ROBECO
The Investment Engineers

Multi-asset market outlook

The profits party peaks, but the aftermath looks benign

September 2021

For professional investors

Sustainable Investing Expertise by ROBECOSAM

General overview

Positions: low on risk but remain underweight duration

	Portfolio	Benchmark	Active
Equities Developed Markets	25.00%	25.00%	0.0%
Equities Emerging Markets	5.00%	5.00%	0.0%
Real Estate Equities	5.00%	5.00%	0.0%
SPX (US Equities)	-2.00%	0.00%	-2.0%
STXE 600 (EUR) Pr (Europese aa	2.00%	0.00%	2.0%
Nikkei 225 (Japanese equity)	0.00%	0.00%	0.0%
Commodities	5.00%	5.00%	0.0%
Global treasuries	27.50%	27.50%	0.0%
US Treasuries	-3.50%	0.00%	-3.5%
Investment Grade Corp Bonds	18.00%	20.00%	-2.0%
High Yield Corp Bonds	5.00%	5.00%	0.0%
Emerging Market Bonds LC	5.00%	5.00%	0.0%
Cash	8.00%	2.50%	5.5%
Portfolio Risk	5.82%	5.9%	

- Equity markets continued their march higher this month. Neither slowing macro momentum nor increasing infections have hindered this rise and the 'buy the dip' strategy continues to be a winner. After a brief dip mid-month, equities quickly regained upward momentum, pushing several major indices toward new highs.
- Owning equities was the sweet spot this month. But owning almost any risky assets would have paid off nicely, as practically all risk asset delivered positive returns. Commodities were the one exception: the asset class was dragged down by the energy sector, which performed extremely poorly.
- While US yields ended the month only marginally higher, the path for yields was choppy over the month. US 10-year yields moved in a range of 18 basis points in August.
- Just like last month, we made only marginal changes to the portfolio. We adjusted the composition of our regional trade in equities. We closed out our overweight in Japan and partially closed our underweight in US equities. We currently hold an overweight in European equities against an underweight in US equities. We continue to hold an underweight in US Treasuries and investment grade corporate bonds.

Source: Robeco

All market data to 31 Augustus unless mentioned otherwise

Asset returns heat map (in euro)

MULTI ASSET	1mo	3mo	YTD	1YR	3YR	5YR
Emerging Markets (UH, EUR)	3.1%	-0.7%	6.6%	22.7%	9.3%	9.1%
MSCI World (UH, EUR)	3.0%	9.7%	22.2%	31.5%	14.4%	13.5%
MSCI World local currency	2.7%	6.9%	19.2%	30.1%	14.7%	14.7%
MSCI World (H, EUR)	2.6%	6.8%	18.8%	29.0%	12.8%	12.9%
Global real estate (UH, EUR)	2.6%	11.7%	26.9%	28.5%	7.5%	4.4%
Emerging Markets (LC)	2.3%	-3.2%	3.6%	18.3%	10.1%	11.1%
EMD hard currency (UH, EUR)	1.2%	2.7%	0.5%	5.5%	5.3%	2.0%
EMD local currency (UH, EUR)	0.9%	2.1%	0.1%	3.5%	4.7%	2.2%
Global high yield (H, EUR)	0.7%	1.5%	3.0%	7.9%	4.6%	3.6%
Gold (USD)	0.1%	-4.4%	-4.7%	-9.0%	13.1%	5.5%
Global inflation-linked bonds (H, EUR)	0.0%	4.0%	3.4%	5.3%	5.1%	2.5%
Cash (EUR)	0.0%	-0.1%	-0.3%	-0.5%	-0.4%	-0.4%
Global Gov Bonds (H, EUR)	-0.3%	1.6%	-1.8%	-1.4%	2.8%	0.8%
Global investment grade bonds (H, EUR)	-0.3%	2.0%	-0.5%	1.9%	4.6%	2.4%
GSCI Commodities (USD)	-1.9%	6.6%	35.2%	45.7%	-2.6%	2.1%
Oil Index (USD)	-7.1%	4.0%	43.5%	58.9%	-20.7%	-6.4%

Fixed Income	1mo	3mo	YTD	1YR	3YR	5YR
EMD hard currency (UH, EUR)	1.3%	5.0%	3.7%	5.0%	6.1%	3.2%
EMD local currency (UH, EUR)	1.1%	3.1%	0.5%	5.3%	5.4%	2.2%
High Yield US (UH, USD)	0.5%	2.2%	4.5%	10.1%	7.1%	6.7%
High Yield Europe (EUR)	0.3%	1.3%	3.8%	8.6%	4.6%	4.3%
Japan Gov Bonds (H, JPY)	-0.1%	0.4%	0.0%	0.2%	0.8%	0.1%
Euro Covered Bonds (EUR)	-0.1%	0.6%	-0.7%	0.0%	1.3%	0.7%
Inflation-linked US (UH, USD)	-0.2%	3.1%	4.3%	5.6%	7.3%	4.6%
US Gov Bonds (H, EUR)	-0.2%	1.8%	-2.3%	-3.3%	3.1%	0.5%
Inflation-linked Europe (EUR)	-0.3%	2.8%	4.2%	7.6%	4.4%	2.7%
Europe Senior Financials (EUR)	-0.3%	1.0%	0.6%	2.7%	2.7%	2.0%
Investment Grade US (UH, USD)	-0.3%	2.7%	-0.2%	2.5%	7.7%	4.8%
Global Gov Bonds (H, EUR)	-0.3%	1.6%	-1.8%	-1.4%	2.8%	0.8%
Investment Grade Europe (EUR)	-0.4%	1.1%	0.3%	2.6%	2.8%	1.8%
Europe Non-financials IG (EUR)	-0.5%	1.2%	0.2%	2.6%	2.8%	1.7%
Spain Gov Bonds (EUR)	-0.5%	1.7%	-1.7%	1.1%	3.9%	2.5%
Italy Gov Bonds (EUR)	-0.5%	1.5%	-0.7%	4.0%	7.6%	2.6%
German Gov Bonds (EUR)	-0.6%	1.9%	-1.5%	-0.1%	1.7%	0.6%
France Gov Bonds (EUR)	-0.7%	1.7%	-2.6%	-0.6%	2.3%	1.1%

Equities: Country Indices	1mo	3r			3YR	5YR
India (INR)	9.5%			[illegible].6%	15.5%	16.5%
Netherlands (EUR)	4.4%	11.0%	26.1%	43.4%	12.1%	11.6%
Russia (RUB)	3.9%	5.3%	19.2%	32.1%	18.7%	14.7%
Emerging Markets (EUR)	3.1%	-0.7%	6.6%	22.7%	9.3%	9.1%
USA (USD)	3.0%	8.0%	21.6%	31.2%	18.1%	18.0%
Japan (JPY)	3.0%	-2.5%	3.2%	23.4%	9.2%	12.9%
Global equities (EUR)	3.0%	9.7%	22.2%	31.5%	14.4%	13.5%
Global equities (LC)	2.7%	6.9%	19.2%	30.1%	14.7%	14.7%
Eurozone (EUR)	2.6%	4.1%	20.0%	30.5%	9.7%	9.3%
Italy (EUR)	2.5%	4.0%	19.4%	35.5%	12.0%	12.4%
Australia (AUD)	2.5%	5.9%	16.8%	27.9%	9.6%	10.6%
Switzerland (CHF)	2.4%	9.2%	19.2%	26.1%	15.0%	12.2%
Emerging Markets (LC)	2.3%	-3.2%	3.6%	18.3%	10.1%	11.1%
UK (GBP)	2.1%	2.6%	13.3%	23.6%	2.4%	5.0%
Spain (EUR)	2.0%	-2.4%	11.3%	29.9%	0.8%	3.3%
Asia ex Japan (LC)	1.9%	-4.6%	1.7%	15.9%	9.6%	11.3%
Germany (EUR)	1.9%	2.7%	15.4%	22.3%	8.6%	8.4%
France (EUR)	1.0%	3.9%	22.7%	38.2%	10.2%	11.7%
China (HKD)	0.0%	-13.8%	-12.3%	-5.1%	7.3%	10.8%
Hong Kong (HKD)	-0.1%	-10.2%	-2.9%	5.6%	0.7%	5.9%
Korea (KRW)	-1.0%	[illegible]			11.8%	10.3%
Brazil (BRL)	-2.5%	[illegible]	[illegible]	19.5%	15.7%	15.5%

FX versus the EUR	current level	1M	3M	YTD	12M	1m	3m	1yr	1yr
EURO/INDIAN RUPEE	86.33	2.5%	2.5%	3.8%	1.4%	88.54	88.50	87.51	87.51
EURO/INDONESIAN RUPIAH	16864.06	2.0%	3.2%	2.4%	2.8%	17216.68	17422.32	17340.94	17340.94
EURO/NORWEGIAN KRONE	10.27	1.8%	-0.9%	2.0%	1.3%	10.46	10.18	10.41	10.41
EURO/BRAZIL REAL	6.08	1.7%	4.7%	4.1%	7.3%	6.18	6.38	6.56	6.56
EURO/SINGAPORE DOLLAR	1.59	1.2%	1.7%	1.6%	2.2%	1.61	1.62	1.62	1.62
EURO/US DOLLAR	1.18	0.5%	3.4%	3.3%	1.1%	1.19	1.22	1.19	1.19
EURO/CHINA RENMINBI	7.63	0.5%	2.1%	4.7%	6.8%	7.66	7.79	8.18	8.18
EURO/HONG KONG DOLLAR	9.18	0.4%	3.2%	3.0%	0.7%	9.23	9.49	9.25	9.25
EURO/JAPANESE YEN	129.92	0.2%	3.0%	-3.0%	-2.8%	130.23	133.97	126.41	126.41
EURO/SWEDISH KRONA	10.18	0.1%	-0.4%	-1.3%	1.3%	10.20	10.15	10.32	10.32
EURO/RUSSIAN RUBLE	86.72	0.1%	3.4%	4.3%	1.8%	86.82	89.75	88.34	88.34
EURO/AUSTRALIAN DOLLAR	1.61	0.1%	-2.1%	-1.7%	0.3%	1.62	1.58	1.62	1.62
EURO/SOUTH KOREAN WON	1371.66	-0.4%	-1.1%	-2.9%	2.7%	1365.69	1356.11	1410.31	1410.31
EURO/SWISS FRANC	1.08	-0.6%	1.7%	0.0%	-0.2%	1.07	1.10	1.08	1.08
EURO/BRITISH POUND	0.86	-0.6%	0.2%	3.9%	3.8%	0.85	0.86	0.89	0.89
EURO/CANADIAN DOLLAR	1.49	-0.6%	-1.0%	4.2%	4.3%	1.48	1.48	1.56	1.56

Source: Bloomberg

All market data to 31 Augustus unless mentioned otherwise

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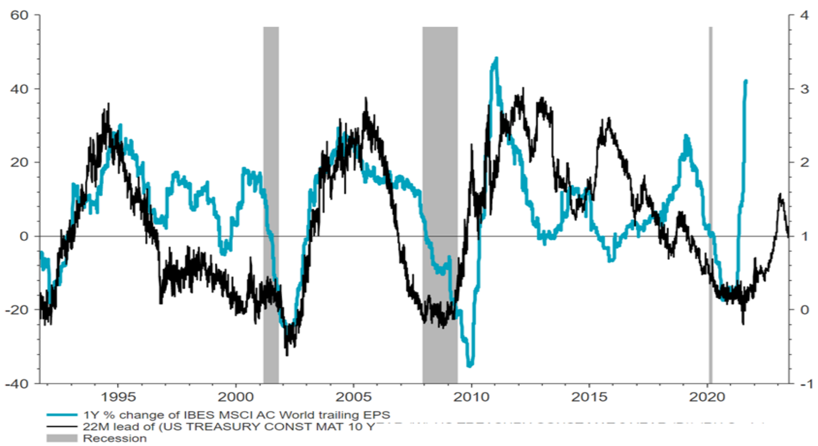
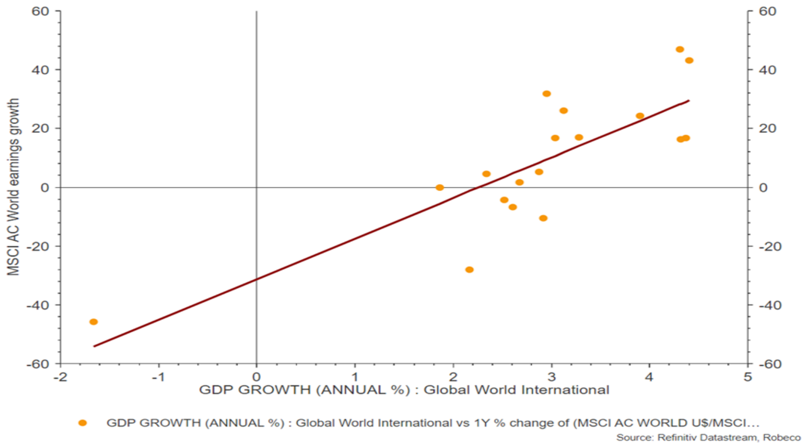
Theme of the month

Earnings: the yield curve leads earnings



Source: Refinitiv Datastream, Robeco

Earnings: Global earnings vs GDP growth



Source: Refinitiv Datastream, Robeco

The profits party peaks, but the aftermath looks benign (I)

> The Q2 earnings season likely marked the peak of the massive earnings rebound observed since the start of 2021. In the US, 88% of companies in the S&P 500 managed to beat prior earnings expectations. Year-on-year earnings growth for the S&P 500 showed a record-high 97% in the second quarter, according to Refinitiv Datastream data.

> With the slowdown in macroeconomic momentum on the back of rising Covid-19 cases (denting consumer confidence lately), the effect of supply-related production curbs in some sectors as well as rising input costs make it likely that earnings growth will decelerate in the third quarter.

> An early cyclical peak in global earnings growth is also suggested by the shape of the yield curve. The spread between the 10-year and 2-year US Treasury yield typically leads the earnings cycle. The recent flattening of the yield curve and declining term premium suggest the tailwinds for earnings growth will weaken in the medium term, with the early-cycle peak in EPS growth already behind us.

> However, it is unlikely that this weakening from historically high levels in the coming quarters will culminate in a stalling of global corporate earnings growth on a 6-12-month horizon. First, supply-related curbs to production will ease as labor supply increases, with furloughs and stimulus checks now being phased out in many countries. This is lowering pressures on labor and recruiting costs, as people start to look for jobs again. In addition, the costs of some inputs in the commodity space (lumber, copper) have already dropped significantly from their peaks in the first half of 2021, benefitting the housing sector.

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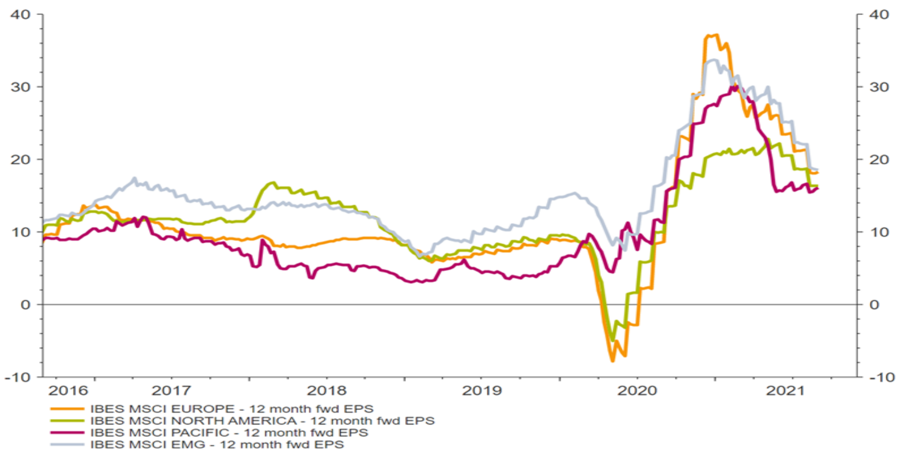
Theme of the month

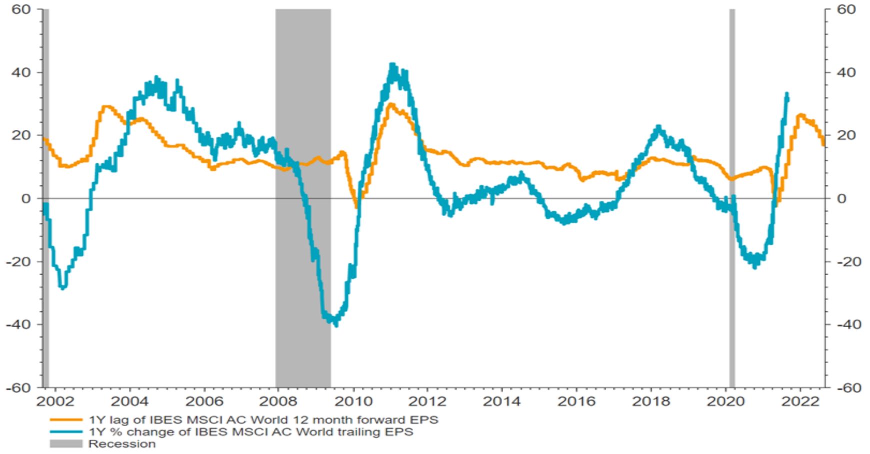
The profits party peaks, but the aftermath looks benign (II)

Forward EPS: peaking but not dropping



Source: Refinitiv Datastream, Robeco

Earnings: behaving as expected



Source: Refinitiv Datastream, Robeco

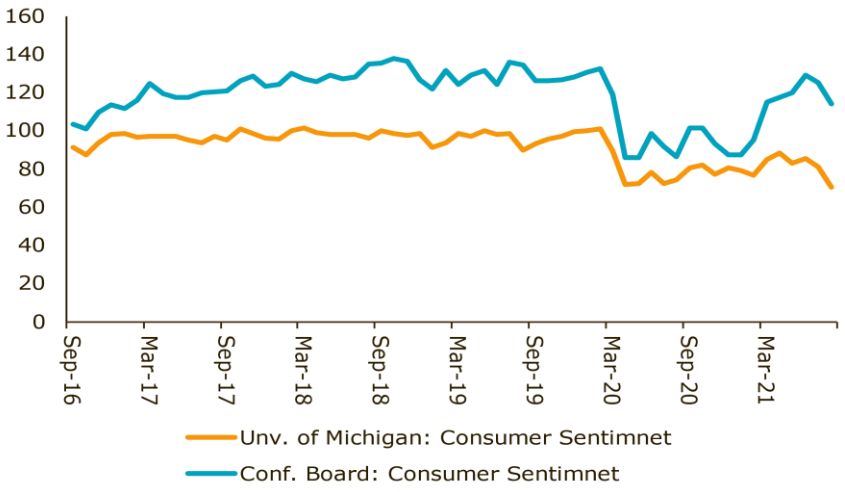
> Second, the recent decline in consumer confidence which could impact top-line growth in Q3 will likely prove to be temporary. This is based on our view that the delta variant of Covid-19 could prove to be manageable this winter, and that lockdown intensity will be lowered again in early 2022. Given still-elevated household savings ratios as well as healthy affordability ratios (the interest burden versus net income), and the absence of a household deleveraging cycle (unlike the GFC aftermath), the spending power of consumers will prove resilient.

> Third, the massive fiscal thrust we have observed in major developed economies over the past year will still have positive lagged effects on economic activity. In Europe, the first tranche of the EU Recovery Fund released last month will also stimulate regional economic growth in the medium term. In short, from a macro point of view, it is likely that above-trend GDP growth in the next 12 months will persist in developed economies, leaving earnings growth well into the double digits.

> The IMF expects 4.9% global GDP growth for 2022, which would be consistent with decelerating EPS growth compared to 2021. But it would still leave us at the upper range of the distribution from a historical perspective, with EPS growth in the 20-30% bracket. This view is corroborated by our bottom-up analysis, as corporate analysts are expecting 12-month forward EPS growth in various regions to be close to but below 20% at this point in time. So, the profit party is peaking, but the aftermath looks benign.

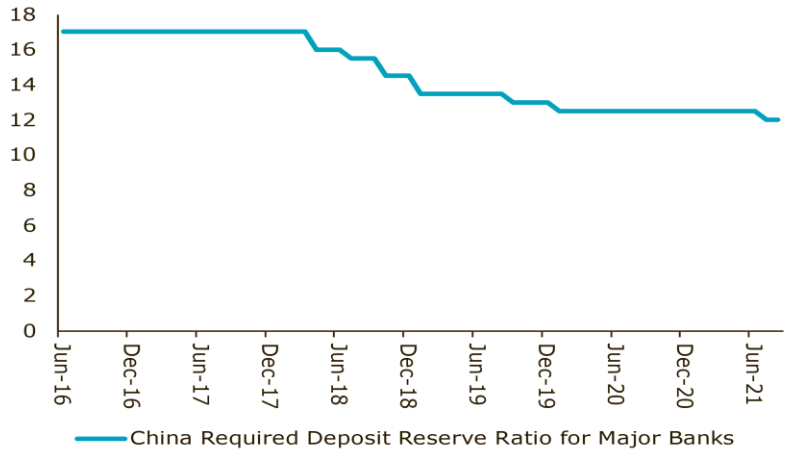
Economy (I)

US: delta variant is impacting consumer sentiment



Source: Bloomberg, Robeco

China: starting to react to economic weakness



Source: Bloomberg, Robeco

> The global recovery remains on track, although activity in the services and manufacturing sectors is cooling from very elevated levels. Many countries are still struggling with the delta variant, leading to renewed lockdowns in countries like New Zealand and Australia. Vaccination rates are high in most other developed economies. Although more breakthrough infections of the vaccinated are reported, the link between cases and hospitalization has clearly weakened. For instance, the number of hospitalizations are a quarter or less of previous Covid-19 waves in most European countries.

> Yet, the surge in the delta variant and the ending of stimulus payment checks has dented consumer confidence in the US, with the Conference Board consumer confidence index dropping from 125.1 in July to 113.8 in August – more than anticipated by the consensus. As several other macro data releases have disappointed recently, the Citi macroeconomic surprise indices for China, the Eurozone and the US have entered negative territory. Households are less exuberant than in the first half, adopting a wait-and-see mode as stimulus checks have expired in the US and some companies have cut back production and work time due to supply-chain constraints. Corporate input costs are still elevated due to high shipping costs (which have increased ten-fold over the past year) and chip shortages, with some companies having to wait twelve months to get the required semiconductor supply for their products.

> The slowing Chinese credit impulse earlier this year (which has a lagged effect on activity) and the Chinese regulatory crackdown contributed to slowing macroeconomic momentum in August.

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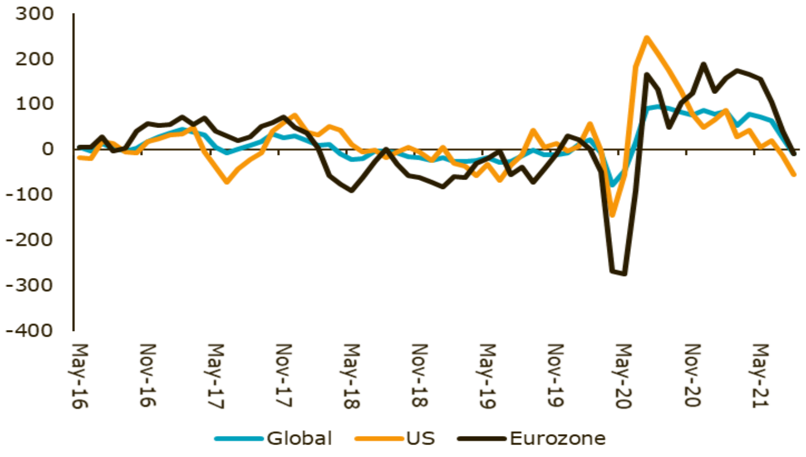
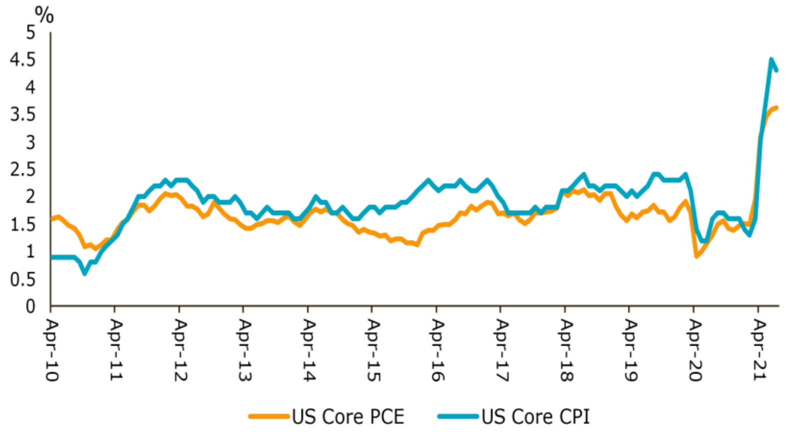
Economy (II)

Economy: decelerating economic surprises



Source: Bloomberg, Robeco

US: still unclear whether inflation is indeed transitory

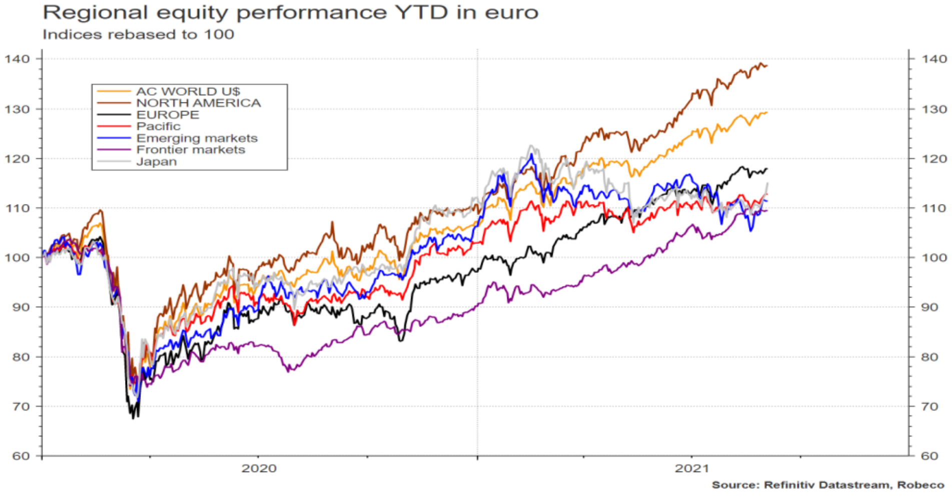


Source: Bloomberg, Robeco

- On 18 August, Chinese president Xi Jingping laid out a new plan for "common prosperity". This plan is Beijing's push to tame rising economic inequality, focus on the quality of economic growth rather than quantity, and improve economic imbalances like highly concentrated market power in several sectors like technology and education.
- The FOMC minutes showed that the willingness to announce a tapering of asset purchases this year is broadly shared among FOMC members. This makes it more likely that the actual tapering process could already start this calendar year. The market responded calmly to this message, as several FOMC members had in recent weeks already communicated their individual readiness to announce tapering this year. During the annual Jackson Hole meeting, Fed chair Powell emphasized that the criteria for the start of a policy rate hike are far more stringent compared to setting the tapering process in motion. There is still substantial progress to be made on the unemployment side in order to reach maximum employment.
- The so-called 'reflation theme' of above-trend economic growth and rising inflation still has legs, in our view, as we expect more persistence in the non-cyclical parts of the core CPI basket due to elevated input costs. Also, we expect to see a rising contribution from owner-equivalent rent in the US CPI numbers towards year end. The market has clearly grown more sanguine about the inflation risk recently, evidenced by lower market-implied inflation expectations. This is as the belief has grown that current inflation is transitory and only driven by a few items in the CPI basket. We tend to disagree with the market on this and expect investors to demand a higher inflation compensation.

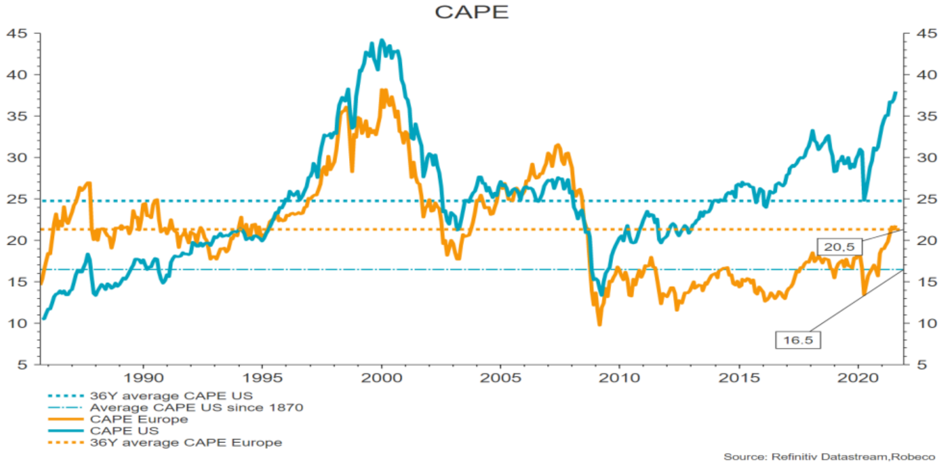
Equities (I)

Regional equity momentum: Japan starts catching up



Source: Refinitiv Datastream, Robeco

Valuation: US CAPE approaching dotcom bubble highs



Source: Refinitiv Datastream, Robeco

> In August, momentum turned positive again for equities after the weakness in the second half of July, with the MSCI World index returning 3.0% (in EUR). Several indices hit new highs, with the MSCI World unhedged up 22.2% (in EUR) for the year ending August. US equities (now 67% of the global index) have been the main force behind this, thanks to the Fed still buying USD 120 bn per month in assets, liquidity conditions remaining easy and a strong fiscal thrust – with a USD 1 trillion infrastructure package and a potential USD 3.5 trillion in the pipeline from Congress.

> Yet, despite the strong run, nervousness has increased, as reflected in the elevated SKEW index (now at 156), which signals investors do not trust this rally and are willing to pay up to insure against a severe sell-off. Investor angst is partly explainable by a mix of high stock valuations, a decelerating macro momentum (across the board, macro surprise indices are now in negative territory again), the China regulatory crackdown and fears around Fed tapering. This cautious undercurrent in today's equity markets is also reflected in the outperformance of the quality factor in the factor universe. Stocks with strong balance sheets and stable cashflows are favored in an environment where economic activity has started to underwhelm expectations against a backdrop of rising Covid cases. Also, the concern about valuation levels seems justified, judging by the absolute level of the Shiller CAPE, now at 38, a level only observed during the heydays of the dotcom bubble. However, valuation is never a good tactical indicator, especially in a historically low real-rates environment and with developed market central banks signaling that the bar for raising policy rates is very high.

> In addition, the tapering fears are probably overdone as the Fed has prepared the market well in advance for a taper. The latest guidance from Jackson Hole on the start of tapering barely caused a ripple in the bond market.

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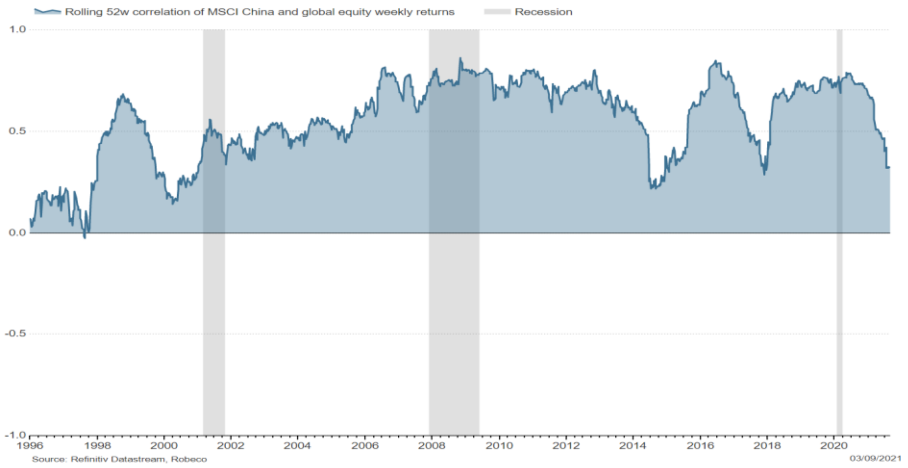
Equities (II)

Spillover risk from China's regulatory crackdown still absent



Source: Refinitiv Datastream, Robeco

Market technical US:Mind a SKEW at 156

SKEW >150	1M	3M	6M	12M
AVERAGE	1,4%	0,1%	0,7%	8,8%
MEDIAN	1,2%	1,1%	-0,9%	6,6%
Normalised SPX returns	0,75%	-1,90%	-3,42%	0,59%

Source: Refinitiv Datastream, Robeco

> Moreover, let's not forget that equites dropped 10% after Bernanke's hint at tapering in May 2013, but global equities rebounded 15% from July to December 2013. The genuine threat from central banks often only comes in the form of excess policy tightening.

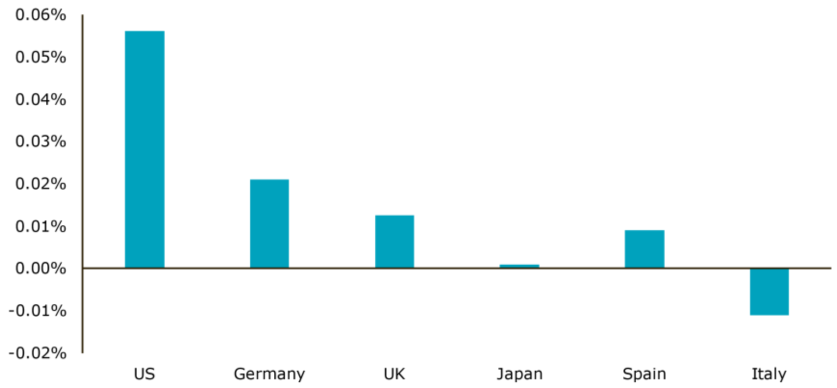
> The Chinese regulatory crackdown seems to pose a more immediate threat, although spillovers to global equity markets from the slide in Chinese equities has been largely absent so far. Uncertainty around further Chinese policy moves to promote economic equality and competition will linger for longer, likely keeping risk premiums in Chinese equities elevated for longer, though the hardest-hit local industry sectors show signs of stabilization.

> After an exceptionally strong Q2 earnings season, we think global earnings growth will cool in Q3. With the slowdown in macroeconomic momentum on the back of rising Covid-19 cases denting consumer confidence lately, the effect of supply-related production curbs in some sectors as well as rising input costs make it likely that earnings growth will decelerate. Looking at the next 6-12 months, though, the earnings outlook still looks bright given easing supply-chain pressures, higher labor supply and a likely rebound in consumer confidence once the delta wave has passed.

> We therefore remain selective risk takers within equities. We are positioned for a second leg of the reflation trade with a modest underweight in US equities, given relative valuation and stretched technicals, while favoring Europe and Japan.

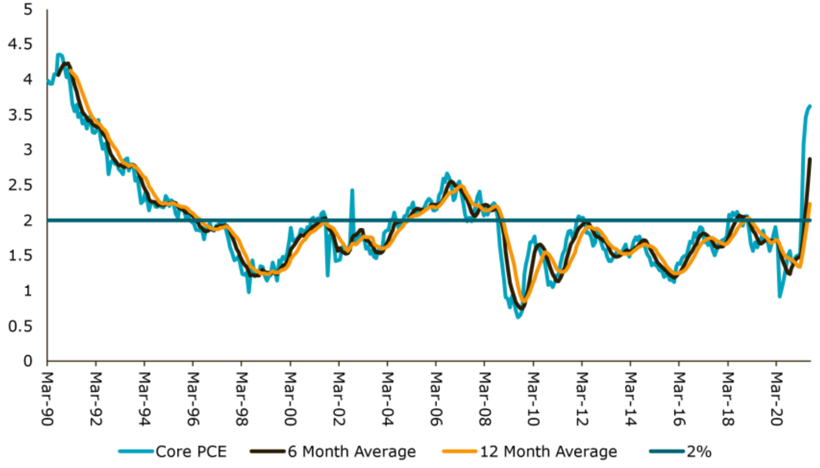
AAA Bonds

10-year yields: trying to find a bottom



Source: Bloomberg, Robeco

US inflation: average core PCE just starting to breach 2%



Source: Bloomberg, Robeco

> After months of decline, yields finally managed to find some sort of bottom. While the upward move could still prove to be a dead-cat bounce, we think that we are slowly building a bottom. This bottom-building phase will probably be extremely choppy, but we think it will ultimately lead to higher yields as the economy proves to be more resilient, as fears around the delta variant ease and as central bank policies shift.

> From the minutes of the July FOMC meeting, it became apparent that it is highly likely that tapering will start this year. So, with tapering almost a given, the focus will shift to when the Fed will start to hike rates. The Fed will try to convince the market that the start of tapering doesn't automatically open the door for rates hikes. So, it will have to be extremely dovish when it comes to rate policy. And for now, the Fed's flexible average inflation targeting framework, the expected transitory nature of inflation, the slowing macro momentum and worries about the delta variant will allow the Fed to be credibly dovish. But as the economy proves to be more resilient and worries about the delta variant start to dissipate, dovishness will lead to an increased inflation-risk premium.

> The ECB's decision in June to continue bond purchases at a forceful pace depressed yields and encouraged market participants to expect more. As the economy continued to recover even at a time that the delta variant spread rapidly, it looks like the ECB is no longer willing to change its policy tool of choice from asset purchases to forward guidance. This will create room for core yields to rise as market participants recalibrate to this.

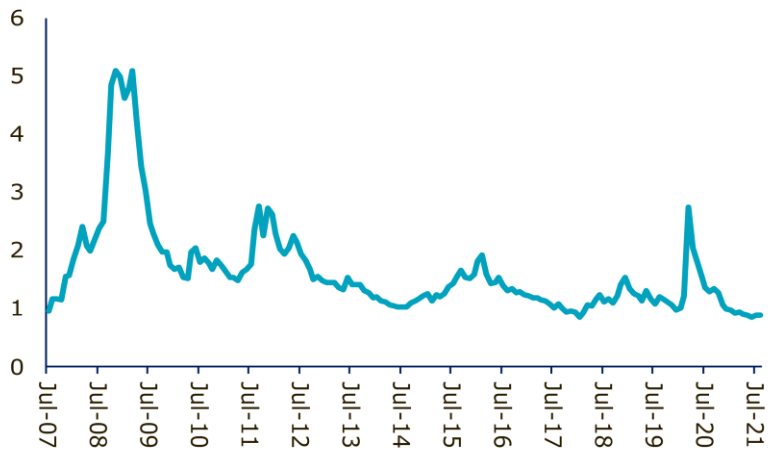
> We remain underweight government bonds.

All market data to 31 Augustus unless mentioned otherwise

ROBECO

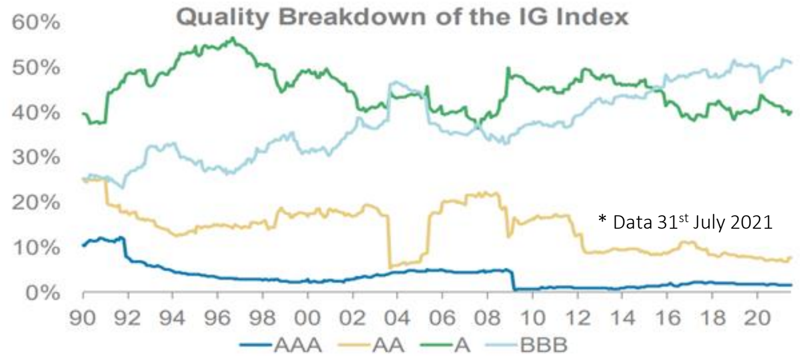
Investment grade credits

Investment grade credits are squeezing ever tighter



Source: Bloomberg, Robeco

US corporate investment grade: less quality

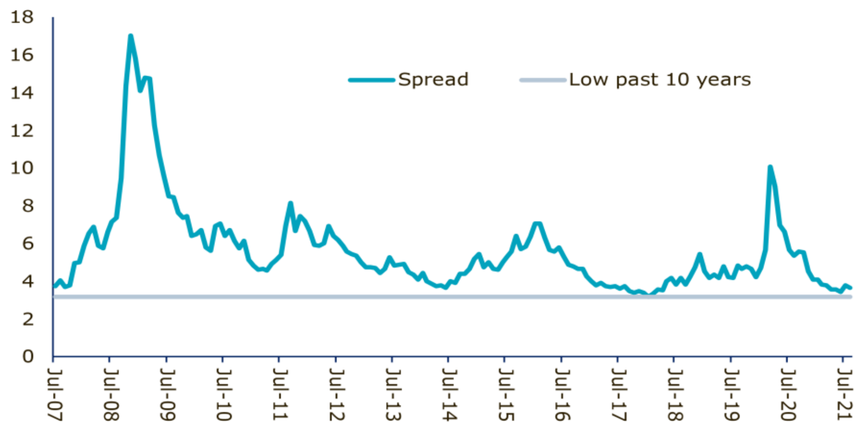


Source: Morgan Stanley, Bloomberg

- Global investment grade bonds delivered a negative return of 48 basis points unhedged in USD and a negative return of 32 basis points hedged to EUR. The spread continued to trade in a narrow range and is roughly 5 basis points off the low of the year reached in June. The spread widened marginally in August.
- The main driver of the negative performance was the rise in yields. After weeks of declines, government yields managed to regain some of the lost ground in August. The rise was marginal and government yields remain firmly off their year-to-date highs.
- Our view remains that the dominant driver of the performance in credits will be government yields. While the spread is still substantially above its all-time lows reached back in 2005, this comparison isn't completely fair. The current quality of the index is substantially worse than back then. The number of bonds that fall within the lowest-quality buckets has increased substantially, giving these bonds a much higher weighting in the index. This in itself warrants a higher spread.
- Still, spreads can tighten further if the economic environment stays benign. Yes, growth is slowing but we see this as transitioning towards more normal growth levels and not as an indication that we are heading towards a recession. Nevertheless, given the current level of spread and our view that government rates need to move higher, we cannot be constructive on credits. Their ability to absorb rates rises is just too marginal.
- We remain underweight global investment grade credits.

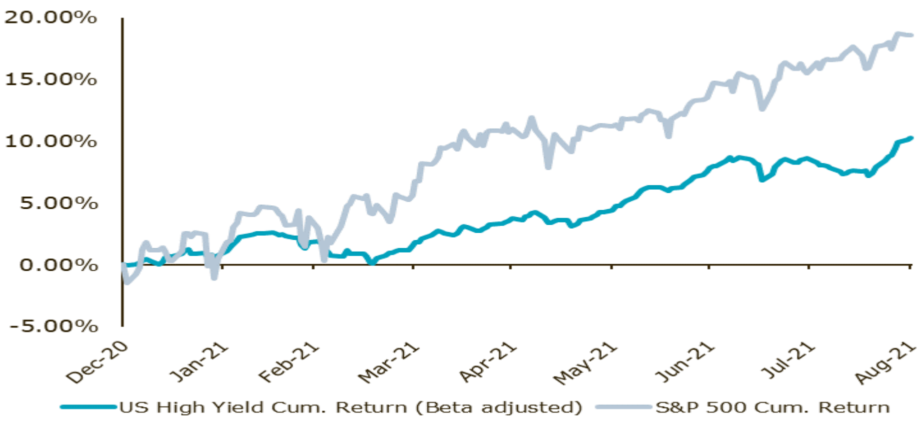
High yield

Global high yield spreads continue to tighten



Source: Bloomberg, Robeco

Equity substantially outperformed HY on a beta-adjusted basis

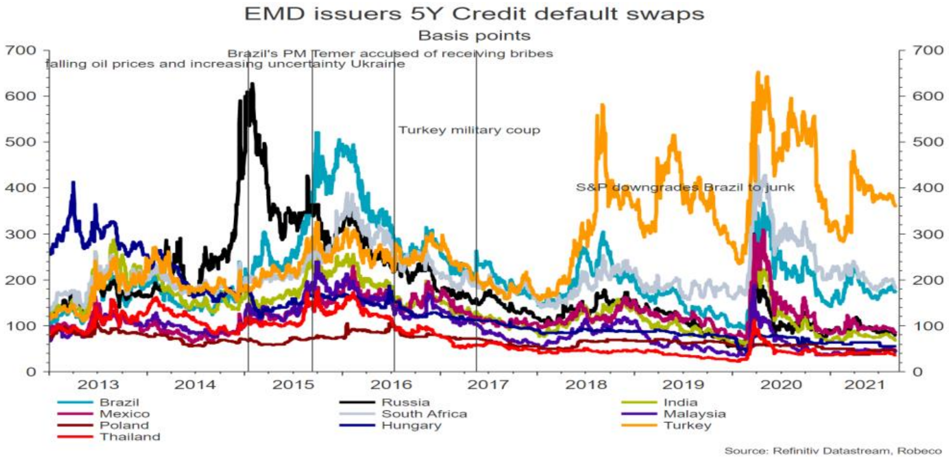


Source: Bloomberg, Robeco

- Global high yield bonds delivered a positive return of around 0.64% in August. The average spread level declined by 12 basis point to 365. This is roughly 22 basis points higher than the low of the year reached in July.
- The main driver of the positive return was spread compression. While high yield has a lower duration than the overall corporate bond market, the rise in government yields nevertheless did have a negative impact on the return this quarter.
- After tightening aggressively in the first quarter, spreads have subsequently widened. Also, on a beta-adjusted basis, high yield has substantially lagged equity markets. So, while there is still room for spreads to compress, as the current level is roughly 150 basis points above the low reached over the past 20 years, we think valuation is starting to weigh on high yield.
- While valuation is seldom a good timing indicator, it does give an indication of the risk-reward profile of an asset class. Viewed in isolation, high yield valuations are not appealing. However, within the fixed income space we still think that high yield is attractive compared to investment grade corporates.
- The delta variant has been having a bigger impact than we thought it would have. Still, we do not think it will derail the still-positive economic picture and therefore think there is room for further compression – albeit at a slow pace. However, with a spread of 365 basis points, high yield still offers attractive carry compared to other bond asset classes.
- We see no imminent reason to sell high yield credit. We remain neutral on the asset class.

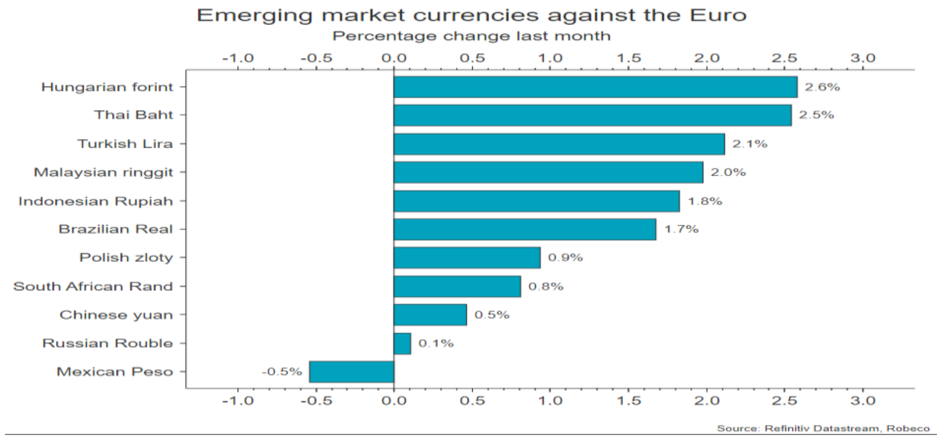
Emerging market debt

Emerging market CDS spreads: divergent recoveries



Source: Refinitiv, Robeco

Emerging market currencies: weakening momentum



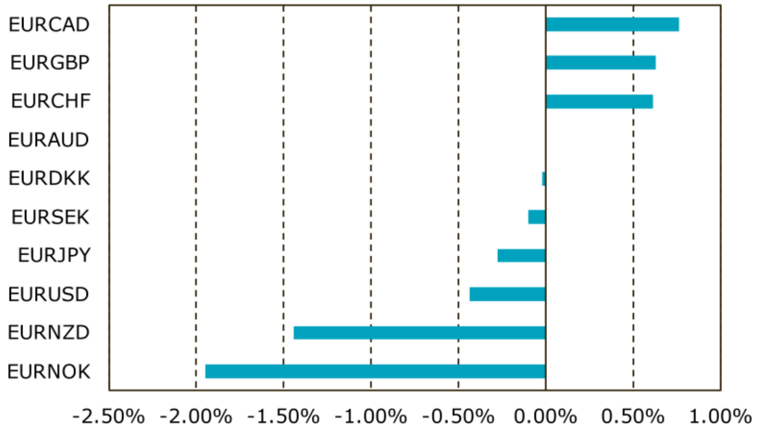
Source: Refinitiv, Robeco

- The JP Morgan GBI-EM Global Diversified index was one of the strongest-performing fixed income markets in August, generating 1.1% return (in EUR).
- The local sovereign debt market is experiencing positive momentum. A recent survey reports net inflows from global reserve managers in their search for positive real yields – which EMD local currency still offers. Credit spreads compressed last month, though remained elevated for Brazil, South Africa and Turkey on the back of idiosyncratic risks.
- Two opposing forces are still at play: on the one hand, improving growth prospects have the potential to compress credit spreads, while on the other hand a hawkish shift among EM central banks has raised duration risk.
- Several EM central banks did hike policy rates earlier this summer, but further rate hike expectations have been toned down as evidenced by recent EM FX currency moves which have been more timid. Broader EM FX momentum has weakened.
- Yet, EM currencies show a continued discount on relative PPP, which suggests upside for the medium term as the global economy continues its recovery from the Covid-19 pandemic. The currency return is strongly correlated with the total EMD local-currency performance (the correlation between EMD local currency and the top 10 EMD FX performance is around 80%).
- Though there are selective opportunities in high-carry, cheap FX local EM currency markets, we remain neutral on local-currency emerging market bonds given limited upside for further spread compression and elevated duration risk.

All market data to 31 Augustus unless mentioned otherwise

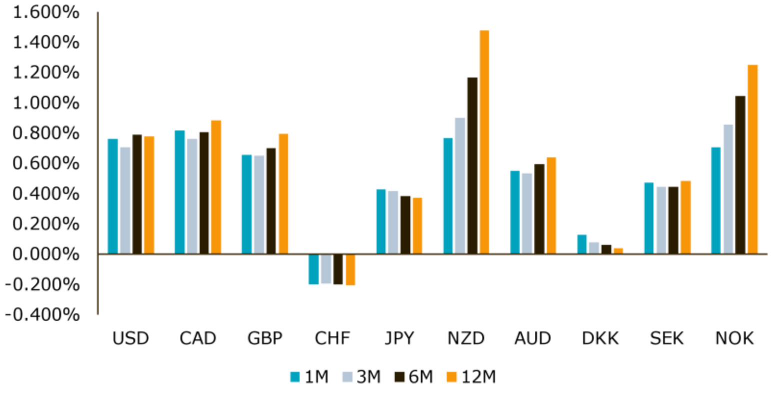
FX

G-10 currencies: NOK leads the pack



Source: Bloomberg, Robeco

Carry: NOK & NZD have the highest carry



Source: Bloomberg, Robeco

- Nok was by far the best-performing currency in G-10. The weakest was the Canadian dollar. Both currencies recovered from a mid-month rebound in line with the move in crude oil prices. While Covid cases have increased in both countries, they have surpassed the previous peaks in Norway. But what still works for Norway is that it offers carry that is among the highest in G-10, in combination with a hawkish central bank.
- The ECB seems to be willing to loosen its hefty grip on the bond markets. After increasing the pace of PEPP purchases in June and maintaining that pace in subsequent months, it seems we have reached a point where the ECB thinks it is time to ease back on purchases. The policy preference seems to be shifting from purchases to forward guidance. A resilient economy even during the upsurge of the delta variant has boosted the ECB’s confidence in the recovery. All In all, this should be supportive for the euro.
- The ECB is not the only central bank looking at its asset purchases. The Fed seemed to have made up his mind that it is time to scale back. Based on current data it is likely that tapering will start this year already. To prevent the market from seeing this as the countdown to rate hikes, the Fed has delivered a dovish message about its rates policy. As long as the Fed can credibly sell this to the market, it will keep the US dollar in check.
- We see potential for upward pressure building in EUR/USD. We will monitor this carefully, but for now prefer to remain on the sideline. We currently hold no currency positions.

Important information

Robeco Institutional Asset Management B.V.

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Robeco Institutional Asset Management B.V.

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