



# Multi-asset market outlook

## The Three Peaks Challenge

July 2022

For professional investors

# General overview

For the first time YTD, commodities offered no solace last month

MULTI ASSET	1mo	3mo	YTD	1YR	3YR	5YR
Cash (EUR)	0.0%	-0.1%	-0.2%	-0.5%	-0.5%	-0.4%
Global Gov Bonds (H, EUR)	-1.4%	-4.8%	-9.4%	-9.7%	-2.6%	-0.7%
Gold (USD)	-2.1%	-7.8%	-1.5%	1.3%	6.9%	6.6%
EMD local currency (UH, EUR)	-2.4%	-3.2%	-5.6%	-6.0%	-1.7%	0.5%
EMD hard currency (UH, EUR)	-2.6%	-3.8%	-11.3%	-9.0%	-1.5%	0.9%
Global investment grade bonds (H, EUR)	-3.0%	-7.3%	-13.9%	-14.2%	-2.6%	-0.7%
Global inflation-linked bonds (H, EUR)	-3.6%	-10.4%	-13.2%	-8.9%	-0.7%	0.5%
Emerging Markets (UH, EUR)	-4.3%	-5.8%	-10.4%	-15.2%	3.5%	4.0%
Global real estate (UH, EUR)	-4.4%	-10.8%	-13.0%	1.4%	2.8%	4.3%
Emerging Markets (LC)	-4.6%	-8.1%	-13.7%	-20.2%	3.3%	4.4%
GSCI Commodities (USD)	-5.4%	8.6%	47.7%	64.5%	18.0%	13.6%
Oil Index (USD)	-5.7%	10.0%	54.9%	65.2%	11.7%	6.4%
MSCI World (UH, EUR)	-6.4%	-10.8%	-13.5%	-2.8%	10.1%	9.6%
Global high yield (H, EUR)	-7.3%	-11.8%	-16.2%	-16.8%	-3.5%	-1.3%
MSCI World local currency	-7.8%	-14.3%	-18.3%	-11.1%	7.9%	8.3%
MSCI World (H, EUR)	-8.1%	-15.1%	-19.1%	-12.5%	6.4%	6.4%

Source: Robeco

2 All market data to 30 June unless mentioned otherwise

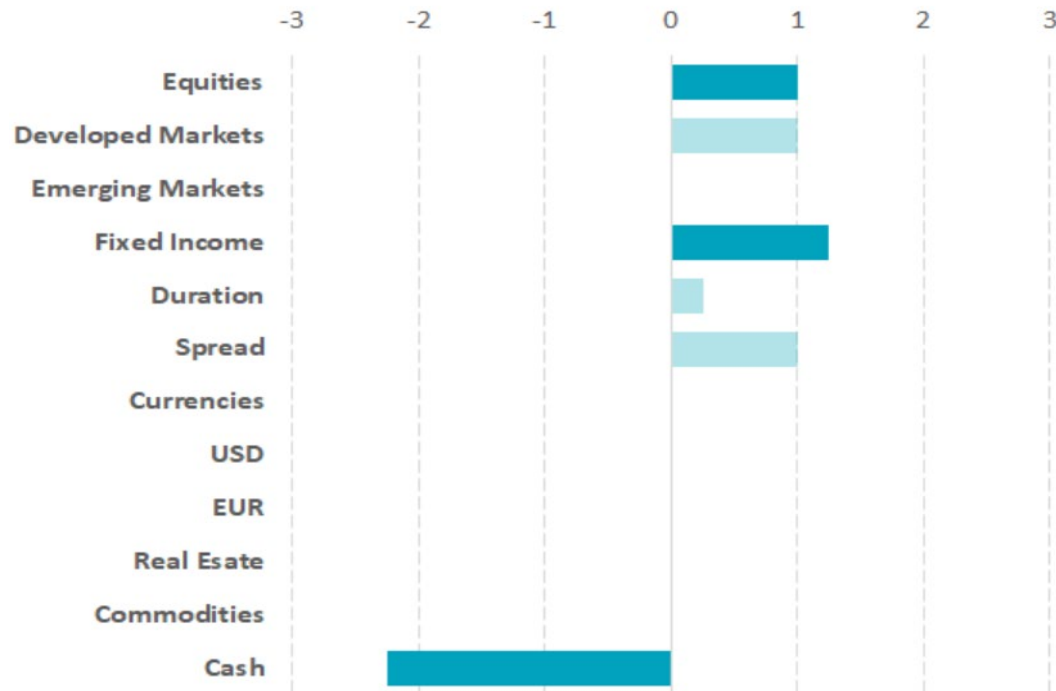
The sands have been shifting in financial markets. Looking at the multi-asset universe for June, it does not seem that way at first glance. The cross-asset performance seems largely consistent with prior months: a broadly driven sell-off as bond-equity correlations turned positive, due to a high inflation environment. Yet, a key change is the broad sell-off in commodities that has now joined the malaise in other asset classes. One of the leading indicators for real economic activity, copper, declined 15% in June. The most growth-sensitive commodities have experienced the largest losses, indicative of mounting worries about a global recession.

In response, cash and safe havens like gold and Treasuries outperformed last month. While markets have been under the spell of inflation in the first half of 2022, market inflation expectations have come down from a peak of 3.5% for the US in March to 2.5% in June. For Germany, market-implied inflation expectations on a 5-year horizon have dropped to 2.1%. As such, the stagflationary scare seems to have blown over, but the reason for the strong disinflationary dynamics is anything but reassuring. In the US, GDPNow data signals a back-to-back contraction in US activity in Q2. Meanwhile, the drying up of Russian gas flows to Europe is increasing recession risk on the continent. European gas storage facilities are only 59% filled so far, and LNG imports are unlikely to make up the difference; a new EU directive requires at least 80% by 1 November.

# Multi asset views

## Sustainable multi asset views

### Active Positions ( Risk Units)



Source: Refinitiv Datastream, Robeco

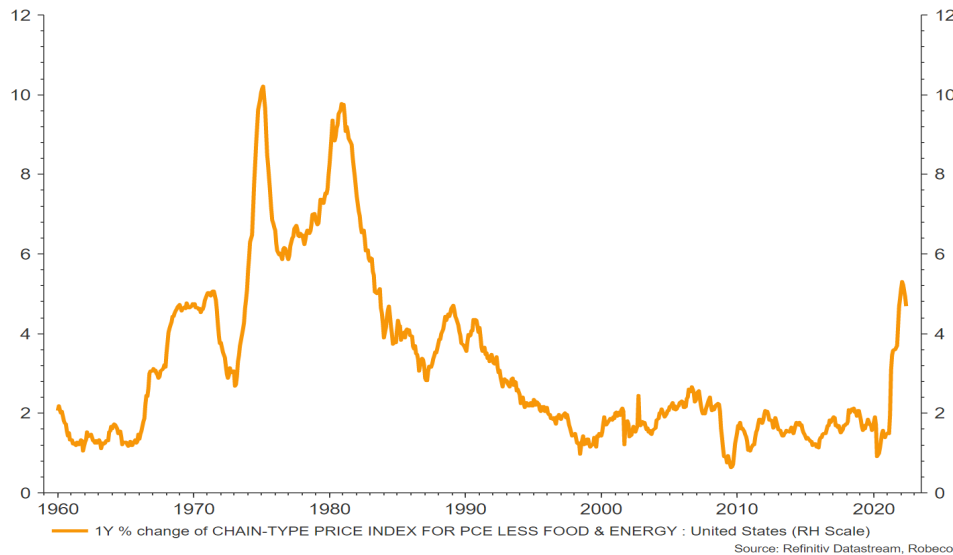
The global macro landscape remains highly complex given the multiplicity of recent shocks. As the downside risks to our base case have increased, with leading indicators in US and Europe now signaling contracting activity in the near term, we are sticking to cautious risk-on positioning. We think the market could get some relief from expectations of a 'Powell pivot' via lower discount rates, while retail sentiment at cyclical lows historically suggests upside. However, a durable rebound in risky assets not only requires the Fed to pivot, but also for the right reasons, so that the market is convinced that it will create a soft landing. In this respect, we observe that recent equity rebounds were followed by ETF outflows, indicating that the buy-the-dip reflex that characterized the QE era is now absent, and the market clearly doubts a soft-landing scenario.

Soft landing or not, even in the face of a marginal recession, there could be further downside for equity markets. In 2000-2002 the S&P 500 fell 50% while the ensuing recession was only marginal. What matters for bear markets is starting valuation levels. As in 2000, equity valuations were historically stretched prior to the early January 2022 market peak.

We continue to have an overweight sovereign bond duration position, as we are cognizant of increased downside risks and the increased likelihood of a Powell pivot against a worsening economic backdrop. The Fed has pivoted 80% of the time when the ISM dropped below 50, even if inflation exceeded the target. Continuing negative growth surprises and a decline in cyclical growth proxies like the copper/gold ratio have become supportive of a long duration position in US Treasuries.

# Theme of the month

## US inflation – The Federal Reserve’s preferred measure ex-food and ex-energy (core PCE)



Source: Refinitiv Datastream, Robeco as @30 June 2022

## The Three Peaks Challenge, No. 1: Inflation

Inflation has been a benign indicator for investors for over four decades, ever since Paul Volcker, the then chair of FOMC, tamed rampant US inflation of 20% and re-established central bank credibility. We know central banks have the tools to control inflation by raising interest rates, which reduces credit creation (the end of free money) and slows the housing market (the end of the cashpoint remortgage), which combines to reduce aggregate demand and increase unemployment. Such a slowdown of the economy will be instrumental in reaching peak inflation, though we acknowledge that the blunt tool of interest rates will leave investors swinging wildly between fearing too much tightening in case it causes a recession, and not enough. So, there is more to come.

The rise in energy prices permeates the whole economy, affecting business and consumers alike, acting a tax on growth and reducing demand for services and other goods. In addition, the increased uncertainty about corporate earnings and the ability of companies to protect margins by passing on rising input costs (including labor and debt costs) will add to equity and high yield volatility. The Fed’s broadening focus from using only Core PCE (ex-energy and food) as its preferred measure to tackle headline inflation means there is hope that peak inflation is on its way in the third quarter of 2022.

## The Three Peaks Challenge, No. 2: US rate expectations

The inflation picture continues to be a headwind for the US and the global economy, though we have to acknowledge that this is a lagging indicator of economic activity. Turning to more forward-looking indicators, we can see that by the end of the year, the US Fed funds rate is projected to be around 3.25%, up from 1.75% at the end of June, which would be the largest rate rise in a calendar year since 1980. In 1994, which saw what is generally considered to be an engineered ‘soft landing’, rates jumped to 2.5%. So, the tightening cycle today is harder, because the economy needs that reaction function. Interest rates remain a blunt tool, and rate expectations are probably a more effective tool now than in the early 1990s.



## Theme of the month

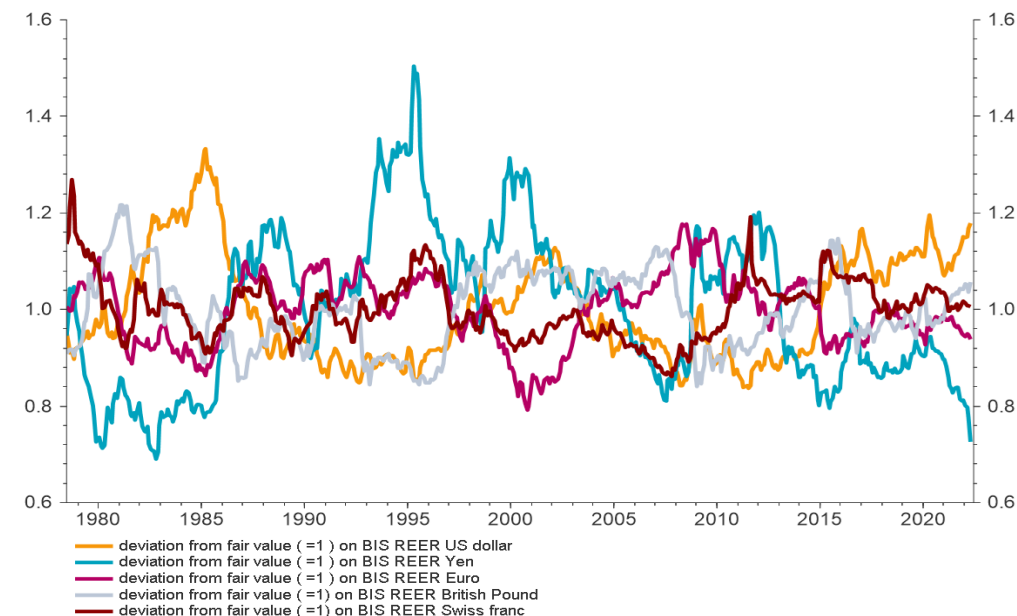
In our view, peaks in the various inflation data will point to lower inflationary pressures and signal that rate rises are working through the economy. In the second half, we expect a more benign outlook for financial conditions: we believe the 'Powell Pivot' means rate expectations will drop, and the Fed Funds terminal rate of 3.75% will not be achieved in 2023. All things being equal, this could not rule out a durable inversion of the yield curve, with recession indicators becoming more aligned and conclusive. Our core scenario is that we don't expect an excessive contraction US in the next 12 months, although China, Japan and Europe may suffer that fate.

### The Three Peaks Challenge, No. 3: Peak US dollar and rate expectations

As US interest rate expectations and inflation both peak, then we can fully expect the US dollar to peak as well. Whether this comes before, during or after the other two peaks, we cannot be certain. But we should watch the US dollar because it has the most diverse set of traders and non-profit maximizing holders. At the moment, the key drivers of the US dollar are positive, namely interest rate differentials, growth differentials and 'safe haven' capital flows. As growth slows and rate expectations fall, then the expensive US dollar should weaken.

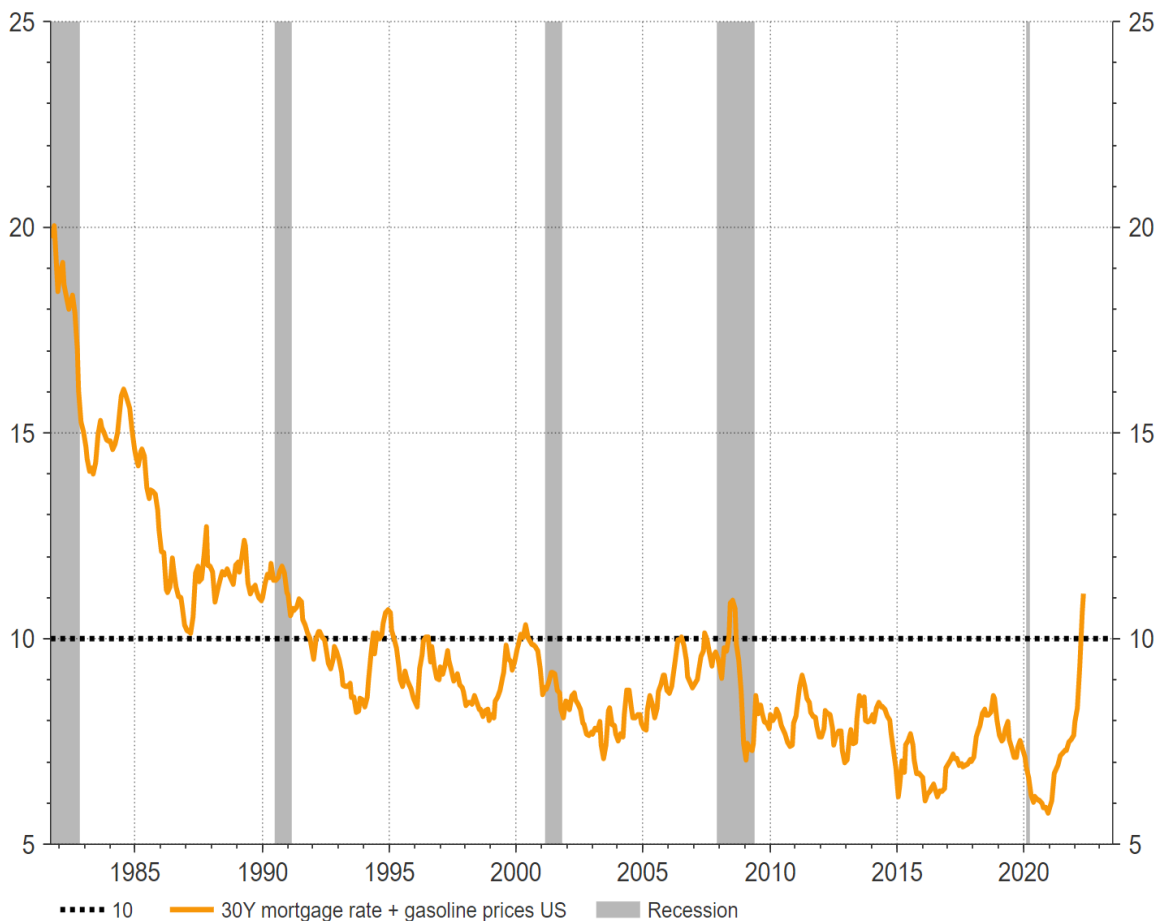
The chart shows real effective exchange rates (REER) in which it is clear that the US dollar is overvalued, and will revert to its mean at some point, with the current catalysts being the two peaks outlined above. However, the more interesting trade involves the Japanese yen, which on this measure is at its most undervalued level since the Japanese property bust and the Volcker moment at the end of the 1980s. Is it a coincidence that we are seeing peaking inflation on the timescale relevant to the chart's x-axis? The problem with the long-term valuation signal is that it may take years to realize, and you will have paid away substantial carry in the form of interest differentials. That said, the yen is a very, very cheap short-term hedge against volatility, and once the country's yield curve control is consigned to history, from our vantage point, we could expect the yen to rise.

The yen should be a safe haven for investors in times of trouble – but not this time



Source: Refinitiv Datastream, Robeco

## The US consumer is feeling the pinch



Source: Refinitiv Datastream, Robeco

Source: Refinitiv, Robeco

In our view, the two necessary conditions for immediate classical recession risk are not flashing red yet; excess Fed tightening and corporates and household running out of cash to spend. Excess savings stemming from the Covid stimulus have though almost vanished in the US. We do observe that the US could be in a technical recession by the end of Q2, given that GDPNow data signals a 2.1% contraction in the quarter, while Q1 already saw contracting activity. Meanwhile, US consumers are feeling the pinch of elevated gasoline prices and mortgage rates, with the University of Michigan consumer sentiment survey at a record low in June. Credit card debt has increased, and the US personal savings rate has declined to its lowest level since 2009. With a very wary consumer around (in Europe, durable goods consumption has also decelerated below trend), inventory levels are increasing while new orders are declining. This fuels disinflation.

That being said, the risks to our base case with regard to growth remain clearly tilted to the downside. Though rate hikes are now getting priced out with the market already expecting Fed rate cuts by Spring 2023, demand destruction is clearly underway, as evidenced by steep declines in spot commodity markets. With China not entirely out of the woods with regard to Covid, a rebound there this time would likely not compensate for demand shortfalls elsewhere in the global economy.

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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 under 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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