ROBECO
The Investment Engineers

Multi-asset market outlook

US consumer carries the world on its shoulders

May 2024

For professional investors

Sustainable Investing Expertise by ROBECOSAM

General overview

Tug o' War between earnings and rates

MULTI ASSET	1mo	3mo	YTD	1YR	3YR	5YR
Gold (USD)	3.4%	11.8%	11.0%	14.7%	8.6%	11.1%
GSCI Commodities (USD)	2.2%	8.6%	15.3%	17.0%	20.1%	8.5%
Emerging Markets (UH, EUR)	1.5%	9.5%	6.2%	13.5%	-1.9%	2.8%
Emerging Markets (LC)	1.4%	9.8%	6.0%	12.9%	-2.4%	4.1%
Cash (EUR)	0.4%	1.0%	1.4%	3.9%	1.5%	0.7%
Oil Index (USD)	-0.1%	11.2%	18.1%	17.8%	21.5%	-2.1%
EMD hard currency (UH, EUR)	-0.6%	1.9%	3.0%	9.7%	0.7%	1.2%
Global high yield (H, EUR)	-0.8%	1.4%	1.5%	10.0%	-0.6%	1.2%
EMD local currency (UH, EUR)	-1.7%	-1.4%	-1.5%	4.2%	1.1%	1.1%
Global Gov Bonds (H, EUR)	-2.0%	-2.2%	-2.7%	-1.8%	-4.5%	-1.9%
Global investment grade bonds (H, EUR)	-2.0%	-2.1%	-2.3%	1.0%	-4.1%	-0.9%
Global inflation-linked bonds (H, EUR)	-2.1%	-1.5%	-3.0%	-2.7%	-5.1%	-1.6%
MSCI World (UH, EUR)	-2.7%	5.2%	8.3%	22.2%	9.9%	11.5%
MSCI World local currency	-3.2%	4.7%	6.5%	20.2%	7.4%	11.1%
MSCI World (H, EUR)	-3.3%	4.4%	6.2%	18.4%	5.7%	9.3%
Global real estate (UH, EUR)	-5.7%	0.2%	-1.6%	6.1%	1.4%	1.2%

Source: Robeco, Bloomberg

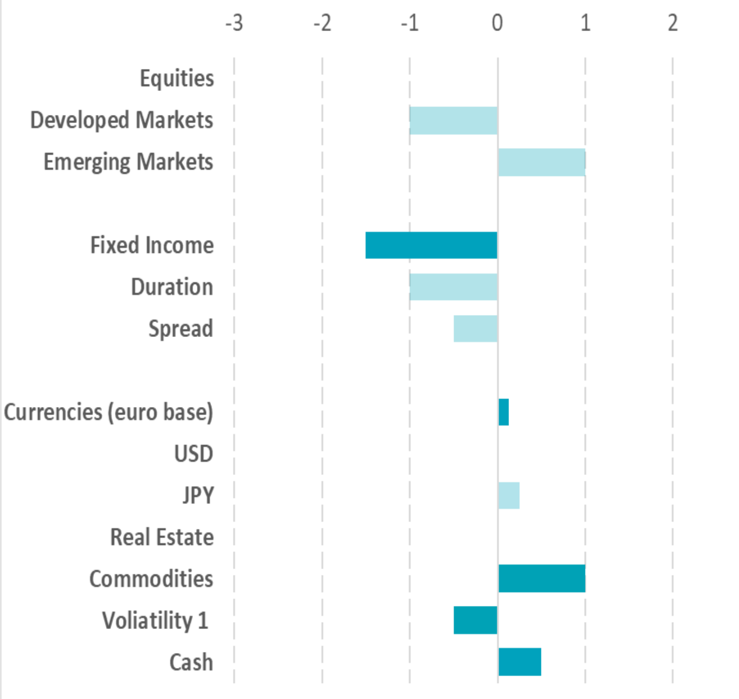
At the end of Q124, expectations for the US outlook solidified around 'no landing' with room for interest rate cuts. As we went through April this narrative has been tested by inflation worries re-emerging, sending equity and bond markets into whipsaw mode. US interest rate expectations continue to price out US rate cuts for 2024 (currently only 1.5 rate cuts priced in) weighing on equity and bond prices, then big tech reported Q1 results. The market initially took this positively with the cloud and AI narrative carrying the day, however the current earnings delivery disappointed. The equity market rallied and bond yields retreated from recent highs. China was the standout equity market, with positive absolute returns, Shanghai index up over 2% and Hang Seng delivering close to 8% return during April, supporting the overall Emerging Equity indices.

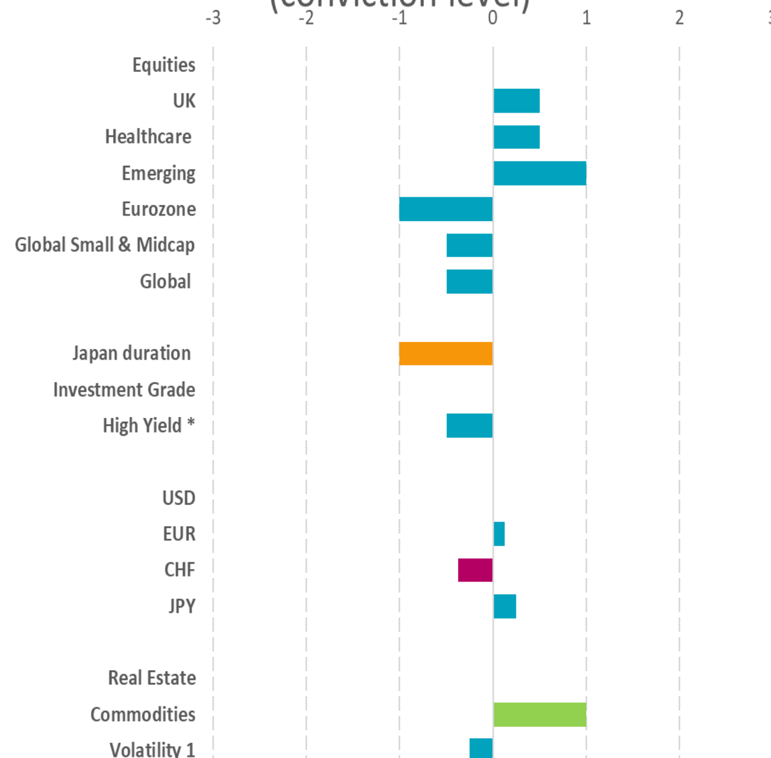
Gold continued its march higher, as central banks stock-piled the lustrous metal to diversify US dollar holdings after the US froze Russia's foreign exchange reserves in reaction to invasion of Ukraine. According to The Economist, China has raised gold holdings from 3.3% to 4.3% of reserves since end of 2021. Investors have been confounded as gold hasn't worked as an inflation hedge and then has risen when real interest rates rose (usually the reverse is true). Another source of demand is consumers. China and India are well known hoarders of the metal, but an additional source has been the US. A very large discount retailer (CostCo) began to sell bite sized chunks of gold, selling out almost immediately.

Interest rate sensitive sectors struggled in April, with small caps and REITs underperforming the broader equity markets.

Robeco Multi Asset views

Sustainable Multi Asset Solutions positions





Source: Robeco

In portfolios, we reduced risk through the month, taking our overall equity exposure to neutral, using market risk rather than exposure to calibrate the new weights. In addition, we continued to switch to more defensive equities.

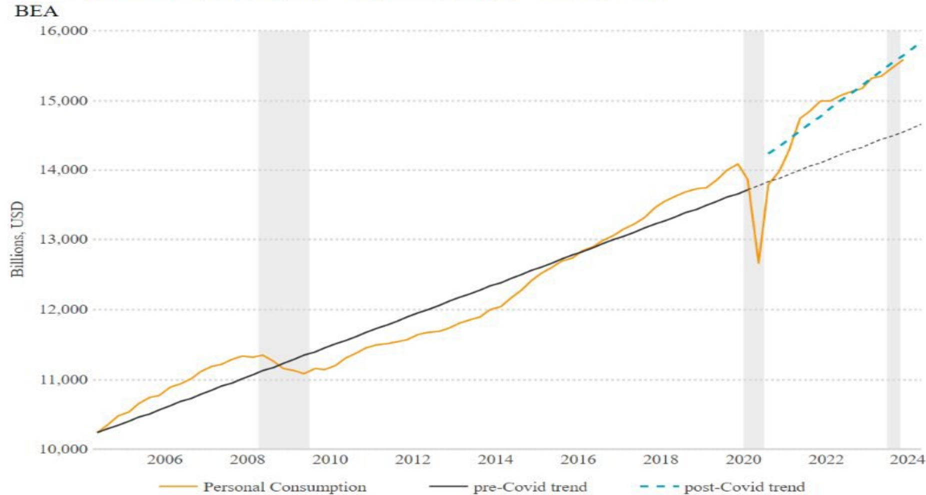
We reduced Japan equities to neutral as this was a consensus long in the market, yen volatility and the technicals have deteriorated. Within equities, we rotated into the UK to increase our defensive allocation, along with healthcare, using US SMID and global equities as funding legs. We also cut our positive conviction level in the Emerging Market equities against Europe, given an improved outlook for Europe.

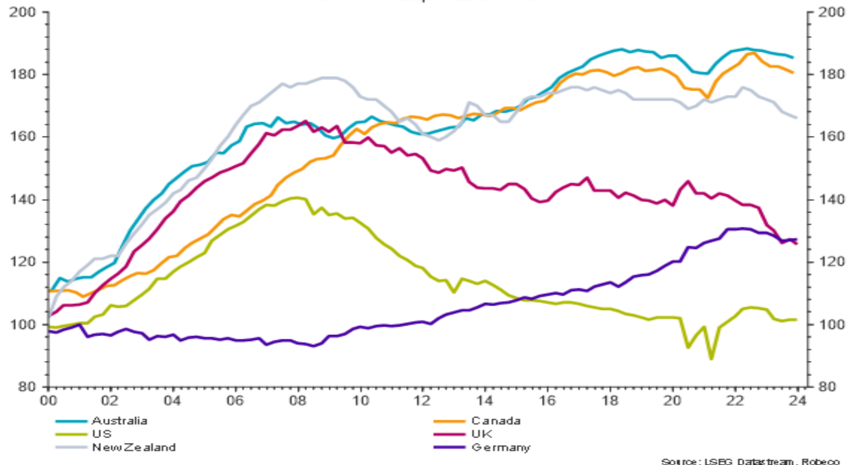
We maintained the credit and Japan duration underweights. The Swiss Franc benefited at times from safe-haven flows during the month. Macro momentum in Switzerland remains weak and with the interest rate path remaining unchanged, and this remains our favored funding currency. Speculators have pushed the yen lower against US dollar, with yen moves driven more by the FED than the BoJ or MoF.

The escalation in the Gaza conflict gave a boost to oil and other commodities, although we have seen a retracement as immediate escalation risk diminished. The global manufacturing upswing is starting to materialize adding support to our position.

Theme of the month

The US consumer carries the world on its shoulders





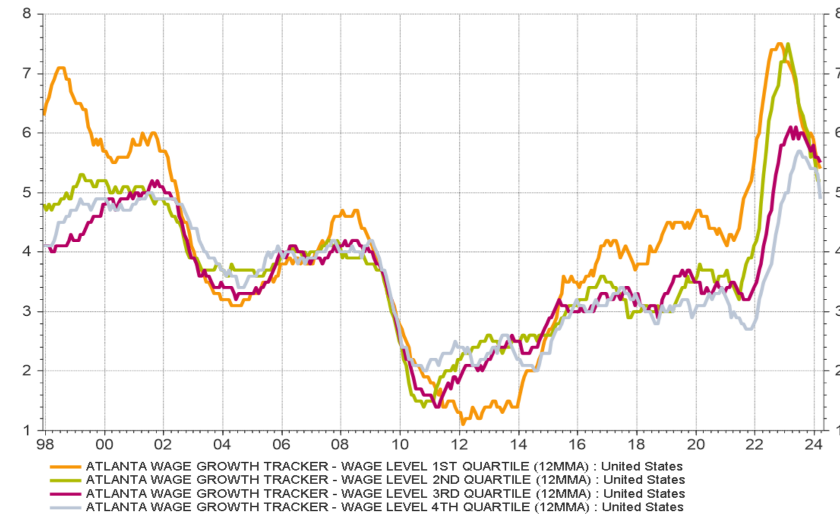
The US economy has been the most important source of growth in the global economy post-Covid. The rest of the world has fared badly, with Europe narrowly escaping recession and China battling a property bubble bust, while the US has grown above trend GDP over the equivalent period. The mainstay of this growth has been the resilient US consumer supported by profligate government spending and a lack of sensitivity to rising interest rates, supporting spending above the pre-COVID trend. At first glance, part of the explanation lies in lockdown policies, where the US put money in the consumers' pockets while other governments gave to companies, or not at all. Second, the US is predominantly a fixed mortgage rate market for households, so ultra-low rates allowed consumers to 'term out' their debt, locking in 3% rates for 30 years as recently as 3 years ago, so the 7.55% 30-year mortgage rate (source: bankrate.com) is irrelevant unless you are a first-time buyer or need to relocate. As a result, US consumers are harvesting the post-GFC deleveraging (lower chart) whilst easily servicing debt costs.

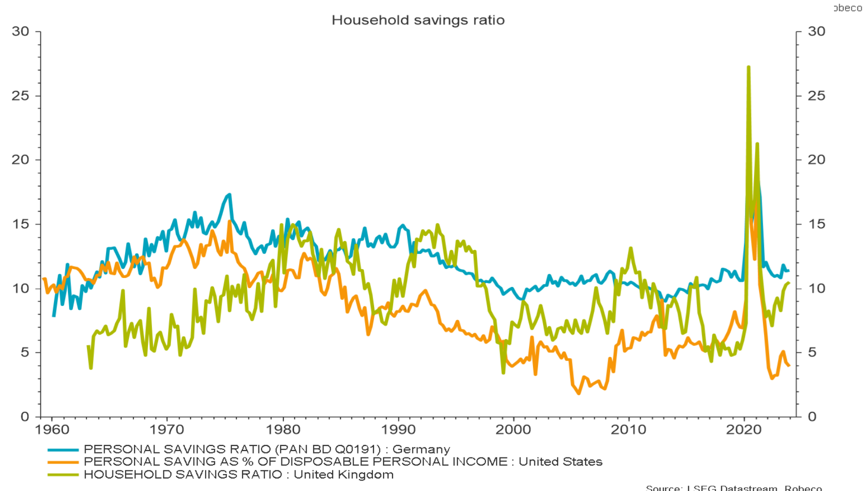
Digging below the surface does not highlight many cracks. First, because of strong disposable income growth that exceeds inflation, the median US consumer is still experiencing real wage growth. This means that their purchasing power is increasing, allowing them to sustain consumption levels even in the face of rising prices. Second, consumer confidence in the US remains relatively high and broad based, which encourages spending. In an inflationary environment it pays to spend today because tomorrow the goods & services will be more expensive. Third, during the Covid-19 pandemic consumption shifted towards goods rather than services due to lockdowns and restrictions. This forced consumers on-line to purchase goods to improve 'home life', and this trend has not reversed because online penetration remains about 30% higher than pre-COVID levels, although some sports equipment manufacturers may disagree.

All market data to 30 April 2023 unless mentioned otherwise

Theme of the month

US wage growth remains high across all cohorts and consumers are willing to spend





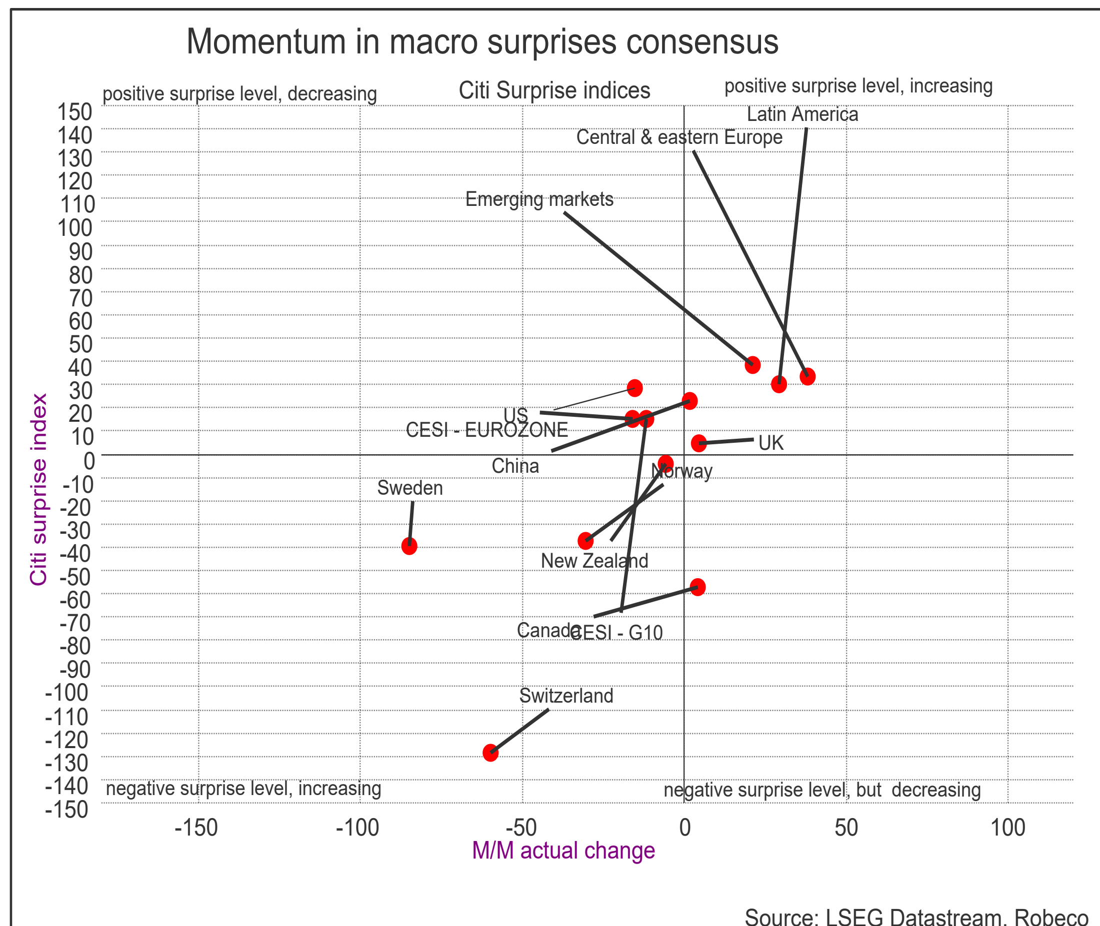
The lasting effect has been that consumers have increased loyalty to ultra-lux brands, reduced brand loyalty more broadly, and are more likely to surf across a wider range of retail stores, price and quality points. Post lockdown, the US experienced an explosion of revenge spending on travel and services, which has continued due to higher wages and US consumers' lower propensity to save handout and wages than in Europe or China. Services is the biggest constituent of US GDP, hence its importance to overall economy, and its contribution to US economic exceptionalism. Lastly, various government support measures, such as stimulus checks and unemployment benefits, have provided a buffer for US consumers, allowing them to maintain spending levels even during periods of economic uncertainty. As mentioned above this was absent elsewhere in the world.

It would be remiss not to mention where the US consumer could be derailed. First, government spending could fall, although that is unlikely as Biden tries to sweeten the voters to back him in the November presidential election. Second, the long and variable lags of monetary policies start to bite and increase the debt servicing burden of more consumers, draining disposable income. Additionally the servicing of government debt by the US Treasury department constrains fiscal expansion (a mainstay of consumer spending support), hence why refinancing in a higher-for-longer Fed policy environment remains a concern for all. Lastly, there are weakening labor market indicators. The recent fall in quit rates suggests that the wage premium for switching to an alternative employer has declined or been eliminated, implying current job security is of increasing importance to US households. We also see potential 'destocking' of labor from the post-Covid hoarding as small and mid-size companies reassess costs and let workers go. This would drag on US consumption as wage growth would cool more rapidly on the back of an increase in US unemployment above 5%.

In conclusion, the US consumer looks well supported during 2024 and ahead of the presidential election, explaining the Fed's reticence to relax monetary policy.

Economy

Real surprise: Latest macro releases, controlled for inflation, have been better than expected



Source: Refinitiv Datastream, Robeco

April data reveals a shift in macro momentum away from developed economies in favor of emerging markets, led by strong (manufacturing) data from Brazil, India and Greece. While macroeconomic data in Europe, the US and Japan kept surprising to the upside, the magnitude of those surprises clearly declined compared to March. Yet, most incoming macro data point to continuing recovery (Eurozone) or persistent resilience (US). While the global manufacturing PMI at 50.3 showed the fourth consecutive month of expansion, the pace of expansion declined somewhat. Yet, some leading indicators of the developed markets manufacturing cycle, like South Korean semi-conductor exports, showed reacceleration. The Chinese manufacturing data is starting to look more promising with the Caixin PMI signaling expansion for the smaller and medium sized companies since November 2023 and accelerating in April to 51.4. From the US labor market there are also signs of a firming manufacturing cycle and restocking. For instance, the transportation and warehouse sector in the US added 22K jobs in April. Retail sales in the US came in above consensus at 0.7% m-o-m.

However, services activity in the US seems to be cooling with the ISM non-manufacturing declining below 50 for the first time since 2022. The employment subcomponent of this index also showed a further weakening in hiring intentions. The April non-farm payroll data showed monthly net job losses were concentrated in credit intermediation and temporary help services, potentially signaling weakening consumer demand for services. The overall increase in new jobs created disappointed at 175K versus a 243K consensus expectation.

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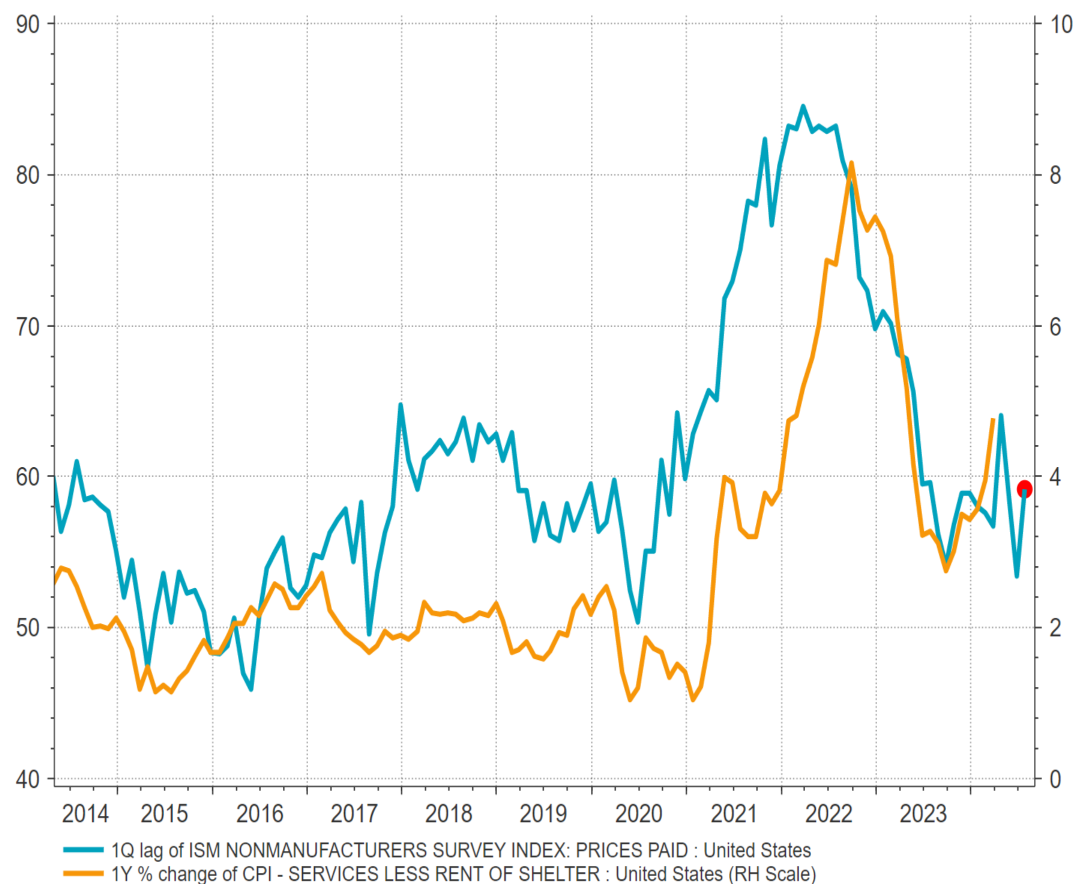
Economy

Compared to the start of the year, a shallower cutting cycle is priced in



Source: Refinitiv Datastream, Robeco

The labor market churn in the US is also declining, evidenced by a low quit rates as well as hiring rates.

In contrast, Eurozone data showed improving services activity with the HCOB services PMI increasing to 52.9 from 51.5 in March, with the composite index confirming the Eurozone has returned to growth in the last two months. Europe’s largest economy confirmed this picture with the IFO leading producer sentiment index showing companies were more satisfied by current business conditions and saw a brightening outlook, especially among service providers. Sentiment among German retail traders improved noticeably.

On the inflation front, the US has been confronted by a string of negative inflation surprises in the first quarter. The closely watched core PCE figure came in at 2.8% over April, 0,1% above consensus. Rents inflation is coming down more slowly than expected but also services less rent of shelter has surprised to the upside. Whereas March ‘prices paid’ data from the ISM non-manufacturing index suggested some relief for the Fed might be forthcoming on the latter, the latest April number saw another notable uptick to 59.8, with Fed officials noting a lack of further progress on inflation. With the process of disinflation stalling in the past few months, the Fed now needs a longer string of data confirming it is on track to 2% before embarking on a cutting cycle.

While a ‘no landing’ has clearly been the largest upside risk for our base case of a softish landing recently, the latest data show a stagflationary twist for the US; Q1 GDP and leading services indicators show lower growth (albeit mainly for a good reason (inventory drawdowns), while inflation surprised to the upside.

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