy.

There are several key channels through which the ongoing Russia-Ukraine conflict impacts the global economy. Rising commodity prices, worsening financial conditions and elevated policy uncertainty negatively impact inflation, consumer confidence and real activity. Stagflation has been the buzzword throughout Q1, and though it is a bit of a misnomer (most developed economies are still growing above trend), the growth/inflation mix has clearly been worsening. In Europe, the Ifo leading producer confidence indicator plunged, along with consumer confidence metrics across the Eurozone. The threat of a partial boycott of Russian gas looms large (Lithuania has already has done so) ,though this would be very costly for the region. Every 10% increase in natural gas prices shaves 90 bps from real activity growth in the Eurozone. (see chart).

The challenge to substitute Russian gas: every 10% increase in gas prices slows Eurozone real GDP growth by 0.9%.



Source: Refinitiv Datastream & Robeco

 All market data to 31 March unless mentioned otherwise

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Economy (II)

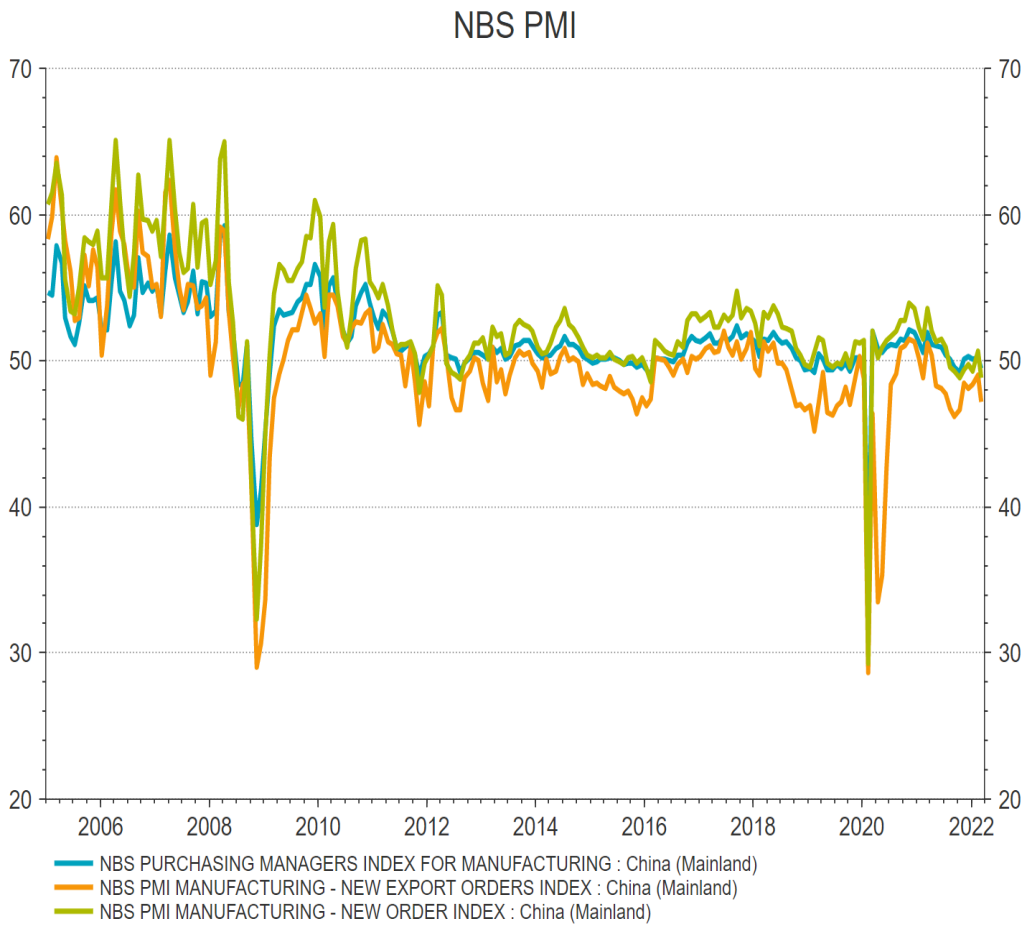
Inflation has remained top of mind as commodity prices surged 36% in the first quarter, delaying the expected peak in headline inflation due to base effects.

While global inflation pressures stemming from shipping and logistics have begun to ease in the first quarter, another inflationary impulse seems to be underway from China.

In China, leading indicators in both the services as well as manufacturing sectors slipped back into contraction for the first time since early 2020 at the end of the quarter, as the country confronts the latest Omicron wave. However, local price sub-indices increased further as lockdown restrictions hurt China's supply capacity and push input costs higher.

In the US, the closely watched core PCE inflation increased further to 5.4% in March. Headline CPI jumped another 40 bps to 7.9%. In the Eurozone, a net energy importer, HICP inflation increased to 7.5% in March, the highest on record.

China's real activity stumbles into contractionary territory for the first time since Jan 2020



Source: Refinitiv Datastream, Robeco

Source: Refinitiv Datastream & Robeco

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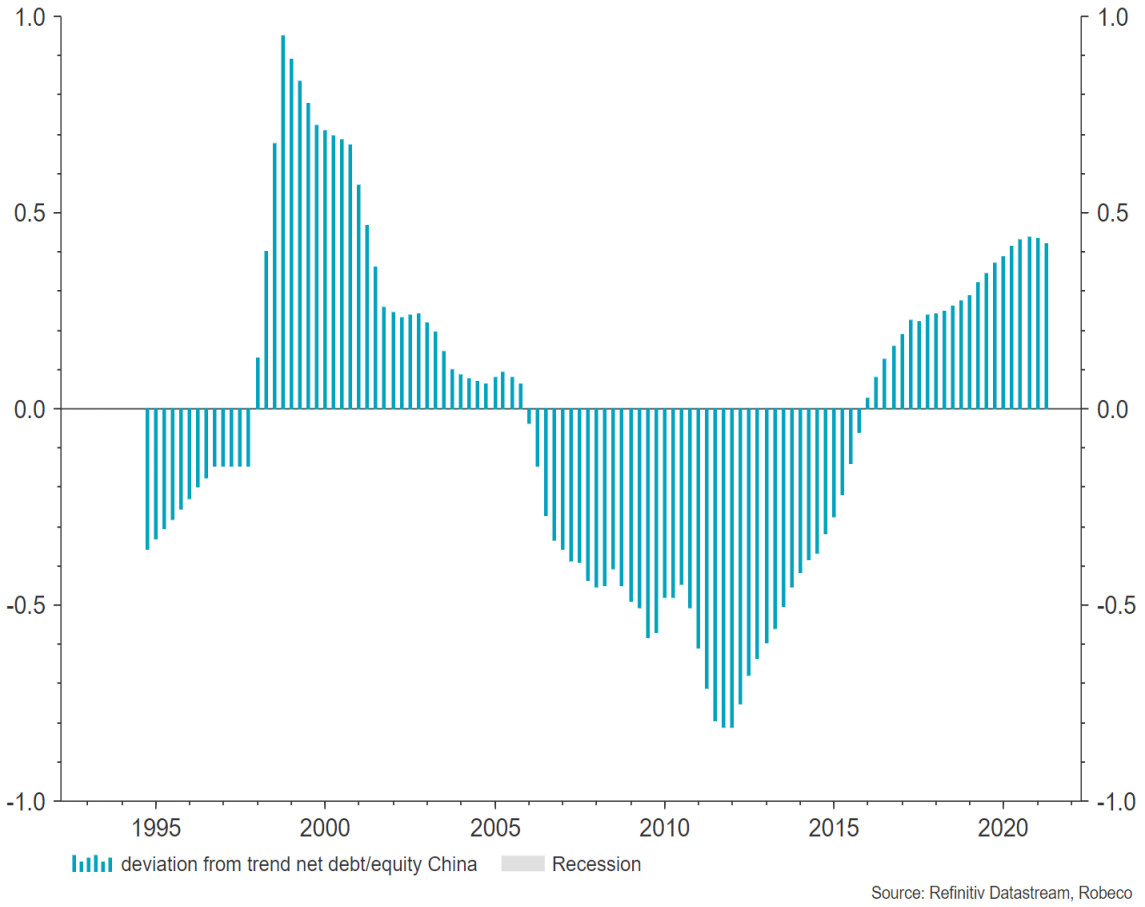
Economy (III)

China's excess leverage may have peaked, levels are still problematic



Source: Refinitiv, Robeco

Non-farm payrolls in the US came in strong at 431,000, with unemployment declining to 3.6%. The largest increases in jobs numbers were in hospitality and professional services. The participation rate increased to 62.4% but 1.6 million workers are still missing from the labor force compared to the pre-Covid situation. These numbers indicate that the labor market is still very strong and will likely encourage the Fed to frontload rate hikes. Yet, the wage growth momentum has seemed to stabilize in recent months, running at a 0.4% (m-o-m) pace in March. The April hourly earnings figure will be an important indicator as to whether this is a genuine slowdown in momentum.

Despite the recent inversion of the US yield curve, we remain constructive on the growth outlook for developed economies in the next 12 months. Two conditions for immediate recession risk are not in place; excess Fed tightening and corporates and household running out of cash to spend. In China, the situation looks to be more dire, as it has to cope with a new bout of Covid, the fall-out from excess leverage in the corporate (real estate) sector and the subsequent malaise in domestic consumption. In response, more stimulus from Chinese policymakers is to be expected, though the official 5.5% GDP growth target for 2022 does not look feasible. Although our base case is that the stagflationary scare will blow over, we judge that risks to our base case are clearly tilted to the downside.

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Important Information

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