ROBECO

The Investment Engineers

Multi-asset market outlook

The sun finally rises in the East

February 2023

For professional investors

Sustainable Investing Expertise by ROBECOSAM

General overview

Equity markets continue to heal investors' 2022 wounds

MULTI ASSET	1mo	3mo	YTD	1YR	3YR	5YR
Global real estate (UH, EUR)	7.4%	4.3%	7.4%	-11.0%	0.1%	4.6%
Emerging Markets (LC)	6.5%	16.6%	6.5%	-8.4%	3.4%	1.2%
MSCI World local currency	6.5%	6.8%	6.5%	-5.9%	8.1%	7.4%
MSCI World (H, EUR)	6.3%	6.2%	6.3%	-8.1%	6.5%	5.6%
Emerging Markets (UH, EUR)	6.0%	11.2%	6.0%	-9.3%	2.1%	1.3%
Gold (USD)	6.0%	17.9%	6.0%	7.3%	5.4%	6.4%
MSCI World (UH, EUR)	5.2%	-0.2%	5.2%	-4.5%	8.3%	9.5%
Global high yield (H, EUR)	3.6%	7.4%	3.6%	-8.1%	-1.9%	-0.4%
Global investment grade bonds (H, EUR)	3.2%	6.4%	3.2%	-11.2%	-3.8%	-0.8%
EMD local currency (UH, EUR)	3.1%	4.4%	3.1%	-2.4%	-2.3%	1.5%
Global inflation-linked bonds (H, EUR)	2.0%	1.4%	2.0%	-16.0%	-3.3%	-0.6%
Global Gov Bonds (H, EUR)	1.9%	1.7%	1.9%	-11.0%	-4.5%	-1.3%
EMD hard currency (UH, EUR)	1.5%	1.6%	1.5%	-8.6%	-3.2%	2.3%
Cash (EUR)	0.2%	0.4%	0.2%	0.3%	-0.2%	-0.3%
Oil Index (USD)	-1.7%	-7.4%	-1.7%	6.3%	-1.6%	-4.3%
GSCI Commodities (USD)	-1.8%	-11.9%	-1.8%	16.4%	15.5%	8.7%

Source: Robeco, Bloomberg

It was the second-best January in 25 years for global equities, continuing the end-of-year feelgood factor for investors. This helped to heal some of the deep cuts in returns seen in 2022, finally posting index levels above those at the end of 2020. Holding equities for the previous two years had generated broadly flat returns. January also saw sustainability-based global equity indices rise in line with their broader brethren.

Emerging markets equities powered ahead again, and with the reopening of China becoming a reality, the bell is ringing 'all clear' on this round of global pandemics. More positive activity patterns were seen in Europe and the US, with services, tourism and travel the main beneficiaries. In addition, China relaxed restrictions on the local tech giants and increased measures to help its property market to aid its economic recovery.

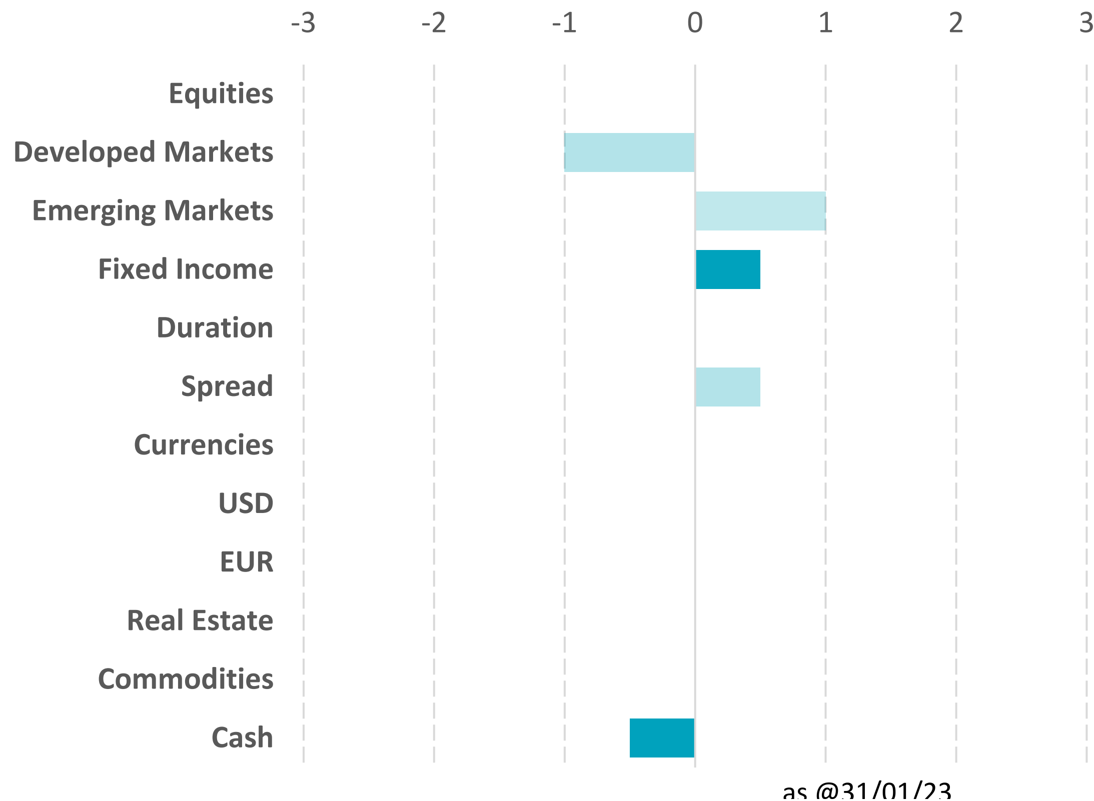
Global real estate was the surprise, as property sector earnings continued to hold up, and lending standards and financial conditions are still loose. So, as with the broader economy, any slowdown has been postponed.

The ECB was the one standout central bank in reaffirming a hawkish stance and the likelihood of 50bp rates hikes. January euro strength took around 1% off returns across the board for Eurozone-based investors. On the other hand, dovish talk by the Fed has led investors to start pricing in rate cuts by the end of the year. The major surprise was the BoJ reinforcing yield curve control, despite the change in governor in the next few months.

 All market data to 31st January 2023 unless mentioned otherwise

Multi-asset views

Sustainable Multi-Asset Solutions views



Source: Refinitiv Datastream, Robeco

Of our three investment building blocks, technicals are supportive of a continued bull run in equities, though the longer horizon analysis through the macro outlook and valuation signals are painting a more downbeat outlook for risk assets.

We continue to hold our high yield position which is benefiting from the postponing of an economic slowdown, lower bond yields and loose financial conditions. The US yield curve continues to flatten, highlighting the contradictions that are also affecting the bond market. The Fed is seen cutting rates by end of year, implying that recession is coming through lower inflation and higher real rates.

Our equity weight remains neutral, reflecting polarized views in the multi-asset team. Within equity markets, we implemented the first tranche of our long emerging versus developed equity markets view at the start of December. We still see the opportunity in EM, given the valuation gap and the reopening of China's economy and tech sector. The more defensive parts of our equity allocations have lagged.

We continue to assess the outlook and the divergence from conclusions in our investment process, respecting the technicals in the markets – hence the neutral stance.

Goldilocks' revenge is the market consensus at the moment. In our mind, the view that falling inflation will mean central banks will cut rates soon is too optimistic, as interest rates will only be cut when growth has slowed.

Theme of the month

The time is right: emerging markets over developed markets

Emerging markets have always been sold on the promise of higher risk, higher returns, driven by higher economic growth. Considering the return pattern since 1992, when this asset class was first born, they have not delivered. Instead, we have had two massive and lengthy upwaves and two disappointing periods of underperformance. Recently we have turned more upbeat on emerging markets and moved overweight in our portfolios, taking the money out of developed markets while staying neutral on global equities overall. We believe we are at the start of a new relative upswing that can last for years. In our 5-year Expected Returns last September, we forecast 4.0% annualized returns in developed markets and 5.25% for emerging markets. We consider this long-term call to be quite timely from a tactical perspective today. Buy now!

We also used to push emerging markets for lowly correlated returns. However, academically, today's bipolar world order means that country diversification benefits are limited. In the developed world, the US dominates, while in emerging markets, China is by far the largest index weight. Still, both return series have been dominated by what happens in the US. They move up and down together, but in the end the US, has given you much better returns, particularly over the past decade. We do believe there is a decent chance for emerging markets to decouple, helped by the asynchronous recovery we see in China, and the positive impact this will have on the rest of Asia. Sector-wise EMs look different too, with a more prominent role for financials (22%), while technology (19%, semiconductors) are an important driver too. We have written bullishly about the outlook for chips before and that view supports the outlook for South Korea and Taiwan in particular.

The lost decade in emerging markets

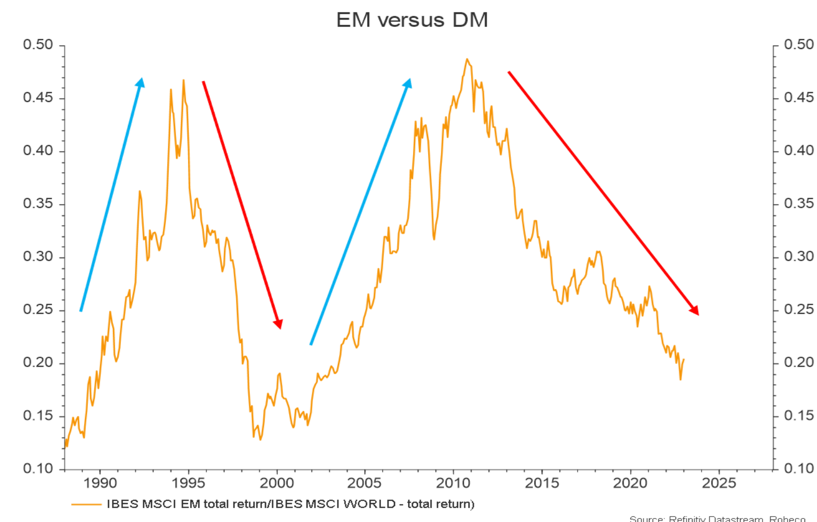


Figure 4 | Relative valuation of emerging versus developed equity markets.

Source: Robeco, MSCI, Refinitiv Datastream. Each month we divide the bottom-up-calculated valuation ratio of the MSCI Emerging Markets Index by the same valuation ratio for the MSCI World Index. The latter only contains developed markets.

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Theme of the month

The value opportunity in EM remains extreme

Source: Robeco Quantitative Research until end of December 2022

Absence of inflationary bubble leaves more room for easier monetary policies

In a world where non-conventional monetary policies have become commonplace, EM central banks in general stand out for their orthodoxy. Even through the tough times during Covid in 2020, few EM economies showed more than 10% M2 money supply growth, which is very modest compared to the money bonanza in the US (>25%), the EU (>12%) and Japan (10%). This means that the root cause of inflation in developed markets – printing money – does not exist in the EM universe. Due to the strong dollar over the past few years, there has been quite a tight monetary policy in many EMs. In 2023, the probability of rate cuts is quite high, while at the same time we do not hold much faith in the potential for a Fed pivot that the recent US rally is based upon. Inflation numbers in the major EMs are much more benign, while interest rates are actually higher. Surely, the higher real rates and the outlook for peaking inflation make for a better chance of easing than we envisage for the US and Europe, where markets are just hoping for the Fed to pivot, against their better judgement.

Positive real rates leave room for easing

	3M rate	Inflation	Real rate
Brazil	13%	9%	+4%
Indonesia	6%	4%	+2%
Mexico	10%	8%	+2%
China	2%	2%	+0%
US	5%	8%	-3%
EU	3%	8%	-5%

As for EM bonds and credits, spreads are still wide in Asian credit, but don't be fooled by risky Chinese property bonds. Overall, we look at levels of 200-250 bps, which may not sound like much, but we see no risk of recession here unlike in US or Europe. Also, the dependence on US dollar financing has come down dramatically over the past 20 years, so local monetary conditions have become much more important drivers.

For an EM investor, corporate governance is a key consideration. We think this also looks good now. South Korea is really making strides in becoming more shareholder value-oriented, and in China it seems we have gone through the depths of the anti-business (common prosperity) sentiment. Currencies are fairly valued, with Latin America and ASEAN currencies looking cheap. The equity valuation argument remains key: not only are they trading at multiples that are close to their relative lows from a relative perspective, but the value opportunity also remains larger than in developed markets. So, there are plenty of reasons to be more upbeat on EM from here. Yes, there were decent inflows in December and January, but positioning data shows the average fund has only reduced its underweight from 3% to 2%.

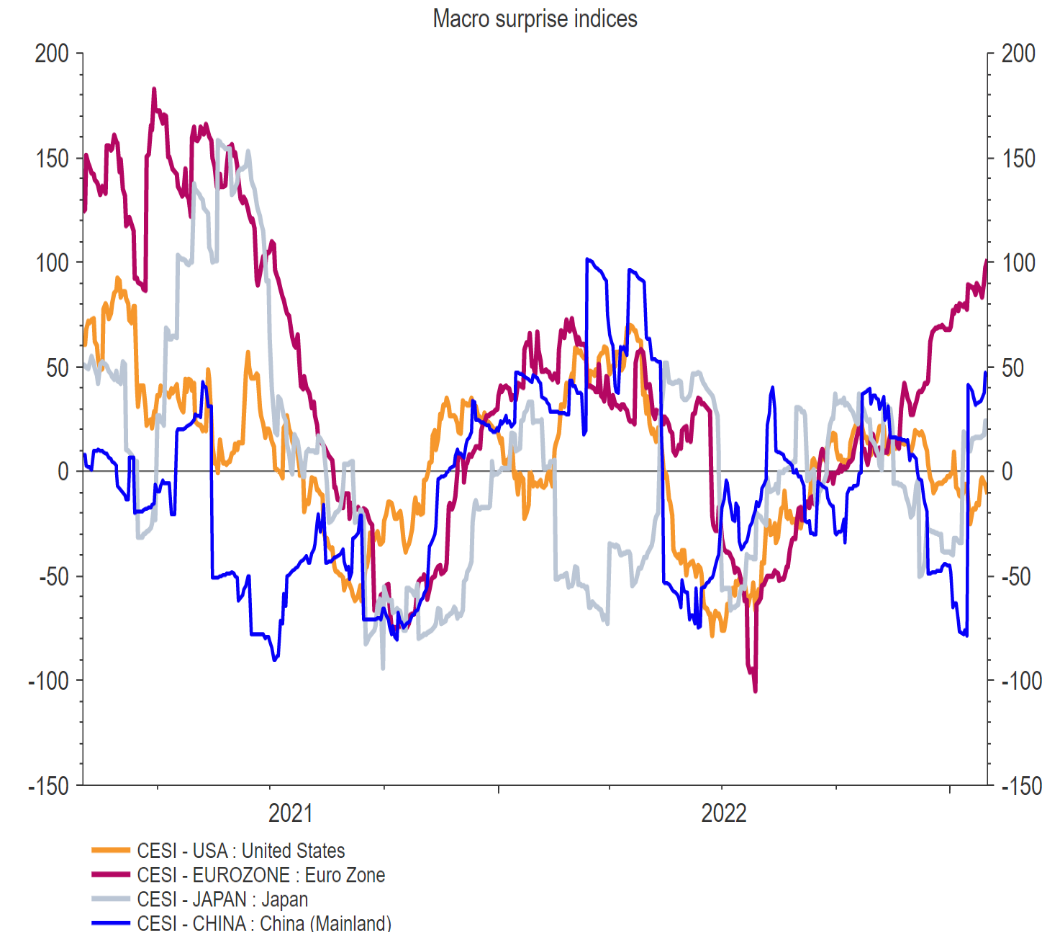
All market data to 31 January 2023 unless mentioned otherwise

Economy (I)

Sentiment about the global economic trajectory among market participants and global institutions improved in January. The data showed that inflationary pressures are getting less pronounced, while real economic activity seemed to perk up, easing worries about the prospect of an imminent recession as well as its potential depth. The IMF upgraded its GDP growth outlook for the global economy by 0.2% to 2.9%. Relief was provided by the end of China's zero-Covid policy, along with the Chinese government's new policy efforts to revive confidence in its domestic real estate markets. Europe's fairly warm winter also helped sentiment, and natural gas prices have even dropped below pre-Ukraine invasion levels. However, Spanish inflation data over January proved that disinflation is not going to be a linear process, with potential sticky core inflation leaving central banks needing to tread carefully when it comes to toning down hawkish rhetoric.

In the US, the Q4 GDP release surprised to the upside, with US GDP growing 2.9% (q-o-q annualized). However, looking at the underlying components the bulk of this upswing was determined by the more volatile and cyclically less important elements. For instance, inventories contributed 1.5%. Core elements like investments and consumption, which determine the bulk of real activity in the US, actually decelerated from previous quarter. Though real estate mortgage rates may have peaked in Q4, house price inflation is slowing, putting a damper on the wealth effect.

Better-than-expected macro data is easing worries about an imminent hard landing for the global economy



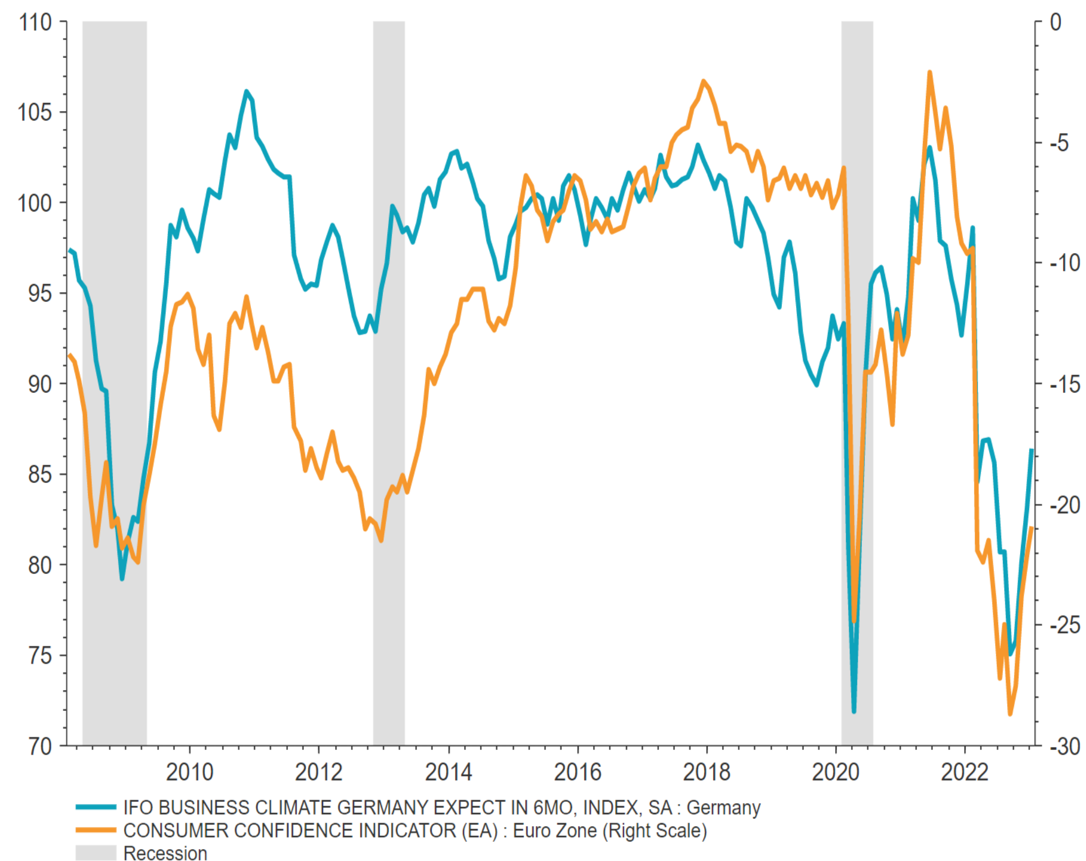
All market data to 31 January, 2023 unless mentioned otherwise

Economy (II)

US consumption expenditures data for December and consumer confidence data for January both declined, while consumer inflation expectations rose. This shows that the consumer is becoming more wary as real wage growth is no longer accelerating. While the Atlanta Fed wage tracker slowed to 6.1% by the end of December, US CPI was still 6.4%. Thus, the latest glimmers of resilience from the US economy are unlikely to provide conclusive evidence of a soft landing, even as the labor market remains very tight: US unemployment remains at 3.5% and there are still 1.6 job openings available for each unemployed person.

In the Eurozone, Q4 GDP was marginally positive, with a 0.12% rise (q-o-q), but would have been negative if Ireland is excluded. Activity was dampened by high inflation – Eurozone HICP was still 8.5% in January – along with decelerating money growth and elevated policy uncertainty due to the continuing Ukraine war on Europe's border and tighter financial conditions. Nonetheless, leading indicators like the German IFO are showing an improvement in producer sentiment. The composite IFO index rose 1.6 points to 90.2 in January, though the purchasing managers sentiment for the next six months remains more depressed compared to their assessment of actual conditions. Eurozone unemployment remained at its historical low of 6.6%.

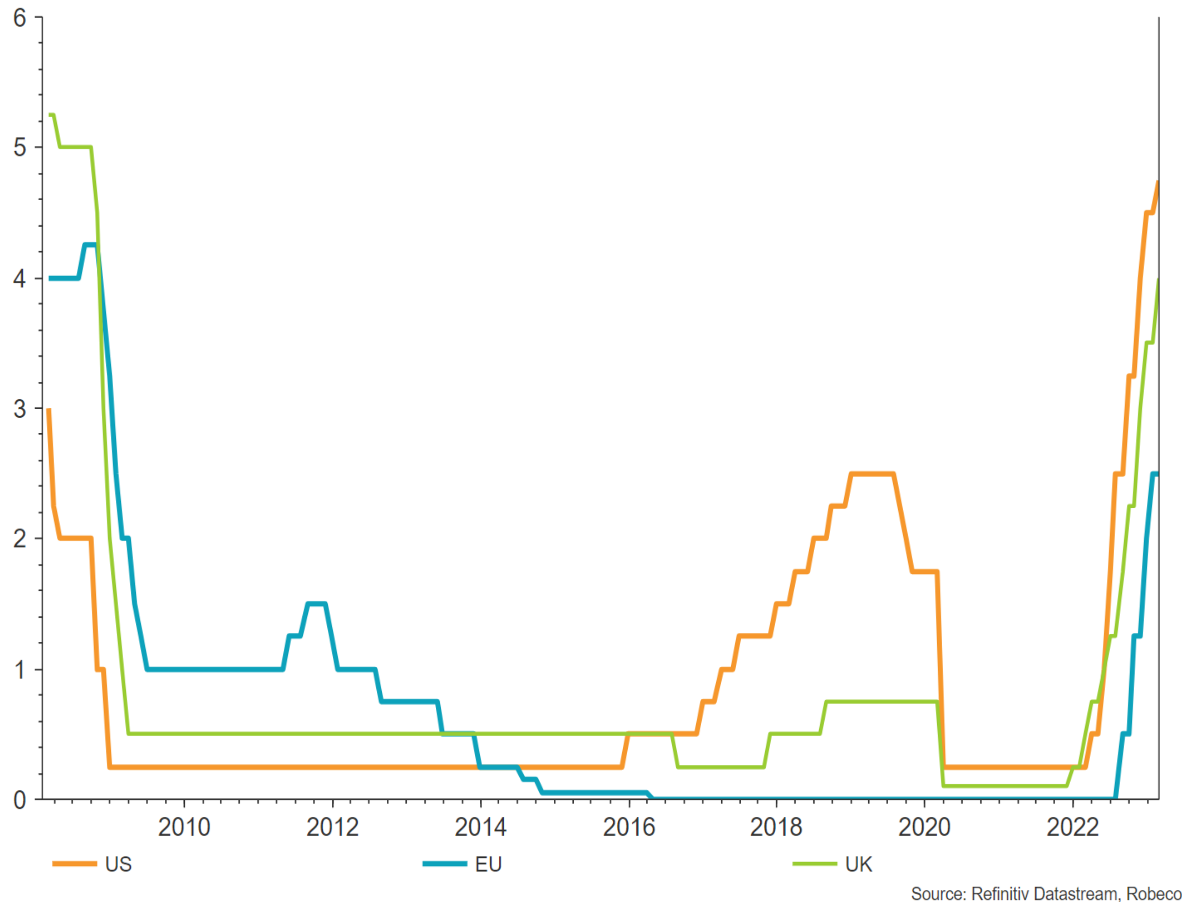
Eurozone sentiment is clearly coming off the lows



Source: Refinitiv Datastream, Robeco

Economy (III)

Closing in towards terminal rates



Source: Refinitiv, Robeco

China's reopening after abandoning its zero-Covid policy is taking effect, though it is too early to see a recovery in domestic activity. The Caixin manufacturing PMI remains in contractionary territory, even as it increased to 49.2, signaling an uptick in producer sentiment in January. Underlying details from the survey, however, showed that even as supply chain disruptions eased, output and total new orders shrank. This is corroborated by Chinese railway traffic, which hasn't notably improved and still shows a y-o-y decline. Still, the services sector is already enjoying a reopening boost, with travel up 80% (y-o-y). A full-blown recovery in consumption is for now inhibited by persisting weakness in the Chinese property market. Given a 71% correlation between Chinese house prices and private domestic consumption, a sustained rebound in consumption requires a stabilization in the housing market.

In line with expectations, the FOMC hiked its Fed Funds rate by 25 bps to 4.50-4.75%. Its statement was a little more positive on recent inflation developments but kept the phrase "ongoing rates increases will be needed". Also in Europe, central bank guidance remained largely unchanged, though the door to a potential near-term pause was left open. The ECB hiked policy rates by 50 bps on 2 February and kept the door wide open for a further 50 bps increase in March. The BoE kept the pace up with a 50 bps hike to 4.0%, citing "significant" upside risks to the inflation outlook.

 All market data to 31 January, 2023 unless mentioned otherwise

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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 in 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 September 27, 1996, as amended.

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